Promoting Foreign Investment in Fragile and Conflict-Affected Situations

Fragile and conflict-affected situations might appear incapable of attracting significant flows of foreign investment due to their often negative international images and weak enabling environments. However, during the last eight years, foreign investment into these economies has grown almost three times more quickly than flows into the rest of the world, albeit from a very low starting point. Untapped natural resources, reconstruction needs, and severely underserved consumer demand present domestic and foreign investors with significant opportunities, many of which continue to go unrealized. This note provides guidance to investment policymakers and promoters in fragile and conflict-affected situations, whose work is needed to bring those opportunities to fruition.

People living in fragile and conflict-affected situations (FCS) are among the world’s most disadvantaged. As of 2012, FCS accounted for only 7 percent of the world’s population, but close to a third of the world’s poor. Two years before the 2015 deadline for meeting the Millennium Development Goals, only 20 percent of FCS had met the goals or made sufficient progress, indicating that transformational forces are still needed if the outlook is to improve. Experience shows that foreign direct investment (FDI) can be one such force; multinational companies can provide a country with access to capital, jobs, skills, technology, and international business networks that are unavailable domestically. FDI may also be a valuable source of reconstruction financing, tax revenue, and foreign exchange.

However, the public image of FDI in fragile and recovering states is often overly associated with extractive projects and major infrastructure concessions. These large-scale, high-grossing projects tend to attract public attention and may stir resentment even when executed and regulated properly. In some cases, low-capacity governments may negotiate contract terms poorly or exercise weak oversight, while a few companies engage in activities with potential environmental and social risks.

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It is a significant challenge to manage such risks while at the same time actively promoting FDI and maximizing its benefits, especially for over-burdened governments tackling economic recovery. However, World Bank Group experience and a review of FDI projects in FCS from 2005 to 2012 show the challenge can be met, and opportunities open to investors in these situations are more varied than one might expect. In this period, FCS attracted FDI projects in 38 of the 39 sectors (all but semiconductors) tracked by the Financial Times. More detailed review of these findings indicates that certain types of investors are consistently interested in FCS, including those with business models based on moving first in new markets, regional investors, diaspora, and institutions that consider nonfinancial motives for investing.

Learning to identify and exploit these opportunities is important for governments in a globalized economy. The growing tendency toward global value chains has allowed FCS and developing countries in general to participate in those segments where they are competitive without having to attract entire industries. Learning to attract and manage the relatively few investment projects that are viable can be a stepping stone to eventually bringing in higher value-added investments, as has been demonstrated in countries that overcame similar challenges, such as Colombia and Rwanda. Early successes have a demonstration effect, signaling to other investors that the location has become viable as a place to do business profitably.

A country’s competitiveness in attracting FDI will grow as it rebuilds its business community, public institutions, international image, and investment promotion capacity (see Box 1). “Implementing programs that expand incrementally as the country becomes ready for additional reforms and assistance” is important to long-term success, according to a review of nearly 100 World Bank Group investment climate projects in FCS between 2003 and 2013 (Masinde and Harwit, forthcoming).

As fragile economies improve, they cease to be considered “FCS.” However, this note is not focused on how to improve the investment climate to move beyond FCS status. Rather, it proposes tactics for attracting FDI in the short term as one way to meet the challenges of rebuilding and economic recovery. World Bank Group experience suggests that, in the short term, the most effective form of investment promotion in FCS is highly targeted investor outreach, often complemented by necessary, sector-specific reforms to the investment climate, and in some cases, image building. Outreach is the process of identifying high-potential investors and approaching them directly to make the case for investing in a location. This note presents three guiding principles to this process:

1. Focus on competitive subsectors or projects.
2. Approach the investment process from the investor’s perspective.
3. Be vigilant against negative environmental and social effects of incoming investments.

Focus on a few competitive subsectors or projects

In the short term, political and economic circumstances may constrain the number and quality of viable investment projects. An investment promoter should recognize this and quickly focus on more realistic targets: the relatively few subsectors and projects that offer compelling business opportunities.

