OECD OCDE

# POLICY FRAMEWORK FOR INVESTMENT

## Draft text for public consultation

**Deadline for comments: 10 February 2006**

*The OECD Investment Committee and its partners in the Task Force developing the Framework are seeking the public's views on the draft Policy Framework for Investment and avenues for future use through an online consultation. The text is work in progress.*

*Comments may be sent to Takeshi Koyama, OECD Investment Division [takeshi.koyama@oecd.org]. In order for comments to be considered at the next meeting of the Task Force, they must be received by 10 February 2006.*

*Comments will be posted on the OECD website (www.oecd.org/daf/investment). It is the policy of the OECD to publish all responses, and anyone not wishing to have his/her response published, or anyone wishing to remain anonymous, should say so explicitly. The purpose of the consultations is to provide inputs of generic interest for the consideration of the Task Force and the other OECD bodies involved – they are not intended for use as a forum for waging campaigns or self promotion.*

Investment Division, Directorate for Financial and Enterprise Affairs
Organisation for Economic Co-operation and Development
2 rue André-Pascal, Paris 75116, France
www.oecd.org/investment

## TABLE OF CONTENTS

## PREAMBLE

Sound and stable private investment supports economic growth and job creation, fosters innovation, promotes sustainable development and thus contributes to the prosperity of countries and their citizens. In today's global economy, private investment is both domestic and foreign and takes many forms, from physical assets to intellectual capital.

Many countries have succeeded in achieving high rates of domestic private investment and attracting substantial foreign investment flows. Countries outside the OECD area are now also emerging as major players in international markets. But many regions have not been able to reap the benefits of investment. The full explanation for varying country performance is not yet to hand. But what is known is already of great interest to policy makers. A country's development depends on its geographical location, its level of economic integration with the rest of the world and the nature and quality of its institutions, and most of all, on a country's continuous efforts to improve and adapt public policies to emerging developments.

The *Policy Framework for Investment* provides a non-prescriptive checklist of issues for consideration by any interested governments engaged in domestic reform, regional co-operation or international policy dialogue aimed at creating an environment that is attractive to domestic and foreign investors and that enhances the benefits of investment to society. Drawing on good practices from OECD and non-OECD experiences, the *Framework* aims to advance the implementation of the United Nations Monterrey Consensus adopted in 2002, which identified private capital, including foreign direct investment, as "vital complements to national and international development efforts" and emphasized the need "to create the necessary domestic and international conditions to facilitate direct investment flows". While acknowledging the role of private sector initiatives, the Monterrey Consensus ascribed responsibility to governments for creating the domestic conditions for private investment to flourish, through macro-economic stability, good public governance and the fight against corruption, equitable and efficient tax systems, human resource development, improved infrastructure and sound financial markets. The Monterrey Consensus also tasks governments with the protection of property rights and the promotion of good corporate governance, competition and open trade policies.

The *Framework* is comprehensive but does not claim to be exhaustive. Reflecting the findings of the Monterrey Consensus, its ten chapters were selected by a task force of government officials from about 60 OECD and non-OECD economies meeting at the OECD and conducting regional consultations in Africa, Asia and Latin America, with the partnership of the World Bank, the United Nations and other international institutions. Business, labour and other civil society organisations were invited to actively contribute to the development of the *Framework.* The priority policy areas covered in the *Framework* are: investment policy; investment promotion and facilitation; trade policy; competition policy; tax policy; corporate governance; policies for promoting responsible business conduct; human resource development; infrastructure development and financial services; and public governance.

The *Framework,* by fostering an informed process of policy formulation and implementation across government, can be used in a variety of ways. Self-evaluation, peer reviews, regional co-operation and multilateral discussions can all benefit from the insights offered in the *Framework*. It also provides a reference point for international organisations' capacity building programmes, for investment promotion agencies, for donors as they assist developing country partners in improving the investment environment, and for business, labour and other non-governmental organisations in their dialogue with governments. Its various elements can be flexibly adapted to the particular economic, social, legal and cultural circumstances that exist in countries at different stages of development. The *Framework* also addresses the potential contribution that governments can make by international co-operation, including through regional integration and home-country policy initiatives.

Likewise, the *Framework* should be seen in the broader context of recent multilateral efforts to strengthen the international and national environments in which business is conducted, including the UN Millennium Declaration, the Doha Development Agenda and the Johannesburg World Summit on Sustainable Development Declaration. In common with those initiatives, it promotes transparency and appropriate roles and responsibilities for governments, business and others with a stake in promoting development.

The *Framework* is a component of the OECD Initiative on Investment for Development, launched in Johannesburg in November 2003, which received support at OECD Ministerial level. The *Framework* builds on the OECD's experience and instruments dealing with the different policy areas that are covered and its global and regional dialogue with non-member economies. It complements recent OECD initiatives directed to the business sector, including the *OECD Guidelines for Multinational Enterprises*.

*The Policy Framework for Investment* is not a volume of ready-made prescriptions. It is, rather, a flexible tool kit with which to frame and evaluate the important policy choices that countries grappling with the challenges of development must face. Its core purpose is to encourage policy makers to ask appropriate questions about their economy, their institutions and their policy settings in order to identify their priorities, to develop an effective set of policies and to evaluate progress. The *Framework* will be reviewed by the OECD and its non-member partners to maintain its usefulness over time.

## PART I: THE POLICY FRAMEWORK FOR INVESTMENT

### Foreword

This Part of the *Framework* brings together ten sets of questions covering the main policy domains identified in the Monterrey Consensus as having a strong impact on the investment environment: investment policy; investment promotion and facilitation; trade policy; competition policy; tax policy; corporate governance; responsible business conduct; human resource development; infrastructure development and financial services; and public governance.

The technique of using questions is intended to facilitate flexible approaches to self-assessment and to priority setting by governments in accordance with their own circumstances, development agendas and institutional arrangements. The questions also help to define the respective responsibilities of government, business and other stakeholders, and to pinpoint areas where international co-operation can most effectively redress weaknesses in the investment environment.

The questions are accompanied by annotations, which provide context and information from an investment perspective in Part II. The documents referenced and policy resources listed in each chapter provide additional analytical background and practical policy guidance, including examples of country experience with the issue at hand.

Macroeconomic stability, political predictability and social cohesion are critical to creating a sound investment environment. Clearly, there are also other policy areas, such as the environment, energy and innovation policies that bear on the business environment as well. While these topics are not separately identified in the checklist chapters, a number of the questions explicitly capture their influence on investor decisions.

Three principles apply throughout the framework. The first is policy coherence, with the questions in each chapter following an integrated approach to the interaction between various policy areas and the investment environment. For example, standards for investment protection and openness are of wide applicability to foreign as well as domestic investors including SMEs; effective competition and tax policies are important to ensure that investment is not deterred by unnecessary barriers to entry, dissuasive taxation, and poor legal compliance; and open trade policies contribute to realising the benefits of an open investment policy.

The second principle is the importance of a transparent approach to policy formulation and implementation, with government agencies accountable for their activities. Transparency reduces uncertainty and risk for investors and the transaction costs associated with making an investment, and facilitates public-private dialogue. Accountability reassures investors that government agencies are exercising their powers responsibly. How transparency and accountability in specific public policy domains fosters an environment where investment flourishes is thus a theme taken up in the questions in each of the chapters.

Regular evaluation of the impact of existing and proposed policies on the investment environment is the third principle that applies across the *Framework*. In this regard, the questions seek to help evaluate how well government policies uphold established good practices in terms of fair treatment for all investors and opening opportunities to invest, taking into account the wider interests of the community in which investors operate. The questions attach a particular emphasis to the adaptability of the institutional framework and the role of periodic evaluations so as to identify early on new challenges and to be able to respond quickly to them.

## Chapter 1. Investment policy

*The quality of investment policies directly influences the decisions of domestic and foreign investors. Transparency, property protection and non-discrimination are investment policy principles that underpin efforts to create a sound investment environment for all.*

1.1 What steps have been taken to ensure that the laws and regulations dealing with investment and their implementation and enforcement are clear, transparent and readily accessible?

1.2 Has the government taken steps towards the progressive establishment of timely, secure and effective methods of ownership registration for land and other forms of property?

1.3 Have laws and regulations for the protection of intellectual property rights and effective enforcement mechanisms been adopted? Does the level of protection encourage innovation and investment by domestic and foreign firms? What steps have been taken to develop strategies, policies and programs to meet the intellectual property needs of SMEs?

1.4 Is the system of contract enforcement effective and widely accessible to all investors? Have alternative systems of dispute settlement been established, including mediation, to ensure the widest possible scope of protection at a reasonable cost?

1.5 Does the government maintain a policy of timely and adequate compensation for expropriation consistent with international norms? Have explicit and well-defined limits on the ability to expropriate been established? What independent channels exist for reviewing the exercise of this power or for contesting it?

1.6 Has the government taken steps to establish non-discrimination as a general principle underpinning laws and regulations governing investment? In the exercise of its right to regulate and to deliver public services, does the government have mechanisms in place to ensure transparency of remaining discriminatory measures and to periodically review their costs against their intended public purpose? Does the government allow and protect the free transfer of capital and profits?

1.7 Are investment policy authorities working with their counterparts in other countries to expand international treaties on the promotion and protection of investment? Are existing international treaties and commitments periodically reviewed to determine whether their provisions create a more attractive environment for investment? What measures exist to ensure effective compliance with the country's commitments under its international investment agreements?

1.8 Has the government ratified multilateral instruments established to protect the rights of international investors, such as the United Nations Convention on the Recognition and Enforcement of Arbitral Awards and the International Centre for Settlement of Investment Disputes?

## Chapter 2. Investment promotion and facilitation

*Investment promotion and facilitation measures, including incentives, can be effective instruments to attract investment provided they aim to correct for market failures and are developed in a way that can leverage the strong points of a country's investment environment.*

2.1 Does the government have a strategy for developing a sound, broad-based business environment and within this strategy, what role is given to investment promotion and facilitation measures?

2.2 Has the government established an investment promotion agency (IPA)? To what extent has the structure, mission, and legal status of the IPA been informed by and benchmarked against international good practices?

