CHANGING FOREIGN DIRECT INVESTMENT DYNAMICS AND POLICY RESPONSES

White Paper for Japan's G7 Presidency

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Abbreviations and Acronyms

AfCFTA	African Continental Free Trade Area
ASEAN	Association of Southeast Asian Nations
BEPS	Base Erosion and Profit Shifting
CPSD	Country Private Sector Diagnostic
CRM	customer relationship management
EAP	East Asia and Pacific
ECA	Europe and Central Asia
FDI	foreign direct investment
G7	Group of Seven
G20	Group of Twenty
GDP	gross domestic product
GMT	global minimum tax
GOLSM	Guinean Online Local Supplier Marketplace
IFC	International Finance Corporation
IFD	investment facilitation for development
IMF	International Monetary Fund
IPA	investment promotion agency
IPRR	Investment Policy and Regulatory Review
ISDS	investor-state dispute settlement
LAC	Latin America and the Caribbean
MENA	Middle East and North Africa
MNC	multinational corporation
MNE	multinational enterprise
MSMEs	micro-, small-, and medium-size enterprises
NA	North America
OECD	Organisation for Economic Co-operation and Development
R&D	research and development
SIRM	systemic investor response mechanism
STRI	Services Trade Restrictiveness Index
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
WB	World Bank
WTO	World Trade Organization

Executive Summary

Since the onset of the COVID-19 pandemic, a series of overlapping crises have brought about volatility and an uncertain outlook for the global economy. The number of people living in extreme poverty has increased by more than 700 million, and the world is not on track to meet the Sustainable Development Goals. Across the world, the increasingly severe effects of climate change are putting further strain on developing countries and having a disproportionate impact on the poor. Meanwhile, debt sustainability challenges and limited fiscal space for many developing country governments limit their ability to respond. Against this backdrop, it is increasingly important to scale up private capital flows to developing countries to support private sector development and to address the growing global challenges they face.

This report focuses on the trends in foreign direct investment (FDI), which encompasses foreign investment in new or existing firms and production facilities. FDI is a subset of overall capital flows, but it is perhaps the most critical because of its potential development impact and stability relative to other cross-border capital flows. The report provides a granular analysis of shifts in FDI flows and policy trends and suggests policy responses that developing countries may consider in order to reverse the decline in FDI and to enable more private capital to support their development needs.

Capital flows to most developing countries, including foreign direct investment, have grown little over the past decade.

Foreign capital flows to developing countries fell to an estimated $662 billion in 2022 from an average of over $1 trillion in the decade preceding the COVID-19 pandemic. Falling portfolio equities and bonds accounted for a disproportionate share of the global drop, as investors sought safety and higher returns. Across countries, most of the decline was due to a fall in capital flows to China and the Russian Federation, reflecting the pandemic lockdowns in China and the Russian Federation's invasion of Ukraine.

FDI flows to developing countries followed a less pronounced decline than overall capital flows, and FDI to countries other than China and the Russian Federation even increased slightly to an estimated $406 billion in 2022 from $386 billion in 2021. However, the importance of these flows has steadily declined over the past decade when measured as a share of developing countries' gross domestic product (GDP). This decline reflects not only weak macroeconomic prospects and geopolitical tensions, combined with the lasting impact of the COVID-19 pandemic, but also the ongoing process of shifting global value chains and transformation of investment in terms of modes of entry, sources, and sectors, among other dimensions.

Growing climate change impacts, rising interest rates, and policy changes in advanced countries—such as incentives for green investments and localization of supply chains for key technologies—have also had far reaching implications for the allocation of investment across the globe.

Shifts in the composition of FDI flows risk reducing their development impact.

The past decade saw the emergence of several changes in the composition of FDI to developing markets that risk reducing the development impact of these flows. "Greenfield" FDI, which involves the establishment of new production facilities and thus the creation of many new jobs, has been in consistent decline as a share of total investment. While annual announcements of new greenfield projects (that is, the future pipeline of investments) averaged more than 100 percent of gross FDI flows to developing countries before the global financial crisis, the ratio had dropped to one-half of gross flows by 2020. At the same time, cross-border mergers and acquisitions of existing companies and project finance grew in importance. Although these other types of foreign investments can also support growth, their impact on employment and economic transformation tends to be more modest.

Concentration of FDI flows into a smaller number of investors is also evident. Whether measured as an index of concentration or as a share of largest enterprises in total, concentration has been on the rise since the global financial crisis. This holds globally as well as for investment into developing countries and for a number of important source countries—China, Japan, and the United States—and sectors such as extractives, chemicals, and energy. A parallel trend is the growing importance of reinvested earnings and intercompany loans relative to new equity investment. The former are associated with the expansion of existing facilities by incumbents in established sectors rather than expansion into new sectors and locations. Taken together, these trends could lead to fewer, larger, and more powerful foreign entrants in developing countries' labor and product markets, potentially weakening competition and many of its benefits in destination markets.

New FDI opportunities are emerging in services, the clean energy transition, and in global value chain reconfiguration.

Historically, FDI in developing countries has been mainly in manufacturing and infrastructure projects. However, during the COVID-19 pandemic, investments in those projects dried up and announcements of greenfield investments in services have now surpassed those in manufacturing. Looking ahead, new opportunities to attract foreign direct investment are emerging in the growing services sectors of developing countries, such as banking, transportation and logistics, tourism, and health care.

Investment opportunities in the clean energy transition are growing. While investment in sectors classified as "green" by the European Union (EU)—such as electric vehicles, battery storage, and solar panels—has been considerably lower than in other sectors for most of the past two decades, the gap has narrowed significantly in mergers and acquisitions and disappeared in greenfield FDI since 2020.

International production networks are experiencing reconfiguration that is particularly intense in Asia. The main motivations reported for these shifts by multinational enterprises are proximity to final consumption and diversification of production to protect against future shocks. The effect of geopolitical tensions on the relocation of investment also appears strong, particularly on flows involving the Russian Federation and China. This reconfiguration of investment aligns with a relocation of more labor-intensive production to regions like Sub-Saharan Africa and South Asia and represents an opportunity for job creation and economic transformation in the receiving countries.

Reforms have generally continued to be favorable to FDI, but recently some measures, primarily in developed countries, have become more restrictive.

Over the past 20 years, more developing countries have liberalized their economies and lifted many restrictions on foreign investment. The latest evidence from the World Bank FDI Entry and Screening Tracker shows that since 2020, more than 24 developing market and developing economies have eased investment restrictions by increasing foreign equity ownership ceilings, further opening sectors such as finance and energy to FDI, streamlining and expanding foreign worker permit regimes, and improving land ownership rights.

However, the lack of growth in FDI flows to developing countries demonstrates that these types of reforms are necessary but not sufficient to attract more private capital. For example, while many reforms have focused on services, further opportunities for easing services sector restrictions remain. In addition, product market regulations, lack of complementary policy reforms in skills and technology adoption, and a dearth of investable projects hamper FDI in developing economies and should be the focus of their future reform efforts.

In contrast to developing countries, restrictions on FDI in advanced economies have been on the rise. FDI screening has gradually increased, motivated by the desire to preserve host country interests such as national security, critical infrastructure, dual-use technologies, and sensitive information. Data from the FDI Entry and Screening Tracker show that since 2020, Organisation for Economic Co-operation and Development (OECD) countries have accounted for 70 percent of all restrictive FDI measures and 60 percent of all screening measures. In addition to the rise in screening of foreign investors interested in new greenfield FDI projects in specific sectors, many advanced countries have also increased their scrutiny of foreign takeovers of strategic assets and technology companies.

Beyond the dynamics in national-level trade and investment policy, a reenergized international investment policy agenda at global, multilateral, and regional levels shows promising signs for developing countries. Some of the leading international initiatives—such as the World Trade Organization's Investment Facilitation for Development Agreement, regional integration initiatives such as the African Continental Free Trade Area (AfCFTA), and the agreement on the global minimum tax on multinational enterprises brokered by the OECD and the Group of Twenty (G20)—have the potential to play a key role for harnessing FDI for sustainable development. To be effective, these initiatives need to be complemented by ambitious domestic reforms and strong implementation efforts.

The evolving global environment requires a renewed effort by countries seeking to mobilize FDI for sustainable development.

Adjustments in the geographic, sectoral, and structural patterns of FDI are increasing the urgency for countries to remain nimble and adaptable to seize these opportunities and maintain their investment climate attractiveness. Clear and transparent rules for FDI that are consistently and predictably enforced are a core anchor of this endeavor. Besides attracting new investments, to foster the retention and expansion of FDI, governments should address risks that often lead to investors withdrawing investments or canceling expansion plans, such as adverse regulatory changes or breaches of contracts. Facilitating links between FDI and the local economy should also be a medium-term priority, through the implementation of broader policies to strengthen firm- and economy-level absorptive capacity.

This report highlights practical country examples of reforms from Sub-Saharan Africa and East Asia to illustrate promising approaches to strengthening countries' policy responses to changing foreign investment dynamics. The reform examples are organized along the three main pillars of the investment life cycle: (a) investment attraction and facilitation aiming at seizing new opportunities, (b) investment retention to decrease the probability of divestment and to foster existing expansion and reinvestment of retained earnings of FDI, and (c) FDI links with the local economy to increase the development dividend of FDI. The examples include successful reforms in liberalizing sectors with high investment potential, such as services in Indonesia; easing legal and regulatory barriers to investment in Ethiopia; and increasing investment attraction through strategic reevaluation of investment opportunities in South Africa. Additional examples from Mongolia, Rwanda, and Viet Nam illustrate how investor grievance management programs enhance investor confidence. In addition, examples from Guinea and Viet Nam demonstrate how building stronger FDI links with the local economy through supplier development programs and FDI linkages initiatives helps decrease information gaps for investors and boosts local business opportunities.

In addition to country-level efforts for enabling private investment, tackling the complex challenges presented by the current global environment requires multilateral and international cooperation and leadership. Given the scale of private sector financing needs for development, official multilateral assistance should catalyze private capital and enable FDI. Major donors, in close coordination with international financial institutions, can play a role in facilitating and enabling increased private capital flows through cofinancing and derisking, as well as supporting domestic resource mobilization and increasing the efficiency of public spending.

The magnitude and scale of the current headwinds for the global economy necessitate that policy makers deploy their full set of policy tools to improve business confidence and boost countries' investment competitiveness. Maintaining an open and rules-based system, fostering global integration and outward-looking policies, solidifying trust among countries, and ensuring shared benefits from FDI and global value chain participation are key to the world's future sustainable and resilient growth.

CHAPTER 1

Evolving Landscape of Investment Flows

The mobilization of private investment in developing economies is essential to meet the financing gaps for sustainable development around the world. The shortfall in annual funding for achieving the United Nations (UN) Sustainable Development Goals exceeds $4 trillion per year, according to the latest UN estimates (UNCTAD 2022). Low-income countries face particularly acute challenges: foreign capital inflows averaged only $2 billion per year over the period 2016–21, compared with the $3 billion during the first half of the past decade. As a share of gross domestic product, foreign capital flows to these countries have fallen from an 8.6 percent peak in 2007 to about 1.7 percent in 2022.

Foreign direct investment is a critical yet increasingly scarce component of private finance flows to developing countries.[1] Global uncertainty, ongoing geopolitical fragmentation, and the slowdown of economic growth in major developing economies associated with a challenging macroeconomic environment are all thought to have contributed to weak investment patterns. Moving forward, the structural transformation of investment—including increased concentration of flows, supply chain reconfigurations, and shifts to activities such as services—is driving change that is not yet well understood, and by extension, less well framed by policy.

Foreign direct investment to developing countries stagnated before the COVID-19 pandemic and the current set of headwinds to the global economy has further exacerbated the longer-term trends. Using the most up-to-date evidence, this section highlights that East Asia and Pacific and Sub-Saharan Africa are among the regions most affected by the recent developments. These regions are highlighted throughout the report both in terms of changing dynamics and policy responses.

A number of structural trends underscore areas of increasing relevance for the policy agenda. Namely, greenfield investments are becoming rarer, reinvested earnings are becoming a more critical component of new investment in developing countries, and FDI projects are becoming increasingly concentrated among fewer investors. At the same time, new opportunities are emerging from the ongoing reconfiguration of global and regional supply chains, as well as from the growth of FDI in services and green sectors. There is also potential for FDI to drive job creation in Africa.

FDI DYNAMICS ARE CHANGING FAST IN DEVELOPING ECONOMIES

Over the years, FDI has played a crucial role in the growth and development of economies across the income spectrum, bringing new technology as well as boosting capabilities, competition, and domestic productivity.[2] The turn of this century was marked by an unprecedented growth of capital inflows to developing countries, making foreign investment a key topic in the Finance for Development agenda. Growing FDI flows to developing economies during the period before the global financial crisis was to some extent the reflection of enabling global macroeconomic conditions. This macro environment was marked by the expansion of China, favorable commodity prices, and a largely positive global growth outlook.

The procyclicality of capital flows to both developing and advanced economies offers some explanation for their evolution across borders in more recent years. Studies have shown that capital inflows tend to expand during good times and to decline during recessions (Broner et al. 2013; Kaminsky, Reinhart, and Vegh 2005; Puy 2013). While this pattern is documented in markets around the world, it appears generally stronger in developing markets and weaker at the lower end of the country income distribution (Araujo et al. 2015; Puy 2013). The decision to invest internationally in a specific project and location is also a decision to not invest those same funds domestically. Macroeconomic spillovers, in other words, can also motivate investment decisions. Evidence pointing to the growth of outflows from high-income to developing economies during business cycle downturns reflects investors' arbitrage among different investment opportunities (Levi Yeyati, Panizza, and Stein 2007). Although the strength of this pattern varies substantially across major investing economies, it may partly explain the dynamics of foreign capital to developing economies over the last decade and very recent years.

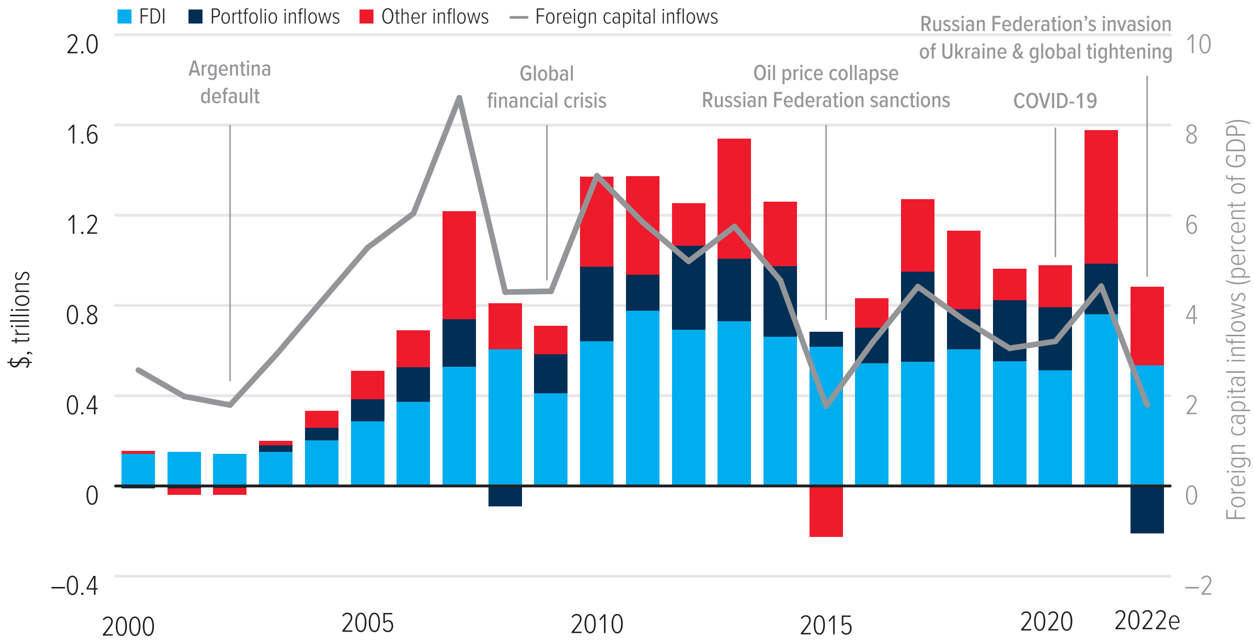
Relative to other foreign capital flows, FDI has been more stable and resilient during financial crises. FDI inflows have exhibited lower volatility and declined by smaller amounts than other capital flows in both country-specific sudden stops and global stop episodes (figure 1.1). FDI's resilience, especially its equity component, is mainly driven by investors' long-term outlook rather than cyclical or short-term financial market considerations. Foreign direct investors tend to look through the short-term fluctuations and divest only if the prospective project has lost its strategic value or long-term attractiveness. The other two FDI components—reinvested earnings and intercompany loans—are more volatile. They are closely linked to the companies' operational activities and are more dependent on the economic cycle.

Foreign capital flows in developing countries have been declining mainly due to components other than FDI.

Despite their spectacular growth in the years leading to the global financial crisis in 2007–08, foreign capital flows to developing countries have been on a downward trajectory since. Foreign capital inflows to developing countries fell to an estimated $680 billion in 2022, marking the lowest level since 2015, following the record-breaking $1.6 trillion in 2021. Relative to GDP, foreign capital flows reached a low level rarely seen the past two decades (figure 1.1). Tighter global financial conditions, heightened uncertainty, and the Russian Federation's invasion of Ukraine weighed on developing country assets in most of 2022.

Declines in portfolio equity and investments other than FDI accounted for a large part of the contraction in foreign capital flows. Even with some recovery in the fourth quarter (Q4), foreign portfolio equity and debt flows reached an estimated net outflow of $203 billion for the whole of 2022, a sharp downturn from the $225 billion of inflows in 2021. International bond issuances by developing countries slumped, accompanied by large domestic bond sales by foreign investors amid the Russian Federation's invasion of Ukraine, global financial uncertainty, and concerns about high debt. Other investment inflows

Figure 1.1 | Foreign Capital Inflows to Developing Countries, 2000–22



Source: IFC and World Bank staff calculations on IMF Balance of Payments (July 2023 update).
Note: Inflows are net of disinvestments and sales of assets held by nonresidents. Bars represent foreign capital flows in current prices (left axis), and the trendline represents their share of GDP (right axis). Data for 2022 were estimated by IFC staff based on high-frequency FDI data for selected developing countries and the country-specific internal databases; FDI = foreign direct investment; GDP = gross domestic product; IFC = International Finance Corporation; IMF = International Monetary Fund.

Note on FDI Statistics

The foreign capital statistics presented within this report are derived from IMF Balance of Payments data covering all countries. The definition of direct investment used by the IMF is the same as in the fourth edition of the OECD Benchmark Definition of Foreign Direct Investment. Data on FDI inflows and outflows are presented on net basis (capital transactions' credits less debits between direct investors and their foreign affiliates) following the sixth edition of the Balance of Payments Manual. Net decreases in assets or net increases in liabilities are recorded as credits, while net increases in assets or net decreases in liabilities are recorded as debits.

The merit of this single source lies in its consistent methodological specifications across countries and its comprehensive coverage of cross-border capital flows beyond direct investment, such as debt and portfolio equity. Alternative prominent publications on foreign investment, like the United Nations' World Investment Report (UN, 2022), or the OECD FDI Statistics, use diverse sources for selected economies, such as China and Russia. Specifically, the United Nations use reports of FDI inflows into China from the Chinese Ministry of Commerce (MOFCOM), on a gross basis, omitting debits from inward transactions. Data regarding outflows from 2003 to present originate from the same source. The OECD relies on IMF Balance of Payments data for China. Regarding Russia, both the United Nations and the OECD report FDI statistics from the National Bank of Russia, which have not been entirely aligned with IMF figures over the years. In 2022, the National Bank of Russia reported a net FDI divestment of $18 billion, as opposed to the IMF's report of $40 billion.

fell significantly, even after excluding the one-off jump driven by the $275 billion of Special Drawing Rights allocations to developing countries in 2021.

In 2022, China and the Russian Federation accounted for a disproportionate share of the global drop in capital flows. Capital inflows to China fell sharply in 2022, with a 43 percent decline in FDI inflows and large portfolio and other disinvestments. The decline in inflows was mainly due to the policies that came into effect during the COVID-19 pandemic, heightened geopolitical tensions, slow growth, rising borrowing costs, and curbs on foreign listings. Similarly, as a result of the Russian Federation's invasion of Ukraine, the Russian Federation experienced close to $130 billion of foreign capital disinvestments in 2022.

The year 2022 also marked the reversal of China's growing role as a source of capital flows to other developing countries.[3] The growth of China's outward investment into both advanced and developing markets has been a salient feature of the global economy in the past 15 years. In 2020, at the onset of the pandemic, China overtook for the first time both Japan and the United States to become the world's largest direct investor, with outflows surpassing those of any other country. If sustained, the recent contraction of Chinese foreign investment may weigh onto the future outlook of investment into developing countries.

The 2022 decline of capital flows into developing countries other than China and the Russian Federation has been less pronounced (see figure A.1 for aggregate flows excluding China). Inflows totaled an estimated $816 billion in 2022, compared with $848 billion the previous year. Overall, foreign capital inflows declined moderately across all developing regions except in Latin America and the Caribbean and South Asia (figure 1.2). The Middle East and North Africa was the most affected, with inflows only reaching an estimated $8 billion compared with $30 billion in 2021. Other regions experienced a reduction of about 20 percent in inflows. The weakness of capital inflows was driven mainly by the sharp fall or reversal of the portfolio equity flows and less by FDI inflows. The only exception was the Sub-Saharan Africa region, where portfolio inflows increased due to some recovery in South Africa. The trends were similar for the region when South Africa was excluded.

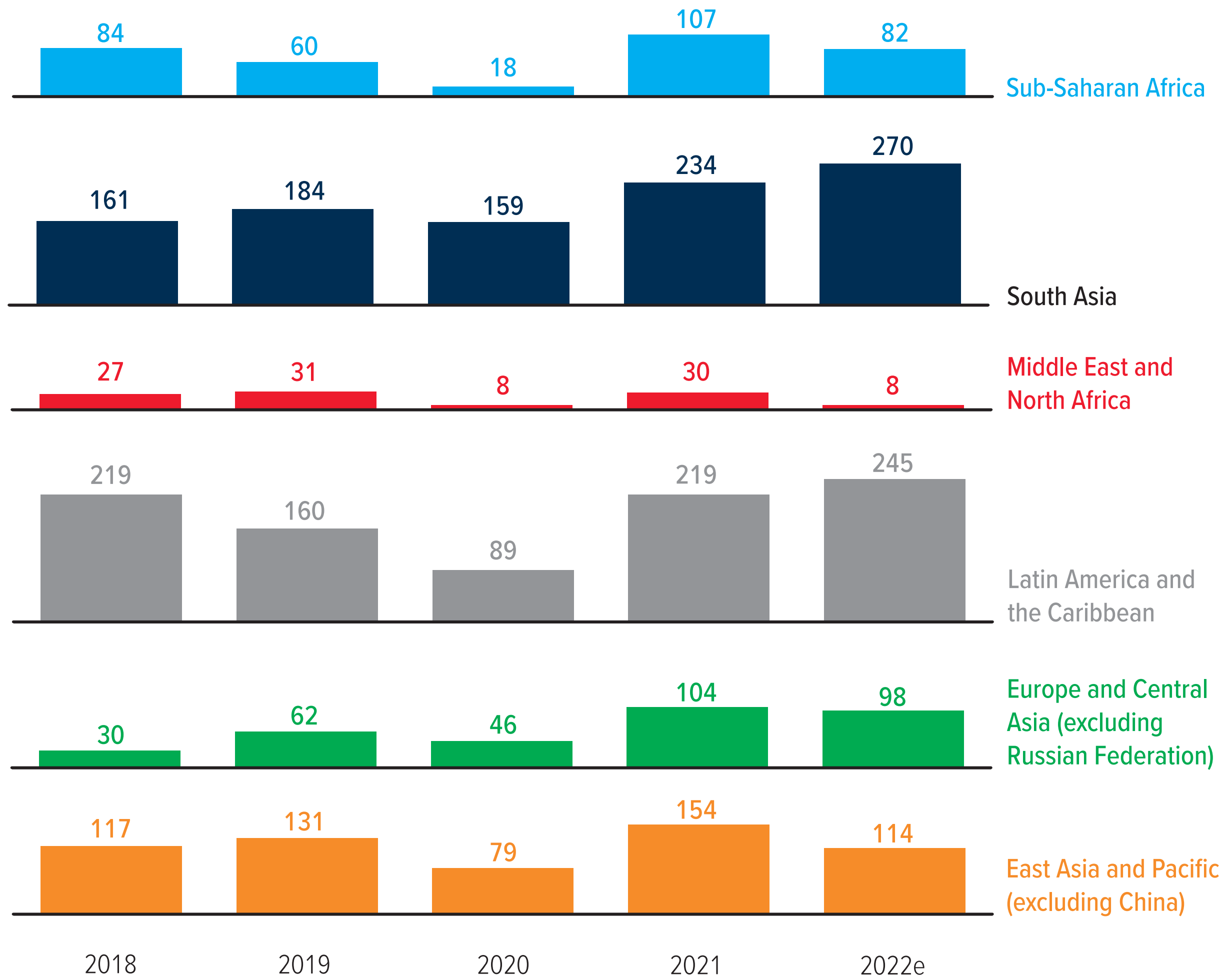
FDI inflows have been more resilient than other capital flows against adverse conditions.