National development needs, policy goals, and political directives often set the priorities for investment promotion. However, many sectors prioritized for national or local development will not be internationally competitive, and political priorities may not align with economic realities. Politically appointed investment promoters with the low capacity and scarce resources typical of fragile economies may see little need to explore other priorities. This is a lost opportunity.
Practitioners must begin with an assessment of a location’s competitiveness. This involves:

- Considering a long list of desirable sectors.
- Understanding each sector’s competitive factors, including markets, value chains, production processes, cost drivers, industry players, relevant public policy, innovations, and trends.
- Assessing whether the business environment would be conducive to promoting investment in key sectors.
- Scoring the location’s long list of sectors against these competitive factors, and deciding if it can attract such investments.
- Comparing the most promising sectors against those of competing locations.

In FCS, this process will often reveal a relatively narrow range of attractive subsectors, for example, rice processing or garment assembly (rather than broad sectors, such as agribusiness and manufacturing), and even specific viable projects, for example, an opportunity to set up a cold storage facility for dairy products. Major reconstruction, resource extraction, and infrastructure development often provide unique opportunities to a small and quickly identified pool of large, capital-rich investors with experience in FCS.

At this point, the mode of investment should be considered. Greenfield investments, joint ventures, public-private partnerships, mergers, acquisitions, franchising, and licensing all have different requirements, affecting the competitiveness of priority subsectors and projects. The search for prospective investors and the exact outreach mechanisms used will often depend on the prevalent modes of investment in the targeted sectors. These are usually chosen by the investor, but they are sometimes dictated by the existing legislative and policy framework in a country. The promoter should take investor needs into account as they relate to likely modes of investment.

Table 1 shows the sectors and subsectors that attracted the most FDI interest in FCS over the period 2005–12. The 13 sectors represent 84 percent of all announced projects.

<table>
<thead>
<tr>
<th>Sectors</th>
<th>No. of projects</th>
<th>% of total</th>
<th>Leading subsectors (no. of projects)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial services</td>
<td>363</td>
<td>25.0</td>
<td>Retail banking (316), corporate and investment banking (21), insurance (17)</td>
</tr>
<tr>
<td>Coal, oil, and natural gas</td>
<td>132</td>
<td>9.1</td>
<td>Oil and gas extraction (54), gas stations (14), support activities for mining and energy (14), natural, liquefied, and compressed gas (12)</td>
</tr>
<tr>
<td>Food and beverages</td>
<td>125</td>
<td>8.6</td>
<td>Food and beverage stores (22), sugar and confectionary products (22), soft drinks and ice (20), crop production (11), breweries and distilleries (9)</td>
</tr>
<tr>
<td>Metals</td>
<td>121</td>
<td>8.3</td>
<td>Mining of iron ore, gold, silver, copper, nickel, lead, zinc, and other metal ores (68), production and processing of alumina, aluminum, and nonferrous metals (27), steel products (12)</td>
</tr>
<tr>
<td>Communications</td>
<td>106</td>
<td>7.3</td>
<td>Wireless telecommunications carrier (41), communications equipment (21), radio and television broadcasting (17), wired telecommunications carriers (16)</td>
</tr>
<tr>
<td>Business services</td>
<td>91</td>
<td>6.3</td>
<td>Advertising, public relations, and related (14), legal services (12), professional, scientific, and technical services (12)</td>
</tr>
<tr>
<td>Transportation</td>
<td>72</td>
<td>5.0</td>
<td>Freight and distribution services (31), air transportation (12), water transportation (11)</td>
</tr>
<tr>
<td>Textiles</td>
<td>41</td>
<td>2.8</td>
<td>Clothing and clothing accessories (30)</td>
</tr>
<tr>
<td>Industrial machinery, equipment, and tools</td>
<td>39</td>
<td>2.7</td>
<td>Agriculture, construction, and mining machinery (14), general purpose machinery (9)</td>
</tr>
<tr>
<td>Real estate</td>
<td>38</td>
<td>2.6</td>
<td>Real estate services (15), commercial and institutional building construction (10), residential building construction (8)</td>
</tr>
<tr>
<td>Building and construction materials</td>
<td>36</td>
<td>2.5</td>
<td>Cement and concrete products (32)</td>
</tr>
<tr>
<td>Alternative and renewable energy</td>
<td>35</td>
<td>2.4</td>
<td>Hydroelectric power (19)</td>
</tr>
<tr>
<td>Hotels and tourism</td>
<td>28</td>
<td>1.9</td>
<td>Accommodation (19), travel arrangement and reservation services (9)</td>
</tr>
</tbody>
</table>

in FCS. In those eight years, 50 countries and territories were classified as FCS for at least one year. Of these, half were classified as such for all eight years. Together these 50 countries and territories attracted 1,454 FDI projects while they were classified as FCS. Even the 25 countries and territories that were FCS for all eight years attracted an average of 31 announced FDI projects, or about one every three months.