2.3 Is the IPA adequately funded and is its performance in terms of attracting investment regularly reviewed?

2.4 How has the government sought to streamline administrative procedures to quicken and to reduce the cost of establishing a new investment? In its capacity as a facilitator for investors, does the IPA take full advantage of information on the problems encountered from established investors?

2.5 To what extent does the IPA promote and maintain dialogue mechanisms with investors? Does the government consult with the IPA on matters having an impact on investment?

2.6 What mechanisms has the government established for the evaluation of the costs and benefits of investment incentives, their appropriate duration, their transparency, and their impact on the economic interests of other countries?

2.7 What steps has the government taken to promote investment linkages between businesses, especially between foreign affiliates and local enterprises? What measures has the government put in place to address the specific investment obstacles faced by SMEs?

2.8 Has the government made use of international and regional initiatives aimed at building investment promotion expertise, such as those offered by the World Bank and other intergovernmental organisations? Has the IPA joined regional and international networks?

2.9 To what extent has the government taken advantage of information exchange networks for promoting investment?

## Chapter 3. Trade policy

*Trade policies can support more and better quality investment by expanding opportunities to reap scale economies and by facilitating integration into global supply chains, boosting productivity and rates of return on investment.*

3.1 What recent efforts has the government undertaken to reduce the costs of customs, regulatory and administrative procedures at the border?

3.2 What steps has the government taken to reduce trade policy uncertainty and to increase trade policy predictability for investors? Are investors and other interested parties consulted on planned changes to trade policy?

3.3 How actively is the government increasing investment opportunities through market-expanding international trade agreements and through the implementation of its WTO commitments?

3.4 How are trade policies that favour investment in some industries and discourage it in others reviewed with a view to reducing the costs associated with these distortions?

3.5 To what extent do trade policies raise the cost of inputs of goods and services, thereby discouraging investment in industries that depend upon sourcing at competitive world prices?

3.6 If home-country trade policy has a negative effect on developing country exports, are there alternative means of accomplishing public policy objectives, taking into account the dampening effect that such a trade policy also has on investment?

3.7 To what extent does trade policy support and attract investment through measures that address sectoral weaknesses in developing countries (e.g. export finance and import insurance).

## Chapter 4. Competition policy

*Competition policy favours innovation and contributes to conditions conducive to new investment. Sound competition policy also helps to transmit the wider benefits of investment to society.*

4.1 Are the competition laws clear, transparent, and non-discriminatory? What measures do the competition authorities use (e.g. publishing decisions and explanations on the approach used to enforce the laws) to help investors understand and comply with the competition laws and to communicate changes in the laws and regulations?

4.2 Do the competition authorities have adequate resources and the political support to implement effectively competition laws?

4.3 To what extent, and how, have the competition authorities addressed anti-competitive practices by incumbent enterprises that inhibit investment?

4.4 Do the competition authorities have the capacity to evaluate the impact of other policies on the ability of investors to enter the market? What channels of communication and co-operation have been established between competition authorities and other relevant government agencies?

4.5 Does the competition authority periodically evaluate the costs and benefits of industrial policies and take into consideration their impact on the investment environment?

4.6 What is the role of the competition authorities during privatizations? Have competition considerations having a bearing on investment opportunities, such as not permitting market exclusivity clauses, been adequately addressed?

4.7 To what extent are competition authorities working with their counterparts in other countries to co-operate on international competition issues, such as cross-border mergers and acquisitions, bearing on the investment environment?

## Chapter 5. Tax policy

*To fulfil their functions, all governments require taxation revenue. However, the level of the tax burden and the design of tax policy, including how it is administered, directly influence business costs and returns on investment. Sound tax policy enables public policy objectives to be achieved while also supporting a favourable investment environment.*

5.1 What is the average tax burden on domestic profits, taking into account statutory provisions, tax-planning opportunities and compliance costs?

5.2 Is the tax burden on the business enterprises of investors appropriate with reference to the policy goals and objectives of the tax system?

5.3 Has the government evaluated the level of tax burden that would be consistent with the government's investment attraction strategy? Is this level consistent with the actual tax burden?

5.4 If framework conditions and market characteristics for investors are weak, is it reasonable to assume that a low tax burden can compensate by impacting favourably on investment decisions?

5.5 Where the tax burden on business income differs by firm size, age of the business entity, ownership structure, industrial sector or location, can these differences be justified? Is the tax system neutral in its treatment of foreign and domestic investors?

5.6 Are rules for the determination of corporate taxable income formulated with reference to a benchmark income definition (e.g. comprehensive income), and are the main tax provisions generally consistent with international norms?

5.7 Have targeted tax incentives for investors and others created unintended tax-planning opportunities? Are these opportunities and other problems associated with targeted tax incentives evaluated and taken into account in assessing their cost-effectiveness?

5.8 Are tax expenditure accounts reported and sunset clauses used to inform and manage the budget process?

5.9 Are tax policy and tax administration officials working with their counterparts in other countries to expand their tax treaty network and to counter abusive cross-border tax planning strategies?

## Chapter 6. Corporate governance

*The degree to which corporations observe basic principles of sound corporate governance is a determinant of investment decisions. These questions provide a brief introduction to some of the key issues that policy-makers and others concerned with corporate governance should take into consideration as part of a sound environment for investment. The list is not comprehensive and should not be considered the basis for a review of corporate governance practices in a particular jurisdiction. For this purpose, the OECD Principles of Corporate Governance as a whole should be used together with the assessment methodology for corporate governance, which is being developed by the OECD Steering Group on Corporate Governance.*

6.1 What steps have been taken to ensure the basis for a corporate governance framework that promotes overall economic performance and transparent and efficient markets? Has this been translated into a coherent and consistent regulatory framework, backed by effective enforcement? Are periodic assessments made of the impact of the corporate governance framework?

6.2 Does the corporate governance framework ensure the equitable treatment of shareholders?

6.3 What are the procedures and institutional structures for legal redress in cases of violation of shareholder rights? Do they function as a credible deterrent to such violations? What measures are in place to monitor and prevent corporate insiders and controlling owners to extract private benefits?

6.4 What procedures and institutions are in place to ensure that shareholders have the ability to influence significantly the company?

6.5 By what standards and procedures do companies meet the market demand for timely, reliable and relevant disclosure, including information about the company's ownership and control structure?

6.6 How does the corporate governance framework ensure the board plays a central role in the strategic guidance of the company, the effective monitoring of management, and that the board is accountable to the company and its shareholders?

6.7 What has been done and what more should be done in terms of voluntary initiatives and training to encourage and develop a good corporate governance culture in the private sector?

6.8 How is the ownership function of state-owned enterprises structured and separated from other state functions to enable the state to act as an active and informed owner, while ensuring a level playing field and competitive market conditions? What are the processes in place to ensure the state does not interfere in day-to-day management of state-owned enterprises (SOEs) and that board members are nominated in a transparent manner, based on competencies and experience, rather than to serve as a conduit for undue political pressure? What procedures and institutions are used to ensure accountability of SOEs to both the government and the public, and in the case of listed SOEs, to other shareholders?

## Chapter 7. Policies for promoting responsible business conduct

*Public policies promoting recognised concepts and principles for responsible business conduct, such as those recommended in the OECD Guidelines for Multinational Enterprises, help attract investments and enhance the contribution that investors make to sustainable development. Such policies include: providing an enabling environment which clearly defines respective roles of government and business; promoting dialogue on norms for business conduct; supporting private corporate responsibility initiatives; leading by example where the government acts as owners, partners or clients of business; and participating in international co-operation in support of responsible business conduct.*

7.1 How does the government make clear for investors the distinction between its own roles and responsibilities and those ascribed to the business sector? Does it actively assume its responsibilities and avoid de facto privatisation of public roles?

7.2 What steps does the government take to promote open communications so that existing and potential investors have the information they need on expected responsible business conduct? How does the government endeavour to protect the rights framework that underpins effective, two-way communication between business and society?

7.3 Does the government provide for an adequate framework to support the various types of disclosure companies make about their business activities? Is this framework flexible enough to meet the needs of investors and their stakeholders?

7.4 In what ways does the government assist companies with legal compliance?

7.5 How does the government through partnership and promotion help to strengthen the business case for responsible business conduct?

7.6 How does the government, in its management of state-owned companies and through its business relations with private sector suppliers, ensure a level playing field for investors?

7.7 Does the government participate in inter-governmental co-operation in order to promote international concepts and principles for responsible business conduct, such as the *OECD Guidelines for Multinational Enterprises*?

## Chapter 8. Human resource development

*Human resource development is a prerequisite needed to identify and to seize investment opportunities, yet many countries under-invest in human resource development due in part to a range of market failures. Policies that develop and maintain a skilled, adaptable and healthy population, and ensure the full and productive deployment of human resources, thus support a favourable investment environment.*

8.1 Has the government established a coherent and comprehensive human resource development (HRD) policy framework consistent with its broader development and investment strategy and its implementation capacity? Is the HRD policy framework responsive to new economic developments and does it engage the main stakeholders? Are periodic assessments made of the impact of HRD policies on the investment environment?

8.2 What steps has the government taken to increase participation in basic schooling and to improve the quality of instruction so as to leverage human resource assets to attract and to seize investment opportunities?

8.3 Is the economic incentive to invest in human capital sufficient to encourage individuals to continue higher education, supporting the improvement in the investment environment that flows from better human resources? What measures are being taken to ensure the full benefit of a countries' investment in its own human resources accrues, including the attraction of nationals who have completed their studies abroad? What mechanisms exist to promote closer co-operation between education institutions and business and to anticipate future labour force skill requirements?

8.4 To what extent does the government promote training programmes and has it adopted practices that evaluate their effectiveness and their impact on the investment environment? What mechanisms are used to encourage businesses to offer training to employees and to play a larger role in co-financing training?

8.5 Does the government have a coherent strategy to tackle the spread of pandemic diseases and procedures to evaluate public health expenditures aimed at improving public health outcomes and, through inter-linkages, the investment environment?

8.6 What mechanisms are being put in place to ensure enforcement of core labour standards?

8.7 To what extent do labour market regulations support job creation and the government's investment attraction strategy? What initiatives have been introduced that support policy coordination, balancing social objectives, the goal of a competitive workforce and the incentives for business to invest?

