Chapter

Business Climate: When Weakness Means Foreign Direct Divestment

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Abstract

This chapter is about weak business climate as a cause for foreign direct divestment. The aim is to show the connection between a poor business climate and foreign direct divestment. The methodology used entails a review of the different factors of the business climate such as the ease to do business, corruption, and rule of law. A review of the UNCTAD foreign direct investment flow as compared to the business climate indicators to determine a pattern is also part of the methodology. The chapter highlights the externalities of foreign direct divestment and suggests some ideas to overcome the global negative impact of foreign direct divestment as it is estimated to be significant in the aftermath of the COVID-19 pandemic. The conclusion is that foreign direct divestments can occur for different factors, some internal and some external. Weak business climates seem to play a role in a decision to divest an investment but there is no direct correlation.

Keywords: business climate, foreign direct divestment, weak business climate, factors of foreign direct divestment, universal wealth fund

1. Introduction

Foreign direct investments (FDIs) are defined as transfer of capital from one country to other where the investor has control or a significant degree of influence on the management of a business located in the host country [1].

Foreign Direct Divestment (FDD) are defined as an adjustment in the ownership of a business that involves the partial or full disposal of an asset or a business unit [2].

The theory of economic development shows that capital is one essential piece of Gross Domestic Product (GDP) growth. The reasoning is that more FDI helps in GDP growth whereas more FDD affects the GDP growth [3].

To understand the dynamic of the FDI process and the FDD process it seems external factors play an essential role on determining the decision to invest or the decision to divest.

The literature defines business or investment climate multifold. In general, usage of the term falls into three major categories: (1) an overall measure of growth or business health in a region; (2) a set of factors believed to contribute to regional economic growth; and (3) an intangible asset in the form of a regional reputation for business friendliness and receptiveness to growth [4].

In that continuum, efficient regulations, transparency, rule of law, strong institutions, low operating costs and predictability, inter alia, are all elements that can enhance the appeal to foreign investors. That premise assumes that previous conditions need to be in place: business opportunities and a positive cost/benefit equation. However, the opposite seems to be true: poor business climates where the rule of law is weak, corruption is pervasive, costs of doing business are high and unpredictable and transparency and predictability are absent appear to deter an investment decision.

This chapter is about the business climate as a relevant factor that drives FDD. Overall the methodology followed is this: review of indicators of business climate factors. Similarly, the FDI rankings are reviewed. It is sought to find a pattern between weak indicators of business climate factors and low flow of FDI. For that purpose, some countries' rankings on doing business, corruption perception index, and rule of law index are reviewed.

The second section highlights the factors that trigger FDI. By looking at the relevant data, it is intended to stress that a better business climate ranking contributes to boost FDI flows.

The third section shows the opposite: a weak business climate fosters FDD. A country will have a weak business climate when it is ranked in the lowest range on Doing Business, Corruption Perception Index and the Rule of Law Index.

The fourth section highlights the externalities of FDD. Just as FDI is considered to bring about externalities such as job creation and productivity enhancement, a connection between FDD and loss of jobs and GDP shrinking is explored.

The fifth section makes some suggestions to mitigate the impact of FDD externalities. As this essay is written during the COVID-19 pandemic it is assumed that FDD negative externalities will be more significant globally and hence global remedies might be needed.

The sixth section contains the conclusions. Combining the analysis of the data with some empirical observations certain conclusions are reached as regards to the connection of business climate and FDD as well as to some suggestions to mitigate the FDD externalities.

The seventh section contains the references.

2. Factors that trigger FDI

Foreign direct investments (FDIs) have been considered an important tool for economic development [5].

FDIs bring about not only capital and jobs to the host countries but also enhance the economic apparatus directly and indirectly in areas such as innovation, cultural trends and even language use [6].

FDIs can be considered the historic equivalent of territory conquests. Like that possibly overextended analogy, the rationale behind the conquests are multifold. In the case of FDIs, the reason for expanding overseas can be strategic or tactical going from market reach, factory allocation, costs reduction, profit enhancement, trend following, merger, competitors chase, trademark protection, etc.

From an economic efficiency standpoint FDIs should be assumed to be conducted when the benefits exceed the costs. That does not occur all the times as some of the benefits of FDIs can differ depending on the rationale behind. In a complicated world and with FDI actors as varied as they area and with interests as varied as they could be, the benefits could be difficult to measure. For example, State owned investors could have geopolitical interests in an investment. Hence, measuring the FDI benefit merely by the existence of profit could yield a wrong conclusion.