For the most part, these projects are well distributed, with about half or more of FCS receiving at least one project in each of the top seven sectors. Although only 8 percent of projects are engaged in extraction, the capital expenditure of these projects is much higher than for other business activities, giving them an outsized presence in FDI inflow statistics in FCS. By number of projects, however, the majority are in financial and business services (31 percent) and manufacturing (20 percent), which may offer higher value-added and greater supply chain effects, with fewer environmental and social risks. The next largest activity—sales, marketing, and support—accounts for 15 percent of all projects. Projects in these sectors are among the lowest value-added, but they represent a common first step for companies wanting to access and study new markets before investing in production. Perhaps not unsurprisingly, of the 1,454 projects, only 12 were in research and development or design, development, and testing, activities highly sought for their higher value-added and potential for skill transfer.

**Approach the investment process from the investor's perspective**

**Focus on investors most likely to invest in FCS**

Despite the willingness of some to invest in locations recovering from strife or disaster, the relatively high risk is clearly not for every investor. An investment promoter’s outreach should target only the most promising investors, and thus it is essential to identify investors with the will or track record of taking such risks. Four main types of investors may have special reasons for investing in these situations and should be given special consideration when investment promoters create their prospect lists: FCS-accustomed investors, regional investors, diaspora, and investors with additional, non-financial motives for investing.

**FCS-accustomed investors.** Many such investors look for large concessions to extract natural resources or develop major infrastructure, such as deep-sea ports and hydroelectric dams. Their business growth depends on getting access to untapped resource reserves or filling large infrastructure gaps, opportunities more prevalent in the undeveloped markets of FCS. These projects come with high risks but also high returns.

A relatively small number of companies from a few countries dominate these projects, given their high-capital, high-technology, high-risk characteristics. The majority of extractive projects have come from five countries: Australia, Canada, China, the United Kingdom, and the United States.

However, outside the extractive and financial sectors some companies employ strategies to seize new markets, and they have developed business models to effectively manage the associated risks (see Table 2).

Companies with sales offices in a fragile or recovering state or actively trading with domestic business partners have demonstrated a level of comfort with the risks. They are good candidates for investor outreach activities, as are pre-conflict investors waiting for the right time to re-engage. The most cost-efficient way to generate new flows of FDI may be to encourage established investors to expand, deepen, or diversify their operations, although this group will be relatively small in most situations.

**Regional investors.** This group tends to have better knowledge of the realities on the ground because of proximity, information, historical connections, personal connections, and cultural understanding or affinity. Investors from countries with former colonial relationships often share these characteristics and should be included in this group.

Excluding extraction projects, 59 percent of all FDI projects in the analyzed database came from countries with a shared border, a capital within a three-hour flight, or a past colonial or wartime relationship. This argues for non-extractive investor outreach activities to carefully consider regional prospects before looking farther abroad; for example, post-conflict Kosovo used this approach to attract the manufacture of Bulgarian steel products.

**Diaspora.** Former or displaced citizens may have relatively high wealth, foreign business experience, and a personal desire to return, or at least to participate as the recovering economy stabilizes and grows. In 2012, $406 billion in remittances was sent to developing countries, and by 2015, this number is projected to exceed half a trillion dollars. Remittances are increasingly seen as a resource to be harnessed for investment. The Liberian Diaspora Fund is an example, with remittances from Liberians abroad pooled and matched to small and midsize enterprises in sectors the investors want to support. The entrepreneurs are provided basic business training and ongoing mentoring.

The beneficiaries of such programs typically operate small enterprises, but the organizations that run the programs can offer beneficiaries useful connections to wealthy citizens abroad and opportunities for collaboration. For example, in a country where most agricultural land holdings are small, a microfinance program that helps
farmers upgrade machinery and agricultural practices could give a large contract farmer the confidence to invest.