8.8 Do laws and regulations restrict the deployment of skilled workers from an enterprise investing in the host country? What steps have been taken to unwind unduly restrictive practices covering the deployment of workers from the investing enterprise and to reduce delays in granting work visas?

8.9 Does the government support programmes designed to assist large-scale labour adjustment and indirectly the investment environment by better positioning firms to seize new investment opportunities? Do the incentive mechanisms in these schemes encourage broad support for change? What role is business encouraged to play in easing the transition costs associated with labour adjustment?

8.10 What steps are being taken to ensure that labour market regulations support an adaptable workforce and maintain the ability of enterprises to modify their operations and investment planning?

## Chapter 9. Infrastructure and financial services

*Sound infrastructure development policies ensure scarce resources are channelled to the most promising projects and address bottlenecks limiting private investment. Effective financial market policies facilitate enterprises and entrepreneurs to realise their investment ideas within a stable environment.*

9.1 What processes does the government use to evaluate its infrastructure investment needs? Does the government have clear guidelines and transparent procedures for the disbursement of public monies funding infrastructure projects? Are the regulatory agencies that oversee infrastructure investment and the operations of enterprises with infrastructure investments independent from undue political interference? How does the government decide which state-owned infrastructure agencies should operate on a commercial basis?

9.2 What measures has the government adopted to uphold the principle of procedural fairness for all investors bidding for infrastructure contracts, to protect investors' rights from unilateral changes to contract terms and conditions, and have provisions been established allowing disputes to be settled through domestic or international arbitration? What steps have been taken to attract investors to supply infrastructure at fair and reasonable prices and to maintain public support for private involvement in the provision of infrastructure services?

9.3 In the telecommunications sector, does the government assess market access for potential investors and the extent of competition among operators? Does the government evaluate whether telecommunication pricing policies are competitive, favouring investment in industries that depend on reliable and affordable telecommunications?

9.4 Has the government developed a strategy to ensure reliable access to electricity services by users, and economic incentives to invest and supply electricity? What programmes exist to ensure on a least-cost basis access to electricity services by a wide range of users? Are these programmes time-bound and based upon clear performance targets?

9.5 What processes are followed to inform decisions on the development of new transport facilities, as well as the maintenance of existing investment in transport infrastructure? Are the requirements for all modes of transport regularly reviewed, taking into consideration investor needs and the links between different modes of transport infrastructure?

9.6 Has the government evaluated the investment needs in water required to support its development goals? To what extent is the private sector involved in water management, supply and infrastructure financing?

9.7 How has the government sought to attract private investment in the development of the financial services sector, offering a wide range of products to a broad cross-section of enterprises? What steps has the government taken to remove obstacles, including restrictions on participation by foreign institutions, to new investors entering the financial sector? To what extent do the authorities take advantage of information sharing and other international co-operative arrangements to facilitate adequate supervision of foreign financial institutions operating in the country?

9.8 What laws and regulations are in place to protect the rights of borrowers and creditors and are these rights adequately balanced? Is a registry system in place to support the use of property as collateral and to expand business access to external sources of credit? What data protection and credit reporting laws have been enacted to facilitate the flow of information and improve financial sector stability, thereby enhancing the investment environment?

## Chapter 10. Public governance

*How public policies and laws are formulated and enforced influences investment decisions. While there is no single model for good public governance, there are commonly accepted standards of public governance to assist governments in assuming their roles effectively. The checklist questions address regulatory quality and public sector integrity, two dimensions of public governance that matter for the investment environment.*

10.1 Has the government established a coherent and comprehensive regulatory reform framework, consistent with its broader development and investment strategy?

10.2 What mechanisms are in place for managing and co-ordinating regulatory reform across different levels of government to ensure consistency and a transparent application of regulations?

10.3 To what extent are regulatory impact assessments used to evaluate the consequences of economic regulations on the investment environment?

10.4 What public consultation mechanisms and procedures, including prior notification, have been established to improve regulatory quality, thereby enhancing the investment environment? Are the consultation mechanisms open to all concerned stakeholders?

10.5 To what extent are the administrative burdens on investors measured and quantified? What government procedures exist to identify and to reduce unnecessary administrative burdens, including those on investors? How widely are information and communication technologies used to promote administrative simplification, quality services, transparency and accountability?

10.6 To what extent have international anti-corruption and integrity standards been implemented in national legislation and regulations? Do penal, administrative and civil law provisions provide a consistent legislative and regulatory framework for fighting corruption as well as promoting integrity, thereby reducing uncertainty and improving business conditions for all investors?

10.7 Do institutions and procedures ensure effective and consistent application and enforcement of laws and regulations on anti-corruption and integrity in the public service? Have standards of conduct by public officials been established and what measures are used to assist public officials to meet the expected standards? What role do civil society organisations and the media play in favouring the open scrutiny of the conduct of public officials' duties?

10.8 Do review mechanisms exist to assess the performance of laws and regulations on anti-corruption and integrity?

10.9 Is the government a party to international initiatives aimed at fighting corruption and improving public sector integrity? What mechanisms are in place to ensure timely and effective implementation of anti-corruption conventions? Do these mechanisms monitor the application and enforcement of the anti-corruption laws implementing the conventions?

## PART II. ANNOTATIONS[1]

### Annotations to Chapter 1. Investment policy

**1.1 What steps have been taken to ensure that the laws and regulations dealing with investment and their implementation and enforcement are clear, transparent and readily accessible?**

For domestic and foreign investors transparent information on how rules and regulations dealing with investment are implemented and how they may be changed is a critical determinant in the investment decision. Transparency and predictability is especially important for foreign investors who may have to function with very different regulatory systems, cultures and administrative frameworks from their own. A transparent and predictable regulatory framework dealing with investment helps businesses to assess potential investment opportunities on a more informed and timely basis, shortening the period before investment becomes productive. The importance of transparency and predictability has thus motivated a number of initiatives, such as the OECD Framework for Investment Policy Transparency, that aim to help governments to achieve greater transparency. Transparency provisions have also been enshrined in virtually all modern international investment agreements, including the agreements of the WTO, regional agreements such as the NAFTA and most bilateral investment treaties of recent vintage. More generally, governments can promote investment, by: consulting with interested parties; simplifying and codifying legislation; using plain language drafting; developing registers of existing and proposed regulation; expanding the use of electronic dissemination of regulatory material; and by publishing and reviewing administrative decisions.

**1.2 Has the government taken steps towards the progressive establishment of timely, secure and effective methods of ownership registration for land and other forms of property?**

Secure, transferable rights to land and other forms of property are an important pre-requisite for a healthy investment environment and are a fundamental element in building a credible corporate governance framework (for further details, see the chapter on corporate governance). They entitle the investor to participate in the eventual profits that derive from an investment and reduce the risk of fraud in transactions. These rights carry an intrinsic economic value and investors need to be confident that their entitlement to these rights are properly recognised and protected. Well defined and secure ownership encourages new investment and the upkeep of existing investments. Land titles, for example, give an incentive to owners to promote productivity enhancing investments. Reliable land titling and property registrars also help individuals and businesses to seek legal redress in case of violation of property rights and offers a form of collateral that investors can use to improve access to credit. Improved access to credit lowers one of the main obstacles to new investment, especially among small and medium-sized enterprises.

---

[1] More detailed analysis and information for each of the policy domains is available in the OECD Secretariat background document *Policy Framework for Investment: A review of good practices in OECD and non-OECD economies* (forthcoming).

### 1.3 Have laws and regulations for the protection of intellectual property rights and effective enforcement mechanisms been adopted? Does the level of protection encourage innovation and investment by domestic and foreign firms? What steps have been taken to develop strategies, policies and programs to meet the intellectual property needs of SMEs?

Intellectual property rights give businesses an incentive to invest in research and development, and ultimately lead to the creation of innovative products and processes. Successful innovations are in time diffused within and across economies, bringing higher productivity and growth. Investment is thus, both a pre-condition for the creation and diffusion of innovation activity. The intellectual property right protection instruments used by governments to encourage investment in research and development include patent and copyright laws, which give the owner, for a pre-determined period of time exclusive right to exploit the innovation. How effective these instruments are in terms of encouraging investment in innovation activity also depends on how well the rights are enforced. Efforts to curb, for instance, counterfeiting are, therefore, an important feature of any intellectual property regime. At the same time, intellectual property right regimes need to strike a balance between society's interests in fostering innovation and in keeping markets competitive and, especially in the case of essential medicines, in sufficient supply (see also the chapter on competition policy).

The intellectual property rights regime is not only a matter of concern to large firms and multinational enterprises with significant research and development programmes, but also to small- and medium-sized enterprises (SME). SMEs are a driving force behind innovation, yet their potential to invest in innovation activities are not always fully exploited. SMEs tend to under utilise the intellectual property system, partly due to their lack of awareness. (On the promotion of investment by SMEs, see also the chapter on Investment Promotion and Facilitation.) Measures that extend access to the intellectual property regime system may thus help to attract investment in research and development and to transmit the positive spillovers to society that such investment embodies. Governments can help by, for example: promoting a greater use of the intellectual property system; developing specific strategies, policies and programs to meet the intellectual property needs of SMEs; improving the capacity of relevant public, private and civil society institutions, such as business and industry associations, to provide intellectual property-related services to SMEs; and by providing information and advice on intellectual property issues to SME support organisations.

### 1.4 Is the system of contract enforcement effective and widely accessible to all investors? Have alternative systems of dispute settlement been established, including mediation, to ensure the widest possible scope of protection at a reasonable cost?

Ultimately, it is the possibility of buying and selling assets through market transactions that reveals the value of an asset. It is, therefore, important that investors have trust in the integrity of the markets. As a central pillar of any system, this requires a legal framework, capable of ensuring the enforcement of contracts, the protection of property rights and the resolution of disputes. In many cases, however, recourse to the judiciary system can be slow and expensive, discouraging potential investors. Confidence in the integrity of markets can also be favoured through the development of alternative dispute settlement procedures, such as arbitration, mediation and conciliation hearings organised by industry bodies or specialised agencies. These are particularly useful options for settling disagreements, at least at the first instance level, between transacting parties at a reasonable cost.

