Investment Perspectives in Eastern Partner Countries
Investment Perspectives in Eastern Partner Countries
Investment is central to growth and sustainable development. It expands an economy’s productive capacity, creates jobs and raises income. Under the right conditions, foreign direct investment (FDI) can provide additional advantages by bringing new knowledge and more sustainable business practices to recipient countries, and ultimately improve their citizens’ standard of living. These benefits do not occur automatically, and an adequate policy framework is necessary both to attract investment and to maximise positive FDI spillovers.

FDI in Eastern Partner (EaP) countries has grown considerably over the last two decades, and is associated with greater innovation capacity. Yet, already below potential compared to neighbouring regions, FDI flows to the EaP countries are likely to drop sharply as a consequence of the coronavirus (COVID-19) pandemic and resulting global economic upheaval. There remains considerable scope for improving the investment climate, in order to retain existing investors, attract new ones, and mitigate the expected drop in FDI inflows.

This report examines recent developments in FDI and related sustainable development outcomes in EaP countries. It then considers several dimensions of the policy framework that affect the investment climate of the six countries; notably, FDI liberalisation, investment promotion and facilitation, investment tax incentives, and responsible business conduct.

The main beneficiaries of this report are the governments of the six EaP countries, and in particular their respective authorities overseeing economic development, investment policy, tax policy, justice, competition, as well as agencies charged with investment promotion.

Foreword
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Table of Contents

Foreword .................................................................................................................................................. 3
Acknowledgements ................................................................................................................................. 4
Acronyms and Abbreviation .................................................................................................................. 7
Executive Summary ................................................................................................................................. 9
1. FDI trends and sustainable development impacts ............................................................................. 12
   FDI in the regions remains below its potential .................................................................................... 12
   Foreign investors contribute to innovation capacity ............................................................................ 15
   Annex 1.A. Sectoral composition of FDI by country ......................................................................... 18
2. FDI liberalisation .................................................................................................................................. 19
   Main findings ........................................................................................................................................ 19
   Markets are open and exceptions to national treatment are limited ..................................................... 19
3. Investment promotion and facilitation .............................................................................................. 25
   Main findings ........................................................................................................................................ 25
   The institutional framework for investment promotion and facilitation ............................................. 26
   Investment promotion requires a clear and well-defined strategy ....................................................... 33
   Investment facilitation and retention measures have improved ......................................................... 37
   Annex 3.A. Comparative overview of investment strategies ............................................................... 42
4. Making better use of tax incentives .................................................................................................... 43
   Main findings ........................................................................................................................................ 43
   Investment tax incentives are costly ....................................................................................................... 44
   Corporate taxes are relatively low in the region ................................................................................... 46
   Incentives offered by EaP countries are targeted but costly ................................................................. 49
   Annex 4.A. Incentives in SEZs .............................................................................................................. 56
5. Promoting responsible business conduct ......................................................................................... 57
   Main findings ........................................................................................................................................ 57
   Branding as a responsible business destination can help attract FDI .................................................... 59
   Efforts to promote RBC often remain too timid ..................................................................................... 62
   EaP countries face challenges in enforcing RBC practices ................................................................. 66
References .................................................................................................................................................. 77
Notes ....................................................................................................................................................... 83

Tables

Table 3.1. Summary of organisational reforms over last five years ....................................................... 28
Table 3.2. Official mandates by agency .................................................................................................... 30
Table 3.3. Priority countries and sectors ............................................................................................... 35
Table 3.4. Criteria used for prioritisation of investment projects ............................................................ 35
Table 3.5. Investment promotion activities of IPAs ............................................................................... 36
Table 3.6. Aftercare services of IPAs ................................................................. 40
Table 3.7. Policy advocacy activities of IPAs .................................................. 41
Table 4.1. Summary of types of tax incentives ............................................. 50
Table 4.2. Overview of investment incentives in EaP countries .................... 52
Table 5.1. NAPs on RBC/HBR in EaP countries .......................................... 63
Table 5.2. Ratifications of ILO Conventions .............................................. 69
Table 5.3. Reported occupational injuries in EaP countries ......................... 71
Annex Table 3.A.1. Typology of investment strategies .................................. 42
Annex Table 4.A.1. Overview of tax incentives available to investors in SEZs .... 56

Figures

Figure 1.1. FDI’s importance relative to GDP has risen strikingly in Georgia and Azerbaijan .......... 13
Figure 1.2. Georgia and Armenia attract growing shares of the region’s FDI stock .................. 13
Figure 1.3. FDI flows remain low in EaP countries ......................................... 14
Figure 1.4. Greenfield investments are dominated by services, fossil fuels and construction .... 15
Figure 1.5. Selected SDG outcomes of FDI ...................................................... 17
Figure 2.1. OECD FDI Regulatory Restrictiveness Index (2018-19) ..................... 22
Figure 2.2. OECD FDI Regulatory Restrictiveness Index by sector (2018-19) ..................... 23
Figure 3.1. Year of creation of IPAs ................................................................. 28
Figure 3.2. Number of official mandates ........................................................ 30
Figure 3.3. Number of mandates and employees of IPAs .................................. 31
Figure 3.4. Board members in Ukraine Invest and selected other IPAs ...................... 32
Figure 3.5. Estimated use of staff across the four investment promotion functions .......... 33
Figure 3.6. Assistance with administrative procedures ...................................... 38
Figure 4.1. Statutory CIT rates in EaP countries ............................................ 47
Figure 4.2. Ease of paying taxes in EaP countries .......................................... 48
Figure 4.3. Typical investment incentive targets ............................................. 50
Figure 4.4. CIT rates in SEZs .................................................................. 54
Annex Figure 1.A.1. Distribution of greenfield projects by sector and country .......... 18

Boxes

Box 1.1. The OECD FDI Qualities Indicators ................................................. 16
Box 2.1. The OECD FDI Regulatory Restrictiveness Index ............................. 21
Box 3.1. The OECD-IDB survey of investment promotion agencies .................. 27
Box 4.1. The economic costs of tax incentives .............................................. 45
Box 4.2. A brief history of corporate taxes in EaP countries ............................ 47
Box 4.3. Overview of SEZ regimes in EaP countries ....................................... 55
Box 5.1. RBC, CSR, and BHR: towards international convergence and coherence .... 59
Box 5.2. Understanding the OECD Guidelines for Multinational Enterprises ........ 60
Box 5.3. Role of governments in promoting and enabling responsible business .......... 61
Box 5.4. Progress toward NAPs: Georgia and Ukraine .................................... 63
Box 5.5. Selected cases assessed by international grievance mechanisms on human rights .... 68
Box 5.6. Progress in occupational health and safety in Georgia ....................... 71
Box 5.7. Steps taken to combat corruption in EaP countries ............................ 74
Box 5.8. Disclosure and Transparency in extractive industries ........................ 76

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### Acronyms and Abbreviation

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<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>AZPROMO</td>
<td>Azerbaijan Export and Investment Promotion Foundation</td>
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<td>BHR</td>
<td>Business and Human Rights</td>
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<td>BHRRC</td>
<td>Business and Human Rights Resource Centre</td>
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<td>CAO</td>
<td>Compliance Advisory Ombudsman</td>
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<td>CIT</td>
<td>Corporate Income Tax</td>
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<td>CoE</td>
<td>Council of Europe</td>
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<td>CRM</td>
<td>Customer Relationship Management</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>EaP</td>
<td>Eastern Partners</td>
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<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<td>EC</td>
<td>European Commission</td>
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<td>EIA</td>
<td>Environmental Impact Assessment</td>
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<td>EITI</td>
<td>Extractive Industries Transparency Initiative</td>
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<td>EU</td>
<td>European Union</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FEZ</td>
<td>Free Economic Zone</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>ICT</td>
<td>Information and Communication Technology</td>
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<td>IDB</td>
<td>Inter-American Development Bank</td>
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<td>IFC</td>
<td>International Finance Cooperation</td>
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<td>ILO</td>
<td>International Labour Organization</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IPA</td>
<td>Investment Promotion Agency</td>
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<tr>
<td>MNE</td>
<td>Multinational Enterprise</td>
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<tr>
<td>NAIP</td>
<td>National Agency of Investment and Privatisation of Belarus</td>
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<tr>
<td>NAP</td>
<td>National Action Plan</td>
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<tr>
<td>NCP</td>
<td>National Contact Point</td>
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<td>NGO</td>
<td>Non-Governmental Organisation</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
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<tr>
<td>RBC</td>
<td>Responsible Business Conduct</td>
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<tr>
<td>SEZ</td>
<td>Special Economic Zone</td>
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<tr>
<td>SME</td>
<td>Small and Medium-sized Enterprise</td>
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<tr>
<td>SOE</td>
<td>State-Owned Enterprise</td>
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<tr>
<td>UN</td>
<td>United Nations</td>
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<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<tr>
<td>UNECE</td>
<td>United Nations Economic Commission for Europe</td>
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<tr>
<td>USD</td>
<td>United States Dollars</td>
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<td>VAT</td>
<td>Value Added Tax</td>
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Executive Summary

FDI in Eastern Partner (EaP) countries has grown considerably over the last two decades, and is associated with greater innovation relative to domestic investment, but it remains below its potential in comparison to neighbouring regions, and will likely suffer as a result of the coronavirus (COVID-19) pandemic and related economic disruptions. This report examines several policy dimensions that affect the investment climate of the six countries – FDI liberalisation, investment promotion and facilitation, investment tax incentives, and, responsible business conduct – and offers some recommendations on potential avenues towards a policy framework that is more attractive to investors and conducive to positive FDI spillovers.

EaP countries have made considerable strides in reducing regulatory barriers to FDI, establishing legal frameworks for entry and establishment that are attractive to foreign investors. Access to, and clarity of, laws and regulations that affect market access and treatment conditions applicable to foreign investors can be improved, and may make the FDI regimes of EaP countries less opaque to potential investors.

The investment promotion agencies (IPAs) of the region make use of a comprehensive set of tools to attract investors, and business facilitation has improved substantially. Nevertheless, the IPAs tend to be understaffed and subject to frequent institutional restructuring. Their limited resources are stretched across numerous mandates spanning different policy areas, and sometimes combining policy-making and promotional functions, which can lead to lower credibility and effectiveness. All of the IPAs in the region have yet to put in place adequate monitoring and evaluation mechanisms.

Statutory corporate income tax rates have declined considerably and tax administration has improved greatly. On top of already low CIT rates, EaP countries tend to offer a generous package of fiscal incentives in the form of reduced CIT rates for qualifying investments. While fiscal incentives are a commonly used tool to attract investments, they strain public finances and risk subsidising investments that would have materialised without them. Special economic zone (SEZ) regimes in the region offer even greater tax breaks, including permanent CIT exemptions or reductions, which harm non-zone investors and can result in huge losses in government revenue. A less distortionary approach is to limit CIT exemptions to a pre-defined period of time and phase out reduced tax rates that overly complicate the tax system (as is the case in Azerbaijan), or phase out zone-specific CIT holidays altogether (as is the case in Ukraine).

EaP countries have all made steps to establish and implement a regulatory and institutional framework that underpins responsible business conduct (RBC). More efforts are needed in all countries to strengthen this framework and to ensure implementation and enforcement of relevant laws and commitments. Awareness of RBC principles and standards is not yet widespread in most EaP countries. Governments in the region have yet to communicate the RBC policies they apply to public procurement and corporate governance of state-owned enterprises (SOEs). Non-governmental organisations (NGOs) in the region are concerned about the human, social and environmental impacts of extractive, chemical and agricultural industries. Trade unions have reported barriers to collective bargaining and discrimination against unionised workers. With some exceptions, the gender gap in the labour market remains a matter of concern. Despite substantial
progress in reducing opportunities for corruption (for example in Georgia), corruption continues to be perceived as an important barrier to doing business in several countries.

**Key recommendations**

- **Consider improving the legibility of the legal framework for foreign investors**, for instance by establishing a foreign investment negative list clearly delimiting the sectors where foreign investment is prohibited or conditioned, and outlining which discriminatory conditions apply (as is already the case in Ukraine). Translating relevant legislation to English and making it available in existing centralised official online sources would greatly improve clarity and transparency with respect to EaP countries’ FDI regimes.

- **Give IPAs resources and capacity that are commensurate to their mandates and adequate to conduct key investment promotion and facilitation functions.** Minimise institutional reorganisations. Clearly spell out IPA mandates, activities, targets and KPIs in a clear and specific investment promotion strategy, in line with national development objectives. Put in place a system to track IPA activities and improve monitoring and effectiveness of investment promotion and facilitation efforts.

- **Consider creating a dedicated board to supervise or advise the activities of IPAs** (as is the case in Ukraine), composed of representatives from government, private sector, academia, and civil society. Ukraine should consider expanding its existing board’s membership to include private sector representatives.

- **Cut unnecessary procedures and requirements to start a business**, digitise procedures where possible, and continue efforts to reduce the time required to start a business in Belarus and Ukraine.

- **Conduct rigorous cost-benefit analyses of existing incentive schemes.** This involves linking incentives to policy objectives and evaluating whether realised investments outweigh the economic costs of the incentive regimes, and meet set targets. Information on incentives should be centralised, easily accessible, and potentially consolidated into a tax code, to increase transparency for investors.

- **Eliminate excessive fiscal advantages offered to zone investors relative to inland investors,** for instance by limiting existing permanent CIT exemptions (Armenia, Belarus and Georgia) and reductions (Moldova) available to free zone investors to a predefined time horizon. This will also help curb government revenue losses and simplify the overall incentive regimes. All EaP countries should consider moving towards cost-based incentives, like tax deductions and credits for specific activities or accelerated depreciation of assets, which are less distortionary, and are likely to have a greater impact on investment generation.

- **Clearly communicate government expectations that all businesses under their jurisdictions respect RBC standards.** Consider developing a National Action Plan on RBC or strengthening existing national plans on human rights, in cooperation with relevant stakeholders and in line with international good practice, to ensure policy coherence and alignment on RBC among government institutions. Engage further in awareness-raising and capacity-building activities (as is the case in Georgia and Ukraine), and consider developing sector-specific guidance for businesses that operate in high-risk sectors (i.e. mining, oil and gas, chemicals, and
agriculture). Ensure systematic implementation of free and meaningful consultations with potentially affected stakeholders, as well as environmental and human rights impact assessments.

- **Develop and communicate the RBC policies that apply to SOEs and public procurement.** Any reforms or new legislation should be subject to stakeholder consultations and undertaken at a pace that is compatible with the ability to safeguard environmental and social entitlements.

- **Keep strengthening legislation to ensure adequate working conditions,** in particular health and safety (as is already the case in countries such as Georgia). Introduce stricter reporting requirements for on-the-job injuries. Increase efforts to protect and promote the rights to form and join trade unions and introduce and enforce penalties for arbitrary dismissal of employees. Increase efforts to guarantee the right to equal pay for work of equal value in law and practice, and further promote gender-inclusive employment policies, starting from government and SOEs.
1. FDI trends and sustainable development impacts

Investment is central to growth and sustainable development. It expands an economy’s productive capacity, creates jobs and raises income. Domestic investments usually dominate, but FDI can provide additional advantages beyond the direct contribution to the capital stock. Under the right conditions, international investment can raise overall productivity in recipient countries and, ultimately, lead to an increase in its citizens’ standard of living. Different channels exist through which these positive contributions can materialise:

- foreign investment often contributes to growth, beyond what domestic investment normally would, by raising both total factor productivity and the efficient use of resources in host economies;
- FDI can support host economies’ global trade integration by providing them with improved access to international markets, developing local export capabilities and integrating them with global value chains;
- MNEs often bring new technologies in recipient economies and FDI can thus lead to local technology transfers and innovation spillovers, especially through the creation of local supplier linkages;
- FDI creates direct and indirect jobs (i.e. through backward and forward linkages with small and medium-sized domestic companies) and can enhance human capital through the dissemination of new skills, know-how and management techniques – which can benefit both MNE workers and local firms that act as suppliers to MNEs;
- international investment can also support greater competition in host markets and thus lead to productivity gains, lower prices and more efficient resource allocation; and
- finally, FDI has the potential to bring social and environmental benefits to host countries by disseminating good practices of responsible business conduct (RBC), as laid out in the OECD Guidelines for Multinational Enterprises.

These benefits do not occur automatically, and an adequate policy framework is necessary to maximise them as well as minimise any potential costs of FDI.

FDI in the regions remains below its potential

The stock of inward FDI in EaP countries has grown considerably over the last decade, from around 30% to 55% of GDP, surpassing the average for EU countries (Figure 1.1). It remains the lowest of the EU’s neighbouring regions, and its growth has been modest relative to Southeast Europe and Central Asia (although the latter has been primarily in natural resource extraction), suggesting that there is still scope for greater FDI attraction in some economies. When considering the countries in the region individually, there is a wide discrepancy in FDI’s importance relative to the economy. Georgia has seen an astonishing growth, with FDI stocks doubling from 55% of GDP in 2007 to over 100% in 2018. Azerbaijan, with FDI stocks now at almost 70% of GDP, has witnessed a similar growth over the last decade. The other countries in the region have experienced more modest
growth, with FDI remaining between 35% and 43% of GDP. In Moldova, FDI’s share in GDP actually shrank over the last decade, from 50% to just over 40%.

In terms of the distribution of inward FDI stocks across the region, the shares have remained fairly stable over the last two decades for Belarus, Moldova and Ukraine (Figure 1.2). By comparison, FDI stocks of Georgia and Armenia more than doubled (to 14% and 5%, respectively), while Azerbaijan’s share shrank from 38% to 25% of total FDI in the region.

**Figure 1.1. FDI’s importance relative to GDP has risen strikingly in Georgia and Azerbaijan**

![Graph showing FDI's importance relative to GDP in Georgia and Azerbaijan](image)

*Note: CA = Central Asia; SEE = Southeast Europe; MED = Southern Mediterranean; EaP = Eastern Partners. Source: UNCTAD Statistics (2019).*

**Figure 1.2. Georgia and Armenia attract growing shares of the region’s FDI stock**

![Graph showing share of total inward FDI stock](image)

*Note: Figure not to scale: inward FDI stocks in 2018 were 15 times higher than in 1998. Source: UNCTAD Statistics (2019).*
The coronavirus (COVID-19) health crisis, government measures to contain the pandemic, and the resulting economic upheaval, are set to accelerate the steady decline in global FDI flows observed over the past two years. The current crisis may affect Eurasia economies more severely than the 2008 financial crisis did, given their greater integration in the global economy, and thus greater exposure to the systemic effects of the pandemic. Low oil prices, exacerbated by the demand contraction and ongoing oil price war, will make energy-exporting countries in the region particularly vulnerable to the economic shock, and related drop in FDI inflows.

Prior to the COVID-19 crisis, inflows of FDI to the region were already somewhat flat (Figure 1.3). In Ukraine, they increased substantially prior to the global financial crisis of 2008-09, but then dropped in its aftermath, and have not recovered since. Azerbaijan’s FDI inflows are highly influenced by oil and gas-related activities being the country’s main recipients of investments. The country experienced large disinvestments in the run up to the financial crisis, which recovered until oil prices dropped again in 2015-16. FDI flows into other countries in the region have been more stable, with noticeable growth in Belarus and Georgia and relatively minor but stable flows to Moldova and Armenia.

Figure 1.3. FDI flows remain low in EaP countries

Inward FDI flows, 1998 = 100


A range of different economic activities attract foreign investors to the region (Figure 1.4). In terms of project value, the majority of announced greenfield investments in the region, over 2003 to 2017, were in information and communication technology (ICT) services and financial services (22%), followed by fossil fuels (18%) and construction (11%). However the picture is considerably different across countries (Annex 1.A.). In Armenia over 50% of greenfield FDI was in ICT and financial services, while half of Azerbaijan’s inward flows over the same period were in oil and gas. Moldova’s FDI portfolio is somewhat more diversified, including significant greenfield investment in transport equipment (23%), natural gas (21%) and ICT services (16%). Belarus, Georgia and Ukraine have an even more diversified portfolio, including significant investments in ICT and finance; consumer products such as electronics and garments; transport and storage (Belarus and Georgia)
food, construction and building materials (Ukraine); natural gas (Georgia); and transport equipment (Belarus).

**Figure 1.4. Greenfield investments are dominated by services, fossil fuels and construction**

![Graph showing distribution of greenfield FDI projects by sector](image)

*Source: Financial Times (2018).*

**Foreign investors contribute to innovation capacity**

Foreign investment can benefit a host economy beyond raising its stock of capital. Under the right conditions, FDI can enhance growth and innovation, create quality jobs, develop human capital, and raise living standards and environmental sustainability. In other words, FDI can generate positive socio-economic and environmental impacts in EaP countries that help make progress towards the Sustainable Development Goals (SDGs).

