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Toward Best Outcomes from Foreign Direct Investment in Poorly Performing States

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Can poorly performing states use foreign direct investment to enhance their domestic growth, welfare, and reduction of poverty in ways middle-income developing states have achieved? Or are the difficulties and obstacles simply overwhelming? What are the lessons from low-income states that have been otherwise relatively successful? In what ways must contemporary host authorities become less "poorly performing" to emulate them? How can developed countries help, or hinder, this process?

In the midst of a stark appraisal of failed efforts by many low-income states to attract and use foreign direct investment, this study tries to gather the good news. The ingredients for making a would-be host more attractive to foreign investors—including poorer states without favorable natural resource endowments—are relatively straightforward. And the challenges of achieving at least modest success in pulling in investors and benefiting from their presence, while often difficult, have proven quite surmountable for a diverse array of low-income countries, "even" in the tropics, "even" in Africa.

This chapter begins with an appraisal of the conditions under which foreign direct investment provides the most positive contribution—or, conversely, the least positive (or most negative) contribution—to the host economy.

The second section focuses on the determinants for success and failure in attracting and harnessing nonextractive, noninfrastructure investment, in the experiences of low-income states. From this analysis, it derives lessons for low-income states in the contemporary period. Of particular importance is the question of whether low-income states must permit or tolerate poor worker treatment to secure foreign investment in low-skilled industries, like garments and footwear. This section concludes with analysis of how low-income states can begin to move up the ladder from least-skilled foreign investment activities to more-skilled foreign investment activities, while increasing backward linkages and spillovers into the local economy.

The third section turns to mechanisms by which developed countries can facilitate the flow of foreign direct investment to low-income countries. It offers an appraisal of how U.S. efforts might be strengthened and identifies U.S. obstacles that should be removed.

Most Beneficial and Least Beneficial Foreign Direct Investment

The following is a brief summary of the difficulties associated with natural resource and infrastructure investment, with new evidence about foreign direct investment in manufacturing, assembly, agribusiness, and services as background for examining the prospects for resource-poor, least developed countries.

Foreign Direct Investment in Natural Resources

Foreign direct investment in extractive industries—oil, gas, copper, nickel, bauxite, gold, diamonds, iron ore, and other minerals—can have a dramatic impact on the balance of payments and the tax revenues of the host country where the natural resources are found.[1] While flows of foreign direct investment in natural resources are subject to a certain natural geological determinism, success in attracting investment can be facilitated by the kinds of reconfiguration of investment promotion agencies and minimization of red tape suggested later. Issues of transparency, bribery, and other corrupt practices, however, require special attention.

Conventional wisdom for decades has characterized a rich natural resource endowment as an unambiguously favorable factor for the host country's development, if foreign investors could be found who would exploit the natural resources with responsible environmental and labor practices. Calling this conventional wisdom into question, however, is evidence that favorable natural resource endowments are in general negatively correlated with the growth performance of the countries so endowed.[2]

One explanation for this outcome lies in the likelihood that large resource exports lead to an overvalued exchange rate, which makes it difficult for other indigenous industries to compete in international markets. This is a developing country rendition of what has been called the Dutch disease. Other explanations, however, center on the temptation to use revenues from natural resource exports for personal gain, political payoffs, and other corrupt or quasi-corrupt practices. The presence of natural resources traps the country into a political system that diverts revenues to special interests and uneconomic purposes.[3] Countries like Nigeria, where oil-based income has largely been squandered, readily fit this picture. Countries like Chile, where copper-based income has generally been devoted over time to sensible economic and social endeavors, do not.

To help supervise and provide transparency about the disposition of natural resource revenues, the World Bank helped negotiate an experiment involving Exxon Mobil in Chad. A nine-person committee, including four nongovernmental organization representatives, was given responsibility for monitoring the expenditure of oil revenues, with 80 percent devoted to education, health, and rural development and 5 percent returned to the regions where the oil originates.[4] Technical assistance from the World Bank would underwrite creation of a technically competent auditing agency within Chad. The government of Chad reneged on this agreement, however, provoking a crisis with the World Bank and suspension of lending in 2006.

To enhance transparency in the disposition of natural resource revenues, various nongovernmental organizations—along with George Soros—have urged that investors in extractive industries be required to publicize all taxes and fees paid to host governments before being allowed to list their shares on the U.S. or other major stock exchanges.[5] The British government has launched an initiative to explore options to promote transparency in extractive industries.[6] The Group of Eight meeting in Evian in June 2003 endorsed the objective of improving information disclosure to fight corruption.

To move the international community toward more responsible handling of natural resource revenues will require complex negotiations among home and host governments as well as investors. Private international companies fear, for example, that publicly traded corporations would be placed at a competitive disadvantage to those state-owned companies that still play a large role in the oil industry.[7] They also fear that an international agreement (as opposed to a voluntary compact) might expose them to be sued in U.S. courts under the Alien Tort Claims Act if they operate in countries where there are human rights abuses.

Foreign Direct Investment in Infrastructure

The invitation of international companies to participate in the privatization of infrastructure has also generally been viewed as contributing to developing country growth prospects. The host economy becomes more competitive to the extent it enjoys efficient and reliable water, power, transport, and telecommunication systems. The use of state companies to hold the price of infrastructure services artificially low often has popular appeal, but private ownership and regulatory mechanisms that allow for realistic pricing may provide better and more reliable services—and extend those services to more users, including poor and rural users.[8]

The largely unforeseen challenge with foreign direct investment in infrastructure is determining which parties should be required to absorb commercial risks associated with fluctuations in supply and demand for services or to bear commercial risks associated with fluctuations in foreign or local currency valuations. Foreign investors in Asia and Latin America have typically insisted, as a condition of making an investment, that host authorities make major commitments to supply inputs, or to purchase outputs, and to guarantee the conversion value of payments made in local currency. When host authorities have been unable to meet these commitments due to downturns in the regional or international economy, the resulting defaults have been considered political acts (unwillingness to make good on obligations) rather than commercial acts (inability to make good on obligations).

When Indonesia was incapable of honoring take-or-pay power purchase agreements due to a drop in demand during the Asian financial crisis, for example, the MidAmerican Corporation took the host government to arbitration and won, leading the Overseas Private Investment Corporation (OPIC) to have to make one of the largest payments on political risk insurance ever awarded (US$290 million of a total award of US$572 million) and pursue the government of Indonesia for recovery.[9] Experiences such as these have led to questioning what genuinely constitutes political as opposed to commercial risk and what responsibility international infrastructure investors should assume for the latter.[10] More broadly, experiences such as these have led to reassessment about whether commercial law arbitration procedures constitute a suitable mechanism for dealing with many kinds of contemporary infrastructure investment disputes.

The use of ICSID (International Center for the Settlement of Investment Disputes) and UNCITRAL (United National Center for International Trade Law) arbitration procedures—as specified in most bilateral investment treaties, national investment guarantee agencies (like OPIC), and multilateral bank lending agreements—is in no sense like an appeal to an international supreme court to decide what best serves the public interest. Quite to the contrary, these arbitration procedures focus deliberately on narrow issues of contract compliance and (as in the case of MidAmerican in Indonesia) are likely to place a foreign exchange payment to a foreign investor ahead of all other funding priorities, including importation of food and medical supplies for a population in the midst of crisis.

Foreign Direct Investment in Nonextractive, Noninfrastructure Sectors

The most striking new assessment about the impact of foreign direct investment on development has come in evaluating the pros and cons of foreign direct investment outside of natural resources and infrastructure. Here again the conventional wisdom (that foreign direct investment in manufacturing, assembly, processing, agribusiness, and services is a "good thing" as long as foreign firms do not pollute the environment or engage in unsafe or physically oppressive treatment of workers) has often been misleading.

The "new" discovery is that the impact of foreign direct investment in nonextractive, noninfrastructure sectors takes two quite distinct forms. The data show that there is a fundamental difference between foreign direct investment in projects (often export oriented) serving markets exposed to international competition and foreign direct investment in projects insulated from international competition. In particular, there is a dramatic contrast in performance between subsidiaries that are integrated into the global or regional sourcing networks of the parent multinationals and subsidiaries that are oriented toward protected domestic markets and prevented by mandatory joint venture and domestic content requirements from being so integrated.[11]

As a result, foreign direct investment outside of natural resources and infrastructure has a bifurcated impact on development. Beginning with Sanjaya Lall, Paul Streeten, and Grant Reuber, and summarized with additional data by Dennis Encarnation and Louis Wells, cost-benefit analyses of data from eighty-three projects in some thirty developing countries over more than a decade, valuing all inputs and outputs at world market prices, show a majority of the operations generating an increase in the host country's income (from 55 to 75 percent, depending upon alternative shadow-price estimates).[12] At the same time, however, the cost-benefit calculations confirm that a large minority (25–45 percent) was actually subtracted from the host country's income; that is, the developing country would be better off without hosting these foreign investment projects at all.

The principal characteristic differentiating the positive projects from the negative projects is the degree of protection associated with the foreign firms' operations (including domestic content requirements imposed by the host authorities on the foreign investor). Projects without protection (or with low levels of protection) tend to enhance the host country's welfare; projects with high protection detract from the host country's welfare. Export-oriented projects are consistently positive in their contribution to the host country's welfare. The outcomes are not close calls. They are bunched at the extremes, either clearly beneficial or clearly detrimental.

Studies using cost-benefit analysis across sectors in one country point to the same dichotomy. For Kenya, Bernard Wasow examined thirty-five goods produced by fourteen foreign-owned firms within the import substitution framework of the late 1980s. His measurements show that only three of the thirty-five generated benefits to the host economy exceeded their costs. Of these three, only one (a large exporter of processed fruit) made a noteworthy contribution to local economic growth. More than half of the thirty-five siphoned foreign exchange from the economy, rather than saving or earning hard currency. In the protected local setting, many of the foreign plants operated with excess capacity, and if they had expanded output their negative impact on host welfare would have been even greater.[13]

The difference between foreign investment oriented toward a protected host economy and foreign investment oriented toward competitive international markets is even more striking as the foreign investor activities become more sophisticated.[14] The ability to operate with wholly owned subsidiaries that are free to source from wherever they choose takes on more importance for companies that want to incorporate electronic, industrial, or medical components into their global sourcing networks. The evidence shows a particularly potent interaction between parent and subsidiary when the inputs from the subsidiary are integrated into the headquarter's strategy to keep the corporation competitive in international markets, an interaction that is lacking when the subsidiary is forced to operate with domestic content and joint ownership performance requirements. The former interaction typically captures all economies of scale and functions at the international frontier in production, quality control, and management practices, all upgraded on a continuous real-time basis; the latter interaction is subscale, uses older technologies, quality control, and management procedures, and is upgraded more slowly.

