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Sovereignty en garde: negotiating with foreign investors

Dennis J. Encarnation and Louis T. Wells, Jr.

Competition among governments for foreign investment appears to be on the rise. Whether the contest pits Ohio against Tennessee, Scotland against Ireland, Singapore against Taiwan, the story remains the same: numerous governments, at all levels and on all continents, are actively vying for the opportunity to serve as hosts for foreign firms. The frequency, volume, and scope of investment incentives granted over the past few years by governments within the European Community and among Latin American and Asian countries illustrate this larger trend.[1] Few countries are exempt from the trend, few are unaffected by the changes it has wrought.

The reasons for this competition are many and varied. Among them is the renewed caution of foreign commercial lenders about covering shortfalls in domestic savings. Foreign firms offer another potential channel for increasing domestic investment. They may at the same time offer access to overseas markets and could generate new sources of foreign exchange. In the past few years the scope of this competition for foreign direct investment has become more global. Gone are the days when Latin America was the territory of only North American firms; European and Japanese firms are interested and can be attracted. Similarly, ex-colonies that once looked to Britain or France for investment now look elsewhere as well, both because

Our intellectual debt to Raymond Vernon is reflected in the title to this article. The reference is to Vernon's *Sovereignty at Bay* (New York: Basic Books, 1971).

1. For an overview of investment incentives in industrialized countries, see OECD, Committee on International Investment and Multinational Enterprises, "Survey on Investment Incentive Policies in Member Countries" (Paris: OECD, May 1982). For an overview of such policies in economically less developed countries, see George E. Lent, "Fiscal and Other Measures to Promote Industry in Developing Countries" (Paris: OECD, November 1980). Aside from the few systematic analyses, data on investment incentives may be garnered from innumerable catalogues of these policies. For the EEC, see Douglas Yuill and Kevin Allen, eds., *European Regional Incentives: 1981* (Glasgow: Centre for the Study of Public Policy, University of Strathclyde, 1981). For south and east Asia, see the SGV Group, *Comparative Investment Incentives: 1981* (Manila: SGV Development Center, 1981).

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firms' horizons have broadened and because the countries want to loosen their dependence on one or two sources of funds and know-how. But the flow of new foreign direct investment has also begun to fall off. Not only have growth rates in total stock declined over the last two decades, but much of the new investment made by multinationals during the 1970s came from retained earnings. As the attractiveness of foreign investment grows, as the competition for that investment becomes more global, and as its supply diminishes, the specter of "foreign investment wars" looms ever larger. Governments try to outbid their "competitors" with packages of investment incentives and other inducements.[2]

How do governments compete for investment? Analysts have identified several interrelated components of competition.[3] Governments may increase the returns to the foreign investor through combinations of commodity and factor incentives, including tariff protection, tax holidays, loan guarantees, and cash grants. These inducements are often designed to offset and often to exceed the potential costs associated with a variety of so-called performance requirements. Limits on ownership of local subsidiaries, rules on how much they must export or buy locally, whom they must employ, and how they must finance their operations apply almost everywhere. In addition to altering net incentives to induce investment, governments also try to differentiate their jurisdictions from "competitors" by creating images of attractive business climates. In so doing, a government may alter the organizational structures and processes that direct the promotion of investment opportunities and the negotiation of investment applications. It is the last of these components of competition that we address in this article—for a government's management of international business negotiations ultimately shapes its effectiveness in competing for foreign investment and negotiating terms with investors.

While the effectiveness of specific incentives in shaping investment decisions is hotly debated,[4] few doubt that government organization for negotiations

2. C. Fred Bergsten, "Coming Foreign Investment Wars," *Foreign Affairs*, October 1974, pp. 135–52.

3. See Dennis J. Encarnation and Louis T. Wells, Jr., "Competitive Strategies in Global Industries: A View from the Host Country," in Michael E. Porter, ed., *Competition in Global Industries* (Boston: Harvard Business School Press, 1985); Stephen Guisinger, "Investment Incentives and Performance Requirements: A Comparative Analysis of Country Foreign Investment Strategies," mimeo (Washington: International Finance Corporation, July 1983); and Donald Lessard, "Specific Incentives for Direct Foreign Investment," mimeo (Washington: International Finance Corporation, January 1978).

4. The most widely held conclusion among researchers is that tariff and tariff-equivalent trade barriers serve as important stimuli for most investments designed to service a domestic or common market. For these investments, tax and other incentives may influence the final location within a national or regional market but not the prior decision to enter that market. By contrast, for export-oriented investments, especially investments characterized by mobile factors of production, tax and other incentives may play a larger role in the initial choice of location sites. Such investments, whether they serve regional or global markets, are often the targets of intense competition among potential host countries. For an early review of this literature, see Grant L. Reuber et al., *Foreign Private Investment in Development* (Oxford: Oxford University Press for the OECD, 1973), pp. 120–32. For a more recent review, see Encarnation and Wells, "Competitive Strategies in Industries."

is critical to bargaining outcomes.[5] The establishment of appropriate decision-making structures and processes has a profound impact not only on the outcome of bargaining with foreign firms but also on the domestic political economy. From the perspective of the host government, failure here may impose economic and political costs on the regime.[6] Incentives may exceed the minimum necessary to attract foreign firms, for example, or may even exceed the social (economic) benefits offered by the firm. On the other hand, incentives may be too small to attract the desired investment. The granting of incentives or the imposition of performance requirements, moreover, may alienate domestic constituencies and thereby carry high political cost.

Foreign enterprises, from their perspective, have much to gain from the increased competition among countries for investment. A financial executive from one large European multinational, which operated in over sixty countries, reckoned that the share of his group's total investment accounted for by grants and other investment incentives doubled in value over the five years through 1982, from 2 percent to 4 percent.[7] But the costs of negotiation and compliance must also figure prominently in a firm's investment decision.[8] Negotiations may be long and thus costly in management time. The outcome of the negotiations, or subsequent implementation of terms agreed to, may be so uncertain as to repel attractive investors. The failure of governments to establish appropriate structures and procedures may thus diminish the level and type of investment sought either by the firm or by the host government. In many cases, however, the approaches that are most attractive for potential investors carry the biggest domestic political costs.

What, then, is the most appropriate organizational response by governments in their negotiations with foreign firms? Government officials, international

5. When managers of foreign firms are asked to rank-order those factors which are important to their investment decision, one consistent conclusion emerges. Irrespective of host country or manufacturing industry, managers consistently rank political and administrative concerns as more important than government incentives. These general concerns figure prominently in managers' appraisals of the overall "investment climate" of the host country. For a summary of and addition to this research, see Stephen J. Kobrin, *Managing Political Risk Assessment* (Berkeley: University of California Press, 1982), pp. 114–20.

6. With regard to economic costs, the frequency of unattractive investments in LDCs is suggested in Reuber et al., *Foreign Private Investment*, pp. 17–39. For more recent evidence employing social cost/benefit analysis of data covering 50 foreign-investment decisions, see Dennis J. Encarnation and Louis T. Wells, Jr., "A Mixed Bag: Foreign Private Investment in Development," Harvard Business School Working Paper (Boston, 1985).

7. Quoted in the *Economist*, 19 February 1983, p. 86.

8. See Kobrin, *Managing Political Risk Assessment*, pp. 109–24. We are also familiar with numerous examples. In one case a U.S.-based oil company spent months negotiating with a state enterprise for a contract for a hard mineral. The fact that the state firm had no power to reach an agreement was not understood by the investor, who had simply extrapolated from the firm's experience in oil in the same country; for in oil the state oil firm could conclude agreements.

organizations, academic researchers, and consultants have made innumerable proposals concerning how governments should organize themselves to negotiate with foreign investors. The centralization of negotiation and decision making is the theme common to most such recommendations. Centralization has been particularly emphasized by critics of foreign private investment in development; for example, Constantine Vaitsos, Paul Streeten, and Sanjaya Lall have argued that the more centralized the screening body, the greater the bargaining power of the host government, and the more favorable the outcome of negotiations for the host.[9] Sharing this perspective, a group of "eminent persons" set up by the United Nations recommended that host countries should "establish centralized negotiating services or coordinating groups to deal with *all* foreign investment proposals."[10] Proponents of centralization have not, to be sure, been limited to critics of foreign investment. The U.S. government, for example, has at times pushed developing countries to centralize their negotiation processes, especially after would-be investors from the United States have been rejected following months of tedious negotiations with numerous host government agencies. The interests of the U.S. and other home governments are, of course, focused on quicker decisions rather than tougher deals by host governments.