The pandemic reversed a long-term trend of developing countries accounting for an increasing share of global FDI. Whereas in 2019 more than 40 percent of global FDI flows went to developing countries—a historical high—in 2021 this share fell back to 35 percent. Despite experiencing a gradual decline, FDI inflows to developing countries have been less volatile than flows to high-income economies (see figure A.2).

China and the Russian Federation accounted for a disproportionate share of the fall of inflows, whereas in the rest of the developing countries, FDI increased slightly to an estimated $406 billion in 2022, from $386 billion in 2021. Flows were supported by several recent developments, such as high energy prices leading to investment in the extractive sectors and renewables, a few large privatizations in Latin America and the Caribbean, and progress in investment reforms in countries such as India. Egypt and Morocco seemed to have attracted investors to renewable energy sectors, given the recognizable jump in cross-border investment announcements throughout 2022. Similarly, there were large investment announcements in the semiconductor sector in Malaysia, Mexico, and Viet Nam.

Latin America and the Caribbean and South Asia were the only regions that experienced an increase in FDI inflows in 2022. Sub-Saharan Africa experienced a significant, yet moderate, contraction driven partly by year-over-year declines in South Africa. In addition to Mauritius—a financial

Figure 1.2 | Foreign Capital Inflows to Developing Regions, excluding China and the Russian Federation, 2018–22 ($, billions)

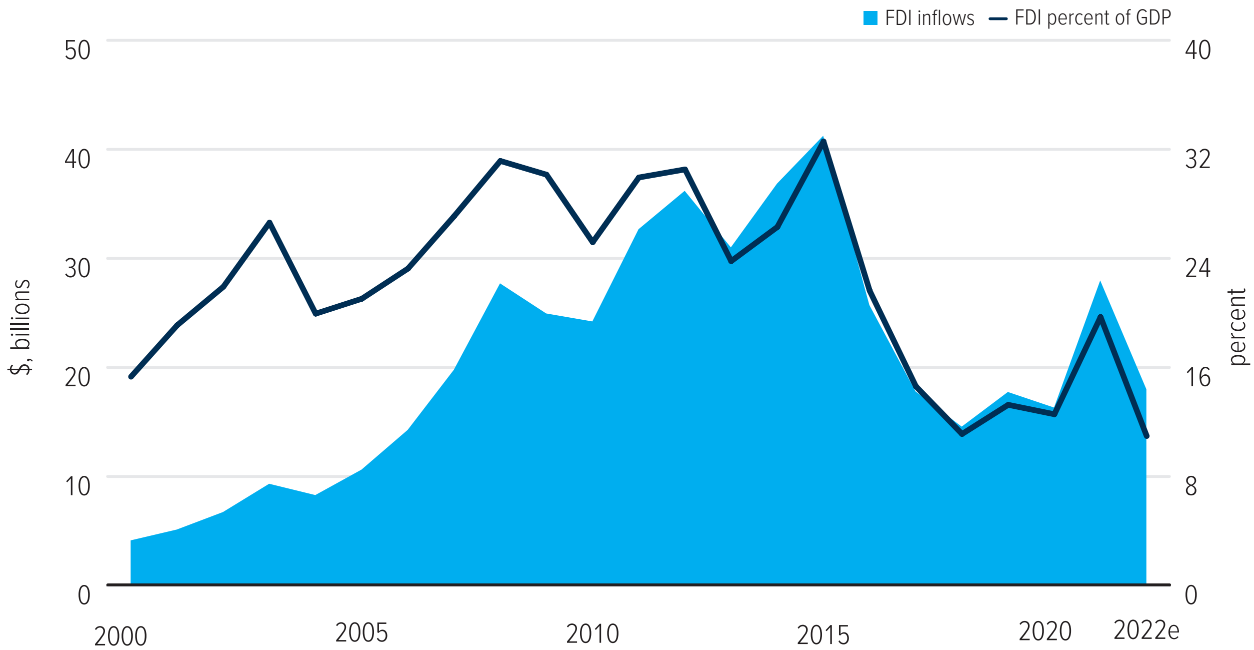


Source: IFC and World Bank staff calculations on IMF Balance of Payments (July 2023 update).
Note: Data for 2022 were estimated by IFC based on high-frequency FDI data for selected developing and country-specific internal databases.; FDI = foreign direct investment; IFC = International Finance Corporation; IMF = International Monetary Fund.

center with volatile investment flows—FDI inflows declined in Mozambique and Ghana. There were also large divestments in oil-exporting countries such as Angola and Nigeria. Overall, FDI to GDP fell from over 30 percent to 11 percent during the second half of the past decade (figure 1.3). The Latin America and the Caribbean region bucked the global negative trend in capital inflows, with upturns supported by significantly higher FDI inflows compared with 2021. Interestingly, the region's portfolio inflows were already lower in recent years compared with the early 2010s, with FDI accounting for 75 percent of capital inflows, much higher than the other regions. In addition to recent global headwinds, including the pandemic and the Russian Federation's invasion of Ukraine, more medium-term factors such as the secular economic slowdown in developing countries, lower profitability of investment, volatile commodity prices, deglobalization policies, and geopolitical uncertainties are all thought to have contributed to these trends in the past decade.

The outlook for FDI to developing countries is generally not optimistic. Overall invest-

Figure 1.3 | FDI Inflows to Sub-Saharan Africa, excluding South Africa and Mauritius, 2000–22 (Value $ and Share of GDP)



Source: IFC and World Bank staff calculations on IMF Balance of Payments (July 2023 update).
Note: FDI = foreign direct investment; GDP = gross domestic product; IFC = International Finance Corporation; IMF = International Monetary Fund.

ment, including FDI, in developing economies is expected to remain subdued in the short term (World Bank 2022a). The deviation from pre-pandemic trends is expected to remain substantial, owing to slower growth, uncertainty, and rising borrowing costs in developing countries. Because advanced economies are the major source of FDI in the developing world, changes in macroeconomic policies in the United States and the European Union, and growing trade and geopolitical fragmentation combined with the risk of financial fragmentation, will affect the investment decisions of multinational enterprises (MNEs) (see box 1.1).

Greenfield investment has shrunk relative to other modes of entry.

Greenfield investment, that is, the creation of new production facilities in host economies, can support growth and job creation in developing countries. For example, in 2022 alone, more than 2 million jobs were generated by greenfield FDI globally, based on data on the announcement of greenfield investments.[4] Beyond the creation of new and often better-paid jobs in the formal sector, these benefits also include capital formation, transfer of technology and managerial expertise, and a long-term commitment of presence.[5]

Over the past two decades, greenfield investment has become a smaller share of overall FDI (figure 1.4, panel a). In the early 2000s, capital expenditure in future greenfield projects that were announced in a given year exceeded total FDI inflows, reflecting a positive outlook and a more interconnected global economy. However, for most of the past decade, expenditure in greenfield projects stabilized at a level lower than current flows. By the onset of the COVID-19 pandemic, announcements of future greenfield investments represented only one-half of current investment

Box 1.1 | Geo-economic Fragmentation of Capital Flows and Investment

The April 2023 World Economic Outlook published by the International Monetary Fund (IMF) describes three compounding layers of developments that shape expectations for the global economy in the short and medium term. The first layer is the continuation of major forces that shaped the world economy in 2022, including high debt levels, geopolitical tensions, and the COVID-19 pandemic, with changed intensities. The second is the policy adaptation to the context of those crises, with stubbornly high inflation, monetary tightening, and the recent financial sector turmoil, resulting in banking sector vulnerabilities. The third layer concerns the medium-term effects of ongoing geo-economic fragmentation on capital flows and investment.

Of particular interest is the analysis of geo-economic fragmentation, which can be summarized in the following findings: First, foreign direct investment (FDI) flows are increasingly concentrated among countries that are geopolitically aligned. Although new in neither direction nor intensity, the role of geopolitical alignment as an FDI driver has increased since 2018, with the resurgence of trade tensions between the United States and China. Second, empirical analysis undertaken at the IMF suggests that, on average, developing market and developing economies are more vulnerable to such FDI relocation than advanced economies. Sub-Saharan Africa and Asia are among the regions substantially affected, though there is considerable heterogeneity within continents in terms of sectoral specialization and the corresponding availability of alternatives to investors. Several large developing markets, such as India and Brazil, show high vulnerabilities in that respect, despite records of growing investment into these locations, indicating that the fragmentation scenario is a risk for more than just a few countries. Third, a further contraction in FDI and a shift in its geographic distribution would likely have large negative effects on host countries via lower capital accumulation and technological deepening, ultimately affecting growth.

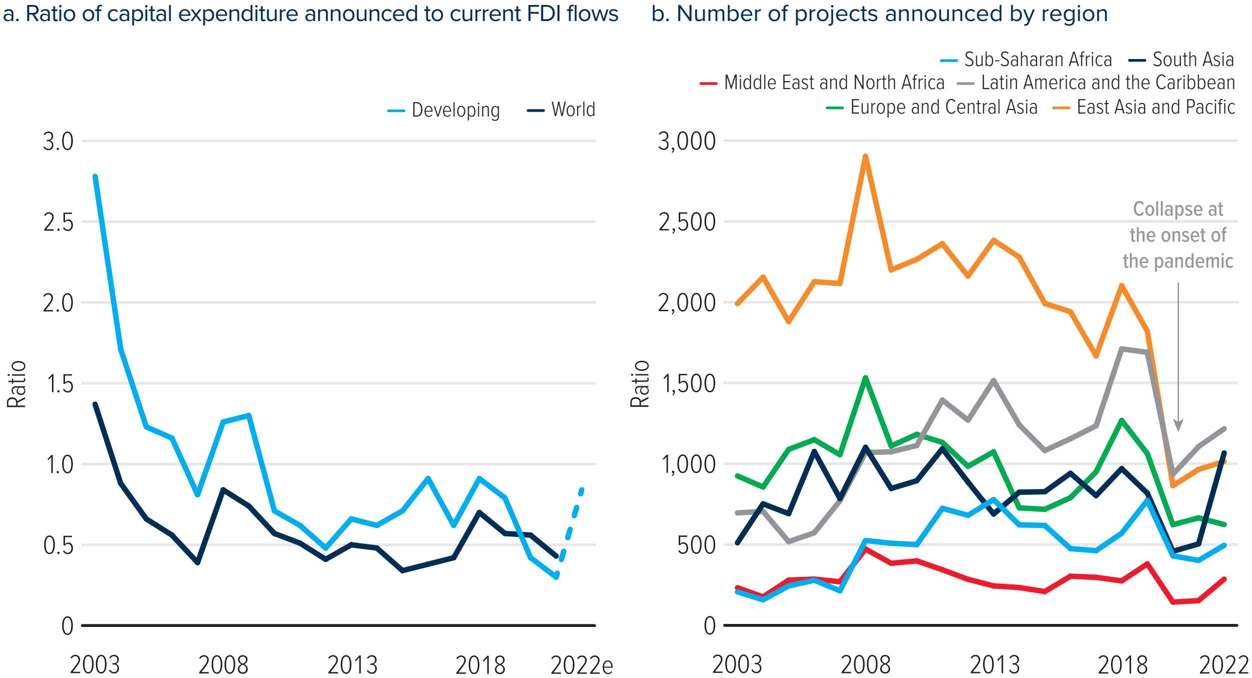
Source: IMF 2023.

flows. This decline can be attributed to a less favorable outlook and the growth of other types of entry, such as cross-border firm acquisitions or international project finance.

Capital expenditures in greenfield projects announced in developing countries have failed to grow consistently over time in value, effectively declining in real terms (see figure A.3). While greenfield FDI had experienced a remarkable surge in certain developing regions (such as Latin America and the Caribbean and Sub-Saharan Africa) over the past decade, the COVID-19 pandemic shock was rather indiscriminate across regions (see figure 1.4, panel b). East Asia and Pacific, in particular, experienced the largest contraction in announcements, reaching levels not seen in the past two decades. Countries in the region have yet to recover from protracted uncertainty, among the array of structural and macroeconomic changes that may collectively explain weaker investment moving forward.

A declining proportion of greenfield projects in total FDI alters expectations of job creation and new technology transfer from foreign investment, although brownfield investment—that is, involving a change of ownership in existing production facilities—can still have significant medium-term effects on productivity and employment (Ragoussis 2020). Variation in development impact expectations should not serve as a reason for discrimination around investor motivations or mode of entry, but rather should serve as a call to action to adopt policies that will best harness the benefits of all investment for development.

Figure 1.4 | Greenfield FDI as a Mode of Foreign Entry, 2003–22



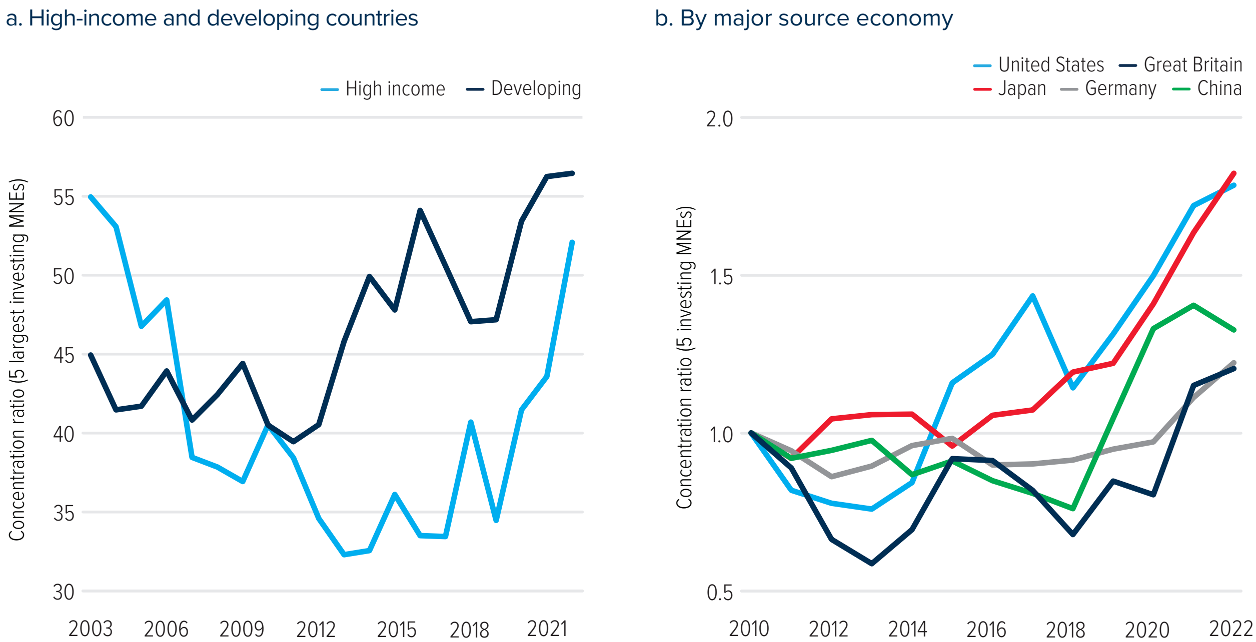
Source: IFC-World Bank staff calculations using Financial Times fDi Markets database.
Note: Data referring to announced greenfield investments do not constitute official FDI statistics and are not comprehensive. FDI = foreign direct investment.

FDI concentration is rising in developing countries.

There is growing evidence that markets are becoming more concentrated, particularly in the United States and Japan, as large enterprises consolidate market power (Gutierrez and Philippon 2017; OECD 2018). This trend has the potential to undermine the positive effects of FDI, as fewer and larger MNEs announce new facilities or proceed with acquisitions in developing countries. Evidence directly linking rising FDI concentration to development impact is lacking. However, existing literature on so-called "superstar" MNEs explores why positive spillovers to domestic firms may be lower in the context of fewer foreign entrants and rising labor and product concentration in destination markets (Vrolijk 2022).

Greenfield FDI as well as mergers and acquisitions have become more concentrated in the past decade. This pattern of increasing concentration holds across different measures, source countries, and sectors.[6] It is worth noting that the share of the largest enterprises in aggregate greenfield investment (both globally and in developing countries) has been increasing since its post–global financial crisis low point, rising especially rapidly in the past two years (figure 1.5, panel a). FDI into all regions has experienced higher concentration over the last decade, independently of the dynamics of aggregate flows which have in several regions grown during that period. Combined, these observations suggest a pattern of larger individual investment projects by fewer multinational firms. Concentration of investment has been particularly pronounced in the extractives, chemicals, and energy sectors, suggesting a potential connection to investors' motivations. The fact that efficiency or resource-seeking investments are experiencing these dynamics more

Figure 1.5 | Greenfield FDI Concentration in Developing Countries



Source: IFC-World Bank staff calculations Ragoussis, Rigo and Santoni, 2023.

Note: Concentration ratios are calculated using Financial Times fDi Markets database of greenfield investment projects. The ratios for country groups are the weighted average of each country's concentration ratio, corresponding in turn to the share in total capital expenditure of the 5 largest investing MNEs. Countries with less than 10 investing MNEs per year on average are excluded from this analysis. Countries are considered as developing if they are low-income, lower-middle income or upper-middle income according to the World Bank classification of 2022 (see Annex E). The robustness of the analysis is tested by considering different thresholds for calculating the concentration ratio and the Herfindahl–Hirschman index (HHI). Data referring to announced greenfield investments do not constitute official FDI statistics and are not comprehensive.

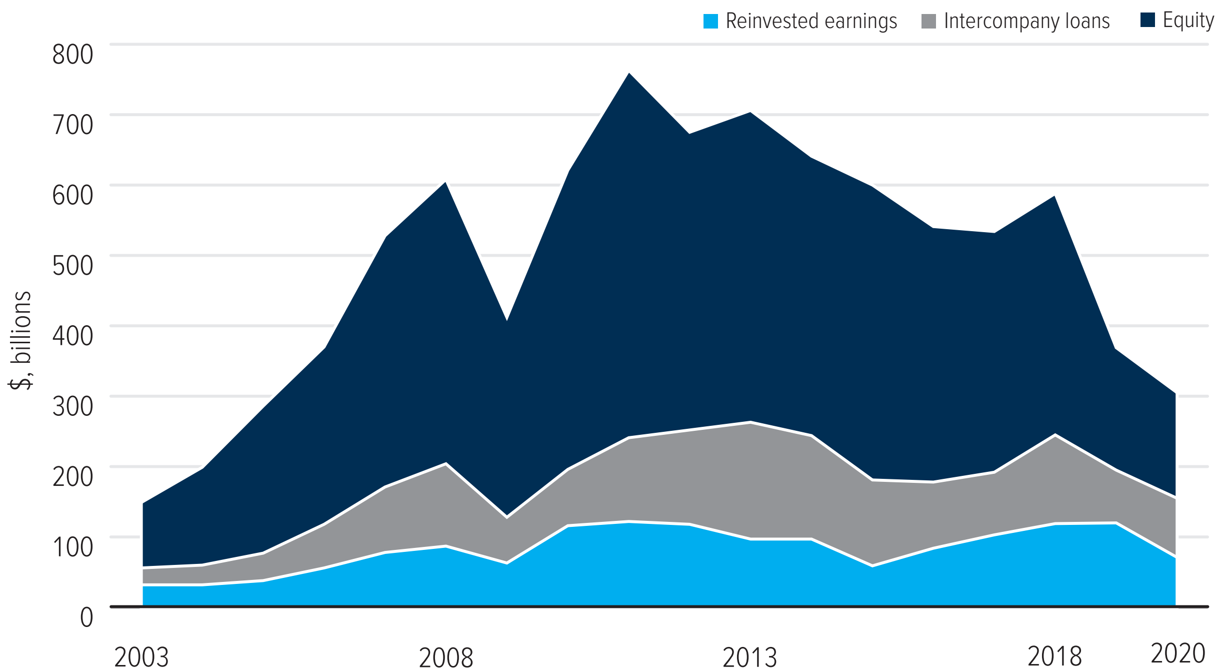
intensely warrants further investigation. Concentration has also been notable in investment coming from the United States, Japan and China as well as the other major foreign investment source countries (figure 1.5, panel b), suggesting a link with market concentration experienced within these economies.

If sustained, these patterns may result in fewer, larger, and more powerful foreign entrants, which could dampen the effects of foreign investment on competition in destination economies. This could happen through multiple channels such as monopsony power in bargaining over wages or domestic inputs. Entry of fewer foreign companies into a more limited set of destination markets and sectors may also limit opportunities for innovation, through lower worker mobility which is essential for technology transfer, or lower returns to R&D for domestic firms.

Reinvested earnings are becoming a more critical source of new investment in developing countries.

FDI consists of equity investment, reinvested earnings, and intercompany debt transactions. Reinvested earnings refer to profits that are not distributed as dividends but are instead reinvested in the company to generate further growth. While the equity component of FDI is relatively more stable than the other components and reflects long-term strategic behavior, intercompany loans and reinvested earnings are often used to adjust FDI exposure and are therefore important components of new FDI and drivers of resilience (Aykut et al. 2009).

Figure 1.6 | Fluctuation in Weight of FDI Components to Developing Economies, 2003–20



Source: IFC-World Bank staff calculations based on IMF Balance of Payments data.

For the past 20 years, developing countries have relied less on reinvested earnings than have advanced economies. This difference may be due to factors such as a lower financial maturity, slower regulatory compliance processes that make less sense for smaller investments, or volatile market access opportunities. While reinvested earnings did increase significantly in developing countries through 2011, they were overshadowed by equity investment trends that drove a significant surge, and then a decline, in FDI flows to developing countries before and after the global financial crisis.

The relative weight of reinvested earnings in FDI to developing countries has been changing. Toward the end of the last decade, equity investment consolidated significantly, which resulted in a higher share of intercompany loans and reinvested earnings in aggregate FDI (figure 1.6) that accounted for nearly one-half of FDI flows to developing countries, according to the latest estimates.

Although the resilience of reinvested earnings and intercompany loans is a positive sign that reflects confidence of investors, it may also erode competition and the potential for technology transfers. Originating from the existing investing companies, these flows are typically expected to grow facilities of incumbents in existing sectors without necessarily involving the transfer of new technologies. If sustained, their prevalence as a source of new investment can be associated with strengthening of existing FDI patterns rather than pioneering investment and the innovation it entails. More generally, past investment in host economies is likely to be a greater determining factor of new investment moving forward.

NEW OPPORTUNITIES ARE EMERGING

Services FDI is growing relative to other sectors.

In many developing economies, the services sector is growing faster than the manufacturing sector. In 2019, the services sector accounted for 55 percent of GDP and 45 percent of employment in developing economies (Nayyar, Hallward-Driemeier, and Davies 2021). Services-led development is therefore increasingly driving economic transformation, enabling income gains, and creating new job opportunities. Moreover, the use of digital technologies and the possibilities for remote delivery allow service providers to access larger markets and spread benefits as upstream enablers and downstream complements for manufactured goods (Nayyar, Hallward-Driemeier, and Davies 2021).