Realising these gains is not a given, however. While, in principle, FDI has the potential to advance sustainable development, private sector incentives and the policy context play a critical role in realising this potential. This review examines how reforms in selected policy areas can promote investment and, through investment, structural transformation in the
region. This section takes a broader view of FDI impacts, and examines new OECD indicators that link FDI to productivity, innovation, job quality, skills, gender equality, and energy efficiency (Box 1.1).

**Box 1.1. The OECD FDI Qualities Indicators**

FDI Qualities Indicators describe how FDI relates to specific aspects of sustainable development in host countries. They are structured around economic, social and environmental sustainability. An in-depth assessment of all 17 SDGs, and their corresponding targets, was undertaken to identify the full spectrum of FDI Qualities – that is, areas where FDI may contribute to achieving the SDGs. This assessment further considers the extent to which FDI potential for advancing the SDGs is reflected in the OECD Policy Framework of Investment, including related frameworks and guidelines, such as the OECD Guidelines on Multinational Enterprises and the OECD Policy Guidance for Investment in Clean Energy Infrastructure.

The FDI Qualities Indicators focus on five clusters: productivity and innovation, employment and job quality, skills, gender equality, and carbon footprint. For each of the five clusters, a number of different outcomes are identified and used to produce indicators that relate them to FDI or activity of foreign multinationals, allowing for comparisons both within and across clusters so as to identify potential sustainability trade-offs.

Taking into account the country-specific context, policymakers can use FDI Qualities Indicators to assess how FDI supports national policy objectives, where challenges lie, and in what areas policy action is needed. Indicators also allow cross-country comparisons and benchmarking against regional peers or income groups, which, taking into account the country context, can help to identify good practices and make evidence-based policy decisions.

Source: OECD (2019)

The FDI Qualities Indicators do not point to systematically different performance of foreign and domestic investors with respect to the selected sustainable development outcomes, particularly with respect to average levels of labour productivity, energy efficiency, wages, skills intensity or gender employment equality (Figure 1.5). Nevertheless, some consistent differences do emerge. For instance, while there is no evidence of differential employment of female workers (Panel C), employment of female managers is somewhat lower in foreign firms relative to domestic firms (Panel D), suggesting that FDI is not necessarily associated with greater female empowerment. This is in contrast to Southern Mediterranean countries, where foreign firms are universally associated with better gender-related outcomes relative to domestic firms.

In terms of labour-market outcomes, foreign investors in EaP countries tend to offer greater job security than domestic peers (Panel H), but fewer training opportunities (Panel G), which is a missed opportunity for FDI-induced skills upgrading. By comparison, foreign firms in Southeast Europe are associated with higher average wages (Panel E), greater use of unskilled labour (Panel F), greater propensity to train workers (Panel G), and greater job security (H), and are thereby likely to contribute to better working conditions for low-skilled workers.

One area in which FDI appears to make a clear contribution in EaP countries is that of innovation. Foreign firms in EaP countries perform significantly better than domestic peers
across three out of four dimensions of innovation capacity; namely, product innovation (Panel I), process innovation (Panel J), and greater use of foreign technologies (Panel L). This is an important result given the high priority given to high-tech and innovative investments across EaP countries.

It is important to bear in mind that the FDI Qualities indicators come with some limitations. Most importantly, the indicators do not isolate causal effects, or the direction of causality. This means that the indicators are agnostic about whether FDI causes an outcome or vice versa, or whether correlations are driven by third factors. The indicators represent correlations and require contextualisation and additional information for interpretation, but provide some direction on what mechanisms are at play for a given outcome (OECD, 2019a).

Figure 1.5. Selected SDG outcomes of FDI

Notes: The figure includes confidence intervals that indicate statistical significance at the 95% level. If the confidence interval crosses the zero line, the difference between foreign and domestic firms is statistically insignificant. Job security is measured as the share of workers with permanent contracts. For further details, see OECD (2019a).

Source: based on OECD (2019a).
Annex 1.A. Sectoral composition of FDI by country

Annex Figure 1.A.1. Distribution of greenfield projects by sector and country

Value of announced greenfield FDI projects, 2003-2017

2. FDI liberalisation

The legal framework for investment is the cornerstone of an enabling investment environment. Investment policy refers to the laws, regulations and policies relating to the admission of investors; the rules once established; and the protection of their property. The non-discrimination principle, the degree of openness to foreign investment, the protection of investors’ property rights, and mechanisms for settling investment disputes are some of the critical elements underpinning a good investment policy. This chapter focuses on market access and exceptions to national treatment, assessed through the measurement of statutory restrictions to FDI.

Main findings

On the whole EaP countries have advanced liberalisation of FDI regimes substantially, and market entry and treatment conditions applicable to foreign investors are relatively attractive. Only Ukraine applies discriminatory screening procedures, and, with few exceptions, sectoral restrictions are broadly consistent with OECD practices. Restrictions related to land use can often be circumvented through local incorporation, or long-term leases. FDI in manufacturing is allowed without exceptions, and restrictions to FDI in services are limited mainly to legal and financial services in Belarus and Azerbaijan.

Foreign investors still need to review myriad sectoral laws and regulations to understand the market access and treatment conditions applicable specifically to them. Often there is no English translation at all – and sometimes official online sources do not even offer the regulations in the original language. While any possible lack of clarity is supposedly less of a concern for investors more familiar with the practices in the region, they make the regime relatively more opaque for potential new investors.

Key recommendations

- Consider improving the legibility of the legal framework for foreign investors, for instance by establishing a foreign investment negative list clearly delimiting the sectors where foreign investment is prohibited or conditioned, and outlining which discriminatory conditions apply (as is already the case in Ukraine). Translating relevant legislation to English and making it available in existing centralised official online sources would greatly improve clarity and transparency with respect to EaP countries’ FDI regimes.
- Azerbaijan and Belarus may consider liberalising the FDI regimes for legal and financial services, as limited productivity in these services may indirectly constrain productivity growth in downstream manufacturing sectors.

Markets are open and exceptions to national treatment are limited

An open and non-discriminatory investment environment is a central tenet of an attractive investment climate. It helps to ensure that all investors are treated alike in like circumstances, irrespective of their ownership. One of the concepts derived from the principle of non-discrimination in the context of foreign investment is that of national
treatment, which requires that governments treat foreign-owned or foreign-controlled enterprises no less favourably than domestic enterprises in like situations (OECD, 2015a). No economy, including EaP and OECD economies, accords market access or national treatment to foreign-owned enterprises in their territories across the board. Despite the potential benefits of FDI being generally accepted across the EaP governments, and FDI attraction having become an important policy tool to finance development in many economies, concerns over the loss of national sovereignty and the protection of national interests continue to lead governments to discriminate or impose statutory restrictions on foreign direct investments. While there have been great FDI liberalisation efforts in manufacturing industries, where governments have more readily accepted the benefits of FDI, some services and primary sectors still remain partly off limits to foreign investors, although this varies greatly across economies.

The following analysis uses the OECD FDI Regulatory Restrictiveness Index (the FDI Index) to assess and benchmark market access and exceptions to national treatment (see Box 2.1). This index gauges the level of restrictiveness of an economy’s statutory measures on FDI by looking at four main types of restrictions: 1) foreign equity limitations; 2) discriminatory screening and approval mechanisms for foreign investment; 3) restrictions on the employment of key foreign personnel; and 4) other operational restrictions (e.g., restrictions on branching and capital repatriation or land ownership). The index is not a full measure of investment climate attractiveness – a range of other factors come into play, including how FDI rules are implemented. Nonetheless, FDI rules are a critical determinant of an economy’s attractiveness to foreign investors, and benchmarking such policies helps governments to see how they compare with their peers in terms of the restrictiveness of their FDI regimes.

Overall, openness to FDI varies greatly across economies and regions (Figure 2.1). Larger economies and those in the Asia-Pacific region tend to be more restrictive on average. Smaller European economies tend to the most open to FDI as measured by the FDI Index. Substantial variation is observed across EaP countries: Georgia and Armenia are among the most open economies covered by the index; Moldova’s FDI regime is very close to the average OECD economy; Azerbaijan and Belarus are slightly more restrictive but broadly in line with OECD practices; while Ukraine’s FDI regime is close to average level of restrictiveness of non-OECD economies. Overall, in the region, the rules concerning foreign investors on their own are unlikely to constitute a major impediment to attracting investments.

While the FDI regimes of EaP countries vary in openness, the distribution of restrictions by sector is fairly consistent with what is observed in the OECD (Figure 2.2). Few sectors stand out as unusually restrictive compared to OECD levels, including media (in all countries except Georgia), agriculture (Ukraine, Moldova, Georgia), and legal and financial services (Belarus, Azerbaijan). Ukraine also has a stricter FDI regime in transport and real estate. These are all sectors which commonly face FDI restrictions in OECD and non-OECD economies.

Sometimes a horizontal measure applies across the board. Ukraine, for instance, is the only EaP country to make use of discriminatory screening and approval mechanisms for regulating the entry and operations of foreign investors. Moldova requires foreign investor to incorporate as a local legal entity in all sectors except banking and investment management. Foreign ownership of land for business operations is also often subject to restrictions, which can however be circumvented by establishing a local legal entity (Azerbaijan, Moldova, Belarus). Armenia, Georgia and Ukraine impose no restrictions on foreign ownership of land for business purposes.
Land ownership and use restrictions also affect agriculture. A similar regime applies to foreign investors in the agriculture sector in Moldova and Ukraine, which prohibits foreigners from owning agricultural land, whether or not they are locally incorporated. Foreign-controlled locally established enterprises are, nevertheless allowed to lease land for agricultural use. In Georgia, foreign ownership of agricultural land is restricted to 50% of equity. Less restrictive regimes apply in Azerbaijan and Belarus, where restrictions to agricultural land ownership apply only to foreign legal entities, which are entitled to long-term land leases (up to 100 years).

Box 2.1. The OECD FDI Regulatory Restrictiveness Index

The OECD FDI Regulatory Restrictiveness Index seeks to gauge the restrictiveness of an economy’s FDI rules. The FDI Index is currently available for more than 60 economies, including all OECD and G20 members, allowing one to compare FDI policies and identify potential areas for reform. It is commonly used on a stand-alone basis to assess the restrictiveness of FDI policies when reviewing candidates for OECD accession and in OECD Investment Policy Reviews, including reviews of new adherent countries to the OECD Declaration on International Investment and Multinational Enterprises. The index does not provide a full measure of an economy’s investment climate as it does not score the actual implementation of formal restrictions and does not take into account other aspects of the investment regulatory framework, such as the extent of state ownership, and other institutional and informal restrictions which may also impinge on the FDI climate. Nonetheless, FDI rules are a critical determinant of an economy’s attractiveness to foreign investors; and the index, used in combination with other indicators measuring the various aspects of the FDI climate, may help to explain variations among economies in attracting FDI.

The FDI Index covers 22 sectors, including agriculture, mining, electricity, manufacturing and main services (transports, construction, distribution, communications, real estate, and financial and professional services). For each sector, the scoring is based on the following elements:

- the level of foreign equity ownership permitted;
- the screening and approval procedures applied to inward foreign direct investment;
- restrictions on key foreign personnel (e.g. CEO, technical expert); and
- other operational restrictions (e.g. land ownership, branching, profit repatriation).

Restrictions are evaluated on a 0 (open) to 1 (closed) scale. The overall restrictiveness index is the average of the 22 individual sectoral scores. The discriminatory nature of measures, i.e. when they only apply to foreign investors, is the central criterion for scoring a measure. State ownership and state monopolies, to the extent they are not discriminatory towards foreigners, are not scored. For OECD and non-OECD country adherents to the OECD Declaration on International Investment and Multinational Enterprises, the measures taken into account by the index are limited to statutory regulatory restrictions on FDI, as reflected in their list of exceptions to national treatment and measures notified for transparency under OECD instruments, without assessing their actual enforcement. For non-OECD economies, information is collected through Investment Policy Reviews or, when not in the review process, through a dedicated questionnaire. Regulatory information is updated on a yearly basis following the monitoring of investment measures carried in the context of OECD Freedom of Investment Forum for participating economies, and on the basis of ad hoc monitoring for the remaining ones.

Figure 2.1. OECD FDI Regulatory Restrictiveness Index (2018-19)

Note: The OECD FDI Regulatory Restrictiveness Index only covers statutory measures discriminating against foreign investors. The implementation of regulations, restrictions related to national security, state monopolies, preferential treatment for export-oriented investors and special economic zone regimes are not considered. Data reflect regulatory restrictions as of December 2018 for most countries, and December 2019 for EaP countries.
Figure 2.2. OECD FDI Regulatory Restrictiveness Index by sector (2018-19)

Note: The OECD FDI Regulatory Restrictiveness Index only covers statutory measures discriminating against foreign investors. The implementation of regulations, restrictions related to national security, state monopolies, preferential treatment for export-oriented investors and special economic zone regimes are not considered. Data reflect regulatory restrictions as of December 2018 for most countries, and December 2019 for EaP countries.


Aside from horizontal measures, FDI in manufacturing sectors is allowed without restrictions, except in security-related sectors (e.g. arms, ammunition) in some cases. As services are an increasingly vital input to other sectors, limited productivity in service
sectors may lead to barriers to competition that may in turn indirectly constrain productivity growth in downstream sectors. Such concerns may be relevant for Azerbaijan and Belarus. Improving the legibility of the legal framework for foreign investors would be a welcome step towards improving the overall investment climate. None of the six economies, for instance, has established a foreign investment negative list clearly delimiting the sectors where foreign investment is prohibited or conditioned and outlining which discriminatory conditions apply. Foreign investors still need to review myriad sectoral laws and regulations to understand the market access and treatment conditions applicable specifically to them; often there is no English translation at all – and sometimes official online sources do not even offer the regulations in the original language. While any possible lack of clarity is supposedly less of a concern for investors more familiar with the practices in the region, they make the regime relatively more opaque for potential new investors.
3. **Investment promotion and facilitation**

Investment promotion and facilitation policies can support the competitiveness of a country by branding it as a profitable investment destination, attracting quality investors and making it easy for businesses to establish or expand their operations. These measures can not only increase the attractiveness of an economy but also help ensure that foreign investments generate positive spillovers, by boosting economic activity in less developed areas and transferring skills and knowledge. It is important that these efforts complement but do not replace measures to ensure a sound investment policy framework.

**Main findings**

Investment promotion activities offered by investment promotion agencies (IPAs) in the region are comprehensive, and investment facilitation has advanced considerably, although there remains scope for improving single-window access to administrative procedures to make starting a business less costly and time-consuming. Only AZPROMO and Enterprise Georgia have put in place a Customer Relationship Management (CRM) system, and none of the four agencies have, up until now, tracked investment generation, facilitation, or aftercare activities through such a system.

The IPAs of EaP countries tend to be relatively small, but their few resources are stretched across numerous mandates spanning different policy areas, particularly in Belarus and Azerbaijan. The IPA of Belarus also combines policy-making and administrative functions (like treaty negotiation and managing public concessions) with promotional functions which can lead to lower credibility towards the business community, due to potential conflicts of interest, and impact, as these functions require different expertise and skills.

**Key recommendations**

- Give IPAs resources and capacity that are commensurate to their number of mandates and adequate to conduct key investment promotion and facilitation functions, such as investor targeting and aftercare. Institutional reorganisations should be kept to a minimum to avoid excessive uncertainty for investors.

- Spell out IPA mandates, activities, targets and KPIs in a clear and specific investment promotion strategy, in line with national development objectives. Put in place a CRM system to track IPA activities and improve monitoring and effectiveness of investment promotion and facilitation efforts.

- Consider creating a dedicated board to supervise and advise the activities of their respective IPAs (as is already the case in Ukraine), composed of representatives from government, private sector, academia, and civil society. Ukraine should expand its existing board’s membership to private sector representatives, and other key stakeholders.

- Belarus may consider reassigning its IPA’s policy mandates (i.e. negotiating treaties, regulating investment, managing privatisations and public concessions) to the Ministry of Economy, and allowing NAIP to focus its resources on investment promotion and facilitation. If this option is considered, the promotion part of NAIP could increasingly take more autonomy from the Ministry of Economy.
• Cut unnecessary procedures and requirements to start a business, digitise procedures where possible, and continue efforts to reduce the time required to start a business in Belarus and Ukraine.

The institutional framework for investment promotion and facilitation

Recognising the importance of private investment for economic and social development, most countries in the world have established investment promotion agencies (IPAs) dedicated to promoting and facilitating investment, often with an emphasis on attracting multinational enterprises (MNEs) and capturing the benefits of FDI. In most countries, IPAs are responsible for four core functions:

• **Image building** consists of fostering the positive image of the host country and branding it as a profitable investment destination.

• **Investment generation** deals with direct marketing techniques targeting specific sectors, markets, projects, activities and investors, in line with national priorities.

• **Investment facilitation, retention and aftercare** is about providing support to investors to facilitate their establishment phase as well as retaining existing ones and encouraging reinvestments by responding to their needs and challenges.

• **Policy advocacy** includes identifying bottlenecks in the investment climate and providing recommendations to government in order to address them.

The first two functions relate to attracting new potential investors that have not yet selected an investment destination (investment promotion). The latter two deal with making it easy for investors to establish, operate and expand (investment facilitation) and starts at the pre-establishment phase, when an investor shows interest in a location (OECD, 2018a). While investment promotion is primarily the business of IPAs, facilitation is not limited to IPAs and involves a whole-of-government approach.

Large differences exist among IPAs in terms of institutional settings, governance policy, strategic priorities, and the tools at their disposal. The way governments around the world organise the institutional framework for investment promotion and facilitation reflects their policy objectives and the priority they give to investment. These choices can greatly influence success in attracting investment in the most efficient and effective manner.

The main institutions responsible for investment promotion and facilitation in the region are: the Investment Support Centre of Armenia (ISC), the Azerbaijan Export and Investment Promotion Foundation (AZPROMO), the National Agency of Investment and Privatisation of Belarus (NAIP), Enterprise Georgia, the Moldovan Investment Agency, and Ukraine Invest.

In the context of the OECD Eurasia Competitiveness Programme, the IPAs of four EaP countries – Azerbaijan, Belarus, Georgia and Ukraine – recently participated in a survey of IPAs conducted by the OECD (Box 3.1). The results serve as the basis of the comparative analysis conducted in this chapter, which benchmarks the IPAs against agencies from other regions. Further consultation with the IPAs and with the other institutions linked to the IPAs is necessary to provide tailored and actionable recommendations for the improvement of the investment promotion and facilitation landscape in each country.
Box 3.1. The OECD-IDB survey of investment promotion agencies

The OECD and the Inter-American Development Bank (IDB) have partnered to design a comprehensive survey of IPAs. The questionnaire provides detailed data that reflect the multiple recent policy developments as well as rich and comparable information on the work of national agencies in different countries.

The survey was completed by representatives of national IPAs from 32 OECD countries (2017-18); 19 Latin America and Caribbean (LAC) countries (2017-18); 8 Southern Mediterranean (MED) countries (2018); 4 Eastern Partner (EaP) countries (2019); and 6 Central Asian (CA) countries (2019). The survey is divided into nine parts, covering:

- Basic profile;
- Budget; personnel;
- Offices (home and abroad);
- Activities;
- Prioritisation;
- Monitoring and evaluation;
- Institutional interactions; and
- IPA perceptions on FDI.

The results of the survey are gathered and presented in comprehensive IPA mapping reports, which provide a full and comparative picture of IPAs in selected regions. The reports benchmark national agencies against each other and against regional averages.

The organisational set-up for investment promotion is volatile

While significant differences exist in the institutional landscape for investment promotion across EaP countries, common features include relatively young IPAs and frequent changes in their organisational structure. In fact, many IPAs have experimented with organisational reforms in recent years, in an effort to adapt to changing environments and emerging challenges. A majority of OECD IPAs (81%) have restructured their organisation at least once in recent years, and a quarter have experienced at least three reforms (OECD, 2018a). However, typically these reforms have consisted in integrating new mandates within the agencies (e.g. export or tourism promotion) rather than significant institutional restructuring. In contrast, the agencies of EaP countries have experienced liquidation and replacement with new agencies, as well as repeated changes in legal status, budget and responsibilities over a very short time period (Table 3.1). This is perhaps a reflection of the relative novelty of IPAs in the region and governments’ experimentation with different institutional set-ups, but can cause significant uncertainty for business and deter potential new investments or reinvestments from existing investors.
Figure 3.1. Year of creation of IPAs

Note: Ukraine’s current IPA, Ukraine Invest was created in 2016.

