MAKING THE INVISIBLE VISIBLE

Investment Promotion and Multinational Production in Latin America and the Caribbean

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Executive Summary

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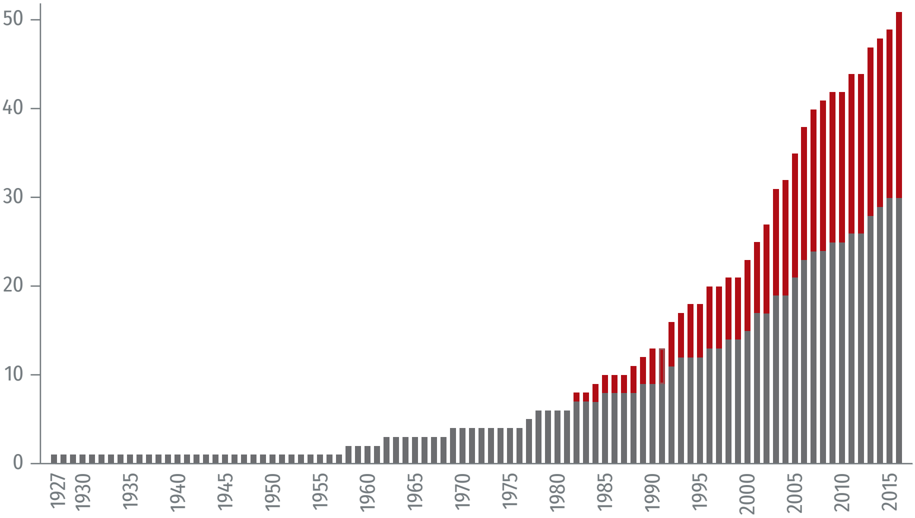
1 CAN INVESTMENT PROMOTION HELP COUNTRIES IN LATIN AMERICA AND THE CARIBBEAN BENEFIT FROM EMERGING INTERNATIONAL OPPORTUNITIES?

The context and the opportunities: The current global context is defined by several phenomena that are unfolding in parallel—the digital transformation, the introduction of a rising number of trade and investment policy interventions, an increased demand for timeliness, and the heightened awareness brought by the Covid-19 pandemic of the vulnerabilities in global supply chains and the need to build resilience. This global context could potentially create opportunities for countries in Latin America and the Caribbean (LAC) as investment destinations for multinational firms, which could be important for the region's economic recovery, long-term growth, and sustainable development.

Investment promotion as a means for leveraging potential opportunities: Making these opportunities a reality will not happen automatically, however. Information barriers are a major obstacle that must be addressed for this to happen. Nearly every country in the world, including those in LAC, have created investment promotion agencies (IPAs) to help them show up on investors' radars (figure 1). IPAs provide a series of information services to lower information barriers and thereby attract multinational firms to their countries.

This report: The study opens with a description of the evolution and patterns of LAC countries' participation in multinational production. It then provides an in-depth analysis of the institutional organization and operational practices of IPAs. It continues with evidence on the effects of IPA assistance on multinational firms' decisions to enter a host country by establishing a first foreign affiliate (*first establishment*) and/or to expand their presence there by opening additional affiliates (*reinvestment*). It ends with a series of policy recommendations.

FIGURE 1 NUMBER OF COUNTRIES WITH IPAS, 1925–2017



Source: Authors' calculations based on IDB/OECD Survey of Investment Promotion Agencies (2017).
Note: The figure shows the number of countries with national IPAs. LAC countries are shown in red and non-LAC OECD countries are shown in dark gray.

