Helpdesk Research Report: Investment Climate in Fragile and Conflict Affected States
Date: 08.10.10

**Query:** What have been the main factors that have prevented the development of a strong investment climate in Fragile and Conflict Affected States (FCAS)? Please focus on uncovering evidence to demonstrate the significance of these factors.

**Enquirer:** DFID

**Contents**

1. Overview
2. Defining a 'strong investment climate'
3. Factors that undermine a strong investment climate
4. Additional information

**1. Overview**

*Defining a ‘strong investment climate’*

The investment climate can be understood as the set of factors in a given location that shape firms’ incentives and opportunities to invest, grow and create jobs. Some of these factors are costs; others are risks; still others are the competitive forces in the economy. Together, they determine the vibrancy and reach of private sector firms in the economy. A strong investment climate is not a serendipitous occurrence: it is the result of country authorities formulating, implementing and enforcing an appropriate set of policies (Dollar et al., 2005).

There are, however, other variations as to what defines an investment climate and profound disagreement as to which social, political or economic factors have prevented the development of a strong investment climate. The World Bank (2005) asserts that a good investment climate is not just about generating profits for firms but also about improving outcomes for society including through its impact on job creation, lower prices, and broadening the tax base.

Often the literature fails to disaggregate the concept of investment climate. A strong investment climate for one firm is not necessarily a strong investment climate for another and a generalised concept of investment climate can be inaccurate. Dollar et al (2005), for example use a series of interviews to produce indicators which assess the investment climate. These interviews are all, however, with firms in the garment industry and the resulting indicators may not produce a true assessment of the wider investment climate. Mills and Fan (2006) note that during the post-conflict period it is the telecoms sector which seems to grow first followed by energy, then transport with water and sanitation developing much later. This suggests that the investment climate in post-conflict situations would be different for different sectors.

Investment in one type of industry can discourage other types of investment. This is particularly the case concerning investment associated with the extraction of natural resources as opposed to other types of investment. Large resource exports can overvalue the exchange rate, which can undermine growth of other industries especially those dependent on exports (Moran, 2006). The presence of natural resources can profoundly distort the political economy of a country and foster corruption and rent-seeking activities.
It is thus difficult to define a generalised concept of a strong investment climate. Changes to the investment climate are favourable or unfavourable dependant on the firm or the sector. Likewise it must be noted that significance of factors can be dependent on the investor in question.

**Factors that undermine a strong investment climate**

Despite a wealth of literature on investment climate there are few empirical studies. The studies that do provide empirical evidence for significance of factors that affect investment climate do so in a manner specific to a firm, a sector or a country. Such evidence is not readily generalisable.

OED (2004) collected evidence from econometric studies, surveys and interviews of a number of firms in different sectors. In particular they note the diversity of responses. The responses varied according to the size of the firm and their sector. Tax policy, fiscal incentives, product market regulations, policy instability, and inflation were commonly found to be related to a firm’s decision to invest with the overarching issue being regulatory uncertainty. There was great variation in the prioritisation of issues where for some firms investment climate conditions were secondary to factors such as cheap labour and large markets. Distance between donor and host country was not related to level of investment neither was natural resource endowment. The most attractive countries to investors were those with economic and political stability and where there were efforts to liberalise, privatise and prevent state capture.

Mills and Fan (2006) identify four pillars of investment climate and outline how conflict can undermine these as well as the broader enabling environment. Conflict can undermine security and stability, specifically physical security, macroeconomic stability, and contract enforcement and property rights. Business life becomes less straight-forward and much more challenging without access to credit and financial services, and poor infrastructure. Businesses cannot depend on formal financial services and so turn to expensive, unregulated options. Transactions become fewer and smaller in size and there can be severe skills shortages, especially where ex-combatants make up the labour pool. Businesses forced into the informal sector can become dependent on small social networks and face challenges growing. Those that remain in the formal sector may end up being over-taxed to compensate for the smaller fiscal base as other firms informalise. They may also become vulnerable to predatory or arbitrary enforcement through a weak or opaque regulatory framework.

One of the crucial factors is the change in the ‘enabling environment’. The enabling environment includes the strength and authority of institutions, the governance environment, the broader political economy, the capacity of government at all levels to implement policies and the social capital or ‘trust in society’ that exists in the affected country (Mills and Fan, 2006). There can be a profound lack of trust in society between individuals, and where the conflict has been based on ethnicity, between ethnic groups. There are often no explicit formal processes, so an absence of trust drives up the cost of business transactions. This environment of distrust propagates itself as a new generation of entrepreneurs educated to work in the informal system emerges.