The growth of FDI in the services sector is a natural outcome of structural transformation and the expansion of the services economy in developing economies. Although many restrictions are still in place, this investment has been supported by the gradual liberalization of the services sector (see subsequent sections) and the growing need for services among manufacturers operating in developing countries in international production networks (Nayyar, Hallward-Driemeier, and Davies 2021). One corollary of the latter is the strong growth in payments for intangibles—including data, software, and licensing fees for the use of intellectual property—which has continued its upward trajectory over the past decade. The structural transformation of developing economies combined with stronger emphasis on global climate action generate new opportunities for investment also in green sectors (box 1.2)

Remarkably, the number of greenfield FDI projects in services has closely mirrored the trend of the overall investment in developing countries. Until 2019, the drop in announcements of new manufacturing establishments by MNEs and the resilience of the services economy led to the number of services projects surpassing those in manufacturing (figure 1.7, panel a). The pandemic has accelerated this trend, notably with greater demand for digitalization. The growth of services FDI from mergers and acquisitions has been more gradual, following the structural transformation of developing economies (figure 1.7, panel b). Foreign enterprises' mergers and acquisitions in services had already exceeded those in manufacturing in 2017, that is, well before the outbreak of the COVID-19 pandemic. The increasing predominance of services in both categories of FDI was mainly driven by the scarcity of new manufacturing FDI, rather than by an outsized growth in services, and the relative resilience of services foreign investment. These patterns point to higher relevance of certain categories of policies related to services trade and market access, as well as the need for targeted reforms that can unleash the potential of the services sector in driving growth and job creation in local economies. They also highlight the importance of investment in infrastructure, technology adoption, and skills development that can enable the services sector to thrive.

International production networks are experiencing reconfiguration—in Asia, the reconfiguration is particularly intense.

Although discussions regarding the reconfiguration of global production networks due to the COVID-19 pandemic have been prevalent, supporting evidence is only now emerging. Findings from a recent World Bank survey (which included more than 1,000 global business executives from large firms in both developed and developing countries) suggest that a considerable number of companies are expected to relocate their investments both within and across regions (World Bank 2020a). East Asia and Pacific stands out as the region likely to experience strongest intraregional relocation of investment, with many firms diversifying production to markets outside of China (figure 1.8 and figure A.5 by sector of main activity).

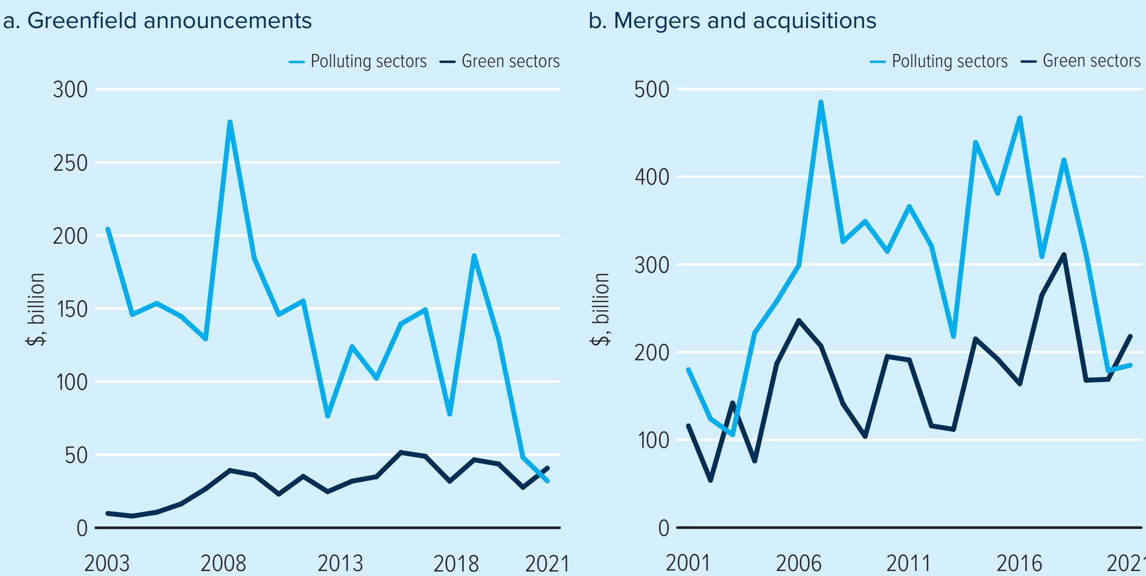
The main motivations reported for these shifts by MNEs are proximity to final consumption markets and diversification of production to protect against future shocks. However, the effect of geo-

Box 1.2 | New Opportunities in Green Sectors

Multinational enterprises have a crucial role to play in global climate action through their investments and technologies. Direct investment in renewable energy activities such as solar panels, waste management, and environmental technologies can advance these objectives in terms of both scale and the technology needed to support climate transition. A classification of sectors into "polluting" and "green" on the basis of their industrial classification and a subsequent allocation of investments into those categories allows for a closer examination of structural shifts of foreign direct investment (FDI) over time to more climate-friendly activities.

Although investment in polluting sectors has been considerably higher than investment in green activities for most of the past two decades, the gap narrowed significantly in mergers and acquisitions, and it disappeared in greenfield FDI during the COVID-19 crisis (figure B1.2.1). Several factors can explain this growth of green sectors in investment into developing countries, including declining costs of renewable energy, pressures from governments and investors to engage in lower-carbon activities, and possibly a greater pricing in of carbon risk premiums by shareholders.

Figure B1.2.1 | Investment in Green Sectors in Developing Countries

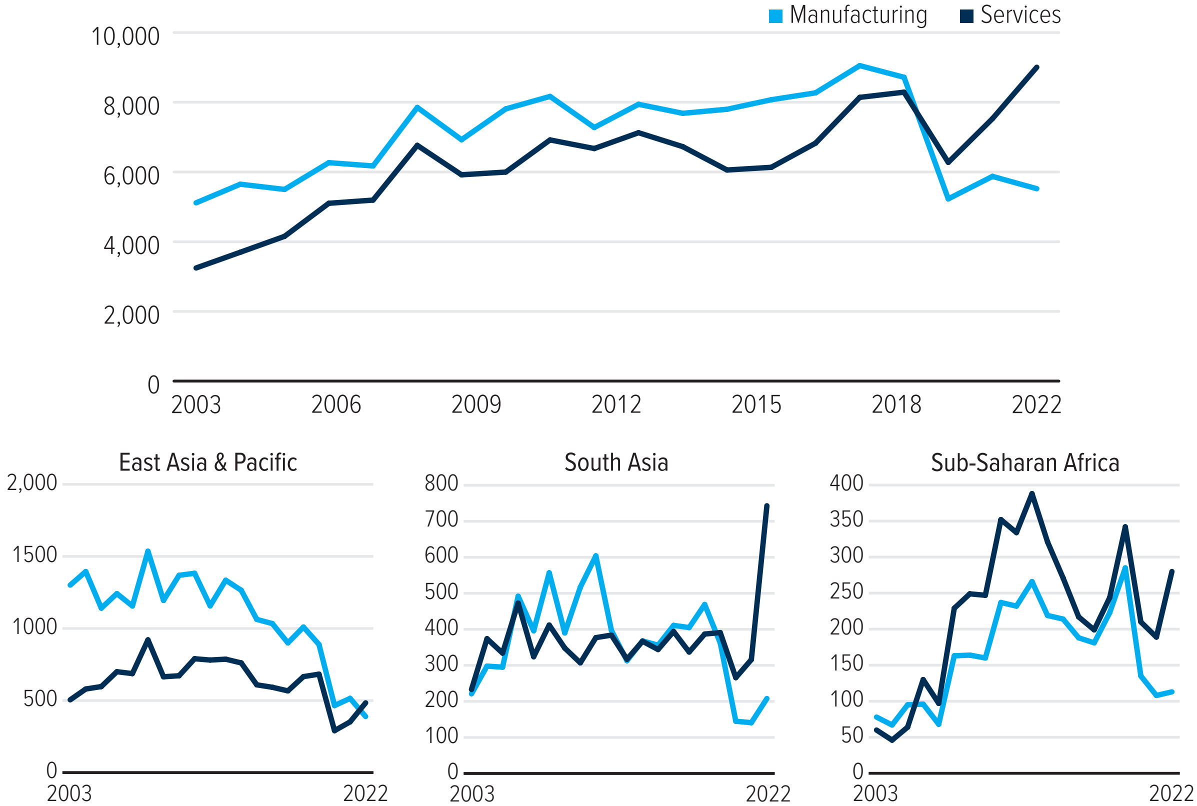


Source: IFC-World Bank staff calculations using Financial Times fDi Markets database and Refinitiv database
Note: Sectors are classified into polluting and green according to the European Union Taxonomy. The data referring to announced greenfield investments or mergers and acquisitions do not constitute official FDI statistics and are not comprehensive.

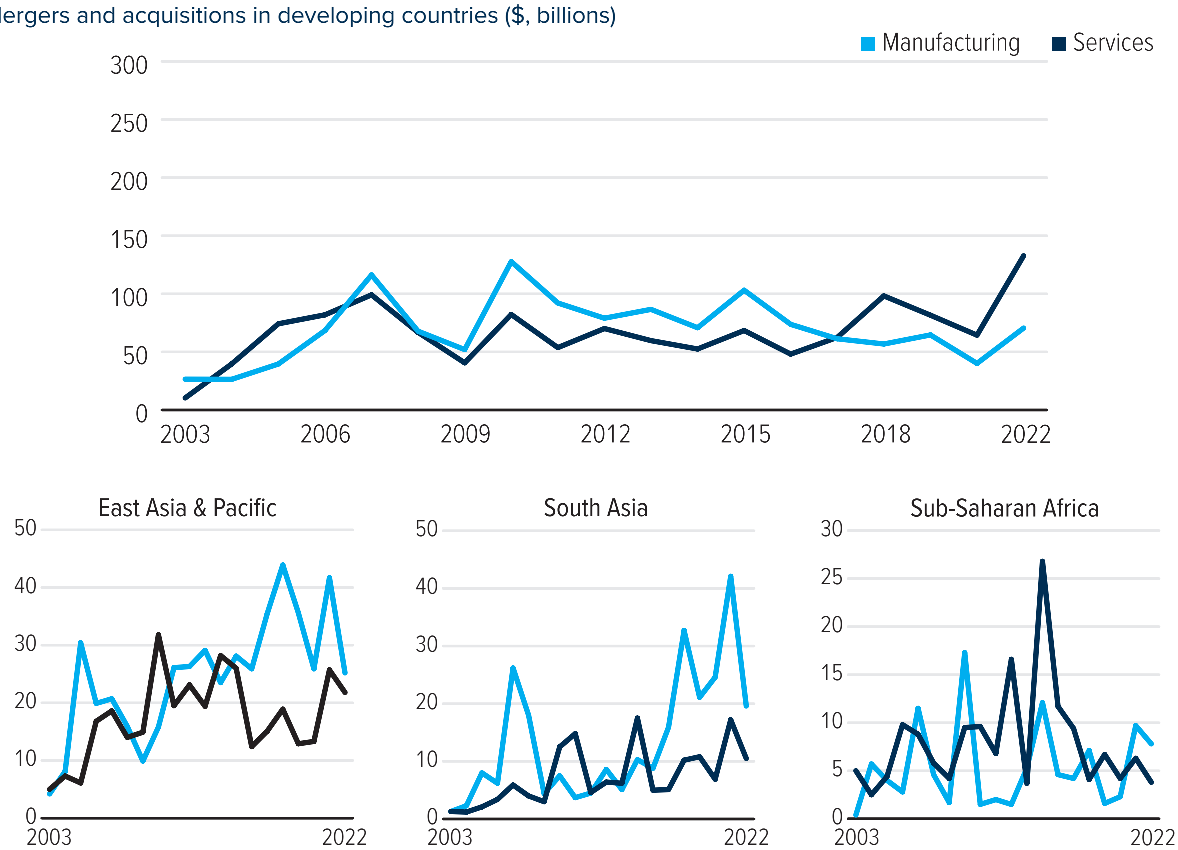
political tensions on the relocation of investment appears strong, particularly to and from Asia. In strategic sectors, such as the semiconductor industry, the flow of FDI into Asian countries started to decline in 2019 while investments to the United States and Europe have proved more resilient. As a result, a significant gap emerged, with strategic FDI going to Europe about twice as much as that going to Asian countries (IMF 2023). The lack of recovery of FDI flowing into China is partly due to fragmentation in these activities. Asia has been losing market share vis-à-vis almost all other regions likely due to a

Figure 1.7 | Growth of Services FDI, Greenfield and Mergers and Acquisitions, 2003–22

a. Greenfield FDI projects announced in developing countries (Total projects)



b. Mergers and acquisitions in developing countries ($, billions)



Source: IFC-World Bank staff calculations using *Financial Times* fDi Markets database and Refinitiv database

Figure 1.8 | Expected Relocation of Production from Largest Investors, by Region (share of firms, percent)

	Region of increase						
By share of firms (percent)	**EAP**	**SAR**	**MENA**	**SSA**	**ECA**	**LAC**	**NAM**
East Asia and Pacific (EAP)	56%	16%	5%	0%	13%	2%	8%
South Asia (SAR)	40%	13%	15%	5%	15%	2%	11%
Middle East and North African (MENA)	26%	3%	5%	15%	33%	3%	15%
Sub-Saharan African (SSA)	16%	7%	19%	35%	9%	3%	12%
Europe and Central Asia (ECA)	21%	12%	7%	1%	41%	5%	13%
Latin America and the Caribbean (LAC)	23%	15%	2%	1%	11%	8%	41%
United States and Canada (NAM)	33%	15%	0%	3%	18%	15%	18%

0% of relocation — > 50% of relocation

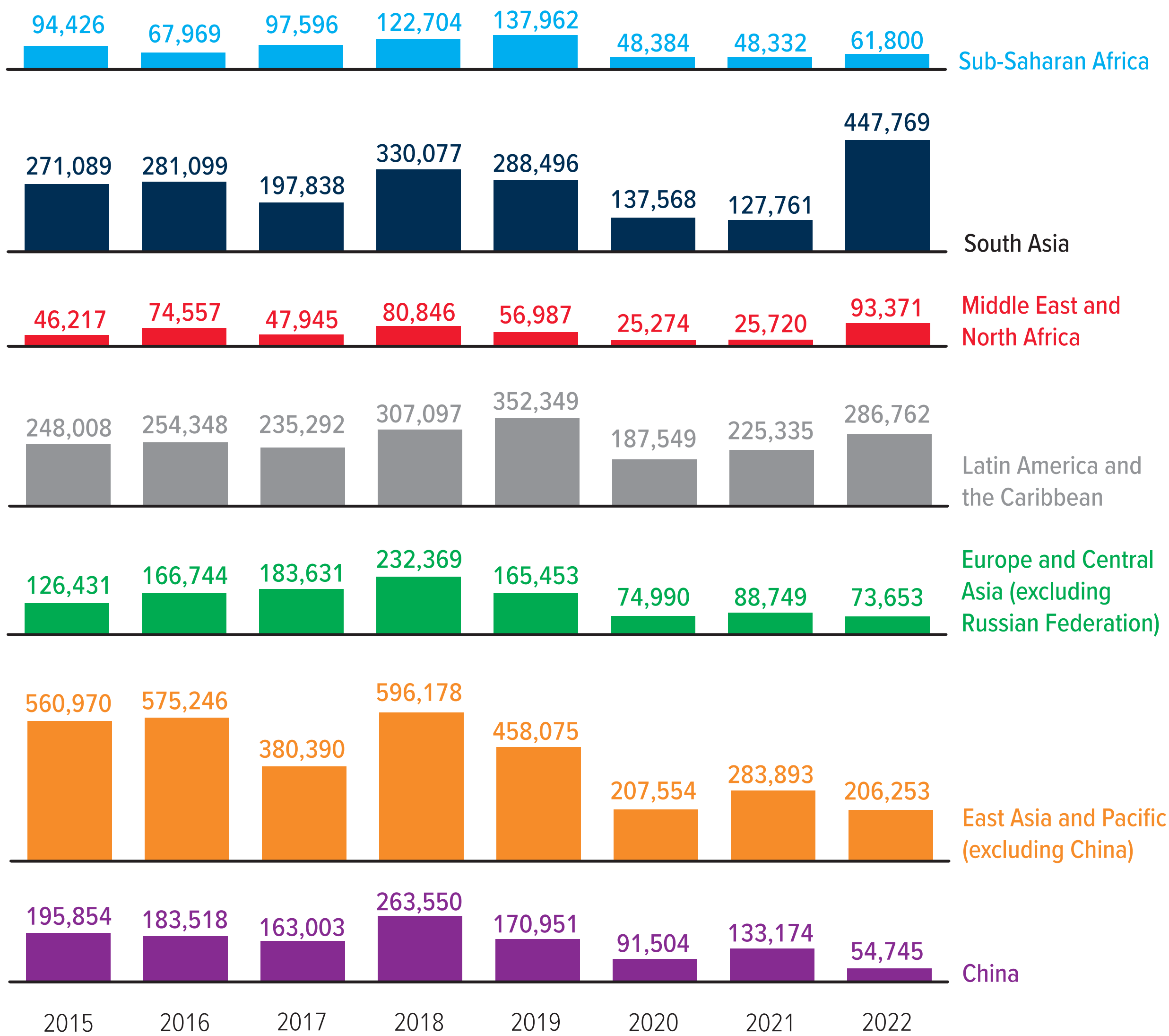
Source: 2021 Global Investment Competitiveness Survey (World Bank 2020a).
Note: The diagonal of the table from upper left to lower right shows relocation within the region. The survey comprised 1,060 business executives in global and regional headquarters. The surveyed firms accounted for 33 percent of total sector revenues globally based on 2019 data.

combination of geopolitical, financial, and structural drivers that came into effect at the same time.

In the same context, a significant portion of the global value chain (GVC) reconfiguration plans concern relocation from China to India in the coming years (see figure A.4). Many firms invested in China are diversifying their operations by expanding to other cost-competitive locations, such as India, Indonesia, Malaysia, the Philippines, and Viet Nam. Meanwhile, India is turning into an increasingly attractive destination of foreign capital, with a high share of surveyed firms globally reporting plans to increase investment in the market.

Overall, these shifts mark a divergence from preexisting trends in global production and investment, signaling potential restructuring of GVCs, as well as changes in the strength of FDI in supporting growth and job creation in lower-income economies. The shifts are particularly meaningful in light of new evidence highlighting an unstable relationship between FDI and economic growth, as well as the weakening in recent years of the mediating role of human capital and financial depth in strengthening the relationship between FDI and growth (Benetrix, Pallan, and Panizza 2022). This finding has been associated with a number of hypotheses. While the GVC revolution reduces requirements in terms of domestic production and technology to receive FDI, the segmentation of production—that is, whereby high-skill, high-tech segments of production remain at home—can reduce the positive spillovers associated with FDI (Antras 2020). In a context of geopolitical fragmentation and stronger vertical motivations for investment, technological transfer stands to weaken in this process. New technologies are also changing costs across global value chains in ways that are fundamentally hard to predict (Lund et al. 2019). While there is still scarce evidence regarding the many potential drivers of a weaker association between FDI and growth, the current context offers vast areas for relevant debate and analysis.

Figure 1.9 | Job Creation in Announced Greenfield Projects, by Region



Source: IFC-World Bank staff calculations using Financial Times fDi Markets database.
Note: The data referring to announced greenfield investments do not constitute official FDI statistics and are not comprehensive.

FDI-linked employment shifts to Africa show renewed momentum.

Labor-intensive greenfield projects and jobs are shifting to Sub-Saharan Africa and South Asia. The cost and availability of labor has always been a crucial factor in determining the configuration of international production in GVCs, as MNEs have sought to optimize their production costs by outsourcing labor-intensive activities to regions with large pools of unskilled labor (Qiang, Liu, and Steenbergen 2021). The ongoing reorganization of global value chains has resulted in a substantial increase in jobs announced by MNEs in greenfield projects in the two regions (figure 1.9). This shift presents an opportunity for job creation, the strength and reach of which remains to be materialized in the coming years. Adding to the increasing cost of labor in traditionally cheaper production hubs, such as China, and the growing sophistication of their production, the trend toward establishing more labor-intensive facilities in lower-income regions has been supported by extensive investment in infrastructure both in the rest of Asia and Sub-Saharan Africa. An array of multilateral and regional initiatives that are discussed in the next section aim specifically at these enabling conditions.

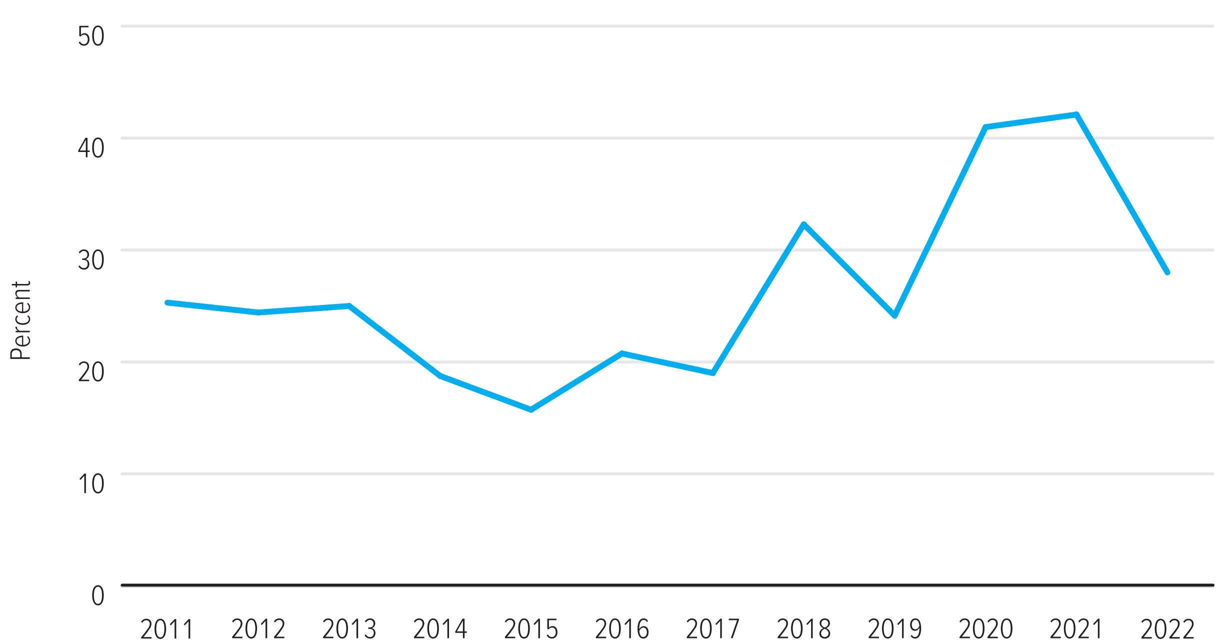
CHAPTER 2

Changes in FDI Rules and Policies

Latest Trends

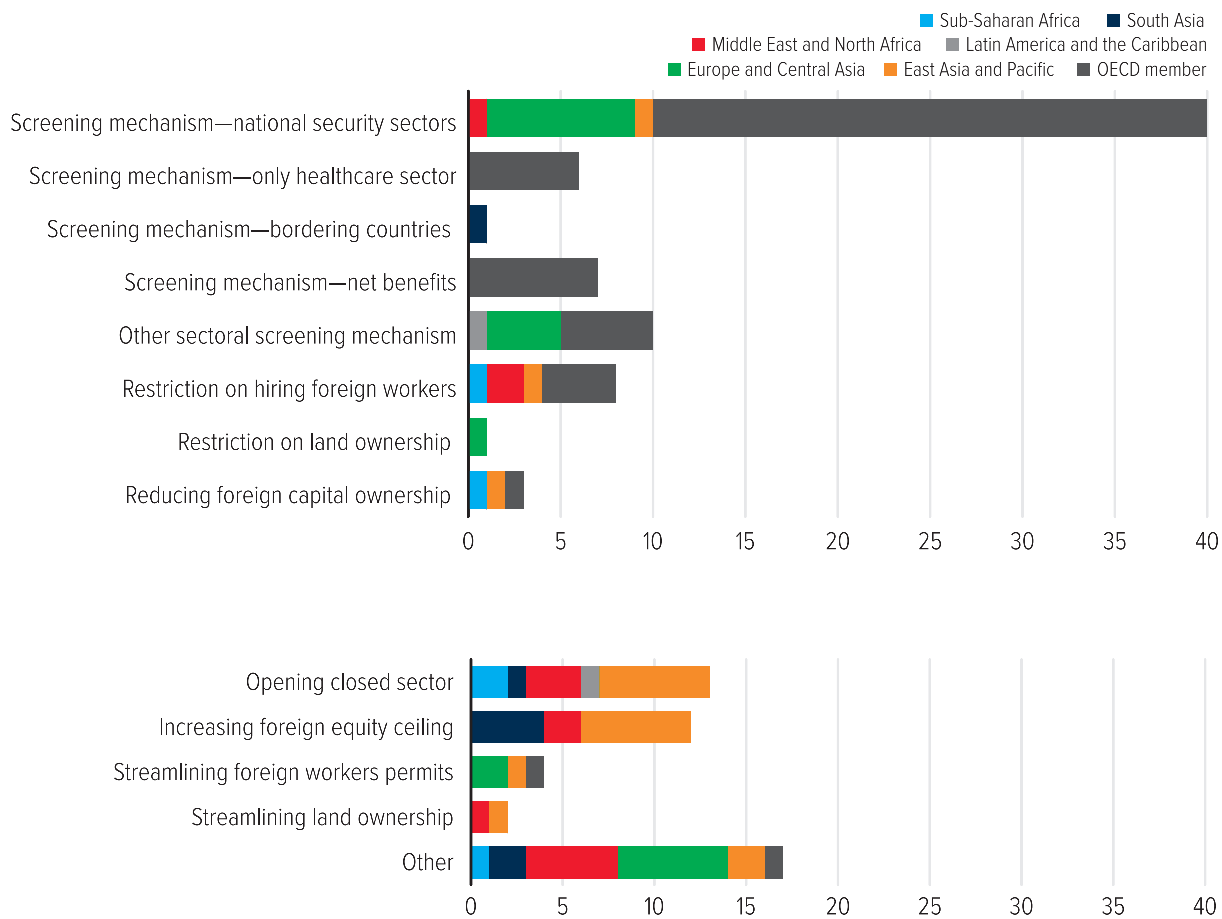
The past few years have witnessed more restrictive foreign direct investment policy measures being adopted by advanced economies while many developing countries have continued to adopt measures that facilitate or even liberalize FDI (figure 2.1). This chapter reviews some of the recent and more salient trends in domestic policies as well as international rules for investment. It zeroes in on policies affecting investor entry and establishment, corporate tax incentives, investment disputes, and

Figure 2.1 | Share of New National Policies Less Favorable to FDI, by year, 2011–22



Source: UNCTAD 2023.
Note: Per latest data released in July 2023, in 2022 the share of policies less favorable to FDI decreased to 28 percent, reflecting a relative rise of favorable policies intended to stimulate investment and promote economic growth in the face of unprecedented challenges posed by the current global crises (UNCTAD 2023c).