**1.5 Does the government maintain a policy of timely and adequate compensation for expropriation consistent with international norms? Have explicit and well-defined limits on the ability to expropriate been established? What independent channels exist for reviewing the exercise of this power or for contesting it?**

A natural corollary of the protection of property rights is the need for compensation when a government expropriates property. This need is uncontested and, indeed, is reflected in all bilateral investment treaties and recent regional international agreements dealing with investment. Notwithstanding the widespread acceptance of the need for timely, adequate and effective compensation, the power of government to expropriate raises policy issues that usually involve a careful balancing of interests and judgement on the part of policy makers, in addition to the inherent negative impact of expropriation on the investment environment. If a government decides to expropriate land or other property, this decision should be guided by transparent rules that define the situations in which expropriations are justified and the process by which compensation is to be determined. An important 'grey' area concerns indirect expropriations. Some recent agreements provide that except in rare circumstances, non-discriminatory regulatory actions that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, are not considered to constitute expropriations. However, governments need to remain mindful that certain regulatory action may constitute expropriation.

**1.6 Has the government taken steps to establish non-discrimination as a general principle underpinning laws and regulations governing investment? In the exercise of its right to regulate and to deliver public services, does the government have mechanisms in place to ensure transparency of remaining discriminatory measures and to periodically review their costs against their intended public purpose? Does the government allow and protect the free transfer of capital and profits?**

Non-discrimination includes a commitment by a country to treat enterprises controlled by the nationals or residents of another country, no less favorably than domestic enterprises in like situations (National Treatment). The OECD Code of Liberalisation of Capital Movements, for instance, provides that non-resident investors should be allowed to establish a subsidiary or branch or take participation in an existing domestic enterprise on conditions equivalent to those offered to resident investors. The OECD National Treatment Instrument applies a similar principle for operations by foreign controlled enterprises once established in the country.

Non-discrimination also means that an investor or investment from one country is treated by the host country "no less favourably" with respect to a given subject matter than an investor or investment from any third country (referred to as Most Favoured Nation or MFN in international agreements). As with the application of the national treatment principle, MFN commitments towards investment vary considerably across countries.

Policies that favour some firms over others (i.e. any policies that derogate from national treatment or MFN) involve a cost. They can, for instance, result in less competition and efficiency losses, thereby damaging the investment environment. For this reason, exceptions to non-discrimination need to be evaluated with a view to determining whether the original motivation behind an exception (e.g. protection based on the infant industry argument) remains valid, supported by an evaluation of the costs and benefits. A broad consideration of the costs and benefits is especially important in service sectors that support a wide range of economic activities across the economy (e.g. telecommunications).

Free repatriation of profit and the ability to exit an industry through the liquidation and repatriation of capital, is a basic condition for attracting investment. Governments should ensure such free transfers, albeit without prejudice to their ability to take policy measures to deal with temporary serious balance of payment difficulties in accordance with their rights and obligations under their international investment agreements.

**1.7 Are investment policy authorities working with their counterparts in other countries to expand international treaties on the promotion and protection of investment? Are existing international treaties and commitments periodically reviewed to determine whether their provisions create a more attractive environment for investment? What measures exist to ensure effective compliance with the country's commitments under its international investment agreements?**

International agreements can promote investment by reducing restrictions on a broadly defined range of investments, by making the regulatory environment more predictable, thereby reducing the policy risks faced by investors, both domestic and foreign, and through other basic disciplines, such as limits on trade-related investment measures and guarantees for the free transfer of capital in a convertible currency. Performance requirements, such as local-content rules, tend to discourage investment by imposing additional costs on firms, which in fact is why they often go hand in hand with incentives to invest. (See also the chapter on Investment Promotion and Facilitation.)

**1.8 Has the government ratified multilateral instruments established to protect the rights of international investors, such as the United Nations Convention on the Recognition and Enforcement of Arbitral Awards and the International Centre for Settlement of Investment Disputes?**

A key feature of international agreements concerns the channels through which disputes are heard and resolved. Many international investment agreements contain provisions that allow disputes between investors and host country governments to be resolved through international arbitration. For example, the International Centre for Settlement of Investment Disputes (ICSID), established in 1966 and with 155 signatory states, allows firms from one member state to pursue their investment disputes against other member states through binding international arbitration. Commitments made in international agreements giving recourse to impartial channels of international arbitration provide an additional layer of protection to investors and, most importantly, signal a government's commitment to the rule of law, bolstering the confidence of investors that their property rights are secure (see also questions 1.2 and 1.4). Also relevant in this regard is the United Nations Convention on the Recognition and Enforcement of Arbitral Awards (the New York Convention), which makes arbitral awards rendered in one party to the Convention enforceable in any other party to the Convention.

Further Policy Resources

- APEC (1994), Non-Binding Investment Principles.
- Foreign Investment Advisory Service (FIAS) (http://www.fias.net/).
- FIAS, Investment Climate Surveys Database (http://rru.worldbank.org/InvestmentClimate/).
- FIAS, Private Sector Toolkits (http://rru.worldbank.org/Toolkits/).
- International Centre for Settlement of Investment Disputes (ICSID), ICSID Convention, Regulations and Rules (http://www.worldbank.org/icsid/).
- OECD (2003), A Framework for Investment Policy Transparency.
- OECD (2003), Assessing FDI Incentive Policies: a Checklist.
- OECD Codes of Liberalisation of Capital Movements and Current Invisible Operations: Users' Guide (2003). www.oecd.org/daf/investment/agreements - OECD, Declaration on International Investment and Multinational Enterprises. www.oecd.org/daf/investment/agreements - OECD, The Code of Liberalisation of Capital Movements (2004).
www.oecd.org/daf/investment/agreements

- OECD, The Code of Liberalisation of Current Invisible Operations (2004).
www.oecd.org/daf/investment/agreements
- OECD, The National Treatment Instrument (2005). www.oecd.org/daf/investment/agreements
- OECD, International Investment Law: A Changing Landscape (2005).
- United Nations Commission on International Trade Law (UNCITRAL), (http://www.uncitral.org/).
- World Bank (1992), Guidelines on the Treatment of Foreign Direct Investment.
- World Bank, Doing Business database (http://www.doingbusiness.org/).
- World Intellectual Property Organization (WIPO) (http://www.wipo.int/portal/index.html.en).
- World Trade Organization Legal Instruments (http://www.wto.org/).

## Annotations to Chapter 2. Investment promotion and facilitation

### 2.1 Does the government have a strategy for developing a sound, broad-based business environment and within this strategy, what role is given to investment promotion and facilitation measures?

Specific measures to promote and facilitate investments can be successful if they take place within the context of, and not substitute for, broader policies for improving the investment environment, which are dealt with in other chapters. As a country establishes a sound investment environment, investment promotion can be a useful instrument to attract new investors, especially in smaller, more remote markets or in those countries with a recent history of macroeconomic and political instability. Effective investment promotion also serves to highlight profitable investment opportunities, by identifying local partners and more generally by raising the investment profile of the country.

### 2.2 Has the government established an investment promotion agency (IPA)? To what extent has the structure, mission, and legal status of the IPA been informed by and benchmarked against international good practices?

In 2004, at least 160 national and more than 250 sub-national IPAs existed, compared with only a handful two decades earlier. The rapid growth in the number of IPAs suggests that many governments have found them to be an effective method for implementing a government's investment attraction policies. Centralising foreign investment promotion and facilitation activities, such as information dissemination and policy advocacy, within a single agency can be more cost effective and provides an opportunity to present a coherent impression of a country's attractiveness to investors. The growth in the number of IPAs also means that a rich body of experience has been developed with respect to different approaches to investment promotion agencies and across countries at different levels of development. Countries that have recently established IPAs, or are contemplating doing so, should use this experience to inform the design of the IPA following international good practices. This approach helps to ensure the full effectiveness of the IPA and to avoid repeating past mistakes.

### 2.3 Is the IPA adequately funded and is its performance in terms of attracting investment regularly reviewed?

Experience suggests that unless there is a full commitment to investment promotion agencies by the government, they are less likely to succeed in attracting new investors. They need to be adequately funded in order to attract and retain qualified and motivated staff, ideally with private sector experience. Experience also suggests that agencies with links to the centre of government and with private sector representation on the board have higher visibility and credibility and hence a better record in attracting foreign investment. They are also more dynamic and adaptable to changing economic circumstances, a critical issue for countries undergoing major economic transformation.

### 2.4 How has the government sought to streamline administrative procedures to quicken and to reduce the cost of establishing a new investment? In its capacity as a facilitator for investors, does the IPA take full advantage of information on the problems encountered from established investors?

Long delays and costly procedures to establish a new business entity is one of the obstacles to new investment and entrepreneurial activity. Many governments have introduced reforms to quicken and simplify the process of starting a new business. One common approach to this challenge has been the establishment of a 'one-stop shop'. These allow investors to access information on the necessary steps to start or expand a business and provide services to speed up the granting of necessary permits and licenses.

‘One-stop shops’ also provide easy access to other information that helps to facilitate investment, both domestic and foreign, for instance, on legal and regulatory matters, on financing options, location choice, or recruitment and training. ‘One-stop shops’ make it easier for the government to centralise the quality provision of these services. This can deliver substantial savings in time and cost to potential and existing investors, thereby facilitating new investment.

**2.5 To what extent does the IPA promote and maintain dialogue mechanisms with investors? Does the government consult with the IPA on matters having an impact on investment?**

Investment promotion agencies can play an important role facilitating effective communication between investors and the government. As the interlocutor between the government and the foreign investor, the IPA is often the main source of feedback to government policymakers on the concerns of investors. Conversely, through its regular contact with government and the relevant government agencies, the IPA can be an effective communication channel for investors on government activities having an impact on the investment environment.

**2.6 What mechanisms has the government established for the evaluation of the costs and benefits of investment incentives, their appropriate duration, their transparency, and their impact on the economic interests of other countries?**

The use of financial and other incentives to attract foreign investors (also see the chapter on Tax Policy) is not a substitute for pursuing policy measures that create a sound investment environment, for domestic and foreign investors alike. In the absence of a solid investment environment, competition among countries for FDI may lead to no overall increase in investment and detract public resources away from more productive uses. In some circumstances, however, incentives may complement an already attractive enabling environment for investment or serve as a partial rectification for market imperfections that cannot be addressed by direct policy reforms. Nonetheless, authorities engaging in incentive-based strategies to attract investment must periodically evaluate their relevance, appropriateness and economic benefits against their budgetary and other costs, including long-term impacts on resource allocation. In doing so, authorities also need to consider their commitments under international agreements, since investment incentives can have effects beyond the countries that offer them, including bidding contests leading to a waste of resources.