Thus, the factors that trigger FDIs are inexorably connected to the subjacent interests. However, the data that is available measures the FDI that is homogeneous, meaning FDIs where the interests are primarily economic and where the efficiency tends to be of the essence, i.e., costs do not exceed the benefits.

Ranking of FDI recipients v. ranking in business climate factors				
Country	**FDI inflow ranking**	**Doing business ranking Total: 190**	**Corruption perception index/ranking Total: 180**	**Rule of law index ranking Total: 128**
The USA	1	6	23	21
China	2	31/ 3 (Hong Kong)	80/16(Hong Kong)	88/16 (Hong Kong)
Singapore	3	2	4	12
The Netherlands	4	42	8	5
The United Kingdom	5	8	12	13

Source: UNCTAD world investment report [7], doing business [8], transparency international [9], and WJP rule of law index [10].

Table 1.
Year 2019.

In that continuum FDI flow is linked to a positive business climate. That is, there is a correlation between a good business climate and high levels of FDI.

An analysis of a business climate combines factors extrinsic to the business that impact the success or failure of the operation. Factors such as costs and time of doing business, including permits to operate or hire, physical and human infrastructure, corruption, rule of law, governance and political stability are all part of the overall analysis of the framework of a business climate.

Countries tend to attract more FDIs when it is easier, cheaper and faster to do business, when corruption is low and when the rule of law is prevalent. **Table 1** about ranking of FDI inflow recipients show the rankings of selected countries in relevant factors of business climate. It shows that the top 5 FDI inflow recipients perform above average in some business climate factors' rankings.

A case of point is Jordan. It has been implementing significant changes to ease doing business in areas such as getting credit, paying taxes and resolving insolvencies. The Doing Business indicators, scores and rankings, have been improving in consecutive years. Inflow FDIs have increased from $1600 million to $2030 million in 3 years up to year 2017. Jordan improved its Doing Business ranking in more than 10% in 3 years (UNCTAD World Investment Report and Doing Business).

Of course, correlation makes sense when the world economy is growing, and GDP is not contracted, when there is no world economic recession and when the economic resources of the country are not limited.

3. The impact of a weak business climate

In circumstances of economic expansion there seems to be a correlation between weak business climates and low FDIs.

The empirical evidence shows that in the absence of strong business climate the host countries are more prone to attract less FDI.

For example, when the rule of law is weak FDI inflow tends to be low. **Table 2** about the rule of law index rankings and FDI inflows shows the amount of FDI attracted by countries ranked at the bottom on rule of law.

When transparency is low, FDI tends to be low. **Table 3** about the corruption perception index rankings and FDI inflows shows the amount of FDI attracted by countries ranked at the bottom on corruption.

Country	Rule of law index ranking	FDI inflow amount (in millions of US dollars)
Congo, D.R.	124	1494
Afghanistan	123	139
Mauritania	122	71

Source: UNCTAD World Investment Report [7] and WJP Rule of Law index.

Table 2.
Year 2018.

Country	Corruption perception index ranking	FDI inflow amount (in millions of US dollars)
Somalia	180	409
South Sudan	179	n/a
Syria	178	n/a
Yemen	177	−282

Source: UNCTAD World Investment Report [7] and Transparency International [9].

Table 3.
Year 2019.

Country	Economic freedom index ranking	FDI inflow amount (in millions of US dollars)
North Korea	180	N/A
Cuba	178	2134
Eritrea	177	61

Source: UNCTAD World Investment Report [7] and Heritage Foundation Economic Freedom Index [11].

Table 4.
Year 2019.

Country	Doing business ranking	FDI inflow amount (in millions of US dollars)
Somalia	190	409
Eritrea	189	61
Yemen	187	−282

Source: UNCTAD World Investment Report [7] and Doing Business [8].

Table 5.
Year 2019.

When economic freedom is restricted, FDI tends to be low. **Table 4** about the economic freedom index rankings and FDI inflows shows the amount of FDI attracted by countries ranked at the bottom on economic freedom.

When doing business is difficult, FDI tends to be low. **Table 5** about the ease of doing business rankings and FDI inflows shows the amount of FDI attracted by countries ranked at the bottom on ease to do business.