African business sectors can be fractured between indigenous, minority and foreign investors (Eifert et al., 2006). Africa’s difficult business climate and the tendency to overcome this by working in ethnic networks slows new entry and may decrease the incentives of key parts of the business community from constituting an aggressive pressure group for reform. The private sector in much of sub-Saharan Africa, which includes several FCAS, is, in fact, dominated by ethnic minorities (Ramachandran et al., 2009).

Multilateral and bilateral donors can themselves undermine the investment climate. This can be through the flow of aid volumes and distortion of the local economy through demands from agency officials and aid workers (Mills and Fan, 2006).

There is little evidence of FCAS being singled out for particularly harsh treatment by investors. Investors seem to invest depending on market size and levels of liquidity in-country
(Moss et al, 2007). At the same time market size is dependent on how open borders are. Small countries in particular gain from regional integration which results in a larger market (Stecher, 2005). Regional integration is often dependent on having built strong and friendly relations with neighbouring countries which is not the case in several FCAS. Instead xenophobia and fear of foreign investors is common, a factor which disincentivises inward investment, at least in East Africa (Moss and Ramachandran, 2005). This is in spite of evidence to show that foreign firms invest in human and physical capital without crowding out local industry.

Investment climate is based to some extent on perceptions of risk. There has been a tendency in the past for investors to disinvest in developing countries following recession or credit rating issues in the investor’s own country (Rowat, 1992).

Finally there are those who criticise the premise of creating a good investment climate through improving governance practices. Moore and Shmitz (2008) argue that formalisation through explicit processes is not strictly necessary. There can be robust informal relationships between powerful elites and business interests which result in increased investment and economic growth. They note however that such informal relationships may also lead to abuse.

Khan (2005) argues that historical experiences show that rather than protecting property rights and eschewing rent-seeking, those countries that successfully grew did the opposite. It is important for states to precipitate profound structural changes. They must have the capacity to alter property rights and to manage rents which enhance growth, while destroying rents that reduce it. The market by itself cannot cause these changes and therefore there must be other targeted interventions. Efforts to formalise property rights and counter rent-seeking in FCAS may in effect be undermining the investment climate.

2. Defining a ‘strong investment climate’

http://siteresources.worldbank.org/INTWDR2005/Resources/03_WDR_PO1_Ch01.pdf

The World Bank World Development Report 2005 argues that improving the investment climates of their societies should be a top priority for governments. The report defines the concept of investment climate as well as providing recommendations for policy-makers.

The investment climate is defined as the set of location-specific factors shaping the opportunities and incentives for firms to invest productively, create jobs, and expand. Government policies and behaviours exert a strong influence through their impact on costs, risks, and barriers to competition.

Firms decide whether to incur costs today to change or augment production in the future, such as investing in machinery, facilities, and research and development. Firms come to the decision with different capabilities and strategies. Their decision is motivated by the quest for profits—and profitability is influenced by the costs, risks, and barriers to competition associated with the opportunity. The volume and productivity of the resulting investment contribute to growth and poverty reduction.

A good investment climate is not just about generating profits for firms—if that were the goal, the focus could be narrowed to minimizing costs and risks. It is about improving outcomes for society. Many costs and risks are properly borne by firms. Reducing barriers to competition expands opportunities, spurs innovation, and ensures that the benefits of productivity improvements are shared with workers and consumers.

A good investment climate is one that benefits everyone in two dimensions. First, it serves society as a whole, rather than just firms, including through its impact on job creation, lower prices, and broadening the tax base. Second, it embraces all firms, not just large or influential firms.

Drawing on firm-level surveys in Bangladesh, China, India, and Pakistan, this paper from the World Bank investigates the relationship between investment climate and firm performance. It explores the hypothesis that variations in "investment climate" across locations can explain much of this variation in growth rates.

The paper defines investment climate as the institutional, policy, and regulatory environment in which firms operate – factors that influence the link from sowing to reaping. If the local government is highly bureaucratic and corrupt; if government's own provision or regulation of infrastructure and financial services is inefficient so that firms cannot get reliable services – then returns on potential investments will be low and uncertain.