Figure 2.2 | World Bank FDI Entry and Screening Tracker—FDI Measures by Type



Source: World Bank 2023c.

Note: Measures were captured from February 2020 to February 2023. EAP = East Asia and Pacific; ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa; OECD = Organisation for Economic Co-operation and Development; SAR = South Asia; SSA = Sub-Saharan Africa.

investment conflict prevention. It also highlights the renewed momentum in investment rulemaking at the regional, international, and multilateral levels by spotlighting recent initiatives of the African Union, the Organisation for Economic Co-operation and Development, the Group of Twenty, and the World Trade Organization. The collective aim of these policy efforts is not only to facilitate increased investment flows to developing countries, but also to enhance the role FDI can play in inclusive and sustainable development.

INCREASED TREND TOWARD FDI LIBERALIZATION ACROSS DEVELOPING COUNTRIES

Many developing countries have eased investment restrictions. Data from the World Bank FDI Entry and Screening Tracker[7] show that many developing countries have eased investment restrictions by increasing foreign equity ownership ceilings, opening closed sectors to FDI, streamlining foreign worker permits, and improving land ownership rights (figure 2.2).

Box 2.1 | FDI Liberalization Examples

The World Bank's Investment Policy and Regulatory Reviews (IPRRs) present information on the legal and regulatory frameworks governing foreign direct investment (FDI) in different countries. They focus on foreign investment entry, establishment, protection and select dimensions of FDI in the digital economy. Two rounds of IPRRs were completed in 2019 and 2021 for Brazil, China, India, Indonesia, Malaysia, Mexico, Nigeria, Thailand, Türkiye, and Viet Nam. Examples of reforms to liberalize FDI regimes in these countries, as captured by the IPRRs, include the following:

- **China (2020–22):** New versions of the negative list and the encouraged industry catalogue were released, opening further sectors and activities to FDI (for example, manufacturing of new energy vehicles and satellite television ground receiving facilities, some financial services). Comprehensive pilot programs were approved on the opening of 12 services sectors to FDI in the Tianjin, Shanghai, and Chongqing municipalities and in Hainan Province.
- **India (2020–21):** Equity ceilings in insurance companies were raised from 49 percent to 74 percent. One hundred percent equity ownership was allowed in coal and lignite mining, contract manufacturing, telecommunications services, and single-brand retail trading.
- **Indonesia (2021):** A new negative list was released liberalizing more than 245 business lines, including important sectors such as transportation, energy, and telecommunications.
- **Viet Nam (2020):** The Law of Investment was amended, simplifying the business registration process, redefining state-owned enterprises, providing updates on incentives, and abolishing or reducing conditions for 22 business lines, such as commercial arbitration and franchising and logistics services.

Sources: Kher, Kusek, and Eltgen 2022.

Notably, most FDI-friendly measures were adopted in the East Asia and Pacific region (16 measures), followed by the Middle East and North Africa and Europe and Central Asia regions (11 and 7 respective measures). Findings from the World Bank's Investment Policy and Regulatory Reviews (IPRRs) corroborate these results for a set of 10 middle-income developing countries (see box 2.1).

While many of the liberalizing reforms across the developing regions have focused on services, further opportunities for easing services restrictions remain. As discussed in this report, services account for an increasing share of employment, output, trade, and FDI globally (Nayyar, Hallward-Driemeier, and Davies 2021).[8] Despite growing economic contributions of the services sectors, restrictions on services trade and investment remain high around the world, especially in South Asia and the Middle East and North Africa (see appendix B).[9] In contrast, Latin America and the Caribbean and North America are relatively less restricted. Similarly, some sectors (for example, professional services and finance) have generally higher FDI barriers than others (for example, telecommunications and distribution). Data also show that there has been some reduction in services restrictions over time, especially in transport and professional services. However, these reforms have been driven mostly by high-income countries, reinforcing the need for continued reforms in developing regions.

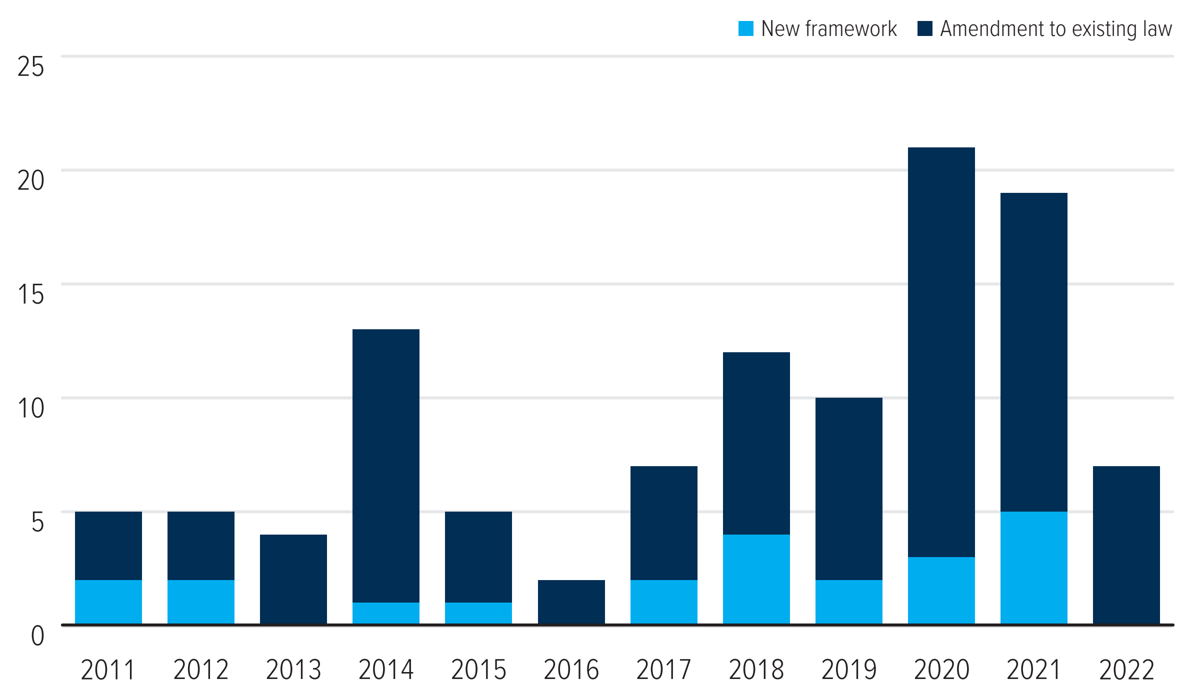
GROWTH IN FDI RESTRICTIONS, ESPECIALLY IN DEVELOPED COUNTRIES

Despite the trend of liberalizing reforms in many developing countries, FDI restrictions in the form of FDI screening have continued to increase, particularly in developed economies (UNCTAD 2023). A forthcoming World Bank paper explains that the increase in investment restrictiveness is evident in the gradual expansion of FDI screening mechanisms motivated by preserving host country interests such as national security, critical infrastructure, dual-use technologies, and sensitive information (Forneris and others, forthcoming) (figure 2.3). Of the 79 new restrictions identified since February 2020 by the World Bank's FDI Entry and Screening Tracker, more measures have been aimed at restricting FDI entry (62 percent) than at liberalizing or facilitating entry (38 percent). OECD countries account for 70 percent of all restrictive measures and 60 percent of all screening measures. In addition to the rise in screening of new greenfield FDI projects, some countries have also increased their scrutiny of foreign takeovers of strategic assets and technology companies.

STRATEGICALLY CALIBRATING AND REFORMING INVESTMENT INCENTIVES

Another policy area that has seen a lot of policy reform momentum concerns corporate tax incentives. Despite mixed evidence regarding their effectiveness and overall economic impact, corporate tax incentives have been used increasingly by governments around the world to attract FDI and pursue other policy objectives, including promoting green growth, supporting higher value-added jobs, or bolstering the digital economy. Between 2009

Figure 2.3 | Prevalence of FDI Screening and National Security Reviews



Source: Forneris and others, World Bank, forthcoming.
Note: Information for 2022 is until August.

Box 2.2 | Sample National and European Union Measures to Address National Security Issues Triggered by the COVID-19 Pandemic

Spain: Royal Decree Law 8/2020 states that the pandemic "poses a certain threat to listed Spanish companies, but also to unlisted Spanish companies that are seeing their equity value decline, many of them in strategic sectors of our economy" and that such companies have become an easy target of foreign takeovers, which poses certain risks for public order, public safety, and public health. Consequently, in numerous sectors, an ex-ante governmental approval is required for the acquisition of 10 percent or more of stock.

Australia: The monetary screening threshold for foreign investments under the Foreign Acquisitions and Takeovers Act 1975 has been temporarily lowered to zero to "protect Australia's national interest." Also, the time frame for the screening procedures has been extended from 30 days to six months.

Italy: The Italian government strengthened its special powers in sectors of strategic importance by expanding the scope of FDI screening to the financial, credit, and insurance sector and temporarily applying it also in relation to foreign acquisitions from within the European Union (EU). The government is also authorized to initiate relevant procedures ex officio, even if a foreign acquisition is not notified as prescribed by law.

Canada: The Canadian government published its Policy Statement on Foreign Investment Review and COVID-19, which announced "enhanced scrutiny" of "foreign direct investments of any value, controlling or non-controlling, in Canadian businesses that are related to public health or involved in the supply of critical goods and services to Canadians or to the Government." This measure is a response to "opportunistic investment behavior" caused by declines in valuations of Canadian businesses as well as by investment of state-owned enterprises that "may be motivated by non-commercial imperatives that could harm Canada's economic or national security interests, a risk that is amplified in the current context." The new policy will apply until economic recovery from the COVID-19 pandemic.

European Union: On March 25, 2020, the European Commission issued a guidance to member states urging them to make full use of existing FDI screening mechanisms to take fully into account the risks to critical health infrastructures, supply of critical inputs, and other critical sectors or to set up a full-fledged screening mechanism.

India: On April 17, 2020, the government of India introduced measures to curb opportunistic takeovers and acquisitions of Indian companies due to the COVID-19 pandemic. The measure targets foreign investors originating from countries that share land borders with India (that is, Afghanistan, Bangladesh, Bhutan, China, Nepal, and Pakistan). These investors are required to receive governmental approval to invest in India.

Romania: On February 27, 2020, the government of Romania issued an emergency ordinance amending Petroleum Law no.288/20004. The ordinance stipulated that the National Agency for Mineral Resources will serve as a competent authority and has the power to refuse any concession and execution of oil operations for the exploration, development, and exploitation of an oil field to a non-EU entity on national security grounds. Similarly, any transfer of a concession is only possible after obtaining governmental approval.

Source: World Bank.

and 2015, 46 percent of countries adopted new tax incentives or made existing incentives more generous (Andersen, Kett, and von Uexkull 2017). More broadly, there has been a trend of growing tax competition. Since the 1980s, statutory corporate income tax rates have continuously fallen. The largest decline has occurred in developed countries, where the average rate more than halved between 1980 and 2021, from 41.8 percent to 19.9 percent (UNCTAD 2022). Most recently, the COVID-19 pandemic ushered in an expansion of corporate tax relief efforts, as governments sought to retain high-impact investments and promote sustainable recovery and growth in the private sector.

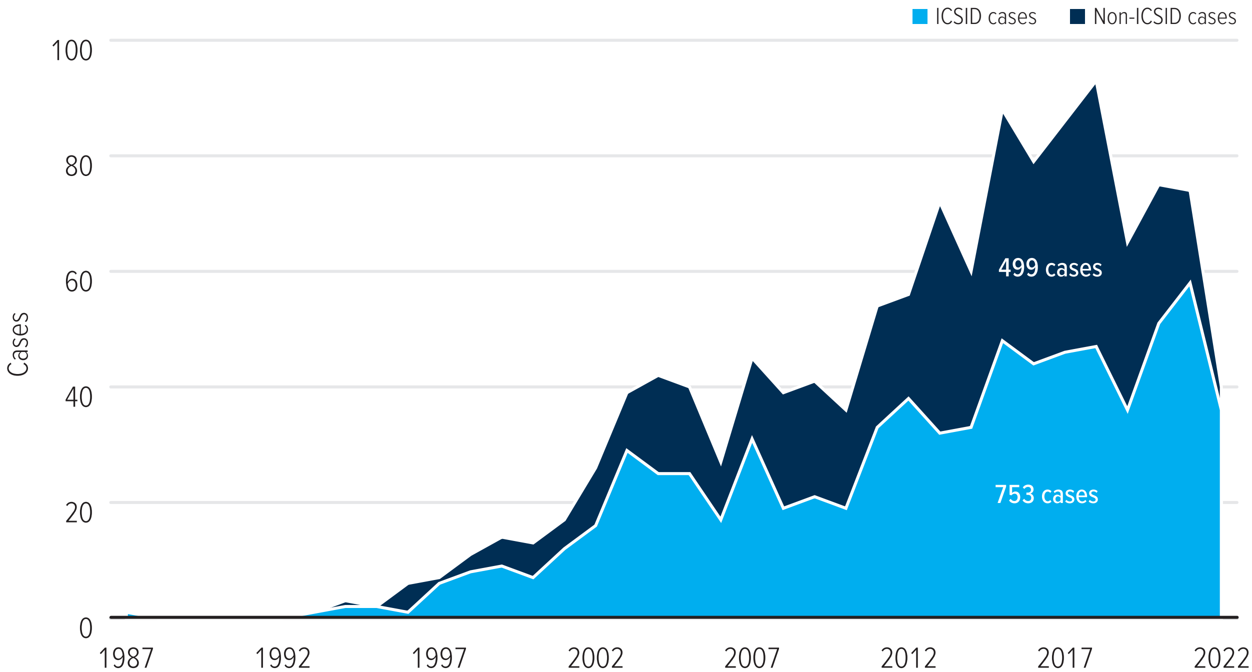
The growing popularity of corporate tax incentives derives partly from increased competition to attract FDI. Policy makers are driven to match, or even surpass, their regional neighbors by offering more generous tax concessions. Those concessions can motivate unhealthy competition between states, commonly referred to as a "race to the bottom." From governments' perspective, foregone tax revenue from the reduction in firms' tax liability can impose significant fiscal losses if incentives are not strategically conceived and applied (IMF, OECD, UN, and World Bank 2015). At the same time, both literature and empirical evidence suggest that tax incentives are often ineffective in achieving their objectives and can also be very costly to governments. For example, an assessment of the Eastern Caribbean Currency Union from 1990 to 2003 found that tax incentives had limited effect on FDI, though the same incentives significantly aggravated fiscal deficits and debt overhangs (Chai and Goyal 2006; James and Van Parys 2010).

The role of tax incentives in influencing companies' investment decisions is quite limited, although tax incentives have demonstrated some results in specific contexts and country-level characteristics. In countries like China, the Republic of Korea, and Singapore, tax incentives have been shown to be part of a broader strategy that helped attract investors and encourage industrialization between the 1960s and 1990s (Tanzi and Shome 1992; Wade 1990). But the success of incentives in attracting FDI depends strongly on country-level characteristics. Tax incentives are more effective in countries with better infrastructure, reasonable transport costs, and a policy framework favoring investment (Bellak, Leibrecht, and Damijan 2009; Kinda 2016). In fact, tax incentives have been shown to be eight times more effective in attracting FDI in countries with good investment climates (James 2014). Investors that are more internationally mobile (such as globally oriented manufacturing and financial services firms) have also been found to be more responsive to tax incentives (Zolt 2013). Other country-level factors such as political stability, regulatory quality, and market opportunities are more critical to investors' initial location considerations compared with tax rates and incentives (Andersen, Kett, and von Uexkull 2017; UNIDO 2011). In general, a low tax burden cannot compensate for a weak or unattractive FDI environment (Göndör and Nistor 2012). Yet, for suitable locations, incentives can play a role in the final stage of the site selection process when investors are deciding on shortlisted locations and wavering between similar options (Freund and Moran 2017).

Policy makers often advocate for the use of tax incentives by suggesting that they are offset by the new investment, jobs, and spillovers for the economy. All too often, policy makers overestimate the role of incentives in swaying investor decisions, and in turn, their projected benefits translate into a windfall for investors at the expense of lost tax revenue for governments. Poor design of tax incentives can lock countries into long-term revenue losses (such as open-ended tax holidays). This is especially worrisome for lower-income countries that are already struggling with domestic revenue mobilization.[10]

A key policy challenge, as well as an opportunity, facing governments is how to use incentives effectively to motivate investments in sustainable and green sectors.[11] The policy approach needs

Figure 2.4 | Trends in Known Treaty-Based ISDS Cases, 1987–2022



Source: World Bank calculations based on UNCTAD ISDS database.
Note: ICSID refers to the International Centre for Settlement of Investment Disputes of the World Bank Group. ISDS = investor-state dispute settlement.

to include considerations for how investment incentives can be adopted strategically and implemented in a way that promotes transparency and accountability and provides a level playing field for investors, maximizes their value for money, and minimizes the risks (see appendix C). At the same time the recent stagnating FDI flows reported in Chapter 1 suggest that these types of reforms are by themselves not sufficient to attract more FDI in the context of prevailing global macroeconomic and geopolitical headwinds.

DERISKING THE INVESTMENT ENVIRONMENT BY CURBING INVESTMENT DISPUTES

To be able to attract, retain, and expand FDI, it is increasingly essential for countries to take concrete measures to mitigate risks that are within the government's sphere of influence. Evidence suggests that political risks—such as breach of contract, sudden and adverse regulatory changes, lack of transparency, and expropriation—and certain operational risks, such as delays in permits and approvals, can cause investors to divest or cancel their expansion plans (World Bank 2020). Existing investors contribute a substantial amount of FDI through reinvested earnings and are especially vulnerable to those risks. These issues can lead to expensive investor-state disputes; they are among the top causes of investor-state disputes globally.

While investor-state dispute settlement (ISDS) cases have continued to proliferate—reaching a cumulative 1,190 known cases—the trend has slightly eased since the 2018 high (figure 2.4).[12] This metric only records known cases and cases based on treaties (such as bilateral investment treaties, preferential trade agreements with investment chapters, and other international investment agreements). However, the phenomenon of investor-state arbitration is even more widespread as there are cases that are not in the public domain or are based on national investment codes and on contracts between states and investors.

As the number of arbitration cases has grown, investor-state arbitration has become increasingly controversial in the field of economic and investment policy. There are three broad categories of concern: those related to the arbitral process, those related to the outcomes, and those linked to arbitrators and decision-makers.[13] Arbitration results in a "win-lose" situation, which is often unsatisfactory to both sides of the conflict. If the relationship between the investor and the state had not already ended when the dispute was brought to arbitration, the chances are slim for the existing business relationship to continue after an international arbitration proceeding.

A rise in investment disputes is also jeopardizing sustainable development objectives in many countries. Globally, about 10 percent of known treaty-based arbitration cases have been in renewable energy. With relatively large upfront cost, longer cost recovery periods and high levels of state intervention, the renewable energy sector is especially vulnerable to such regulatory risks and legal disputes (Bank 2023a). Maintaining high levels of FDI in renewable energy needed to achieve sustainable development and climate goals will require sound strategies to minimize or eliminate risks. Political risk, measured as a disruption in business operations caused by sudden political changes or actions, is a key factor impeding the ability of countries to attract and retain FDI (World Bank 2020a). One specific kind of political risk—regulatory risk caused by regulatory actions—can lead to costly legal disputes between investors and states (World Bank 2023c).

It is in this context that stakeholders have focused on dispute prevention to avoid costly divestment decisions and expensive legal disputes. One main tool for dispute prevention and investment retention is the investor grievance management mechanism. Such a practical tool is designed to enable governments to identify, track, and resolve investor issues in a timely manner to help countries resolve investor issues before they cause any adverse impact or escalate unnecessarily. Reform examples shown later in this report illustrate how various countries have implemented such investment dispute prevention measures.

SELECTED EXAMPLES OF MULTILATERAL, PLURILATERAL, AND REGIONAL INITIATIVES ON INVESTMENT

In addition to the dynamics in the national-level rulemaking, a reenergized international investment policy agenda at global, multilateral, and regional levels promises new opportunities for developing countries. Main international initiatives—such as the recently concluded Investment Facilitation for Development Agreement of the World Trade Organization (WTO), regional integration initiatives such as AfCFTA, and the global minimum tax on multinational enterprises—have the potential to play a key role for fostering a new era of leveraging FDI for sustainable development.[14]

Investment Facilitation for Development Agreement of the World Trade Organization

The WTO Investment Facilitation for Development (IFD) Agreement, whose negotiations concluded in July 2023, represents an important opportunity for countries to generate reform momentum regarding FDI and to facilitate increase in FDI flows. The IFD initiative will be the first multilateral/plurilateral agreement on investment at the global level. Expected economic welfare[15] gains of the agreement range between 0.56 percent and 1.74 percent depending on the depth of the agreement

(Balistreri and Olekseyuk 2021), with developing countries, which have the lowest levels of adoption of investment facilitation measures (Berger, Dadkhah, and Olekseyuk 2021), identified as the main potential beneficiaries. Having made steady progress since its inception in 2017,[16] the IFD initiative now counts more than 110 participating WTO members. This number represents over two-thirds of the WTO membership, including more than 70 developing countries, among which 20 are classified as least-developed countries.[17]

With its focus on improving transparency, efficiency, and effectiveness of investment-related administrative procedures, the draft agreement (as currently negotiated) includes several provisions requiring participating WTO members to improve their investment facilitation frameworks. Obligations include publication of investment-related information, streamlining of investment-related procedures, and setting up of focal points for foreign investors. Participating countries are also discussing provisions that encourage the uptake of responsible business conduct principles and standards by investors and enterprises, as well as the adoption of anti-corruption measures. The aim is to help countries attract not only more, but also better, higher-quality investment that contributes to sustainable development.