4. Negative externalities of FDD

FDIs are poverty alleviation weapons. The benefits of FDIs have been consensually accepted to be vast and broad. The range goes from job creation, cluster creation, education enhancement, food improvement, infrastructure development, tourism recognition, technology transfer and commerce catalyst up to political stability and social peace.

FDI can also fill, first, the "investment gap" by providing the much-needed capital for domestic investment; secondly, the "foreign exchange gap" by providing foreign currency through initial investments and subsequent export earnings; and finally, the "tax revenue gap" by generating tax revenues through creation of additional economic activities [12].

The contrary is also true. FDIs are defined by control of a foreign entity of a business operation beyond the borders of origin. That control usually takes the form of ownership but it is not an exclusive trait to fulfill the goal. When control of the foreign operation ceases totally or partially by change, reduction or suppression of the activity or ownership a foreign direct divestment (FDD) can be deemed to have occurred [13].

FDD can be motivated by internal reasons. Those internal reasons can be intrinsic to the whole business undertaking or internal to the local operation. They include tactical ones, such as geographic location advantage or disadvantage, financial maneuvering, business structure, or limited resources as well as strategic ones such as market reach, competitors challenge, and product development [14].

FDDs can also be motivated by external reasons. A weak business climate where rules are not respected and predictable and where doing business is not efficient might the strongest determinant to FDD (**Figure 1**).

Thus, excessive corruption which makes costs, times and procedure outcomes unpredictable can be a deterrent of FDI. However, the evidence shows that efficiency, i.e., less costs, more benefits, is the determinant external factor of FDI. The opposite, absence of efficiency, i.e., more costs, less benefits, could be a determinant factor of FDD. Hence, a correlation between difficulty of doing business and low FDI is prevalent.

A relevant example on this point is Angola. Angola has worsened its ranking and scores in the Doing Business indicators. Two of the indicators, enforcing contracts and obtaining credit have worsened during the period lapsing from the year 2015. During that period the FDI inflow have gone from $10,028 million to $ – 5732 million in 2018 (UNCTAD World Investment Report, Doing Business).

With FDD the host countries can suffer significantly in economic, social, and political terms. A fleeing capital that has been significant in terms of GDP and that

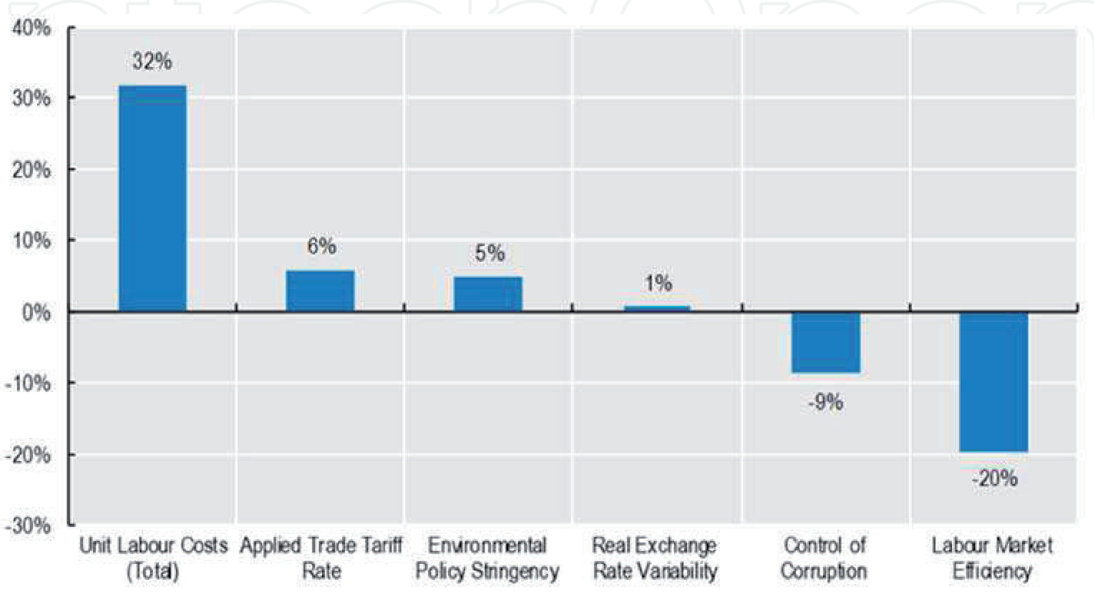

Figure 1.
The role of host country investment climate factors. Source: Borga et al. [15].