**2.7 What steps has the government taken to promote investment linkages between businesses, especially between foreign affiliates and local enterprises? What measures has the government put in place to address the specific investment obstacles faced by SMEs?**

Many governments aim to attract foreign direct investment, because it can bring additional benefits to its citizens through the diffusion of new technologies and human resource and management expertise. These spillovers can materialise more quickly when foreign investors are closely linked to local enterprises and are especially helpful to harness the potential of local small- and medium-sized enterprises (SMEs). These linkages can be fostered through efforts to establish a sound investment environment. For instance, open trade and investment regimes in the context of a strong competition policy provide a fertile environment for the transfer of technology (see also the chapters on Investment Policy, Trade Policy and Competition Policy). Close linkages and the broader benefits of foreign investment are also supported by government efforts to improve human resource development, through investments in education, training and public health (see the chapter on Human Resource Development policy).

Promoting linkages between foreign and local enterprises is a particular challenge for SMEs. SMEs are the largest investor community group, accounting for over 95 per cent of the business population. SMEs tend to have more difficulties gaining access to credit and in forming investment linkages with foreign affiliates. As a result, the take-up of profitable investment opportunities may be delayed, or even foregone.

### 2.8 Has the government made use of international and regional initiatives aimed at building investment promotion expertise, such as those offered by the World Bank and other intergovernmental organisations? Has the IPA joined regional and international networks?

Many international organisations work with IPAs, facilitating the exchange of best practices on investment promotion strategies and assisting in building policy capacity. For instance, the World Association of Investment Promotion Agencies (WAIPA) assists IPAs in advising their governments on the formulation of investment promotion strategies; the Foreign Investment Advisory Service, within the World Bank Group provides investment climate diagnostic studies at the request of host governments, consisting of recommendations for a combination of policy, regulatory and procedural reform, institutional frameworks for investment promotion and methods for monitoring effectiveness; and UNCTAD's Advisory Services on Investment and Training (ASIT) is experienced in instruction programmes for IPA staff to improve capacity.

### 2.9 To what extent has the government taken advantage of information exchange networks for promoting investment?

One of the roles of IPAs is to facilitate the recognition of potential investment opportunities by promoting partnerships between domestic and foreign enterprises. A number of initiatives exist to help governments and IPAs in their linkage-promotion efforts. For example, the UNIDO Subcontracting and Partnership Exchanges (SPXs) act as technical information, promotion and matchmaking centres for industrial subcontracting. The SPX Network currently provides detailed, standardised, updated and certified data on approximately 20,000 manufacturing companies worldwide, thereby favouring the establishment of partnerships between contractors, suppliers and subcontractors. To date, more than 60 SPXs have been set up with UNIDO's assistance in more than 30 countries. Further, a number of regional forum based information exchange networks exist. For example, the Tokyo International Conference on African Development (TICAD) established, through UNIDO, the Asia-Africa Investment Technology Promotion Centre (AAITPC) to promote Asian investment in Africa. It provides an information technology platform (the TICAD Exchange Website) to share business related information on investment opportunities between Asia and Africa.

Further Policy Resources

- Asia Africa Investment and Technology Promotion Centre (The Hippalos Centre) (http://www.unido-aaitpc.org).
- FIAS, Private Sector Toolkits (http://rru.worldbank.org/Toolkits/)
- International Finance Corporation (IFC) (http://www.ifc.org/).
- IFC Small and Medium Enterprise (SME) Toolkit (http://www.ifc.org/ifcext/sme.nsf/Content/SME_Toolkit).
- Multilateral Investment Guarantee Agency (MIGA): Investment Promotion Toolkit (http://www.fdipromotion.com/toolkit/user/index.cfm).
- OECD (2003), Assessing FDI Incentive Policies: a Checklist.
- OECD, Bologna Charter on SME Policies (http://www.oecd.org/document/17/0,2340,en_2649_34197_1809105_1_1_1_1,00.html)
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD, Istanbul Ministerial Declaration on Fostering the Growth of Innovative and Internationally Competitive SMEs (OECD).
- OECD (2002), SEE Investment Compact, Strategic Investment Promotion: Successful Practice in Building Competitive Strategies. (http://www.oecd.org/document/16/0,2340,en_2649_34197_32020176_1_1_1_1,00.html)
- OECD LEED Programme (Local Economic and Employment Development ) (http://www.oecd.org/department/0,2688,en_2649_34417_1_1_1_1_1,00.html)
- TICAD (Tokyo International Conference on African Development) (http://www.ticad.net/).
- TICAD Exchange network (http://www.TICADExchange.org).
- United Nations Industrial Development Organization (UNIDO) (http://www.unido.org/).
- World Association of Investment Promotion Agencies (WAIPA) (http://www.waipa.org/).

## Annotations to Chapter 3. Trade policy

### 3.1 What recent efforts has the government undertaken to reduce the costs of customs, regulatory and administrative procedures at the border?

The relationship between international trade, domestic and foreign investment has evolved over time. Today, international investment is more motivated by productivity enhancing opportunities and relatively less linked to accessing local markets, or extracting natural resources. In these circumstances, distortionary trade policies and customs procedures not conforming with internationally recognised standards delay cross-border deliveries and increase business costs. This makes it harder to harness efficiency gains from global supply chains, lowering rates of return and discouraging investment. Often trade policy procedures can be simplified through harmonised requirements and regulatory co-operation (e.g. to enable pre-arrival clearance of shipments), with benefits for the overall investment environment. More generally, however, because of the linkages between trade and investment and because policy objectives are best achieved via a coherent set of initiatives, trade policies cannot be framed in isolation. It is, therefore, important to assess periodically the impact of customs, regulatory and administrative procedures on the investment environment.

### 3.2 What steps has the government taken to reduce trade policy uncertainty and to increase trade policy predictability for investors? Are investors and other interested parties consulted on planned changes to trade policy?

Investors compensate for greater risk and uncertainty by adjusting upwards the rate of return required to undertake an investment project, leading to less overall investment. In the trade policy domain, uncertainty may be created by spontaneous government decisions that obstruct the smooth functioning of international supply chains and cause less stable pricing structures. Transparency in trade policy making, for instance, via public consultations with businesses and other constituents and better communication of policy decisions helps to provide a more stable environment in which enterprises can plan their investment programmes.

### 3.3 How actively is the government increasing investment opportunities through market-expanding international trade agreements and through the implementation its WTO commitments?

WTO-consistent trade agreements attract investment by creating larger markets, and by raising the potential to exploit scale economies make investment more profitable as well as boosting the gains from trade to society. Further, regional trade agreements usually include provisions in the fields of investment that complement domestic efforts to create a sound investment environment. Typically, trade agreements that are consistent with WTO requirements enable enterprises to source suppliers, and sell their output at globally competitive prices and thereby create additional investment opportunities.

### 3.4 How are trade policies that favour investment in some industries and discourage it in others reviewed with a view to reducing the costs associated with these distortions?

Trade policy instruments, such as import tariffs, are sometimes used by governments to promote investment in targeted industries. Overall, however, the impact of such practices is likely to harm the investment environment. Favoured industries compete for resources with other enterprises, crowding out investment in activities that are more productive. Moreover, to the extent the output of the targeted industry is an input to others, external competitiveness is crimped, reducing profitability and the attractiveness of additional investment in these export-oriented sectors. These costs are often long-lived, since they are not transparent and usually are spread among many producers and consumers, giving a limited incentive to pressure governments for reform.

If investment in a specific industry is to be attracted by assistance, it should be done in a transparent manner and consistent with obligations under the WTO Agreement on Subsidies and Countervailing Measures. The first best approach, however, is to put in place policies that allow competitive industries to develop and flourish, rather than try to instigate an artificial competitive edge through trade policy. This does not necessarily imply removing all import protection. Improvements to the structure of trade policies (e.g. uniform tariffs), as with taxation policy (see Chapter 5) allow policy objectives to be achieved at a smaller distortionary cost to the investment environment and in terms of resource allocation more generally.

### 3.5 To what extent do trade policies raise the cost of inputs of goods and services, thereby discouraging investment in industries that depend upon sourcing at competitive world prices?

The majority of international trade involves transactions from business to business. Modern business supply chains concern hundreds of domestic and international producers. This specialisation of production attracts investment, because it results in productivity gains and lower production costs. Trade policies that hinder reliable access to intermediate goods and services and which raise their cost can hold back this process. Some countries, for example, require a minimum proportion of investment project inputs to be sourced locally, regardless of their cost competitiveness. Such policies may be inconsistent with WTO obligations arising from the Agreement on Trade-Related Investment Measures (TRIMs). Policy makers should evaluate their potential dampening effects on investment.

Services can be traded either by modes: (1) cross-border supply; (2) consumption abroad; (3) commercial presence; or (4) temporary movement of natural persons. The four modes are intrinsically linked. The value of trade-in-services through all four modes has expanded both as proportion of total trade and in magnitude for both developed and developing countries. These service exports often grew from international investment and work outsourced from home multinational enterprises. Their export (through modes 1 and 2) cannot only benefit the host country from which the service originates, but concurrently make the home's multinational enterprises globally competitive. Reviewing and liberalising existing regulations of home countries may lead to benefits for host countries. Liberalisation in mode 4 can allow entrepreneurial talent to find niches and circulate that entrepreneurial talent to and from host and home countries. If effective policies are in place, mode 4 liberalisation may mutually benefit the home and host country.

### 3.6 If home-country trade policy has a negative effect on developing country exports, are there alternative means of accomplishing public policy objectives, taking into account the dampening effect that such a trade policy also has on investment?

The beneficiaries of restrictive trade policies are concentrated while those that incur a cost are dispersed among many businesses and consumers. Indeed, a home country's trade policies may reduce a developing country's exports and therefore its ability to purchase imports and source investment, including from abroad. Further, part of the overall cost is borne by actual and potential trading partners and may include a less attractive investment environment. These costs should be considered when evaluating specific trade policy measures. More generally, the investment environment is helped if trade policy options are informed by analysis that identifies the least trade and investment restricting instruments.