Success of the IFD agreement will depend on its effective implementation. Due to the multidisciplinary nature of investment and the complexity of the IFD Agreement, strong organization and coordination between different government actors, as well as the involvement of all relevant stakeholders, will be key in implementing the agreement. To facilitate these processes—especially for developing and least-developed countries—participating countries have highlighted the importance of "needs assessments" to allow countries to self-assess their readiness, needs, and priorities regarding implementation of the agreement. These assessments, in turn, can serve as entry points for country engagement for undertaking investment facilitation reforms.

African Continental Free Trade Area

The creation of the African Continental Free Trade Area represents an important opportunity to stimulate Africa's cross-border trade and investment by creating a continent-wide market, reducing barriers to trade, removing investment hurdles, and boosting competition. The AfCFTA will create a single market worth $3.4 trillion; and by establishing a single set of norms for Africa, it will reduce overlap and offer accountability. The agreement aims for broader and deeper regional integration than has been attempted in Africa so far, which will attract investment, grow businesses, boost trade, provide better jobs, and reduce poverty.

The AfCFTA has the potential to boost intra-African FDI by up to 68 percent and external FDI by up to 122 percent, especially from Europe and Asia. Calculations show exports and GDP will also be boosted, potentially by $613 billion and $67 billion, respectively, by 2035 (Echandi, Maliszewska, and Steenbergen 2022). Reductions in non-tariff barriers on goods and services and improvements in trade facilitation measures will account for about two-thirds of the potential income gains. The reductions will remove long delays across most of the continent's borders and lower compliance costs in trade, making it easier for African businesses to become integrated into regional and global supply chains. The agreement's joint effect on trade and FDI could create almost 18 million new jobs, with 2.5 percent of the continent's workers shifting jobs to expanding sectors by 2035. This may further raise incomes for the whole African continent by 9 percent and reduce extreme poverty by 50 million people by 2035 (Echandi, Maliszewska, and Steenbergen 2022).

However, realizing the potential of the AfCFTA will require going beyond the initial agreement and implementing the protocols on investment, competition, and intellectual property rights.[18] Jointly, these protocols will be extremely important in boosting investor confidence and further attracting business. Deeper integration in these policy areas would build fair and efficient markets, improve competitiveness, and attract further FDI by reducing political and regulatory risk and raising investor confidence. At the same time, countries should leverage this opportunity to concurrently accelerate and deepen reforms to improve the overall business enabling environment for private sector development in areas such as governance, competition policy, digital transformation, infrastructure, and state-owned enterprise reform, among others.

The AfCFTA Investment Protocol has the added benefit of requiring signatories to promote and facilitate investments that support actions to mitigate greenhouse gas emissions and measures to adapt to the negative impacts of climate change. It also requires signatories to promote and facilitate investment of relevance for a fair and just transition in sectors such as renewable energy and low-carbon technologies, and by adopting policy frameworks conducive to transfer and deployment of climate-friendly technologies and goods and services. This requirement provides an important innovation to help raise the benefits of FDI for development.

Realizing the potential of the AfCFTA will require implementation of a set of parallel actions. The conclusion of negotiations is critical. The content, structure, and depth of commitments in each topic area will be vital to turning the aspirations of the AfCFTA into reality. For trade and investment in services, for example, member states should publish audits that identify regulatory barriers to trade and investment in services.[19] The countries should aim to progressively liberalize their barriers to services trade in the five priority sectors: business, communication, financial, transport, and tourism services. On investment policies, member states should seek to agree on transparent, precise, and enforceable rules and disciplines that increase the credibility and predictability of administrative action. They should also promote non litigious means for addressing investor-state grievances. Finally, new action is required to promote and facilitate foreign investments that support actions to mitigate greenhouse gas emissions and measures to adapt to the negative impacts of climate change.

OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting

MNEs have capitalized on the opportunities presented by globalization to structure their businesses in ways that minimize their global tax bills, often by transferring profits to lower-tax jurisdictions through complex mechanisms with no real economic justification. Many reforms of the international tax framework have been undertaken over the past decade to address tax base erosion and profit shifting, particularly through the Base Erosion and Profit Shifting (BEPS) Actions. However, despite these reforms, the international tax system continues to face pressure from trends of increasing globalization and digitalization of the economy.

In October 2021, a historic two-pillar international agreement—the OECD/G20 Inclusive Framework on BEPS—was reached by 137 countries to address the twin challenges of globalization and digitalization. Pillar One aims to reallocate corporate tax revenues to the country of the consumer. Pillar Two introduces a global minimum tax (GMT) for MNEs. The GMT is designed to ensure that large MNEs (with annual revenue greater than €750 million) pay a minimum effective tax of 15 percent.[20]

The introduction of a global minimum tax will have important global implications for tax policy and incentives and for the location and investment decisions of MNEs. Many countries will need to consider reforms to their corporate tax regimes because they could otherwise face scenarios where profits earned in their jurisdictions could be subject to additional taxes in the jurisdiction of the parent company or in other jurisdictions. The agreement is expected to reduce the use of tax havens by MNEs to shift profits out of their main operating countries. With GMT implementation, countries would effectively no longer be able to attract investments from large MNEs through zero or low rates that result in an effective tax rate of less than 15 percent, and certain incentives will no longer be GMT compliant, such as tax holidays and zero-tax zones. Other incentives, like those purely targeting domestic firms, will not fall in the scope of the framework. Some instruments, like accelerated depreciation and extended loss-carry-forward, as well as some forms of tax credits would still be compatible (see appendix C).

It is estimated that the minimum effective tax rate will result in the collection of $150 billion in new revenues annually (OECD 2021). The revenue gain is anticipated to come (a) from jurisdictions increasing tax rates or introducing a qualified domestic minimum top-up tax to ensure that insufficiently taxed profits in the jurisdiction are taxed at the minimum tax rate (or otherwise the parent entity will collect the top-up tax or it can be collected as a backstop by other jurisdiction(s) with subsidiaries); and (b) through reducing incentives for MNEs to shift profits to tax-free or low-tax jurisdictions.

Collectively, the aforementioned policy developments at the national and international levels present unique opportunities for countries to position themselves as forward-looking destinations for investment. Moreover, these initiatives boost and catalyze countries' efforts to attract and retain more FDI, as well as to harness FDI for advancing their development goals. Chapter 3 looks at the experience of FDI reform programs in a set of Sub-Saharan African and East Asian countries.

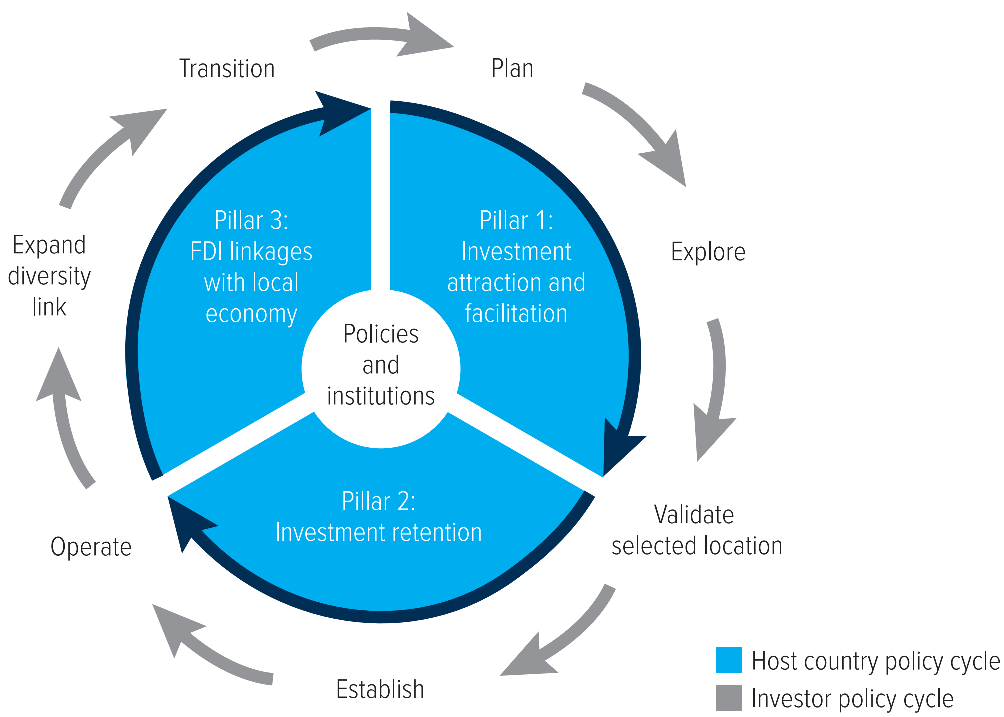
CHAPTER 3

FDI Policy Reforms

Examples from East Asia and Sub-Saharan Africa

In the context of the FDI and policy trends analyzed in this report, developing country policy makers have been revising their FDI development agendas. Their efforts have often focused on designing and implementing effective policies, regulations, and institutional practices around the investment life cycle (figure 3.1). The investment life cycle is centered on the role of institutions and policies as key tools in helping governments increase their countries' investment attractiveness, boost their ability to retain existing FDI, and leverage FDI for linkages with the domestic economy. The key role that policies and institutions play in countries' investment competitiveness is also highlighted by systematic

Figure 3.1 | The Investment Life Cycle



Source: Adapted from World Bank 2022b.

Table 3.1 | Overview of Country Investment Policy Reforms in Sub-Saharan Africa and East Asia

Objective	Country	Reform
Investment attraction and facilitation through targeted reforms to seize opportunities in new sectors	Indonesia	Removing sectoral discrimination toward FDI across multiple sectors
	Ethiopia	Liberalization of Ethiopia's economy to FDI
	South Africa	Boosting South Africa's investment attractiveness by building investor confidence and enhancing investment promotion
Investment retention and investor grievance management	Rwanda	Establishing an investor grievance mechanism within the investment promotion agency (IPA) (Rwanda Development Board)
	Viet Nam	Developing a mechanism for prevention and settlement of grievances
	Mongolia	Establishment of a systemic investor response mechanism (SIRM)
Development of stronger linkages with local economies and supporting pioneering local businesses	Viet Nam	Pilot Supplier Development Program (SDP) in partnership with large multinational enterprises
	Guinea	FDI linkages program on closing information gaps and introducing a platform that encourages broad business participation

Source: World Bank catalog of investment policy reforms.

assessments of developing countries' constraints to and opportunities for private sector–led growth. For example, the joint International Finance Corporation and World Bank Country Private Sector Diagnostics (CPSD) reports for Sub-Saharan Africa and Asia have found that a burdensome business environment with a weak legal and regulatory framework tends to be one of the most frequently identified barriers to private investment, along with impediments in infrastructure, trade, transport, and finance.

The following sections present practical examples of policy reforms in Sub-Saharan Africa and East Asia that have been aimed at strengthening countries' policy and institutional regimes for FDI (see table 3.1). These examples were selected to illustrate the key role that public policies, rules, and regulations play in influencing FDI performance and impact. The reform examples are organized along the three main pillars of the investment life cycle: (a) investment attraction and facilitation aiming at seizing new investment opportunities, (b) investment retention to decrease probability of divestment and to foster existing expansion and reinvestment of retained earnings of FDI, and (c) FDI linkages with the local economy to increase FDI's development dividend. The examples include successful reforms in liberalizing sectors with high investment potential, such as services in Indonesia, easing legal and regulatory barriers to investment in Ethiopia, and increasing investment attraction through strategic reevaluation of investment opportunities in South Africa. Additional examples from Mongolia, Rwanda, and Viet Nam illustrate how investor grievance management programs enhance investor confidence and lead to increased reinvestments. Last, examples from Guinea and Viet Nam demonstrate how building stronger FDI links with the local economy—through supplier development programs and FDI linkages initiatives—helps decrease information gaps for investors and boosts local business opportunities. For extended versions of each case study, please refer to appendix D.

PILLAR 1: INVESTMENT ATTRACTION AND FACILITATION THROUGH TARGETED REFORMS TO SEIZE INVESTMENT OPPORTUNITIES IN NEW SECTORS

To attract FDI, countries need to improve the factors that drive investors' location decisions. Several investor surveys, including the World Bank's

Global Investment Competitiveness Survey, show that political stability, macroeconomic stability, and an enabling legal and regulatory environment are among the top factors considered crucial by foreign investors (World Bank 2018, 2020a, 2022a). Governments play a key role in creating an enabling business environment for investment attraction and facilitation. A competitive FDI policy and institutional framework includes an open FDI entry regime, streamlined and transparent investment facilitation system, targeted investment promotion, and overall, a predictable regulatory environment for investment. The following examples from Indonesia, Ethiopia, and South Africa illustrate how various reforms have targeted these key factors for investment attraction and facilitation.

Indonesia adopted a new Omnibus Law to liberalize its investment regime and open the labor market to highly skilled foreign workers. The reform effort included amending dozens of individual laws, reducing the number of business activities subject to at least one investment restriction from 813 to 260,[21] and eliminating foreign equity limits across a wide range of sectors. Furthermore, new rules on foreign workers have helped increase the supply of highly skilled professionals for the labor market. The implementation of the Omnibus Law significantly liberalized Indonesia's foreign investment regime, moving Indonesia from one of the most restrictive to one of the more open FDI regulatory systems in East Asia. Estimates of the impact of the new law suggest it could generate between $4.1 billion and $6.0 billion in additional investments, both foreign and domestic, in the liberalized sectors. Moreover, removal of restrictions on investments, in the longer term, is expected to foster market entry, improve commercial performance, and tame price increases, owing to stronger competition (World Bank 2020b).

Ethiopia has overhauled its FDI environment with a comprehensive set of institutional and legal reforms. While Ethiopia was among the fastest growing economies over the past decade and a half, the share of private investment—and especially FDI—contributing to this growth was relatively low. Impediments to FDI included a range of structural, legal, and institutional factors. The government's FDI reform program therefore targeted the reduction of legal and administrative barriers to foreign investment, enhancement of investor confidence through improved transparency and predictability in investment policy implementation and strengthening investment promotion in target sectors. An independent evaluation of the various reforms realized through the reform program during 2015–18 estimated an attraction of $96 million of new FDI and the creation of more than 11,000 new jobs. Additionally, the reforms helped open at least six sectors that had been previously closed for FDI, improve the visa and work permit process, and support government-investor dialogue. Overall, in part thanks to these reforms, Ethiopia's FDI grew ten-fold from the early 2010s to the years preceding the COVID-19 pandemic.

South Africa strengthened its institutional support for investment facilitation. In South Africa, declining FDI flows before the COVID-19 pandemic were driven, in part, by negative investor sentiment, including concerns about the ease of doing business, competition policy, and the market dominance of state-owned enterprises. To address these challenges, the government of South Africa constituted an Inter-Ministerial Committee on investment to support improving the South African business environment, increasing FDI inflows, and promoting investment generation. An Investment Reform Map assessment and an investor survey identified several key institutional and regulatory barriers to FDI. These diagnostics also spotlighted opportunities to strengthen the capacity of InvestSA (South Africa's investment promotion agency) for investment generation and retention; to target priority sectors for investment; to address fragmentation and lack of coherence in investment promotion efforts across national, provincial, and municipal levels; and to establish a dedicated investment aftercare and retention program. The ensuing reforms focused on these opportunities and included adoption of a new corporate plan and investor engagement strategy. The reforms also encompassed the establishment of the Investment and Infrastructure Office at the Presidency as an intragovernmental body to unblock investments stymied by regulatory barriers. The reform program's impact assessment showed that the reforms generated more than $375 million in new investment and retained $5 million in existing investment.

PILLAR 2: INVESTMENT RETENTION AND INVESTOR GRIEVANCE MANAGEMENT TO RETAIN EXISTING INVESTORS

Countries' reforms in investment retention have focused on building government capacity for more effective investment problem-solving of issues putting existing foreign investments at risk. Many countries lack the institutional infrastructure and interagency coordination mechanisms to detect and resolve investor issues in a timely manner. Many governments also typically do not collect systematic data on investor grievances and their impact on investment decisions. Setting up an institutional framework to address investor issues effectively can ultimately lead to higher retention and expansion of existing investments. Through early detection and resolution of such high-risk issues, governments can also prevent their escalation, thereby avoiding disputes and reputational damage to host countries. Evidence has shown that retaining investment by addressing political and operational risk has positive effects on investor confidence that contributes to the retention of investment.

The objectives of investment retention reforms are to help governments address investors' operational and political risks through targeted investment aftercare programs, grievance management mechanisms, and investment retention and reinvestment initiatives. Common components of these programs comprise empowering a lead agency, detecting, and recording investor issues, conducting legal and economic assessments, and leveraging a wide range of problem-solving methods, as illustrated by the following examples from Mongolia, Rwanda, and Viet Nam.

Rwanda strengthened its investor aftercare system to foster investor retention and expansion. While Rwanda had over the years made significant efforts to improve its investment climate, investment attraction and especially retention remained a challenge. In response, the Rwanda Development Board augmented the role of its Reinvestment and Investor Aftercare Department. It expanded its mandate to include investor issues arising from government conduct, particularly those that entailed a high risk of investors leaving the country or of potential state liability for the violation of laws or contracts. The reform put in place a new process whereby investor grievances that could not be solved at the level of the Reinvestment and Investor Aftercare Department were escalated through several different levels of the bureaucracy, including, ultimately, the Private Investment Committee, which consisted of the Rwanda Development Board's chief executive officer, the minister of finance, and a representative of the Office of the President. As of April 2021, the Rwanda Development Board registered 17 high-risk issues arising in different sectors, including agriculture, energy, food manufacturing, health, information and communications technology services, and tourism. Analysis has shown that the issues pertained mostly to breach of contract and arbitrary regulatory changes. At the time of the latest assessment, nearly one-half of the cases had been successfully resolved, resulting in the retention of $26.5 million in investments and 761 jobs.

Viet Nam introduced proactive management and resolution of investor grievances. Viet Nam has successfully attracted FDI as an important source of its economic growth for more than 30 years; however, the lack of consistent and predictable enforcement of its laws has consistently been reported by the business community as a significant concern. To help address this concern and to pursue other economic objectives, in 2018 the government of Viet Nam decided to move to a next-generation FDI strategy in the context of implementing the Comprehensive and Progressive Agreement for Transpacific Partnership and the European Union Free Trade Agreement. To better implement these agreements and reduce risk for foreign investors, the government established a pilot task force to increase retention of existing FDI. Viet Nam's new investment law included a mandate to manage investor grievances. Analysis has shown that from December 2018 to May 2020, the successfully resolved grievances amounted to $260 million of investment and 314 jobs retained (Kher, Obadia, and Chun 2021).

Mongolia adopted a systemic investor response mechanism to mitigate investors' concerns. While Mongolia's FDI peaked at $4.7 billion in 2011, it declined significantly to $10 million in 2015 and remained low during the COVID-19 pandemic and the Russian Federation's invasion of Ukraine. Investors reported concerns relating to economic and financial shocks, ineffective dispute resolution, and low stakeholder input into the policy-making process. Specifically, three major impediments to investment were identified: (a) ineffective mechanisms for providing investor protection, (b) policy makers' inadequate awareness of Mongolia's legal obligations, leading to violation of international agreements, and (c) insufficient communication across government agencies. To address these concerns, the government of Mongolia established a systemic investor response mechanism (SIRM) and the Investor Protection Council. These reforms resulted in changed organizational behaviors, including a shift from reactive to more proactive investment aftercare services, a focus on outcomes and results, and a new process for reporting on resolved investment grievance cases using data on investment and jobs retained rather than just counting grievances and complaints. At the time of the last analysis, the SIRM system had successfully retained investments worth $3.2 million. Moreover, foreign investors have reported satisfaction with how their grievances were being addressed. The government has also committed to accelerating the SIRM operation by intensifying policy advocacy and outreach campaigns with foreign embassies, business chambers, and the investor community.

PILLAR 3: FDI LINKAGES WITH LOCAL ECONOMIES TO HARNESS FDI SPILLOVERS AND BENEFITS

Linkages between FDI and local firms are an important channel for transferring new technology, knowledge, and improved standards to local firms in host countries. Closing the information gap between domestic firms and multinational enterprises and supporting supplier development programs can be key steps to increasing a country's investment competitiveness. Furthermore, a competitive domestic supplier base is attractive to potential new investors. Increased local linkages help embed foreign investors in the local economy and encourage them to apply a more long-term strategic vision for their investment in the country.

Despite the evidence of positive spillovers generated by FDI linkages, proactive effort is necessary to ensure that policy measures support these linkages. It is a function of multiple factors that include the spillover potential of FDI, the absorptive capacity of domestic firms, and the host country's policy and institutional environment. The scope and scale of FDI linkages and technology transfer can therefore vary significantly between countries. As a result, reforms geared toward supporting host country governments to strengthen the development of FDI linkages typically include the following components: (a) assessing the scope and size of the opportunity for FDI linkages and identifying policy constraints preventing that potential from being realized; (b) supporting governments in developing a strategy for linking high potential domestic firms to foreign investors and global value chains (GVCs); and (c) providing support for the design and implementation of supplier development programs (SDPs) that aim to connect businesses and improve firm competitiveness. The following examples from Viet Nam and Guinea illustrate how two governments have applied these reform principles in practice.

Viet Nam launched a supplier development program to upgrade local firms in partnership with multinational enterprises. Although Viet Nam has outperformed most regional competitors in terms of FDI inflows (IFC 2018), this success has not translated into increased domestic value added for the wider economy. While numerous multinational enterprises have been active in the country, they have typically specialized in labor-intensive, low-complexity, and final-assembly stages of GVCs. There have been weak linkages between foreign firms and local suppliers, who have often struggled to meet FDI firms' expectations and standards for quality, delivery time, and price. Compounding these impediments was a suboptimal policy framework hampering domestic value addition and upgrading within GVCs. To address these challenges, an FDI-SME (small and medium enterprise) linkages program was set up with a two-pronged approach. First, it focused on creating an enabling environment for linkages through policy reforms aimed at attracting next generation FDI with higher domestic value addition. Second, it launched an SDP to upgrade local firms in partnership with MNEs. Domestic firms received intensive support to build their business and production capacity through tailored training and matchmaking initiatives, including development of a supplier database to better link local suppliers with buyers. Results have shown that 70 percent of participating local suppliers increased their productivity, resulting in a 20 percent jump in their performance benchmark score. This increase has translated into 20 qualified new suppliers to MNEs and $13.4 million in supplies. Based on these results of the pilot program, the government launched a national database to help link 3,500 local suppliers with potential clients.

Guinea introduced an online local supplier marketplace to connect local firms with mining multinationals. In Guinea, economic growth has been closely linked to the development of the mining sector, with 25 percent of the country's GDP coming from extractives. However, with limited local production capacity, mining operators have tended to import products and services—meaning the local economy has seen disproportionately low benefits from the sector. To tackle this challenge, the government designed a program focused on improving the competitiveness of its local suppliers and closing the information gap between foreign investors and local businesses. The objective has been to help local suppliers secure more contracts, access new markets, and create better jobs. As part of this strategy, the government of Guinea launched the Guinean Online Local Supplier Marketplace to (a) allow mining operators greater access to information on local suppliers and allow local suppliers more information on tenders and procurement plans, (b) create visibility for local suppliers and confer credibility to their products and services, and (c) increase competitiveness of local suppliers via training sessions on managerial functions and supply chains. By 2021, the GOLSM facilitated $17 million in total contracts and registered 1,600 local firms on its platform. Moreover, six commercial banks were brought onto the marketplace and those banks provided $9 million in loans for upgrading technology and skills.