The list of indicators that were used to measure investment climate was based on interviews with firms, including open-ended questions about the main problems that they face. The authors note that it is always possible that something important is overlooked. The indicators of investment climate were:

- Number of inspections per year
- Management time dealing with regulations
- Unofficial payments as percentage of sales
- Days to clear customs
- Power loss in percentage of sales
- Days for a phone line
- Share of firms that have their own generator
- Share of firms that have their own well
- Share of firms with overdraft facility
- Share with bank loan
- Days to clear a cheque

Within the same theme the correlation between indicators was high. The paper suggests that firms in the best investment climate can be nearly twice as productive as those in weaker environments.

3. Factors that undermine a strong investment climate

http://lnweb90.worldbank.org/oed/oeddoclib.nsf/24cc3bb1f94ae11c85256808006a0046/ddc0d9477dab054e85256fa2007833bf/$FILE/investment_climates_eval_overview.pdf

This evaluation report identified a great deal of diversity in the constraints cites by different firms, or what to them would constitute a good investment climate. The econometric evidence suggested that business investment is influenced by tax policy and fiscal incentives, product market regulations, and high barriers to entry. The World Business Environment Survey (WBES) show that taxes and regulations, financing, policy instability and uncertainty, and inflation matter most for company growth and investment.

Some overarching issues (e.g., regulatory uncertainty) matter to most firms, but more specific constraints may be ranked differently by different firms, because firms are diverse. The relative priority of various constraints seems to depend on the size, age, input mix, and mobility of the firm and the industry in which it operates. Foreign investors care about different constraints than domestic investors do because of their greater mobility. Foreign direct investment (FDI) decisions are more heavily influenced by macroeconomic and political risk than are domestic investment decisions.
Interviews were conducted with a small number of multinational corporations headquartered in the United States, Europe, and Japan. For some firms, investment climate conditions take second place to factors such as cheap labour and large markets. Other investors cited physical security, rule of law, and currency convertibility as critical factors determining their investment locations. The cost and time required to register a business were viewed as relatively unimportant by most of these international investors.

Among the market and market-related factors, the paper found that a large market size as well as low entry barriers had a strongly positive effect on foreign investment activities as well as low entry barriers. By contrast, there is no clear empirical evidence that the distance between the donor and host country mattered for FDI inflows into the transition countries. As far as production inputs are concerned, the paper observed a strong negative effect of high unit labour costs on FDI, whereas the endowment of natural resources had no effect.

In addition to these market and market-related factors, the economic and political conditions played an important role. The countries that are most attractive have high economic stability, often reflected by tight monetary and sustainable fiscal policies, political stability, and are embracing of all efforts to liberalise and privatise and minimise state capture. These are much more attractive to foreign investors than countries which still suffer from economic and political instability.

Increasing trade openness is also associated with higher FDI inflows. Many of the factors that shape the transition process and lead to better economic and political conditions are also important determinants for FDI inflows. At the same time, high FDI inflows also contribute significantly to the continuation of the transition process - via economic growth or general improvements in the acceptance and transparency of corporate governance, for instance. This means that some of the determinants of FDI in turn depend on the amount of FDI inflows.


This report builds somewhat on the 2005 World Development Report (World Bank, 2005). It defines the concept of investment climate as the set of factors in a given location that shape firms’ incentives and opportunities to invest, grow and create jobs. Some of these factors are costs; others are risks; still others are the competitive forces in the economy. Together, they determine the vibrancy and reach of private sector firms in the economy. A strong investment climate is not a serendipitous occurrence: it is the result of country authorities formulating, implementing and enforcing an appropriate set of policies

Chapter 2 surveys the impact of conflict on what the report defines as four policy pillars if the investment climate – security and stability, finance and infrastructure, workers and labour markets, regulatory framework and taxation – as well as the broader enabling environment.

Security and Stability

- Physical Security – Business life becomes less transparent, less competitive and demands greater reliance on personal contacts. Individual business transactions are fewer in number and smaller in size. Private sector becomes less efficient through inability to benefit from economies of scale, or through kidnappings or extortion. International investors and tourists choose safer options instead.
- Macroeconomic stability – A shattered financial sector can cut off access to working capital and eliminates non-cash transactions. Depleted foreign exchange reserves can impede cross-border transactions, severe debt overhangs can disincentivise foreign investment, and there can be high inflation. Post-conflict exports tend to lag – productive capacity is reduced, export infrastructure (airports, ports) can be damaged, international commercial links are cut as foreigners seek more reliable suppliers. Assets can be expatriated – financial assets (i.e. capital) directly and non-financial
assets (e.g. property) sold and then the capital expatriated. Difficulty of exporting can incentivise activity in the non-tradable sector (e.g. construction and commerce) distorting the economy over the medium to long term.