### 3.7 To what extent does trade policy support and attract investment through measures that address sectoral weaknesses in developing countries (e.g. export finance and import insurance).

The magnitude of trade and investment flows also depends on the existence of other markets that facilitate cross-border transactions. These include markets that hedge and transfer the risk attached to exchange rate movements, payment default, transit insurance as well as the financing of international commerce. These are sophisticated markets and in many countries, they do not exist or are under-developed. Experience shows that putting in place the conditions needed to support the development of such markets can take considerable time. (Issues related to the development of financial markets are discussed in the chapter on Infrastructure and Financial Services.) In the interim, correcting for market failures in host countries may require help from home countries. For example, in the absence of a developed financial sector, trade financing and insurance can often best be provided by home countries.

Further Policy Resources

- OECD, Declaration on International Investment and Multinational Enterprises.
- United Nations Commission on International Trade Law (UNCITRAL) (http://www.uncitral.org/).
- World Trade Organization Legal instruments (http://www.wto.org/).

## Annotations to Chapter 4. Competition policy

### 4.1 Are the competition laws clear, transparent, and non-discriminatory? What measures do the competition authorities use (e.g. publishing decisions and explanations on the approach used to enforce the laws) to help investors understand and comply with the competition laws and to communicate changes in the laws and regulations?

For competition policy to be effective, businesses and other stakeholders need to understand the "rules of the game." This requires that competition laws and policies be transparent and their implementation predictable. It also requires that rulings on competition cases be made based on non-discriminatory criteria and consistently. In other words, while no two situations are exactly the same, under reasonably similar circumstances decisions should be consistent with each other. Transparency can be promoted by, for instance, ensuring that businesses and other interested parties have access to all necessary information, by offering guidance on the interpretation of the competition laws and by publishing reasons for judiciary and regulatory agency decisions. Transparency and predictability help to improve the investment environment, because they reduce the risk of inconsistent application of laws and regulations and lower uncertainty faced by investors and others. (Also see the chapter on Investment Policy.) In addition, transparency reduces firms' costs of compliance and promotes confidence by reassuring investors that they are being treated fairly and that government is exercising its powers responsibly.

### 4.2 Do the competition authorities have adequate resources and the political support to implement effectively competition laws?

The distinction between adopting a new law or policy and effectively implementing it can represent the difference between success and failure. Effective policy implementation requires that the competition authority have the resources and political support to do the job properly. Competition authorities must often challenge vested interests, such as private firms with monopolistic positions in the market or state-owned firms that fall under the regulatory authority of other parts of government. In the absence of a strong political commitment, efforts to promote competition, and hence investment, are in such cases likely to fail. Furthermore, a strong commitment to policy implementation and oversight at the political level can help to protect competition authorities themselves from regulatory capture. Political support for competition policy, which includes supplying sufficient resources for effective enforcement, is an important determinant of the potential contribution of competition policy to an attractive investment environment. Institutional settings vary widely, complicating the assessment of the degree of political support for competition policy, or of its vulnerability to special-interest intervention. Criteria that might be considered could include the status of the competition authorities within the government structure and the institutional arrangements for insulating enforcement decision-makers from political direction or influence.

### 4.3 To what extent, and how, have the competition authorities addressed anti-competitive practices by incumbent enterprises that inhibit investment?

Incumbent enterprises can sometimes discourage investment by abusing their market power. For example, if an incumbent maintains exclusive distribution arrangements with its retailers or wholesalers, and the cost of establishing an alternative network is prohibitive, new entry and new investment may be impeded. Likewise, if a producer sells a product below cost (appropriately defined) with a view to recouping losses incurred after rivals have exited the industry, or would-be new entrants have been deterred. A credible threat of predatory pricing behaviour discourages prospective investors and can discourage investment in upstream and downstream industries. The demonstrated willingness of competition authorities to prevent, correct and sanction anticompetitive practices can thus have a significant positive bearing on the investment climate.

**4.4 Do the competition authorities have the capacity to evaluate the impact of other economic policies on the ability of investors to enter the market? What channels of communication and co-operation have been established between competition authorities and other relevant government agencies?**

Some government policies and regulations directly discourage investment, for example, prohibitions or restrictions on investment in certain sectors. Other policies and regulations are less direct, but can also discourage investment. Trade restrictions, for instance, can make a national market too small for those investments where economies of scale need to be reaped to be viable. One of the key challenges to establishing a sound investment environment is to identify and remove the unnecessary impediments to new investment. In this context, and without prejudice to the authority of government to regulate and the authority of other agencies in the conduct of their responsibilities, it is desirable to involve the competition policy authorities. This would help when laws and regulations are being developed to better appreciate competition policy perspectives, which through inter linkages bear on the investment environment.

More generally, ensuring coherence across policy areas is a principle of the Policy Framework for Investment. But it can present difficult trade-offs, notably in the domain of competition policy. For example, intellectual property rights (IPR) reward investments in creative and innovative activities with exclusive rights, limiting direct competition for a period. In the absence of IPR, such investment would be smaller, or non-existent. The difficulty for policy lies in balancing the considerations of competition policy and ensuring an incentive to create and innovate through, for instance, investments in research and development. There are also cross border considerations, including issues associated with the impact of licensing in home countries on competition in host countries, an area which has been identified as requiring further consideration.

**4.5 Does the competition authority periodically evaluate the costs and benefits of industrial policies and take into consideration their impact on the investment environment?**

In some countries, the investment attraction strategy includes efforts to promote "national champions". This involves granting preferential treatment to some firms over others. Often it includes significant state involvement, in terms of direct or indirect financial assistance (also see the chapter on Tax Policy) and the granting of special treatment, for instance, through restrictions on foreign direct investment, trade barriers and exemption from competition laws. The arguments for national champions are contentious. Evaluations on the effectiveness of such schemes, in terms of attracting investment should be broad-based, taking into consideration their impact on the investment decisions of other investors and more broadly on the investment environment. The competition authorities are often well placed to conduct such an exercise, at least in terms of assessing the impact on markets from granting exemptions from competition law.

**4.6 What is the role of the competition authorities during privatizations? Have competition considerations having a bearing on investment opportunities, such as not permitting market exclusivity clauses, been adequately addressed?**

Competition authorities have sometimes found themselves at the margins of policy formulation in areas not directly associated with competition law or policy, per se. This has been the case, for example, with respect to the wave of privatizations that swept through many regulated sectors during the 1990s, which was a major driver of increased flows of foreign direct investment. A concern of governments and competition authorities has been to avoid replacing public monopolies with private ones. This challenge has sometimes been exacerbated by the pursuit of conflicting objectives. More specifically, the desire to create more efficient industry structures, on the one hand, and the desire to sell state owned assets at the highest possible prices, on the other. The latter has sometimes led governments to grant market exclusivity to foreign investors, a non-transparent incentive to FDI and a restraint on the degree of competition. The competition authorities should play an active role during privatisations. They should focus on competition considerations, including the potential benefits that private investment, both domestic and foreign can bring to an economy, rather than the possible short-term budgetary windfalls. Their advocacy role capabilities should also extend to include an evaluation of the costs associated with arrangements that lead, either tangentially or by design, to monopolies. While merger control powers could be applied to prevent or correct anti-competitive dispositions of privatised assets, it would be more efficient for the competition policy authorities to be involved in decisions about privatisation well before transactions reach that stage.

### 4.7 To what extent are competition authorities working with their counterparts in other countries to co-operate on international competition issues, such as cross-border mergers and acquisitions, bearing on the investment environment?

With the rapid increase in cross-border investment, competition authorities are increasingly dealing with competition issues that span borders, such as international mergers and acquisitions and international cartels. Invariably, investigation of competition cases with an international dimension requires co-operation with the competition authorities in other countries. Establishing formal working relationships and channels of communications can speed up the investigation of such cases, reducing the period of uncertainty, benefiting the investment environment.

Further Policy Resources

- OECD (2005), Council Recommendation on Merger Review.
- OECD (2001), Recommendation of the Council Concerning Structural Separation in Regulated Industries.
- OECD (1998), Recommendation of the Council Concerning Effective Action Against Hard Core Cartels.
- OECD (1995), Revised Recommendation of the Council Concerning Co-operation between Member Countries on Anti-Competitive Practices Affecting International Trade.
- OECD, Declaration on International Investment and Multinational Enterprises.

## Annotations to Chapter 5. Tax policy

### 5.1 What is the average tax burden on domestic profits, taking into account statutory provisions, tax-planning opportunities and compliance costs?

The statutory tax burden on domestic profits should be assessed using quantitative measures and qualitative information, taking into account the main statutory provisions and the effects of tax-planning strategies commonly employed by domestic and foreign-owned businesses (e.g. thin capitalisation, non-arm's length transfer prices) to lower the host country tax burden. Compliance costs from excessive complexity, non-transparency and unpredictability should also be factored in.

### 5.2 Is the tax burden on the business enterprises of investors appropriate with reference to the policy goals and objectives of the tax system?

In deciding the tax burden to impose on domestic profit of the business enterprises of investors, the analysis should weigh the objectives guiding overall tax policy design, including efficiency and equity concerns, compliance costs and revenue requirements. Where different goals suggest different tax burden levels, an appropriate balancing of competing objectives should be sought, initially taking revenue requirements as given. Revisions of overall revenue targets and expenditure possibilities may be required.

### 5.3 Has the government evaluated the level of tax burden that would be consistent with the government's investment attraction strategy? Is this level consistent with the actual tax burden?

A central issue in gauging what level of tax burden would be consistent with the government's investment attraction strategy is whether the country offers appealing risk/return opportunities, taking into account framework conditions, market characteristics and location-specific profits, independent of tax considerations. Investors are generally willing to accept a higher tax burden the more attractive are the risk/return opportunities. On the returns side, potential investors examine the level of business costs, such as those attached to complying with regulations and administrative practices (see chapters on Public Governance and on Competition Policy) and pay attention to factors, such as the ability to recruit skilled labour (see chapter on Human Resource Development). On the risks side, potential investors examine the level of non-diversifiable risks associated with securing access to capital and profits (see chapter on Infrastructure and Financial Services). Absolute and comparative assessments with regard to competing tax jurisdictions are also relevant for investor location decisions.