Yet, with prescriptions galore, none of these parties has proposed an empirically grounded analytical framework for choosing among alternative negotiating approaches. The conventional advice, moreover, regardless of its source, has frequently gone unimplemented or, when implemented, has turned out to lead to results quite different from those intended.[11] We propose an analytical framework in this article, but we also depart from existing mythology. We argue instead that no single organizational structure or administrative process is optimal for all countries or for all industries. Centralization is "right" for some countries or for some industries if certain conditions are satisfied, but "wrong" for others. It is, we hold, one choice in the portfolio of organizational responses available to host governments. As we shall demonstrate, associated with each organizational choice available to government is a range of economic and political costs and benefits that are valued differently by the domestic and foreign interests affected by the negotiation's outcomes. Advocates of unbridled centralization fail to assess these costs. But the patterns of choice are not random, they are the result of identifiable variables. Competition among countries for investment is one of these variables.

9. Constantine Vaitsos, *Intercountry Income Distribution and Transnational Enterprises* (Oxford: Clarendon Press, 1974), p. 122; Sanjaya Lall and Paul Streeten, *Foreign Investment, Transnationals and Developing Countries* (London: Macmillan, 1977), p. 217.

10. UN, Department of Economic and Social Affairs, *The Impact of Multinational Corporations on Development and International Relations* (New York, 1974), p. 38, our emphasis.

11. Southeast Asian countries, for example, are strewn with proposals for creating or modifying boards of investment and related bodies. To illustrate, see Stephen A. Guisinger, "Investment Incentive Strategies for Thailand's Industrial Development," mimeo (Washington, D.C.: World Bank, 1980).

1. The bargaining power of host governments

Despite the importance a host's internal organizational choice has for the investment decision, neither the dependency nor the bargaining school of thought has paid much attention to the issue. Only a few studies delve deeply into the institutional dynamics of government to explain the processes and outcomes of negotiations between multinational firms and host governments.[12] Most studies, by contrast, view government as a monolithic, undifferentiated whole—whose behavior is modeled, often implicitly, in a way not unlike the neoclassical economist's idealized firm.[13] This research holds that a host government's bargaining power relative to the foreign investor is likely to increase if:

the investment is designed to service the domestic market rather than service export markets that may be controlled by the investor downstream from the production site;[14]

the investment employs factors of production (energy feedstocks as opposed to cheap labor) that are not easily substitutable across countries;[15]

the investment is actively sought by competing firms;[16]

the investment requires a relatively low technology with multiple substitute sources;[17]

the investment produces largely undifferentiated (generic) goods that do not require large marketing or research and development expenditures;[18]

the investment requires large capital investments that once in place are not easily liquidated or moved;[19]

the investment requires the involvement of government as a principal financier, a principal consumer, a principal distributor of outputs, a

12. For example, Joseph M. Grieco, "Between Dependence and Autonomy: India's Experience with the International Computer Industry," *International Organization* 36 (Summer 1982), pp. 609–32, and Gary Gereffi, "Drug Firms and Dependency in Mexico: The Case of the Steroid Hormone Industry," ibid. 32 (Winter 1978), pp. 237–86.

13. See, for example, Stephen J. Kobrin, "Foreign Enterprise and Forced Divestment in LDCs," *International Organization* 32 (Winter 1980), pp. 65–88.

14. Gereffi, "Dependency in Mexico," pp. 237–86; Nathan Fagre and Louis T. Wells, Jr., "Bargaining Power of Multinationals and Host Governments," *Journal of International Business Studies* 13 (Autumn 1982), pp. 9–23.

15. Reuber et al., *Foreign Private Investment*, pp. 120–32.

16. Grieco, "Between Dependence and Autonomy"; Frederick T. Knickerbocker, *Oligopolistic Reaction and Multinational Enterprise* (Boston: Harvard Business School, 1973).

17. Grieco, "Between Dependence and Autonomy"; Fagre and Wells, "Bargaining Power."

18. Dennis J. Encarnation and Sushil Vachani, "Creative Responses to a Hostile Environment: MNCs in India," Harvard Business School Working Paper (Boston, January 1984); Fagre and Wells, "Bargaining Power."

19. Theodore H. Moran, *Copper in Chile* (Princeton: Princeton University Press, 1977); David A. Lax and James K. Sebenius, "Insecure Contracts and Resource Development," *Public Policy*, Autumn 1981, pp. 417–36.

principal supplier of inputs, or a principal regulator of either inputs or outputs;[20]

and finally, the investment is negotiated by a centralized body.[21]

It is this final proposition which merits closer scrutiny. As Lall and Streeten argue,

> In many LDCs, different items for negotiation are decided upon by different ministries or departments, which do not see the issue as a whole and often act in contradictory ways. The TNC [transnational corporation], on the other hand, acts as one coherent unit with a fairly clear idea of what its objectives are. The result often is that the TNC is able to secure advantages which it would not be able to secure if all the official functions, or, at least, the responsibility for important decisions concerning them, were centralized in one powerful body.[22]

The hypothesized linkage between centralized screening bodies and host-country bargaining power assumes that these new, centralized institutions will be able to diminish interagency squabbling in dealing with foreign investors and thereby muster the requisite technical expertise and ultimately obtain more social (economic) benefits for the host country. But such an assumption ignores other sources of agency power elsewhere in the government, sources that are independent of the formal centralization of authority. Generally, according to a burgeoning literature on bureaucratic behavior, a government agency's bargaining power increases if:

the agency occupies a monopolistic or dominant oligopolistic position in the tasks that it performs, tasks such as policy implementation that may be "downstream" from the original negotiation;[23]

the agency supplies the rest of the government with inputs such as technical evaluations that are highly differentiated and not easily substitutable across agencies;[24]

the agency has access to alternative supplies of resources, including financial revenues and political support, outside larger government control;[25]

20. Dennis J. Encarnation, " 'Self-Reliant' Development: The Political Economy of Industrial Policy in India" (manuscript, 1984); John Zysman, "The French State in the International Economy," in Peter J. Katzenstein, ed., *Between Power and Plenty* (Madison: University of Wisconsin Press, 1978), pp. 255–93.

21. Lall and Streeten, *Foreign Investment*, p. 217; UN, *Impact of Multinational Corporations*, p. 38.

22. Lall and Streeten, *Foreign Investment*, p. 217.

23. For an original exposition of this hypothesis, see William A. Niskanen, Jr., *Bureaucracy and Representative Government* (Chicago: Aldine-Atherton, 1971).

24. For a review of this literature, see Dennis J. Encarnation, "William Niskanen on Bureaucratic Responsiveness: An Empirical Analysis," Harvard Business School Working Paper (Boston, January 1983).

25. Graham T. Allison, *Essence of Decision: Explaining the Cuban Missile Crisis* (Boston: Little, Brown, 1971); Aaron Wildavsky, *The Politics of the Budgetary Process*, 2d ed. (Boston: Little, Brown, 1974).

and the agency has the administrative, technical, and political capacity to integrate all functions within its domain.[26]

The creation of a new, truly centralized screening body involves the suppression of other government agencies with potential power. This suppression is likely to be undertaken at high political cost. Moreover, the new, centralized body, even if it obtains the requisite power, may not possess the technical skills or the political mandate necessary to insure that a proposed investment produces the greatest social benefits for the country.

By focusing on bargaining relations inside host governments, and between host-government agencies and foreign investors, our research represents a sharp departure from existing studies. Furthermore, our research was designed to include differences across countries, across industries, and over time—variation that prior research has generally ignored.[27] Finally, existing research is strewn with studies that examine cross-nationally what governments say they do, with little attention to what governments actually do.[28] Again in contrast, we focused on actual negotiations that often extended over several years.

This research is based on field interviews, supplemented by published accounts, delving into business-government negotiations about "greenfield" investments proposed in the five years between 1978 and 1982.[29] We attempted to reconstruct with government officials and private managers the details of specific negotiations in the time period. Four industries and four countries were chosen for close scrutiny. Industry selection recognized variation in characteristics that have a known effect on bargaining relations between host and investor and, ultimately, on competition for investment: level of technology, size of investment, export potential, and supply of investment.[30] The industries chosen were petrochemicals[31] (especially high-

26. For a review of this literature, see Lester M. Salamon and Gary L. Walmsley, "The Federal Bureaucracy: Responsive to Whom?" in Leroy N. Riesalback, ed., *People vs. Government: The Responsiveness of American Institutions* (Bloomington: Indiana University Press, 1975), pp. 151–88.

27. Several studies ignore variation in negotiations across industries. They include Yair Aharoni, *The Foreign Investment Decision Process* (Boston: Harvard Business School, 1966); Ashok Kapoor, *International Business Negotiations* (New York: New York University Press, 1970); William A. Stoever, *Renegotiations in International Business Transactions* (Lexington, Mass.: Lexington Books, 1981). Other studies ignore variations in negotiations across countries. They include Francois J. Lombard, "Screening Foreign Direct Investment in LDCs: Empirical Findings in the Colombian Case (1967–75)," *Journal of International Business Studies* 9 (Winter 1978), pp. 66–80, and his *The Foreign Investment Screening Process in LDCs: The Case of Colombia* (Boulder: Westview, 1979).