- Contract enforcement and property rights – Civil benches do not sit, case backlogs build up, and judgements are not enforced. Private sectors actors are thus disincentivised to enter into formal transactions with unknown parties. There can be the ‘informal’ expropriation of property and disputes over rightful ownership. Post-conflict, there is likely to be large backlogs of unresolved disputes and an under-resourced judiciary with political uncertainty.

![Image](https://via.placeholder.com/150)

**Finance and Infrastructure**

- Access to credit and financial services – Banking sector disruption can mean business transactions must rely on cash. The lack of access to formal credit can necessitate reliance on informal financial services which are often expensive, unregulated and limited in range. Lack of nation-wide physical presence requires money to be moved around despite poor infrastructure and lack of secure storage and secure transition. This can limit the size of business deals.
- Infrastructure – infrastructure damage is particularly damaging to larger and formal firms and exporters. They may have physical infrastructure degraded through direct damage or inability to maintain them, lack access to power, and face significant transportation challenges. During infrastructure regeneration the sequence tends to be telecoms, energy, transport with water and sanitation last due to high capital costs and constrained regulatory environment.

**Workers and Labour Markets**

- There can be severe skills shortages with ex-combatants in particular often lacking education and marketable skills.

**Regulatory Framework and Taxation**

- Regulatory framework and informality – Many firms move operations into the informal sector. This increased risk and vulnerability and a greater reliance on social networks. The informal sector tends to be less efficient, with lower levels of investment, fewer economies of scale and a more localised customer base. New entrepreneurs start their business lives outside a culture of regulatory compliance compounding the challenge of formalising businesses. Where there is regulatory enforcement this may be arbitrary or predatory. The vacuum of ‘official bureaucracy’ may be filled by informal actors which can create an environment which restricts competition and participation.
- Fiscal policy – There is a depletion of the tax base and thus revenues. This can lead to ‘over-taxing’ the few businesses that remain in the formal sector, thus disincentivising business formalisation.

**Enabling environment**

The breakdown of governance norms associated with institutional weakness can lead to rampant corruption with extensive rent-seeking opportunities for unscrupulous individuals. Poorly-paid officials may start collecting bribes and senior officials may take advantage of administrative disorder to siphon off funds.

Private sector actors are not necessarily passive and may directly benefit from conflict, thus helping to sustain it. Extractive industries, for example, can play an important role in triggering conflict. Post-conflict reforms that attempt to re-start activity in these sectors can benefit the same conflict actors.

There is a general lack of capacity in government and private sectors. Government lacks capacity to provide security, appropriate infrastructure and to enforce rules. Businesses can lack the skills required to collaborate with each other and lack the capacity to innovate.
Conflict can impact social capital or ‘trust in society’. Damage to professional trust leads to an unwillingness to enter into transactions with unknown parties. This reduces the size and frequency of transactions. Where conflict has been fought along ethnic lines – the private sector can become balkanised, with private firms collaborating within respective groupings.

The very presence of development partners in post-conflict situations can also have a negative impact on the investment climate. Both the flow of aid, with its accompanying macroeconomic effects, and of aid workers, with their demands for housing and skilled labour, can distort the local private sector economy.

http://books.google.co.uk/books?id=oQ-OJg1U9gsC&lpg=PA195&ots=H6z-C3o-B7&dq=investment%20climate&lr&pg=PA195#v=onepage&q=investment%20climate&f=false

This paper ties together the macroeconomic and microeconomic evidence on the competitiveness of African manufacturing sectors. This paper finds a pattern of generally low productivity, and also suggests the importance of high indirect costs and business-environment-related losses in depressing the productivity of African firms relative to those in other countries. There are differences between African countries, however, with some showing evidence of a stronger business community and better business climate.

The paper considers African attitudes to business and notes the fractured nature of African business sectors as between indigenous, minority and foreign investors. The latter have far higher productivity and a greater propensity to export; however, Africa’s difficult business climate and the tendency to overcome this by working in ethnic networks slows new entry and may decrease the incentives of key parts of the business community from constituting an aggressive pressure group for reform. Even though reforms are moving forward in several countries, this slows their impact and raises the possibility that countries settle into a low-productivity equilibrium.