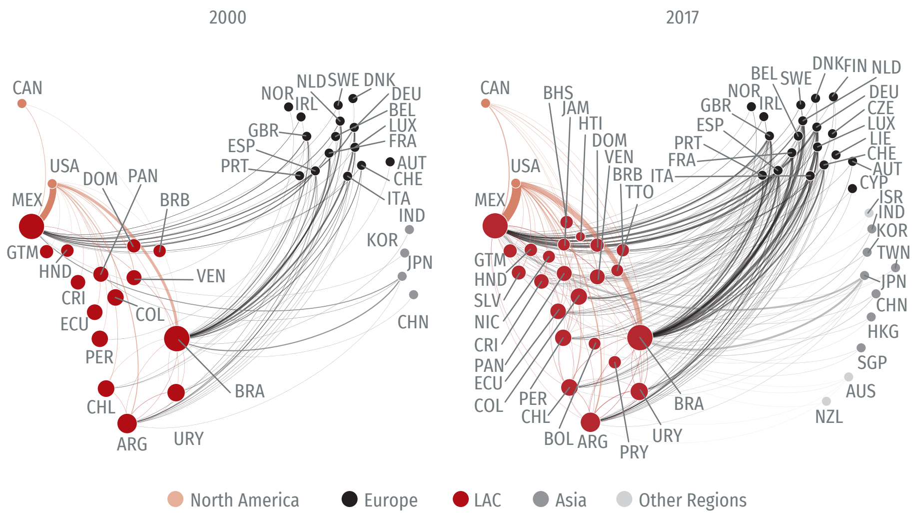
2 LATIN AMERICA AND THE CARIBBEAN ON THE GLOBAL MULTINATIONAL PRODUCTION MAP

Overview: The number of parent multinational firms hosted by LAC increased by 88% between 2000 and 2017—almost 50 percentage points (p.p.) lower than the growth recorded in the rest of the world (133%). As a consequence, the total number of firms reached roughly 15,000 in 2017, which amounted to 7.5% of the world total (figure 2).

Host countries: Argentina, Brazil, and Mexico together hosted 57% of the multinational firms that were present in LAC in 2017 and 72% of the foreign affiliates of these firms.

Home regions and countries: Europe and North America accounted for almost 50% and 27%, respectively, of the total number of foreign affiliates of multinational firms operating in LAC

FIGURE 2 **LAC ON THE CHANGING GLOBAL MULTINATIONAL PRODUCTION MAP, 2000 AND 2017**



Source: Author's calculations based on data from WorldBase and national IPAs.
Note: The nodes represent different countries. The size of the node represents the country's number of degrees (linkages) in logarithmic terms. The edges (lines) represent the number of foreign affiliates in the host country of the multinational firms that are headquartered in the home countries, also in logarithmic terms. Only edges where the number of foreign affiliates established in LAC is above 10 and nodes with at least one edge according to this criterion are shown.

in 2017. Asia and LAC itself were each responsible for 9% of this total. The most important home countries included the United States (25.2%), Spain (8.0%), and Germany (7.4%).

Sectors: Almost 60% of the foreign affiliates of multinational firms established in LAC operated in the manufacturing and nonfinancial services sectors (30% each). Certain individual subsectors stand out: machinery, chemical products, and food products within manufacturing, and head offices and consultancy, office support services, and engineering within nonfinancial services.

Multinational firms: The multinational firms present in LAC were significantly larger than their counterparts in other regions in terms of their total number of affiliates, the number of host countries in which they are present, and the number of sectors in which they are active through these affiliates. Of these firms, around 40% had more than 50 foreign affiliates.

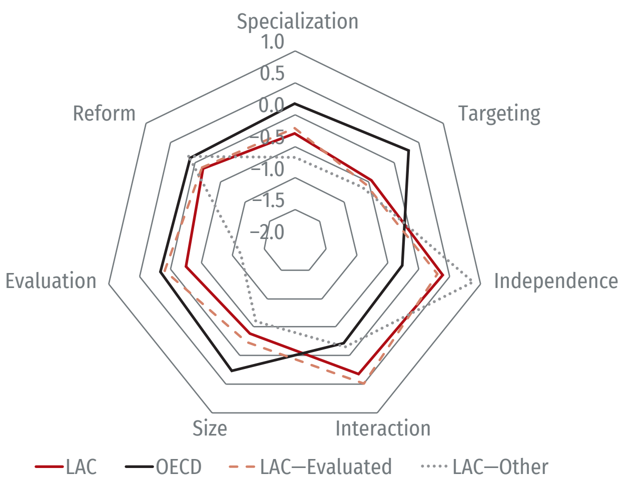
3 HOW TO SHOW UP ON MULTINATIONAL FIRMS' RADARS: THE MULTIPLICITY OF INVESTMENT PROMOTION APPROACHES

A multitude of approaches are available to policymakers for shaping their investment promotion strategies: These different approaches are reflected in *who* IPAs are (their organization and institutional aspects), *what* they do (their specific services and activities), and *how* they do it (their ways of doing business) (figure 3).