Table 3.1. Summary of organisational reforms over last five years

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>IPA reform</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>2014</td>
<td>The Industrial Development Fund, the National Competitiveness Framework and the National Tourism Agency were merged into the Development Foundation of Armenia.</td>
</tr>
<tr>
<td></td>
<td>2018</td>
<td>The Development Foundation of Armenia became a state-funded autonomous agency called Business Armenia.</td>
</tr>
<tr>
<td></td>
<td>2019</td>
<td>Business Armenia ceased to function as the national IPA, no longer receiving direct funding from the state budget.</td>
</tr>
<tr>
<td></td>
<td>2020</td>
<td>The Investment Support Center was established as the national IPA under the Ministry of Economy.</td>
</tr>
<tr>
<td>Georgia</td>
<td>2015</td>
<td>The Georgian National Investment Promotion Agency was moved under the direct supervision of the Prime Minister and was separated from the ‘Partnership Fund’.</td>
</tr>
<tr>
<td></td>
<td>2017</td>
<td>The Georgian National Investment Promotion Agency was merged with the Enterprise Development Agency and became Enterprise Georgia, under the Ministry of Economy and Sustainable Development.</td>
</tr>
<tr>
<td></td>
<td>2018</td>
<td>Two departments responsible for investment promotion and investment support were merged and currently there is one investment department at the agency.</td>
</tr>
<tr>
<td>Moldova</td>
<td>2018-19</td>
<td>The Moldovan Investment Agency was reorganised and changed legal status from autonomous agency to a public institution subordinated to the Ministry of Economy.</td>
</tr>
<tr>
<td>Ukraine</td>
<td>2014</td>
<td>The State Agency for Investment and National Projects (SAINP) was liquidated and its functions passed to the Ministry of Economic Development and Trade.</td>
</tr>
<tr>
<td></td>
<td>2016</td>
<td>Ukraine Invest was created as an independent advisory body with a mandate to attract and support FDI.</td>
</tr>
<tr>
<td></td>
<td>2018</td>
<td>Ukraine Invest completed its transformation from a consultative body to the Government of Ukraine into a state institution.</td>
</tr>
</tbody>
</table>

Source: OECD-IDB (2019); UNCTAD (2019).

IPAs in the region may have too many mandates and too few resources

IPAs can be either fully dedicated to investment promotion and facilitation – and exclusively focus on the four core functions mentioned above – or be part of a broader agency that includes additional mandates, such as the promotion of exports, innovation,
regional development, outward investment and domestic investment, among others. In practice, most IPAs around the world have multiple mandates and conduct activities that go beyond inward foreign investment promotion. In OECD economies, the most frequent combination of mandates in IPAs are with export promotion and with innovation promotion (OECD, 2018a).

Despite considerable variety across agencies, IPAs in OECD countries are relatively more focussed, with an average of 5.7 different mandates under the agency’s responsibility, whereas IPAs in the Southern Mediterranean have broader missions, spanning on average 8.6 official mandates (Figure 3.2). Among EaP countries, the IPAs of Ukraine and Georgia are relatively more specialised with five and six mandates each, the former focusing on innovation promotion and business facilitation, and the latter on local development and export promotion. The IPAs of Azerbaijan and Belarus, on the other hand, have a more generalist role each with seven mandates, the former encompassing export and innovation promotion as well as trade facilitation and negotiation of international agreements, and the latter covering the operation of one-stop shop, privatisation and management of public concessions and public-private partnerships (Table 3.2).

The combination of export and investment promotion into a single agency, as is the case in Azerbaijan and Georgia, can be motivated by the need to maximise synergies and the opportunity for economies of scale by grouping qualified foreign trade and foreign investment promotion staff under one roof. This is particularly true for governments of smaller countries seeking to attract export-oriented investors, as similar industries and markets can be targeted. Governments that choose to keep separate agencies, like Ukraine and Belarus, may deem that the different skillsets and activities necessary to respond to the needs of their respective clients – foreign investors for IPAs and domestic companies for export promotion organisations – are too different to justify an institutional merger.

Merging investment and innovation promotion within the same agency, as seen in Azerbaijan and Ukraine, can be a shrewd choice when IPAs seek to attract high-tech and R&D-driven MNEs that can invest in high value-added activities. Location determinants in high-technology industries include the availability of an innovation network, such as high-quality scientific infrastructure, skilled labour, technology clusters and public knowledge centres (OECD, 2011c). In this context, merging FDI and innovation promotion can allow for synergies to attract innovation-oriented MNEs. In some cases in the OECD, the agency in charge of innovation was established beforehand and created a specific investment promotion unit (e.g. Innovation Norway).

It is not a common practice in OECD IPAs to combine regulation and promotion of investment under the same roof, however, and there might be a disadvantage in mixing the two, as is the case in Belarus and to a lesser extent Azerbaijan. Some studies show that those IPAs focusing exclusively on investment promotion achieve significantly higher results in attracting investors than those which carry out both regulatory or administrative and promotional activities (World Bank, 2012). The reason behind this finding is that attracting FDI and negotiating treaties, or managing public concessions, are very different functions with different objectives and that require different skillsets. The IPA is often expected to represent private investors’ interests within government and it will be less credible to do so and to influence policymaking if it is the same agency that regulates them.

A long-term alternative for Belarus, for instance, might be reassign the policy mandates (i.e. negotiating treaties, regulating investment and managing privatisations and public concessions) to the Ministry of Economy and allowing NAIP to focus its resources on investment promotion and facilitation. If this option is considered, the promotion part of
NAIP could increasingly take more autonomy from the Ministry of Economy. In most countries, especially in the OECD area, the ministry in charge of investment is responsible for investment policymaking and, if appropriate, other regulatory aspects such as reviewing investment proposals and monitoring companies’ projects. Meanwhile, the IPA is more autonomous from the ministry, sometimes with private sector participation, seeking to find a balance between following the government’s strategic orientations and representing the views of investors. This consideration directly relates to legal status and governance policy, examined below.

Figure 3.2. Number of official mandates

![Graph showing number of official mandates](image)

Note: CA = Central Asia; MED = Southern Mediterranean; LAC = Latin America and the Caribbean.

Table 3.2. Official mandates by agency

<table>
<thead>
<tr>
<th>Mandate</th>
<th>% of OECD IPAs</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>UKR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inward foreign investment promotion</td>
<td>100%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Innovation promotion</td>
<td>56%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Export promotion</td>
<td>56%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Promoting regional development</td>
<td>50%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Domestic investment promotion</td>
<td>41%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Granting financial incentives</td>
<td>31%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Trade facilitation</td>
<td>25%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Other (Ease of doing business facilitation)</td>
<td>13%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Operation of one-stop shop</td>
<td>13%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Management of public-private partnerships (PPPs)</td>
<td>9%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Negotiation of international agreements</td>
<td>9%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Negotiation and administration of public concessions</td>
<td>3%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Management of privatisations</td>
<td>0%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>


The level of specialisation of an IPA, reflected in the number of its official mandates, is sometimes considered in relation to its size and resources (OECD, 2018a). Given the smaller size of EaP countries, their IPAs are often also relatively small, employing up to 60 employees in Georgia and as few as 3 in Azerbaijan, compared to the OECD median of 116 (Figure 3.3). Adopting a generalist approach with multiple mandates across different
policy areas but very few human and financial resources, as is the case in Azerbaijan and Belarus, can result in limited effectiveness of IPA efforts. Most countries in the OECD opt either for smaller IPAs with few core mandates (e.g. Austria, Canada, Iceland, Netherlands, Denmark) or larger IPAs with broader responsibilities (e.g. Germany, Korea, Czech Republic, Estonia, Japan).

Figure 3.3. Number of mandates and employees of IPAs

Governance of IPAs should involve private sector participation

The governance of an IPA relates to the way it is supervised, guided, controlled and managed. IPAs’ governance policies are often dictated by their institutional contexts and broader political choices. It affects their legal status, reporting lines and managerial structure, including the role of their board in case they have one.

IPAs can usually be created as: i) part of a ministry; ii) an autonomous public agency; iii) a joint public-private body; or iv) a fully privately-owned organisation. Enterprise Georgia, and NAIP belong to the second category, as they are autonomous public agencies under the authority of the ministries to whom they report; Ukraine Invest is also an autonomous public agency but responds directly to the prime minister; while AZPROMO is a departmental unit within the Ministry of Economy. Autonomous public agencies are the most common forms of IPA legal status according to the IPA surveys conducted by the OECD. All IPAs in the MED region and 60% of those in the OECD are autonomous public agencies (OECD, 2018a and 2019). Across OECD agencies, the second most frequent legal status – just below a third – are governmental IPAs (part of a ministry) and the remaining 9% are private or semi-private.

An important part of the governance of IPAs is the existence and role of a board. A board is sometimes established to supervise the work of the agency. Boards vary greatly from one IPA to another; they can be of advisory nature or with a high degree of decision-making power. They can be composed of public or private sector representatives, or both, and sometimes include representatives from research and academia, civil society or other parts of society. In OECD economies, over two thirds of IPAs (69%) have a board, either supervisory or advisory, and 41% have a supervisory board. In general, IPAs that enjoy greater legal autonomy are more likely to be governed by a board, but even those IPAs that are within a ministry can benefit greatly from having a board to advise them.
Of the four surveyed IPAs in the region, only Ukraine Invest reports to a supervisory board, in addition to the prime minister and the secretariat of the cabinet of ministers. The board is composed of six members including a chairperson, three public sector members and two independent experts (Figure 3.4). The existence of the board in itself is a positive element, as it allows for an external and independent entity to supervise the work of the agency. However, the board would benefit greatly from including private sector representatives among its members, as they would ensure that the views and interests of businesses are taken into account in Ukraine Invest’s strategic directions.

As a matter of comparison, in OECD IPAs, boards are often larger (around ten people on average) and members include just over 40% of private sector representatives, on average – the remaining being representatives of the public sector, research and academia, civil society or other areas. In MED agencies, public sector members tend to dominate but the private sector is often well represented. For Moldova and Armenia, who are currently in the process of restructuring their respective IPAs, it is worth considering whether to establish a supervisory board to govern the new IPAs and if so, to include private sector representatives among the board members. Importantly, having private sector representatives in the board should not substitute for wide and systematic private sector consultation platforms and mechanisms.

**Figure 3.4. Board members in Ukraine Invest and selected other IPAs**

![Bar chart showing board members in various IPAs]

*Note: MED = Southern Mediterranean; Other = external experts. Source: OECD-IDB survey of Investment Promotion Agencies (2019).*

**Resources tend to prioritise image building functions**

The way IPAs allocate their resources across the four core functions differs from one agency to another, and is driven by different factors. First, some functions can be more costly than others, as they are more personnel-intensive, for example. This is the case for investment generation and investment facilitation. Second, objectives vary from one agency to another and some of them face lower expectations to deliver facilitation and retention activities than others. Lastly, resource limitation in terms of budget and staff can have an impact on the way they choose to prioritise some activities over others to fulfil their mission.
There is a clear distinction in the allocation of human resources across IPAs of EaP countries (Figure 3.5), with considerably greater focus given to image building in Azerbaijan (40%) and Belarus (60%), compared to Georgia (30%) and Ukraine (25%), where human resources are distributed more evenly across image building, investment generation and investment facilitation and retention activities (25%-35%). In comparison, the estimated share for image building remains higher than in the OECD (17%), while the estimated percentage of staff dedicated to investment generation is somewhat lower than the average for OECD (42%). This reflects the fact that agencies from more advanced countries usually use fewer resources to work on branding or improving their countries’ image and dedicate most of their promotion efforts to more focused FDI attraction and generation activities. The investment facilitation and retention function is more homogenous across countries and regions, occupying around a third of employee hours. Policy advocacy is another function that is relatively similar across countries, and typically lower than 10%, although it is somewhat higher in the case of Azerbaijan.

**Figure 3.5. Estimated use of staff across the four investment promotion functions**

![Bar chart showing the allocation of human resources across the four investment promotion functions for Azerbaijan, Belarus, Georgia, Ukraine, and OECD average.]

*Source: OECD-IDB IPA survey of Investment Promotion Agencies (2019).*

**Investment promotion requires a clear and well-defined strategy**

To attract FDI in support of national economic objectives, a government first needs to design a clear and well-defined strategy to provide an overall direction, with specific targets and means to achieve the set targets. Depending on the government’s objectives, three different types of investment strategies exist:

1) National policy statements on investment, which present and describe the investment landscape and the government’s strategic orientations;

2) Investment promotion strategies that define the government’s main targets, tools and performance indicators to attract inward foreign investment; and

3) Comprehensive investment strategies that outline in an action plan the government’s objectives and reform plans to foster investment and the roles and responsibilities of all relevant government bodies.
Annex 3.A provides a comparative overview of these different strategies, which could help the governments of EaP countries in their future investment strategy making. It is recommended that the authorities prepare both an overarching policy statement on investment, to give broad orientations to their institutions and a clear vision to the international business community, and a more-focused investment promotion strategy to guide the IPA in its activities and ensure they are well-aligned with national development objectives.

**Investment promotion strategies, where available, are not sufficiently specific**

An investment promotion strategy is a focused and operational policy tool, usually designed by or for the country’s national IPA. It should focus on inward foreign investment and define the major objectives, tools and activities to attract investment, including specific targets and performance indicators to evaluate success, priority sectors and countries for FDI attraction, and the role and responsibilities of the IPA and other agencies to support these objectives or targets.

Investment promotion strategies are designed to ensure that promotion efforts contribute to the government’s broader national development objectives. They revolve around the question of what to promote (i.e. sectors, countries, projects, investors) and how to promote in practice. They should rely on a thorough evaluation of the economy’s strengths, weaknesses, opportunities and threats (SWOT), as there is a risk associated with focusing on specific sectors or “picking winners” if these decisions are made based on political agendas rather than on economic rationales. To ensure flexibility to respond and adapt to new market demands and opportunities, it is important to subject the investment promotion strategy to regular assessments and reviews, based on market realities.

It is important that the investment promotion strategy and its main features are developed in co-ordination with other key ministries as, investment priorities need to be aligned with other major policy strategies – including trade, innovation, industry and skills. Additionally, making the investment promotion strategy publicly available not only supports inter-governmental co-ordination, but also helps raise the country’s positive image within the international business community and informs it about priority sectors and investment opportunities.

The investment promotion strategy should be very clear and specific about targets, tools to reach the set targets, and performance indicators to measure progress. It should provide clear indications on its implementation, including how staff should be organised internally, what the main activities it should focus on, what the key performance indicators (KPIs) to measure outputs and outcomes are, and what procedures are in place to collaborate effectively with other relevant public agencies and stakeholders (e.g. the private sector). Among EaP countries, three of the surveyed IPAs have dedicated investment promotion strategies, and in Belarus a draft strategy is currently going through the public consultation process. So far, only those of Georgia and Ukraine define specific targets and related KPIs.

Most IPAs favour some investments over others in performing their functions, even without a clear investment promotion strategy in place. In the OECD, all agencies prioritise certain sectors or countries, three quarters prioritise specific investment projects and over a third specific investors; but only 41% of IPAs combine these four layers of priorities (OECD, 2018a). According to the OECD-IDB survey, the IPAs of Azerbaijan and Belarus do not prioritise investments along any of these four dimensions, although informally Belarus’s NAIP favour investments with high innovation potential and those in logistics, given the strategic position of Belarus saddled between two large economic blocs. The IPA of
Georgia targets both sectors and projects, but no specific countries or investors, while Ukraine’s IPA has the most focused investment promotion approach, targeting sectors, countries, projects and investors in their FDI attraction efforts. At the same time, the sectors targeted by Georgia are somewhat narrower, reflecting the country’s comparative advantages and strategic priorities, whereas Ukraine targets manufacturing more broadly, with an emphasis on high-tech or innovative projects (Table 3.3).

Prioritising sectors, countries, projects and investors should be conducted according to a set of well-defined criteria in line with national development objectives. The way Ukraine prioritises investment projects, for example, reflects its desire to maximise the potential impact of FDI on society, including criteria such as the impact of investment projects on jobs, wages, exports, innovation and regional development (Table 3.4).

**Table 3.3. Priority countries and sectors**

<table>
<thead>
<tr>
<th>Priority countries</th>
<th>Georgia</th>
<th>Ukraine</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority sectors</td>
<td>Hospitality, BPO, IT, garments and footwear, auto and aircraft equipment, electronics</td>
<td>Agribusiness, manufacturing, energy, infrastructure and innovation technology</td>
</tr>
</tbody>
</table>

*Source: OECD-IDB survey of Investment Promotion Agencies (2019).*

**Table 3.4. Criteria used for prioritisation of investment projects**

<table>
<thead>
<tr>
<th>Project criteria</th>
<th>GEO</th>
<th>UKR</th>
<th>EGY</th>
<th>IRE</th>
<th>KAZ</th>
<th>KOR</th>
<th>MAR</th>
<th>TUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority Sector</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Priority Country of Origin</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Mode of Entry</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Size of Investment</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Investment Horizon / Duration</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Size of the Company</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Nationality of Investor</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Company's Engagement in FDI</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Impact on Job Creation</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Impact on Wages</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Impact on Exports</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Impact on Innovation</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Impact on Regional Development</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Impact on Tax Revenue</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Impact on Country's Image</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Impact on Local Firms' Capacities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Impact on Competition</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Sustainability</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

*Source: OECD-IDB survey of Investment Promotion Agencies (2019).*

**Investment promotion activities are comprehensive but not monitored**

All four of the surveyed IPAs in the region market their countries through websites and publish promotional materials such as brochures and investment guides. These two activities are considered the fundamentals of image building. Having a website is a cost-efficient way to offer centralised, available, up-to-date and key information for a large audience of potential foreign investors. The absence of a website could potentially send the
wrong signal to investors about the investment climate on the ground. Investment guides and brochures are a more traditional marketing tool. They provide the advantage to be more tailored in terms of audience and contents and to remain cost-effective compared to TV and print advertising. IPAs often publish their brochures and investment guides on their websites. The IPAs of Azerbaijan and Ukraine also make use of the relatively less common media advertising channels (e.g. TV, print or radio), which have the disadvantage of being relatively very costly and less targeted in terms of audience.

Investment generation is at the heart of investment promotion as the mission to locate investment projects in the host country is the core mandate of national IPAs, and can hardly be outsourced. Unsurprisingly, the IPAs of EaP countries widely undertake the investment generation activities listed in the survey, ranging from intelligence gathering and sector-specific events to pro-active investor engagement (Table 3.5). All four IPAs actively contact investors, arrange one-to-one meetings and handle enquiries and requests, which are vital activities for investment generation. The agencies of Georgia and Ukraine have a relatively more comprehensive menu of activities including also outward and inward missions, intelligence gathering and market studies, while the more resource constrained agencies of Azerbaijan and Belarus are less active in these areas. Importantly, at the time of surveying, only Azerbaijan’s agency has in place a Customer Relationship Management (CRM) system, and none of the four agencies tracked investment generation activities through such a system. This makes it very difficult to assess the effectiveness of existing tools and activities, and to reconsider how to better allocate resources across these activities. Enterprise Georgia later reported establishing a CRM system to track all investor-related activities, in 2019. The agencies of other EaP countries should also consider putting in place such a system to improve monitoring and effectiveness of investment promotion efforts.

<table>
<thead>
<tr>
<th>Activity</th>
<th>% of OECD IPAs</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>UKR</th>
</tr>
</thead>
<tbody>
<tr>
<td>intelligence gathering</td>
<td>100%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>raw data analysis</td>
<td>97%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>market studies</td>
<td>90%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>attending sector-specific events abroad</td>
<td>97%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>attending sector-specific at home</td>
<td>94%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>organising missions abroad</td>
<td>97%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>hosting incoming missions</td>
<td>90%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>direct contacts with investors</td>
<td>100%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Initiating one-to-one meetings</td>
<td>97%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>pro-active email/ phone campaigns</td>
<td>87%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>enquiry/ request handing</td>
<td>90%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>


Preferential tax regimes and economic zones are commonly used tool to attract new investment, and potentially to influence the size, location and industry of investors. These special regimes are used across the globe, but are particularly relevant in developing and emerging economies, and are discussed at length in Chapter 4.
**Investment facilitation and retention measures have improved**

Investment facilitation starts when an investor shows interest in a location. It includes the way enquiries are handled by the relevant authorities, notably the IPA, and measures to reduce potential obstacles faced by investors once they have decided to invest. But investment facilitation does not stop there: encouraging the expansion of existing investors and helping them overcome the challenges they face in operating their business is at least as important as facilitating new investments. Aftercare measures can be influential in companies’ decisions to stay in the country and reinvest, and policy advocacy is a powerful instrument to bolster reforms and enhance the business environment by leveraging the private sector’s feedback.