This paper draws on a set of enterprise surveys to investigate why the private sector has failed to thrive in much of sub-Saharan Africa. It identifies inadequate infrastructure (especially unreliable electricity and poor quality roads) and burdensome regulations as the biggest obstacles to doing business. The paper also finds that the private sector in many countries is dominated by ethnic minorities, which inhibits competition and lowers demand for a better business environment.

http://www.cgdev.org/files/12773_file_Moss_Rama_Stanley_Portfolio_Africa.pdf

This paper addresses the question of investment in sub-Saharan African listed securities by examining characteristics of the continent’s 15 equity markets, the rise and fall of African regional funds, and the asset allocation trends for global emerging market (GEM) funds. The paper finds that African markets are not treated differently than other markets and presents evidence that small market size and low levels of liquidity are a binding deterrent for foreign
in institutional investors. Thus, orthodox market variables rather than market failure appear to explain Africa’s low absolute levels of inward equity flows.

http://books.google.com/books?id=eSsyW2GxnlC&lpg=PA95&ots=rPXgLQ7_oJ&dq=determinants%20of%20investment%20climate&pg=PA21#v=onepage&q=determinants%20of%20investment%20climate&f=false

This brief chapter was written by the Corporate Vice President of Siemens to provide an investor’s perspective on the requirement for a good investment climate in developing countries. Developing countries need to provide investors with:

- Open borders and Regional Integration – Open borders and free entry and exit for goods, capital and staff define market size which influences investment decision. This is especially important with small countries.
- Infrastructure – Production sites with poor infrastructure – telecoms, energy, transport and water – can only integrated into international value chains with substantial cost, undermining their comparative advantage.
- Good governance – As well as rule of law this means a transparent and functioning legal and regulatory system.
- Human capital – A minimum level of education as well as a functioning public health system are necessary.

Moss, T. and Ramachandran, V. 2005, ‘Foreign Investment and Economic Development: Evidence from Private Firms in East Africa’ Brief, Center for Global Development

Africa’s share of global non-extractive FDI has been declining. Despite ongoing liberalization, part of this trend can be traced to lingering sentiments against foreign capital reinforced by local politics that help to create a difficult business environment. New results from firm surveys in Kenya, Tanzania, and Uganda suggest that many of the objections to foreign investment are exaggerated or false.

Foreign firms are more productive, bring management skills, invest more heavily in infrastructure and in the training and health of their workers, and are more connected to global markets. They do not appear to succeed by grabbing market share and crowding out local industry. These data suggest that there are important positive effects from FDI for both the host economies and the workers in foreign-owned firms.

Rowat, M., 1992 ‘Multilateral Approaches to Improving the Investment Climate of Developing Countries: The Cases of ICSID and MIGA’, Harvard International Law Journal Volume 33, Number 1 pp103 -144
http://heinonline.org/HOL/Page?collection=journals&handle=hein.journals/hilj33&id=109

This paper documents the substantial decline in the flow of investment to less developed countries (“LDCs”) in the 1980s. These declines reflected the adverse effect of the debt crisis on the perceived creditworthiness of LDCs and a sharp drop in investor confidence due to macroeconomic instability and recession in many countries. During this period, commercial bank lending suffered a great decline as banks reacted to mounting arrears by moving to reduce their overall exposure to LDC debt. Substantial capital flight from LDCs, resulting from an erosion of domestic confidence, compounded the problem.

Many LDCs have signed bilateral investment treaties (“BITs”) with capital exporting countries. BITs traditionally deal with such elements as regulation of entry and establishment, national
treatment, monetary transfers, and protection against dispossession. More recently, BITs have addressed the settlement of investment disputes, and about half specifically mention the World Bank's International Centre for Settlement of Investment Disputes ("ICSID"). Although it is difficult to measure the impact of BITs on actual investment flows, they tend to enhance investor confidence by acting as a deterrent to arbitrary host government measures. The widespread use of these provisions indicates that ICSID has contributed materially to the increase in investor confidence and the attractiveness of LDCs as investment targets. Finally, ICSID appears to have had a synergistic impact on foreign investment in LDCs. This has been through supporting the Multilateral Investment Guarantee Agency (MIGA) indirectly through MIGA's commitment to the use of ICSID rules to resolve certain kinds of disputes. ICSID has also helped MIGA directly in its risk assessments by collecting and analyzing investment laws and treaties.


This paper reviews what is meant by the investment climate and then concentrates on the institutional dimension of investment climate reform. The paper challenges the standard advice in such reform that governance through informal relationships should be replaced with governance through formal rules.