Who Investment Promotion Agencies Are

- LAC IPAs have higher degrees of institutional independence than their OECD counterparts (as proxied by the role of the board of directors and sources of funding, among other factors).

FIGURE 3 OVERALL IPA SCORECARD, LAC VS. OECD IPAS, 2017



Source: Author's calculations based on IDB/OECD Survey of IPAs (2017).
Note: "LAC—Evaluated" refers to the group of 12 LAC countries (out of the 21 included in the IPA mapping exercise) that participated in the IDB-led impact evaluation of IPA activities. A higher score implies a greater distance from the average and hence a higher degree of dissimilarity from the average IPA in the sample.

- LAC IPAs are significantly smaller than their OECD counterparts (in terms of budget, personnel, and networks of overseas offices).

What Investment Promotion Agencies Do

- LAC IPAs specialize less than their OECD counterparts (in terms of mandates, investment promotion functions, and activities).
- The LAC IPAs for which data is available provided support for approximately 100 multinational firms per year, on average, with a joint total of up to 1,500 firms per year between 2010 and 2017.
    - Around 75% of this assistance was provided to multinational firms that were not yet present in their countries at the time and hence sought to help them establish a first foreign affiliate there.
    - Almost two-thirds of the multinational firms that received IPA assistance were headquartered in Europe and North America (around one-quarter in the United States alone), roughly 18% in Asia, and 15% within LAC.
    - More than 60% of the multinational firms that were assisted operated in the manufacturing and nonfinancial services sectors (roughly 30% in each).
    - Almost 50% of the multinational firms that were assisted had either no foreign affiliates (in other words, they were not actually multinationals yet) or just one. When they were already operating abroad, they did so in one country and one sector.

How Agencies Promote Investment

- LAC IPAs have less targeted promotion strategies than their OECD counterparts.
- LAC IPAs have broad networks of interinstitutional collaborations.
- LAC IPAs have less-developed evaluation approaches than their OECD counterparts.

4 INVESTMENT PROMOTION IN LAC: HOW IT WORKS, WHAT WORKS, AND WHEN IT WORKS

- **Investment promotion has been effective in the region**
  On average, IPA assistance increases the probability of multinational firms opening first affiliates in the region by 8.2 p.p. This impact is economically relevant given that the unconditional likelihood of them doing so is very low.[1] Importantly, support from the national IPA has made a significant difference in the 12 individual countries studied.[2] IPA assistance also raises the probability of multinational firms establishing subsequent affiliates. However, this seems to primarily affect additional openings of affiliates in the largest countries and only when 10 or more years have passed since the firms in question opened their previous affiliate.
- **Who IPAs are, what they do, and how they do it all shape their effectiveness**
  IPAs that are larger, are more specialized in terms of their mandates and activities, have more targeted promotion strategies, and have more robust evaluation approaches tend to be more effective at attracting multinational firms.
- **The impacts of investment promotion are largest when information barriers are most severe**
  Support from IPAs has the largest positive effect on multinational firms' decisions to establish affiliates when they are headquartered in Asia, North America, and Europe, are active in differentiated manufacturing and nonfinancial services sectors, and are medium-sized (2–10 affiliates worldwide, present in 2–10 countries, with operations in 2–10 different sectors), in the case of first establishment, and are larger and more diversified in that of reinvestment (figure 4).