Investment facilitation and retention is the most heterogeneous of the four core functions across IPAs, as there are wide disparities from one national agency to another in the different activities covered under this function. This can often be explained by the fact that in some countries facilitation and aftercare services are provided by local autonomous agencies such as regional development agencies. In these cases, national IPAs and local agencies in charge of facilitation functions usually co-operate to ensure an end-to-end service to foreign investors. Thus, the fact that a national IPA does not provide facilitation and aftercare services is not so much an indication of the existence of such services in a country as it is a characteristic of its overarching institutional setting for investment promotion and facilitation. According to the IPA survey, among EaP countries, only the IPAs of Belarus and Ukraine are mandated with operating a one-stop shop.

**Business facilitation has advanced considerably in the region**

A common approach to facilitating investment is to set up a one-stop shop to access all government services and clearances necessary for establishing and operating a company, by placing officials from different government agencies and ministries under the same roof to centralise administrative procedures and requirements for incoming investors. One-stop shops have been established in various parts of the world, often under the IPA and are frequently geared towards foreign businesses.

The pros and cons of one-stop shops have been widely debated in the literature and amongst investment promotion and facilitation practitioners. On the one hand, they can significantly reduce transaction costs for businesses if they are fully-functional but, on the other hand, they can become “one-more stop” if officials from external ministries do not have sufficient decision power and full approval authority. They can also prove costly for governments, as they force ministries to duplicate or multiply the number of officials to allow a presence in both their own administration and in the existing one-stop shop offices (OECD, forthcoming 2020).

As a general rule, one-stop shops should not be mandatory entry points for investors, as allowing businesses to opt for alternative routes to open a business if they so wish is an incentive for one-stop shops to remain efficient. Additionally, they should be equipped with a Customer Relationship Management (CRM) system, including indicators for monitoring performance, and customers should be invited to fill in satisfaction surveys and forms. It is also important that the decisions to grant or refuse a business licence are transparent and made publicly available, with a right of appeal for those investors who have seen their licence rejected.

All EaP countries have one-stop shops in operation, some operated by the investment promotion agency (Belarus, Ukraine, Georgia) others by specific ministries (e.g. Armenia
Moldova) and others still by state agencies under the presidential administration (Azerbaijan). Their decision power, competencies and effectiveness vary across the region. Georgia’s Public Service Halls offer citizens and businesses a one-stop-shop for about 300 different administrative procedures, and are widely regarded as an international best practice (OECD, 2016c). In Azerbaijan, registering for an electronic signature (ASAN-imza) and taxpayer’s ID number can be done in tax offices and the one-stop-shops run by the State Agency for Public Services and Social Innovation (ASAN Service Centres) (OECD, 2016c). In Moldova, the one-stop-shop mechanism has shortened company registration procedures from five steps and five days to just one step and one day, but some of the one-stop-shops that have been created still fall short of offering multiple services in a single place.

According to the IPA survey, the range of services offered by the IPAs of Belarus and Ukraine in terms of facilitating administrative procedures are not as comprehensive as those of other IPAs with dedicated one-stop services centres (Figure 3.6). Belarus’s IPA provide tax and business registration, licences and construction permits; while Ukraine’s IPA offers licences and construction approvals, as well as assistances with utilities, legal issues and other business matters, but does not provide tax registration and work permits. In both cases, the established one-stop services centres do not offer a true single window to all administrative procedures necessary to start and formally operate a business, and are therefore effectively not one-stop shops. This is reflected in the significantly lower Doing Business ranking for starting a business of Belarus (30th) and Ukraine (61st), relative to other countries in the region, headed by Georgia (2nd) and closely followed by Azerbaijan (9th), Armenia (10th) and Moldova (13th).

Figure 3.6. Assistance with administrative procedures


**Investment retention activities remain more limited**

Aftercare or retention services help established investors develop and expand their activity, with a view to trigger reinvestments (or at least maintain existing investments). This includes solving problems encountered by businesses (i.e. dispute resolution measures),
and helping them expand their activities through business support services (i.e. capacity building and linkage programmes). As the economic crisis triggered by the COVID-19 pandemic unfolds, and investment promotion efforts are dampened by government measures to contain the pandemic, high-quality aftercare services will be vital to ensure that investors remain and reinvest in the region.

The most widely offered aftercare service is structured trouble-shooting with individual investors, provided by 81% of OECD IPAs and three out of four surveyed EaP IPAs (Table 3.6). This is the preferred mode to solve problems and issues, as only 45% of OECD IPAs engage in mitigation of conflicts and 26% offer an ombudsman service. Among EaP IPAs, Ukraine Invest is the only one to offer all three of these aftercare services, while AZPROMO offers trouble shooting and mitigation, only. In some cases, countries choose to locate conflict and dispute resolution mechanisms outside of their IPA, as is the case in Georgia, where a tax and business ombudsman, created in 2011, acts as mediator by transmitting private sector concerns to the government. In Armenia aftercare services are provided by the newly established ISC, while in Moldova they are not yet in place; the two governments are currently in discussions regarding the establishment of a business ombudsman.

Locating ombudsman services within the framework of investment promotion can be an efficient way to leverage it to improve the overarching policy framework through policy advocacy. Korea offers a good example of a well-functioning ombudsman service, which was established in the larger context of investment policy reform. The ombudsman not only handles specific investors’ grievances but also contributes to enhancing the investment policy framework by providing inputs from his observations and field experience (OECD, 2013). Granted that adequate human and financial resources can be secured, covering this type of function can be very effective in retaining investors.

Business support services are another important component of aftercare services, an area in which IPAs are comparatively less active. Matchmaking with local suppliers and customers is the service that is the most often offered to foreign investors (65% of OECD IPAs). Capacity-building for local firms, assistance in recruiting, and local staff training programmes are performed by a minority of OECD IPAs (48% or less), as they require different competencies than those central to investment promotion and facilitation. However, many OECD IPAs co-ordinate with vocational and technical education and training (TVET) institutions to deliver complementary services as requested by the investors they cater to.

All surveyed EaP IPAs, with the exception of Ukraine Invest, provide investors with a database of local suppliers, which is a highly effective way to support new investors in finding local partners. Ukraine Invest provides more tailored business support services, including business matchmaking and cluster programmes. To complement these services, the agency should consider compiling a detailed database of local suppliers.

In all EaP countries, aftercare activities would benefit from tracking and monitoring through a CRM system customer feedback and regular evaluation, currently not in place in any of the surveyed IPAs.
Table 3.6. Aftercare services of IPAs

<table>
<thead>
<tr>
<th>Activity</th>
<th>% of OECD IPAs</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>UKR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Structured trouble-shooting with individual Investors</td>
<td>81%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Database of local suppliers</td>
<td>65%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Matchmaking service between investors and local firms</td>
<td>65%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Linkage programmes</td>
<td>58%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Cluster programmes</td>
<td>48%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Mitigation of conflicts (e.g. between investors &amp; authorities/communities)</td>
<td>45%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Capacity-building support for local firms</td>
<td>39%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Assistance in recruiting local staff</td>
<td>39%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Ombudsman Intervention</td>
<td>26%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Personnel recruitment programmes</td>
<td>23%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Training or educational programmes for local staff</td>
<td>19%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>


Policy advocacy is recognised as important to improve the investment climate

Policy advocacy broadly consists of actions to monitor the investment climate (e.g. international rankings, surveys, meetings with business) and formal or informal feedback to the government on how to improve the investment climate (e.g. meetings with high-ranking officials, participation in taskforces and councils, reports, public awareness campaigns). Although, policy advocacy represents only 6% of OECD IPAs’ total budgets and 7% of their staff, seven activities out of twelve relating to policy advocacy are undertaken by more than 80% of agencies (OECD, 2018a). Even in EaP countries, all of the surveyed IPAs undertake at least half of the policy advocacy activities (Table 3.7). AZPROMO, in particular, assigns the greatest importance to policy advocacy allocating 20% of its staff time to 11 out of 12 activities related to monitoring the investment climate and providing feedback to government. The extent to which policy advocacy actions are frequent among IPAs shows the importance of this function. Through their interactions with foreign investors, IPAs are best placed to understand their challenges and expectations, and can accordingly provide invaluable insights and feedback to enrich the policy-making process and contribute to enhancing the overall investment climate.

Use of analytical tools to monitor the investment climate is less common than meetings and consultations. The vast majority of IPAs track available rankings such as the World Economic Forum (WEF) Global Competitiveness Index and the World Bank’s Doing Business scores, but only 65% survey foreign investors, 42% provide inputs on regulatory impacts assessment, 35% survey domestic firms and 19% survey expatriate staff. In EaP countries, only AZPROMO undertakes all of these relatively more resource-intensive and time-consuming activities, while Ukraine Invest also offers inputs to regulatory impact assessments. In terms of reporting to government, all EaP IPAs offer informal feedback on the investment climate and participate in inter-governmental taskforces or councils on investment climate reform. Ukraine Invest covers the broadest range of activities, from meetings with heads of state to public awareness campaigns, production of reports and informal feedback.
### Table 3.7. Policy advocacy activities of IPAs

<table>
<thead>
<tr>
<th>Activity</th>
<th>OECD IPAs</th>
<th>AZE</th>
<th>BLR</th>
<th>GEO</th>
<th>UKR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meetings with the private sector or business associations</td>
<td>97%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Informal feedback to the government on investment climate</td>
<td>97%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Tracking of rankings (e.g., WEF, WB)</td>
<td>94%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Meetings with the prime minister / president / other agencies</td>
<td>90%</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Participation in a taskforce on investment climate reforms</td>
<td>90%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Production of reports or position papers</td>
<td>87%</td>
<td>✓</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Consultation with foreign offices, embassies, consulates</td>
<td>84%</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Public awareness campaigns or events</td>
<td>74%</td>
<td>✓</td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Surveys of foreign investors</td>
<td>65%</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inputs on Regulatory Impact Assessment</td>
<td>42%</td>
<td>✓</td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Surveys of domestic firms investing at home/abroad</td>
<td>35%</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Surveys of expats</td>
<td>19%</td>
<td>✓</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

*Source: OECD-IDB IPA survey of Investment Promotion Agencies (2019).*
## Annex 3.A. Comparative overview of investment strategies

### Annex Table 3.A.1. Typology of investment strategies

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Type of document</th>
<th>Objectives</th>
<th>Recipients</th>
<th>Special features</th>
<th>Common features</th>
</tr>
</thead>
<tbody>
<tr>
<td>NATIONAL POLICY STATEMENT ON INVESTMENT</td>
<td>Political and succinct, promotional statement</td>
<td>Presenting the government’s strategic vision on the role and impact of investment in the economy&lt;br&gt;Demonstrating the government’s commitment to foster and attract investment&lt;br&gt;Showcasing investment policy objectives: past, current and future reforms</td>
<td>International community, economic partners&lt;br&gt;International investors&lt;br&gt;National institutions, citizens, businesses and civil society</td>
<td>Presenting the government’s economic vision and broader investment objectives&lt;br&gt;Presenting recent achievements and showcasing upcoming ones&lt;br&gt;Presenting the investment regulatory framework and responsible institutions; Presenting investment promotion and facilitation objectives and services</td>
<td>Presenting national development objectives&lt;br&gt;Presenting main economic sectors&lt;br&gt;Presenting key FDI trends&lt;br&gt;Presenting investment policy principles and values&lt;br&gt;Presenting investment policy and promotion objectives&lt;br&gt;Presenting measures to achieve objectives&lt;br&gt;Presenting the country’s local value propositions&lt;br&gt;Presenting the target sectors, markets and related activities&lt;br&gt;Presenting performance in international rankings Introducing with a foreword by a senior official (e.g. Minister)</td>
</tr>
<tr>
<td>INVESTMENT PROMOTION STRATEGY</td>
<td>Technical and operational action plan</td>
<td>Defining the IPA’s the territorial marketing strategy, including: targets, tools, timeframes and performance indicators to attract inward investment&lt;br&gt;Defining the role of the IPA and other institutions involved in FDI promotion</td>
<td>Investment promotion practitioners (IPA’s staff)&lt;br&gt;Policymakers (competent ministries)&lt;br&gt;Other implementing agencies</td>
<td>Identifying targets for FDI attraction (sectors, markets, etc.)&lt;br&gt;Defining marketing and targeting tools&lt;br&gt;Defining measures to simplify investors’ establishment and expansion&lt;br&gt;Establishing timeframes for activities&lt;br&gt;Establishing monitoring mechanisms and performance indicators</td>
<td>Presenting the target sectors, markets and related activities&lt;br&gt;Presenting measures to achieve objectives&lt;br&gt;Presenting the country’s local value propositions&lt;br&gt;Presenting the IPA’s the territorial marketing strategy, including: targets, tools, timeframes and performance indicators to attract inward investment&lt;br&gt;Defining the role of the IPA and other institutions involved in FDI promotion</td>
</tr>
<tr>
<td>COMPREHENSIVE NATIONAL INVESTMENT STRATEGY</td>
<td>Technical, comprehensive and descriptive roadmap</td>
<td>Defining the government’s vision to foster investment in the country and translating it into an action plan&lt;br&gt;Defining how investment can support economic growth and sustainable development&lt;br&gt;Defining what should be the related reforms and concrete measures&lt;br&gt;Defining the role of national investment-related institutions</td>
<td>Policymakers (competent ministries)&lt;br&gt;IPA and other implementing agencies</td>
<td>Defining the country’s objectives and orientations on investment&lt;br&gt;Defining measures to ease the entry, establishment and operation of investors&lt;br&gt;Presenting a detailed action plan, including on investment policy reforms&lt;br&gt;Assigning implementation responsibilities&lt;br&gt;Establishing timeframes for activities&lt;br&gt;Establishing monitoring mechanisms and performance indicators</td>
<td>Presenting the target sectors, markets and related activities&lt;br&gt;Presenting measures to achieve objectives&lt;br&gt;Presenting the country’s local value propositions&lt;br&gt;Presenting the IPA’s the territorial marketing strategy, including: targets, tools, timeframes and performance indicators to attract inward investment&lt;br&gt;Defining the role of the IPA and other institutions involved in FDI promotion</td>
</tr>
</tbody>
</table>
4. Making better use of tax incentives

Investment tax incentives are a commonly used tool to influence the size, location or industry of an investment project, by affecting its relative cost or by altering the risks attached to it. For some governments, it is simpler and more immediate to provide incentives than to correct deficiencies in infrastructure and labour skills, for example. Tax incentives can also be politically easier to deliver than other types of subsidies as they do not require additional funds. Despite the prevalence of tax incentives, some studies have found that they have a limited effect in attracting investment. At the same time, they impose considerable costs in terms of tax complexity, neutrality and revenues foregone, and the societal benefits they have the potential to generate must be weighed against these costs.

Main findings

Statutory corporate income tax rates have declined considerably, worldwide, and among EaP countries, where they reached an average rate of 17% in 2019. EaP countries also experienced vast improvements in tax administration, thanks to simplification and increased transparency of the tax system, although paying taxes remains time-consuming and costly in Ukraine, Armenia and Belarus.

EaP countries tend to offer a generous package of fiscal incentives that are increasingly targeted towards promoting investments in R&D-intensive activities, agriculture and renewable energy. These incentives primarily take the form of slashed corporate taxes to investors in designated locations or that engage in qualifying activities, typically (but not always) for a defined period of time. Armenia, Georgia and Moldova also offer CIT deductions on R&D expenses to all investors, which are considered to be less detrimental to fiscal budgets and in line with good practice.

Many countries in the region provide support for green energy investments. In Moldova, incentives include reduced customs duties on imports, exemption from VAT on installation work and other inputs for renewable energy projects. However, some of the relevant provisions have been reported to be unclear in terms of technologies and projects eligible for tax benefits, both by the investor community and the authorities responsible for implementation.

The SEZ regimes of EaP countries offer exceedingly generous fiscal incentives to attract investors, conditional on minimum levels of capital, and in the case of free zones, exports. Profit tax is permanently zero in the free zones of Armenia, Belarus and Georgia, and permanently halved in Moldova, resulting in potentially huge losses in government revenues. Compared to the in-land regime, these free zone regimes offer a substantial competitive advantage to the detriment of in-land investors. There is considerably more variation in the advantages offered in industrial and technology parks, with permanently zero or reduced rates in Belarus and Moldova, a 10-year holiday followed by the statutory rate in Azerbaijan, and no preferential rate in Ukraine’s industrial parks. The more economical and less distortionary approach is to limit CIT exemptions to a pre-defined period of time and phase out reduced tax rates, which unnecessarily complicate the tax system (as is the case in Azerbaijan), or phase out zone-specific CIT holidays altogether (as is the case in Ukraine).
Key recommendations

- Conduct cost-benefit analysis of existing incentive schemes. This involves linking incentives to policy objectives and concrete targets, and evaluating whether realised investments outweigh the economic costs of the incentive regimes and meet the established targets. Information on incentives should be centralised, easily accessible, and potentially consolidated into a single tax code, to increase transparency for investors.

- Phase out permanent CIT exemptions (Armenia, Belarus and Georgia) and reductions (Moldova) available to free zone investors to curb government revenue losses, eliminate excessive advantage offered to zone investors relative to inland investors, and simplify the overall incentive regimes.

- All EaP countries should consider moving towards cost-based incentives, like deductions and credits for specific activities or accelerated depreciation of assets, which make investments profitable at the margin, and are likely to have a greater impact on investment generation.

Investment tax incentives are costly

Investment tax incentives are frequently used with the aim of influencing the size, location or sectors of FDI investment. Tax incentive programmes can contribute to improving a country’s socio-economic welfare, so long as the societal benefits generated exceed the associated costs. The potential to attract investment, create jobs, acquire knowledge, skills and technology, and boost economic growth must be weighed against the resulting costs in terms of tax complexity, neutrality and revenues forgone (Box 4.1). International organisations often advise against excessive reliance on tax incentives, and, at a minimum, emphasise the need to improve their design, transparency and administration. Poorly designed tax incentives have limited effectiveness in attracting new investment and may induce distortions across different investments, or result in windfall gains for projects that would have taken place in absence of the incentives. Countries may end up in a race-to-the-bottom competition, where tax incentives become increasingly generous and less effective at the same time. Ensuring that the most appropriate (or smart) incentives are in place can help maximise their societal benefits.

The OECD and other international organisations have developed principles and options for the use of investment tax incentives. In 2003, the OECD Committee on International Investment and Multinational Enterprises agreed on a checklist for FDI incentive policies (OECD, 2003). The checklist allows for an assessment of the costs and benefits of using incentives to attract FDI, provides operational criteria for avoiding wasteful effects and identifies the potential pitfalls and risks of excessive reliance on incentive-based strategies. In 2011, OECD’s Task Force on Tax and Development developed a set of principles to enhance the transparency and governance of tax incentives for investment in developing countries (OECD, 2011). Both the checklist and the principles are reflected in the 2015 update of the OECD Policy Framework for Investment (OECD, 2015a). Other international organisations and researchers have also studied investment incentives and have developed guiding principles on how to use them most effectively. A joint 2015 IMF-OECD-UN-World Bank report to the G20 Development Working Group as well as the World Bank’s Global Investment Competitiveness Report 2017/18 laid out options for effective and efficient use of tax incentives for investment in low income countries (IMF-OECD-UN-World Bank, 2015; World Bank, 2018).
Existing guidelines and principles provide direction on how to efficiently design and implement investment tax incentives. However, use and implementation remains weak, both at the national and international levels and particularly in developing countries. A key challenge for implementation is tax incentive competition and the expectation that unilateral tax incentive reform, particularly if the implementation involves the elimination of specific incentive programmes, could lead to less investment. Empirical evidence on the differences in use and impacts of incentives across countries also remains scarce. The wide use of incentives globally, along with the lack of understanding of their net impacts, is an important concern for national governments and the international policy community, which could lead to wasteful policy efforts.

While this review does not provide a comprehensive cost-benefit analysis of investment incentives in EaP countries, it provides an overview of the existing preferential regimes, their advantages and limitations, and potential alternatives that may help shift toward a smarter use of fiscal instruments.

