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## SUMMARY REPORT

**UNITAR/SHU SERIES ON INTERNATIONAL ECONOMICS AND FINANCE:  
Workshop on Foreign Direct Investment for Development Financing  
22-23 August 2006, Conference Room D, United Nations Headquarters, New York**

### BACKGROUND

On 22-23 August 2006, the United Nations Institute for Training and Research (UNITAR) in collaboration with the Stillman School of Business at Seton Hall University (SHU) hosted the Eighth Annual UNITAR/SHU Seminar on International Economics and Finance. The two day workshop focused on Foreign Direct Investment (FDI) for Development Financing. The workshop was designed to enhance understanding of the forces at play in the current global economic and financial environment. The primary emphasis of the workshop was on FDI to developing countries, with a focus on how to attract FDI as a tool to finance development. Other topics included legal issues of FDI, marketing a country to attract FDI, experiences of a developing economy in attracting FDI, financing infrastructure projects, and opportunities and risks posed by globalization.

### SUMMARY OF INTERVENTIONS

#### **A Primer and Legal Aspects of FDI**

Richard J. Hunter, Professor of Legal Studies at SHU, explained that economic history has shown that investment and trade are necessary requirements for any developing country to become a rich, developed country. But, for any developing country to become rich, its people should be able to invest and trade in a wide circle. When people cannot invest and trade beyond a small circle (say, beyond their relatives, village neighbors, and friends who know and trust each other), they remain poor.

FDI is the act of investing and trading in large circles. FDI occurs with the purchase of the “physical assets or a significant amount of ownership (stock) of a company in another country in order to gain a measure of management control.” FDI is distinguished from portfolio investment that does not involve obtaining a degree of control in a company. It may take the form of “greenfield projects” and is also often accomplished through “merger and acquisition” activities or through international franchising. FDI is especially critical in both emerging and transition economies. It helps to answer the question: “How do you create capitalism in a nation where



there are neither capitalists nor capital?" The reasons why companies engage in FDI are to gain a foothold in a new geographic market, increase a firm's global competitiveness, branding, and positioning, fill gaps in a company's product lines in a global industry and reduce costs in such areas as research and development (R&D), production, and distribution. FDI may be easier to attract through the existence of a low cost but qualified labour pool, long-term market potential or yields greater than can be achieved domestically, access to natural resources, geography and stability of the economic and political environment.

The most important legal and investment factors for successful FDI activities include few restrictions on investments or the repatriation of currencies, decline of the "golden share", a sound "company law" and commercial code, transparent customs and tariff procedures, the adoption of a "perceived as fair" and favorable tax code (often with incentives), political/economic stability, size of the domestic markets, lack of corruption, quality of local management and bureaucracy, availability of land and suitable infrastructure (especially telecommunications, roads, highways and airports).

Finally, Professor Hunter stressed the importance of a highly specialized FDI Agency or Department aimed at attracting - and keeping - FDI. Such an agency can generate foreign investment activity and interest by identifying suitable domestic partners, providing professional management assistance, pointing out specific FDI opportunities - especially "Greenfield" projects - , creating and fostering a favourable domestic climate for FDI, monitoring and reporting on FDI activities, providing necessary "market entry" data and providing necessary information on taxation, administrative regulations, and other legal and financial matters.

### **The Power of Belief Systems: Marketing Your Country to Attract FDI**

Mr. Wahn Yoon, Principal and Strategy Officer at Scientific Intelligence, presented a new research technique called "Gillman Archetypes" as an alternative to focus groups and polling. Mr. Yoon discussed the degree to which purchasing and investment decisions of all kinds are influenced by psychological and often unconscious and non-rational drivers. He presented findings of a recent Gillman Archetypes session conducted with a group of senior investors and entrepreneurs.

The findings culminated in a 'mind map' that identified the belief system governing foreign investment decisions, leading to some surprising results: The key success factors, or 'must-haves', consisted of "due process of law" and "honesty/transparency". These factors far superseded the 'nice-to-haves' such as modernized infrastructure and positive messages in the media about one's country which often receive the lion's share of attention from the leaders of developing countries. The net finding is that mitigating the risk perceived and experienced by foreign investors was clearly the most important prerequisite for attracting a higher quantity and quality of FDI. Additional important variables include: passing the "smell test", which implies withstanding scrutiny; and that stakeholder talk about the country is in line with insider knowledge about the country.