28. See, for example, Richard D. Robinson, *National Control of Foreign Business Entry* (New York: Praeger, 1976).

29. "Greenfield" investments were defined as new investments requiring the fresh inflow of foreign equity and loans and not involving expansion or reinvestment by existing foreign investors.

30. Fagre and Wells, "Bargaining Power." Case studies of bargaining relations between host countries and foreign firms further demonstrate the importance of these variables; see note 12 for citations.

31. For a good examination of the role of incentives and performance requirements in shaping

density polyethylene), vehicle engines (diesel and gasoline), business and personal computers (hardware and peripherals), and food products (milk- and flour-based).[32] Country selection first insured geographic proximity, since nearby countries often assume that they are in competition for investment. In choosing four proximate countries, we also sought variation in other characteristics that may have an effect on competition for investment: trade strategy (import substitution vs. export promotion); investment strategy ("pay-as-you-go" vs. external financing); and domestic market size. The countries chosen were Singapore, the Philippines, Indonesia, and India.[33]

We identified twenty investment negotiations that were conducted in the four industries and four countries during the five-year period. Some had been successfully concluded; some had not. We visited each of the four countries during 1982 and 1983 to interview both government officials and business managers who had been involved in the negotiations. We probed for the reasons why the negotiations were conducted as they were and who was involved at each stage. By contrasting the events of the negotiations on which we focused with other negotiations mentioned by informants, we were able to understand more about the broader patterns followed in each country.

2. General patterns of decision making: a portfolio of organizational response

Governments are organized primarily along functional lines—finance, industry, agriculture, foreign affairs, defense, and so forth—with an additional component of such industry-specific units as state-owned enterprises and regulatory bodies.[34] Structures reflect the needs of governments for technical

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foreign investment in this particular industry, see H. Peter Gray and Ingo Walter, "Investment-Related Trade Distortions in Petro-chemicals," *Journal of World Trade Law* 17, 4 (1983), pp. 283–307.

32. Low-tech food products contrast with high-tech computers; huge petrochemical investments contrast with small facilities used in the manufacture of computers and food products; the export potential of computers contrasts with the short-term spoilage of milk-based products or the worldwide glut of petrochemicals; the paucity of overseas computer investments contrasts with the recent spate of diesel-engine negotiations.

33. Export-led Singapore with its small domestic market contrasts with import-substituting Indonesia or India with its large market; the strategies of "self-reliant" investment pursued by India and Indonesia contrast with the heavy use of external finance by Singapore and the Philippines.

34. General surveys of government strategies and structures for negotiating with foreign investors may be found in several sources. For an overview of all four countries in our study, see U.S., Department of Commerce, *Investment Climate Statements: Major Trading and Investment Partners* (Washington, D.C.: International Trade Administration, April 1981), and *Incentives and Performance Requirements for Foreign Direct Investments in Selected Countries* (Washington, D.C.: Domestic and International Business Administration, January 1978); UN Centre on Transnational Corporations, *Foreign Investment Policies and Screening and Monitoring Procedures in Selected Developing Countries* (New York: UNCTC n.d.), and *National Legislation*

support from policy experts and for political support from policy constituencies.[35] Since private investment and especially foreign investment inevitably affects the interests and constituencies of more than one existing governmental unit, the several ministries or agencies most affected are likely to want to be involved in discussions with and decisions about potential investors. However, the haphazard involvement of all of these units may result in substantial costs.

To address the varied interests of their subunits, governments employ at least four approaches to negotiate with foreign investors. Each of these patterns of decision making involves a different combination of governmental structures and of processes and procedures. Each also offers a different combination of economic and political, social and private costs and benefits. Taken together, these approaches represent the portfolio of organizational responses available to government.

a. Abstention from individual negotiations: a reliance on rules

Some countries leave little or nothing for individual negotiations with a foreign firm. Rules toward a specific foreign investment project are predetermined by the government's national economic policies. Most foreign investors are simply excluded from Albania or Burma, for example. At the other extreme are countries that welcome foreign investors but that specify clear rules applicable to all firms. They also preclude any need for business-government negotiations. Hong Kong and the U.S. federal government illustrate this approach. Both follow generally nonselective policies with respect to private investors, be they foreign or domestic. The areas from which foreign investors are excluded are few and fairly sharply defined. Thus there is almost never a need for Hong Kong or federal government agencies in the United States to negotiate important matters with foreign investors.

Similarly in some countries that we studied, a policy of non-negotiation is offered to foreign investors if they choose not to seek host-country incentives or if they are not subject to local performance requirements. In Singapore, for example, no application for approval was necessary for investment in manufacturing if no incentives were sought. Even governments that erect more comprehensive regulatory regimes often refrain from engaging themselves formally in negotiations that involve investment in certain industries or minimal foreign participation. In the Philippines, for example, joint ven-

and Regulations relating to Transnational Corporations: Part I and Part II (New York: UNCTC, 1983). For surveys of Indonesia, the Philippines, and Singapore, see Guisinger, "Investment Incentive Strategies," as well as Richard D. Robinson, *Foreign Investment in the Third World: A Comparative Study of Selected Developing Country Investment Promotion Programs* (Washington, D.C.: U.S. Chamber of Commerce, 1980). Individual country profiles can also be obtained from consulting groups; for example, SGV Group, *Comparative Investment Incentives.*

35. For the interplay of policy experts and policy constituencies in business-government negotiations in one of the countries we examined, see Dennis J. Encarnation, "The Indian Central Bureaucracy: Responsive to Whom?" *Asian Survey* 19 (November 1979), pp. 1126–45.

tures in most industries that involve less than 30-percent-foreign equity did not need to register with the Philippine Board of Investment, provided they requested no incentives. Only registration with the central bank in compliance with minimal foreign-exchange regulations was required. In these cases, earlier negotiations within government had already established overall rules.

Among the benefits of non-negotiation is the greater predictability of the outcome for both government and investor compared to the inevitably more ambiguous negotiations associated with selective policies. Consequently, the potential costs for the firm considering entry are likely to be low. On the other hand, simple rules are unlikely to optimize for a country the benefits theoretically obtainable from each potential investment. General exclusion will keep out some investments that might be beneficial to the country, whereas a very open policy will result in the entry of some investments that are not socially profitable. Between these two extremes, investment screening may be necessary if the host country is to extract all the potential social benefits, especially in the presence of trade barriers and limited domestic competition.

b. Diffusion of government decision making

Once a government adopts public policies that require negotiations with prospective foreign investors, the government's approach to negotiating with these investors is likely to involve, in some way, several units that represent various domestic interests. In many cases, the result has been that a foreign investor must conduct a series of difficult negotiations dispersed across several ministries, agencies, and enterprises whose operations and interests would be affected by the proposed investment: for example, the ministries of industry, trade or finance, the central bank, and perhaps a state enterprise in the sector.

All four countries we studied once followed a diffused organizational pattern in most of their negotiations with foreign investors. By the period under study, however, they were using a diffused approach only occasionally. In Indonesia before 1967 about ten ministries were formally responsible for processing investment applications and issuing licenses. Likewise in India most potential investors had to negotiate until recently with an assortment of government departments, directorates, commissions, enterprises, lending institutions, and subnational authorities. Over the past two decades in the Philippines a host of government agencies—including the National Economic Development Authority and the Ministry of Trade, for example—were eventually eclipsed by the Board of Investment (BOI) as the principal negotiating arm of the government. Similarly during Singapore's brief flirtation with import substitution several government agencies were involved in negotiations that set protective tariffs and granted concessions.

This direct involvement of many units of government in foreign-investment negotiations can result in several benefits for the country. Certain agencies and state-owned enterprises can muster the technical expertise necessary for evaluating proposals for a specific industry. When the same people are regularly assigned to foreign-investment negotiations, furthermore, technical skills and in some cases longevity of employment enable such specialized units to learn and retain lessons that may enhance the government's negotiating skills for the future. At the same time, however, agencies and ministries with little technical knowledge or limited experience are likely to have a major impact on negotiations. They may insist on performance requirements that repel an otherwise desirable investor, for example, without even caring about or understanding the full implications of their demands. Diffuse units operating autonomously also have little ability to evaluate overall net benefits in light of larger policy issues. For example, a ministry of labor is likely to support a project for the employment it generates, whatever the cost in terms of foreign exchange or foregone tax revenues. As a consequence, too little or too much may be offered to the potential investor. Moreover, an individual government unit has no incentive or mechanism to consider the wider implications of its actions on potential foreign investors or in other industries. As a result, inappropriate precedents may be established.