Box 4.1. The economic costs of tax incentives

The economic costs of tax incentives can be classified in four main categories:

- **Forgone revenues**: the losses in tax revenue from tax incentives mainly come from three sources; first, the forgone revenue that otherwise would have been collected from the activities undertaken; second, the forgone revenue from projects that would have been undertaken even if the investor did not receive any tax incentives; and, third, lost revenue from investors and activities that improperly claim incentives (taxpayers abuse) or shift income from related taxable firms to those firms qualifying for favourable tax treatments (tax planning). Tax base erosion reduces funds available for other interventions and activities that positively affect the business environment, and society at large, in the long-run. These include much-needed public spending on infrastructure, health, education, and other forms of social support.

- **Resource allocation neutrality costs**: originated when tax incentives create distortions on investment choices among sectors or activities instead of correcting market failures.

- **Enforcement and compliance costs**: these costs increase with the complexity of the tax system and the system of fiscal incentives (in terms of qualifying and reporting requirements, different schemes). Additionally, there is a problem of perception of lack of fairness when targeted incentives are used, which reduces compliance and, therefore, increases enforcement efforts.

- **Lack of transparency**: when the rationale for granting tax incentives is based more on discretionary and subjective qualification requirements, instead of automatic and objective requirements, they can originate rent-seeking behaviour and facilitate officials’ abuse on the granting process. In particular for developing and emerging economies, it is important to move away from discretionary incentives towards greater reliance on rules-based means of attracting FDI – national and international rules that maintain or strengthen environmental and labour standards and create stability, predictability and transparency for policy makers and investors alike.
Corporate taxes are relatively low in the region

The corporate income tax (CIT) rate is the first point of reference for domestic and foreign investors in considering the tax burden of an investment project. However, these statutory tax rates are limited in their ability to reflect the effective tax burden on businesses, as additional taxes paid on distributed dividends and interest payments (withholding taxes) may add to the tax payable by the investor, while incentives may significantly lower actual tax liabilities.

Statutory CIT rates have declined considerably in the last three decades worldwide and at all levels of income, with average rates among middle income countries dropping from around 40% in 1990 to 24% in 2018 (IMF, 2019). Competition to attract multinational investors has contributed to progressive tax cuts and, in some cases to a “race to the bottom” (Abbas and Klemm, 2013). In the early 2000s, tax competition was particularly intense in transition economies, including the EaP countries, pushing CIT rates in the region even further down (Box 4.2). Statutory CIT rates in the region averaged 22% in 2005 and have since dropped in all countries but Armenia, averaging 17% in 2019. Currently most countries in the region offer rates of 18% or 20%, while Moldova and Georgia have adopted significantly lower rates of 12% and 15%, respectively (Figure 4.1). Armenia is expected to lower its CIT rate to 18% as of 2020 as part of a comprehensive reform to reduce opportunities for arbitrage between personal and corporate income taxation (UNCTAD, 2019).

In addition to a relatively low statutory rate, Georgia applies distributed profit taxation (DPT) to corporate earnings. Under this fiscal regime – heavily inspired by the Estonian model, first adopted in 2000 – earned profits are only taxed when they are distributed to shareholders, at a flat rate of 15%. The intent of this regime is to encourage companies to re-invest profits, thereby expanding or upgrading activity and stimulating economic growth. For re-invested profits, payments of tax is deferred for a potentially indefinite period – as long as re-investment continues to occur. The regime also lowers the effective tax rate paid on investment projects, as the taxation on compounded earnings from the re-investment is lower, thereby acting as a tax incentive. The Estonian case has shown exempting re-investments from taxation is a way for developing countries with limited credit options to improve liquidity, reduce company reliance on outside financing, and stimulate investment (Masso and Meriküll, 2011), although the macroeconomic effects of this regime remain unclear (Staehr, 2014).

Moldova experimented with an Estonian-inspired model between 2008 and 2012, whereby the CIT rate was lowered to zero and a 15% withholding tax was charged on distributed profits. While on paper the two models are equivalent, setting the statutory CIT rate to zero created a number of issues in the application of double taxation relief on remitted earnings, as it could not be granted under existing treaties (Lehis et al., 2008). The fiscal model did not generate substantial increases in FDI, while having a strong negative impact on tax revenue (Piatkowski and Jarmuzek, 2008). As a result, the policy was reversed and the CIT rate raised to 12%. Ukraine is currently discussing adopting a similar system, consisting of a tax on withdrawn capital that would apply to dividends and transfers of a similar nature, but, to date, Estonia and Georgia remain the only two countries with a DPT for corporate profits.
Figure 4.1. Statutory CIT rates in EaP countries

![Graph showing statutory CIT rates in EaP countries](image)

Note: Belarus applies a rate of 25% on banking. Georgia’s 2019 rate applies to distributed profits.
Source: OECD based on national legislation on KPMG (2019), Tax Tools & Resources (database).

Box 4.2. A brief history of corporate taxes in EaP countries

The six EaP countries underwent major changes to their tax systems in their transition from centrally planned to market economies during the 1990s. Corporate income (i.e. profit) was typically the most important source of public revenues, and taxed at high rates. Idiosyncrasies in the calculation of profits (e.g. wages were treated as profit payments rather than expenses) generally resulted in an overestimation of profits compared to market-based taxation models (Martinez-Vazquez and McNab, 2000). Modernising the system required a complete overhaul of the existing tax and revenue structure for many transition economies (Criclivaia, 2015).

Lowering profit tax rates and aligning legislation to international standards was a challenge shared by EaP countries. The transition to lower CIT rates occurred gradually during the 1990s and early 2000s as countries shifted towards a different mix of tax revenues with a lower relative importance of revenues from business taxation (Barbone and Sanchez, 2003). Competition among newly opened markets to attract foreign investments was intense. To maintain the competitiveness of traditional industries and encourage new investments, transition countries made extensive use of fiscal and financial incentives (Cass, 2007). In many cases, incentives were negotiated and granted at the discretion of the economic authorities (Barbone and Sanchez, 2003). Since the early 2000, the level of incentives offered showed signs of stabilising and eventually declined by the early 2010s, as CIT rates in the region reached generally low levels (Cass, 2007). In part, tax competition for investment attraction shifted from ad hoc tax incentives and subsidies to universally applied lower statutory rates. Deteriorating fiscal deficits may have played a role in rolling back tax breaks for some countries in the region.
**Tax administration is increasingly simple and efficient**

An efficient tax administration reduces the costs associated with paying taxes, which can in turn positively contribute to improving the business environment and attracting new investments, regardless of the level of taxes (Braunerhjelm and Eklund, 2014). Limited tax administration capacity has been raised as one of the most significant challenges among the troubling legacies of centrally planned economies (Martinez-Vazquez and McNab, 2000). The EaP countries experienced vast improvements in tax administration, including the simplification and increased transparency of the tax system.

The number of tax payments businesses make per year fell sharply over the last decade. In 2010, businesses of EaP countries had to make on average 68 different tax payments per year, and over twice as many in Ukraine (Figure 4.2, Panel A). In 2019 the number of tax payments fell by over 70% in all countries to a maximum of 14 payments in Armenia and only five in Georgia and Ukraine. Similarly, the number of hours spent by business preparing, filing and paying for taxes more than halved in most countries, from an average of 534 to 222 (Figure 4.2, Panel B).

Reducing the number of tax payments alone is insufficient in improving the ease of paying taxes. For instance, while businesses in Ukraine report the lowest number of tax payments in the region (5), they also report spending the most time filing taxes (327 hours). When both aspects are taken into account, wide differences among countries in the region emerge, despite all having made considerable improvements over the past decade. According to the World Bank’s ease of paying taxes ranking, Georgia, Azerbaijan and Moldova rank highly (14\textsuperscript{th}, 28\textsuperscript{th} and 35\textsuperscript{th}, respectively), Ukraine has an intermediate ranking (54\textsuperscript{th}), while Armenia (82\textsuperscript{th}) and Belarus (99\textsuperscript{th}) are somewhat behind compared to the rest of the region. In the latter countries, further progress in simplifying the procedures for filing taxes is necessary to alleviate the burden of tax administration on business.

**Figure 4.2. Ease of paying taxes in EaP countries**

A. Number of tax payments per year

B. Hours spent paying taxes per year


*Note:* Doing Business measures compliance costs as time to prepare, file and pay -or withhold- three major types of taxes: the corporate income tax, value added or sales tax and labour taxes, including payroll taxes, and social security contributions for a medium-size company.
Incentives offered by EaP countries are targeted but costly

Tax incentives are a widely used tool to promote investment, particularly foreign direct investment (FDI), in developed and developing economies. Different instruments present advantages and disadvantages beyond forgone public revenue, related to their resource allocation costs, administration costs, and effectiveness in promoting desired investment. They can be grouped along several dimensions that relate to their scope, or eligibility requirements, and how they affect a company’s income statement (Table 4.1).

A first distinction is between profit- and cost-based incentives and applies to corporate income tax (CIT). Profit-based incentives are determined as a percentage of profits (or income) already secured. CIT holidays and reduced CIT rates fall into this category, as well as allowances to carry forward losses for income tax purpose over subsequent fiscal years. They lower (or eliminate) the CIT rate on any amount of profit earned by a firm, and therefore heavily favour firms with high profits – those that need the least support from government. Profit-based incentives, particularly CIT holidays, are more widely used in developing countries due to their relative ease of implementation and low monitoring costs (Andersen et al., 2017). An important drawback of profit-based incentives is that they are prone to abuse by companies through artificial re-incorporation or shifting of taxable income from non-qualifying to qualifying business entities (transfer pricing), to take advantage of the preferential treatment intended only for new investments, and are therefore potentially very costly in terms of forgone revenues (OECD, 2018a). Loss carry-forward provisions offer a less costly alternative, as they defer tax payment but do not exempt it (Chai and Goyal, 2008).

Cost-based incentives, by contrast, lower the cost of a specific input or production factor. They include deductions, credits and accelerated capital investment allowances. In the case of deductions, a firm can remove a certain share of the investment value from its taxable income. In the case of tax credits, the firm can directly subtract certain expenses or revenues from the amount of payable taxes. Accelerated capital allowances allow for an asset to be depreciated at a higher rate during earlier years of its useful economic life, reducing the price of acquiring new capital. They have the additional advantage of naturally providing diminishing fiscal benefits as an investment project matures. In all cases, the benefit for the firm depends only on the size of the investment undertaken and not on its profit-level. Cost-based incentives affect the investment decision of investors by lowering the cost of capital, and making more investment projects economically viable at the margin. In other words, they are expected to facilitate investment that would otherwise not be made and have the potential to mobilise more investment per dollar of forgone tax revenue (Clark and Skrok, 2019).

A second and related distinction is between targeted and non-targeted incentives. Non-targeted incentives depend only on new investment spending, whereas eligibility for targeted investment incentives is limited to specific industries, geographies, activities or some combination of the three (Figure 4.3). Targeted profit-based incentives typically favour specific industries or geographies so as to promote the development of strategic sectors or disadvantaged regions. By diverting labour and capital to prioritised areas, targeted incentives may create distortions on investment choices among sectors or activities instead of correcting market failures. Targeted cost-based incentives are instead linked to certain activities and related expenses (e.g. staff training, supplier development, R&D, exports), in support of specific policy objectives. A major downside of cost-based and targeted tax incentives is that they require greater tax administration capacities and are associated with higher enforcement and compliance costs in terms of
qualifying and reporting requirements. Capacity-constrained developing countries therefore tend to make less use of these instruments relative to profit-based incentives (Andersen et al., 2017; James, 2014).

Table 4.1. Summary of types of tax incentives

<table>
<thead>
<tr>
<th>Targeted</th>
<th>Non-targeted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit-based</td>
<td>CIT holiday or reduced rate</td>
</tr>
<tr>
<td></td>
<td>CIT exemption for export companies</td>
</tr>
<tr>
<td>Cost-based</td>
<td>CIT holiday or reduced rate</td>
</tr>
<tr>
<td></td>
<td>Accelerated capital allowances</td>
</tr>
<tr>
<td>Exemptions from indirect taxes</td>
<td>Customs duty on exports, or imports used</td>
</tr>
<tr>
<td></td>
<td>to produce export goods</td>
</tr>
<tr>
<td></td>
<td>Customs duty, property tax, land tax, VAT</td>
</tr>
<tr>
<td></td>
<td>on machinery and equipment</td>
</tr>
</tbody>
</table>

Note: This classification is not exhaustive but summarises main tax incentives along key dimensions. Source: Adapted from OECD (2001), United Nations (2000), and Fletcher (2002).

Figure 4.3. Typical investment incentive targets

Source: OECD elaboration.

Broadly speaking, international organisations tend to agree that tax incentives that lower the cost of investment should be preferred over profit-based tax incentives, because of their longer-term impact on investment and higher likelihood of generating spillovers (IMF-OECD-UN-World Bank, 2015). Targeted approaches should similarly be preferred as they are more suitable to achieve specific policy goals and make it more difficult for firms to engage in aggressive tax planning (IMF-OECD-UN-World Bank, 2015). To minimise distortions, they should be embedded in a broader national development strategy that lays down the principles and policy objectives for their introduction or continuation (OECD, 2013).

Additional types of investment incentives include exemptions from indirect taxes paid by businesses, such as value added tax (VAT) on machinery and equipment (other VAT payments are usually creditable), land tax, property tax, and customs duties on imported and exported goods. A main benefit of these incentives is that they allow investors to
avoid contact with tax and customs administration, lowering their cost of paying taxes, which can be particularly high in countries with complex tax systems or high corruption. A drawback is that they are prone to abuse, as it relatively easy to divert exempt purchases to unintended recipients.

**Incentives in EaP target innovation, agriculture and renewable energy**

EaP countries tend to offer a generous package of fiscal incentives that are increasingly targeted towards promoting investments in specific industries and types of activities; notably, high-tech or R&D-intensive activities, agriculture and renewable energy. These incentives are predominantly profit-based, offering slashed corporate taxes to qualifying investors in designated locations or that engage in specific activities, typically (but not always) for a defined period of time (Table 4.2). In some cases (e.g. for agricultural production) an expiration date for the incentive (or sunset clause) is prescribed by law. A major attraction of the expiry date is that it provides a natural point of evaluation in terms of whether the incentive should be continued, reformed or repealed. Incentives with an end-date have been found to generate a larger investment effect than those with no sunset clause (IMF-OECD-UN-World Bank, 2015). The drawback is that expiry dates can be amended, as has often been the case in the region, making temporary tax exemptions, de facto permanent ones. Importantly, any changes to policy end-dates should be consolidated within the tax code to avoid uncertainty for investors in terms of which incentives are valid at any given moment.

For relatively small transition economies, innovation and technological upgrading is vital for remaining competitive and becoming an attractive business destination. With the exception of Ukraine, all countries in the region engage in aggressive tax competition for high-tech investments, both within and outside designated zones. Investors in high-tech parks are exempt from CIT for ten years in Azerbaijan, and permanently in Belarus, for instance. Outside of the zones, Belarus also offers a full exemption or reduced CIT rate of 10% to high-tech investors, depending on the share of revenue earned from high-tech goods. Armenia offers a five year CIT holiday and subsequent 50% reduced rate to high-tech start-ups (employing less than 30 staff). In Georgia, IT service providers are exempt from CIT on exported services, and subject to a reduced dividend tax on earnings distributed overseas. Armenia, Georgia and Moldova also offer CIT deductions on R&D expenses to all investors, which are considered to be less detrimental to fiscal budgets and in line with good practice. In Ukraine, industry incentives targeting the development of the IT sector were repealed in 2015 (OECD, 2016). However, import duty exemptions continue to be offered for equipment and raw materials import for nanotechnology industries.

Modernisation and expansion of agricultural production are also a policy priority for many countries in the region, and investment in the sector receives favourable tax treatment in all countries except Belarus. In particular, profits obtained from agricultural production are exempt from CIT (subject to sunset clauses) in Armenia, Azerbaijan and Georgia. In Armenia, enterprises that earn 90% or more of their revenue from agricultural sales receive a tax holiday until the end of 2024. Azerbaijan has provided tax benefits to the sector since 2001, exempting agricultural producers from all but land taxes (in addition to subsidising certain agricultural inputs) until the end of 2024. Georgia limits preferential tax treatment to small-holder farmers and revenues obtained by agricultural cooperatives. In Moldova, farming enterprises pay a permanently reduced CIT rate of 7%. Eligible producers in Ukraine (earning at least 75% of revenues from agricultural products) are entitled to one of two favourable tax regime: either a
Another prioritised sector is renewable energy. With the exception of Azerbaijan, EaP countries are net importers of energy. The development of green energy alternatives offers an opportunity for reducing reliance on fossil fuel imports. Many countries in the region provide support for green energy investments. In Moldova, incentives include reduced customs duties on imports, exemption from VAT on installation work and other inputs for renewable energy projects. However, some of the relevant provisions have been reported to be unclear in terms of technologies and projects eligible for tax benefits, both by the investor community and the authorities responsible for implementation (IRENA, 2019). In Armenia, revenues from electricity sales from renewable energy are exempt from CIT. In Ukraine, the acquisition of renewable power sources or energy-saving equipment for own-use of electricity production is exempt from customs duties.

In line with IPA mandates of some EaP countries, including Armenia, Belarus and Georgia, additional incentives beyond the priority areas are offered in support of

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**Table 4.2. Overview of investment incentives in EaP countries**

<table>
<thead>
<tr>
<th>Location</th>
<th>Armenia</th>
<th>Azerbaijan</th>
<th>Belarus</th>
<th>Georgia</th>
<th>Moldova</th>
<th>Ukraine</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regional Development</td>
<td>CIT &amp; VAT exemption (SMEs only)</td>
<td>CIT &amp; property tax holiday (7 years)</td>
<td>CIT Holiday (10 years)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SEZs and industrial parks</td>
<td>CIT, property tax, trade tax exemption</td>
<td>CIT, property &amp; land tax holiday (10 years); trade tax exemption</td>
<td>CIT, property tax, trade tax exemption</td>
<td>CIT, property tax, trade tax exemption</td>
<td>CIT holiday (5 years); 50% reduced CIT rate; trade tax exemption</td>
<td></td>
</tr>
<tr>
<td>High-tech/IT</td>
<td>CIT holiday (5 years)</td>
<td>Reduced CIT (15% rate) and VAT</td>
<td>Trade tax exemption</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>CIT holiday (until 2024)</td>
<td>CIT &amp; VAT holiday; property tax exemption (until 2024)</td>
<td>CIT Holiday (until 2023)</td>
<td>50% Reduced CIT (7% rate)</td>
<td>Unified tax or CIT deduction</td>
<td></td>
</tr>
<tr>
<td>Renewable Energy</td>
<td>CIT exemption</td>
<td>VAT exemption; reduced trade tax</td>
<td>Reduced trade tax, VAT exemption</td>
<td>CIT holiday; trade tax exemption</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Job creation</td>
<td>CIT Deduction</td>
<td>CIT Deduction</td>
<td>CIT Deduction</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R&amp;D</td>
<td>CIT deduction</td>
<td>CIT deduction</td>
<td>CIT Deduction</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td>Trade tax exemption</td>
<td>Trade tax exemption</td>
<td>Trade tax exemption</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note: Tax holiday = 100% tax exemption over defined period or subject to a sunset clause; exemption = permanent 100% tax exemption; reduced rate = tax rate lower than statutory rate over defined period; deduction = deductions of certain expenses from taxable income; trade tax = import duties, VAT on imports, or export taxes; unified tax = simplified tax encompassing all business taxes (e.g. applied to sales).

See Annex 4.A for more details of incentives offered in SEZs and industrial parks.

Source: OECD elaboration based on national legislation.
regional development. Armenia offers unlimited CIT exemption to SMEs of border regions. In Belarus, companies that invest in small cities or rural areas are granted a two-year CIT and property tax holiday, while enterprises investing in high-mountain settlements in Georgia may receive up to ten years of CIT holiday.

Across the board, commonly applied exemptions or reductions on indirect taxes such as VAT and customs duties, serve to facilitate the acquisition and import of machinery and equipment. In Armenia, VAT payments on imported machinery are deferred for three years for new investments of at least AMD 300 million (570 000 EUR). In Ukraine, foreign investors are entitled to import duty exemption on acquisitions of capital goods, and as of 2017, imported fixed assets in Georgia are exempt from VAT. Favourable tax treatment of re-invested earnings in Georgia also serves a similar purpose. However, as mentioned previously, VAT and indirect taxes are either explicitly or implicitly passed on to end-users. As such, the main benefits of these incentives are lower transaction costs, related to dealing with administrative bureaucracy.