## **How Do Financial Incentives Matter in Attracting FDI?**

Professor Yeomin Yoon, Professor of Finance and International Business at SHU and Senior Special Fellow of UNITAR explained that in recent years, financial incentives and bidding wars for FDI have increased as competition intensified. Multinational corporations get a variety of tax holidays, import duty exemptions, subsidized land and power, and other enticements, all offered by developing countries in the belief that this is the way to attract multinational firms. For every job created, the incentives may add up to tens of thousands of dollars annually. McKinsey, a prominent global consulting firm, estimates that in some cases, these can be as high as \$200,000.

Yet even as governments in developing countries dole out lucrative incentives to attract FDI, they are often wary of multinational corporations. Attempting to protect domestic industry and to ensure that FDI benefits the local economy, many restrict the way foreign companies can operate. A recent research from the McKinsey Global Institute finds that both the incentives used to attract FDI and the restrictions placed on it are largely ineffective. In addition, they are frequently counterproductive, costing governments millions of dollars annually, protecting inefficient domestic firms, and lowering living standards and productivity. The study unequivocally shows that regardless of the policy regime, the industry, or the period studied, FDI can benefit developing economies greatly. However, to make the most of it, they must strengthen the foundations of their economies, including the infrastructure, the legal and regulatory environment and the level of competition.

## **FDI in China: Implications for Other Developing Countries**

Professor Yin of SHU stated that China, as a developing economy, was very successful in attracting and absorbing FDI. It has become the number one country in FDI inflow since 2003, fueling its impressive economic growth and the transformation of the Chinese economy. There are two fundamental reasons for this success. First, China has identified its particular needs and directs FDI to these sectors. China has also insisted on introducing foreign technology and modern management techniques and localizing them. Second, China knows what foreign investors need and invests in improving its infrastructure and in establishing a stable political and economic environment for business people. Professor Yin concluded by saying that the bottom line is that China's policy-makers know that foreign investors do not invest simply for the sake of development, but rather with the intention of gaining profitable returns on their investments.

## **Financing Mega Infrastructure Projects: Risks and Opportunities**

Christopher Kisco, graduate student of SHU, addressed: the importance of improving a country's infrastructure in order to attract FDI; the nature of mega project financing; increasing



involvement of the private sector in mega project financing; and various issues connected to project financing; as well as risks and opportunities associated with project financing.

### **The Roads to Globalization: Over Lands, Seas, and Time and its Implications for Economic Development**

Professor Yoon explained that the first great globalization period lasted from the middle of the 19th Century to 1914 and was in its way a far more dramatic occurrence than the integration of world markets that has been taking place since 1945. The first great globalization was spurred by technological progress such as the steamship and telegraph. In the 19<sup>th</sup> Century it was commonly assumed that the world would continue to get smaller and more integrated. But conventional wisdom was wrong

The second great globalization spurt dates back to the end of World War II, and has not benefited all equally. Much of Latin America and Sub-Saharan Africa have failed to thrive. Globalization is currently proceeding in a world that has bigger absolute and proportional gaps between the average incomes of the rich and poor countries, compounded by the close proximity of grandiose wealth and hopeless poverty. The gap in inequality can be a serious threat to the long-run sustainability of globalization and development. In this respect, Professor Yoon quoted Prime Minister Guy Verhofstadt of Belgium saying that the question of the century was how we can prevent a violent class struggle between the world's poorest and richest people.

Professor Yoon concluded that whether or not the second great globalization will continue (as implicitly assumed by many people) will largely depend upon how wisely the world's political leaders and diplomats can distribute the benefits of globalization more universally throughout the whole world.

### **Opportunities and Risks of Globalization**

According to the recent Pew Global Attitude Survey, anti-globalization protesters were viewed more positively in the United States and Western Europe. In addition, people in developing countries tend not to blame globalization for lack of progress in their countries, but rather poor governance in their own countries.

Professor Yoon referred to the United Nations Report on the World Social Situation (2005), which reflects that much of the world trapped is in an "inequality predicament"; inequalities between and within countries have accompanied globalization; unemployment remains high in many contexts and youth unemployment rates are particularly high; millions are working but remain poor; and nearly a quarter of the world's workers do not earn enough to lift themselves and their families above the \$1 per day poverty threshold.

The United Nations Report recommends that: worldwide asymmetries resulting from globalization should be addressed, with emphasis placed on more equitable distribution of the benefits of an increasingly open world economy. Further, to prevent global conflict and violence, attention should be paid to reducing the inequalities in access to resources and opportunities.



Professor Yoon emphasized that in the final analysis, the sustainability of globalization depends on: preserving peace among the great powers; curbing the threats of terrorism and large-scale organized crime; keeping borders open to flows of goods, services, capital and labour; avoiding large-scale economic instability; managing cross-border transmission of disease; and finding and producing adequate supply of energy

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