Finally, a diffused approach is likely to be costly to the foreign investor. The period of negotiation is likely to be longer and the results unpredictable at the outset. The potential investor with only marginal interests is likely to go elsewhere. In the countries that we studied, it was this last factor that led governments to seek other approaches to negotiation.

c. Coordination of government decision making

Certain institutional frameworks can reduce the costs that diffuse decision making seems to impose on the attraction of foreign investment and, perhaps, on the optimization of decisions by government. To this end, some host countries have attempted in recent years to coordinate their side of foreign-investment negotiations. In fact, all the countries in this study had abandoned the diffuse pattern in favor of more coordinated structures for practically all the negotiations that we examined. These efforts at coordination most often entailed the creation of new decision-making structures whose operations cut across the existing functional divisions of government. Membership involved representatives of the agencies and constituencies most affected.

The interministerial bodies subsequently created may be either permanent or temporary and may handle negotiations involving a single firm, a single industry, or entire sectors of the economy. The Board of Investment in the Philippines and the Capital Investment Coordinating Board (BKPM) in Indonesia were examples of permanent, interministerial, coordinating bodies that dealt with several industries and that played a significant role in their governments' decision processes.

The Secretariat for Industrial Approvals (SIA) in India also played a coordinating role for several industries; however, in marked contrast to the BOI or the BKPM, the most important function of India's SIA was to serve as an administrative clearinghouse for investment applications. These applications were subsequently routed to ad hoc committees—various combinations of government agencies. These ad hoc committees are a second type of coordinating approach. Some foreign investors in Indonesia and the Philippines, although with less frequency than in India, also faced ad hoc committees made up of representatives of concerned ministries and enterprises. These coordinating committees, such as the one used to negotiate a $2-billion petrochemical project in Indonesia, were separate from the permanent interministerial investment board and may have been created with the expectation that they would be short-lived.

Many of the disadvantages associated with a diffusion of decision making may be overcome by coordinating bodies. The motivation for establishing such bodies is usually to reduce a potential investor's costs of negotiating; as a result, more investors may be attracted to the negotiating process. In fact, the biggest potential gains could come from the reduction of interministerial conflict (as is implied in the prescriptions offered by advocates of centralization). The potential benefits of such conflict reduction are several: a more coordinated position focuses government attention on the social benefits derived from a prospective investment, on the construction of incentives and performance requirements to optimize these social benefits, and on the coordination of related government decisions across investors. Coordination is probably best derived from permanent organizations concerned with a wide range of industries. But in practice, as we argue below, these benefits did not seem to be realized to the extent hypothesized.

In comparison to permanent structures that span industries, ad hoc, specialized coordinating units (such as the one created for a petrochemical investment in Indonesia) have their own special strengths; in particular, they are able to assemble experts with in-depth knowledge of technical and financial issues for particular industries. But they have special weaknesses as well: what they gain in technical skills they lose in considering larger policy issues. They usually have little concern for the impact of their decisions on other industries. The opposite holds for a permanent body that negotiates in many industries: while wider policy issues may be addressed, the organization is likely to be quite poor at amassing in-depth knowledge of a particular industry.

One major barrier stands in the way of the creation and effective functioning of coordinating bodies, either ad hoc or permanent. Both types of organization entail serious internal political costs, whose magnitude researchers and advisers usually underestimate. Any participating ministry is likely to see its influence diminished if it cooperates fully with a coordinating body. To preserve influence, politically powerful ministries are tempted to send only low-level people to meetings and later impose their power over the investor administratively, during the implementation of agreements. In Indonesia, for example, the Ministry of Finance was reported not to have honored some agreements reached in the past between the BKPM and foreign investors. Furthermore, neither the BKPM in Indonesia nor the BOI in the Philippines had the authority to set tariff rates—often the single most important investment incentive for domestically oriented projects. This power remained in the ministries of finance or trade. The result, in many such cases, is a weak coordinating body that fails to resolve differences among ministries, a body that may fail to reduce appreciably the negotiating costs incurred by investors.

d. Delegation of government decision making

Seeking to overcome these problems, governments may delegate to specific decision-making units complete authority to negotiate with foreign firms. Rather than coordinating the considerations of ministries or other government agencies, these bodies have the authority to make decisions themselves. Governments may delegate decision making in two ways.

First, governments may delegate the foreign-investment decision for a single industry to individual government agencies or state-owned enterprises. In so doing, governments hope to accumulate and use technical expertise and to optimize organizational learning with regard to that industry. In Indonesia foreign petroleum firms continued to negotiate primarily with Pertamina, the national oil company, even though the board for foreign investment coordinated negotiations with investors in most other industries.

Second, and more recently, governments have delegated similar powers to a single decision-making structure charged with negotiating foreign investments across several industries. For example, when India and the Philippines established export-processing zones, they also established autonomous authorities empowered to conclude agreements with firms entering the zones. Similarly, but on an expanded scale, Singapore established a single, permanent agency to negotiate with most foreign investors, whether the investors intended to export or to serve the domestic market. The Economic Development Board (EDB) of Singapore was not an interministerial body but rather an autonomous public agency that recruited personnel outside the government's regular civil service.

Delegation of government decision making is intended to rectify the shortcomings associated with interministerial involvement in negotiations while at the same time retaining the advantages of coordination. The potential investor's costs of negotiating are reduced; organizational learning is enhanced. The delegation of authority to state-owned enterprises and other specialized agencies that possess vast industry knowledge leads, however, to some of the same shortcomings associated with diffuse decision making: the single-industry organization is likely to ignore larger policy issues concerning the net national benefit of investment and the precedent established for future negotiations in other industries. A single, autonomous board like the EDB, on the other hand, with the authority to negotiate in several industries, does not have these problems; but industry expertise is more limited. For both kinds of delegation, the interests of government agencies and their constituencies may be less well represented. To reassert their power, agencies may act during implementation in ways inconsistent with the agreements negotiated earlier with the investor. The resulting disjunction between negotiations with a single authority and policy implementation by several agencies could be, and usually is, high. And again, the political costs of effective centralization are potentially very high, for short-circuiting the internal bargaining process disenfranchises those ministries and constituencies which may be affected.

3. Determinants of negotiating structures and decision-making patterns

The choice of organizational structures for foreign-investment negotiations appears to be influenced primarily by three variables: the general development strategy of a country, the "salience" of an industry in that country, and competition for investment among countries. The first variable shapes the most general goals and policies that a country employs. The other two variables largely reflect how government views the characteristics of certain industries. They lead governments to depart from their general approaches and to adopt special structures for certain kinds of investors. We shall examine the impact of each of these.

a. General development strategy

Some approaches to negotiating with foreign investors, as we pointed out earlier, are particularly suited for injecting the institutional interests and policy perceptions of various units of the government into the negotiating process. Others sacrifice this ability but make it easier to attract foreign investors. This tradeoff lies at the heart of the choices countries make when they develop a general approach that is applicable to most potential foreign investors. When general strategy for economic development is hostile toward foreign investors, our evidence suggests, governments are likely to establish structures that grant various government departments direct access to the negotiation process. In extreme cases the investor must negotiate individually with the most affected ministries or enterprises. In less extreme cases a weak coordinating agency may be created.

In contrast, a government that is eager to attract foreign investment may sacrifice the emphasis on narrow domestic interests and centralize the negotiations in order to ease the way for the foreign investor. Among the countries we examined, India adopted the most stringent policies. India did, however, have a coordinating organization, the SIA, a body that endorsed the policy decisions of member agencies. At the other extreme was Singapore. Eager to attract foreign investment, Singapore delegated to its EDB virtually full authority to conclude agreements with most investors and to conduct negotiations outside the regular ministerial structure.

The range of possibilities, and the relation of choice to general development goals, is more clearly illustrated by the evolution of arrangements in the countries we examined. Some governments, previously more hostile toward foreign direct investment, had begun to alter their evaluations prior to the period we studied. That change reflected a more accommodating attitude toward the potential benefits from foreign technological and financial collaboration. In all of these cases, as each country's policies moved toward greater encouragement of foreign investment, there was a shift in decision-making structures. The general movement has been away from a diffuse multitude of individual, uncoordinated government agencies administering different, often competing policies and toward greater coordination of government decision making through the creation of a host of permanent and ad hoc bodies. With this movement, internal negotiations among agencies became more formal, and the influence of individual ministries was weakened.

In India a potential investor once faced a long series of diffuse ministry-to-ministry negotiations. In recent years, however, the SIA and its several committees were increasingly strengthened, interministerial export promotion boards were established, and administrative procedures were streamlined to reflect changed attitudes toward foreign investment in various industries. In Indonesia prior to regime change in the mid-1960s, abstention and diffusion characterized government decision making. The creation of the BKPM resulted from the shift in economic policies following the change from Sukarno to Suharto. The BKPM evolved from a subministerial review body in the late 1960s to an actual investment coordinating board with cabinet rank by the 1970s. In the Philippines the BOI, established in 1967 as an interministerial coordinating body, eclipsed other government agencies during the 1970s, eventually to become the principal negotiator with foreign investors. Even in Singapore the EDB was evolving throughout the 1960s and 1970s as the planning and promotion arm of the Singapore government. In each instance greater encouragement of foreign investment prompted a concerted effort toward greater coordination of government decision making.