### 5.4 If framework conditions and market characteristics for investors are weak, is it reasonable to assume that a low tax burden can compensate by impacting favourably on investment decisions?

Policy-makers are encouraged to reflect on the disappointing experience of economies that have attempted to rely on a low tax burden - typically targeted at foreign investment - to boost investment. Where framework conditions or market characteristics are weak, realistic expectations should be made of how much additional investment a reduced tax burden would bring forth and the scale of tax-planning opportunities created. Where a low tax burden is to be achieved through the use of special tax incentives, evaluations of their potential to attract investment should take into consideration the possibility that tax incentives may discourage investment by contributing to project cost and risk.

### 5.5 Where the tax burden on business income differs by firm size, age of the business entity ownership structure, industrial sector or location, can these differences be justified? Is the tax system neutral in its treatment of foreign and domestic investors?

Tax systems may purposefully impose a non-uniform effective tax rate on businesses, based on criteria such as the size and age of an enterprise, its ownership structure (e.g. domestic versus foreign-owned), the type of business activity or its location. In other cases, certain firms may be specifically targeted to receive preferential tax treatment. Where tax relief is targeted, policy makers should examine the arguments in favour and against such preferential treatment, be able to weigh up these arguments and be in a position to justify differential tax treatment. (On the issue of fair treatment of investors, see the Chapter on Investment Policy.) Where justifications are weak, first consideration should be given to a non-targeted approach, so as not to induce a misallocation of resources.

### 5.6 Are rules for the determination of corporate taxable income formulated with reference to a benchmark income definition (e.g. comprehensive income), and are the main tax provisions generally consistent with international norms?

With any corporate tax system, investors expect the calculation of corporate taxable income to adequately reflect business costs, via basic tax provisions such as loss carry-forward rules that are not more onerous than those commonly found elsewhere. Investors also view negatively the double taxation of income within the corporate sector, and generally expect zero taxation of or tax relief on, inter-corporate dividends, particularly when these are paid along a corporate chain. In short, policy makers are encouraged to give recognition to the reasonable expectations of taxpayers when designing or reforming their corporate tax system.

### 5.7 Have targeted tax incentives for investors and others created unintended tax-planning opportunities? Are these opportunities and other problems associated with targeted tax incentives evaluated and taken into account in assessing their cost-effectiveness?

Tax holidays and partial profit exemptions, typically targeted at ‘new’ companies, offer significant scope for tax relief unintended by the tax authorities. Other forms of targeted tax relief may also create unintended scope for tax planning, and result in revenue losses well in excess of levels originally anticipated (e.g. where the relief spills over to benefit non-targeted taxpayer groups). While notoriously difficult to predict, policy makers are encouraged to consult widely to sharpen estimates of the revenue losses from a given incentive.

To varying degrees, depending partly on the instrument used, reduced taxation will provide tax relief in respect of investment that would have been undertaken in the absence of such relief (‘windfall gains’ to investors, or, in the case of FDI, foreign treasuries). Targeted tax incentives may also create unintended distortions to the allocation of productive capital and to corporate financing and repatriation policies. Targeted tax incentives may not bring about as much reduced complexity as expected, and may encourage corruption if provided with excessive administrative discretion. (See chapter on Public Governance.) Finally, the use of certain tax incentives may be inconsistent with international obligations. Policy-makers are encouraged to factor in these considerations when considering the pros/cons of a non-targeted approach.

Where strong political pressure is felt for introducing tax incentive relief, despite analysis indicating limited investment response relative to the revenue losses (to existing qualifying and non-qualifying investors) and administrative costs entailed – implying failure to meet a cost-benefit test – policy makers should argue the case for exploring options to address the impediments to investment directly.

### 5.8 Are tax expenditure accounts reported and sunset clauses used to inform and manage the budget process?

Tax expenditure analysis measuring revenue foregone by targeted tax incentives and other departures from a benchmark tax system should be a feature of fiscal policy in countries where attracting investors and addressing public governance issues (see chapter 10 on Public Governance) are high on the policy agenda. Such accounts should be subject to public scrutiny and be considered alongside corresponding direct expenditures to inform the budget process.

For proper management of public finances, tax incentives targeted to boost investment should be assessed in advance and, if introduced, evaluated on a periodic basis to gauge whether such measures continue to pass a cost-benefit test. To enable a proper evaluation and assessment, the specific goals of a given tax incentive need to be made explicit at the outset. Further, if tax incentive legislation is introduced, "sunset clauses" calling for the expiry of the incentive (e.g. 3 years after implementation) should be included to provide an opportunity to assess whether the incentive should be extended or not.

### 5.9 Are tax policy and tax administration officials working with their counterparts in other countries to expand their tax treaty network and to counter abusive cross-border tax planning strategies?

A wide tax treaty network is helpful to countries seeking to raise and attract investment. They provide investors with increased certainty over their tax treatment, reduce the scope for double taxation of income, and they operate to improve profits and reduce risk. Tax treaties also provide a framework for the exchange of information among tax authorities to counter more aggressive forms of tax planning in relation to foreign and domestic source income.

<u>Further Policy Resources</u>

- OECD (2003), Assessing FDI Incentive Policies: a Checklist.
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD (1992), Model Agreement for Simultaneous Tax Examinations.
- OECD, Model Agreement on Exchange of Information on Tax Matters.
- OECD Model Tax Convention on Income and on Capital (Latest: 2005 edition).
- OECD (2001), Recommendation of the Council on the Use of the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes.
- OECD (2001), Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

## Annotations to Chapter 6. Corporate governance[2]

### 6.1 What steps have been taken to ensure the basis for a corporate governance framework that promotes overall economic performance and transparent and efficient markets? Has this been translated into a coherent and consistent regulatory framework, backed by effective enforcement? Are periodic assessments made of the impact of the corporate governance framework?

An effective corporate governance framework requires an effective legal, regulatory and institutional foundation, which all market participants can rely upon when they enter into contractual relations. (See also the chapters on Investment Policy and Public Governance.) This legal, regulatory and institutional foundation typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of a country's specific economic circumstances, history and traditions. The desirable mix between legislation, regulation, self-regulation, voluntary standards, etc. will therefore vary from country to country.

In this context, designing the regulatory and legal framework that underpins the corporate governance system needs to be flexible enough to meet the needs of corporations operating in widely different circumstances. Another key consideration is the need for effective enforcement and implementation. Among other things, this requires that the allocation of responsibilities for supervision, implementation and enforcement among different authorities be clearly defined so that the competencies of complementary bodies and agencies are respected and used most effectively. It is also important that policy makers remain focused on the ultimate economic outcomes from interventions, and when considering different policy options, to undertake an analysis of the impact on key variables that affect the functioning of markets. More generally, and from an investment environment perspective, it is worthwhile to assess periodically the impact of the corporate governance framework on the incentives to invest.

### 6.2 Does the corporate governance framework ensure the equitable treatment of shareholders?

The ownership structure has important implications for the corporate governance framework. In many economies, major shareholders control most companies, in some cases through differential voting rights or complex ownership and control structures that allow them to maintain control with relatively little equity. In other cases, ownership is controlled by the state, raising additional governance challenges (see question 10). Controlling shareholders have strong incentives to monitor closely the company and its management, and can have a positive impact on the governance of the company. However, their interests may also conflict with the interest of minority shareholders. This conflict is most destructive when the controlling shareholders extract private benefits at the expense of minority shareholders.

All shareholders pay the cost of poor corporate governance in the form of lower valuations, restricted access to equity finance, and difficulties with respect to succession planning and accessing outside talent. Moreover, the economy pays through reduced productivity, as investment funds are allocated less efficiently. To reduce these costs, some controlling shareholders take voluntary measures to improve their own corporate governance and to improve their reputations with other shareholders. The creation of institutions like special stock market tiers and voluntary corporate governance codes can facilitate these voluntary measures by allowing companies to signal credibly to markets that they have high standards of corporate governance. However, there are limits to what voluntary actions can achieve. In the long run, controlling shareholders may actually benefit from legally binding and effectively enforced measures to improve investor protection.

---

2 Version of 30 November 2005.

### 6.3 What are the procedures and institutional structures for legal redress in cases of violation of shareholder rights? Do they function as a credible deterrent to such violations? What measures are in place to monitor and prevent corporate insiders and controlling owners to extract private benefits?

Certain types of corporate activities involve inherent conflicts of interest on the part of the participating parties. It is, therefore, important for the market to know if such activities are carried out with due regard to the interests of all shareholders and to establish effective methods to obtain redress for grievances. The confidence of shareholders and potential investors is enhanced when the legal system provides mechanisms for shareholders to bring lawsuits at a reasonable cost and without excessive delay. However, there is some risk that a legal system, which enables any investor to challenge corporate activity in the courts, can become prone to excessive litigation. A balance must be struck between allowing investors to seek remedies for infringement of ownership rights and avoiding excessive litigation, which may also cause management and boards to become excessively risk averse.

An effective judiciary is also essential for providing a credible deterrent to abuse of shareholder rights. In countries with a weak judiciary, lengthy legal processes with unpredictable outcomes undermine the incentives for shareholders to pursue their rights and discourage potential investors. Another dimension for the redress of abusive violations of shareholder rights is through prevention. To this end, and more generally, it is essential that companies fully disclose material related party transactions to the market, including whether they have been executed at arms-length and on normal market terms. In discussing the content and coverage of such measures, consideration should be given to a workable definition of related parties. It will also be necessary to address the individual's responsibility for announcing a conflict of interest and the role of the board of directors in assessing the material implications of such a conflict. In many cases, for example when a family member is involved, only the individual company officer who is in a position to exercise control or influence with related companies would be able to know about the conflict of interest.

### 6.4 What procedures and institutions are in place to ensure that shareholders have the ability to influence significantly the company?

Participation in general shareholder meetings is a fundamental shareholder right that is critical to their ability to influence the company. The procedures for notification of shareholder meetings and for casting of votes should be designed to facilitate and encourage participation. This requires, inter alia, timely notification and voting systems that enable shareholders to engage in the decision making process at reasonable cost.