Overall, these examples from East Asia and Sub-Saharan Africa highlight how legal, policy, and institutional reforms can lead to a demonstrated impact in catalyzing investment. Although some of these programs started several years ago—as successful policy reforms require time to be appropriately designed and implemented—they are providing a robust foundation for countries' efforts aimed at seizing new opportunities and mitigating evolving risks presented by the changing FDI landscape.

CHAPTER 4

Policy Considerations

The challenging global macroeconomic environment and geo-economic fragmentation require new policy responses from countries seeking to leverage FDI for development. Adjustments in the geographic, sectoral, and structural patterns of FDI are creating a changing environment for FDI, increasing the reform urgency for countries to remain nimble and adaptable to seize these opportunities and maintain their investment attractiveness. Specifically, geographic changes to FDI flows in the form of reshoring and nearshoring, sectoral changes toward services and green investments, as well as the transformation of production caused by digitization and automation, can all present new opportunities for countries seeking to attract and leverage FDI for development. Furthermore, the urgency of the environmental challenge requires that countries make use of investment for climate change mitigation and adaptation. Given this context and the increasingly competitive global environment for FDI, developing countries are challenged to redouble their efforts to attract and retain investment.

A critical priority for policy makers is to reduce investor uncertainty and bolster investor confidence. The state of the global economy has led to high levels of international and domestic uncertainty, presenting risks to the outlook for economic growth and investment. Global conditions are also limiting companies' ability to anticipate future events, which is a key factor affecting investment decisions. Increasing investor confidence by reducing uncertainty is therefore a prime concern. Governments can reduce investor risk and build investor confidence by implementing transparent and predictable policy and regulatory regimes, reaffirming commitments to market access and rules-based international systems, and enhancing overall coordination and cooperation among stakeholders, such as host and home country governments, foreign investors, domestic business community, and civil society (World Bank 2020a).

The ongoing trade and investment liberalization efforts through regional and multilateral agreements also aim to increase investor confidence by reducing restrictions on investment and trade. These efforts should be complemented through domestic reforms focused on improving business environment and competition policy, enhancing macroeconomic stability, and improving legal and regulatory frameworks for FDI. Research demonstrates that domestic business environment, governance, and institutions have a positive effect on FDI and competitiveness. Yet the quality and predictability of the regulatory environments in many developing countries continue to be hindered by direct and indirect barriers to investment.

Clear and transparent rules and policies for FDI that are consistently and predictably enforced are therefore a core anchor of a competitive regime for FDI.[22] Liberalization efforts also help countries seize new investment opportunities emerging from the structural evolution of FDI. The reform examples from Sub-Saharan Africa and East Asia featured in this report highlight the role of FDI policies in increasing countries' investment attractiveness and in helping governments leverage FDI for boosting domestic companies' competitiveness. The World Bank's MNE survey evidence also shows that government policies and countries' legal and regulatory environments are among the top investment location factors considered by foreign investors. Moreover, survey results reveal that policies and regulations are the single most influential driver of business adoption of greener production practices and of improving companies' environmental performance. In fact, the positive impact of environmental policies is often twice as high as the role of investor and shareholder pressures or consumer expectations.

Countries should seek to attract and facilitate FDI that fosters sustainable development while simultaneously avoiding protectionist policies that could further elevate business and economic uncertainty. Fostering new investment opportunities entails identifying developing competitive sectors and value chain segments that are arising from the ongoing reorganization of global value chains and FDI landscapes caused by digitization and automation of supply chains and production, growth in intangibles and non-equity modes of investment, and potential nearshoring or friend-shoring trends. Appropriately targeted, carefully designed, and transparently implemented corporate tax incentives can play a role in leveraging FDI for advancing sustainable development goals. At the same time, the overall role of tax incentives in attracting FDI is often overestimated, and selective fiscal and financial support of specific sectors or industries—such as through subsidies—can distort trade and investment.[23] Furthermore, in the context of the expanding use of FDI screening mechanisms, it is key to take a balanced approach to policy making through enhancing states' ability to address essential security concerns—in a predictable, transparent, and administratively efficient manner—without weakening FDI promotion and attraction efforts.[24]

Retaining and expanding existing investments should constitute a complementary focus to attracting new investments. Reinvested earnings are a critical source of FDI, and the longer FDI projects remain in a country, the more they tend to expand and contribute to the host economy. To foster the retention and expansion of FDI, governments should seek to address investors' political and operational risks that can lead to withdrawing investments or canceling business expansion plans. Governments should provide for appropriate investment protection—including access to dispute settlement—in their investment laws and international investment agreements and promote proactive investment retention mechanisms. Such investor protection should be balanced with policy and regulatory space to enable governments to choose development paths based on sustainable development and climate change considerations. For instance, investment protection agreements should strive for high environmental standards and promote gender equality. The new generation of international investment agreements, such as the Protocol on Investment of the African Continental Free Trade Area and bilateral investment treaties like the European Union Sustainable Investment Facilitation Agreement, place new sustainability obligations on investors.

Because the benefits of FDI for the local economy are not automatic, governments need to put in place proactive policies and programs that promote FDI spillovers. These policies and programs can be directly focused on fostering linkages between foreign and local firms and promoting firm upgrading, for example through matchmaking or supplier development programs. Incentives to induce multinational enterprises to enhance environmentally sustainable practices, increase research and development, innovation, workforce training, and stimulate technology transfer with local suppliers are also encouraged. These policies and programs will become even more critical given the ongoing evolution in FDI patterns, including rise in services and green FDI, and the growing concentration in FDI flows.

Broader policies should also seek to strengthen firm- and economy-level absorptive capacity. Productivity spillovers from FDI are facilitated and are dependent on domestic firms possessing a sufficient level of absorptive capacity, allowing them to leverage new technologies and benefit from the presence of foreign-owned firms. The specific type of relevant policy will depend in large part on a country's economy and stage of development. What is most critical is an approach of continuous learning and adaptation for domestic firms and the domestic economy to maximize the benefits of FDI.

While FDI generates positive spillovers, it is also prudent to mitigate its possible negative externalities. FDI can be part of the development solution, but it also can be part of the problem, for example, through exacerbating income inequalities or contributing to greenhouse gas emissions.[25] This means governments must craft a policy architecture that taps into—and channels—the resources of multinational enterprises toward the challenges of building resilience to future shocks, reversing trends toward inequality, and coping with climate change. For example, conducive FDI policies will not automatically result in a substantial increase in low-carbon FDI or help decarbonize supply chains. Enabling policies for low-carbon investments should be complemented by specific regulations that seek to systematically internalize the cost of carbon emissions and facilitate low-carbon FDI and technology spillovers. Policy considerations for green, resilient, and inclusive development should therefore be an integral part of the strategic policy agenda for fostering FDI's development potential.

Policies by highincome countries can also have a sizeable effect on FDI patterns in both developed and developing countries. Industrial policies, for example, are gaining traction in advanced economies, and influence inward FDI flows in targeted industries. These measures may however divert potential investment away from countries that may lack specific fiscal or financial incentives, especially in developing countries (Kronfol, Steenbergen and Kett, forthcoming). An unequal level playing field between countries in the use of incentives to shape location decisions by firms can result in a relocation in investment away from developing economies. The wider use of government subsidies in several major economies keen to promote and secure domestic production of critical goods like semiconductors can lead to potential trade and investment distortions. Many developing countries are at risk of losing critical investment and missing out on opportunities to connect with thriving GVCs as they need to be able to compete at fair terms (World Bank 2023d). Multilateral cooperation will be needed to keep these distortions from escalating. It is essential for policy makers to consider the potential impact of their policies on other countries and ensure that they do not unfairly disadvantage developing countries.

Given the scale of private sector financing needs for development, official multilateral assistance should catalyze private capital and enable FDI. Major donors in close coordination with international financial institutions can play a critical role in facilitating and enabling increased private capital flows through cofinancing and derisking, as well as supporting domestic resource mobilization and increasing the efficiency of public spending. Finally, successful mobilizing of private capital requires bringing rigorous analysis, global knowledge, and focus on development outcomes to ensure maximum effectiveness of financial resources.

Tackling the complex challenges presented by the current global environment requires international cooperation and leadership. The COVID-19 pandemic and ensuing polycrises have illustrated the shared economic, public health, and environmental vulnerabilities that countries face. They have also highlighted the critical importance of strengthening coordination and collaboration. The magnitude and scale of the current crises necessitate that policy makers deploy their full set of policy tools to improve business confidence and boost countries' investment competitiveness. Maintaining an open and rules-based system, fostering global integration and outward-looking policies, solidifying trust among countries, and ensuring shared benefits from FDI and global value chain participation are key to the world's future sustainable and resilient growth.

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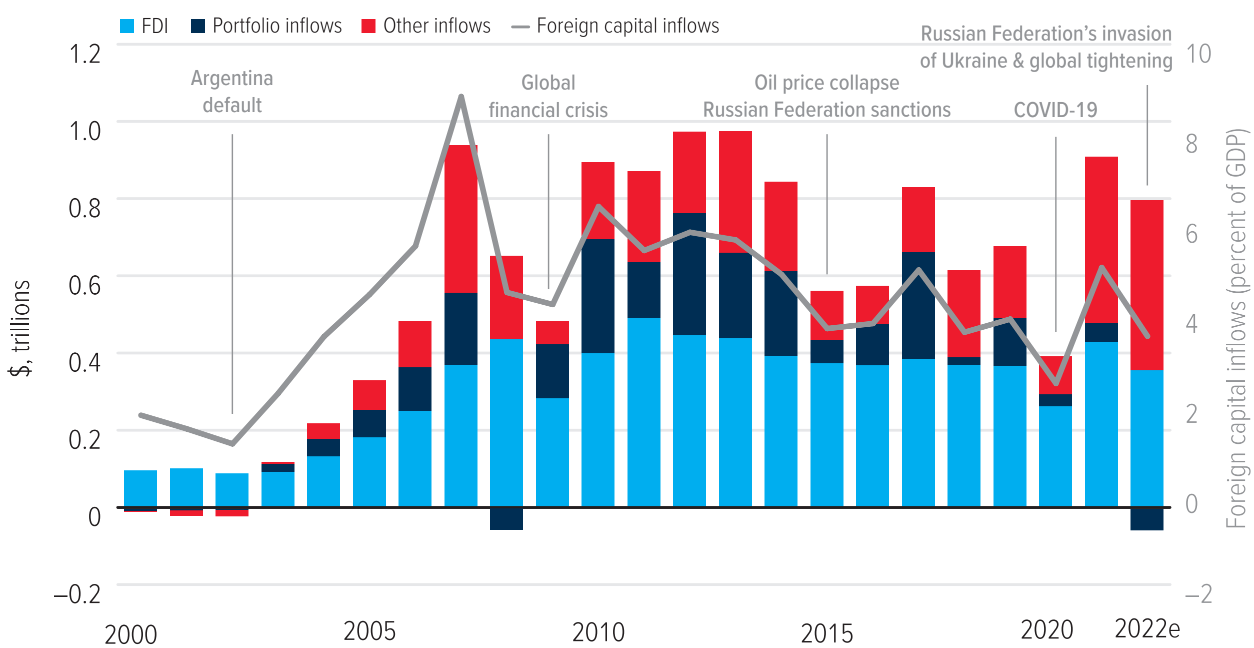
APPENDIX A

Supplementary Analysis for Chapter 1 on Evolving Landscape of Investment Flows

Figure A.1 | Foreign Capital Inflows to Developing Countries, excluding China, 2000–22



Source: IFC and World Bank staff calculations on IMF Balance of Payments (July 2023 update).

Note: Inflows are net of disinvestments and sales of assets held by nonresidents. Bars represent foreign capital flows in current prices, and the trendline represents their share of GDP. Data for 2022 were estimated by IFC staff based on high-frequency FDI data for selected developing countries and the country-specific internal databases; FDI = foreign direct investment; GDP = gross domestic product; IFC = International Finance Corporation; IMF = International Monetary Fund.

Figure A.2 | Total FDI Inflows, 2003–22 ($ billions)

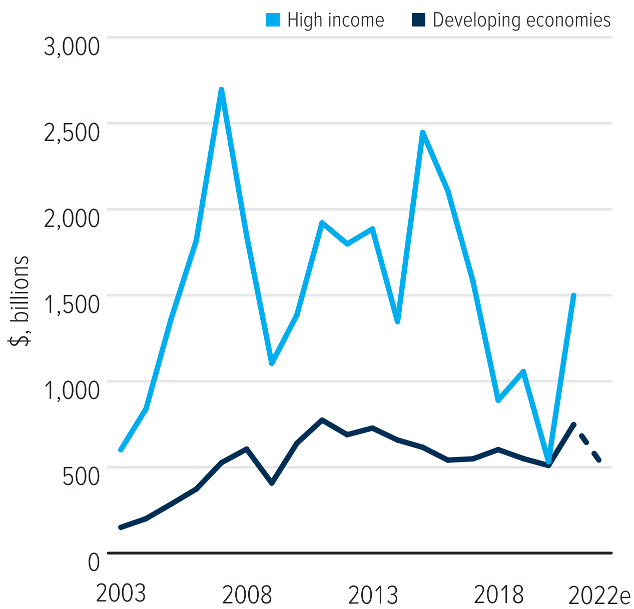
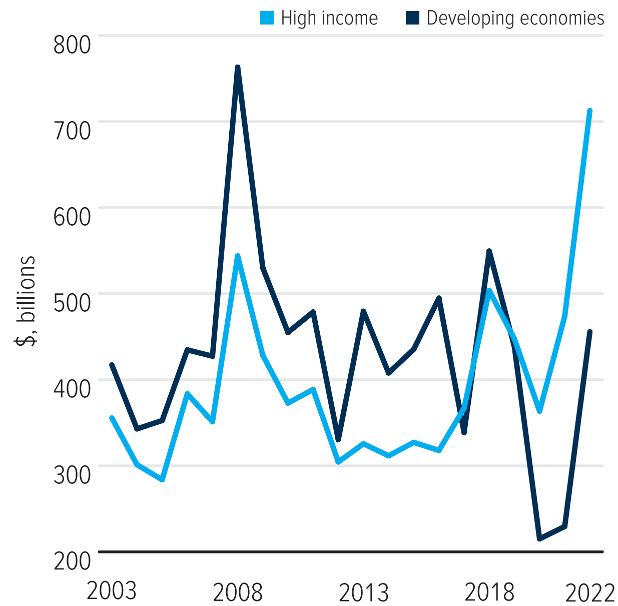
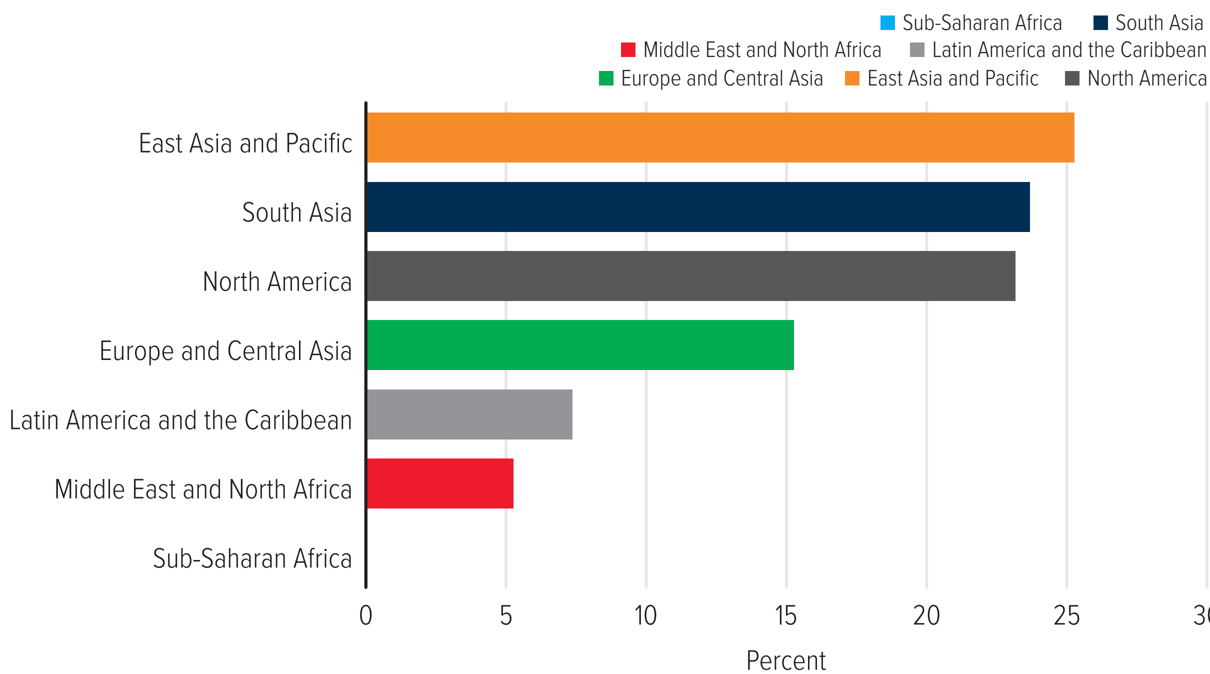


Figure A.3 | Greenfield FDI Announcements, 2003–22 ($ billions)



Source: IFC and World Bank staff calculations on IMF Balance of Payments (July 2023 update).
Note: FDI = foreign direct investment; IFC = International Finance Corporation; IMF = International Monetary Fund.

Figure A.4 | Regions Accounting for Expected Investment Relocation out of China



Source: World Bank 2021–22 Global Investment Competitiveness Survey data (World Bank, forthcoming).
Note: Computed using the following survey question asked of multinational enterprises planning to reduce their investment in China: "Over the next three years (2021–23), in which country do you expect your company to increase its assets the most?"

Figure A.5 | Sectors and Regions Accounting for Expected Investment Relocation out of China

By share of firms (percent)	Region of increase						
	EAP	SAR	MENA	SSA	ECA	LAC	NAM
Automotive manufacturing	20%	28%	3%	0%	20%	10%	20%
Food and beverage manufacturing	16%	11%	5%	0%	19%	5%	43%
Textiles and apparel manufacturing	51%	15%	8%	0%	13%	5%	8%
IT-enabled services and BPO	27%	45%	2%	0%	4%	8%	14%
Transport and logistics services	4%	8%	12%	0%	28%	8%	40%

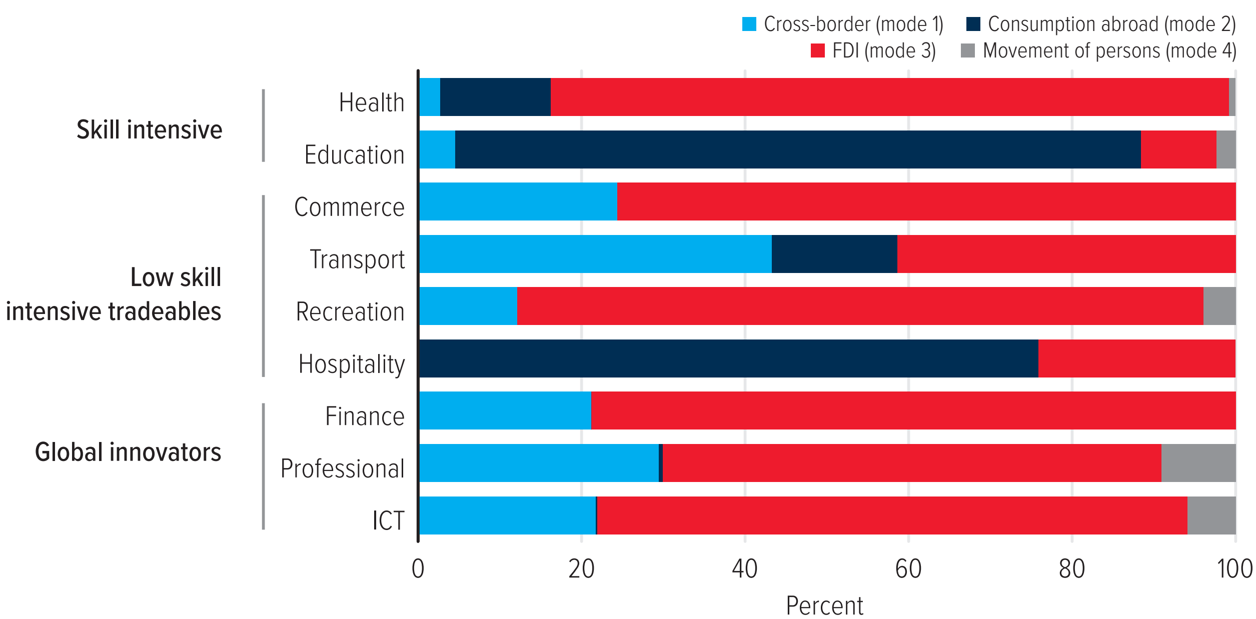
0% of relocation — > 50% of relocation

Source: World Bank 2021–22 Global Investment Competitiveness Survey data (World Bank, forthcoming).
Note: The survey comprised 1,060 business executives in global and regional headquarters. The surveyed firms accounted for 33 percent of total sector revenues globally based on 2019 data. Textiles and apparel manufacturing is the sector of most reduction in China. BPO = business process outsourcing; CAN = Canada; EAP = East Asia and Pacific; ECA = Europe and Central Asia; LAC = Latin America and the Caribbean; MENA = Middle East and North Africa; SAR = South Asia; SSA = Sub-Saharan Africa.

APPENDIX B

FDI Trends in Services

Figure B.1 | Distribution of the Global Trade in Services, by Sector and Mode of Services Trade

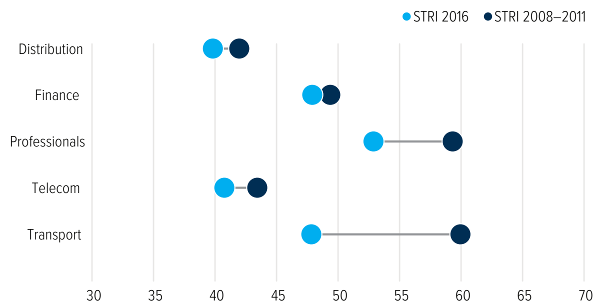


Source: Nayyar, Hallward-Driemeier, and Davies 2021.

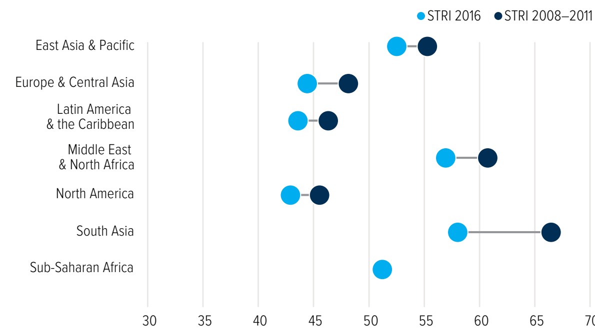
Note: The General Agreement on Trade in Services (GATS) framework distinguishes between four "modes" of trade in services: cross-border provision (mode 1, e.g., digital delivery), consumption abroad (mode 2, e.g., tourism, students studying abroad), foreign direct investment (mode 3), and the movement of natural persons (mode 4). FDI = foreign direct investment; ICT = information and communications technology.