Cost-based incentives that target specific activities or capital investments, more generally, are used more sparingly in the region. CIT deductions are available for job creation (Armenia, Moldova, Ukraine) and R&D (Armenia, Georgia, Moldova). Accelerated capital investment allowances are only available in Belarus, where 15% of initial construction and 30% of machinery and equipment can be deducted from CIT in the first year of a project.

Incentives offered in SEZs may generate limited spillovers

In addition to the broad array of incentives offered in the region, all countries with the exception of Ukraine, have established various forms of special economic zones (SEZs), broadly defined as designated areas where business activity is subject to different (and often laxer) rules from those prevailing in the national territory. While there are many variations in name and form, the main SEZs in the region are free economic zones, essentially customs-free areas designed to promote exports; and industrial or technology parks, conceived for the development of industry and technology hubs. An overview of the existing SEZ regimes in each country is presented Box 4.1 and Annex 4.A.

Overall, the SEZ regimes of EaP countries offer exceedingly generous fiscal incentives to attract investors, conditional on minimum levels of capital, and in the case of free zones, exports. Profit tax is permanently zero in the free zones of Armenia, Belarus and Georgia, and permanently halved in Moldova (Figure 4.4, Panel A), resulting in potentially huge losses in government revenues. Compared to the in-land regime, these free zone regimes offer a substantial competitive advantage to the detriment of in-land investors. There is considerably more variation in the advantages offered in industrial and technology parks, with permanently zero or reduced rates in Belarus and Moldova, a 10-year holiday followed by the statutory rate in Azerbaijan, and no preferential rate in Ukraine’s industrial parks (Figure 4.4, Panel B). The more economical and less distortionary approach is to limit CIT exemptions to a pre-defined period of time and phase out reduced tax rates, which unnecessarily complicate the tax system (as is the case in Azerbaijan), or phase out zone-specific CIT holidays altogether (as is the case in Ukraine).
SEZs impose a cost on society through forgone revenues from tax incentives, duty exemptions and infrastructure investment specific to the zone, and potential crowding out of investments outside the zones. In order to justify the establishment of zones, the societal gains must outweigh these costs. The potential long-run benefits of SEZs are that they generate spillovers that benefit workers and firms located outside the zone through knowledge transfers.

Knowledge spillovers from SEZ are not automatic. A review of the impacts of the free zones in Moldova, for example, found limited evidence of spillovers to domestic firms, and concluded that the zones were unlikely to contribute significantly to their technological upgrading (World Bank, 2016). To a certain extent, host countries can influence the spillover potential of SEZs with appropriate policies and institutions that target skills and supplier development, and facilitate the exchange of information between SEZ investors and local companies. From the point of view of fiscal incentives,
one way to avoid creating economic enclaves with limited linkages to the wider economy is to reduce reliance on profit-based incentives and offer cost-based deductions on, for instance, staff training or local supplier development initiatives. Conditions for residing in the zones could further include clauses requiring investors to undertake formal staff training.

**Box 4.3. Overview of SEZ regimes in EaP countries**

**Armenia** offers generous incentives to investors within its export-oriented free economic zones, granting unlimited exemptions for CIT, property tax, and VAT to residents. Three zones are in operation and a fourth one was authorised in mid-2019. Investors must apply for a residence permit to establish within the zone, but details of the criteria used to select applicants are not widely available. The zones operate to some degree as enclaves with limited linkages with the rest of the economy.

**Azerbaijan** provides considerable fiscal advantages to residents of its seven industrial and high-tech parks, including exemption from CIT, property tax, land tax, and VAT for a period of ten years, and exemption from custom duties on imported machinery and equipment for a period of seven years. A pre-requisite for establishing in the industrial parks is the receipt of an Resident Registration Certificate issued by the authorized body under the Ministry of Economy.

In **Belarus**, three different types of SEZs exist. The country’s free economic zones are oriented towards exporters, with permanent CIT exemptions on exported goods. The China-Belarus Great Stone Industrial Park, created 2012 and modelled after the China-Singapore Suzhou Industrial Park, prioritises capital- and R&D-intensive industries (e.g. machinery, logistics, chemicals, electronics, big data), and offers a 10 year CIT holiday. High-tech parks target IT services and software development, and provide permanent CIT exemption.

Free economic zones were introduced in **Moldova** in 1995. The zones have been successful in attracting investment from both domestic and foreign sources and have become true export platforms, generating a five-fold increase in exported industrial production from the zones between 2004 and 2014 (World Bank, 2016). The zones offer a tax holiday of up to 5 years to investors, followed by a 25-50% permanently reduced CIT rate thereafter. While they have been largely successful in boosting export, spillovers to domestic economy have been limited as enterprises operating inside these zones have developed limited linkages with domestic firms.

Three free industrial zones are currently in operation in **Georgia**, and generous fiscal advantages to investors, who are permanently exempt from CIT, property tax, and VAT on imports. Customs duties are charged at a 4% on sales to and imports from mainland Georgia.

**Ukraine** established a legal regime for SEZs in 1998; but a 2005 law abolished both the customs and tax preferences granted to these zones, and zones were formally closed in 2016 (OECD, 2016b). The 2012 Law on Industrial Parks set out the legal framework for industrial parks of which over 50 are currently in operation in Ukraine, which does not offer special fiscal treatment to residents.
Annex 4.A. Incentives in SEZs

Annex Table 4.A.1. Overview of tax incentives available to investors in SEZs

<table>
<thead>
<tr>
<th>Type of SEZ</th>
<th>Armenia</th>
<th>Azerbaijan</th>
<th>Belarus</th>
<th>Great Stone Industrial Park</th>
<th>Georgia</th>
<th>Moldova</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Free Economic Zones</td>
<td>Industrial and Technology Parks</td>
<td>Free Economic Zones</td>
<td>High-Technology Parks</td>
<td>Free Industrial Zones</td>
<td>Free Economic Zones</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>Exemption</td>
<td>Holiday (10 years)</td>
<td>Exemption for exports</td>
<td>Exemption</td>
<td>Holiday (10 years) + 50% reduced rate</td>
<td>Exemption</td>
</tr>
<tr>
<td>Property tax</td>
<td>Exemption</td>
<td>Holiday (10 years)</td>
<td>Holiday (3 years)</td>
<td>Exemption</td>
<td>Exemption</td>
<td>Exemption</td>
</tr>
<tr>
<td>Land tax</td>
<td>Exemption</td>
<td>Holiday (10 years)</td>
<td>Holiday (5 years)</td>
<td>Holiday (3 years)</td>
<td>Exemption</td>
<td></td>
</tr>
<tr>
<td>Customs duties</td>
<td>Exemption</td>
<td>Holiday for imported machinery and equipment (7 years)</td>
<td>Exemption</td>
<td>Exemption for imported machinery and equipment</td>
<td>Exemption</td>
<td>Exemption for export, 4% import/export duty with Georgia.</td>
</tr>
<tr>
<td>VAT on imports</td>
<td>Exemption</td>
<td>Holiday for import of machinery and equipment (10 years)</td>
<td>Exemption</td>
<td>Exemption for certain high-tech goods</td>
<td>Exemption</td>
<td>Exemption</td>
</tr>
<tr>
<td>Dividend taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Reduced rate (5%)</td>
<td>Holiday (5 years)</td>
</tr>
<tr>
<td>Investor requirements</td>
<td>Resident permission authorised by government</td>
<td>Holder of Resident Registration Certificate</td>
<td>Minimum investment of USD 0.5 million (within first 3 years): import-substituting or export goods</td>
<td>Majority domestic-owned; IT services and software development</td>
<td>Minimum investment of USD 5 million or 0.5 million for R&amp;D activity (within first 3 years)</td>
<td>Minimum investment of EUR 1 million to receive CIT holiday</td>
</tr>
</tbody>
</table>

*Note: Holiday = total tax exemption over defined period; reduction = tax rate reduction over defined period; exemption = total tax exemption that is permanent or subject to a sunset clause; deduction = deductions of certain expenses from taxable income; customs duties = import duties or export taxes; Withholding taxes = tax deducted at source on interest or dividends paid, especially to non-residents. Requirements for entering the zone are only included when clear criteria is defined.*
5. Promoting responsible business conduct

Promoting and enabling responsible business conduct (RBC) is of central interest to policymakers wishing to ensure that business activity contributes to broader value creation and sustainable development. This chapter offers an overview of the main developments in the areas of RBC which are most relevant to Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine, and key challenges these countries face. It considers the processes, strategies, laws and regulations aimed at bolstering RBC, while paying due attention to the general framework for promoting and enabling RBC.

Main findings

EaP countries have all made steps to establish and implement a regulatory and institutional framework that protects the public interest and underpins RBC, although some countries have done so more comprehensively than others. More efforts are needed in all countries to strengthen this framework and to ensure implementation and enforcement of relevant laws and commitments. Awareness of RBC principles and standards is not yet widespread, although notable progress can be seen in Georgia and Ukraine, where thanks to initiatives by government and civil society, attention to RBC is growing. Ukraine’s adherence to the OECD Declaration on International Investment and Multinational Enterprises, the implementation of the EU Association and Partnership Agreements with Armenia, Georgia, Moldova and Ukraine, as well as negotiations over future agreements or priorities with Azerbaijan and Belarus, provide significant opportunities to consolidate existing efforts and further promote RBC principles and standards, both within the government and with businesses and the wider public.

Governments should not only set expectations on RBC for business enterprises; they have a duty to protect the public interest and a role in providing an enabling framework for RBC. In this role, they can lead by example through their own commercial activities. Public procurement and the activities of state-owned enterprises (SOEs) play a significant role in the economies of EaP countries and can serve as levers to foster RBC. Governments in the region have yet to communicate, in a clear and transparent manner, the RBC policies they apply to public procurement and in the corporate governance of SOEs.

Countries in the region face a number of challenges in implementing RBC commitments. Weaknesses in the judicial system persist in EaP countries and pose sometimes a serious impediment to enforcement of laws and regulations that underpin RBC. NGOs in the region are concerned over the impacts of extractive, chemical and agricultural operations on health (of workers and communities), occupational safety, and environmental degradation. Trade unions have reported frequent barriers to collective bargaining and discrimination against unionised workers. The significant gender pay gap and low representation of women in the market and in management positions have also been noted as issues of concern in all countries, although some progress has been made in Georgia and Moldova. While steps have been taken to address the shortcomings of the environmental impact assessments and improve public access to the assessments, there remains scope for progress. Despite noticeable efforts in the fight against corruption, corruption prevention in the private sector remains low on governments’ agendas, as a result of which with few exceptions, businesses have made timid progress in promoting business ethics and adopt internal codes of conduct.
Key recommendations

- Clearly communicate expectations that all businesses operating in and from the EaP territories act responsibly and respect RBC standards, both domestically and abroad. Engage further in awareness-raising and capacity-building activities, particularly in sectors identified as high-risk, including, mining, oil and gas, chemicals, and agriculture. This includes promoting the implementation of available guidances, such as the OECD Due Diligence Guidance for Responsible Business Conduct and the sector-specific due diligence guidances. Ensure that free and meaningful consultations with potentially affected stakeholders, as well as environmental and human rights impact assessments, are systematically carried out, in line with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.

- Promote policy coherence and alignment on RBC among government institutions. Developing a National Action Plan on RBC or Business and Human Rights in cooperation with relevant stakeholders (including businesses, trade unions and civil society) and in line with international good practices, could be useful in this regard for Armenia, Azerbaijan, Belarus, and Moldova. Ukraine is encouraged to accelerate efforts to develop a NAP, incorporating findings from the existing National Baseline Assessment. In Georgia, revising the current business and human rights chapter in the NAP on human rights, or drafting a self-standing NAP on RBC or BHR, in line with international guidance and capturing the findings of the National Baseline Study, could help ensure effective design and implementation of RBC policies.

- Ensure that any RBC-related reforms, including in relation to state-owned enterprises (SOEs), public procurement, disclosure, and corporate reporting, adequately reflect and address RBC considerations. All reforms and new legislation should be subject to stakeholder consultations and undertaken at a pace that is compatible with the ability to safeguard environmental and social standards. Specifically, on SOEs, take actions to align state ownership rules with the Guidelines, the SOE Guidelines, and the UN Guiding Principles; establish and clearly communicate RBC and corporate governance policies of SOEs, and establish mechanisms for their implementation.

- Further ensure adequate working conditions, in particular on occupational safety and health, and the effective and robust functioning of labour inspection, including a comprehensive mandate and large scope of application. Increase efforts to protect and promote the rights to form and join trade unions and introduce and enforce penalties for arbitrary dismissal of employees. Increase efforts to guarantee non-discrimination in the workplace.

- Promote compliance with internationally recognised environmental standards as a competitive advantage that can open up opportunities for international investment and trade. Strengthen the quality of environmental impact assessments, the public’s access to them, and overall compliance with EIAs. Set clear expectations that businesses report on environmental impacts and risks of specific operations.

- Continue ongoing reforms to combat bribery and corruption. Engage companies, including SOEs, in combatting corruption by assisting them in developing and implementing preventive measures such as codes of conduct, internal controls, and compliance programmes.
Branding as a responsible business destination can help attract FDI

Responsible business conduct is a key element of a healthy business environment – one that attracts quality investment, minimises risks for businesses, ensures stakeholder rights are respected, and ultimately contributes to sustainable development. RBC principles and standards set out the expectation that businesses – regardless of their legal status, size, ownership structure or sector – should avoid and address potential adverse impacts of their activities in the countries where they operate. The three main instruments that have become the key reference points for responsible business, and which outline how companies can act responsibly, are the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (ILO MNE Declaration), the OECD Guidelines for Multinational Enterprises (the Guidelines) and the UN Guiding Principles on Business and Human Rights (the UN Guiding Principles). They are aligned with, and complement, each other. RBC expectations are also integrated in regional systems such as the European Union and, increasingly, in national legislation (Box 5.1).

Box 5.1. RBC, CSR, and BHR: towards international convergence and coherence

Many businesses, governments and stakeholders are familiar with the term Corporate Social Responsibility (CSR), which has historically been used to describe activities by businesses that aim to contribute to society and the common good. Over the last years, CSR has increasingly been used alongside RBC and BHR, with some using the terms interchangeably (for instance, the European Union).

How do these concepts relate to each other? They all reflect the expectation that businesses should consider the impact of their operations and supply chains on people, the planet and society as part of their core business considerations and not as an add-on. This includes the need to avoid and address negative environmental and social impacts. A key characteristic of CSR, RBC and BHR is that they refer to corporate conduct beyond simply complying with domestic law and call on business to contribute positively to sustainable development while managing risks and impacts that may result from their activities. These concepts should not be understood to be equivalent to philanthropy.

The consensus built around the 2011 update of the Guidelines and the unanimous endorsement of the UN Guiding Principles by the UN Human Rights Council, together with the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (ILO MNE Declaration, last updated in 2017), has brought about international convergence and coherence on what RBC entails. This international convergence is echoed at the European level. The European Union (EU) adopted a renewed EU Strategy on Corporate Social Responsibility in 2011 that reflects the Guidelines and the UN Guiding Principles. CSR is defined as “the responsibility of enterprises for their impacts on society.”

Human rights are an important aspect of CSR/RBC. The UN Guiding Principles clarifies the corporate responsibility to respect human rights and ways in which companies should operate to prevent, mitigate and redress adverse human rights impacts, as well as the state duty to protect against such impacts by companies. The Guidelines draw on and are aligned with the UN Guiding Principles, which elaborate in detail the corporate responsibility to respect human rights, and access to remedy for business-related breaches. The EU endorsed the UN Guiding Principles in its 2015 Action Plan on Human Rights and Democracy and has committed to their implementation. The Council of Europe’s Committee of Ministers 2016
Recommendation calls upon its member states to “effectively implement the UN Guiding Principles as the current globally agreed baseline in the field of business and human rights.”

At national level, in 2015, the UK adopted the Modern Slavery Act requiring businesses offering goods and services on the UK market and with a certain turnover to report each year on the steps they have taken during the previous year to ensure that slavery and human trafficking are not taking place in their own business or in their supply chains. In 2017, France adopted due diligence legislation applicable to very large French companies and other companies with a substantial presence in France. Other governments, like Canada and Germany for example, have foreseen consequences for companies in terms of trade advocacy support in case of non-compliance with the expectation that they operate in a manner consistent with the Guidelines.

Source: OECD (2011b); UN (2011); EC (2011); OECD et al. (2019)

RBC means integrating environmental and social concerns within core business activities, and throughout supply chains and business relationships. The Guidelines recommend integrating RBC in the areas of disclosure, human rights, employment and industrial relations, environment, combating bribery, consumer interests, science and technology, competition, and taxation (Box 5.2). A key element of RBC is risk-based due diligence – a process through which businesses identify, prevent and mitigate their actual and potential negative societal impacts, and account for how those impacts are addressed.

Box 5.2. Understanding the OECD Guidelines for Multinational Enterprises

Addressed by Adherents to the OECD Declaration on International Investment and Multinational Enterprises (the Declaration) to businesses operating in or from their jurisdictions, the Guidelines set out principles and standards in all major areas related to RBC, including information disclosure, human rights, employment and industrial relations, environment, bribery and corruption, consumer interests, science and technology, competition, and taxation. Their purpose is to ensure that business operations are in harmony with government policies, to strengthen the basis of mutual confidence between businesses and the societies in which they operate, to improve foreign investment climate, and to enhance the contribution of the private sector to sustainable development. As noted in Box 6.1, together with the UN Guiding Principles and the ILO Conventions and ILO MNE Declaration, they are one of the major international instruments on RBC.

The Guidelines do not aim to introduce differences of treatment between multinational and domestic enterprises, but to reflect good practice for all. Adherents to the Declaration wish to encourage the widest possible observance of the Guidelines to the fullest extent possible, including among SMEs, while acknowledging that these businesses may not have the same capacities as larger enterprises.

The Guidelines are supported by a unique implementation mechanism of National Contact Points (NCPs), agencies established by adhering government to promote and implement the Guidelines. The NCPs assist enterprises and their stakeholders to take appropriate measures to further the implementation of the Guidelines. They also provide a mediation and conciliation platform for resolving practical issues that may arise.

Many businesses also find that responsible business is good business, beyond ensuring that they respect human rights and comply with relevant laws and regulations. Responsible businesses are more likely to obtain and retain the social licence to operate, a critical component of long-term business strategy. Understanding, addressing, and avoiding risks material to business operations – beyond financial risks – often leads to a competitive advantage. For example, environmentally friendly production processes can significantly decrease overall costs, while effective management of labour practices in supply chains can boost productivity and protect brand capital. Conversely, a market in which internationally accepted environmental and social principles and standards are not respected faces an increased risk of being excluded from value chain activity.

While it is the role of businesses to behave responsibly, governments have a primary duty to protect the public interest. The RBC chapter in the OECD Policy Framework for Investment (PFI) is a useful reference for governments wishing to design and implement a strong RBC policy framework (Box 5.3). RBC expectations could be included in investment promotion efforts and may help attract MNEs that are more inclined to source locally. The current EaP IPA websites do not mention environmental and social issues or corporate social responsibility. This is a missed opportunity to connect with investors that are keen on doing business responsibly and to brand EaP countries as a responsible business destinations. For example, companies from the European Union are important investors in EaP countries. RBC is a pillar of the EU trade strategy (EC, 2015), and, for some EU members, RBC expectations can be a legal requirement. EaP countries could consider making a more explicit link between RBC and investment promotion efforts; this could help fill the information gap for foreign investors, who may otherwise perceive the risk of operating in EaP countries to be higher than it otherwise is.

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**Box 5.3. Role of governments in promoting and enabling responsible business**

According to the OECD Policy Framework for Investment (PFI), governments can promote and enable RBC in several ways:

- **Regulating** - establishing and enforcing an adequate legal framework that protects the public interest and underpins RBC, and monitoring business performance and compliance.

- **Facilitating** - clearly communicating expectations on what constitutes RBC, providing guidance with respect to specific practices and enabling enterprises to meet those expectations.

- **Co-operating** - working with stakeholders in the business community, workers’ organisations, civil society, general public, across internal government structures, as well as other governments to create synergies and establish coherence with regard to RBC.

- **Promoting** - demonstrating support for best practices in RBC.

- **Leading by example** - setting the example as an economic actor.