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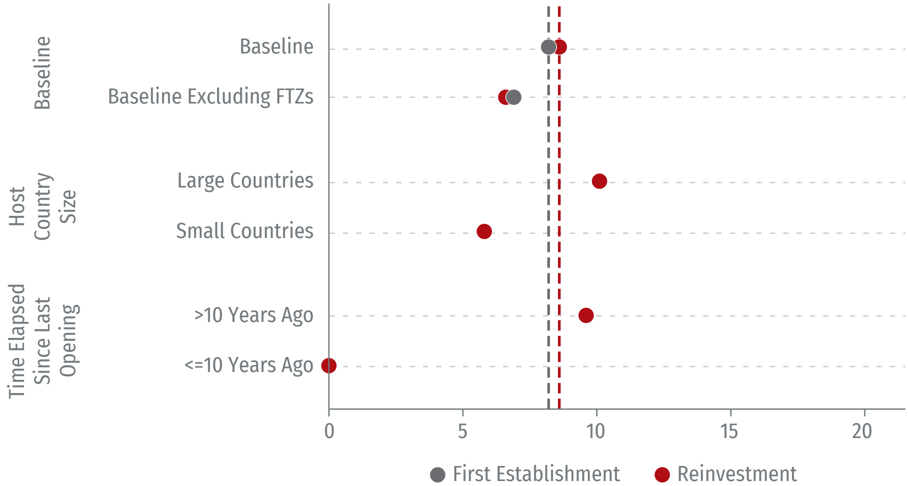
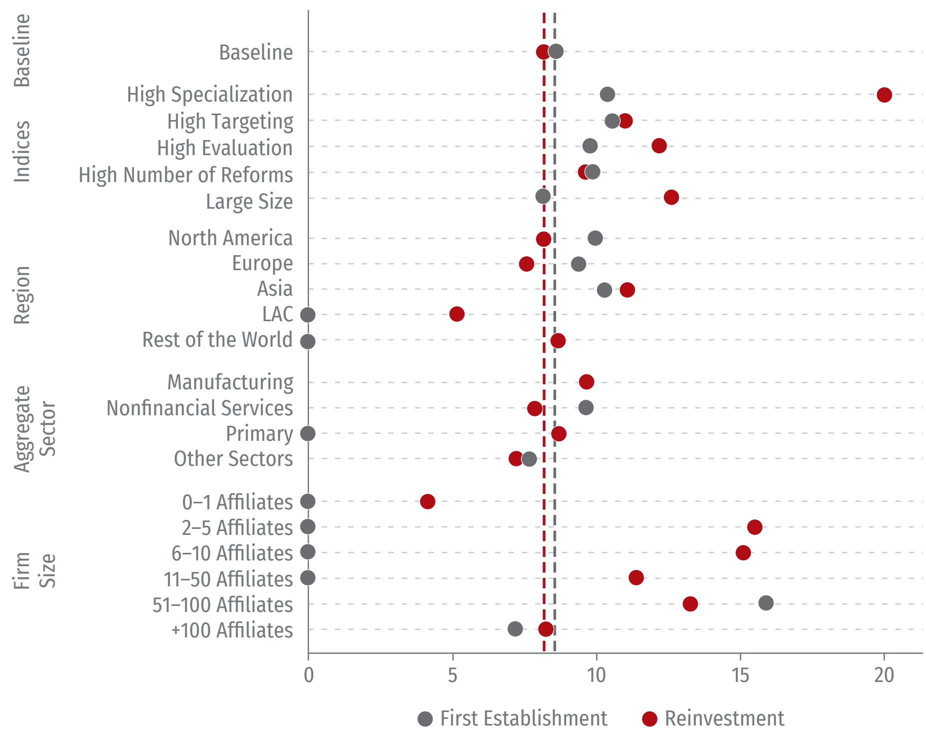
1 The empirical analysis considers a universe of more than 200,000 multinational firms. The number of these firms present in LAC is only a small fraction of this total.

2 These individual countries are: Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Peru, and Uruguay.

FIGURE 4 INVESTMENT PROMOTION IN LAC: HOW IT WORKS, WHAT WORKS, AND WHEN IT WORKS





Source: Author's calculations based on data from WorldBase and national IPAs.
The dots report the specific point estimates, whereas the vertical lines correspond to the average effects of investment promotion assistance on first establishment (red) and reinvestment (dark gray).