Figure B.2 | Distribution of the Global Trade in Services, by Sector and Mode of Services Trade

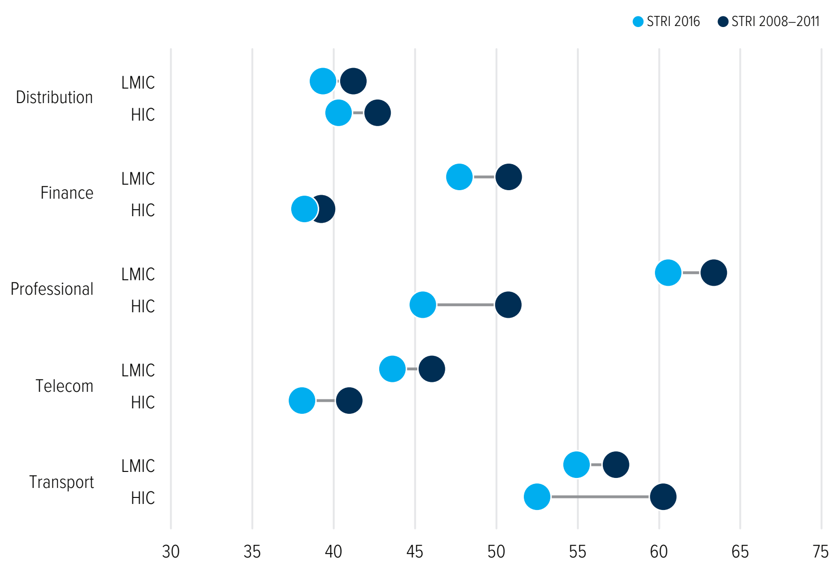
a. STRIs across sectors (mode 3 only), 2008–11 versus 2016



b. STRIs across regions (mode 3 only), 2008–11 versus 2016



c. STRIs across sectors (mode 3 only, developing countries versus high-income countries), 2008–11 versus 2016



Source: World Bank-World Trade Organization Services Trade Restrictions Index (STRI) Database.

Note: Only the mode 3 Services Trade Restrictiveness Indexes (STRIs) are shown. The mode 3 STRIs are defined only at a subsectoral level. Sectoral indexes are based on the simple average of all subsectors belonging to that sector. Regional indexes are based on a simple average across five sectors (distribution, finance, professional, telecommunications, and transportation). 0 = fully open, 100 = fully closed. HIC = high-income country; LMIC = lower-middle-income country; STRIs = Services Trade Restrictiveness Indexes.

APPENDIX C

High-Level Summary of Good Practice Elements to Implement Corporate Tax Incentives

All too often, policy makers overestimate the role of tax incentives in swaying investors. In turn, the projected benefits of these incentives are also overestimated, translating to a windfall for firms at the expense of lost tax revenue for governments. Beyond the budgetary implications, tax incentives carry other costs and risks, including rent-seeking, tax evasion, high administrative burdens, market distortions, and retaliatory behavior spurring a "race-to-the-bottom." The stakes are especially high in developing countries where fiscal, legal, and institutional challenges are more pronounced.

The following guidelines can help governments design and implement incentives strategically, in a manner that maximizes their value for money and minimizes the risks.

- **Use tax incentives sparingly to address identified market failures.** The purpose of granting tax incentives should be clearly defined. Is the primary objective to create more jobs, promote the absorption of foreign technology, or diversify the economy through investment in new sectors? Once the objective is articulated, policy makers should identify the underlying barriers and market failures (for example, underinvestment in public goods, skills mismatch or incomplete information to link foreign firms and domestic firms); evaluate whether tax incentives can effectively change investors' behavior to address those barriers and failures; and assess whether tax incentives are optimal, considering other measures (for example, legal or regulatory changes, broader reform of the tax system, or direct government investment in public goods). Even when tax incentives are suitable interventions, they are most effective when implemented within conducive investment environments characterized by enhanced connectivity and institutional efficiency, as well as stronger legal protections and streamlined business regulations.
- **Directly link incentives to defined policy objectives.** Developing countries rely on profit-based tax incentives, such as tax holidays and corporate income tax reductions, for FDI promotion. These instruments generally do not result in cost-efficient outcomes as they confer a blanket benefit, often based on up-front granting mechanisms, rather than actual investor performance. Instead, governments should consider shifting to merit-based incentive instruments, such as investment allowances, tax credits, and accelerated depreciation. Those tools have the advantage of directly tying incentives to targeted outcomes, for example, by providing allowances for research and devel-

opment (R&D) expenditures or tax credits for staff training programs.

- **Target investors strategically.** Policy makers first need to prioritize the type and quality of FDI they seek to attract, and then identify the subset of investors that are most responsive to incentives. Developing cost-efficient incentive schemes largely rests on identifying which type of investor ultimately decides to invest in one country over another because of tax incentives. Globally, incentives are more influential in attracting efficiency-seeking FDI, which is export-oriented, because such investors are mainly driven by competitive cost advantages in host countries, as opposed to natural resource– or market-seeking FDI. Also, a more detailed analysis of country-level data on the profitability of firms with and without incentives can help distinguish the types of sectors and characteristics of investors that are more sensitive to possible gains from incentives.
- **Rigorously evaluate the costs and benefits.** An ex-ante analysis paired with a monitoring and evaluation framework during and after implementation would provide critical data to consider the performance of incentives policy. Key inputs into this evaluation are estimates of tax expenditure, that is, the tax revenue that would have been collected in the absence of incentives. These data, paired with information on the targeted outcomes and the responsiveness of investors, can help reveal how the costs compare with the benefits, and can inform whether the incentives need to be revised or phased out.
- **Promote transparency and rule-based administration.** When implementing incentives policy, institutional coordination, bureaucratic effectiveness, and transparency matter—not only to sustain accessible and streamlined systems, but also to reduce opportunities for discretion and to ensure a level playing field for firms. Information on tax incentives should be publicly available in a user-friendly format, and tax expenditure estimates should be incorporated into the budgetary process (Kronfol 2020).

Table C.1 | Incentives Instruments and Compatibility with GMT Rules

Incompatible with GMT[a]	May be compatible but will depend on circumstances[b]	Should be compatible with GMT
Tax holiday arrangements	Reduced-rate incentives (patent, IP)	Tax incentives targeted at pure domestic companies (not part of an MNE group)
Zero corporate tax	Non-GMT compliant tax incentives on refundable tax credits[c]	Preferential rates above 15% for start-up businesses
Effective tax rates below 15% in the absence of the qualifying domestic minimum top-up tax	Cash incentives (will be considered as grant income for IIR purposes)	Unlimited loss carry-forward
Tax-free zones		Accelerated depreciation
		GMT-compliant refundable tax credits[d]

Source: O'Sullivan and Cebreiro Gómez 2022.

Note: GMT = global minimum tax; IIR = income inclusion rule; IP = intellectual property; MNE = multinational enterprise.

a. These incentives are unlikely to be compatible unless there is a possibility to blend rates at a jurisdictional level or such incentives may be targeting out-of-scope entities (for example, smaller businesses below the threshold or purely domestic businesses).

b. Individual country circumstances will be particularly relevant for this category of incentives with respect to compatibility.

c. A qualified refundable tax credit will be treated as income under GMT rules, while a nonqualified refundable tax credit will be treated as a reduction in tax. The latter will be potentially subject to a top-up tax that will nullify the impact of the tax credit.

d. Qualified refundable tax credits could reduce effective tax rates (ETRs) below 15 percent and therefore would need to be assessed.

APPENDIX D

Examples of FDI Policy Reforms

INVESTMENT ATTRACTION AND FACILITATION THROUGH TARGETED REFORMS TO SEIZE OPPORTUNITIES IN NEW SECTORS

Indonesia: Removing sectoral discrimination toward FDI across multiple sectors

Context and challenge

Indonesia has historically had a rather restrictive legal regime for FDI. Among the high- and middle-income countries measured by the OECD FDI Regulatory Restrictiveness Index, Indonesia showed some of the highest FDI restrictions due to Indonesia's negative investment list (*Daftar Negatif Investasi*, DNI) imposing different types of restrictions on investments, particularly foreign equity limits. Until early 2021, the DNI applied at least one investment restriction in almost one-third of all economic sectors, and in 20 percent of them, it either limited foreign equity participation or prohibited foreign investment altogether. Yet such foreign entry restrictions can significantly inhibit FDI inflows. Evidence shows that liberalizing FDI restrictions by about 10 percent, as measured by the OECD FDI Regulatory Restrictiveness Index, could increase bilateral FDI in stocks by an average of 2.1 percent (Mistura and Roulet 2019).

Approach

With the COVID-19 crisis acting as a catalyst, the government of Indonesia implemented one of the most ambitious investment reform programs in decades. The Omnibus Law on Job Creation aimed to improve the investment climate by amending dozens of individual laws. The Parliament promulgated the Omnibus Law in November 2020. The first wave of implementing regulations (in the form of government regulations and presidential regulations) was issued in February 2021; foremost of those regulations was the Presidential Regulation on Investment, which reduced the number of business activities subject to at least one investment restriction from 813 to 260.[26] This reform eliminated foreign equity limits across a wide range of sectors. Specifically, the reform turned many sectors where FDI was not allowed or restricted by minority shareholding into sectors fully open to FDI (that is, up to 100 percent foreign equity). Examples of such sectors include mobile and fixed telecom services, power generation, fishing, horticulture, small- and medium-size supermarkets, seaports, airports, shipping lines, distribution, and auto repair services. Furthermore, Government Regulation No. 34/2021 on Foreign Workers complemented this first set of reforms by facilitating a more adequate supply of highly skilled professionals for the labor market.

The World Bank supported these reforms through lending and advisory services (World Bank 2021a). The development policy lending built on the World Bank's long-standing assistance to Indonesia on trade and investment reforms. Technical assistance had been provided in previous years, while the challenges related to the liberalization of the foreign investment regime were analyzed in depth in the 2020 Systematic Country Diagnostic Update. FDI liberalization had been consistently flagged as a focus area in the policy dialogue with the authorities. The sweeping reforms undertaken by the government in 2020–21 provided an opportunity for the World Bank to build on previous assistance and align its support to the government's program through investment and trade development policy lending. The complementary assistance of the International Finance Corporation focused on reviewing the FDI policy, the negative investment list, and other key sectoral policies and legislation to identify barriers and formulate recommendations. Throughout the program's life cycle, the team was deeply involved in making the case for the liberalization of foreign and domestic regime and providing technical support to the government on the topic of removing foreign investment restrictions to boost the Indonesian economy.

Results

The implementation of the Omnibus Law significantly liberalized Indonesia's foreign investment regime. This liberalization has moved Indonesia from one of the most restrictive to one of the more open FDI regulatory regimes in the East Asia and Pacific region. The new law raised Indonesia's attractiveness to FDI at an opportune time, as investors are increasingly searching for new production bases while global value chains reconfigure. Estimates of the impact of the reform suggest it could generate between $4.1 billion and $6.0 billion in additional investments, both foreign and domestic, in the liberalized sectors (World Bank 2021a). Moreover, removal of restrictions to investments would, in the longer term, foster market entry, improve commercial performance, and tame price increases, owing to stronger competition (World Bank 2020b). Removal of DNI restrictions would, in parallel, have a positive impact on export-oriented manufacturing plants, thus improving competitiveness and strengthening Indonesia's position in global value chains while also crowding in domestic investment. As a longer-term outcome, Indonesia is expected to benefit from larger sources of technology, knowledge transfer, and external funding for the economy, all of which are critical to support Indonesia's long-term productivity growth. Stronger FDI would thus eventually boost employment and gross domestic product growth, especially if received in sectors that support technology transfer and are linked to domestic economy (Irsova and Havranek 2013).

Ethiopia: Liberalization of Ethiopia's economy to FDI

Context and challenge

Although Ethiopia was among the fastest growing economies over the past decade and a half, with double-digit growth in many years, much of its growth was dominated by public investment. The share of private investment, especially FDI, was low. Before the rapid pace of reforms that characterized Ethiopia's economy in the years immediately preceding the COVID-19 pandemic, several factors hindered FDI attraction and retention in Ethiopia. These factors included legal barriers to FDI, administrative bottlenecks, and weak institutional capacity for proactive investment promotion. Specifically, investment legislation followed an outdated positive list approach—allowing investments only in explicitly listed sectors—while it kept many other sectors closed for foreign participation, including banking, telecommunications, and other commercially critical industries. Moreover, the national investment promotion agency—the Ethiopian Investment Agency, later re-branded as the Ethiopian Investment Commission—had a weak mandate and it had low technical capability to provide investor services.

Approach

The investment policy and promotion advisory program of the World Bank Group, which was started in 2015 as the first in a series of investment policy engagements in Ethiopia, focused on (a) reducing legal and administrative barriers to foreign investment; (b) enhancing investor confidence by improving transparency and predictability in investment policy implementation; and (c) strengthening investment promotion in target sectors. One specific target area was the liberalization of the maintenance service sector. Before the reform, Ethiopia's investment legislation—including its Investment Proclamation (No. 769/2012) and Investment Regulation (No. 270/2012)—was overly restrictive and in various areas was not in conformity with international good practices. Sectors such as maintenance services were closed for foreign direct investment. The limited availability of maintenance, repair, and servicing operations in the country imposed serious burden on domestic and foreign investors in various sectors and industries, especially those operating large factories, machinery, and most importantly, medical devices. This burden had a significant negative impact on firm operations, efficiency, and ultimately, productivity. Consequently, based on the request of the Ethiopian government, the WBG supported the preparation of the reform agenda to liberalize maintenance, repair, and servicing operations in two major areas: general industrial maintenance services (that is, for machineries, factories, etc.) and maintenance and services operations of medical devices. The reform attracted several foreign firms that specialized in industrial machinery and in medical device manufacturing and maintenance.

Results

The overall investment policy and promotion advisory program successfully catalyzed Ethiopia's adoption of several key reforms, unlocking opportunities for private investment. An independent evaluation of the legal, regulatory, and institutional reforms realized through this project during 2015–18 estimated $96 million of new FDI and more than 11,000 new jobs—all directly attributed to the project. The specific legal reforms supported by this project included the opening of at least six sectors that were previously closed for FDI (logistics, capital goods leasing, maintenance, bonded input warehouse, printing, and packaging), visa and work permit process improvement, reforms supporting government-investor feedback loops and dialogue, and key legal reforms such as adoption of a model bilateral investment treaty. These reforms have resulted in not only the creation of new markets, but also an expansion and enhancement in the competitiveness of existing sectors. In addition, the project modernized the Ethiopian Investment Commission, building its capacity to undertake proactive outreach that led to new investments in priority sectors such as textile, apparel, and pharmaceuticals. Overall, in part thanks to these reforms, Ethiopia's FDI grew ten-fold, from an annual average of around $300 million in the early 2010s to $3 billion in the years preceding the COVID-19 pandemic. Moreover, while the first year of the pandemic caused a dip in Ethiopia's FDI inflows to $2.4 billion, in 2021 the flows recovered to an all-time high of $4.26 billion.

South Africa: Boosting South Africa's investment attractiveness by building investor confidence and enhancing investment promotion

Context and challenge

In 2017, FDI inflows into South Africa hit a new low, following a precipitous multiyear decline from FDI levels of $8.3 billion in 2013 to $1.7 billion in 2017 with outflows of $7.4 billion in that year. Among other influences, the decline in FDI and increase in capital outflows had been influenced, in part, by negative investor sentiment over the previous few years, concerns about the ease of doing business (reflected in South Africa's regression in the World Bank's annual *Doing Business* report from a global ranking of 29 in 2004 to 82 in 2018), concerns about competition policy and market contestability, and apprehensions about the market dominance of state-owned enterprises.

To address the challenges that had precipitated the decline and to meet the targets of the National Development Plan, the government of South Africa constituted an Inter-Ministerial Committee on Investment, which engaged the World Bank Group to support its prioritization of the following:

- Improve South Africa's business environment by enhancing its performance on such benchmarks as the World Bank's annual *Doing Business* report, as well as addressing sector-specific regulatory burdens.
- Enhance FDI inflows into South Africa by developing an FDI strategy that identifies sectors where South Africa has competitive advantages, improving investor confidence and removing any barriers to investment in such sectors.
- Enhance investment generation through capacity development for InvestSA's promotional unit, upgrading investor services to enhance responsiveness and ensuring coherence between national and subnational investment promotion outfits.

In addition to a cooperation agreement signed in 2018 between the Department of Trade, Industry, and Competition and the World Bank Group, IFC worked with the government of South Africa on a multicomponent technical advisory program that aimed to support the national and subnational governments of South Africa on a range of initiatives to:

a. tackle key business climate constraints and barriers to transparency, predictability, and efficiency, to increase investment and create jobs;
b. improve competition policy and market regulations to permit competition in key markets in South Africa, permit the implementation of competition policies to combat anticompetitive business practices, and improve policy coordination and implementation among national and subnational government bodies;
c. enhance FDI inflows into South Africa by identifying sectors where South Africa has competitive advantages and by working with counterparts to address barriers to investment in such sectors; and
d. support investment generation by ensuring coherence between national and subnational investment promotion bodies and by supporting their capacity development to address negative investor perceptions and improve investor confidence.

These initiatives were elevated by the Presidency in its public undertaking in the 2018 State of the Nation address to make South Africa one of the top 50 economies in the World Bank's annual *Doing Business* report and to generate $100 billion in investment in five years. Key counterparts to deliver on the government's undertakings were the Department of Trade, Industry, and Competition, InvestSA, the Competition Commission, the National Treasury, and a number of provincial and metropolitan (subnational) governments.

Approach

The World Bank Group engagement to support investment generation began with an Investment Reform Map that undertook a series of diagnostics to identify policy, institutional, legal, and regulatory barriers to FDI. This was augmented by a structured sector scan that presented various lenses, some mutually exclusive, including employment creation, FDI attraction, and GDP growth. This process helped the government of South Africa identify sectors that could generate significant domestic and foreign investment. The

World Bank Group team also undertook an assessment of the landscape for investment promotion in South Africa through an extensive survey of investors to understand the investor experience with InvestSA's institutional capacity for promotion and retention. Key findings from the assessment demonstrated the following:

- A proactive focus in more than 30 industry segments for investment promotion at the national level was not a strategic approach and yielded significant droppages.
- National and subnational investment promotion agencies did not have critical tools and the necessary capacity to support their investment generation and retention efforts.
- The three spheres of government in South Africa, each with relative autonomy, meant that investment promotion efforts across national, provincial, and municipal levels were fragmented and incoherent.
- National and subnational investment promotion agencies (IPAs) did not have dedicated investment aftercare or retention units.

Technical support was rendered based on the findings of the Investment Reform Map, and the national investment promotion agency, InvestSA, developed a framework to strengthen the team's strategic focus through sector prioritization and institutional capacity to deliver investor services. In multiple engagements and workshops with InvestSA, the team socialized the Investment Reform Map recommendations on InvestSA positioning within the context of the investor experience and highlighted institutional limitations. Those limitations included the absence of a corporate plan, the absence of terms of reference and performance indicators for staff to actualize the corporate plan, and the absence of critical client relationship management tools to support investment generation and retention.

The program team, working directly and through technical experts embedded within InvestSA, provided ongoing technical expertise and support to InvestSA to address capacity constraints and to drive investment promotion and retention efforts. Specifically, the partnership created an ecosystem for enhancing operational efficiencies within InvestSA through adoption and implementation of a new corporate plan, adoption of investor engagement tools such as a customer management relationship system and a modern website, the development of South Africa–investment propositions, and articulation of an investment promotion strategy with a proactive focus on 12 sectors showcased at annual investment conferences. The program also supported the creation of a high-level Investment and Infrastructure Office at the Presidency. This office was a critical tool for intragovernmental coordination to unblock investments that could not proceed because of regulatory barriers, as well as activation of a national/subnational IPA coordination framework (CEO Forum) that ensures coherence in investment promotion, facilitation, generation, and retention across the three spheres of government in South Africa.

Results

The partnership between the government of South Africa and the World Bank Group yielded a measurable increase in investor confidence in InvestSA as a consequence of its internal reorientation. InvestSA, which currently has primary responsibility for delivering on the Country Investment Strategy, works closely with the Presidency and has played a key role in developing and defining South Africa's approach to FDI and refining the institutional infrastructure for investment mobilization. Principal outcomes of the partnership with the government of South Africa include the following:

- Operational efficiencies of InvestSA evidenced by adoption of a new operational Corporate Plan
- Creation and application of key performance indicators

- Adoption of customer relationship management (CRM) system
- Creation of a dedicated unit to support investment retention focus and deployment of new InvestSA website
- Three successful investment conferences (2018, 2019, and 2020) executed with program support which yielded significant leads
- Quantifiable conversion of investment leads developed through program support to investments

Since 2018, successful annual investment conferences hosted by the Presidency, which sought to address such barriers as negative investor perceptions, have confirmed that the range of reforms delivered through the partnership were effective in arresting the decline of FDI inflows, stemming FDI outflows, and generating high volumes of FDI. As of April 2022, confirmed investment inflows from four conferences totaled $95 billion (95 percent of the $100 billion five-year target set by the Presidency in the 2018 State of the Nation address). The very rigorous World Bank Group impact assessment—assessed at 40 percent of the value of investment from investors who would not have invested but for InvestSA's support—has affirmed that the partnership with InvestSA has generated more than $375 million in new investment and retained $5 million in existing investment.

Specifically, according to InvestSA's CRM, investment project leads developed through the first three investor conferences included 152 investment leads and 103 investment announcements at the conferences. These were translated into investments through an operationally enhanced InvestSA, which demonstrably led a quantifiable conversion of investment leads to commitments and investments. The program's focus on investment retained was achieved thanks also to the Investment and Infrastructure Office in the Presidency, which elevated InvestSA's oversight and interagency coordination to address investor challenges. This has allowed for a number of tracked investments that were hindered by regulatory barriers to proceed, thus retaining $5 million from those tracked investments.

INVESTMENT RETENTION AND INVESTOR GRIEVANCE MANAGEMENT

Rwanda: Establishing an investor grievance mechanism within the IPA (Rwanda Development Board)

Context and challenge

Although Rwanda had made significant efforts to improve its investment climate, research showed it had unrealized potential to improve its performance in terms of investment attraction and retention. The country faced investment-related issues, particularly with respect to transparency, predictability, and contract enforcement. To increase investment attraction and retention, the Rwanda Development Board (RDB), the country's investment promotion agency, requested the World Bank Group's assistance in developing an investor grievance mechanism (Kher, Obadia, and Chun 2021).

Approach

The approach focused on reinforcing RDB's Aftercare Division by augmenting its role to become the Reinvestment and Investor Aftercare Department. It expanded its mandate to include issues of established investors arising from government conduct, particularly those with a high risk of investors leaving or potential state liability for the violation of laws or contracts. The reform instituted a new formalized process whereby if the investor grievance could not be solved at the level of the Reinvestment and Investor Aftercare Department, it would be escalated through the bureaucracy at several different levels. First, it would go to the Investment Committee, chaired by the chief investment officer and comprising the heads of the Investment Office within the RDB. Second, it would move to the RDB chief executive officer (CEO), which is a cabinet-level appointment. Third, it would go the Private Investment Committee, composed of the RDB

CEO, the minister of finance, and a representative of the Office of the President. Specifically, Article 15(3) of the new investment law specified that the Private Investment Committee may "discuss investors issues and propose acceleration measures to resolve them." Finally, if needed, the issues would be submitted to the Cabinet.

Results

As of April 2021, the Reinvestment and Investor Aftercare Department registered 17 high-risk issues arising in different sectors, including agriculture, energy, food manufacturing, health, information and communications technology, services, and tourism. Analysis shows that half of the cases fell within the category of breach of contract—principally because of the absence of payment by the relevant government agency—while the other half were linked to sudden or arbitrary regulatory changes. Initial assessment shows that half the cases have been successfully resolved, resulting in $26.5 million investment retained and 761 jobs retained.

Viet Nam: Developing a mechanism for prevention and settlement of grievances

Context and challenge

Viet Nam has successfully attracted FDI as an important source of economic growth for more than 30 years. However, the lack of consistent and predictable enforcement of the legal framework has consistently been reported as a significant concern by the business community in Viet Nam. To help address this concern and to pursue other economic objectives, in 2018 Viet Nam decided to move to a next-generation FDI strategy in the context of implementing the Comprehensive and Progressive Agreement for Transpacific Partnership (CPTPP) and the European Union Free Trade Agreement (EU FTA).