*Source: OECD (2015a)*
**Promoting RBC in EaP countries: the role of the European Union**

The relations between the EaP countries and the EU, formalised for most countries through bilateral agreements, are relevant additional factors bearing upon the reform path which the countries have embarked into, including on RBC. The overall framework guiding those relations consists of: the Association Agreements, including a Deep and Comprehensive Free Trade Area, with Georgia, Moldova and Ukraine; the Comprehensive and Enhanced Partnership Agreement with Armenia; and the Partnership Priorities with Azerbaijan (negotiations on a new comprehensive agreement were launched in 2017). Negotiations over Partnership Priorities are under way with Belarus.

EU Agreements commit signatory governments to a course of reforms to bring governmental, regulatory, and business practices in line with EU standards. Association Agreements between the EU and Georgia, Moldova and Ukraine, as well as the Partnership Agreement with Armenia, have explicit commitments on RBC, including explicit reference to the Guidelines. Article 352 of the EU-Georgia Agreement states that signatories “shall promote corporate social responsibility and accountability and encourage responsible business practices, such as those promoted by a number of international corporate social responsibility guidelines and especially the OECD Guidelines for Multinational Enterprises.”

The Agreements also include commitments on a range of policy areas that are relevant to RBC, such as human rights, labour rights, environmental governance, and the fight against corruption. On labour standards, for instance, the Association Agreements with Georgia, Moldova and Ukraine reaffirm government commitments to ensure that trade contributes to sustainable development, noting the beneficial role that core labour standards and decent work can have on economic efficiency, innovation and productivity. The countries also commit to seeking greater policy coherence between trade policies and labour policies. The Agreement between the EU and Ukraine recognises that “the common values on which the European Union is built – namely democracy, respect for human rights and fundamental freedoms, and the rule of law – are also essential elements of this Agreement” (Preamble, EU-Ukraine Agreement), while it commits parties to cooperate in the fight against crime and corruption (Article 22). These commitments have a bearing on EU funding. For instance, the EU temporarily recalibrated its assistance to Moldova in 2018, due to a “backsliding in democratic principles and the rule of law” (EC, 2019).

**Efforts to promote RBC often remain too timid**

RBC is still a relatively new topic in most of the EaP countries, except for Georgia and Ukraine where it has now emerged as an important issue. Ukraine’s adherence in 2017 to the OECD Declaration on International Investment and Multinational Enterprises (which the Guidelines are part of) played an important role in encouraging the design and implementation of RBC policies and initiatives in the country.

**National action plans can help strengthen RBC**

An effective tool to promote RBC, as well as policy coherence and alignment on a number of topics related to RBC, is through a national action plan (NAP). Governments use NAPs to highlight their policies on RBC and signal the need for future action. The UN has recommended that all states develop NAPs on business and human rights as part of their responsibility to disseminate and implement the UN Guiding Principles on Business and Human Rights. The European Commission (EC) and the Council of Europe (CoE) have
also encouraged their respective members to NAPs on BHR. A number of OECD governments, such as the United States and France, have broadened these efforts and included RBC issues such as environment and public procurement in their NAPs. As of January 2020, 23 countries (20 of which are Adherents to the Guidelines) have adopted a NAP on either RBC or BHR. Efforts to develop NAPs in EaP countries remain timid (Table 5.1), with some progress observed in Georgia and Ukraine (Box 5.4).

Table 5.1. NAPs on RBC/HBR in EaP countries

<table>
<thead>
<tr>
<th>Country</th>
<th>National action plan</th>
<th>National baseline assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Belarus</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Georgia</td>
<td>Chapter on BHR in NAP on Human Rights 2018-2020</td>
<td>Ombudsman in cooperation with civil society</td>
</tr>
<tr>
<td>Moldova</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Ukraine</td>
<td>In the process of developing NAP on BHR</td>
<td>University mandated by the Ministry of Justice</td>
</tr>
</tbody>
</table>


Box 5.4. Progress toward NAPs: Georgia and Ukraine

In Georgia, the government had committed in its National Human Rights Action Plan (2016-2017) to develop an Action plan on Business and Human Rights, including the conduct of a national baseline survey. The Human Rights Secretariat, under the Prime minister’s office, initiated steps to conduct the national baseline survey, which was ultimately developed by the Ombudsman, with the support of the Danish Institute on Human Rights. A detailed National Baseline Study on business and human rights was published in early 2018. It has reportedly informed the drafting of ‘Chapter 25 on business and human rights’ in the National Action Plan on Human Rights 2018-2020, which was developed by the Government’s Human Rights Secretariat in conjunction with a range of Government ministries, following consultation with stakeholders. The NAP was adopted by Parliament in March 2018.

The business and human rights Chapter contains activities to raise awareness of RBC by business enterprises and other government institutions. Encouragingly it includes aims to strengthen whistle-blower protection, public procurement regulations, and human rights issues within public enterprises. However, the Chapter lacks specific information on other RBC issues potentially relevant to Georgia (such as due diligence, the extractive industry, or environmental impacts). The UN Working Group (2019) has also raised concerns over the slow pace of implementation and the lack of assigned adequate funds for it. Some awareness-raising activities on RBC, for government institutions, have nonetheless taken place.

In Ukraine in 2019, the government, in cooperation with civil society partners, made notable efforts to strengthen regulations and coordination on RBC. In early 2019, the Ministry of Justice started a process to develop a self-standing National Action Plan on Business and Human Rights and published a detailed National Baseline Assessment on business and human rights in July 2019.

Governments may incorporate RBC principles in development strategies or as provisions in legislation to clarify what they expect from businesses. The Ukrainian government has
been working on a draft resolution on promoting CSR, with revisions to the draft by the Cabinet of Ministers in 2019 (OECD, 2019b). One of the priority actions of Georgia’s 2016-2020 SME Development Strategy is the promotion of RBC (Gov. of Georgia, 2015). In 2011, Azerbaijan adopted corporate governance standards said to have been prepared with reference to the OECD Principles on Corporate Governance, which include recommendations that companies respect the rights of stakeholders (including workers and local communities) and disclose information on economic, environmental and social issues of concern to stakeholders (Gov. of Azerbaijan, 2011). The standards remain voluntary; reportedly they are not being implemented by many companies (World Bank, 2017a).

For countries that have adhered to the Declaration – this is only the case of Ukraine among the six EaP countries – National Contact Points (NCPs) can play an important role in promoting and enabling RBC. NCPs are agencies established by governments, as a requirement for adherence to the Declaration, to promote the Guidelines and related Due Diligence Guidance instruments, and to handle cases as a non-judicial grievance mechanism. In 2018, upon its adherence to the Declaration, Ukraine established an NCP, which has since engaged in numerous awareness-raising and promotional activities among government institutions and businesses. An Interdepartmental Working Group on the Provision of NCP Activities by the Ukrainian authorities, composed of representatives of state bodies, non-governmental organisations (NGOs), business associations, and trade unions, was also established, and has since revised the NCP’s procedure rules for handling specific instances (OECD, 2019). As of February 2020, no case had been submitted to the NCP.

**Governments should implement RBC in their own economic activities**

The state as an economic actor (e.g. employer, procurer, shareholder, or through the enterprises it owns or controls) is an issue of significance for the RBC agenda. Governments are expected to not merely behave responsibly when performing a commercial role, but to exemplify RBC in their own role within the economy. This is a question of policy coherence as well as credibility and legitimacy, as the state should not ask less of companies that are closely associated with it than it asks of private businesses.

Public procurement plays a significant role in the national economies of the six surveyed countries, and therefore constitutes a powerful policy instrument, which, if used strategically, can help pursue broader socio-economic and environmental policy objectives. Public procurement policies and processes offer an important avenue for governments to incentivize RBC. While governments in the region have not formally addressed public procurement in this light yet, commitments were made by Georgia in its NAP on Human Rights to “seek best international practice about human rights protection issues during state procurement processes” (Government of Georgia, 2018), and progress was made in Ukraine in terms of transparency and governance of public procurement (Government of Ukraine, 2019). As governments reform their procurement policies, they should consider incorporating RBC criteria in them.

SOEs, with the exception of Armenia and Georgia, still dominate the economies of EaP countries. In Belarus, enterprises controlled by the state account for about half of total employment and value-added in the economy (IMF, 2019). Despite privatisation efforts in Moldova, SOE assets account for more than 32% of GDP and approximately 10% of the corporate sector’s assets. SOEs in Azerbaijan generate more than 45% of GDP, with the largest SOE – the State Oil Company of Azerbaijan (SOCAR) – contributing approximately 40% of GDP, while privatisation efforts focus on small SOEs (World Bank, 2017a).
Ensuring that SOEs operate in accordance with good governance practices and RBC principles and standards is fundamental to convey political commitment to RBC while guaranteeing their positive contribution to society. The countries under survey could consider strengthening RBC considerations in policies that apply to SOEs. This is all the more important as like any private enterprise, SOEs may have adverse impacts on a range of human rights, social and environmental issues and other areas relevant to RBC. Likely impacts of SOEs in the region, reflecting those by their private sector peers and reported by NGOs and trade unions, include environmental and health impacts, health and safety issues, treatment of workers and freedom of association, and communication with potentially affected stakeholders (see below sections on human rights and employment and labour relations). Governments in the region could, as a first step, consider communicating, in a clear and transparent manner, the RBC policies that their SOEs have in place. The Guidelines, together with the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the SOE Guidelines) and the UN Guiding Principles, provide a comprehensive framework for addressing RBC aspects in SOEs. Given Ukraine’s set target to comprehensively reform its SOE sector, this presents an opportunity for the government to align its ownership model with international instruments and to incorporate expectations the state has with respect to sustainability and RBC by SOEs.

**Awareness and understanding of RBC is growing in Ukraine and Georgia**

Awareness raising initiatives are another important channel for government, in collaboration with civil society, to advance the RBC agenda. In Ukraine and Georgia government and civil society have undertaken collective actions to raise awareness on RBC issues among business and the public at large. In the other four countries, the level of awareness and understanding of RBC remains more limited.

In Ukraine, notable efforts to raise awareness include the ongoing promotional activities by Ukraine’s NCP, NGOs and academia. In the context of follow-ups to Ukraine’s adherence to the Declaration, the NCP reported that a number of RBC fora and training workshops were held. Surveys conducted by the NCP reveal an increase in business awareness of RBC and a cooperative and positive attitude towards the NCP and the Guidelines. In particular, the Union of Ukrainian Entrepreneurs and the Ukrainian Business Council, as well as other business associations, have played a solid role in contributing to RBC promotion. In 2018, CSR Development conducted studies that revealed that 83% of surveyed companies implement a CSR policy strategy (OECD, 2018b). The UN Global Compact Network was launched locally in 2013 and, at the beginning of 2020, counted 62 participants.

Awareness and understanding of RBC is also growing in Georgia (OECD, 2016d). The American Chamber of Commerce (AmCham) and the Global Compact Network (launched in 2016 and with 34 local participants in early 2020) help companies and NGOs understand what RBC means. Although Georgia is not a member of the Extractive Industries Transparency Initiative (EITI), some work has reportedly been done by foreign chambers, the ombudsman, and trade unions to promote RBC in the extractive sector. In addition, UN Women promote the Women’s Empowerment Principles, which offer guidance to business on how to promote gender equality and women’s empowerment in the workplace, marketplace and community, and to which 43 local companies were signatories as of late 2019 (UN Women, 2019).

In Armenia, Azerbaijan, Belarus and Moldova, awareness of RBC among local companies is more limited (United States, 2019). In Azerbaijan, AmCham has established a committee
on sustainable development and corporate impact, although further information on its activities is not publicly available.\(^3\) The human rights ombudsman has been raising awareness among government institutions and civil society on business and human rights issues for several years now (OHCHR, 2015a). The Global Compact network is active in Belarus with 26 local participants. No UN Global Compact network exists in Armenia and Moldova. By contrast in those four countries, civil society is increasingly playing a role in raising RBC-related issues, particularly in relation to corruption, transparency and specific business operations.

**EaP countries face challenges in enforcing RBC practices**

Countries in the region face a number of challenges in implementing RBC policies. Across the board, the independence of the judiciary is a crucial foundation of law enforcement that affects investment, as business enterprises and the public need a reliable and impartial mechanism for resolving disputes, whether labour, commercial, environmental or otherwise, as well as for combatting corruption. Access to remedy is an essential part of the state duty to protect against business-related adverse impacts. States are expected to take appropriate steps to ensure, through judicial, administrative, legislative or other appropriate means, that when such abuses occur within their territory and/or jurisdiction those affected have access to effective remedy.

Although most EaP countries have a history of reforming their judiciary, ensuring the integrity and professionalism of the judicial system has remained a challenge for many of them. Weaknesses in the judicial system persist in several countries. For example, in Azerbaijan, Belarus and Moldova, according to publicly available reports, the courts face undue political influence. In Armenia, in order to defuse concerns about the lack of impartiality of the judiciary and guide its reform agenda, the government recently developed a draft strategy on legal and judicial reform for 2019-2023 (United States, 2019; OHCHR, 2018).

Beyond judiciary independence, there remains significant opportunities for strengthening implementation of RBC policies related to the respect of human rights by both governments and businesses, with respect to business impact on environment, social dialogue on labour and gender issues, and public and corporate integrity.

**Implementation of international human rights commitments is a work in progress**

States have a primary duty to protect human rights against abuses. At the same time, businesses are expected to respect human rights independently of the state’s ability or willingness to fulfil its human rights obligations. EaP countries are parties to most of the core international human rights treaties, except for the International Convention on the Protection of the Rights of Migrant Workers and Members of their Families (ratified by Azerbaijan only), and the Convention for the Protection of Enforced Disappearance (ratified by Armenia and Ukraine only).\(^4\) All countries but Belarus are also members of the CoE and are party to the European Convention on Human Rights.

As with many other countries in the world, implementation of international human rights commitments remains a work in progress. Concerns about human rights violations in EaP countries have been raised on several occasions by international organisations, in particular the UN, and human rights defenders. The countries generally cooperate with the UN human rights system, and most (with the exception of Belarus) have a human rights ombudsman with a mandate to promote and protect human rights and receive individual complaints. As
of 2019, the institutions of Armenia, Georgia, Moldova and Ukraine have achieved the ‘A’ status denoting full independence (GANHRI, 2019).

**Protecting human rights defenders**

Human rights defenders play a critical role in the human rights due diligence process and in enabling companies to understand the concerns of affected stakeholders. The *OECD Due Diligence Guidance for Responsible Business Conduct* stresses the importance of consulting human rights defenders when conducting due diligence, and the adverse effects of reprisals against civil society and human rights defenders who document or raise potential and actual human rights impacts (OECD, 2018c). While governments have a duty to protect freedom of expression, association and assembly, businesses have a responsibility to respect human rights defenders. An increasing number of business enterprises are recognising that, beyond merely consulting with human rights defenders, they can play a positive role in promoting and protecting the work of defenders in difficult environments (BHRRC, 2020).

Human rights defenders in the region have been conducting their activities on many occasions under difficult circumstances, Georgia being the only country where no major impediments by either the state or non-state actors have been reported in the past few years (see below). Specific to RBC, in a recent report by the Business and Human Rights Resource Centre (BHRRC, 2020) based on information reported to the BHRRC by non-governmental organisations and business companies, Belarus, Ukraine, Azerbaijan, and Armenia ranked respectively number 2, 3, 5, and 7, amongst countries in Eastern Europe and Central Asia, with the most attacks against human rights defenders working on anti-corruption, land and environmental rights.

Concerns about the state of play with human rights defenders in Azerbaijan and Belarus have been raised by international organisations, and human rights defenders. For example, restrictions and harassment against human rights defenders in Azerbaijan in recent years have been noted with concern by the UN (OHCHR, 2016, 2018, and 2020). Restrictions on NGO activities were also the basis for Azerbaijan’s suspension of membership by the Extractive Industry Transparency Initiative (EITI) in 2017, which resulted in Azerbaijan withdrawing from the EITI. Concerns about the situation of human rights defenders in Belarus have also been raised by the UN and OECD members (OHCHR, 2020; OHCHR 2018; United States, 2018). In Moldova, despite a globally satisfactory legislative framework, the UN Special Rapporteur on human rights defenders has cited the shrinking of the civil society space and raised concerns that human rights defenders may have been subject to intimidation (OHCHR, 2019).

**Business impacts on human rights**

Enterprises can affect virtually all internationally-recognised human rights. The industries of greatest contention in EaP countries with respect to potential human rights violations include mining, oil and gas, and agro-processing, which are of significant relevance to Armenia, Azerbaijan, Georgia and Ukraine. Concerns related specifically to the impacts of hydro-power plants have also been raised in Georgia. NGOs in the region have voiced their concerns over the impacts of extractive and agricultural operations on water, air and soil quality, and health of communities. Concerns have also been expressed by civil society over the lack of stakeholder consultation and information dissemination by businesses or the state; alleged intimidation of communities and environmental rights activists; and the perceived failure to conduct human rights due diligence including environmental and
human rights impact assessments. A selection of complaints submitted to and assessed by NCPs, international accountability mechanisms of development finance institutions, and the UN are summarised in Box 5.5.

**Box 5.5. Selected cases assessed by international grievance mechanisms on human rights**

In **Armenia**, the Amulsar gold mine project, operated by Lydian International, has been the subject of international and local attention. In 2014, the Compliance Advisory Ombudsman (CAO) of the International Finance Corporation (IFC) received a complaint regarding IFC’s investment in Lydian International by 147 local residents, raising concerns about the project’s impacts on livelihoods, the environment and community health. In 2016 a complaint on the same case was submitted to the Compliance Committee of the Aarhus Convention. CAO concluded its audit, finding shortcomings in IFC’s application of environmental and social safeguards, and IFC divested from the project in 2017. Similarly, the Teghut copper-molybdenum mining project in north-eastern Armenia, raised concerns related to the inadequacy of the environmental impact assessment and consultations with stakeholders, and potential impacts on forest, water and soil. Communities submitted a complaint to the Danish NCP on the project’s financing by the Danish Export Credit Agency, and whether it had exercised adequate due diligence. The complaint was rejected, although the position of NGOs such as OECD Watch was that the decision was inconsistent with NCP procedure. The UN Special Rapporteur on peaceful assembly and association recommended that the Armenian government carry out genuine consultations to align mining projects with the **UN Guiding Principles**.

Over thirty complaints were submitted to CAO from 2004 through 2011 in relation to the IFC’s financing of the Baku-Tbilisi-Ceyhan (BTC) oil and gas pipeline, passing through **Azerbaijan, Georgia** and Turkey, noting impacts on agricultural land, lack of consultation, and noise and nuisance linked to construction. Complaints were filed simultaneously with the NCPs of UK, Germany, Italy, and US, alleging that BP and consortium partners breached the **Guidelines** by seeking tax and law exemptions and exerting undue influence on governments to accept a legal regime that was detrimental to human rights and the environment. The complaint also raised concerns about BP’s failure to adequately consult with project-affected communities. Another complaint, filed by Proyecto Gato with the Belgian NCP, alleged that the Belgian banks ING, Dexia, and KBC, which supported the BTC project financially, had not conducted adequate due diligence on the environment, health, and security impacts of the pipeline. The complaints went through a protracted process of appraisal, with the UK NCP issuing its final revised statement in 2011, finding BP to be in breach of the **Guidelines** for some aspects (such as stakeholder consultation). Another complaint to CAO, currently under appraisal by Compliance, concerns land compensation and consultation during the construction of the South Caucasus Pipeline Expansion in Azerbaijan.

The rise of large-scale industrialisation of meat production in **Ukraine** has been the subject of complaints before CAO. The most recent complaint in 2018 relates to the country’s largest poultry producer (Myronivsky Hliboprodukt, Publichne AT). The complaint raises concerns over adverse impacts of air, water, soil and noise pollution, and depletion of water resources. Additional concerns include improper community consultation, information disclosure, and occupational health and safety standards. Communities also reported incidents of intimidation. The complaint is currently with the ombudsman function. Another complaint was submitted to CAO in 2014 in relation to Azxon, a pig farming and
meat processing group with operations in Ukraine, Poland and Russia. Complainants raised issues regarding odours, land and water pollution; improper use of and compensation for land; inadequate information disclosure and consultation; adverse impacts on road infrastructure; and degradation of natural parks and other areas. While some complaints were resolved through the Ombudsman function, the remaining complaints are with Compliance.

In Georgia, concerns were raised by the UN Working Group on BHR at the lack of social and environmental safeguards attached to the construction of hydro-power plants, the shortcomings of past environmental impact assessments, and potential impacts on groundwater levels, biodiversity, and safety issues for surrounding communities.