Host-Country Measures for Harnessing Most Beneficial Foreign Direct Investment

Historically, the flow of foreign direct investment to the developing world has been quite concentrated.[15] Over four decades, twenty countries—none of them poor developing countries without favorable natural resource endowments—accumulated 83 percent of the total stock of foreign direct investment in the developing world and economies in transition (see appendix). In 2002 twenty countries—again, none of them poorer developing countries without favorable natural resource endowments—received 82 percent of all foreign direct investment flows in the developing world and economies in transition.

A perusal of international business surveys, moreover, shows that the list of what the multinational investment community considers the ingredients for a good investment climate is long and demanding: low inflation; correct exchange rates; steady economic growth; privatized infrastructure services; high literacy rates; extensive access to the Internet; liberalized trade; low incidences of HIV-AIDS, malaria, and other infectious diseases; little ethnic tension; minimal corruption; stable and transparent political institutions and procedures; independent and capable judicial systems.[16]

As a consequence, there has been a tendency to conclude that the difficulties for poorer countries to join the ranks of countries able to attract and use nonextractive foreign direct investment for development must be staggering and in the case of tropical countries—including most of sub-Saharan Africa, Central America, and the Caribbean—may be almost impossible to overcome. But the evidence indicates otherwise. Two of the most prominent success stories in the literature on foreign direct investment and development are Mauritius and the Dominican Republic. Their accomplishments required straightforward policy reforms, which are readily duplicable.[17]

The Case of Mauritius

Mauritius in the 1960s was dependent on sugar production for 99 percent of its exports. Unemployment was high. Jobs in local industry were limited to sectors protected by import substitution policies. A study commissioned by the British before independence was entitled "Mauritius: A Case Study in Malthusian Economics."[18] Its dismal message was that young workers who were able to secure some education should be urged to emigrate.

In 1975 the government introduced legislation to confer export processing zone (EPZ) status on foreign investors who committed themselves to exporting their output. EPZ status allowed 100 percent foreign ownership and a ten-year tax holiday. But the country continued import substitution policies, subsidized inefficient, state-owned utilities, ran unsustainable budget deficits, and maintained an overvalued exchange rate complete with currency controls and foreign exchange rationing. The pace of foreign investment remained weak.

In 1982 a new political alliance ousted the party that had been dominant since electoral politics had been introduced in 1947.[19] It liberalized the currency, retreated from subsidizing state corporations, and adopted an aggressive policy of voluntary structural adjustment. To help make up for weak infrastructure, foreign investors were granted EPZ status wherever they chose to locate in the island country, often choosing sites where transport and utility services were best.

Led by textile investors from Hong Kong, foreign investment began to expand. Export earnings from manufactures in Mauritius climbed from 3 percent of the total in the early 1970s to 53 percent of the total in 1986, surpassing traditional sugar exports for the first time. Over the entire period from the mid-1970s to the mid-1990s, Mauritius ranked seventh among the fifteen most consistently growing exporters of manufactured products among low- and middle-income countries around the world—less spectacular than Singapore, Taiwan, and Hong Kong but superior to such high performers as Thailand, Portugal, and Israel, with an average annual growth rate of 2.9 percent.[20] By 2000 manufactured goods constituted 70 percent of all exports, totaling more than US$1.2 billion annually and sustaining 80,000–90,000 jobs.[21]

Like most low-income developing countries, Mauritius was initially disappointed by the lack of spillovers and externalities from export-oriented foreign investment and frustrated that the great majority of foreign firms were concentrated in lowest-skilled, labor-intensive operations. In 1985 the Mauritius Export Development and Investment Authority was given responsibility to search out and diversify export-oriented investors, with an aggressive strategy that replaced the earlier Ministry of Industry approach of screening inward investors to determine which would contribute most to import substitution. French, U.K., German, Taiwanese, and Chinese investors began to join the ranks of those from Hong Kong. Taking advantage of a trainable but not highly skilled workforce (4.5 years average schooling), foreign firms with EPZ status began to include light industry, sports equipment, agribusiness, and cut flowers, as well as higher-end garments such as shirting for the London department store Marks and Spencer.

At the same time, Mauritius began to attend to the health of its indigenous business community, reducing regulatory requirements for the establishment of local firms and lowering the corporate tax rate from 35 percent to 15 percent for manufacturers who did not qualify for the EPZ tax exemption. This helped indigenous entrepreneurs to become suppliers to foreign-owned exporters. It also gave them a platform to enter export markets themselves. The data show that indigenous managers and supervisors were able to gain experience in foreign-owned plants and then use this expertise to set up their own companies.[22] By the late 1990s host-country investors represented 50 percent of all equity capital in export-oriented firms.

The Case of the Dominican Republic

The efforts of the Dominican Republic to attract foreign direct investment to EPZs date from the late 1960s, but budget deficits, high inflation rates, and an overvalued exchange rate prevented the country from becoming an export base in the 1970s. Macroeconomic reform in the early 1980s, however, combined with a shift in EPZ strategy began to generate results.[23] Like many host governments, Dominican authorities had initially considered EPZs as a form of employment creation for the most destitute regions of the country, near the border with Haiti. But the combination of a poor infrastructure and an unskilled workforce limited the appeal of such locations to foreign investors. As the government opened up more sites for EPZ activity, closer to Santo Domingo, the number of investors expanded, reaching 178 firms in 1987 and employing some 85,000 workers.

In the second half of the 1980s Dominican authorities adopted a novel approach to the task of trying to upgrade and diversify foreign investor operations: they began to allow private developers to launch new EPZs and to permit international companies in more sophisticated industries to operate both as investors and as promoters. In the model Itabo zone, Westinghouse acted as both zone owner and exporter, soliciting other Fortune 500 companies to set up operations alongside its plants. In the San Isidro zone, GTE (now Verizon) pulled other electronics firms to the Dominican Republic. Private zone developers designed the Las Americas zone for information services. Other private zone operators configured pharmaceutical industrial parks to meet the inspection standards required by the U.S. Food and Drug Administration. Electronics, electrical equipment, medical equipment, metal products, and data processing became the largest new sectors represented, totaling 36 percent of all zone investment in 2000.[24]

While the data on indigenous workers and managers moving from employment in foreign plants to setting up their own firms are not as clear for the Dominican Republic as for Mauritius, 35 percent of all zone companies (166 of 481) were owned by Dominican citizens in 2000.[25] Total zone investment exceeded US$1 billion, total zone employment 197,000, total zone exports US$4.7 billion (80 percent of the country's total exports, and virtually the entirety of its manufactured exports).

Free Trade Zones: Lessons from Mauritius and the Dominican Republic

In Mauritius and the Dominican Republic, the typical effort to attract foreign direct investment in lowest skilled operations centered on creating export processing or free trade zones, but such zones have a very problematic record.[26] The rationale for these zones is to offer foreign investors freedom from duties on the capital equipment and inputs used in assembly operations, to enable them to operate with reliable, competitively priced infrastructure, and to shield them from adverse business conditions that may afflict other parts of the economy (corruption, crime, bureaucratic delay, high taxes, legal uncertainty).

The principal reason that the special zones have failed in low-income countries is that host authorities have simply not delivered these conditions. Ports and airports experience delays. Telecommunications services have been undependable and expensive. Electric power outages have necessitated backup generators. Bonded warehouses (single-factory EPZs with a customs agent at the site) have required graft payments. Duty-drawback arrangements (wherein duties on imported inputs are reimbursed when the final product is exported) invite bribes, to be handled expeditiously. Crime has plagued workers and managers living near the zones.

Beyond providing at least the beginnings of a business-friendly setting, foreign investors need low inflation and a realistic exchange rate. The boom in exports from Mauritius and the Dominican Republic did not take place until exchange rates reflected market conditions. An increasingly overvalued exchange rate in the 1990s in Kenya caused some sixty of the seventy bonded warehouses in the country to cease operations by the end of the decade. An artificially high exchange rate hindered export-oriented investment in Egypt despite extremely generous tax incentives.

Many developing countries have looked to the establishment of EPZs as a policy that might be used for direct poverty reduction. But the requirement for reliable infrastructure has shown that this is often not possible. The decision to locate EPZs in the poorest and most remote regions has seldom resulted in attracting large numbers of foreign investors or generating rapidly growing amounts of exports. For two decades, the most widely analyzed EPZ in all development literature was the zone that the Philippine government established in Bataan in an attempt to attract investors to where the workers were poorest and wages cheapest. But the mountainous area around Bataan was also bereft of good infrastructure, and the Philippine government had to spend millions of dollars to compensate. The Bataan zone generated a sufficiently poor cost-benefit ratio that it became a model of what to avoid.[27]

Much more successful have been policies of permitting foreign investors to qualify for zone status wherever the investors choose to locate (as Mauritius did) or multiplying the zones in proximity to the host country's economic centers with access to at least modestly skilled workers (as the Dominican Republic did). In what is called a buildup rather than a trickle-down strategy, this approach also provides the setting for the most positive experiences in developing local suppliers and generating backward linkages into the local economy.

In fact, to anticipate the argument given later, the most effective zone-led development strategies involve the gradual elimination of special zones, accompanied by progressive improvement in infrastructure services, in the stability and transparency of the institutional regime, in the control of corruption, and in the provision of safety throughout the country. This simultaneously strengthens indigenous business groups, which can become suppliers to foreign-owned exporters, and enables them perhaps to become exporters themselves. Completing the roster of reforms needed for indigenous firms to have a fair chance at becoming suppliers to foreign-owned exporters and perhaps exporters themselves, local firms must have access to competitively priced inputs, requiring steady progress in trade liberalization. At the end of the road, host countries find themselves with most of the key ingredients identified earlier as constituting what the multinational investment community considers a good investment climate.

But case studies of individual countries show that would-be hosts do not have to achieve anything like perfection to be successful in getting started on the road to using nonextractive foreign investment for development. A little macroeconomic, microeconomic, and institutional reform—backed by a consistent trend line—goes a long way. Mauritius and the Dominican Republic are by no means unique among relatively poor developing countries in creating hundreds of thousands of jobs and generating hundreds of millions of dollars of exports from foreign investor operations. In popular parlance, a poor developing country does not have to "become like Denmark" to attract and benefit from foreign direct investment.