There are cases where substantial increases in investment have occurred even though property and contracts were not legally protected. In these cases, informal relationships between those who hold political power and those who decide on investment seem to have been critical to stepping up investment and economic growth. Such hand-in-hand arrangements between politicians and investors may offer a more realistic way forward in poor countries with weak public institutions. However, such arrangements can be, and indeed have been, abused. It is important to specify the circumstances in which hand-in-hand arrangements have the desired effect. Where these arrangements are transitional and raise productive investment, they are likely to strengthen the demand for formal rules. The central issue is thus one of sequence and dynamics – investors may be catalysts for institutional reform rather than followers of it.

http://books.google.co.uk/books?id=eSsybW2GxnIC&lpg=PP1&pg=PA77#v=onepage&q&f=false

This paper provides empirical observations that raise questions about the adequacy of the theory underlying the current consensus on what constitutes a good investment climate. Underlying the good governance and investment climate approaches is a theory of capitalist development which the author argues has many weaknesses. Good governance and investment climate approaches may well be bypassing the difficult questions about social transformation. Instead it focuses on reforms that make an already existing capitalist market economy work better.

Recent historical experience suggests that developing countries that successfully transformed themselves into growth economies shared a number of important characteristics that were quite different from those identified in the investment climate and good governance approaches. These characteristics enabled their states to play a critical role in ensuring rapid structural changes. Two of the most important were:

- The capacity to alter property rights
- The capacity to manage growth-enhancing rents and destroy growth-reducing rents.
Far from guaranteeing not to intervene in property rights, dynamic transformation states actively engaged in property right transformations that transformed poorly performing pre-capitalist property rights into rights that were more appropriate for rapid productivity growth. These changes in the structure of rights were organized only partly through markets. Many important changes involved non-market transfers and interventions. These ranged from direct interventions in property rights (such as land reform) to indirect interventions that tilted the playing field to make it easier for some groups to acquire new rights (involving policies affecting relative prices, taxes, exchange rates, and land regulations) and even included state involvement in illegal transfers of rights (land grabs by individuals or groups connected to political power). It is not possible to generalize about the role of any of these processes in the capitalist transformation, since the type of intervention and its effect varied dramatically across countries, depending on initial technological and institutional conditions and internal political power structures.

Of note is that capitalism did not emerge where states lacked the institutional and political capacity to carry out far-reaching changes in rights and where states simply protected the sanctity of pre-capitalist property right structures. Dynamic states also intervened in markets to create and manage rents to accelerate technology acquisition and to promote the competitiveness of emerging domestic capitalists. This, too, is very different from the good governance claim that competitive markets require that states should not intervene. There is a big difference between creating and maintaining international competitiveness and withdrawing all rents from the market and eliminating the capacity of the state to create any rents. Industrial countries maintain significant rents in their markets to promote technological innovation and stabilize their polities. In just the same way, developing countries have to acquire the capacity to create and manage rents to accelerate the adoption of new technologies and manage their polities. Dynamic transformation states had these capacities; less dynamic states often did not.

The good governance and investment climate approaches divert attention from how to create the critical rent management capacities in developing countries. The service delivery conception of the state underlying the good governance and investment climate models argues that the state should restrict itself to a very limited number of service delivery tasks. If the state is trimmed down to a few key service delivery agencies and made to protect existing property rights to the best of its ability, the possibility of creating an effective transformation state in the future may be significantly reduced. If making a real difference in the investment climate requires creating a viable capitalist economy, investment climate reforms that reduce the state to service delivery tasks may paradoxically make it more difficult to achieve the investment climate that is desired.


This chapter outlines the conditions under which foreign direct investment provides the most positive contribution to the host economy; identifies the determinants for success and failure in attracting and harnessing nonextractive, noninfrastructure investment, in the experiences of low-income states; and identifies mechanisms which developed countries can facilitate the flow of foreign direct investment to low-income countries.

The paper notes that large resource exports can lead to an overvalued exchange rate, which makes it difficult for other indigenous industries to compete in international markets. This is a developing country rendition of what has been called the Dutch disease. There is also the temptation to use revenues from natural resource exports for personal gain, political payoffs, and other corrupt or quasi-corrupt practices. The presence of natural resources can trap the country into a political system that diverts revenues to special interests and uneconomic purposes. Countries like Nigeria, where oil-based income has largely been squandered, readily fit this picture. Countries like Chile, where copper-based income has generally been devoted over time to sensible economic and social endeavours do not.
Additional Information

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