



Best Practices for Attracting Inward & Promoting Outward Foreign Direct Investment



**STEVEN GLOBERMAN
WESTERN WASHINGTON UNIVERSITY
& SIMON FRASER UNIVERSITY**

**VICTOR ZITIAN CHEN
SIMON FRASER UNIVERSITY**

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Focus of Presentation



- **What public policies are appropriate to encourage and promote inward and outward foreign direct investment?**
- **What public policies are appropriate to enhance the economic benefits of inward and outward foreign direct investment from the perspective of governments in Canada?**



Overview of Methodology



- **The underlying study involved a major review of the empirical literature addressing two broad topics:**
 1. **Factors influencing the location choices of multinational companies**
 2. **Factors influencing the “spillover” benefits of (mostly) inward and outward foreign direct investment**
- **The bulk of the available studies focus on inward foreign direct investment at the national or regional levels. Relatively few focus on sub-national political units.**



Some Well-Known Assertions



- **Large economies are more attractive to foreign investors and are more likely sources of outward foreign direct investment.**
- **“Good” political governance attracts foreign investment.**
- **Foreign ownership restrictions discourage inward foreign direct investment.**
- **An educated/skilled labour force and a modern physical infrastructure attract foreign investors.**

Our empirical analysis confirms these assertions.



More Contentious Issues Regarding Determinants of Location Choice



- **How important are differences in tax rates?**
- **How important are foreign investment promotion agencies?**
- **How important is the “openness” of host economies?**
- **How important are targeted subsidies?**
- **How important are “requirements” imposed on foreign investors?**



Findings Regarding Tax Rates



- **Difficult to draw unequivocal conclusions regarding tax rates in part because of empirical complexities. Everything else constant, higher tax rates discourage inward foreign direct investment.**
- **But, public services/social infrastructure attract inward foreign direct investment.**
- **So, if higher tax rates are accompanied by improved public services/social infrastructure, net impact on inward foreign direct investment will be positive and the “package” might be strategically preferable to simply reducing tax rates.**



Findings Regarding Other Less Obvious Factors



- **Investment promotion agencies can make a difference.**
- **No consistent relationship between the openness of host economies and their attractiveness to foreign investors.**
- **Targeted subsidies can attract inward foreign direct investment, but the benefits to the host economy are diminished.**
- **Requirements imposed on foreign investors are not consistently linked to reduced inward foreign direct investment. (It's possible the costs are passed on to owners of domestic assets)**



Policy Relevant Factors Encouraging Inward Foreign Direct Investment



- **Good political governance**
- **Well-educated, trained workforce**
- **Physical/communications infrastructure**
- **Innovation capabilities**



Factors Encouraging Outward Foreign Direct Investment



- **Main factors promoting inward foreign direct investment also promote outward foreign direct investment.**
- **Explanation: Those factors encourage the growth of efficient and competitive domestic companies that, in turn, exploit firm-specific assets by investing directly in foreign markets.**



Factors Promoting Spillover Benefits From Inward Foreign Direct Investment



- **Domestic capacity to absorb technology:**
 - **R&D capability**
 - **Education level of workforce**

- **Geographical concentration of specialized assets (industrial clusters)**



Factors That Do Not Consistently Promote Spillover Benefits From Inward Foreign Direct Investment



- Requirements for foreign investors to form joint ventures or to take minority ownership**
- Requirements for foreign investors to “source locally”**



Factors Promoting Spillover Benefits From Outward Foreign Direct Investment



- **Domestic capacity to absorb technology**
- **? (very few studies of spillovers from outward foreign direct investment)**



Anything Different For Sub-National Units?



- **Tax rate differences/infrastructure differences are stronger influences at the sub-national level.**
- **Clusters are sub-national phenomena (local and provincial governments can have strong policy influence).**
- **Promotional agencies can work at the sub-national level (particularly if they facilitate assistance in site selection, clearing bureaucratic hurdles and so forth).**