Other Country Experiences

Explicitly trying to emulate Mauritius, Madagascar made the decision to liberalize its economy, end an overvalued exchange rate, and establish an EPZ-led growth strategy in 1989.[28] Like Mauritius, Madagascar awarded EPZ status to investors regardless of where they chose to locate. The pace of success in attracting foreign investors was even faster than had been the case in Mauritius, with 120 firms setting up operations in the first five years, in comparison to 100 firms in the first ten years for Mauritius.[29] In 1996 the country had 158 firms, with EPZ employment above 36,000. Between 1994 and 1998 (the most recent year for which data are readily available), exports from EPZs grew from US$64 million (14 percent of all exports) to US$195 million (37 percent of all exports).[30]

Elsewhere in Africa, Lesotho has attracted fifty-five foreign export–oriented manufacturing firms, thirty-eight producing clothing, three producing footwear, four producing electronics, four involved in food processing, and the rest producing assorted products such as umbrellas and plastic goods.[31] The garment sector alone employed approximately 32,000 workers, with exports of US$111 million in 1999, US$140 million in 2000, and US$216 million in 2001. If not somehow blocked by the South African trade unions, according to Sanjaya Lall, Lesotho might be able to integrate its foreign export/manufacturing sector into the South African economy the way Mexico has done via NAFTA, even after the expiration of the Multifiber Agreement in 2005 and the African Growth and Opportunity Act (AGOA) in 2008.[32]

Bangladesh, the Philippines (after it abandoned the Bataan model of placing EPZs in the most impoverished regions and began to allow foreign investors to locate their plants adjacent to the industrial and commercial hubs of the host country), Vietnam, Honduras, and El Salvador have enjoyed various degrees of success.[33] Their country experiences do not suggest that the task of attracting low-skilled, labor-intensive foreign direct investment is easy; but their country experiences do show that the task is highly doable.[34]

The New Model of Investment Promotion

Over the past decade and a half there has been a dramatic transformation in developing country strategy for attracting foreign investors.

In the 1970s and 1980s the predominant perspective among investment promotion agencies in the developing world was that multinational corporations were all-seeing, all-knowing actors ready to jump whenever profitable opportunities presented. Most agencies charged with dealing with foreign investors were devoted to screening those proposals that foreigners presented and then to levying performance requirements upon investors. This heavy-handed approach of screening investment proposals and requiring foreign firms to take on local joint-venture partners and meet domestic content mandates worked only for inward-oriented investment aimed at protected local markets where foreign investors could reap high oligopoly rents for their trouble.

For those host countries that wanted to attract export-oriented foreign investment, the task of attracting multinational investors was much more difficult. Even for the lowest-skill-intensive exports like garments, footwear, and electronic assembly, multinational corporations had to make sure their plants met international standards of quality and reliability. And as export-oriented investment moved into relatively higher skilled operations that would be integrated into a manufacturing corporation's international sourcing network—such as auto parts, plastics, machine tools, industrial equipment, medical devices, and business services—multinational corporations became risk-averse and hesitant about making capital-intensive "irreversible commitments" upon which their standing in international markets would depend.[35] For export-oriented plants, they insisted upon the right to establish wholly owned subsidiaries free from domestic content requirements. And even then they were cautious about building plants in new and untried host countries.

This changed the conceptualization of what was required for investment promotion profoundly. In place of passively waiting for the all-seeing profit seekers to pound on the door, the new task for host authorities became to demonstrate that their country was superior to alternatives elsewhere, when the target investors could not know for sure until they actually had tried the site out. The job of investment promotion agencies became to "market the country" actively and persuasively.[36] In investigating how to go about marketing a country, a study commissioned by the Foreign Investment Advisory Service (FIAS) of the World Bank Group found that host countries that actively courted new investors, provided them with a customized package of concessions oriented toward their specific industry, set up something approximating a "one-stop shop" to speed their approvals, and serviced their needs once they arrived received a statistically significant return on their efforts: for every dollar spent on investment promotion of this kind, the host received a stream of social benefits with a net present value of more than four dollars.[37] The aim became to make approvals as rapid, automatic, and transparent as possible, in place of highly discretionary, case-by-case determinations, which were slow, opaque, and subject to manipulation.

Over the course of the 1990s countries in Latin America and Southeast Asia that wanted both to attract export-oriented foreign direct investment and to upgrade investment from lowest skilled to relatively higher skilled manufacturing and assembly operations devoted increasing attention to the creation of skilled and aggressive investment promotion agencies. The Inter-American Development Bank and the Asian Development Bank have provided training. The Multilateral Investment Guarantee Agency of the World Bank Group (MIGA) created a web-based interactive system (IPANET) that dramatically reduced the search time, effort, and expense for investors to compare countries, compare legislation, and to obtain links to established investors on a real-time basis. Among low-income states, many governments have lagged behind in participating in this new wave of investment promotion and in keeping information sources and other inputs up-to-date.

As the experience of the Dominican Republic shows, a particularly potent discovery has been the role that private EPZ developers can play in identifying, seeking out, and delivering new foreign investors. The use of private operators to create and manage these zones was initially judged to be an unpromising strategy among experts in investment promotion. But the evidence soon demonstrated that the self-interest of the developers in recruiting investors (frequently from the home country of the developer), and in ensuring levels of service that kept investors in a given zone satisfied and growing, matched quite well the goals of the host country.[38] Complementing the use of private developers, a key component of many host countries' proactive strategy to market the country is the role of satisfied investors in attracting other participants from the same industrial sectors. In the Philippines, Texas Instruments, Philips, Toyota, and an array of other high-profile U.S., Japanese, Taiwanese, and European corporations became prime exhibits in helping Philippine authorities to sign up later investors in the same industries. This parallels the part played by companies like Westinghouse and GTE/Verizon in the Dominican Republic. In Latin America and Southeast Asia, investment promotion agencies have used direct web-based access to current investors to enhance the credibility of information about their policies and their economies for potential new entrants.

Sometimes these two components have been combined, as when the host authorities provide a leading international company with both an investment and an administrative stake in a particular industrial park. Zone developers and investors report that they have been able to earn large profits by providing business, managerial, and human resource services to fellow investors. Those fellow investors, in turn, report paying fees three times higher in private zones (the Dominican Republic provides the most extensive evidence) to surround their plants with adequate housing, transport, security, health care, and day care because these facilities help ensure a stable and productive workforce and in addition burnish their corporate image.[39]

The creation of new-generation investment promotion agencies may be difficult, but it is doable. It requires a commitment to transform or eliminate well-entrenched bureaucracies devoted to heavy-handed, case-by-case screening of applications. Investment promotion has a cumulative dynamic: it takes a proactive, efficient agency to attract the early investors and developers; the presence of the early investors creates an opportunity for private industrial park developers to use their home-country networks (in the United States, Europe, Japan, Korea, Taiwan, India) to find new investors; the interaction of established investors and aggressive developers provides comfort and credibility to further investors and more advanced activities. For countries that do not have the resources or the training to launch an effective investment promotion agency, or even to update the information on their websites, this cumulative virtuous cycle never gets started. Investment promotion therefore might be a prime candidate for external assistance and capacity building on the part of developed countries and multilateral lending agencies. The Lesotho National Development Corporation, charged with attracting and promoting foreign direct investment, for example, is 90 percent owned by the Lesotho government and 10 percent by the German Finance Company for Investments in Developing Countries.[40]

Many low-income developing countries are significantly behind the frontier of best practices. In 2000 the FIAS surveyed the process of obtaining the approvals necessary for foreign investors to locate in Namibia, Mozambique, Tanzania, and Uganda.[41] It examined company registration, business licenses, expatriate work and residence permits, tax registration, access to land, construction permits, access to investment incentives, and other licenses and specialized approvals. Rather than one-stop-shop investment promotion agencies designed to facilitate entry, the FIAS reported time-consuming screening by multiple agencies for industrial licenses, for tax holidays, and for expatriate work and residence permits. The result was that it took eighteen months to three years to establish a business and become operational in Tanzania and Mozambique and one to two years in Ghana and Uganda. This contrasts with six months or less in the Dominican Republic, Malaysia, and Thailand. Once again, however, the challenges are not insurmountable. The FIAS found that the system in Namibia compared favorably with best practices around the world, in Windhoek, and in particular around Walvis Bay.[42] Since 2000, investment approval procedures have improved in Mozambique, Ghana, Senegal, and Uganda.

Treatment of Workers in Foreign Direct Investment's Labor-Intensive Jobs

Leaders of poorly performing states have voiced fears to the International Labor Organization (ILO) and others that foreign direct investment in labor-intensive sectors of their countries might push them to adopt poor labor standards.[43]

On the one hand, the labor costs for foreign investors or subcontractors with lowest skill operations—such as making garments or footwear for export—range from 20 percent to more than 200 percent of the profit margin at the production stage. Barriers to entry are low, and competition is great. Managers at this stage are likely to find themselves under strong pressure to keep wages and benefits low in current plants and to be on the lookout for alternative locales where unit labor costs might be lower still. In addition, there is evidence that some international investors (and their home governments) insist upon weak labor standards as a condition of investment. According to the ILO, the governments of Namibia and Zimbabwe, for example, were being told in the mid-1990s that their EPZs would have to be excepted from national labor laws in order to be successful.[44] Pakistan admitted to the ILO that its EPZs had been exempted from some aspects of national labor legislation as a result of pressure from Daewoo.[45] The ambassadors from Japan and Korea intervened with the government of Bangladesh to prevent trade unions from being organized in EPZs where their companies were considering investments; only counterpressure from the United States in the form of a threat to withdraw GSP prevented this from happening.[46] The historical record of workers being fired—or even arrested or murdered—for organizing unions in EPZs is notorious.[47] The early years of the experience with EPZs in the Dominican Republic and the Philippines were wracked with labor strife.

