ANNUAL INVESTMENT MEETING

THE NEW WORLD OF FDI

Key features and best practices

11-13 April 2016

Dubai, United Arab Emirates

Remarks

by

Ricardo Pascale, (1)

Investment promotion stratgies to attract NFIs and best practices therein.

Authorities of Dubai, organizers of the AIM, I am pleased to present here my personal remarks about the today's topic in the case of Uruguay, which not necesarily represent those of the Uruguayan Government.

Ladies and gentlemen

First,I will review some of Uruguay´s incentives to promote NFIs. Second , expose some achievements and finally, make a couple of remarks on the goals of the strategy.

The discussion towards FDI has changed considerabily in the last three decades as most countries have liberalized their policies to attracts all kind of investments from foreign firms on the expectation that this FDI will rise employment, exports or some kind of knowkedge by spillovers to the host country private and public sector. Various goverments have also introduced several forms of investment incentives to encourage foreign owned companies to invest in the country.

In the case of Uruguay this incentives includes:

-Freedom to conduct business in any currency

-No discrimination between foreing and domestic investors

-No local counterpart prior authorization o registration required

-No restrictions on the repatriation of profits

-Single taxation system throughout the country

-Corporate income tax exemption on the investment and also VAT and wealth tax an import tax

-The only free airport and port in Latin America

We also enjoy some achievements according with international institutions

-MVD Highest quality of life in Latin America

-First in Democracy index in Latin America

-First in low Corruption in Latin America and one of the lowest in the world

-First in Prosperity index in Latin America

- First in rule of law in Latin America

-GDP growth p.a. (2007-2016) 4.6%

- First in income distribution in Latin America (Gini = 0.38)

-Investment grade rating

-FDI as % of GDP 5.6% , number 2 after Chile

After this policies and some achievements,I would like to comment a point which- in my view-.

is very important.

Uruguay is trying to turn to a knowledge based economy. So the FDI who contributes with this objective is very well welcomed. But, some remarks could be important.

The most powerful arguments in favour of incentives are based on the prospect for knowledge spillovers. Since technology to some extent is a public good, foreign investment can result in benefits for host countries even if the international firms carry out their foreign operations in wholly-owned affiliates. These benefits take the form of various types of externalities or "spillovers". For instance, local firms may be able to improve their productivity as a result of forward or backward linkages with firm affiliates, they may imitate technologies, or hire workers trained by the international firms. The increase in competition that occurs as a result of foreign entry may also be considered a benefit, in particular if it forces local firms to introduce new technology and work harder.

(1)*PhD in Appied Economics*, *President of the Central Bank of Uruguay (1985-1990,1995-1997), Professor of Finance (Emeritus),University of the Republic,Uruguay.*

However , there is a strong consensus in the literature about why multinationals invest in specific locations . Foreign firms are mainly attracted by strong economic fundamentals in the host economies. Among them are market size and real income levels, skills levels in the host economy, the availability of infrastructure and other resource that facilitates efficient specialisation of production, trade policies, and political and macroeconomic stability. The relative importance of the different fundamentals varies depending on the type of investment.

So in brief, theory suggests that in order to compete successfully in a foreign market a firm must possess some ownership-specific assets in knowledge, technology, organization , managerial and marketing skills. A firm blessed with such assets enjoys several possible ways (apart from exporting) to claim the rents that they will yield in foreign markets, including subsidiary production, joint ventures, licensing, franchising, management contracts, marketing contracts, and turnkey contracts.

.

The location of FDI may also be influenced by various incentives offered by governments to attract firms. These incentives take a variety of forms .

.

However empirical research shows that international investment incentives play only a limited role in determining the international pattern of foreign direct investment.Factors like market characteristics, relative production costs and resource availability explain most of the cross-country variation in FDI inflows and in this days risks involved.

Nevertheless, it is clear that international investment incentives might play a role for firms decisions on the margin.

The question is :whether the host country’s costs for providing the incentives – in terms of grants, subsidies, and other expenses – are justified?

Are investment incentives likely to yield benefits that are at least as large as the costs? There are several strong arguments against this type of incentives.

Firstly, there are obvious problems in identifying those marginal cases that would not enter the host economy without the incentives.

Secondly, it is difficult make reliable calculations about the expected future benefits in terms of growth, employment, or tax revenue.
This is particularly complex in cases where FDI projects that are driven by investment incentives rather than economic fundamentals of the host country. The reason is that these investors are likely to be relatively footloose, and could easily decide to move on to other locations offering even more generous incentives before the expected benefits in the first location have been realised.

Thirdly –and most importantly – if foreign investors do not differ in any fundamental way from local investors, subsidising FDI will distort competition and may generate significant losses among local firms.

Concluding remarks

Two final considerations. Spillovers and FDI and Trust

FDI and spillovers?

By spillovers is meant the positive externalities emanating from FDI, which go beyond the direct benefits that may be adequately reflected in market pricing. Foreign direct investment can play an important role in raising a country's technological level, creating new employment, and promoting economic growth. Many countries are therefore actively trying to attract foreign investors in order to promote their economic development. However, there are different ways to attract FDI. In this paper we have argued that the use of investment incentives focusing exclusively on foreign firms, although motivated in some cases from a theoretical point of view, is not a recommended strategy. The main reason is that the strongest theoretical motive for financial subsidies to inward FDI – spillovers of foreign technology and skills to local industry – is not an automatic consequence of foreign investment. The potential spillover benefits are realised only if local firms have the ability and motivation to invest in absorbing foreign technologies and skills. To motivate subsidisation of foreign investment, it is therefore necessary, at the same time, to support learning and investment in local firms as well. Hence, rather than proposing narrowly defined FDI policies, I argue that effective investment incentive packages should be seen as part of the country's overall industrial policy, and be available on equal terms to all investors, foreign as well as local. The incentives should focus in particular on those activities that create the strongest potential for spillovers, including linkages between foreign and local firms, education, training, and R&D. It should also be noted that the country's industrial policies in general are important determinants of FDI inflows and effects of FDI. By enhancing the local supply of human capital and modern infrastructure and by improving other fundamentals for economic growth, a country does not only become a more attractive site for multinational firms, but there is increased likelihood that its private sector benefits from the foreign participation through spillover benefits.

Trust

Finally , I would like to enphasize that Uruguay is a trustworthy country. In my point of view, trust is crucially important to attract FDI's. I am talking about individual, groupal or systemic trust. Economics ignores emotions in its theoretical construction. Trust is one complex emotion wich has always been and is particularly important in today´s world.

Thank you.