CUTS INTERNATIONAL

IMPROVING POLICY COHERENCE TO ATTRACT EXPORT ORIENTED FOREIGN DIRECT INVESTMENT FOR SUSTAINABLE DEVELOPMENT

1. Relevance of export oriented FDI

Foreign direct investment (FDI) has been recognised as an important channel of economic growth for its receiving country. It has the ability to: enhance production competitiveness of an economy through technology transfer; provide employment opportunities, promote investment in infrastructure, facilitate access to scarce raw materials outside domestic territories, and opens windows for cross-border trade.

With respect to development and trade, export-oriented foreign direct investment (EFDI) is generally considered better than non-export oriented FDI, Lall (2000). Further, bundle of assets (new technology, skill, marketing knowledge, and management) in EFDI is comparatively superior and higher than in local market oriented FDI, Pradhan and Abraham (2005). EFDI, particularly for developing countries, is seen as an effective tool to strengthen export competitiveness especially in knowledge-based industries, Pradhan and Abraham (2005). The potential of EFDI can be utilised to make progress towards SDG 8 on Decent Work and Economic Growth and SDG 9 on Industry, Innovation and Infrastructure. Both the goals focus on employment generation and interests of small and medium enterprises, which are likely to benefit most from EFDI.

Emerging economies consistently compete with each other to attract EFDI and often announce special incentives in this regard. These include favourable policy frameworks and attractive international investment agreement (IIA) regime. Incentives to boost EFDI are often provided by setting up of duty/tax free special economic zones (SEZs). Different countries have experimented with different types of SEZs. These include setting up export processing zones, free industrial zones, free trade zones, science and technology parks (such as Electronic City in Bengaluru, India), special pilot zones, border special economic zones, and regional economic corridors. SEZs in China, South Korea and Mauritius are successful examples of attracting EFDI. However, export generation is no longer the only feature of many SEZs, and numerous new forms have been developed around the world for specific purposes.

2. Examining reasons for decline in investment

Despite the initiatives to attract foreign investment, FDI in general, and EFDI in particular, has been witnessed declining trend in recent years. According to the UNCTAD World Investment Report 2018, the global FDI flows fell by 23 per cent to US$1.43 trillion in 2017. In first half of 2018, global FDI flows fell by 41 percent.

The tariff led trade barriers imposed by several large countries on trade of goods and services, and stagnation in growth of global value chains are likely to accused of such situation. However, a closer look reveals that policy incoherence among national investment policies in developing and least developed countries should also share the blame of slowdown. Problems faced by investors in select countries are set out below.

India

CUTS International recently concluded an evidence based research study to identify reasons for slowdown of export oriented FDI in India. Some of the reasons cited by stakeholders for lack of FDI in SEZs were:

No policy roadmap: There was a lack of roadmap by the government for increase of FDI in SEZ development and in SEZ units. The units themselves attempt to get FDI at their own level, which is not necessarily successful.

Inadequate and inconsistent economic incentives: Monetary and fiscal incentives are limited and only for initial years. Policy inconsistency has resulted in withdrawal of several duty drawback schemes. It was further pointed out that taxes like Minimum Alternate Tax, Value Added Tax, Dividend Distribution Tax etc were not imposed at the time of establishment of units. However, a number of taxes are imposed now. Further, at the time of establishment, units were promised single window system but the same has not become a reality. Exemptions in taxation, customs and excise duties, might need to be extended and expanded.

Limited incentives to expand: Limited incentives have been provided for expansion or escalation of work. Most of the benefits are only for establishing a new unit and not for expansion of existing units. Moreover, units in SEZ obtain land on lease basis. As a result, they are required to undergo several compliances in order to expand or close the units.

Multiplicity of procedures: In order to claim incentives, SEZ units need to provide the details online on the website of Director General of Foreign Trade (DGFT) and at the same time submit all the documents manually. Also, when obtaining permissions and approvals regarding basic infrastructure (Fire no objection certification, Pollution Control Board Certificate), SEZ units need to approach multiple government authorities.

Multiplicity of inspections: SEZ units face problem of regular inspection and checks by various governmental agencies leading to harassment and undue demands. Sealed containers are often checked on suspicion basis and unnecessary checks of all the containers at ports leads to increase in time and delay and increases both direct as well as direct costs.

Limited Digitization: Incomplete digital and information technology (IT) connectivity is another challenge faced by SEZ units. Not all the SEZ were digitized which caused delay in clearance of bills. Disparate online channels also create problems for SEZ units.

Operational challenges: Many SEZ units are suffering with under-utilization of their plant capacity, due to lack of export opportunity. Even if there is opportunity to get job work from Domestic Tariff Area (DTA), the same is not permitted.

Infrastructure constraints: Sub-optimal infrastructure and dilapidated conditions of roads, electricity connectivity in the SEZs does not inspire confidence in potential investors.

Congo

Congo has recently introduced a new law on subcontracting and a new mining code. A new law on subcontracting in the private sector restricts foreign investors' participation in subcontracting in almost all sectors, and restricts subcontracting activity to majority Congolese-owned and capitalized-companies. It carries stringent penalties the risk of closure of operations.

The new mining code increased royalty rates by two to ten percent, raised tax rates on "strategic" metals, and imposed a surcharge on "super profits" of mining companies. The government unilaterally removed a stability clause contained in the mining code which protected investors from any new fees or taxes for ten years.