Sources: Office of the Compliance Advisory Ombudsman (CAO) of the IFC, no date and 2018a; UN Human Rights Special Procedures (2020); OECD Watch, NCP database (no date); UN WG (2019); UN Special Rapporteur on the rights of freedom of assembly and association (2018); Compliance Committee of the Aarhus Convention.

**Fundamental labour rights protections need to be strengthened in EaP countries**

Chapter V of the Guidelines highlights the promotion of observance among enterprises of international labour standards, notably the fundamental principles and rights at work as recognised in the ILO Declaration on Fundamental Principles and Rights at Work. Businesses should respect the rights of workers to establish or join trade unions and representative organisations of their own choosing, to collective bargaining, and to adequate working conditions. They have a duty to operate free of child labour or forced labour, and to respect the principle of non-discrimination and equality in the workplace.

The six EaP countries have varying degrees of respect for labour rights and industrial relations. Ratification of ILO Conventions differs widely, from 18 ratifications in Georgia to 71 in Ukraine (Table 5.2). All countries have ratified the eight Fundamental Conventions, and most of the four Governance Conventions, with significantly more variation in the ratification of Technical Conventions. Some concerns have nevertheless been expressed by international organisations and other stakeholders around implementation in some countries as well as with respect to issues related to occupational health and safety, labour inspection and freedom of association, as described in greater detail below.

<table>
<thead>
<tr>
<th>Country (member since)</th>
<th>Fundamental (8)</th>
<th>Governance (4)</th>
<th>Technical (178)</th>
<th>Total (190)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia (1992)</td>
<td>8</td>
<td>3</td>
<td>18</td>
<td>29</td>
</tr>
<tr>
<td>Azerbaijan (1992)</td>
<td>8</td>
<td>4</td>
<td>46</td>
<td>58</td>
</tr>
<tr>
<td>Belarus (1954)</td>
<td>8</td>
<td>3</td>
<td>38</td>
<td>49</td>
</tr>
<tr>
<td>Georgia (1993)</td>
<td>8</td>
<td>2</td>
<td>8</td>
<td>18</td>
</tr>
<tr>
<td>Moldova (1992)</td>
<td>8</td>
<td>4</td>
<td>38</td>
<td>42</td>
</tr>
<tr>
<td>Ukraine (1954)</td>
<td>8</td>
<td>4</td>
<td>59</td>
<td>71</td>
</tr>
</tbody>
</table>


Georgia’s low ratification rate is coherent with the large deregulation reforms in the mid-2000s that led to a dramatic reduction in the safeguards for workers, with Georgia’s Labour
Law assessed by some international organisations as the most deregulated among European and neighbouring countries (OHCHR, 2019c). Since 2013, the government has taken important steps to re-regulate and strengthen its protection of labour rights as discussed below.

At the other end of the spectrum in terms of ratification, Ukraine’s existing economic priorities, and the pace at which they are conducted, are said to be testing the government’s willingness and ability to safeguard environmental and social standards, with all the consequences on responsible business conduct (OHCHR, 2019d). In December 2019, a draft labour law that was presented to parliament received criticism from national and international trade unions on both the content of the law and the rushed process through which it was drafted (ITUC 2019; EPSU, 2019).

**Freedom of association and collective bargaining**

International human rights instruments and ILO Conventions recognise the rights to freedom of association (including forming or joining trade unions), to collective bargaining, and to strike. The OECD Guidelines call on enterprises to respect the rights of workers employed by them to establish or join trade unions and representative organisations of their own choosing. Legislation of EaP countries recognise the rights, but sometimes with reservations in law or in practice (CoE, 2018a/b/c/d).

Protection against discrimination because of membership in a trade union is an important aspect of the right to join trade unions. In Armenia and Georgia, the law explicitly protects against such discrimination. In Belarus, there is no such formal protection, leaving no explicit recourse to challenge a dismissal in court (United States, 2019). Overall, gaps remain in most countries: for instance, in Georgia and Moldova, effective remedies for the arbitrary dismissal of employees are reportedly missing (CoE, 2018d).

Trade unions have reported frequent barriers to collective bargaining and freedom of association, with the situation in Belarus and Azerbaijan being particularly challenging. For instance, in Belarus in recent years several trade unions were refused registration by the authorities, thus making it impossible for them to engage in collective bargaining. Restrictions on demonstrations by trade unions, arrests, and restrictions against trade union leaders have also been reported (United States, 2018; OHCHR, 2015a; OHCHR, 2018).

**Working conditions and labour inspections**

International standards maintain the right to decent work, including fair remuneration, reasonable working hours, paid leave, and occupational health and safety (OHCHR, 1966; CoE, 1996; ILO, 1919-2019). All countries but Belarus are party to the European Social Charter, which establishes the right to just and fair working conditions (CoE, 1996).

In several countries, there remains scope for greater progress to ensure decent work, in particular with respect to working hours and health and safety conditions. The situation has been particularly evident in extractive industries, with frequent accidents reported at mines in Armenia, Georgia, and Ukraine. In Ukraine, for instance, over 100 miners were killed in an explosion in 2007, and nine were killed in 2014 (BHRRC, 2014); some progress has been made in recent years, however, as occupational fatalities have reached levels that are in line with the OECD average in 2018 (Table 5.3). The number of on-the-job fatalities remains, on the other hand, significantly above the OECD average in Armenia and Moldova, and unreported in Georgia. In fact, prior to 2018, employers in Georgia were neither required to report accidents to labour inspectors nor to insure their workers.
Significant steps have been taken in Georgia to address occupational hazard in the mining industry, including a new law in 2019 that mandates both preventive and remedial measures, as well as reporting of accidents by employers (Box 5.6). The discrepancy between reported non-fatal injuries in EaP countries compared to the OECD average suggests that there is still significant under-reporting of occupational accidents in the former, particularly as regards less severe cases.

### Table 5.3. Reported occupational injuries in EaP countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Non-fatal injuries per 100 000 workers</th>
<th>Fatal injuries per 100 000 workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>50.0</td>
<td>13.6</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>9.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Belarus</td>
<td>46.7</td>
<td>2.8</td>
</tr>
<tr>
<td>Georgia</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Moldova</td>
<td>72.0</td>
<td>7.3</td>
</tr>
<tr>
<td>Ukraine</td>
<td>49.1</td>
<td>3.6</td>
</tr>
<tr>
<td>OECD average</td>
<td>1455.5</td>
<td>2.5</td>
</tr>
</tbody>
</table>

*Note: Data covers occupational injuries including cases of disease and of injury due to commuting accidents.*

*Source: ILO Statistics (2020).*

A related issue is that of labour inspection, which is crucial to prevent and detect potential violations of labour regulations in the workplace, and as such particularly important to ensure health and safety in the workplace (CoE, 2018c). All EaP countries but Georgia have ratified the ILO Convention on labour inspection (No.81), which requires governments to maintain a system of labour inspection in industrial workplaces. Georgia’s lack of a comprehensive system of health and safety until recently (see Box 5.6), including a functioning labour inspection system (since its abolition in 2006), has had bearings on occupational health and safety. Despite ratification of the ILO Convention No.81, in 2017, Azerbaijan proclaimed a moratorium on all labour inspections and a requirement to obtain permission for such inspections from the Ministries of Justice and Economy, which is said to be effective through 2021 (OHCHR, 2018).

### Box 5.6. Progress in occupational health and safety in Georgia

In Georgia, over a thousand workers were injured and 418 killed, over 2010 to 2018 — although the real number is likely to be higher since, prior to 2018, employers were neither required to report accidents to labour inspectors nor to insure their workers. The high number of accidents in the country has been attributed by NGOs to a lack of adequate regulations on occupational health and safety and on working hours, combined with insufficient labour inspections, and compounded by the practice of prioritising production quotas in mining activities. Labour inspection has been a salient issue in Georgia since its abolition in 2006. In 2015, the government established a Labour Conditions Inspection Department, which however presented limitations. A new Law on Labour Safety was introduced in 2018 to reinforce the mandate of labour inspectors, covering only sectors identified as especially hard, risky and hazardous, and thereby remaining limited in scope.

In response to these concerns, in 2019 Georgia passed the Organic Law on Occupational Health and Safety, which includes both preventive and remedial measures, and mandates reporting of accidents by employers. The adoption of the 2019 Organic Law further made
the labour inspectorate a separate legal entity with the authority to inspect all sectors without a court order or prior notice, which is a welcome development. Further amendments to the Organic Law were made in 2019 to ensure that from 2022 onwards, inspectors will have a mandate to cover all sectors and the full range of labour rights.

*Source: OHCHR (2019c); Public Defender of Georgia (2018); CoE (2018c); Human Rights Watch (2019b)*

### Non-discrimination

The ILO Equal Remuneration Convention of 1951 (No. 100) ratified by all EaP countries, calls upon states to ensure the application of the principle of equal remuneration for men and women for work of equal value. The *Guidelines* uphold the corporate responsibility to ensure gender equality in the workplace. In particular, “enterprises are expected to promote equal opportunities for women and men with special emphasis on equal criteria for selection, remuneration, and promotion, and equal application of those criteria, and prevent discrimination or dismissals on the grounds of marriage, pregnancy or parenthood.” (Ch.V, para 54).

The significant gender pay gap and low representation of women in the market and in management positions have been noted as issues of concern in several countries. For example in Azerbaijan, women’s average monthly earnings were estimated to be 50% of men’s average monthly earnings in 2016 (CoE, 2018b); in Armenia, the existence of a list of professions declared dangerous for women reinforce occupational segregation (OHCHR, 2016). Similar restrictions were found in Belarus in 2015 (OHCHR, 2015b). UN human rights bodies, the ILO and the CoE have all recommended that EaP countries make greater progress toward gender equality in the workplace (CoE, 2018a/b/c/d/e; OHCHR, 2018).

Some progress has been made to amend the legal framework and incorporate a gender perspective into national sector policies in Georgia and Moldova. In Moldova, the National Strategy on Ensuring Equality between women and men (2017-2021) aims to mainstream gender equality in a wide range of policy areas including health, social services, labour market, and political participation, as well as to adopt EU standards on equal pay for equal work (CoE, 2018d). In Georgia, the government has committed to amend the Labour Code to introduce the statutory guarantee of equal pay in the private sector, as is already the case in the public sector (CoE, 2018c) and, in this context, has been holding consultations with relevant stakeholders and other interested parties. As of June 2020, according to the Georgian authorities, the draft was looking at different issues such as gender-based employment policy, equal pay principle, discrimination issues.

As previously mentioned, UN Women has also actively engaged with businesses in Georgia over the Women’s Empowerment Principles, with 43 signatory companies as of December 2019. It is unclear whether UN Women’s economic empowerment programs in Armenia, Azerbaijan and Moldova also engage with businesses. Given the large gender gap in several countries of the region, implementing gender-equal policies and practices in SOEs, raising awareness and encouraging businesses to follow suit should be a priority.

### Environmental protection needs improvement

The *Guidelines* at Chapter VI call on enterprises to take due account of the need to protect the environment and to conduct their activities in a manner that contributes to wider sustainable development. This entails, among other responsibilities, establishing and
maintaining appropriate environmental management systems; assessing and addressing the environmental impacts associated with the processes, goods and services of the enterprise over their full life cycle with a view to avoiding or, when unavoidable, mitigating them; improving environmental performance; and being transparent about environmental impacts and risks. Governments should set clear expectations to business enterprises in this regard.

There is scope for greater progress in environmental protection in EaP countries, as highlighted by the relatively low ranking of some countries according to the 2018 Yale Environmental Performance Index. Belarus (44th) ranks top of its peers, followed by Azerbaijan (59th) and Armenia (63rd). In Georgia (94th), environmental protection (like labour protection) went through a phase of massive de-regulation in 2011-2013, which aggravated environmental pollution and slowed down policy reforms (UNECE, 2016b). Since then positive steps have been taken to strengthen environmental governance, and in particular to harmonise policies with EU standards. This is to some degree the case also for Ukraine (109th) and Moldova (112th), thanks to their obligations under the EU Association Agreements and support from the EU (EC, 2019b; EC, 2019d).

A number of industries in EaP countries have potentially significant environmental impacts, such as pollution of air, water, and land through the release of toxic waste or hazardous chemicals. In Armenia, concerns have been raised over threats from the mining and metal smelting industry, related to air pollution and heavy metal contamination of air, water, land and food, which in turn present substantial threats to human health (UN UPR, 2019). In Ukraine, the agricultural sector contributes to severe environmental risks, including soil erosion, water pollution through nutrient and wastewater run-off, increased levels of potentially harmful pesticides, and climate change impacts (OECD, 2015c). In Belarus, exposure to hazardous chemicals for workers and the population living in the vicinity of mechanical and chemical manufacturing facilities is also a concern, prompting recommendations to the government to perform biomonitoring of human health in industrial areas (UNECE, 2016a).

In light of the major potential environmental impacts of industry in EaP countries, the use of environmental impact assessments (EIAs) is a crucial tool at the disposal of both governments and businesses. Steps have been taken to improve the overall poor quality of the EIAs in the region. In 2017, Georgia adopted a new EIA Code (OHCHR, 2019c), and there are plans to improve resources and capacities for enforcement, including through the adoption of a Law on Environmental Liability (EC, 2019a). In Ukraine, UNDP supported the creation of a Unified National EIA Registry, in line with EU standards, to simplify the process and ensure transparency (UNDP, 2019). The OECD has also been promoted the use of EIAs, and supported environmental inspectorates to improve their performance (OECD, 2016a).

Related to EIAs is public access to information on environmental matters. All EaP countries have ratified the Aarhus Convention, which recognises people’s rights to access information and to participate in decision-making in environmental matters. Businesses have a concomitant responsibility to communicate to stakeholders about the environmental risks of their operations. Cases reported by civil society before international accountability mechanisms reveal that increased efforts are needed to ensure the public has full access to environmental information in matters that concern them.

Corruption remains one of the main obstacles to doing business

The fight against corruption is an important agenda for governments, as bribery and corruption can discourage investment, erode democratic institutions, hinder RBC practices,
and slow down progress toward development goals. Companies have an important role in contributing to it. The OECD Guidelines recognise this role. Enterprises should not, directly or indirectly, offer, promise, give, or demand a bribe or other undue advantage to obtain or retain business or other improper advantage, and should also resist the solicitation of bribes and extortion. Chapter VII of the Guidelines calls for enterprises to develop and adopt adequate internal controls, ethics and compliance programmes or measures for preventing and detecting bribery through a risk-based approach. All six EaP countries have ratified the UN Convention against Corruption and Council of Europe’s Criminal Law Convention on Corruption.

Despite noticeable efforts in the fight against corruption (Box 5.7), corruption is still perceived by businesses as an important constraint for doing business in most countries in the region, with some exceptions (for example with respect to Georgia, which ranked best in Eastern Europe and Central Asia according to the 2018 Transparency International Corruption Perception Index). Still, the 2018 Transparency International Corruption Perception Index suggests that the level of corruption in the six countries is relatively high, with only three countries scoring above the global average of 43 points (with 100 being the best), including Georgia (58), Moldova (45), and Belarus (44).

Corruption prevention in the private sector has been significantly lower on governments’ reform agendas so far, compared to efforts targeted at public institutions and officials. Only a few governmental initiatives have encouraged the development of good practices in the corporate sector, such as the establishment of internal codes of conduct. Reforms associated with the Extractive Industries Transparency Initiative (EITI) are indirectly relevant in that they demand on the part of business enterprises strong disclosure practices (Box 5.8). More directly focused on promoting business ethics, the Ukrainian Network of Integrity and Compliance was launched in 2017 by the Business Ombudsman Council with the support of EBRD and the OECD. The network brings together responsible businesses and promotes the idea of doing business ethically through educational events, developing policies, and evaluating members’ compliance (EBRD, 2018).

Box 5.7. Steps taken to combat corruption in EaP countries

Most EaP countries have made progress in the fight against corruption. Georgia in particular appears to have come a long way in creating a regulatory and institutional framework for fighting corruption in line with international and EU standards. The government has succeeded in significantly reducing petty corruption, and Georgia’s score on the CPI in 2018 was the best in Eastern Europe and Central Asia. At the same time, some of the more complex types of corruption remain a problem, and NGOs have expressed some concerns at the perceived weakening of the democratic institutions, which might jeopardise gains made until now (GRECO, 2019a).

More recently, other countries in the region have made significant efforts to align their procedures and anti-corruption mechanisms with those of the EU. In Ukraine the High Anti-Corruption Court began operating in September 2019 to address the issue of high-profile corruption involving senior public officials. Laws on the relaunching of the National Agency for Prevention of Corruption and on the protection of whistle-blowers were also adopted, as well as a law re-criminalising illicit enrichment (EC, 2019c). Recognising that a well-functioning system of asset disclosure is a powerful tool in corruption prevention and detection...
for all branches of government, Ukraine also set up a new electronic asset disclosure system for public officials, which has allowed greater transparency on the assets of public officials.

In Armenia, since the change of government in 2018 a number of investigations have been launched to address the issue of high-profile corruption. A new Anti-corruption Strategy for 2019-2021 and an Action Plan were adopted in 2019, and an independent corruption prevention body with operative-investigative functions (the Commission for Prevention of Corruption) was set up (GRECO, 2017).

In Moldova, the government focused on strengthening public integrity through the adoption of new measures to prevent, detect and deter corrupt behaviour among civil servants. Recent reforms include the entry into force of the Law on whistle blowers in 2018, and the operationalisation of the monitoring mechanism under the 2017-2020 National Integrity and Anticorruption Strategy (EC, 2019c).

In Azerbaijan, steps have also been taken by the authorities to reduce corruption. However, most of the efforts have focused on low-level corruption and there is little evidence of corruption being pursued with determination among the political elite and the upper echelons of the public service (GRECO, 2019b), despite the fact that fighting corruption is a stated priority for the government. Moreover, as evidenced by high-level corruption scandals, risk of state capture remains high (Transparency International, 2019).

While five of the six countries have made some progress in their ability to prevent and combat corruption, the situation in Belarus warrants attention. In 2019 GRECO publicly declared Belarus non-compliant with its anti-corruption standards. According to GRECO (2019c), Belarus failed to address 20 out of 24 recommendations made in 2012, most of which related to fundamental anti-corruption requirements, such as strengthening the independence of the judiciary and of the prosecution office, increasing the operational autonomy of law enforcement, limiting immunity protection, strengthening the regime for access to public information, and ensuring involvement of civil society and other stakeholders in the fight against corruption. It was also noted that corruption seemed particularly alarming in procurement for state-run enterprises.

With few exceptions, like in Armenia, businesses have in general only timidly taken the initiative to promote business ethics and the adoption of internal codes of conduct. In Armenia, for instance, several foreign and local companies working with international financial institutions have implemented corporate governance mechanisms to tackle corruption internally, but the practice is not well developed (United States, 2019). In most if not all EaP countries there is a need for the private sector to take on a greater role in self-regulating its own activities; this would complement existing public policies, which so far have primarily focused on state agencies investigating and prosecuting public sector officials.
Revenue transparency is crucial to curb corruption, especially for resource-rich countries. Both Armenia and Ukraine are part of the Extractive Industries Transparency Initiative (EITI). Azerbaijan’s decision to leave the EITI in 2018, following its temporary suspension by the EITI due to the civil society crackdown, is therefore a missed opportunity.

**Ukraine** joined the EITI in 2013 and has been assessed against the 2016 EITI standard as making some progress. Of note is the entry into force in 2018 of the Law on Ensuring Transparency in Extractive Industries, which defines the legal framework for corruption prevention in extractive industries. The law specifies disclosure requirements for both companies and government authorities. For instance, subsoil users are expected to disclose information on taxes and royalties paid and on commercial activities related to mining operations. Since 2014 Ukraine also maintains a beneficial ownership register of all companies, under the Ministry of Justice (EY, 2018b).

**Armenia** joined the EITI in 2017 and has yet to be assessed against the 2016 standard. Armenia’s active participation in the EITI, especially since the change of government in 2018, contributes to the government’s anti-corruption reform objectives. As part of its EITI membership aspirations, the government in 2018 adopted a roadmap to disclose beneficial owners in the metal ore mining industry (EY, 2018c).
References


Notes

1 The investment promotion agencies of Armenia and Moldova were undergoing restructuring at the time of drafting and unable to participate in the survey.

2 Details of the broader SEZ frameworks that exist in the region are beyond the scope of this report, but could be addressed in the context of an in-depth regional investment policy review.


4 The full list of core international human rights treaties is available at www.ohchr.org/EN/ProfessionalInterest/Pages/CoreInstruments.aspx