On the other hand, however, the aggregate evidence does not show that poor labor standards attract foreign direct investment. Mita Aggarwal, of the U.S. International Trade Commission, examined the relationship between labor standards and U.S. investment in ten developing countries (China, Hong Kong, India, Indonesia, Malaysia, Mexico, the Philippines, Singapore, South Korea, and Thailand).[48] Aggarwal finds no association between enforcement of labor standards and level of U.S. foreign direct investment. On the contrary, U.S. investors tend to favor countries with higher labor standards and to invest in sectors within a given host country where labor conditions are superior to—or at least equal to—labor conditions in the rest of the economy. In a study of thirty-six developed and developing countries, Dani Rodrik also discovered no statistical relationship between low labor standards and increasing levels of U.S. foreign direct investment. The evidence points, in fact, in the opposite direction: nations with low labor standards have lower foreign direct investment than might be expected in light of other host-country attributes. These results, proposes Rodrik, "indicate that low labor standards may be a hindrance, rather than an attraction, for foreign investors."[49]

Surveys by the ILO, moreover, consistently find that pay for workers in EPZs is higher than alternatives elsewhere for these workers.[50] Similarly, the U.S. Department of Labor reports that firms producing footwear and apparel generally pay more than the minimum wage and provide working conditions superior to those that prevail in other labor-intensive industries.[51] Other investigations confirm that workers in foreign-owned, export-oriented factories receive higher pay, have better benefits, and have better working conditions than comparable workers in comparable industries. In Mauritius, for example, wages in EPZ companies are higher than in other sectors of the economy and rose in real terms by more than 50 percent between the late 1980s and the late 1990s.[52] In the Dominican Republic, 85 percent of the workers in U.S. firms and 80 percent of the workers in Korean, Taiwanese, and Hong Kong firms report that they acquired their skills exclusively at their current company and opined that they would be either unemployed or earning only 60 percent of their current wages without those skills.[53]

In one of the most carefully designed studies of EPZ workers in the development literature, Mireille Razafindrakoto and François Roubaud find that in Madagascar EPZ workers receive wages and benefits not only better than low-skilled agricultural workers but also better than comparable jobs across the economy. Holding education, professional experience, and tenure in the enterprise constant, they show that EPZ workers in Madagascar earn 15–20 percent more than other workers throughout the country.[54] Edward Graham demonstrates, in fact, that compensation for indigenous workers for foreign affiliates in the manufacturing sector is greater as a multiple of average compensation per worker in the host country's manufacturing sector for lesser and least developed countries than that in middle-income developing countries: in middle-income developing countries the ratio is 1:8; in low-income developing countries the ratio is 2:0, or twice as high as the average compensation in the manufacturing sector of the host country.[55] Thus the contention that host governments have to endorse poor worker treatment to attract foreign investors in labor-intensive industries—or must expect to find their workers receiving substandard wages, benefits, and working conditions when foreign investors arrive—is not supported by the data.

Nor is the perception supported that EPZ-led development is incompatible with the existence of trade unions. To be sure, most foreign investors and developers in EPZs have historically been averse to union organizing in EPZs, but in more recent times the evidence is mixed. The Philippines has a bloody history of antiunion repression in its EPZs in the 1970s and early 1980s. By the 1990s, however, as the right to union organizing became recognized and enforced by law in the EPZs, some of the zones with the least-skilled workers witnessed successful unionizing (one-third of the firms in the Bataan zone are currently operating with union contracts); other EPZs with higher-skilled semiconductor and auto parts plants, such as the Cavite and Baguio City zones, have had elections in which workers chose not to form unions.[56] Similarly, before 1992 the Dominican Republic exempted its zones from the national labor legislation. With help from the ILO, in 1992 the Dominican Republic began to apply its labor legislation uniformly throughout the economy. As in the case of the Philippines, firms in the Dominican Republic's EPZs devoted to lower-skilled operations sometimes became unionized; firms in EPZs beginning to attract higher-skilled workers tended not to.

In Mauritius, labor regulations applying to EPZ firms were brought into line with national labor regulations elsewhere. Union organizing has been permitted, and approximately 10 percent of workers in EPZ firms are unionized. In Lesotho, approximately 40 percent of garment workers are registered with the Lesotho Clothing and Allied Workers Union, an organization supported by Dutch funding.[57] Moreover, once host countries begin to move out of the least sophisticated investor operations into slightly more sophisticated investor operations supplying inputs that must meet standards of quality and reliability in international markets—in electronics, plastics, medical devices, auto parts, and the like—foreign investors find that they must take measures (in their own self-interest) to attract and retain superior workers.[58] In these sectors, foreign investors pay workers two to five times more than what is found in garment and footwear industries elsewhere; working conditions are demonstrably superior, sometimes including day care, health care, and educational opportunities associated with work.

And when plants producing more-skill-intensive products are mixed with plants producing less-skill-intensive products, the treatment of workers has improved among all plant-types.[59] Host countries that have begun to add slightly more-advanced investor activities to least-advanced investor activities have experienced a broad process of institutional change in worker-management relations across EPZs and industrial parks. Indeed, the evidence suggests that increases in the number of firms and the upgrading of foreign investor operations constitute the most forceful means that host countries have to improve the treatment of workers. The most powerful remedy for the problems of worker mistreatment as part of the process of the globalization of industry comes from more vigorous and more extensive globalization of industry. In the aggregate, the flow of foreign direct investment to relatively more sophisticated sectors in the developing world—like transportation equipment, electrical machinery, chemicals, and industrial products—is twenty-five times larger each year than it is to less-sophisticated, lower-skilled sectors like garments, footwear, leather products, and sports equipment.

Indigenous Linkages and Spillovers from Foreign Direct Investment

What lessons can poorly performing countries learn from host countries in which backward linkages, spillovers, and externalities have been created by foreign direct investment? What factors are needed for success?

Just as in the earlier discussion of the necessary ingredients for attracting foreign direct investment, the first factor is a stable macroeconomic setting, with low inflation and realistic exchange rates. Indigenous companies cannot tolerate an adverse macroeconomic environment any better than can foreign investors. The second factor is duty-free imports, dependable infrastructure, lack of red tape, and low crime and corruption, backed by reliable legal and regulatory institutions. Accompanying this must be a domestic banking system able to provide competitive financing to local businesses. Survey data of the World Economic Forum and the Harvard Center for International Development suggest that the cost and availability of local financing are widely considered to be among the most important obstacles to the operation and growth of private firms in Africa.[60]

The third factor is availability of capital and reasonably skilled labor (workers, technicians, engineers, and managers). Once again the data show a high payoff to the host country's investment in local education, often not higher than high school and trade school vocational training. Consistent with results from other continents, the findings of Tyler Biggs, Vijaya Ramachandran, and Manju Kedia Shah are that access to formal education (especially technical education at the secondary or high school level) by the owners of indigenous African-owned enterprises in sub-Saharan Africa significantly raises the rate of growth of these enterprises.[61] As with Mauritius and the Dominican Republic, these factors are needed to create the beginnings of an energetic national business community, with experience in meeting standards of quality and price required by open markets and in taking risks to achieve success, rather than relying on favors to protect themselves from competition.

Beyond this, is there a particular role for host governments to try to promote local suppliers or to nurture local supplier relationships? Recent work by the UN Conference on Trade and Development highlights the ability of some host countries to use foreign investors as talent scouts to sort through potential local suppliers by designating a manager in each foreign subsidiary with the responsibility to invite the most promising local firms to participate in management, quality control, and production planning sessions within the foreign subsidiary.[62] The foreign investor recommends to the best local participants what equipment, machinery, and training would best raise local performance. These local participants can then finance the required equipment, machinery, and training through purchase contracts from the foreign investor. The process must be competitive and transparent enough to avoid the danger of cronyism to reward privileged host-country firms. The key is for the host country to be light-handed in manipulating the foreign investors' own self-interest in finding low-cost, reliable suppliers—and not impose onerous requirements to meet domestic content and technology transfer mandates. In middle-level developing countries the stimulation of backward linkages may take the form of contract manufacturing by local firms. In the poorest developing countries, the stimulation of backward linkages may be much more basic, such as maintenance for sewing, cutting, and pressing machines, packaging, and the provision of simple accessories (buttons, trim).[63]

Overall, a strategy to use foreign direct investment for development (including the creation of a vibrant industrial base of indigenous suppliers) requires what might be called a buildup approach to strengthening the host country's economic base rather than a trickle-down approach of channeling rents to privileged recipients. A buildup strategy has a macroeconomic dimension that supports domestic as well as foreign firms with low inflation and a realistic exchange rate, a microeconomic dimension that rewards saving and investment, and an institutional dimension that provides regulatory and legal stability with a minimum of red tape and corruption. It provides domestic as well as foreign firms with reliable infrastructure services. It offers domestic as well as foreign firms access to inputs at internationally competitive prices. Finally, it supplies broad-based access to vocational training and skill development for workers and managers in domestic as well as foreign firms. A buildup strategy does not require separate and differential—and more protective—treatment for low-income developing states than for middle-income developing states, nor does it require reopening the TRIMs Agreement in the World Trade Organization (as some argue) to relegitimate the use of domestic content and trade-balancing requirements on foreign investors.[64]

To be sure, at the end of the day, foreign direct investment cannot be expected by itself (and in isolation from other economic, educational, and health factors) to be a cure-all for the problems of poverty in low-income countries, or even in middle-income countries. But there is a path whereby developing countries can harness foreign direct investment in progressively more important ways to contribute to their growth and welfare. Poorer countries can look to Mauritius, Madagascar, and Lesotho for examples of how to get launched. Countries that replicate the experience of Mauritius, Madagascar, and Lesotho can look to the Dominican Republic and the Philippines for examples of how to diversify their foreign investment base out of least-skilled operations like garments and footwear. Countries that replicate the experience of the Dominican Republic and the Philippines can look to Costa Rica, Malaysia, and Thailand for examples of how to move toward increasingly higher skilled operations, like auto parts, semiconductors, and business services, with expanding layers of indigenous suppliers and increasingly robust spillovers to the local economy.

Home-Country Measures for Providing Most Beneficial Foreign Direct Investment

The two principal ways in which developed countries can facilitate direct investment from the home market to the developing world are via provision of quasi-official political risk insurance and via measures to avoid double taxation of profits earned abroad. Other methods include assistance with identifying investment opportunities, help with creating investment promotion agencies in the host country, advocacy on behalf of foreign investors, and promotion of transparency in payments combined with restrictions on the payment of bribes or other corrupt practices. Home countries may also offer locational incentives to attract multinational investors.