**Investors with additional, non-financial motives for investing.** This group includes state-owned enterprises, sovereign wealth funds—which are increasingly attracted to infrastructure projects—and socially concerned investment funds. These institutions, while still needing to show economic returns, may have longer time horizons and be able to accept higher risk and lower returns to achieve political or social aims.

For example, China’s “Go Out” policy encourages competitive Chinese enterprises to invest abroad to create strong Chinese multinational corporations, recognition of Chinese brands, and adequate supply of the raw materials that are fueling the country’s long-term growth. In this context a Chinese state-owned enterprise, in exchange for long-term access to critical raw materials, might accept short-term losses that would be unacceptable to commercial enterprises.

**Organize support and fix any “deal-breaking” investment climate issues**

Once the competitive subsectors or projects and their likely investors have been identified, investment promoters should map out the entire investment process from the investor’s perspective. This includes steps for due diligence, fulfilling government requirements, starting operations, and getting to market. The purpose is two-fold: to enlist the support of policymakers, regulators, and other stakeholders with influence over approvals, and to identify investment climate reforms that may be needed for outreach to succeed.

Stakeholders within the government are more likely to assist in overcoming constraints if they understand the investor’s business objectives, the benefits for the country’s economic recovery, and how collaboration to secure the investment serves the government’s interests. This dialogue also helps the investment promoter better understand the root causes of the constraint and may lead to ideas for solutions.

Common deficiencies in the investment climate in fragile and conflict-affected situations include missing or inadequate infrastructure, underdeveloped human resources, disrupted distribution channels, difficulty obtaining inputs, and weak service providers. Some critical deficiencies may need to be fixed before investment promotion becomes viable.³

For example, in 2012, a World Bank Group project in Haiti identified a lack of industrial park space as a major impediment to expansion of the otherwise promising garment sector. The country’s garment sector representatives collaborated with the National Industrial Parks Authority to clarify land and property rights impeding park development; get funding from the World Bank Group for four factory buildings with 11,400 square meters of new space; and put together an investor outreach campaign that led to 2,000 new jobs from new or expanded investments by three companies.
Whether using a project-specific approach, as in Haiti, or a broader reform-oriented approach, putting support in place before approaching investors will greatly increase the effectiveness of investor outreach. Investment promotion without this foundation is likely to waste time and resources.

**Correct overly negative impressions and deal with political risk concerns**

Investment promoters in FCS may have to overcome lingering international perceptions of danger and instability, even after their locations have achieved relative safety and security. In the late 1990s and early 2000s, World Bank Group projects in Colombia, El Salvador, and Nicaragua helped set up and build the capacity of new investment promotion agencies. All three places had experienced armed conflicts in recent memory and Colombia was still in conflict; however, crime statistics showed Bogota to be safer than Sao Paulo and Rio de Janeiro, while Nicaragua’s capital was the safest in Central America. The municipal and national investment promotion agencies in these locations built promotional messages around these facts and collaborated with their national governments on rebranding campaigns to target international markets: “El Salvador works” and in Colombia “The only risk is wanting to stay.” In investor presentations, the agencies took pains to demonstrate their messages were based on credible, objective data and not self-interested hyperbole.

These three examples illustrate clearly that, when pitching an FCS as a destination for investment, it is important to establish credibility. The following principles can help:

1. **Be honest about the situation.** Overly rosy pictures lead to disappointment and distrust which can kill projects and future chances. Discuss the location’s strengths—using facts from respected, objective sources—and weaknesses. Take the opportunity to present any mitigating factors the investor may have missed.

2. **Take ownership of the investors’ concerns and present workable options for mitigating risk.** Options should include advice on protective laws and government guarantees, political risk insurance, professional security and other services, and housing and transportation for personnel.

3. **Show that the location’s pitch is based on an understanding of the investor’s specific situation.** Prepare investor information and promotional materials for individual target sectors and companies. Such a targeted approach can be much more cost effective, particularly for promoters in often cash-strapped situations.

4. **Surprise the investor with something positive.** Take any opportunity to transform an investor’s preconceptions about the situation. The challenges of doing business there may be well known, but positive developments may not be. Good examples include testimonials from existing investors and concrete demonstrations of public and private sector support lined up by the investment promoter as part of the initiative. Promoters in both El Salvador and Colombia used this approach very effectively to grab the attention of investors.