Tanzania

Tanzania has recently introduced separate "Mining Regulations on Local Content" to promote the use of local expertise, goods and services, businesses and financing in the mining value chain. It strongly encourages the hiring of, contracting with, and partnering with Tanzanian companies or individuals. Private sector has expressed concern over such laws largely enacted without stakeholder consultation. The laws increased the risk/cost of investing in broadly defined natural resources, primarily by removing rights to international arbitration and giving Parliament the right to rewrite undefined “unconscionable” contract terms.

The regulations require that indigenous Tanzanian companies are given first preference for mining licenses. Furthermore, foreign mining companies must have at least 5 percent equity participation from an indigenous Tanzanian company and must grant the Government of Tanzania a 16 percent carried interest. Lastly, foreign companies that supply goods or services to the mining industry must incorporate a joint venture company in which an indigenous Tanzanian company must hold equity participation of at least 20 percent. The regulations have also set the timeframe for local content percentages to be raised over the next 10 years which vary by type of good or service provided. There are immediate requirements to use 100 percent local content in some sectors violating which can lead to a fine or imprisonment.

Tanzania has also introduced a ban on exports of unprocessed minerals which may adversely affect the country’s foreign mining assets. Further, the Tanzania Telecommunications Corporation (TTC) plans, builds, operates and maintains the “strategic telecommunications infrastructure,” which is defined as transport core infrastructure, data center and other infrastructure that the Government of Tanzania proclaims “strategic” via official public notice. It is not yet clear whether telecommunications operators will be required to use the TTC’s data center or provide the TTC greater data access.

Viet Nam

Viet Nam recently introduced a law on cybersecurity that would require Vietnamese users’ data to be stored in Vietnam and would require all cross-border service providers to host servers within Vietnamese territory. It is also proposing draft legislation to request cross-border service providers via Internet protocol to have a representative office in Vietnam, citing the necessity of local office requirements for taxation purposes.

3. Tools required to improve coherence

The aforementioned regulatory approaches might not inspire confidence in investors. Consequently, in order to attract foreign investment for sustainable development, UNCTAD had issued investment policy framework for sustainable development in 2015. It recommended tools to promote coherence in domestic policies and international investment agreement regimes.

Tools to promote coherence in domestic policies included:

- **Strategic**: Grounding investment policy in a broad road map for economic growth and sustainable development. The policy should aim to harness investment for productive capacity building and enhancing competitiveness.
- **Normative**: Setting rules and regulations for gearing investment towards sustainable development goals. Sustainability based incentives in areas like tax, IP, competition, labour, environment, CSR and standards could be used.
- **Administrative**: Ensuring continued relevance of investment policymaking, by measuring effectiveness and impact, and building capacity.

Tools to promote coherence in domestic policies included:

- Incorporating concrete commitments to promote and facilitate investment for sustainable development (information sharing, technical assistance).
- Balancing state responsibilities with investor obligations and protection obligations with regulatory space for development.
- Shielding host countries from unjustified liabilities and high procedural costs.

In 2017-18, UNCTAD issued a reform package for international investment regime which recommended further measures to promote coherence between policy frameworks at different and similar levels. These include:

- Vertical coherence between national and international dimensions of investment policy making.
- Horizontal coherence between investment policies and other public policies.
- Synchronisation and dispute settlement at national, bilateral, regional and multilateral level.

4. Challenges in implementing tools to achieving coherence

While UNCTAD has suggested tools for achieving policy coherence, it is also cognizant of the challenges in implementing tools to achieving coherence. These include:

- **Selection challenge**: Difficulty in identifying the most appropriate tool for the country in the given situation to attract FDI for sustainable development. This is likely to require a careful and facts based cost-benefit analysis.

- **Strategic challenge**: Difficulty in preventing 'overshooting' of reform which could be counterproductive. For instance, excess protectionism or unchecked free flow of investment have their dangers.
- **Systemic challenge**: Difficulty in addressing existing gaps, overlaps and fragmentation in policies, bodies and capacities that led to incoherence and inconsistency problems.
- **Coordination and communication challenge**: Difficulty in prioritising reform actions, finding the right actors for implementation.
- **Capacity challenge:** Difficulty in designing and implementing solutions, overseeing their execution, measuring effectiveness and conducting course correction.

5. Unanswered questions

In order to select the right tool and achieve policy coherence, each country will need to dive deep to answer causal questions relating to emergence of policy coherence and efforts hitherto made in addressing the same. These questions could include:

- Given that there are examples of policy frameworks incoherent with the need to attract FDI for sustainable development, what are the rationale and objectives of such frameworks that potentially disincentivise foreign investment? Are vested interests at play while framing such policies? Or policy makers are not subject to stringent transparency and accountability measures?
- There have been several instances of inconsistencies among different policy frameworks, despite recognition of the need to attract FDI for sustainable development. What are the reasons for such inconsistent policy frameworks? Are limited capacity, coordination and communication capabilities, and lack of political will to blame?
- How to prioritise tools to improve policy coherence given apparent conflicting interests, imminent trade wars, and capacity constraints? In other words, how to bridge the trust deficit between foreign investors and local authorities and stakeholders, and address challenges of lack of coordination of different government bodies?
- How to build capacity within countries to address incoherence related challenges, design and implement appropriate tools?

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