In addition, of course, there is a significant interaction between trade liberalization and the facilitation of foreign direct investment. Multilateral trade liberalization and bilateral or regional trade agreements have as a by-product the stimulation of foreign direct investment flows among the participants. Conversely, developed country agricultural subsidies and protection against imports undermine the ability of international investors to use poor host economies as platforms for export. Antidumping regulations that are filed for reasons other than international price discrimination have the protectionist effect of deterring foreign investment in industries such as processed seafood and fruit juices as well as in manufacturing and assembly operations. (In general, the design of trade policies to support the poorest developing states is left to other chapters in this volume.)

Quasi-Official Political Risk Insurance

All international investors can purchase political risk insurance from private providers, such as AIG, Zurich, or Lloyds of London. The providers offer compensation if host countries take political actions that damage the project covered, such as expropriation or denial of ability to convert local currency into dollars (or other hard currencies). The existence of private insurance policies is often kept secret, so that host authorities do not single out well-covered projects for harsh treatment (knowing that the investor will not actually suffer large losses).

Multilateral lending agencies like MIGA and OPIC also offer compensation, but their "extra" facilitative support for investors comes in the form of deterrence, since host governments are reluctant to require MIGA or OPIC to pay for a loss suffered by a major firm. A claim against MIGA may influence lending decisions of the International Bank for Reconstruction and Development or the International Finance Corporation. A claim against OPIC may result in the U.S. Embassy, the Agency for International Development, the Department of Defense, and other U.S. agencies weighing in on the investor's behalf. Similarly, the host government wants to keep on good terms with the Inter-American Development Bank, the Asian Development Bank, and other multilateral lenders that offer political risk insurance. Some countries—such as Canada, the United Kingdom, and Japan—offer political risk insurance via their export credit agencies.

Besides bringing pressure to bear on behalf of an injured investor, the quasi-official agency—especially MIGA or its counterpart in a regional multilateral development bank, like the Inter-American Development Bank, the Asian Development Bank, or the European Bank for Reconstruction and

Development—can help mediate potential disputes behind the scenes before they become actual claims. Some countries offer quasi-official political risk coverage to any firm that has a significant presence in their home market. Other countries require that recipients of quasi-official political risk insurance be majority owned by home-country nationals.

The performance of developed countries in facilitating foreign direct investment to poorly performing countries should be evaluated as a function of whether the country involved provides home-country firms with access to political risk insurance and guarantees from multilateral lending agencies, provides home-country firms with access to political risk insurance from the country's own political risk insurance agency, and provides all firms with a significant presence in their economy with either or both of these kinds of coverage. U.S. investors can take advantage of the services of MIGA, since the United States is a member of MIGA; New Zealand investors cannot, since New Zealand is not a member of MIGA. All investors with a significant presence in Canada can purchase political risk coverage from Export Development of Canada, whereas only investors with majority ownership by U.S. nationals can purchase political risk coverage from OPIC.

Several aspects of quasi-official political risk insurance must be weighed. Some standards are desirable, others are not. For example, many quasi-official political risk insurers screen projects to ensure that they meet environmental standards, worker treatment standards, and human rights standards (as MIGA and OPIC do), a custom to be encouraged. On the other hand, some requirements are obstacles to outward investment. For example, some insurers are forbidden by the home country to consider projects in "sensitive sectors" of the home economy, such as textile, footwear, electronics, auto parts, steel investors; others may require investors to promise not to lay off workers or close plants in the home country, or promise to consult with local authorities. Also to be weighed negatively is the freedom of some insurers to provide coverage to any project that is commercially viable, including import-substitution projects that are harmful to the host country's development and that rely on trade protection to generate a profit.

Other Home-Country Measures

Home-country authorities may weigh in to the advantage of both foreign direct investors and their host countries in several other ways.

ADVOCACY, ARBITRATION, AND DISPUTE SETTLEMENT. In general, the performance of developed countries in facilitating foreign direct investment to poorly performing countries should be evaluated positively if home-country authorities try to resolve investment disputes in a mutually beneficial fashion. Home governments that intervene on behalf of foreign investors for purposes that contravene core labor standards or other international norms (such as the pressure from the Japanese and Korean governments on Bangladesh to place legal restrictions on freedom of association and right to collective bargaining in export zones) should receive a negative score.

Fundamental questions have emerged about the appropriate framework for the arbitration and settlement of foreign investor–host government disputes, with a growing appreciation of the limitations of commercial law arbitration. Reform of arbitration procedures would include broader provision for assessment of what best serves the public interest of the host state and of the international community and greater attention to distinguishing commercial from political risk.

MECHANISMS TO AVOID DOUBLE TAXATION. A foreign investor may be exposed to double taxation if it is required to pay an income tax or royalty to the host government and also to the home government when the income from the developing country project is remitted or consolidated with its home-country earnings. A tax-sparing agreement, or the use of a foreign tax credit, can avoid this. In addition, a tax-sparing agreement, or the use of a foreign tax credit, helps the developing country to attract foreign direct investment by offering a low tax rate or a tax holiday. If a host country granted a 10 percent tax rate to foreign investors, or granted a "pioneer status" tax holiday to foreign investors, the home country would simply collect the difference between the host country's rate and the home country's rate when the foreign earnings were repatriated or consolidated, if there were no tax-sparing arrangement or foreign tax credit.

Some tax regimes that avoid double taxation are more efficient than others, but the details can be quite complex and it may not be easy to grade alternative efforts. In general, the performance of developed countries in facilitating foreign direct investment in poorly performing countries should be evaluated positively if the sponsor's tax treaties or tax-sparing regimes avoid double taxation.

PREVENTION OF BRIBERY AND CORRUPT PRACTICES. In the past there have been blatant differences among home countries in the way they treated bribery and corrupt practices by home-country investors in overseas markets. The United States considered such practices criminal; other home countries did not consider them either criminal or civil offenses and allowed bribe payments to be considered business expenses. Thus the performance of developed countries in facilitating foreign direct investment to low-income countries should be evaluated in light of the home country's regulations and of its participation in contemporary OECD agreements to prevent bribery and other corrupt practices.

Beyond these OECD initiatives, however, individual governments and firms fear being put at a competitive disadvantage through measures to ensure transparency in payments. The multilateral community has a common interest therefore in establishing standards (perhaps in conjunction with the World Bank and regional development banks) to enhance transparency regarding the taxes and payments made by international investors in ways that can be monitored by external parties.

LOCATIONAL SUBSIDIES AND ASSISTANCE. More and more, home countries offer packages to multinational investors to keep their investments at home; these packages consist of tax breaks, subsidies, free land, below-market office space, and training grants.[65] Ireland was a leader in this. Such U.S. states as South Carolina, Alabama, and Kentucky became active players too, as have the provinces of Canada. European countries (such as Germany, for investment in the former East Germany) have increased their role. Although traditional analysis suggests that multinational investors do not base their locational decisions on tax considerations and that there is little competition between developed country and developing country sites, both of these assertions are being challenged by contemporary econometric research, which suggests that multinational investors are becoming more responsive to locational incentives and that competition between developed and developing countries for such investment is growing.[66] It may be extremely difficult to find accurate and comparable measures of locational incentives, in part because local and national authorities have an interest in concealing or quasi-concealing these measures from their own populaces as well as from outsiders.

The foreign service or the commercial service of some developed countries are trained to help home-country firms to find investment opportunities (as well as export opportunities) in the developing world. Others are not. The performance of developed countries in facilitating foreign direct investment to low-income countries should be evaluated positively if they use these domestic entities to help locate investment opportunities in developing countries—and negatively if they deploy locational incentives to attract or hold international investors.

An Appraisal of the United States on These Measures

By the above measures, the United States does facilitate foreign direct investment flows in many ways. U.S. investors are eligible for political risk insurance via multilateral and regional banks as well as via OPIC. OPIC screens for environmental impact and for worker and human rights abuses. The United States employs a foreign tax credit and has a criminal Foreign Corrupt Practices Act to prevent bribery and other corrupt behavior. U.S. embassies advocate on behalf of foreign direct investors on a regular basis. But it may come as a surprise that in many specific ways the United States does not in fact have a strong record of encouraging U.S. companies to set up labor-intensive operations in least-developed countries, especially when the resulting output might be imported into the U.S. market.

As noted above, the principal instrument of the U.S. government to facilitate foreign direct investment flows to developing countries is OPIC.[67] But OPIC is precluded from providing political risk insurance of financial guarantees to "sensitive sector" investments. By statute, OPIC cannot assist textile and garment projects aimed at exporting more than 5 percent of production to the United States unless a bilateral treaty placing a limit on exports of textiles and apparel to the United States is already in place. By statute, OPIC cannot cover agribusiness projects if the crops involved are "in surplus" in the United States and if more than 20 percent of the output is expected to be exported to the United States. By internal guidance, OPIC has similarly considered all projects in the electronics industry or the automotive industry (including all auto parts) too "sensitive" to support. Similarly, by statute, OPIC cannot support "runaway investments" (any project that results in any job loss even if the net job creation within the United States is strongly positive). It also refuses to finance or insure projects whose exports to third markets might displace exports from the United States. Finally, OPIC has not provided support over the years to U.S. investors interested in setting up EPZs, effectively precluding U.S. companies from playing the investor-developer role that has been such a powerful force in poorer country investment promotion.

Where OPIC has been able to operate in low-income states, it has frequently been able to support pioneering projects with broadly positive social impact that have served as demonstration models to other investors. A relatively modest US$1.9 million political risk insurance policy from OPIC allowed an American investor (Agro Management), for example, to provide chrysanthemum seedlings to farmers in Uganda, to set up buying stations close to the farms, and to establish a communal bank to deposit payments for flower deliveries. By 2001 some 19,000 Ugandan farmers were participating in this export-oriented endeavor. But this is the exception rather than the rule. As a result of statutory and internal policies concerning possible job loss in the United States, no more than 10 percent of OPIC's portfolio is in manufacturing or assembly or in agribusiness. Most investors in labor-intensive sectors simply do not bring their projects to OPIC for consideration. To allow OPIC to return to its original mandate to assist development, OPIC's authorizing legislation and internal policy practices need to be fundamentally revised to prohibit support only for those projects that can be shown to do net harm to the U.S. home economy. This would greatly enlarge the universe of potential investments in nonextractive sectors that OPIC could assist. But an effort to reform OPIC along these lines was defeated in the reauthorization struggle in 2003 as a result of opposition from the AFL-CIO.