Recent global investor surveys indicate that political risk is a major obstacle to investment in FCS (MIGA 2013, 1). An effective investor outreach program needs to consider how to respond when prospective investors raise issues such as expropriation of assets, breach of government contracts, and currency convertibility. Articulating steps taken by the government to protect investments will help demonstrate how the situation is improving. It can also be reassuring to outline known private and public providers of political risk insurance and trade guarantees. The Multilateral Investment Guarantee Agency of the World Bank Group, which provided guarantees of about $1.1 billion in FCS over six years between mid-2006 and mid-2012, is one of a few insurance providers covering periods beyond 10 years in FCS (IEG 2013, xiii–xxvii).

**Be vigilant against negative environmental and social effects**

A successful investment promotion initiative does not seek to attract any investment at any cost. It should not pursue investments which the public will not support and the government does not have the capacity to effectively administer and regulate. The weaker regulatory environment characteristic of FCS may not provide the necessary safeguards. For example, concession agreements should retain sufficient value for the country; screen for illegality, such as money-laundering; and defend against negative environmental and social effects that can aggravate fragility, work against projects’ potential benefits, and turn opinion against FDI generally.

Investment promoters should not be the ultimate guardians against these risks. However, they need to be aware of environmental and social issues and avoid pursuing problematic investments.

General environmental and social risks include labor abuses; resource depletion; environmental degradation; harm to health, safety, and security; population displacement; loss of biodiversity; threats to indigenous peoples; and harm to cultural heritage. In post-conflict situations, investment promoters should pay special attention to any dimensions...
of the conflict which had implications for particular sectors, for example control of certain natural resources or industries by conflicting sides, and ensure that targeted investments would not foster further instability.

By controlling for potentially deleterious factors in the selection and implementation of target projects, an investment promoter can help the overall operational performance, social acceptance, and long-term development impact of priority sectors. Projects that do not meet these standards should be advised to come into compliance. If they do not, they should be dropped.

Three guidelines can help to set the scope of environmental and social scrutiny to be undertaken by investment promoters:

- **Exercise caution with new investors:** Many fragile and post-conflict economies are in the process of rebuilding an industrial base and associated sector-specific legal and regulatory frameworks. Sectors prioritized for growth may not yet have an environmental and social track record or adequate safeguards in place. Thus, it is important to start early in addressing how the government can mitigate these risks as part of the process of targeting and attracting investors to a sector. The less established the sector, the greater is the need to ensure adequate safeguards.

- **Understand that adequate governance capacity is critical:** A government should be able and willing to perform due diligence in negotiating concessions for extraction and infrastructure, as well as to enforce compliance with regulations meant to protect the public interest. For example, a World Bank Group review of forest concessions in Liberia found that an aggressive program to attract forestry investment had been administered with inadequate due diligence. The resulting landscape of unqualified companies and a government unable to collect millions of dollars in back taxes led to a cancellation of all forest concessions (IEG 2012, 68–70). This resetting of the situation may or may not lead to better protection of the Liberian people, their interests, and the environment; in either case, responsible investors in the future may have doubts about the government’s reliability as a partner and hesitate to invest.

More fundamentally, a low capacity for governance may lead to investment regimes that are poorly conceived or executed, such as those relying on fiscal and other incentives, which may not be the most effective way to induce investment and can be particularly costly for recovering economies.

- **Be sensitive to controversial issues:** The political, social, and cultural contexts of the situation may hinder the types of investment that can be successfully promoted. In South Sudan, which achieved independence from Sudan after a long, ethnically charged conflict, the notion of foreign investors using South Sudanese land to enrich themselves was likened by many to a return of the “old guard.” In 2008, the country’s legislature proposed a bill which, while ostensibly intended to promote investment, imposed arbitrary and onerous barriers including a $500,000 fee and inefficient governance mechanisms, such as a 54-person committee to review and approve all investment projects. Realizing this was counterproductive for national development, the assembly and the administration worked with the World Bank Group for four months to strengthen other protections in the bill enough that stakeholders were comfortable removing the fee and streamlining the approval committee to 12 people.