The shifts just described are not easy and do not represent an inexorable pattern that all countries follow. Individual ministries do not give up their influence readily. In some of the countries we studied, the shift to a coordinating board was not at all smooth. Powerful ministries would refuse to send high-level officials to board meetings and would exercise unauthorized vetoes after negotiations had supposedly been concluded. Thus, as mentioned, a ministry of finance would refuse to honor tax concessions or tariff exemptions authorized by a coordinating board. Eliminating such problems usually involved cabinet or presidential intervention, a step not lightly undertaken. Such problems were sorted out only as it was discovered that foreign investors were being repelled and only if that matter was viewed as important.

When countries create coordinating bodies, they do not always abandon the old system completely. In India the relatively weak SIA was only a funnel through which applications reached ad hoc committees. When industrial licenses were sought, such committees were composed of the Directorate General for Technical Development (DGTD) and the administrative agency responsible for the industry concerned—for example, the Department of Electronics for investment in the computer industry. Additional agencies were involved on an ad hoc basis depending on the specific investment proposal. If foreign financial collaboration or locally raised capital was required, the Ministry of Finance participated; if exports were anticipated or required, the Commerce Ministry would be brought into the deliberations; and if the capital investment was large, the Department of Company Affairs would be consulted to review antitrust policies. Even in Indonesia, which had a stronger coordinating body, some foreign firms—in typewriters and industrial boilers, for example—sidestepped the BKPM and went directly to individual government ministries; however, other firms in the same industries went through the BKPM for incentives.

Complete delegation to an investment authority, as in Singapore, requires individual ministries to surrender power even more dramatically than they do when a coordinating body is created. We do not know enough of the history of the EDB to know how this delegation of power came about. But it may be that complete delegation is possible only in a small country without contentious political factions.

b. Industry salience

Whatever a country's general approach to negotiating with foreign investors, it is likely to handle certain classes of investors in special ways. Yet the law and published guidelines generally say little about the exceptional cases, although the exceptions are likely to count among the largest projects. If a particular kind of foreign investment is extremely important to a country—that is, if the investment is politically "salient" to the country's development goals—the country will tend to circumvent general decision-making structures and employ various special organizational arrangements. Usually some technically qualified unit is charged with negotiating ad hoc packages of regulations and concessions targeted to a specific firm or industry. The extent to which this governmental unit heeds the claims of various other ministries and their constituencies is a function of the relative bargaining power of the government units involved.

The definition of this subset of salient industries—sometimes called "pioneer" or "core" industries—varies widely across countries and over time. Nevertheless, as the recent spate of worldwide petrochemical negotiations suggests, an investment is always salient if it is very large (as in Indonesia, Singapore, and the Philippines). Likewise, governments that place a premium on R&D–intensive technology, such as Singapore and India, will rank other industries (e.g., computers) as salient and therefore worthy of special attention through special policy tools and organizational arrangements. In contrast, the few standardized incentives applied to investments in food processing, cosmetics, and similar industries suggest that governments pay less attention to individual foreign investments in these nonpioneer, low-priority industries. In nonsalient industries a country uses a generally applicable organization that reflects the country's overall attitude toward foreign investment (e.g., the BKPM in Indonesia).

Within a single country, the way government organizes to negotiate with foreign investors in different salient industries is subject to wide variation, as the structure of negotiations involving large-scale projects in Indonesia illustrates. The state-owned oil company, Pertamina, had long been the single principal negotiator in oil and gas exploration projects and had paid little attention to the claims of other government actors. It retained its preeminence, in fact, even after an ad hoc interministerial committee was established so that affected ministries could inject their views into the decision process. But Indonesia's supposedly "one-stop" investment board, the BKPM, was not involved at all. Pertamina had a counterpart in a state coal company. In contrast to oil negotiations, the state coal company had little authority or influence; instead, foreign coal investors faced an ad hoc interministerial committee, one with influential representatives from the Department of Mines and the Ministry of Finance. At the height of its power, Pertamina had alone begun negotiations for the construction of a petrochemical facility. With the weakening of Pertamina, later negotiations were turned over to yet another ad hoc interministerial committee, one made up of representatives from the ministries of industries and finance as well as Pertamina and the National Planning Agency.

Despite the variety of decision-making structures within a single government, similarities may be discerned in the ways different governments organize themselves to negotiate with foreign investors in the same salient industry. These commonalities may exist even if the market orientations of similar investors are different in different countries. In Southeast Asia negotiations for domestic-oriented and export-oriented petrochemical projects designed to produce high-density polyethylene were being conducted simultaneously in several countries. In Singapore, where decision making was otherwise delegated to the EDB, Sumitomo Chemicals negotiated with an ad hoc, cabinet-level, interministerial committee whose de facto head was the prime minister. In Indonesia Exxon Chemicals negotiated with another ad hoc, but formal, committee dominated in this instance by the Ministry of Industries and Pertamina. A similar arrangement could be found in Malaysia, one that also included its state-owned petroleum company, Petronas. In the Philippines negotiations were conducted by a cabinet-level interministerial committee dominated by the Ministry of Finance and the Ministry of Industry and Trade; the Philippine National Oil Company (primarily a distribution network) was not actively involved in deliberations since it was not a producer of feedstock. In no case was a foreign investment board important; moreover, in no case did the potential investor have to conduct uncoordinated ministry-to-ministry negotiations.

The list of industries considered salient can change. For example, foreign investments in automobile and diesel-engine production were viewed as salient in the Philippines, Indonesia, and most recently, India because of the large spillover effects associated with such investment, but they were not highly valued in Singapore during the period we studied. A few years earlier, however, new foreign investment in the automobile and ancillary industries had been encouraged in Singapore and discouraged in India. Shifts in attitudes toward foreign investment in these industries resulted in changes in organizational structures for negotiations with potential investors.

The special treatment of investors in salient industries is not usually the result of well-planned steps. In some cases state enterprises gradually assumed the role of negotiator because of their technical expertise. This movement is especially likely when the enterprise has political power because of its independent sources of income. Thus Pertamina remained the principal oil negotiator in Indonesia. The technical complexity that characterizes many petroleum agreements limited the ability of other organizations to understand the negotiations and challenge Pertamina. The national coal company, by contrast, did not have the same income or political influence, and maybe not the equivalent technical expertise. Its role in coal negotiations was correspondingly small.

Similarly, the ad hoc coordinating team to negotiate recent petrochemical investment in Indonesia was more the result of Pertamina's financial problems in the early 1970s than of any conscious plan. When Pertamina ran into financial problems, all nonoil projects were removed from its sole jurisdiction. Yet it had more technical expertise in petrochemicals than any other Indonesian agency. Furthermore, the projects were too large (over U.S.$1 billion to be invested) to leave to a general organization such as the BKPM with little in-depth knowledge of the industry. The impact on industrialization was potentially so great that the Ministry of Industries stepped in, adding some expertise from its Directorate General of Chemicals. The sheer size of the olefins project also attracted the National Planning Agency, which was already involved in untangling Pertamina's financial problems. Thus grew the ad hoc team dominated by Pertamina and the Ministry of Industries.

c. Competition for investment

While seeking to attract investments in certain industries, governments find themselves in intense competition with other governments. Competition for investment is especially pronounced in those industries consisting of "footloose" export firms. Companies supplying, say, electronics or textiles to Europe or North America are relatively free to locate in a wide range of low-wage countries. Moreover, many such firms can easily move once they have set up operations. Garment companies, for example, consist of little more than portable sewing machines. The location decisions of such exporters contrast with those of import-substituting firms, which must locate and retain facilities inside the market they hope to supply. If a country desires export-oriented investments, it must make a special effort to attract firms. With other countries offering generous terms and speedy negotiations, competitive pressures prompt the adoption of special policies, structures, and procedures.

Export firms are in some ways quite different from the salient investors just mentioned. Since many are small, the impact of any single project is unlikely to be great. Governments usually emphasize courting such investment and providing predictable outcomes from quick negotiations. Consequently, some countries establish organizational structures separate from those used for domestic-oriented investment. These structures further reduce the investor's costs of negotiating with government but differ from the ad hoc structures or state enterprises responsible for salient industries.