The performance of the United States government in facilitating foreign direct investment flows would be improved by other reforms as well. International companies with a major presence in the United States are not eligible for OPIC coverage for the use of their U.S. operations as a base to invest in developing countries unless the companies are majority owned by U.S. investors. Siemens-USA, which employs 90,000 U.S. workers in its U.S. plants (more than in Germany), for example, is not eligible for OPIC coverage. Siemens-Canada, in contrast, is eligible for coverage by Export Development Canada. OPIC's statute should be revised to permit foreign-owned companies with a significant presence in the U.S. economy to be eligible. Another missed opportunity is the underutilized potential of the Foreign Commercial Service (FCS) to facilitate foreign direct investment in low-income states. The FCS does help U.S. firms to spot export opportunities, and the U.S. Foreign Service helps U.S. firms bid on some developing country contracts, but neither has been trained to identify potential foreign investment projects, even though the typical sequence is for an international company first to export to a target market and then to consider investing in a distribution or assembly facility.

Finally, individual state governments in the United States (Alabama, South Carolina, Kentucky) have been at the forefront in the escalation of locational incentives to attract investment and to keep international company plants from leaving. The United States has resisted efforts in the OECD to extend national supervision of investment subsidies to cover subnational authorities. Tax breaks, free land, subsidized office space, and training grants provided to international companies represent a classic example of the prisoner's dilemma: no single government dares refuse to participate, but all would be better off if there were a multilateral agreement to cap (and roll back) these giveaways. The United States could be a prime mover in this endeavor.

Appendix 11A: Foreign Direct Investment, by Host Countries

Table 11A-1. *Foreign Direct Investment, Inflows, by Host Region, 2000–02*
US$ million

Host region	*2000*	*2001*	*2002*
Africa	8,489	18,769	10,998
North Africa	3,125	5,474	3,546
Algeria	438	1,196	1,065
Egypt	1,235	510	647
Libyan Arab Jamahiriya	–142	–101	–96
Morocco	423	2,808	428
Sudan	392	574	681
Tunisia	779	486	821
Other Africa	5,364	13,295	7,452
Angola	879	2,146	1,312
Benin	60	44	41
Botswana	54	26	37
Burkina Faso	23	9	8
Burundi	12	0	0
Cameroon	31	67	86
Cape Verde	34	9	14
Central African Republic	1	5	4
Chad	115	0	901
Comoros	1	0	1
Congo	166	77	247
Congo, Democratic Republic of	23	1	32
Côte d'Ivoire	235	44	223
Djibouti	3	3	4
Equatorial Guinea	108	945	323
Eritrea	28	1	21
Ethiopia	135	20	75
Gabon	–43	169	123
Gambia	44	35	43
Ghana	115	89	50
Guinea	10	2	30
Guinea-Bissau	1	1	1
Kenya	127	50	50
Lesotho	31	28	24
Liberia	–431	–20	–65
Madagascar	70	93	8
Malawi	–33	–20	0
Mali	83	122	102
Mauritania	9	–6	12
Mauritius	277	32	28

Table 11A-1 *(continued)*

Host region	*2000*	*2001*	*2002*
Mozambique	139	255	406
Namibia	153	275	181
Niger	9	23	8
Nigeria	930	1,104	1,281
Rwanda	8	4	3
São Tomé and Principe	2	6	2
Senegal	63	32	93
Seychelles	56	59	63
Sierra Leone	5	3	5
Somalia	0	0	0
South Africa	888	6,789	754
Swaziland	39	78	107
Togo	42	63	75
Uganda	254	229	275
United Republic of Tanzania	463	327	240
Zambia	122	72	197
Zimbabwe	23	4	26
Latin America and the Caribbean	76,792	69,436	43,534
South America	57,248	39,693	25,836
Argentina	11,657	3,206	1,003
Bolivia	723	660	553
Brazil	32,779	22,457	16,566
Chile	3,639	4,477	1,603
Colombia	2,237	2,521	2,034
Ecuador	720	1,330	1,275
Guyana	67	56	44
Paraguay	104	95	–22
Peru	681	1,151	1,462
Suriname	–97	–27	–85
Uruguay	274	318	85
Venezuela	4,465	3,448	1,318
Other	19,544	29,743	17,698
Anguilla	39	33	33
Antigua and Barbuda	33	39	36
Aruba	–144	–319	241
Barbados	19	19	11
Belize	19	40	52
Costa Rica	409	454	642
Cuba	–10	4	4
Dominica	11	12	14
Dominican Republic	953	1 079	961

Host region	*2000*	*2001*	*2002*
El Salvador	173	250	208
Grenada	37	49	41
Guatemala	230	456	110
Haiti	13	4	6
Honduras	282	195	143
Jamaica	468	614	479
Mexico	15,484	25,334	13,627
Montserrat	4	1	1
Nicaragua	267	150	174
Panama	603	513	57
Saint Kitts and Nevis	96	88	81
Saint Lucia	55	22	22
Saint Vincent and the Grenadines	29	21	19
Trinidad and Tobago	472	685	737
Asia and the Pacific	142,209	106,937	95,129
Asia	142,091	106,778	94,989
West Asia	1,523	5,211	2,341
Bahrain	364	81	218
Cyprus	804	652	297
Iran, Islamic Republic of	39	50	37
Iraq	–3	–6	–9
Jordan	787	100	56
Kuwait	16	–147	7
Lebanon	298	249	257
Oman	44	42	40
Occupied Palestinian Territory	62	11	41
Qatar	252	296	326
Saudi Arabia	–1,884	20	–350
Syrian Arab Republic	270	205	225
Turkey	982	3,266	1,037
United Arab Emirates	–515	257	95
Yemen	6	136	64
Central Asia	1,871	3,963	4,035
Armenia	104	70	100
Azerbaijan	129	227	1,067
Georgia	131	110	146
Kazakhstan	1,283	2,823	2,561
Kyrgyzstan	–2	5	–12
Tajikistan	22	9	9
Turkmenistan	131	150	100
Uzbekistan	73	570	65

Table 11A-1 *(continued)*

Host region	*2000*	*2001*	*2002*
South, East, and South-East Asia	138,698	97,604	88,613
Afghanistan	0	1	0
Bangladesh	280	79	45
Bhutan	0	0	0
Brunei Darussalam	549	526	1,035
Cambodia	149	148	54
China	40,772	46,846	52,700
Hong Kong, China	61,939	23,775	13,718
India	2,319	3,403	3,449
Indonesia	–4,550	–3,279	–1,523
Korea, Democratic People's Republic of	5	–24	12
Korea, Republic of	9,283	3,528	1,972
Lao People's Democratic Republic	34	24	25
Macau, China	–1	133	150
Malaysia	3,788	554	3,203
Maldives	13	12	12
Mongolia	54	43	78
Myanmar	208	192	129
Nepal	0	21	10
Pakistan	305	385	823
Philippines	1,345	982	1,111
Singapore	12,464	10,949	7,655
Sri Lanka	175	82	242
Taiwan Province of China	4,928	4,109	1,445
Thailand	3,350	3,813	1,068
Vietnam	1,289	1,300	1,200
The Pacific	118	159	140
Fiji	25	90	77
Kiribati	1	1	1
New Caledonia	22	–1	0
Papua New Guinea	96	63	50
Samoa	–2	1	1
Solomon Islands	1	–12	–7
Tonga	5	1	2
Tuvalu	0	0	0
Vanuatu	20	18	15
Central and Eastern Europe	26,373	25,015	28,709
Albania	143	207	213
Belarus	119	96	227
Bosnia and Herzegovina	147	130	321
Bulgaria	1,002	813	479

Host region	*2000*	*2001*	*2002*
Croatia	1,089	1,561	981
Czech Republic	4,984	5,639	9,319
Estonia	387	542	307
Hungary	1,646	2,440	854
Latvia	410	164	396
Lithuania	379	446	732
Moldova, Republic of	129	156	111
Poland	9,341	5,713	4,119
Romania	1,025	1,157	1,106
Russian Federation	2,714	2,469	2,421
Serbia and Montenegro	25	165	475
Slovakia	1,925	1,579	4,012
Slovenia	136	503	1,865
TFYR Macedonia	177	442	77
Ukraine	595	792	693
Addendum			
Least developed countries	3,427	5,629	5,232
Oil-exporting countries	2,468	8,099	7,364
Developing economies (not including Bermuda, Cayman Islands, Virgin Islands, Bahamas, Netherlands Antilles)	253,864	220 157	178 370

Source: UN Conference on Trade and Development, *World Investment Report 2003: FDI Policies for Development: National and International Perspectives* (annex table B.1) (www.unctad.org/fdistatistics).

Table 11A-2. *Foreign Direct Investment, Inward Stock, by Host Region, 2000–02*
US$ million

Host region	*2000*	*2001*	*2002*
Africa	144,659	157,980	171,032
North Africa	38,082	43,191	48,310
Algeria	3,441	4,637	5,702
Egypt	19,589	20,099	20,746
Libyan Arab Jamahiriya	–4,648	–4,748	–4,844
Morocco	6,758	9,566	9,994
Sudan	1,396	1,970	2,651
Tunisia	11,545	11,667	14,061
Other Africa	106,577	114,788	122,723
Angola	7,977	10,122	11,435
Benin	588	632	673
Botswana	1,821	1,494	1,946
Burkina Faso	149	158	166
Burundi	48	48	48
Cameroon	1,263	1,331	1,417
Cape Verde	174	183	197
Central African Republic	95	101	105
Chad	618	618	1,519
Comoros	24	24	26
Congo	1,893	1,970	2,217
Congo, Democratic Republic of	617	618	650
Côte d'Ivoire	3,407	3,451	3,674
Djibouti	34	37	40
Equatorial Guinea	1,128	2,073	2,396
Eritrea	301	301	322
Ethiopia	941	961	1,036
Gabon	–1,707	–1,538	–1,415
Gambia	216	221	264
Ghana	1,462	1,551	1,601
Guinea	263	265	295
Guinea-Bissau	46	47	48
Kenya	996	1,047	1,097
Lesotho	486	514	539
Liberia	2,516	2,496	2,431
Madagascar	341	434	442
Malawi	183	163	163
Mali	453	576	678
Mauritania	108	101	113
Mauritius	687	719	746
Mozambique	1,094	1,350	1,755