Country	FDI inflow amount (in millions of US dollars)	Refugees
Syria	N/A	5.6 million
Afghanistan	139	2.7 million
South Sudan	N/A	2.3 million
Myanmar	3554	1.1 million

Source: UNCTAD World Investment Report [7] and World Vision [16].

Table 6.
Year 2019.

Country	FDI inflow amount (in millions of US dollars)	Environmental performance index
Burundi	1	180
Bangladesh	3613	179
Congo, D.R.	1494	178

Source: UNCTAD World Investment Report [7] and Environmental Performance Index [17].

Table 7.
Year 2018.

is not substituted with other capital makes locals lose jobs, makes local small businesses vanish, and brings about losses in fiscal income, among other consequences. More significantly, the impact in the host country can also have social repercussions such as riots, violence and unrest as well as political instability.

Countries with low FDI are usually exporters of migrants. **Table 6** about FDI inflows and number of refugees shows the amount of FDI attracted by countries with most outgoing refugees.

With lack of incentives to prosper economically countries with low FDI are also more unlikely to adopt environmental friendly policies. **Table 7** about FDI inflows and environmental performance index shows the amount of FDI attracted by countries with poor environmental performance.

Home countries are not necessarily the beneficiaries of FDD. The capital that flew away from a host country can go to another one. It might not be significant to impact in the GDP of the home country, nor to create more jobs, enhance the home country productivity or to gross up the home country's treasury. However, the global impact of massive FDDs can worsen the inequality, flows of refugees and global warming.

5. Remedies to FDD negative externalities

FDIs pursue many purposes, one of which is profit seeking. Investors might still achieve that goal after a FDD has taken place and host countries might not necessarily face all the negative externalities of FDDs if certain global policies are implemented.

5.1 ESGF

Setting up a global Environment Social and Governance Fund (ESGF) through a multilateral entity could mitigate the negative externalities of FDDs. The ESGF could endow with private capital, such as proceeds from FDD and/or open to all types of capital. The capital that is not invested in FDIs could still be beneficial to developing countries. Investors in search of profits could be benefitted, albeit without controlling the investment in a modality much more similar to portfolio investments.

The ESGF will make impact investments in different types of international business opportunities that are environmentally friendly, socially beneficial, and well governed. Home countries could play a role suggesting or encouraging owners of the FDD returning capital to devote a portion of the capital to the ESGF perhaps under certain tax arrangements, such as tax benefits to be granted to investors who devote capital to the ESGF.

The ESGF in turn could grant money to countries falling under certain economic category provided they fulfill certain objectives in environmental, social and governance policies. For example, if a country can increase its ranking in the rule of law index more than 10% every year for 2 years, the country can be entitled to participate in requests for grants from the ESGF. The grants will be disbursed on condition of maintaining certain conditions and developing programs devoted to mitigating the externalities of FDDs.

5.2 From UBI to UWF

The global economic, social and political consequences of the COVID-19 pandemic are still to be seen. It might easily happen that FDDs will occur not as a consequence of weak business climates but because of a global economic recession, lack of demand, or irrelevance of supplies. The same externalities of FDDs could be suffered by most countries.

Universal Basic Income (UBI) has been widely recommended as a measure to alleviate the needs of the poor. UBI has received recent publicity as a possible remedy to alleviate the needs of many during the pandemic crisis. The rationale behind the UBI is that people under certain conditions will receive a fixed amount of money. Once spent the UBI is evaporated and there is no legal right to it. Bluntly, it is a donation by the government.

A complementary concept might be useful: Sovereign Wealth Funds (SWF) with a more ambitious twist. SWFs are investment funds created and commonly owned by sovereign States to maximize the profits of their wealth usually but not necessarily yielding from commodities. Currently, there are more than 90 SWFs holding more $8 trillion [18].

SWFs have been highly profitable. For example, the Norway Government Pension Fund Global is the largest SWF, created in 1990 and currently holding more than $1 trillion. It has generated an average annual return of 6% since 1998 [19].

Many SWFs have been created mainly for purposes different than direct social benefits to the citizens of the owner States, such as macroeconomic policies [20]. However, in general, people receive proceeds from SWFs investments directly or indirectly, even in seemingly citizens' remote circumstances as managing the balance of payments [21].