The Philippines demonstrated the pattern that usually develops of different governmental structures for investors with different market orientations. As we have pointed out, for investments designed to service the domestic market (and involving more than 30%-foreign equity), the Philippines made extensive use of its Board of Investment. However, an export-oriented firm desiring to locate in one of the country's three operating export-processing zones negotiated either with the Export Processing Zone Authority (EPZA) alone or with the EPZA and the BOI operating jointly; whereas the same firm locating outside the zones might negotiate only with the BOI. The registration requirements and procedures prescribed by the EPZA were simpler than those prescribed by the BOI, and the incentives were different: tax holidays could be granted only by the EPZA, but the BOI offered a broader array of incentives.

India also distinguished export firms from others. Three permanent structures existed simultaneously fot such investors. India's two export zones each had a separate governing board housed in the Commerce Ministry and empowered to approve investments. For 100-percent-export projects operating outside these zones, the SIA channeled all applications to a permanent interministerial board chaired by the commerce secretary. This separate board had been set up to give all such projects a single clearance point with regard to industrial licensing, foreign collaboration, import of capital goods and raw materials, and so forth.

Singapore and Indonesia were among the few countries in the world that conducted individual negotiations but did not employ different decision-making structures for investors with different market orientations. Singapore's approach resulted from its almost exclusive focus on export-oriented projects. In contrast, most foreign investment in Indonesia was oriented toward the domestic market. But as Indonesia began to boost manufactured exports, it was beginning to distinguish between export firms and those serving the domestic market. An export-oriented manufacturing firm seeking to operate in Indonesia still negotiated with the BKPM at the time of our study. Indonesia was, however, increasingly eager to attract export firms. In recognition of its poor past record in this area, it was following the Philippines, India, and other nations by considering the establishment of export-processing zones and the creation of an authority that would be relatively autonomous from the BKPM.

Delegation is probably easier for purely export projects than for most other cases. Domestic interests are likely to be affected to a much lesser extent than they are by import-substituting investments. Most such export projects are in no real sense in competition with domestic firms, which often seek protection against foreign inroads. Fiscal authorities seem to view export-oriented investment as a sort of windfall; any revenues collected are an unexpected benefit, not an entitlement. And, at least at the early stages, agencies concerned with employment and training are likely to have similar views. Thus the pressures for involving many parties in the negotiations are weak. On the other hand, if exports are only a minor part of the firm's output, the usual pressures for wide agency involvement exist, and bargaining is likely to be handled through government structures other than those concerned with export projects.

4. Competitive strategies of host countries

Just as corporations formulate and implement strategies designed to gain a relative advantage over competitors, so governments adopt strategies to attract politically valued or socially profitable foreign investment projects.[36] In so doing, countries may act independently of one another. In their quest for domestic-oriented investment, for example, host countries with large markets usually face no direct competition for these investments from other host countries. At other times, bidding for certain projects, especially footloose export firms, takes place as governments at the subnational or national level raise incentives in response to competitive bids from other governments. Efforts to control these foreign investment wars have been largely unsuc-

36. For a discussion of the similarities in competitive strategies between governments and private corporations, see Encarnation and Wells, "Competitive Strategies in Global Industries."

cessful.[37] Rather, some governments appear to adopt incentive instruments more with an eye to the policies of competitor governments than to the prospective investor.

But bidding need not be directly financial or even geared to a specific investment proposal. Countries have considerable latitude to differentiate themselves from their competitors in order to capture some share of the total supply of foreign-investment projects available. For example, countries can introduce export-processing zones to appeal to a narrow segment of foreign investors and create "one-stop" investment boards to promote investment opportunities and negotiate with foreign firms. These institutional arrangements represent some of the marketing strategies available to host governments. When competition for investment is fierce, governments are likely to employ various combinations of financial incentives and marketing tools to attract the investments they desire.

a. Financial incentives

Policies. Financial incentives are given to encourage behavior whose social profitability or political value is positive, but where private profitability relative to other investment sites is inadequate to induce investment. From the investor's perspective, the total incentive offered by government must be reduced by the value of all government-induced disincentives, often in the form of regulations. Regulations, after all, rule out certain privately profitable behavior that a political or social perspective deems undesirable. The objectives of these incentives and restrictions are multiple. They are designed to influence the choice of inputs, location, sector, technology, ownership, plant size, and international financial flows. Incentives attempt to alter corporate behavior by lowering the costs of capital, energy, and other factors of production; by raising product prices through barriers to foreign and domestic competition; and by directly increasing after-tax cash flows through tax relief or direct subsidies. Restrictive measures, on the other hand, serve as disincentives by adjusting costs upward or prices and profits downward, or by prohibiting certain activities.

Among the countries we examined, Singapore clearly adopted an aggressive

37. One response of governments to what appears to be counterproductive warfare is to negotiate understandings with other governments to refrain from granting excessive financial incentives. Within the EEC, for example, agreements exist on the maximum "grant equivalent" that may be offered to attract investors. Similarly, the Andean Group has set bounds on offers to investors. Such agreements are, however, particularly difficult to reach and to enforce. Even in the face of explicit agreements among countries to limit competition, as in Europe, competition for certain types of foreign investment remains intense because of the relative magnitude of the stakes. When competition is fierce, governments are likely to try all types of financial incentives and marketing tools to achieve their objectives. The number of potential policies and tools for bidding is so great that agreements usually are quickly undermined. Moreover, once one country is successful in attracting foreign investment through the use of financial incentives and marketing tools, other governments will often follow that lead.

financial strategy, stating frankly its intention to meet any competitive offer for a socially or politically desirable project. This was certainly Singapore's strategy in the computer industry, where Apple Computer was a principal beneficiary. It was also true in petrochemicals, where the government actively courted a reluctant Sumitomo Chemicals. Singapore invariably targeted its financial incentives, giving different net incentives to different firms. Incentives were targeted selectively to priority industries and to specific firms within those industries. Thus Singapore singled out Apple Computer as an industry leader when it decided to shift to priority high-technology investments. The incentive package offered to Apple was relatively straightforward: although large in value, the incentives that made up the package were few, their mechanics were simple, and many were automatic. Even those incentives whose levels were negotiated rather than automatic were largely based on simple and known criteria.

Indonesia, in contrast, followed a more passive strategy. Incentives were ostensibly targeted to priority industries. Within an industry, however, there was seemingly no discrimination among firms in terms of incentives offered to attract a particular investor. Perhaps the most striking difference among countries is the very large number and variety of incentives and restrictions that are applicable to foreign investors. In government negotiations with Toyota and Nissan over domestic automobile production, Indonesia altered the net benefit to the investor, using varying combinations of commodity and factor, price and nonprice, direct and indirect incentives. Moreover, the government linked these incentives to performance requirements, stipulating local content and local ownership. We discerned a similar pattern in negotiations between the Philippines and Isuzu and between India and Suzuki.

Evaluations. Once governments adopt policies that apply investment incentives and performance requirements to some foreign firms and not others, government agencies become involved in an evaluation of the investment proposal to determine if it is acceptable, deserving of incentives, or a candidate for performance requirements.

Evaluations may be of four interrelated types. In the name of "technological feasibility," technical evaluations most often examine the sources of inputs and the markets for outputs, and compare the labor and capital intensity of the proposed project relative to (often implicit) government standards. Fiscal evaluations establish the impact of tax incentives on project viability. Financial evaluations of returns on investment are called for when local, often government, equity participation and loan capital are sought by either government or investor. Finally, moving beyond fiscal and financial evaluations, social (economic) cost-benefit analyses of project proposals estimate the net benefits of the project to the economy; they take into account any incentives granted and performance requirements imposed.

We found wide variation across countries in the method and degree of evaluations carried out. At one extreme, Singapore's EDB conducted cursory technological and fiscal evaluations, relying instead on the investor's appraisal of a proposed project's viability. The principal technological concern was captured in the government's pursuit of skill-intensive, high-value-added investments. Financial evaluations were even rarer and, when conducted, were carried out by the autonomous, government-held Development Bank of Singapore or the government's holding company, TAMASEK.

In marked contrast, government agencies in India, Indonesia, and the Philippines conducted more extensive evaluations of the technological characteristics, sources of inputs, and markets for outputs for every investment application. In the case of very large projects (e.g., in petrochemicals), Indonesia and the Philippines occasionally employed outside consultants to conduct independent evaluations, a practice not common in India, which can draw on a large pool of technical personnel. Within all three countries there was a division of labor among organizations that conducted separate technological, fiscal, and financial evaluations. The DGTD (India), BKPM (Indonesia), and BOI (Philippines) focused largely on technological considerations. Fiscal issues, if appraised separately, were likely to be considered by the Ministry of Finance in Indonesia and by the Finance Ministry or Reserve Bank in India. Government-run development banks (e.g., the Industrial Development Bank of India) focused on financial evaluations if their money was to be involved. In some projects, ad hoc teams carried out financial analyses because government equity was to be a part of the arrangement.