- **Investment promotion also affects the level of activity of multinational firms in host countries**
  IPA assistance is associated with an average increase of more than 2% in the number of employees, almost 6% in domestic purchases, and 6% in the export values of multinational firms' foreign affiliates.
- **Investment promotion is cost-effective**
  Taking into account both the benefits and costs of investment promotion, the study found that each US$1 spent on investment promotion generated US$41 of additional FDI in first establishments and US$15 of additional FDI in reinvestment, for a total of US$56 of additional FDI. Moreover, each US$10,000 assigned to investment promotion was associated with the creation of 4 additional jobs in the case of first establishment and 1.5 additional jobs in that of reinvestment, for a total of 5.5 additional jobs.[3] When the top 10% of projects by size are excluded, the benefit-cost ratio is US$15 of additional FDI for each US$1 allocated to investment promotion.

5 WHERE TO GO AND HOW TO GET THERE: THE FUTURE OF INVESTMENT PROMOTION

While this report's findings are encouraging, the challenge facing IPAs in the future is how to remain relevant and further increase their effectiveness in the new global environment. To achieve this, IPAs need to:

- **Respond to the growing imperative to go digital.** IPAs need to leverage more and better ICTs and draw on the increasing availability of specialized digital tools to expand and improve

[3] These ratios can be expected to differ across sectors. For instance, the financial means mentioned above may be associated with more job creation in service sectors that are intensive in human capital.

their portfolio of services to assist clients more agilely and effectively.

- **Mainstream sustainability and gender equality in IPA promotion approaches and metrics.**
- **Improve promotion strategies by making them evidence-based.** A natural way of doing this would be to make systematic use of available trade and multinational production microdata by consistently applying new technologies and methods to predict the probability of multinational firms establishing a first affiliate or subsequent ones in the country in question.
- **Institutionalize monitoring and evaluation practices** and carry out systematic, comprehensive impact assessments of both the direct and indirect effects on the local economy.
- **Coordinate programs as much as possible,** such as those relating to the promotion of innovation, linkages, and trade, given the highly integrated nature of and intense complementarities between exports, FDI, and multinational production, particularly within specific global value chains.

Attracting foreign direct investment is a crucial component of national development strategies. It is also a powerful tool for fostering the development of micro, small, and medium-sized enterprises by linking them to technology and know-how. To successfully attract investment, countries must not only be open for business, but also welcome and walk investors through the process of establishing partnerships. This timely report underscores the role of investment promotion agencies in closing critical information gaps and thereby attracting much needed foreign resources to sustain the post-Covid recovery and long-term growth in Latin America and the Caribbean. It dissects the who, the what, and the how of investment promotion agencies to show they cost-effectively put the region on multinational firms' radars. Its recommendations, along with targeted measures to encourage linkages with small businesses, should help policymakers harness investment for sustainable and inclusive growth.

Pamela Coke-Hamilton
Executive Director, International Trade Center

Investment promotion is one of the most underappreciated policy interventions, so I really welcome the IDB's report on this critical topic. As the report confirms, pure investment promotion—which focuses on lowering information barriers and does not involve fiscal and monetary incentives—can go a long way in attracting FDI inflows. It is effective, relatively inexpensive, and has few downsides if you get it wrong. And if you get it right, increased FDI inflows can bring good jobs, boost exports, and stimulate innovation. This report is a must-read for policymakers in Latin America, the Caribbean, and beyond.

Beata Javorcik
Chief Economist, EBRD, and Professor of Economics, Oxford University

The true significance of investment promotion has finally been revealed. Specialized services brought to foreign investors by investment promotion agencies (IPAs) in Latin America increase the probability of multinational firms opening their first affiliate in the region. This book really does make the invisible visible: it provides an in-depth analysis of the institutional organization and operational practices of IPAs and the implications that these have in terms of the effectiveness of their interventions. These findings are invaluable inputs that will improve the quality of governments' and stakeholders' decision-making on investment promotion policies.

Jorge Sequeira
Managing Director, CINDE, Costa Rica's Investment Promotion Agency

The support we received from the country's IPA was very positive. The various services that the agency provided helped us establish the affiliate and streamline our operations from the start. The assistance from the Finishing School program enabled us to start providing our business partners with services on time and created a valuable collaborative process that continued throughout the different stages of setting up our global services operations in the country.

Mike Mies
Managing Director, BASF Services Americas, Uruguay

IDB