The Alaska Permanent Fund is an example of a SWF where there is a direct benefit to the citizens as returns are distributed through a citizens' dividend program under certain conditions. It was established in the Alaska Constitution in 1976 and managed by a state-owned corporation, the Alaska Permanent Fund Corporation (APFC). It is endowed from the proceeds of oil. It distributes its returns through a citizens' dividend program. The fund currently holds over $66 billion in assets. It has paid up to $2072 in dividends.

The negative externalities of FDDs will be more prevalent in the aftermath of the COVID-19 crisis. The impact of the global recession and reduction of the demand is likely to be reflected in massive FDD. Developing countries will suffer significantly economically and socially at a minimum. The chaos of many developing countries struggling with basic needs can in turn deteriorate the business climates to further affect the flow of FDD.

Thus, inspired by the SWF, a Universal Wealth Fund (UWF or 3UF) could be established through multilateral arrangements. It could be set up to mitigate not only the effects of a surge of FDD but also the global economic and social damage post COVID-19.

The 3UF could be endowed by countries, by corporations and by NGOs. The corporations could make their contributions directly from the capital of the FDD or as some kind of tax planning tool or even as some kind of fine or penalty mitigation when they are punished or fined by multilateral entities such as the European Union.

Proceeds could be distributed directly to countries under condition that they are either invested in social projects and/or turn to the citizens in form of dividends which could be structured in terms of legal rights to which they are entitled. As opposed to UBI which are discretionary, rights to 3UF dividends can benefit large scale capitalization, financial literacy, and governance of the 3UF.

Be it as it may, the disadvantages of FDD to host developing countries could be mitigated. It was important before; it is more important in the world after the COVID-19 crisis.

6. Conclusions

FDIs are important tools for economic development. FDIs entail capital transfer to host countries which sometimes starve of funding to provide for the wellbeing of their citizens. Through FDIs many developing countries can ameliorate the impact of the poverty in the social and economic realms. Jobs are created, local business emerge, more public revenues can be collected, physical infrastructure is enhanced, human infrastructure is benefited, and the host country's branding can emerge as a favorable place to invest, among others.

The FDI process is complex as is the decision to invest. Many factors play a determinant role in FDIs. Internal and external factors of different nature can push the capital inside or outside the host country. Among the external factors, business climate plays a crucial role. The combination of external factors that is commonly known as business climate relates to all the host country's conditions that make the business easy to operate, diminish the costs and sets up in advance the rules under which the business will function. Unpredictability of rules, costs, and processes are usually contrary to FDIs. However, even in conditions of difficult, expensive, and lengthy conditions to do business, corruption, and weak rule of law, FDIs flow, albeit somehow diminished.

Countries that receive the most FDIs are ranked above average in the Doing Business indicator, Corruption Perception index and Rule of Law index. On the contrary the countries that are badly ranked in those indexes have attracted a lower amount of FDI.

The empirical evidence shows that in the absence of strong business climate the host countries are more prone to attract less FDI. That is the case with the Doing Business indicator, the Corruption Perception indicator, and the Rule of Law indicator.

It can be concluded that excessive corruption which makes costs, times, and procedure outcomes unpredictable can be a deterrent of FDI. However, the evidence shows that efficiency, i.e., less costs, more benefits, is the determinant external factor of FDI. The opposite, low efficiency, could be a determinant factor of FDD.

The correlation between weak business climates and FDD is noticeable although not determinant. As FDD decisions are dependent on internal factors of the investor as well, a conclusion on a direct relation between weak business climates and FDD cannot be reached. However, the evidence shows that absence of efficiency, i.e., more costs, less benefits, could be a determinant factor of FDD.

The impact of FDD is somehow the reverse of the benefits of FDI for the host countries. FDDs can also bring about negative externalities to the home countries under the form of migrants and deteriorated environment.

At a global level, investment funds can play a role to mitigate the impact of FDDs. A multilateral fund devoted to environmental and social projects properly governed can be established in a way that appeals the outflow capital resulting from the FDD. The profits could in turn be offered to countries that satisfy certain requirements and conditioned to be invested in projects devoted to reducing poverty or other FDD negative externalities. Similarly, an unprecedented universal Sovereign Wealth Fund could also mitigate the negative impact of massive capital mobilization from poor counties. In the seemingly critical times that will follow the COVID-19 pandemic, global policy makers need to be creative in large scale to long term sustainable solutions for all.

Conflict of interest

The author has avoided listing some countries in the rankings due to professional conflicts of interests.

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