No government explicitly performed a single social (economic) cost-benefit analysis for any of the projects included in this study. Yet the likelihood of encouraging economically unattractive projects was very large. Investments were made behind high tariff walls; local competition was often weak if not nonexistent; inputs were often subsidized by the government. In addition the incentives requested and offered entailed large domestic resource costs. Nevertheless, no systematic attention was paid to the impact of any project on the host economy or to the impact of government incentives on a project's financial viability (except, and the exception is important, when certain third-party [e.g., International Finance Corporation] financing was involved). When we asked why no economic evaluations were done, answers included distrust of the technologies, fears that such analyses would frighten away potential investors, and lack of trained personnel.

Personnel. Personnel policies varied dramatically across countries. The industry division of Singapore's EDB was staffed by fewer than fifty professionals, most of whom were young engineers, all recruited outside the regular civil service system. Their tenure was quite short (3–5 years). They were attracted to, and recruited by, private industry. This career path encouraged accommodation between business and government with regard to the evaluation and promotion of foreign direct investment.

At the other extreme, the various Indian government agencies that evaluated investment proposals employed through the civil service system thousands of professionals, whose training included engineering, economics, law, and public administration.

Between these extremes lay the BKPM in Indonesia and the BOI in the Philippines. Each employed several hundred professionals, many on loan from existing government ministries, especially the Ministry of Industry. The BKPM was dominated by engineers, while the BOI employed personnel with a wider balance of professional skills, including law.

The recruitment, socialization, and training of personnel also vary dramatically across different organizational structures within the same country. Interministerial investment boards, for example, cannot muster the same technical expertise that can be assembled in an individual government department charged with overseeing a particular industry or, more prominently, a state-owned enterprise. The more salient the industry, the more critical loom the limited technical capabilities of boards. Interministerial investment boards likewise seem better able to muster technical expertise than financial expertise, because they recruit personnel from industry ministries and are partially separate from financial ministries. On the other hand, these boards, because of the diversity of personnel they employ, are in a better position than individual ministries or enterprises to consider the wider impact on other investors of any single government decision. That consideration of a wider impact may also shape a ministry's subsequent promotion of investment and its scanning of the environment. Given the preponderance of personnel recruited from industry ministries and the paucity of individuals trained in finance, however, interministerial investment boards are in a poor position to evaluate the fiscal and financial viability of investment proposals.

b. Marketing tools

Some of the governments we examined in this study placed great emphasis on differentiating their jurisdiction from other possible investment sites, as well as providing financial incentives. Such differentiation could be accomplished through various marketing tools.

Again, Singapore stood out for the special efforts that it devoted to attracting investment. The EDB was viewed by many observers as the "marketing arm" of the Singapore government. Its agents not only granted incentives but also conducted careful marketing operations. Domestic "marketing" efforts were supplemented by offices in Europe, Japan, and North America that were tightly integrated with the home office. EDB's internal incentive structures were consistent with its marketing objectives: "performance evaluations" are used by the EDB directors to reward personnel for their success in reaching quantitative and qualitative investment targets. These evaluation procedures certainly did not encourage analysis of economic (social) costs.

At the other end of the spectrum lay Indonesia. By all accounts the BKPM had not yet resolved whether its mission was exclusively to regulate foreign investment or simultaneously to promote that investment. The BKPM and other government agencies did comparatively little to promote investment opportunities in Indonesia. Small, infrequent investment missions were standard fare, and publications were prepared. Even the proposed creation of an export-processing zone authority, with its promotional activities, would do little to alter the absence of concerted effort to promote domestic-oriented investment.

Whether the same agency should promote as well as regulate foreign direct investment has been an issue that long dominated policy debate in India. As a partial response to this debate, the Indian Investment Centre (IIC) was established in 1972 as a separate promotion board operating parallel to the existing regulatory structures. IIC operated four overseas offices in Europe, Japan, and North America; it also helped arrange numerous investment missions. This separation of marketing from negotiations is an important difference between Indian and Singaporean promotion strategies.

Seeking to integrate promotion and regulation in a single body, the BOI of the Philippines had begun to publicize investment opportunities in that country. For export-oriented investments, these promotional activities were supplemented by the EPZA. These efforts were markedly less concerted and coordinated than in Singapore, and they lacked the overseas support structures enjoyed by India and, especially, Singapore.

Scanning. There appears to be a relationship between a country's promotional activities and how much its principal negotiating body scans the international environment: as governments expand their promotional activities, they also begin to scan investment decisions and survey worldwide activities of foreign firms in particular industries. As with the promotion of investment, the trend over time has been toward a gradual recognition of the need for more information from abroad.

Scanning operations were most extensive in Singapore. The EDB not only monitored the activities of other countries that it viewed as Singapore's principal Asian "competitors" for investment—South Korea, Taiwan, and Hong Kong—but it also used Singaporean embassies, EDB offices abroad, extensive travel by EDB staff, and discussions with prospective investors to keep track of policies in other potential contenders outside the region, ranging from Ireland to Puerto Rico. Simultaneously, the EDB's planning department conducted in-house evaluations of worldwide industry patterns. Although India's monitoring of the international environment was less structured than Singapore's, the extensive travel of Indian policy makers, their active participation in UN bodies, and the operations of numerous state-owned enterprises all seemed to provide India with a rich source of information about other host-country policies and on industry patterns worldwide.

In contrast to Singapore, Indonesia integrated into its BKPM's decision making very little environmental information, even about activities within other ASEAN countries. Most information at hand came from outside consultants, ASEAN meetings of investment boards, and agencies of the United Nations. Occasionally, information on business activities and government decisions elsewhere was supplied by prospective investors who attempted to play one country off against another in a "bidding war" for investment. One dominant view within the BKPM was that information on the international environment was unnecessary given the competitive advantages associated with Indonesia's large domestic market.

The BOI in the Philippines was similar to Indonesia's BKPM, but it was reviewing its information-gathering and information-processing operations at the time of our study.

Implementation. Another form of marketing includes a country's efforts to deal with investors after entry negotiations are completed. The way a government implements policy is central to a firm's prior evaluation of investment opportunities and to the government's success in competing for foreign investments. The failure of some government agencies to honor contractual arrangements often leads investors to believe that the terms as negotiated are not likely to be implemented fully once the firm begins operations.

The agencies that implement government decisions are often different from the agencies that negotiate prior to investment. Among the reasons for this division is the need to accommodate the interests and to make use of the expertise of various government agencies charged with performing different functions. Thus skills for auditing tax matters and for assessing customer duties are likely to be found in the finance ministry. The division of responsibility between agencies that negotiate financial incentives and performance requirements and those that implement the agreed terms can also be viewed as providing checks and balances. While a board of investment may be especially qualified to court new investors and to evaluate feasible projects, its subsequent monitoring capabilities may be biased as a result of its earlier advocacy of a project.

Nowhere is the disjunction between negotiations and implementation more apparent than in a large country such as India, where diffused authority extends the number of potential agencies involved in decision making. No fewer than forty administrative departments in upward of twenty-six central government ministries could be involved in either negotiations or implementations, or both. Not surprisingly, policies that govern the initial entry of a firm can differ from those that govern the implementation of agreements that have been concluded. In sharp contrast to India is a small country like Singapore, where there is virtually no disjunction between policies as negotiated and policies as implemented. To guarantee these results, the EDB is empowered not only to negotiate policy but also to monitor and facilitate the implementation of policy through contact with relevant ministries.

Between these extremes lies the Philippines. There the Bureau of Internal Revenue, Customs, and the Central Bank are the principal actors during the piecemeal implementation of policies previously negotiated through the BOI. The BOI's powers are largely advisory once a firm's operations are under way. The same may be said for Indonesia and its BKPM; there the disjunction between negotiation and implementation is more exaggerated than in the Philippines. In particular, the periodic renegotiation of tax liabilities by the Ministry of Finance once a project is under way may abrogate earlier negotiations with the BKPM.

In some cases, financial incentives and marketing tools were inextricably intertwined—particularly true when governments sought to attract 100-percent export-oriented firms. As a result, the strategies pursued by the export-processing-zone authorities of India and the Philippines were not characteristic of the strategies their governments adopted toward foreign investment as a whole. The distinguishing strategic feature of these export zones is their packaging of financial incentives with government investments in infrastructure. Recognizing the possible advantages of packaging incentives aggressively, at least for a narrow subset of investment proposals, other countries have imitated their potential rivals. For example, Indonesia's proposal to establish a single zone trails by several years the establishment of export zones in other ASEAN member states. By 1982 there were eight export zones in the Philippines and four each in Malaysia and Thailand. Singapore could even be considered to be one large zone.