Host region	*2000*	*2001*	*2002*
Namibia	1,230	797	978
Niger	426	449	457
Nigeria	20,184	21,289	22,570
Rwanda	252	256	259
São Tomé and Principe	4	9	11
Senegal	827	859	952
Seychelles	577	636	699
Sierra Leone	19	22	26
Somalia	4	4	4
South Africa	47,418	50,246	50,998
Swaziland	432	479	656
Togo	511	574	649
Uganda	1,255	1,484	1,759
United Republic of Tanzania	1,783	2,111	2,351
Zambia	2,350	2,422	2,619
Zimbabwe	1,085	1,088	1,114
Latin America and the Caribbean	517,421	599,954	643,952
South America	380,061	414,979	441,110
Argentina	72,935	75,989	76,992
Bolivia	5,176	5,839	6,392
Brazil	196,884	219,342	235,908
Chile	44,955	44,693	46,296
Colombia	12,144	16,008	19,375
Ecuador	7,081	8,410	9,686
Guyana	759	815	859
Paraguay	1,311	1,162	867
Peru	10,503	10,669	12,565
Suriname	–719	–746	–830
Uruguay	2,088	2,406	1,291
Venezuela	26,944	30,392	31,710
Other	137,360	184,975	202,842
Anguilla	227	260	293
Antigua and Barbuda	566	606	642
Aruba	816	497	738
Barbados	308	326	338
Belize	269	310	362
Costa Rica	5,206	5,660	6,302
Cuba	74	78	82
Dominica	271	283	297

Table 11A-2 *(continued)*

Host region	*2000*	*2001*	*2002*
Dominican Republic	5,214	6,293	7,254
El Salvador	1,973	2,223	2,431
Grenada	346	395	436
Guatemala	3,420	3,876	4,155
Haiti	215	220	226
Honduras	1,489	1,684	1,826
Jamaica	3,316	3,930	4,409
Mexico	97,170	140,376	154,003
Montserrat	84	85	86
Nicaragua	1,386	1,536	1,710
Panama	6,744	7,257	7,314
Saint Kitts and Nevis	484	572	653
Saint Lucia	804	826	849
Saint Vincent and the Grenadines	489	510	529
Trinidad and Tobago	6,489	7,173	7,910
Asia and the Pacific	1,275,985	1,310,200	1,406,527
Asia	1,272,245	1,306,301	1,402,488
West Asia	69,979	70,035	72,376
Bahrain	5,906	5,986	6,205
Cyprus	3,878	4,530	4,827
Iran, Islamic Republic of	2,474	2,524	2,561
Iraq	–23	–29	–38
Jordan	2,258	2,358	2,414
Kuwait	527	380	387
Lebanon	1,116	1,365	1,622
Oman	2,501	2,543	2,583
Occupied Palestinian Territory	155	165	206
Qatar	1,920	2,216	2,541
Saudi Arabia	25,963	25,983	25,633
Syrian Arab Republic	1,699	1,904	2,129
Turkey	19,209	17,521	18,558
United Arab Emirates	1,061	1,318	1,413
Yemen	1,336	1,271	1,336
Central Asia	16,123	20,856	25,139
Armenia	513	580	680
Azerbaijan	3,735	3,962	5,354
Georgia	423	533	679
Kazakhstan	9,259	12,871	15,354
Kyrgyzstan	439	427	415
Tajikistan	144	153	162
Turkmenistan	913	1,063	1,163
Uzbekistan	697	1,267	1,332

Host region	*2000*	*2001*	*2002*
South, East and Southeast Asia	1,186,143	1,215,410	1,304,973
Afghanistan	17	18	18
Bangladesh	983	1 062	1 107
Bhutan	3	4	4
Brunei Darussalam	3,856	4,383	5,418
Cambodia	1,336	1,449	1,503
China	348,346	395,192	447,892
Hong Kong, China	455,469	419,348	433,065
India	18,916	22,319	25,768
Indonesia	60,638	57,359	55,836
Korea, Democratic People's Republic of	1,046	1,022	1,034
Korea, Republic of	37,106	40,767	43,689
Lao People's Democratic Republic	550	574	599
Macau, China	2,725	2,858	3,008
Malaysia	52,747	53,301	56,505
Maldives	118	130	142
Mongolia	182	225	302
Myanmar	3,178	3,266	3,395
Nepal	97	116	126
Pakistan	6,912	5,536	6,359
Philippines	9,081	10,468	11,579
Singapore	113,431	116,428	124,083
Sri Lanka	2,389	2,471	2,713
Taiwan Province of China	27,924	32,033	33,478
Thailand	24,468	29,158	30,226
Vietnam	14,624	15,924	17,124
The Pacific	3,740	3,899	4,039
Fiji	1,017	1,106	1,183
Kiribati	5	5	6
New Caledonia	146	144	144
Papua New Guinea	2,007	2,069	2,119
Samoa	53	55	56
Solomon Islands	126	114	107
Tonga	21	22	25
Tuvalu	1	1	1
Vanuatu	366	384	399
Central and Eastern Europe	129,169	155,734	187,868
Albania	568	775	988
Belarus	1,306	1,374	1,602
Bosnia and Herzegovina	376	506	828
Bulgaria	2,716	3,410	3,889

Table 11A-2 *(continued)*

Host region	*2000*	*2001*	*2002*
Croatia	3,560	5,049	6,029
Czech Republic	21,644	27,092	38,450
Estonia	2,645	3,160	4,226
Hungary	19,804	23,562	24,416
Latvia	2,084	2,332	2,723
Lithuania	2,334	2,666	3,981
Moldova, Republic of	446	600	717
Poland	34,227	41,031	45,150
Romania	6,480	7,638	8,786
Russian Federation	17,956	20,142	22,563
Serbia and Montenegro	1,319	1,484	1,959
Slovakia	4,634	6,213	10,225
Slovenia	2,809	3,209	5,074
TFYR Macedonia	387	829	907
Ukraine	3,875	4,662	5,355
Addendum			
Least developed countries (LDCs)	35,609	40,867	46,099
Oil-exporting countries	174,176	182,275	189,638
Developing economies (not including Bermuda, Cayman Islands, Virgin Islands, Bahamas, Netherlands Antilles)	2,067,234	2,223,868	2,409,380

Source: See table 11A-1, annex table B.3.

Notes

1. The analysis of the impact of various kinds of foreign direct investment on the host country's physical environment requires much more extensive treatment than is possible here. In general, the focus of this chapter is the positive or negative contribution of foreign investors to the host country's economic welfare (including the treatment of workers) and to the host country's growth prospects.

2. Jeffrey Sachs and Andrew Warner, "The Curse of Natural Resources," *European Economic Review* 45. no. 3 (2001): 827–38.

3. William Ascher, *Why Governments Waste Resources: The Political Economy of Natural Resource Policy Failures in Developing Countries* (Johns Hopkins University Press, 2000); Michael L. Ross, "The Political Economy of the Resource Curse," *World Politics* 51, no. 2 (1999): 297–322.

4. Jerry Useem, "Exxon's African Adventure: How to Build a $3.5 Billion Pipeline—with the 'Help' of NGOs, the World Bank, and Yes, Chicken Sacrifices," *Fortune,* April 15, 2002, pp. 102–09. For a critical perspective on the Chad-Cameroon project, see Ian Gary and Terry Lynn Karl, *Bottom of the Barrel: Africa's Oil Boom and the Poor* (Baltimore: Catholic Relief Services, 2003), chap. 5.

5. See the Publish What You Pay Campaign at www.globalwitness.org.

6. See www.dfid.gove.uk.

7. Jeff Gerth, "U.S. and Oil Companies Back Revised Effort on Disclosure," *New York Times,* September 19, 2003, p. w1.

8. T. Irwin and others, eds., *Dealing with Public Risk in Private Infrastructure* (Washington: World Bank, 1997).

9. Julie A. Martin, with Pamela A. Bracey, "OPIC Modified Expropriation Coverage Case Study: MidAmerica's Projects in Indonesia—Dieng and Patuha," in *International Political Risk Management: Exploring New Frontiers,* edited by Theodore H. Moran (Washington: World Bank, 2001).

10. Charles Berry, "Shall the Twain Meet? Finding Common Ground or Uncommon Solutions: A Broker's Perspective," in *International Political Risk Management: The Brave New World* (Washington: World Bank, 2003).

11. For the detailed evidence and background for the examples that follow, see Theodore H. Moran, *Parental Supervision: The New Paradigm for Foreign Direct Investment and Development* (Washington: Institute for International Economics, 2001).

12. Dennis J. Encarnation and Louis T. Wells Jr., "Evaluating Foreign Investment," in *Investing In Development: New Roles for Private Capital?* edited by Theodore H. Moran (Washington: Overseas Development Council, 1986).

13. For a theoretical analysis of why trade protection, domestic content requirements, or other restraints on competition are likely to lead to a proliferation of subscale and inefficient plants, see H. Eastman and S. Stykolt, "A Model for the Study of Protected Oligopolies," *Economic Journal* 70 (1970): 336–47.

14. See Moran, *Parental Supervision.*

15. Portions of this section draw on Ted Moran, "Attracting Non-Extractive Investment to Africa: Challenges, Success Stories, and Lessons for the Future," paper prepared for the Corporate Council on Africa/Institute for International Economics, Washington, June 2, 2003.

16. *International Country Risk Guide 2002* (East Syracuse, N.Y.: PRS Group, 2002); *Competitiveness Indicators 2002* (Geneva: World Economic Forum, 2002); Klaus Schwab and others, *The Africa Competitiveness Report 2000–2001* (Oxford University Press, 2000); Jeffrey Sachs and Sara Sievers, "Foreign Direct Investment in Africa," in *The Africa Competitiveness Report 1998* (Geneva: World Economic Forum, 1998); William Easterly and Ross Levine, "Africa's Growth Tragedy: Policies and Ethnic Divisions," *Quarterly Journal of Economics* 112, no. 4 (1997): 1203–50; *Global Economic Prospects and the Developing Countries 2003: Investing to Unlock Global Opportunity* (Washington: World Bank, 2002); Aart Kraay, and Jaume Ventura, "Current Accounts in Debtor and Creditor Countries," *Quarterly Journal of Economics* 115 (2000): 1137–66.

17. These case studies can be found in Theodore H. Moran, *Beyond Sweatshops: Foreign Direct Investment and Globalization in Developing Countries* (Washington: Brookings, 2002).