Approach

To better implement the agreements, the government of Viet Nam established a pilot task force led by the director general of the Foreign Investment Agency (FIA). Focusing on political risks, the task force comprised eight members from the FIA, other departments of the Ministry of Planning and Investment, the Ministry of Justice, and the Office of Government. Part of the mandate of the task force was to pilot and develop the SIRM aimed at addressing investor issues and retaining existing investment. Resolution 50 of the Politburo of the Communist Party, adopted in August 2019, provided the overall direction for establishment of the SIRM. In June 2020, Viet Nam passed its new Investment Law, which also included a reference to the SIRM. The government worked on an implementing decree for the law providing more details on the SIRM. A detailed report on the pilot SIRM was also submitted to the prime minister in November 2020, paving the way for scaling up the pilot once the legal framework was in place. Through the initial pilot, the task force gained experience in data collection and analysis of grievances. FIA was particularly well positioned to coordinate the retention mechanism by leveraging its role as the coordinator for the Viet Nam Business Forum, the public-private dialogue between the FDI community and the government of Viet Nam. The standard operating procedures of the task force stipulated that if the grievance was not resolved at the technical level through a discussion between the task force and relevant agencies, the task force would prepare a report on the cases that included a legal and economic assessment, task force recommendations, and the position of the relevant ministry. The report would be submitted to the prime minister's office for consideration and decision. All activities of the task force would be recorded on a log sheet, allowing for easy follow-up and preventing duplication of activities.

Results

Between December 2018 and May 2020, 31 grievances were recorded in the tracking tool and log sheet. As of May 2020, successfully resolved grievances amounted to $260 million of investment retained and 314 jobs retained (Kher, Obadia, and Chun 2021).

Mongolia: Establishment of a Systemic Investor Response Mechanism

Context and challenge

Mongolia's FDI peaked at $4.7 billion in 2011, but then declined significantly to $10 million in 2015 and remained low during the COVID-19 pandemic. The pandemic and the Russian Federation's invasion of Ukraine have heightened the urgent need for Mongolia to diversify and enhance the competitiveness of its economy given its close economic ties with both the Russian Federation and China. The potential impacts of the Russian Federation's invasion of Ukraine and continuation of border closure with China are likely to significantly influence the economy, as evinced by the drop of economic growth forecasts from pre-war 5.1 percent to 2.4 percent. The new government has prioritized attracting greater private investment, both foreign and domestic, as a key pillar of its COVID-19 recovery strategy.

Many of Mongolia's foreign investments have traditionally been in extracting the country's lucrative mineral resources, but investors reported concerns relating to economic and financial shocks, ineffective dispute resolution, and low stakeholder input into regulation. Those concerns were deemed as significant impediments to investing in the politically sensitive sectors. Specifically, three major problems pertaining to investment retention were identified:

- Lack of an effective systematic method for addressing investor problems relating to investor protection. IFC's Study on Investor Protection showed that government-investor consultations were rarely effective, often because relevant public agencies did not have knowledge or awareness about the investor issues involved, nor did they have the technical skills to engage in consultations with affected investors.
- Inadequate awareness of Mongolia's legal obligations under domestic and international law. This has been one of the main causes of the violation of international guarantees and agreements.
- Insufficient communication among government agencies. Investors would continue visiting multiple agencies, because remedying a grievance requires approvals and actions by more than one agency and there is no mechanism for collaboration among agencies. As a result, the Ministry of Justice would receive sudden notice of international arbitration on violation of investors' guarantees, which creates a vicious circle of reacting to the issue rather than detecting it at an early stage to prevent international and domestic disputes.

Approach

IFC has supported the government of Mongolia to establish a systemic investor response mechanism. This process began with the establishment of the Investor Protection Council (IPC) in 2016, chaired by the minister of the Cabinet Secretariat, and continued to evolve with the appointment of the National Development Authority as the working Secretariat in November 2018. The process is regulated by a SIRM bylaw and monitored through an IT tracking tool that was launched in June 2020. The SIRM resulted in changed organizational behaviors—from reactive to more proactive in aftercare services—including becoming more focused on outcomes, reporting on solved cases using investment retained and jobs retained rather than just counting received grievances and complaints. IFC also worked in close collaboration with the foreign business communities, including the Japanese business community, by organizing meetings between them and the National Development Authority to discuss issues companies faced and to increase their participation in public-private dialogue.

Results

At the time of the last analysis, the SIRM system has received more than 30 investor grievances. By June 2021, the SIRM had successfully retained investments worth $3.2 million and foreign investors have reported satisfaction with their grievance being addressed. The government has also voiced its commitment to accelerate the SIRM operation by intensifying policy advocacy and an outreach campaign with foreign embassies, chambers, the business community, and law firms.

DEVELOPING STRONGER LINKAGES WITH LOCAL ECONOMIES AND SUPPORTING PIONEERING LOCAL BUSINESSES

Viet Nam: Pilot Supplier Development Program in partnership with large multinational enterprises

Context and challenge

Viet Nam is an FDI success story. Open-door investment and trade policies have led annual FDI inflows to increase almost ten-fold in the past decade to outperform most regional competitors (IFC 2018). As a driver of the country's rapid economic development, competitiveness, and inclusive prosperity, FDI has generated employment opportunities and diversification of exports. Chiefly attracted by low labor costs and generous incentives, FDI firms are major players in manufacturing production and exports and typically specialize in labor-intensive, low-complexity, and final-assembly stages of global value chains—primarily exporting apparel, shoes, and mobile phone handsets. This approach has been impactful for Viet Nam: as a share of GDP, FDI inflows into the country exceed those into China and most large Association of Southeast Asian Nations (ASEAN) countries (World Bank 2021b). However, there is a growing realization that Viet Nam requires breakthrough reforms to unlock the next generation of FDI and compete for higher-quality streams of investment.

Despite record inflows of FDI, the country faced a "Viet Nam paradox"—successful in attracting numerous multinational enterprises, particularly as a direct beneficiary of firms' "China plus one" strategy—to become a regional manufacturing hub, but Viet Nam has not experienced tangible benefits from domestic value add and spillovers into the wider economy. A key obstacle has been weak links with local suppliers. While numerous global MNEs, such as Foxconn, Samsung, and Toyota, are active in the country, the share of parts that they and other FDI firms source locally is extremely low. In 2015, Japanese firms—large foreign investors in Viet Nam—sourced only 32 percent of inputs from local suppliers, much lower than in China (65 percent), Thailand (55 percent), and Indonesia (40 percent). These porous links have resulted from a dearth of productive domestic suppliers capable of meeting FDI firms' quality, delivery time, and price standards. Weaknesses in quality control and environmental risk management, R&D, and new product development have been apparent in local suppliers. Compounding these impediments was a suboptimal policy framework hampering local private sector development, domestic value addition, and upgrading within global value chains.

Approach

In 2016, IFC launched a small and medium enterprise (SME)-FDI linkage project to help address the above-mentioned issues. The project took a two-pronged approach. First, it focused on creating an enabling environment for FDI-SME linkages through policy reforms aimed at attracting next-generation FDI with higher domestic value addition. Second, it sought to enhance FDI-SME linkages and spillovers by launching a pilot supplier development program (SDP) to upgrade 45 local firms in the first phase and 25 in the second phase in partnership with multinational enterprises (Panasonic, Canon, Toyota, Denso, Bosch, GE, Datalogic, Ford). The SDP aimed to build linkages and to act as a best practice example for the government to replicate, as well as to trigger catalytic impacts within the respective sectors. To elevate the performance of domestic firms, they received intensive project support to build their business and production capacity through tailored training and mentoring. Various matchmaking initiatives were launched, including development of a supplier database to better link local suppliers with buyers.

Results

This initiative achieved strong development results and met or exceeded all project targets. The targeted, intensive support and mentoring under the pilot SDP triggered dramatic improvements in participant local suppliers' capacity, with a 20 percent jump in their performance benchmark score and 70 percent of firms with increased productivity. This translated into 20 qualified new suppliers to FDI/MNEs, 38 new contracts signed, and $13.4 million in supplies provided by local firms to their FDI clients. Furthermore, the SDP has been replicated by the government since 2019 to sustain the intervention. In addition, the country's first national database was launched, facilitating matchmaking activities and linking 3,500 local manufacturing and supporting industry suppliers with potential clients.

The project was equally influential in the policy sphere with the formulation and enactment of Viet Nam's FDI strategies for 2021–30, including a Politburo Resolution on orientation for FDI attraction in 2019 and the new Investment Law in 2020 and its implementing regulations in 2021. These reforms have encompassed enhancing the investment incentive regime, modernizing investment promotion and proactive investor outreach in targeted sectors, enhancing the investment climate, and establishing the legal foundations for an investment dispute prevention mechanism.

Guinea: FDI linkages program on closing information gaps and introducing a platform that encourages broad business participation

Context and challenge

Economic growth in Guinea has been closely linked to the development of the mining sector. But even though 25 percent of GDP comes from extractives, the local economy has seen disproportionately low benefits from the exploitation of the country's rich mineral deposits. Due to low local capacity and unskilled labor force, mining operators have tended to import products and services rather than seek to work with local suppliers. Countries in the region have adopted legal requirements for local procurement quotas, even though such interventionist measures are bound to backfire in the absence of competitive local supply chains or skilled labor force. The government of Guinea chose a different strategy. Contrary to other countries in the region, Guinea focused efforts and resources on improving the competitiveness of its local suppliers; closing the information gap between foreign investors and local businesses; and helping local suppliers get more contracts, access new markets, and create better jobs.

Approach

As part of its strategy, the government of Guinea launched the Guinean Online Local Supplier Marketplace in November 2018. GOLSM is based on Decree 278/2018 on the Creation of the Guinean Online Local Supplier Marketplace. The decree stipulates that GOLSM is to be implemented by a not-for-profit organization with a supervision board composed of representatives of public institutions. The main objectives of GOLSM are as follows:

- Close the information gap between FDI and Guinean suppliers, by allowing mining operators to access information on Guinean suppliers and by allowing Guinean companies to access information on tenders and procurement plans and become validated suppliers.
- Create visibility for local suppliers and confer credibility as to their production capacities and quality of services with the goal of facilitating partnerships with mining operators.
- Increase the competitiveness of Guinean suppliers. GOLSM organizes training sessions for

Guinean companies on procedures required for validation and access to the supply chain, standardization, improving managerial functions, increasing access to finance, etc.

GOLSM has been designed based on multiple stakeholder participation workshops with both potential buyers and potential suppliers, with several supplier workshops taking place in Conakry and Boke. It is self-sustainable financially, with both supplier and buyers paying annual fees to access the information available on the platform. The platform also includes a capacity-building component, as the team managing the platform is mandated to organize training and workshops for local suppliers to help them improve their competitiveness.

Results

By June 2021, the GOLSM had resulted in $17 million in total contracts facilitated through the platform, from which 44 Guinean firms benefitted. Registration expanded to include 1,600 local firms, including 111 women-owned businesses, and five major mining operators. To address a critical access to finance constraint of Guinean firms trying to meet FDI buyers, six commercial banks were brought onto the marketplace to provide $9 million in loans for upgrading technology, skills, and capacities. The government of Guinea has recognized the digital marketplace as a tool to engage the domestic private sector and to complement regulatory measures to increase local content with those that enable connections and emphasize competitiveness improvements.

APPENDIX E

Country Classifications

World Bank Analytical Classifications
GNI per capita in $ (Atlas methodology)
Bank's fiscal year: FY24
Data for calendar year: 2022
Low income (L): ≤ 1,135
Lower middle income (LM): 1,136 – 4,465
Upper middle income (UM): 4,466 - 13,845
High income (H): > 13,845

Afghanistan	L	Benin	LM	Chile	H
Albania	UM	Bermuda	H	China	UM
Algeria	LM	Bhutan	LM	Colombia	UM
American Samoa	H	Bolivia	LM	Comoros	LM
Andorra	H	Bosnia and Herzegovina	UM	Congo, Dem. Rep.	L
Angola	LM	Botswana	UM	Congo, Rep.	LM
Antigua and Barbuda	H	Brazil	UM	Costa Rica	UM
Argentina	UM	British Virgin Islands	H	Côte d'Ivoire	LM
Armenia	UM	Brunei Darussalam	H	Croatia	H
Aruba	H	Bulgaria	UM	Cuba	UM
Australia	H	Burkina Faso	L	Curaçao	H
Austria	H	Burundi	L	Cyprus	H
Azerbaijan	UM	Cabo Verde	LM	Czech Republic	H
Bahamas, The	H	Cambodia	LM	Denmark	H
Bahrain	H	Cameroon	LM	Djibouti	LM
Bangladesh	LM	Canada	H	Dominica	UM
Barbados	H	Cayman Islands	H	Dominican Republic	UM
Belarus	UM	Central African Republic	L	Ecuador	UM
Belgium	H	Chad	L	Egypt, Arab Rep.	LM
Belize	UM	Channel Islands	H	El Salvador	UM

Equatorial Guinea	UM
Eritrea	L
Estonia	H
Eswatini	LM
Ethiopia	L
Faeroe Islands	H
Fiji	UM
Finland	H
France	H
French Polynesia	H
Gabon	UM
Gambia, The	L
Georgia	UM
Germany	H
Ghana	LM
Gibraltar	H
Greece	H
Greenland	H
Grenada	UM
Guam	H
Guatemala	UM
Guinea	LM
Guinea-Bissau	L
Guyana	H
Haiti	LM
Honduras	LM
Hong Kong SAR, China	H
Hungary	H
Iceland	H
India	LM
Indonesia	UM
Iran, Islamic Rep.	LM
Iraq	UM
Ireland	H
Isle of Man	H
Israel	H
Italy	H
Jamaica	UM
Japan	H
Jordan	LM
Kazakhstan	UM
Kenya	LM
Kiribati	LM
Korea, Dem. Rep.	L
Korea, Rep.	H
Kosovo	UM
Kuwait	H
Kyrgyz Republic	LM
Lao PDR	LM
Latvia	H
Lebanon	LM
Lesotho	LM
Liberia	L
Libya	UM
Liechtenstein	H
Lithuania	H
Luxembourg	H
Macao SAR, China	H
Madagascar	L
Malawi	L
Malaysia	UM
Maldives	UM
Mali	L
Malta	H
Marshall Islands	UM
Mauritania	LM
Mauritius	UM
Mexico	UM
Micronesia, Fed. Sts.	LM
Moldova	UM
Monaco	H
Mongolia	LM
Montenegro	UM
Morocco	LM
Mozambique	L
Myanmar	LM
Namibia	UM
Nauru	H
Nepal	LM
Netherlands	H
New Caledonia	H
New Zealand	H
Nicaragua	LM
Niger	L
Nigeria	LM
North Macedonia	UM
Northern Mariana Islands	
Norway	H
Oman	H
Pakistan	H
Palau	LM
Panama	UM
Papua New Guinea	H
Paraguay	LM
Peru	UM
Philippines	UM
Poland	LM
Portugal	H
Puerto Rico	H
Qatar	H
Romania	H
Russian Federation	H
Rwanda	UM
Samoa	L
San Marino	LM
São Tomé and Príncipe	H
Saudi Arabia	LM
Senegal	H
Serbia	LM
Seychelles	UM
Sierra Leone	H
Singapore	L
Sint Maarten (Dutch part)	H
Slovak Republic	H
Slovenia	H
Solomon Islands	H
Somalia	LM
South Africa	L
South Sudan	UM
Spain	L
Sri Lanka	H
St. Kitts and Nevis	LM
St. Lucia	H
St. Martin (French part)	UM
St. Vincent and the Grenadines	H
Sudan	UM

Suriname	L	Trinidad and Tobago	UM	Uruguay	H
Sweden	UM	Tunisia	H	Uzbekistan	H
Switzerland	H	Türkiye	LM	Vanuatu	LM
Syrian Arab Republic	H	Turkmenistan	UM	Venezuela, RB	LM
Taiwan, China	L	Turks and Caicos Islands	UM	Viet Nam	LM
Tajikistan	H	Tuvalu	H	Virgin Islands (U.S.)	H
Tanzania	LM	Uganda	UM	West Bank and Gaza	UM
Thailand	LM	Ukraine	L	Yemen, Rep.	L
Timor-Leste	UM	United Arab Emirates	LM	Zambia	LM
Togo	LM	United Kingdom	H	Zimbabwe	LM
Tonga	L	United States	H		

Endnotes

1. See Annex E for a full list of countries by income level according to the World Bank 2022 classification.

2. For example, an extensive study in Türkiye shows that interactions between MNEs and their Turkish suppliers have facilitated an upgrading of Turkish products (Javorcik, Lo Turco, and Maggioni 2017). In Costa Rica, investment by Intel helped diversify exports toward advanced manufacturing, fostered deeper integration into global value chains (GVCs), and helped upgrade the economy to higher-value activities (World Bank 2020).

3. By 2018, developing country sources accounted for 24 to 40 percent of international loans and deposits, portfolio investment, and foreign direct investment into other developing countries; an increase of about 10 percentage points since 2001 (Broner et al. 2020).

4. Announcements of greenfield investments are tracked by the Financial Times fDi Markets database.

5. For a literature review and new comparative evidence from six developing economies of benefits from greenfield as opposed to other modes of foreign investment, see World Bank (2020a)

6. Regular measures tested include the Herfindahl–Hirschman index (HHI) applied to observations of total investment capital expenditure (for greenfield projects) or value (for mergers and acquisitions) by investing enterprise, as well as concentration ratios of value or expenditure in a definite number of enterprises relative to total. The Herfindahl–Hirschman index yields more comparable estimates of concentration when reference units vary in size, such as investment source countries or sectors.

7. The World Bank FDI Entry and Screening Tracker monitors specific FDI policy developments since the onset of the COVID-19 pandemic. The Tracker uses a range of sources to inventory and monitor measures on entry that have been proposed or enacted since February 2020, when many countries began implementing policy measures in response to the pandemic, both in terms of measures making entry easier and measures strengthening existing controls. The tool shows what regions or countries are most active and the types of measures they tend to rely on (World Bank 2023c).

8. FDI also accounts for the majority of cross-border trade in services sectors—across all services sectors, FDI ("mode 3" services trade under the General Agreement on Trade in Services [GATS] framework) represents 59 percent of overall services trade (see figure C.1) (Nayyar, Hallward-Driemeier, and Davies 2021).

9. The Services Trade Restrictiveness Index (STRI) captures such restrictions through a score between 0 (fully open) and 100 (fully closed). Data show that there are important variations in mode 3 services restrictions across regions.

10. But such assertions are rarely based on the underlying economic evidence. For each 10-percentage point increase in corporate tax incentives, corporate tax revenue goes down by about 0.35 percent of GDP (Kronfol and Steenbergen 2020). Another study (Keen and Simone 2004) that collected data on tax incentives in 40 developing economies from 1990 to 2002 found that unlike advanced economies, which have tended to broaden tax bases and cut tax rates while maintaining revenues, developing economies have cut rates, introduced special regimes, and lost revenues.

11. In the current policy environment, governments are seeking to reform their tax incentives (in light of international experience) and their best practices to achieve broader economic objectives like equity and efficiency, as well as strategic objectives like attracting FDI, pursuing green growth, generating employment, and growing the digital economy. This agenda is especially timely considering global economic crisis in the wake of the COVID-19 pandemic and the Russian Federation's invasion of Ukraine necessitating urgent mobilization of higher domestic revenue by countries to finance the growth in public expenditures on health, education, and inclusive development. Advances on imposition of a global minimum tax (Pillar II of the G20/OECD-led Framework for Base Erosion and Profit Shifting) will also have profound implications on the location decisions of multinational enterprises and the complementary tax policies of governments to attract investment. As governments face the question of how to design and implement incentives strategically, and in a manner that maximizes their value for money and minimizes the risks, guiding principles drawn from international good practices can be leveraged.

12. According to UNCTAD (2022), the number of known treaty-based ISDS cases increased from 1,190 at the end of 2021 to 1,251 as of December 31, 2022.

13. Specifically, the main "process issues" concern the cost, duration, and transparency of arbitration. A 2021 study found that for respondent states, the average (mean) costs incurred in investment arbitration proceedings are approximately \$4.7 million (and the median figure is \$2.6 million), and for investors, the mean costs exceed \$6.4 million, while the median figure is \$3.8 million (Hodgson, Kryvoi, and Hrcka 2021). Those are administrative and legal costs related to the arbitration proceedings only and do not include amounts awarded to a party as damages (that is the possible compensation allocated to one of the parties by the arbitrator(s)). The same study found that the mean amount of damages claimed among successful investors is \$1.5 billion while the mean amount awarded is \$438 million. As for duration, on average, arbitration proceedings last more than four years. This is a long period for an issue to remain unresolved between the parties but it also represents time that affected business executives and policy makers will not devote to more productive tasks (opportunity costs). With respect to transparency, investor-state arbitration was perceived as justice being administered "behind closed doors," while the disputes concerned usually involve public policy matters that attract the attention of civil society groups and citizens. Several reforms have focused on ensuring more transparency of the proceedings and public access to ISDS cases. The second broad concern relates to the outcome of investor-state arbitration cases. The main criticisms here relate to the perceived lack of coherence, consistency, and quality of the arbitral decisions. Finally, the third broad concern is linked to the arbitrators, who are seen as lacking sufficient independence and impartiality.

14. Some studies have shown that preferential trade agreements (PTAs) and international investment agreements (IIAs) can raise bilateral FDI significantly (Kox and Rojas-Romagosa 2020). For example, a paper on the effects of PTAs on net FDI inflows using a comprehensive database of PTAs in a panel setting finds that PTA membership is associated with a positive change in net FDI inflows—especially for developing countries—and that FDI gains increase with the market size of PTA partners and their proximity to the host country (Medvedev 2012). At the same time, a recent summary of empirical evidence assessing strengths and weaknesses of different approaches to measuring the relationship between IIAs and FDI flows finds that limited conclusive and robust evidence exists on the positive or negative impact of IIAs on FDI flows (Pohl 2018).

15. Economic welfare is measured as equivalent variation in private consumption of the representative regional household. Equivalent variation in this context establishes the theoretically consistent ex ante nominal value that the representative household places on the policy change.

16. At the Eleventh WTO Ministerial Conference (MC11) held in Buenos Aires in December 2017, 70 WTO members cosponsored a Joint Ministerial Statement on Investment (WT/MIN(17)/59) calling for the start of structured discussions with the aim of developing a multilateral framework on investment facilitation. In September 2020, participants formally moved to negotiations.

17. For more information on the IFD initiative, including the updated list of participating members, please refer to the WTO IFD portal at https://www.wto.org/english/tratop_e/invfac_public_e/invfac_e.htm.

18. An initial agreement was reached in 2019 that focused on trade in goods and trade in services. Yet, a deeper agreement is currently underway in phase two of negotiations, with harmonization in investment, competition, and intellectual property rights policy areas.

19. The World Trade Organization-World Bank STRI provides a detailed mapping of all such laws and regulations, and could serve this purpose.

20. Countries, including nonmembers of the Inclusive Framework, could have high economic and fiscal incentives to implement Pillar Two. The GMT's design means that a country can apply a top-up tax to the subsidiary of an MNE that has been taxed below the minimum effective rate. If a country does not apply the GMT rate, it means that another jurisdiction (the source country or other countries in which the MNE conducts its business activities) can levy these taxes.

21. This regulation was amended by the Presidential Regulation No. 49 of 2021, enacted May 25, 2021. That amendment saw the number of business activities restricted slightly increase. Nevertheless, the decline from the previous number of 813 was notably substantial.

22. Evidence shows that FDI flows increase with regulatory transparency, investment protections, and effective recourse. The FDI effects of these core pillars of FDI regulatory risk are sizable and comparable in magnitude to the investment-enhancing effects of trade openness in the same regression models (World Bank 2020a).

23. Moreover, the implementation of the global minimum tax will largely limit the role of certain types of tax incentives—requiring thoughtful policy reform action.

24. To find the latest developments in investment policies around the world, see the United Nations Conference on Trade and Development website at https://investmentpolicy.unctad.org/investment-policy-monitor.

25. Steenbergen and Saurav (2023) find that the direct activities and supply chains of the world's 157 large MNEs jointly account for up to 60 percent of total industrial emissions. This finding is similar to analysis from think tanks and academic literature tracing emissions from industrial carbon producers (Ekwurzel et al. 2017; Griffin 2017).

26. This regulation was amended by Presidential Regulation No. 49 of 2021, enacted May 25, 2021. The amendment saw the number of business activities restricted slightly increase. Nevertheless, the decline from the previous number of 813 was notably substantial (UNCTAD 2023).