5. Conclusions

The making of agreements with foreign investors forces governments to trade off between reliance on general policies and reliance on individual negotiations. Once some form of negotiation is required, governments face difficult choices. They do not, as some writers who emphasize bargaining models in their analysis of foreign investment seem to assume, negotiate as monoliths.

The choices can be said to lie along a continuum, from diffused through coordinated to delegated. At the diffused pole, negotiations are conducted individually by all the units of government whose interests a proposed project might affect. Away from this extreme are various degrees of coordination, until finally the negotiations are fully delegated to a single authority (the other end of the continuum).

The evidence from this study of four countries suggests that the less favorable the government's attitude toward foreign investment, the more likely its general negotiating pattern for foreign investment will be diffused. Increasing eagerness to attract foreign investment seems to lead countries to follow the more centralized approaches of coordinated and delegated negotiation. We were able to trace changes in attitudes through changes in negotiating patterns within the four countries we studied.

Here lies a real irony. Countries most favorably inclined toward foreign investment centralize decision making—and thereby follow the advice of dependency writers, who question the benefits of that investment. The reasons should be clear: centralizing negotiations entails a major political cost. The extent of this cost has been underestimated by those who encourage governments to centralize their negotiations with foreign investors. Governments are willing to disenfranchise ministries only if particularly concerned with the most apparent costs of decentralized decision making, which repels potential foreign investors.

Writers of the dependency school, on the other hand, are concerned with a different, less apparent cost associated with the diffused approach to negotiation: the risk that the foreign investor can pit one ministry against another and thus come out with an inappropriately favorable bargain. The centralization advocated by the dependency school was, however, attempted by the governments we studied not because they saw the merits of the arguments proposed by the school but because of their eagerness to respond to the concerns of those would-be investors of which the dependency school is so suspicious. Dependency writers might argue, perhaps correctly, that the choice of negotiation structure was largely determined by foreign investors' desires. Although the shifts might be in the directions advocated, they may be undertaken for the "wrong" reasons.

We would be more sanguine that the worthy goals of advocates of centralization were also accomplished in the shift toward centralization, whatever the motivation of governments, if it were not for two facts: first, in many cases, especially of coordination, government units reasserted themselves at the implementation stage, counteracting some of the benefits of coordination; and second, even the more centralized organizations did not do serious economic analyses of the costs and benefits of proposed investments. Some appear to see their role as primarily promotional, not surprising in light of the reasons for their creation. In countries with limited domestic markets, high protection, and subsidized inputs, the chances of economically harmful proposals from would-be investors is high.[38] More centralized organizations appear no less likely to approve bad (costly) proposals than do individual ministries. Nor is the ability of ministries to sabotage agreements reached between investor and coordinating unit by refusing to honor them a source

38. See Reuber et al., *Foreign Private Investment*; Lall and Streeten, *Foreign Investment*; and Encarnation and Wells, "A Mixed Bag." Despite their differences, these three studies are consistent in reporting that nearly 40% of proposed import-substituting projects are harmful for the domestic economy.

of confidence that the national interest will eventually be reasserted. Breaches seem as likely to favor the investor as not.

We also found that governments do not use only one approach to negotiating with foreign investors, in spite of the descriptions they usually provide to would-be investors. Rather, they use a portfolio of approaches, depending on the investment at hand. When a particular project is politically salient, a government is likely to choose a delegated pattern regardless of its general attitude and approach to negotiation. The driving forces behind this choice for particularly salient projects seem to be similar to those of the dependency proponents of centralization: mustering the required industry knowledge and maximizing the benefits out of negotiations. Yet the approach has disadvantages that its proponents have not always noted. The state enterprise or ad hoc coordinating body that usually conducts such negotiations has little concern with precedent or with overall investment policy. In a few of the cases we saw, we suspect that the goals of the negotiating body were more in line with increasing benefits to the organization than with maximizing the contribution of the project to the country as a whole.

If the state seeks investments in intense competition with other countries, it is particularly likely to centralize negotiations. The cases we noted were export projects. Again, as when the general approach of a country moved away from the diffused pole of the continuum, the driving force behind the changes for export projects was that of making the negotiations easier for the investor. One could argue that export projects are particularly unlikely to be harmful to the economy, since the product of the investment must be competitive on the world market. Thus an economic evaluation of proposed projects would not be needed to the extent required for import-substituting investments. Our principal concern with this argument derives from the size of incentives sometimes granted to attract such projects. It may well be that they outweighed the benefits that the investment offered to the country. We cannot say so for sure, but given the lack of economic analysis, nor could the governments refute the possibility.

Four countries do not make a thoroughly convincing sample. Limited evidence is available, however, from other studies and from our own experience, to suggest that the patterns observed in these four countries are typical of patterns in other developing countries.[39] The choices do not depend on size of country or political system (except possibly that only a small country with a very powerful central authority could delegate virtually all investment decisions to one body, as has Singapore). Countries as different in political system and size as Liberia and Indonesia have created coordinating boards, for example. With increasing interest in export investment, countries

39. For surveys of what LDC governments say they do, see the citations in note 34; for a single-country study with findings consistent with our framework, see Lombard on Colombia in his *Foreign Investment Screening Process.*

TABLE 1. *Decision-making patterns, negotiating structure, and administrative procedures: strengths and weaknesses*

Patterns and Structures of Decision Making	*Strengths/Benefits*	*Weaknesses/Costs*
A. Abstention no structures or procedures	a. Predictability for investors b. No administrative costs c. Speed of response	a. Unrestricted entry: entry of firms inconsistent with national interest b. Autarchy: excludes socially beneficial investments
B. Diffusion 1. Government functional agencies 2. State-owned enterprises	a. Can muster technical expertise for specific industry b. Results in high organizational learning on part of government c. Agencies that negotiate often same that implement policies	a. Little evaluation of overall net benefits: focus on technical feasibility b. Little consideration of larger policy issues c. Little consideration of impact of decisions on other investors d. Little promotion of national investment opportunities e. High negotiating costs to investors f. Disjuncture between policy as negotiated and policy as implemented since implementors are multiple
C. Coordination 1. Permanent interagency board 2. Ad hoc interagency committee	a. Both: reduce investor's negotiating costs b. Both: reduce interministerial conflict c. Both: improve monitoring of international environment d. Permanent: considers larger policy issues and issues' impact on other investors e. Permanent: greater promotion of investment opportunities f. Ad hoc: masters industry expertise	a. Permanent: little in-depth industry knowledge b. Permanent: disjuncture between policy as negotiated and policy as implemented since implementation occurs outside the new structure c. Ad hoc: little organizational learning d. Ad hoc: little consideration of impact on other investors or larger policy issues e. Ad hoc: little promotion of investment opportunities

D. Delegation 1. Industry-specific agencies and state-owned enterprises 2. Broadly defined development authorities	a. Both: reduce investor's negotiating costs b. Both: policy negotiated is policy implemented c. Both: greater promotion of investment and greater scanning of environment d. Both: improved organizational learning e. Broad authority: consider larger policy issues and impact on other investors	a. Industry agency: larger policy issues and impact on other investors ignored b. Broad authority: little in-depth industry knowledge c. Broad authority: loss of personnel to industry d. Both: ignore interests of other agencies and their constituencies

as diverse as India and the Philippines have delegated authority to a single body for that kind of negotiation. Limited evidence even suggests that the conceptual framework we have elaborated is useful in understanding negotiations in more industrialized countries.[40] French, Irish, Japanese, and U.K. procedures differ dramatically among themselves, and in ways consistent with their attitudes toward foreign investment and the type of investments that they attempt to attract.

The framework, tentative as it might be, should be helpful to countries that are reconsidering their approach to negotiating foreign investment. Table 1 shows the costs and benefits typically associated with each approach. Unfortunately, no approach is always optimal. Choice always involves trade-offs. The weights to be attached to particular costs and particular benefits must be chosen to reflect the country's general development strategy and resulting attitude toward foreign investment, the salience of the project being proposed, and the degree of competition with other governments for the kind of investment being sought.

The choices that must be faced for foreign-investment negotiations resemble those that a government faces in other negotiations that affect the interests of its various units. The lessons from foreign-investment negotiations are probably more generally applicable. Coordination and delegation have their advantages in the bargaining process, no matter what the subject of the negotiations, but those advantages can be realized only with real political costs. Regardless of the nature of negotiations, ministries do not easily surrender their autonomy or withdraw from negotiations if the outcomes are likely to have major impacts on their interests or constituents. Only when the stakes are high do governments seem to be able to force coordination or withdrawal on interested groups—and even then they are not always successful.

40. For France, Ireland, and the United Kingdom, see Michael A. Amsalem, "Investment Incentives and Performance Requirements in Europe," mimeo (Washington: International Finance Corporation, 1982); for Japan, see Chalmers Johnson, *MITI and the Japanese Miracle* (Berkeley: University of California Press, 1982), especially pp. 275–304.