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Losing the Foreign Investment Race

byGraciana del Castillo

Latin America is in serious trouble when it comes to foreign direct investment (FDI). True, inward FDI reached about $70 billion in 2006, but this is below the 1998-1999 peak, and a large share came from Latin American firms investing in neighboring countries, whereas inflows from Europe and the United States have fallen. Many companies are withdrawing from the region, and large investments from China, particularly in Brazil, though promised, have failed to materialize.

At its peak in the 1970's, and again in the 1990's, Latin America's share of total global FDI reached 17%. Now it is only 8% (in 2006), after averaging 11% over the previous five years. Among developing countries, Latin America's share of global FDI also fell dramatically, from 40-50% in the 1970's to about half that in 2006.

Redressing the problems of high unemployment and large informal sectors – where almost half of all goods and services are produced – is perhaps the region's most urgent policy challenge, particularly because most investment and growth by domestic firms is related to high commodity prices, which do little to create new jobs. Likewise, FDI inflows have been expanding only in resource-intensive sectors, while falling in services and practically stagnating in manufacturing.

What is lacking are effective government policies to attract high-quality FDI, particularly for exports, which could have a multiplier effect domestically, creating both direct and indirect employment. But, in addition to the right legal and regulatory framework to ensure appropriate links to the national economy – which is also lacking in most of the region – the search for desirable investors requires an effective foreign investment promotion agency.

To change the way Latin American countries sell themselves to foreign investors is a creative challenge. Selling goods for export and selling the country to foreign investors is very different. As Padraic White, a pioneer in this field who headed the Irish Industrial Development Agency (IDA-Ireland) from 1980 to 1990 argues, FDI promotion requires imagination and the ability to think innovatively.

As White points out, promoters of FDI are not selling a product, which the country's embassies abroad may be able to do. The sales technique should be based on fiscal and regulatory concepts and be expressed in legal and financial jargon, which only experts can do. For this reason, FDI has to be promoted separately from domestic investment and exports. Furthermore, foreign investors do not want to deal with diplomats or civil servants. They want to talk to private-sector experts who understand the technical and financial needs of their companies or sectors.

Yet, except for Costa Rica's foreign investment promotion agency, CINDE, modeled after the IDA-Ireland, none of Latin America's FDI promotion agencies have succeeded in adopting best practices. Many promote both foreign and domestic investment, despite the failure of such institutional arrangements in the past. Ireland, for example, had to separate the two functions before it became successful. Moreover, most FDI promotion agencies in the region lack the minimum financial and human resources needed in order to be effective, owing to governments' lack of political will to support them and to eliminate parallel processes that confuse investors.

An effective FDI promotion agency must be headed by an executive director with strong credentials and an excellent reputation in the private sector, supplemented by good international contacts and fluency in English. Just as importantly, there cannot be any conflict of interest (or even the perception of such a conflict) with other personal or political activities, past or present.

The executive director should put together a team of analysts located in critical locations abroad and able to conduct business intelligence. This requires investigation of markets and trends, and identification of specific firms that would be desirable for the clusters or niches that the country wants to promote.

The team will also need "promoters" in these locations, with public-relations expertise and technical knowledge of the country and the clusters. Finally, the team will need local "service providers" with technical knowledge of specific clusters to support foreign investors once they have located in the country, thereby ensuring that they remain and expand.

International competition for investors is brutal, so waiting for them to fall from the sky is not an option. Without the right strategy, Latin America will continue to fall behind.

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