18. The author of the study is James Meade, Port Louis, Mauritius, 1960.

19. Lucie C. Phillips and others, "Foreign and Local Investment in East Africa, Interactions and Policy Implications: Case Studies of Mauritius, Uganda, and Kenya," research paper, Bureau for Africa, Office of Sustainable Development (Washington: U.S. Agency for International Development, 2000). According to *World Development Indicators* (Washington: World Bank, 2004), Mauritius had a GDP per capita of US$1,883 in 1982 (in constant 1995 dollars).

20. Steven Radelet, "Manufactured Exports, Export Platforms, and Economic Growth," CAER II Discussion Paper 43 (Harvard Institute for International Development, Harvard University, 1999), table 3.

21. *International Financial Statistics: Mauritius, 2001* (Washington: International Monetary Fund, 2001).

22. Yung Whee Rhee, Katharina Katterback, and Jeanette White, *Free Trade Zones in Export Strategies* (Washington: World Bank, 1990), p. 39.

23. According to *World Development Indicators* (Washington: World Bank, 2004), the Dominican Republic had a GDP per capita in 1982 of US$1,333 (constant 1995 dollars).

24. National Free Zone Council of the Dominican Republic, *Free Zone Statistical Report Year 2000* (Santo Domingo: 2001), figures 20, 29, 39.

25. Ibid.

26. Dorsati Madani, "A Review of the Role and Impact of Export Processing Zones," PREM-EP working paper (Washington: World Bank, 1999).

27. Peter G. Warr, "Export Promotion via Industrial Enclaves: The Philippines Bataan Export Processing Zone," *Journal of Development Studies* (January 1987): 220–41; Helena Johansson, "The Economics of Export Processing Zones Revisited," *Development Policy Review* 12 (1994): 387–402.

28. Mireille Razafindrakoto and François Roubaud, "Les Entreprises Franches a Madagascar: Economie d'enclave ou promesse d'une nouvelle prosperite? Nouvel exclavage ou opportunite pour le developpement du Pays?" *Economie de Madagascar,* no. 2 (1995): 219–32. According to the *World Development Indicators* (Washington: World Bank, 2004), Madagascar had a GDP per capita of US$275 in 1989 (in constant 1995 dollars).

29. Razafindrakoto and Roubaud, "Les Entreprises Franches a Madagascar," p. 223.

30. Economist Intelligence Unit, *Country Profile 2000: Madagascar,* reference table 12 (London: Economist, 2000).

31. Sanjaya Lall, "Lesotho Integrated Framework Study: Foreign Direct Investment," working paper (Washington: World Bank, 2002). According to the *World Development Indicators* (Washington: World Bank, 2004), Lesotho had a GDP per capita of US$535 in 1998 (in constant 1995 dollars).

32. Lall, "Lesotho Integrated Framework Study."

33. Mauricio Jenkins, Gerardo Esquivel, and Felipe Larrain, "Export Processing Zones in Central America," development discussion paper, Central America Project Series (Harvard Institute for International Development, Harvard University, 1998); Manuel R. Agosin, David E. Bloom, and Eduardo Gitli, "Globalization, Liberalization, and Sustainable Human Development: Progress and Challenges in Central American Countries (El Salvador, Guatemala, Honduras, and Nicaragua)," Occasional Paper UNCTAD/EDM/Misc. 126, 2000 (Geneva: UN Conference on Trade and Development, 2000). Among resource-oriented economies, the list of the more successful of the poorer host countries would include Namibia and Botswana.

34. In an analysis of foreign investment flows from fourteen home countries to forty-five host countries in the early 1990s, for example, S.-J. Wei found that each one-grade increase (on a ten-point scale) in the corruption level was associated with a 16 percent increase in the flow of foreign direct investment, or approximately equal to a 3 percentage point decrease in the marginal tax rate. S.-J. Wei, "How Taxing Is Corruption on International Investors?" *Review of Economics and Statistics* 82 (2001): 1–11.

35. Avinash K. Dixit and Robert S. Pindyck, *Investment under Uncertainty* (Princeton University Press, 1994).

36. This has been likened to trying to convince buyers of a used car that they won't end up with a lemon. Unlike a used car dealer, though, a would-be host country can neither let the prospective investor take a test drive nor share the risk of future failure by offering a lengthy warranty. George A. Akerloff, "The Market for Lemons: Quality Uncertainty and the Market Mechanism," *Quarterly Journal of Economics* 84, no. 3 (1970): 488–500.

37. Louis T. Wells Jr. and Alvin G. Wint, *Marketing a Country: Promotion as a Tool for Attracting Foreign Investment,* rev. ed. (Washington: Foreign Investment Advisory Service of the World Bank Group, 2000).

38. Louis T. Wells Jr., afterword to ibid.

39. Rhee, Katterback, and White, *Free Trade Zones in Export Strategies.*

40. The Lesotho National Development Corporation has begun to divest itself of the management of the country's five major export-oriented industrial estates, subcontracting responsibility to JHI Real Estate Limited, a South African multinational firm. Lall, "Lesotho Integrated Framework Study."

41. James J. Emery and others, "Administrative Barriers to Foreign Investment: Reducing Red Tape in Africa," Occasional Paper 14 (Washington: FIAS, 2000). See also FIAS, "Ethiopia; Foreign Investment Promotion Strategy Framework," draft, December 2000.

42. FIAS indicated that if there could be better coordination of duplicative approvals required from the Namibia Planning Advisory Board and the townships boards, Namibia could well be considered a model for other countries.

43. This section draws heavily upon Moran, *Beyond Sweatshops.*

44. ILO, "African Regional Workshop on the Protection of Workers' Rights and Working Conditions in EPZs and the Promotion of the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy" (Geneva: 1996), p. 11.

45. Kimberly Ann Elliott, "Getting Beyond No . . . ! Promoting Worker Rights and Trade," in *The WTO after Seattle,* edited by Jeffrey J. Schott (Washington: Institute for International Economics, 2000), p. 198.

46. Economist Intelligence Unit, *Bangladesh: Country Report* (London: 2001), p. 19. Bangladesh is now in the midst of a five-year phase in of trade unions in the country's EPZs.

47. ILO, *Labor and Social Issues Relating to Export Processing Zones* (Geneva: 1998).

48. Mita Aggarwal, "International Trade, Labor Standards, and Labor Market Conditions: An Evaluation of the Linkages," Working Paper 95-06-C (Washington: Office of Economics, U.S. International Trade Commission, 1995).

49. Dani Rodrik, "Labor Standards in International Trade: Do They Matter and What Do We Do about Them?" in *Emerging Agenda for Global Trade: High Stakes for Developing Countries,* edited by Robert Lawrence, Dani Rodrik, and John Whalley (Johns Hopkins University Press for the Overseas Development Council, 1996), p. 57.

50. ILO, *Labor and Social Issues Relating to Export Processing Zones.*

51. U.S. Department of Labor, Bureau of International Labor Affairs, *Wages, Benefits, Poverty Line, and Meeting Workers Needs in the Apparel and Footwear Industries of Selected Countries* (Washington: 2000).

52. Radelet, "Manufactured Exports, Export Platforms, and Economic Growth," p. 47.

53. Rhee, Katterback, and White, *Free Trade Zones in Export Strategies,* p. 22.

54. Razafindrakoto and Roubaud, "Les Entreprises Franches a Madagascar," pp. 233–34.

55. Edward M. Graham, *Fighting the Wrong Enemy: Antiglobal Activists and Multinational Enterprises* (Washington: Institute for International Economics, 2000), table 4-2, pp. 93–94. Graham eliminates salaries for foreign managers and supervisors from these calculations.

56. ILO, *Labour and Social Issues Relating to Export Processing Zones,* pp. 23–24.

57. Lall, "Lesotho Integrated Framework Study," p. 9.

58. This hypothesis is tested in Moran, *Beyond Sweatshops,* with positive results.

59. Ibid.

60. Peter Cornelius, "Financial Development and the Liberalization of Financial Services Trade," in *The Africa Competitiveness Report 2000–2001,* edited by Klaus Schwab and others (Oxford University Press, 2000). This finding is also reported in "Economic Diversification and Competitiveness in East Africa: An Analysis of Firm-Level Data from Ethiopia, Kenya, Tanzania, and Uganda" (Washington: World Bank, 2002).

61. Clear land title is a significant factor in determining relative firm growth rates. Access to an initial bank loan or informal loan does not seem to play a role in driving growth but is significant in determining firm size at start-up. Tyler Biggs, Vijaya Ramachandran, and Manju Kedia Shah, "The Determinants of Enterprise Growth in Sub-Saharan Africa: Evidence for the Regional Program on Enterprise Development" (Washington: World Bank, 1998). Vijaya Ramachandran and Manju Kedia Shah, "Minority Entrepreneurs and Private Sector Growth in Sub-Saharan Africa," RPED Paper 086 (Washington: World Bank, 1998).

62. UNCTAD, *World Investment Report 2001* (Geneva: 2001). See also Jenkins, Esquivel, and Larrain, "Export Processing Zones in Central America"; Agosin, Bloom, and Gitli, Globalization, "Liberalization, and Sustainable Human Development."

63. Lall, "Lesotho Integrated Framework Study." In addition, in Bangladesh (also a country with relatively low skill and education levels) many employees of multinational corporations left their garment employers within a few years and set up their own export operations. See Yung W. Rhee and T. Belot, "Export Catalysts in Low-Income Countries: A Review of Eleven Success Stories," Discussion Paper 72 (Washington: World Bank, 1989). More broadly, it should be remembered that the indigenous world-class international machine tool competitors in today's Malaysia grew from local machine maintenance providers who serviced the foreign semiconductor and telecommunications investors. See Rajah Rasiah. "Flexible Production Systems and Local Machine-Tool Subcontracting: Electronics Components Transnationals in Malaysia," *Cambridge Journal of Economics* 18, no. 3 (1994): 279–98

64. The TRIMS Agreement dealt with trade-related investment measures, obliging WTO members to phase out the imposition of required levels of local content on foreign investors and to end the requirement that foreign firms match imports with exports.

65. Kenneth P. Thomas, *Competing for Capital: Europe and North America in a Global Era* (Georgetown University Press, 2000).

66. J. Mutti, *Taxation and Foreign Direct Investment* (Washington: Institute for International Economics, 2003); R. Altshuler, H. Grubert, and S. Newlong, "Has US Investment Abroad Become More Sensitive to Tax Rates?" Working Paper 6383 (Cambridge: National Bureau of Economic Research, 1998).

67. This analysis of OPIC draws on *Reforming OPIC for the 21st Century* (Washington: Institute for International Economics, 2003.)