**Conclusion**

Investors can and do locate projects into situations recovering from conflict or disaster. Many of these projects are well implemented with obvious benefits, but some are mishandled, becoming squandered opportunities. A good investment promoter can have a significant impact—in attracting investors that would not have come otherwise, negotiating good terms for the country, and helping guard against environmental and social harm. The process helps create jobs and stimulate industries that reduce fragility and form a foundation for future growth.

This investment generation can be achieved by a small team with a small budget, as long as its efforts are outcome-oriented and focused on directly approaching the few investors optimally suited to the situation’s few competitive subsectors and projects. Clear and comprehensive regulations should be in place for those subsectors, at a minimum, and the investment promotion team must have the capacity and will to be vigilant against proposed projects that pose unacceptable risks to the environment and society.

A review of recent FDI flows and a decade of World Bank Group projects in fragile and conflict-affected situations support the conclusion that investment promoters can have a meaningful effect, and this evidence suggests that recovering economies can tap into the benefits of FDI and globalization in spite of their difficult circumstances.
ABOUT INVESTMENT CLIMATE IN PRACTICE

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The Investment Climate Department of the World Bank Group helps governments implement reforms to improve their business environments and encourage and retain investment, thus fostering competitive markets, growth, and job creation. Funding is provided by the World Bank Group (IFC, the World Bank, and MIGA) and over 15 donor partners working through the multidonor FIAS platform.

Notes

1. Fragile and conflict-affected situations, or FCS, are countries and territories that have a harmonized average Country Policy and Institutional Assessment (CPIA) rating of 3.2 or less (or no CPIA) and/or have or have had a United Nations and/or regional peace-keeping or peace-building mission during the past three years. The 50 countries and territories classified as FCS for at least one year in the period 2005–12 are Afghanistan, Angola, Bosnia and Herzegovina, Burundi, Cambodia, Cameroon, the Central African Republic, Chad, the Comoros, the Democratic Republic of Congo, the Republic of Congo, Cote d’Ivoire, Djibouti, Eritrea, The Gambia, Georgia, Guinea, Guinea-Bissau, Haiti, Iraq, Kiribati, Kosovo, the Lao People’s Democratic Republic, Liberia, Libya, the Marshall Islands, Mauritania, the Federated States of Micronesia, Myanmar, Nepal, Nigeria, Papua New Guinea, São Tomé and Príncipe, Sierra Leone, the Solomon Islands, Somalia, South Sudan, Sudan, the Syrian Arab Republic, Tajikistan, Timor-Leste, Togo, Tonga, Tuvalu, Uzbekistan, Vanuatu, West Bank and Gaza, Western Sahara, the Republic of Yemen, and Zimbabwe.

2. Twenty-five countries were classified as fragile and conflict-affected situations for every year in the period 2005–12. According to data from the United Nations Conference on Trade and Development, FDI grew in those countries at a compound annual rate of 12 percent, compared to 4.5-percent growth in the rest of the world’s FDI.


4. Data from World Bank website at http://data.worldbank.org/mdgs/progress-status-across-groups-percentage-of-countries (accessed March 16, 2014). The percentage of FCS that had met or made sufficient progress toward each of the nine Millennium Development Goals ranged from 3 percent (infant mortality) to 45 percent (education gender parity). The average was 20 percent.

5. Data from FDI Markets (database), Financial Times (accessed September 29, 2013), http://www.fdimarkets.com. The authors analyzed 1,454 FDI projects registered for all countries designated as FCS by the World Bank Group, in the years they were designated as FCS, between January 2005 and December 2013. For example, if a location was classified as an FCS for just the one year of 2006, only its 2006 FDI projects were included in the analysis.

6. Note that while the average was 31, the median for these countries was only 14. Angola has almost 300 projects and Myanmar almost 100 projects, thus distorting the average. The median of 14 may therefore be a more accurate picture of project volume in a “typical” fragile or conflict-affected situation.

7. A three-hour flight time was approximated by a measurement of distance: 2,500 kilometers between the two countries’ executive capitals.

8. Areas of reform to improve the investment climate include investment laws and policies, aspects of business start-up, tax procedures, and trade logistics, among others.

9. These may include international rankings, such as those in the World Bank Group’s Doing Business report, the World Economic Forum’s Global Competitiveness Index, Transparency International’s Corruption Perceptions Index, and Heritage Foundation’s Index of Economic Freedom.

10. For more on the subject of investment incentives, see James (2010).

References