Access to information and reliable proxy procedures are particularly important in the case of foreign investors who often hold their shares through chains of intermediaries. This can gives rise to special challenges with respect to determining the entitlement of foreign investors to use their voting rights and the process of communicating with such investors. The obvious risks are that information from the company does not reach the ultimate shareholder and that the opinion of the ultimate shareholder does not reach the shareholder's meeting. It is, therefore, important to address to what extent the legal and regulatory framework clarifies the duties and procedures for informing about the shareholders' meeting, and the procedures for voting of shares that are held by foreign owners.

### 6.5 By what standards and procedures do companies meet the market demand for timely, reliable and relevant disclosure, including information about the company's ownership and control structure?

Present and potential shareholders require access to regular, reliable and comparable information in sufficient detail for them to exercise their ownership rights on a fully informed and equal basis. A disclosure regime that promotes transparency is thus a pivotal feature of a market-based corporate governance system. It underpins confidence in the stock market and is a powerful tool for influencing the behaviour of companies and for protecting investor rights. Insufficient or ambiguous information will hamper the ability of the markets to function. It will increase the cost of capital and discourage investment.

A discussion about the content of disclosure standards and the dissemination procedures will naturally address numerous trade-offs that relate to the completeness, quality and cost of establishing and disseminating the information. In order to determine what information should be disclosed at a minimum, many countries apply the concept of materiality. Material information can be defined as information whose omission or misstatement could influence the economic decisions taken by users of information. In the course of developing a strong disclosure regime, that the channels, timing and procedures for disseminating corporate information can be just as important as the content of the information itself. There is no use in issuing material information if it does not reach the market and the concerned authorities in a predictable and timely fashion.

### 6.6 How does the corporate governance framework ensure the board plays a central role in the strategic guidance of the company, the effective monitoring of management, and that the board is accountable to the company and its shareholders?

The board should play a central role in the governance of the company. The board is chiefly responsible for guiding corporate strategy, for monitoring managerial performance - replacing it if necessary -, overseeing systems designed to ensure that the corporation obeys the applicable laws and achieving an adequate return for shareholders, while preventing conflicts of interest. In addition, boards have a duty to act in the best interests of the company and its shareholders, and are expected to take due regard of, and deal fairly with, other stakeholder interests, including those of employees, creditors, customers, suppliers and local communities. (Also see the chapter on Policies for promoting responsible business conduct.)

Regardless of how the board members are chosen, in order to effectively fulfil their responsibilities, they must be able to exercise informed, objective and independent judgement, acting as representative of all shareholders. Some of their responsibilities are formalized as a duty of care and loyalty, and it is important that these concepts be firmly anchored in law and jurisprudence, and in the understanding and practices of the board members themselves. In some countries, companies have found it useful to articulate explicitly the responsibilities that the board assumes and those for which management is accountable.

### 6.7 What has been done and what more should be done in terms of voluntary initiatives and training to encourage and develop a good corporate governance culture in the private sector?

In dealing with corporate governance issues, countries use a varying combination of legal and regulatory instruments, voluntary codes and initiatives, depending in part on history, legal traditions, efficiency of the courts, the political structure of the country and the stage of enterprise development. Many countries, hoping to minimize compliance costs and to provide greater flexibility within a market framework, have developed and sought to promote greater use of voluntary codes and initiatives to improve their corporate governance. In addition, some countries have sought to implement their codes through "comply or explain" provisions that do not require compliance, but require an explanation when the provision is not followed. In some countries, such codes are implemented by stock markets through listing requirements. Corporate governance institutes or institutes of boards of directors have also been established in many countries, with an aim to promote awareness and to train directors to understand better corporate governance objectives and requirements. Some institutes have also engaged in media training programmes as another avenue for increasing public understanding of corporate governance.

**6.8 How is the ownership function of state-owned enterprises structured to enable the state to act as an active and informed owner, while ensuring a level playing field and competitive market conditions? What are the processes in place to ensure that the state does not interfere in day-to-day management of state-owned enterprises (SOEs) and that board members are nominated in a transparent manner, based on competencies and experience, rather than to serve as a conduit for undue political pressure? What procedures and institutions are used to ensure accountability of SOEs to both the government and the public, and in the case of listed SOEs, to other shareholders?**

How the ownership function of the state is organised – that is, the functioning of the entities responsible for establishing and implementing the state's ownership policies - can influence the overall investment environment. In particular, it is important that the ownership function is clearly identified and separated from other state functions. This helps to ensure a level playing field for all investors, especially with regard to complying with laws and regulations. It also helps to ensure that the state, while being an active and informed owner, does not interfere in the day-to-day management of SOEs, leaving their boards with full operational autonomy to realise their defined objectives and fulfil their responsibilities. This often requires limiting the number of board members coming from the administration and precludes any direct or indirect political representation on SOE boards.

Transparency and accountability go hand-in-hand with autonomy. They reassure investors that government agencies, including SOEs, exercise their powers responsibly and help to instil confidence that investors entering new markets compete on an equal basis. Following some basic corporate governance principles can help SOEs to raise their standards of accountability and transparency. For example, through ensuring adequate reporting by the ownership entity and SOEs themselves on their performance and achievement of their objectives, based on the same high-level accounting and auditing standards as listed companies. This also requires that SOEs develop efficient internal audit procedures and are subjected to an annual independent external audit based on international standards. Adequate disclosure of material information is also important to foster accountability, in particular relating to any financial assistance received from the state, commitments made on behalf of the state and any material transactions with related entities. Such transactions are often an important source of an uneven playing field for investors, particularly in weak institutional environments. Publishing annually an aggregate report on SOEs, focusing on their financial performance and their valuation, and giving an overview of their evolution also helps to ensure accountability of SOEs to the public.

Further Policy Resources

- OECD, Principles of Corporate Governance (2004). See http://www.oecd.org/daf/corporate-affairs
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD, Guidelines on Corporate Governance of State-Owned Enterprises (2005)

## Annotations to Chapter 7. Policies for promoting responsible business conduct

**7.1 How does the government make clear for investors the distinction between its own roles and responsibilities and those ascribed to the business sector? Does it actively assume its responsibilities and avoid de facto privatisation of public roles?**

The core mission of business is to identify and manage investment projects that yield competitive returns to suppliers of capital. The role of governments is to look after the collective interests of their citizens. As part of this role, they work with companies, trade unions and other civil society to create enabling environments for responsible business conduct. If this enabling environment is well designed, including through a clearly communicated distinction between the respective roles and responsibilities of government and business, uncertainty over expectations concerning responsible business conduct are lowered, thus encouraging investment, and private and public sector actors will be encouraged to play mutually-supporting roles in enhancing economic, social and environmental well-being.

**7.2 What steps does the government take to promote open communications so that existing and potential investors have the information they need on expected responsible business conduct? How does the government endeavour to protect the rights framework that underpins effective, two-way communication between business and society?**

Law-making is a key channel for communicating societal expectations to companies, thus creating a stable, predictable environment conducive to investment. Expectations concerning responsible business conduct are also communicated through a multitude of other channels and these also impact upon the quality of the investment environment. Such communication can take place within the workplace, with local communities, through discussions with investors, via the press and so forth. These two-way communication channels provide inputs that can be valuable for setting company policies and evaluating performance. These other channels complement the information communicated to companies through formal legal and regulatory processes.

Governments play several roles in ensuring that these other communication processes work well. While the protection of human rights (e.g. political, social, civil, labour and property) is a fundamental objective in itself, it is also a pre-condition for effective communication to take place. This removes threats of rights violations so that many voices, including those of investors, can be heard. Thus, the protection of the rights framework is a key responsibility of governments. Government-based instruments for corporate responsibility – such as the *OECD Guidelines for Multinational Enterprises* -- are also important channels for communicating with business.

**7.3 Does the government provide for an adequate framework to support the various types of disclosure companies make about their business activities? Is this framework flexible enough to meet the needs of investors and their stakeholders?**

Rules and guidance for financial reporting are already well developed in most countries (see also Chapter 6). The framework for non-financial reporting has emerged relatively recently and is still evolving. Several countries actively encourage non-financial reporting. As in any other area where investors need to respond to societal expectations, whether these are codified in laws and regulations or not, a healthy investment environment requires transparency and effective communication. Governments can enhance the quality of the investment environment by clearly communicating all relevant rules, guidelines, and expectations for both financial and non-financial disclosures. When disclosures are mandatory, governments need to ensure that the application and enforcement of these requirements is non-discriminatory. At the same time, governments should seek to avoid undue regulatory burdens and to allow innovation and adaptation to particular company circumstances to take place.

### 7.4 In what ways does the government assist companies with legal compliance?

Binding, effectively-enforced law motivates compliance in a particularly straightforward way – by creating costs for non-compliance (e.g. the costs of investigations, legal costs, fines, imprisonment and damage to reputation). Complying with law and other expectations can be a formidable management challenge, especially for companies that have thousands of employees and products and that straddle numerous legal jurisdictions and business cultures. Compliance in such companies requires the knowledge of specific business circumstances and deployment of significant managerial expertise and of formal management systems. Only companies have this knowledge and managerial capabilities – thus, they are indispensable partners in the broader system of economic regulation.

Governments can assist companies by seeking out companies' views on laws and enforcement practices, and by acknowledging and supporting private initiatives to enhance compliance. Law and regulatory enforcement agencies can provide guidance to companies on appropriate compliance practices and "reward" credible implementation of such practices by reducing fines paid by companies that appear to have made a genuine effort to avoid misconduct. [3]

### 7.5 How does the government through partnership and promotion help to strengthen the business case for responsible business conduct?

The 'business case' for responsible behaviour is often clear-cut. For example, environmentally-friendly production processes can decrease costs. Likewise, careful control of labour practices in supply chains can boost productivity at production sites and protect brand capital in consumer markets. The existence of a business case depends very much on particular circumstances (for example, the desire to protect brand capital would not be relevant for companies positioned in non-branded market segments). To the extent that the business case exists, private initiatives are self-enforcing (that is, government intervention is not required to make them happen).

Governments can act to reinforce the business case by promoting responsible companies and by lowering the costs of developing and adopting responsible practices, such as through support for industry initiatives and promotion of internationally accepted concepts and principles, such as those embodied in the *OECD Guidelines for Multinational Enterprises*. The numerous initiatives and experiences of governments at different levels of development aimed at developing closer partnerships with business on issues relating to the promotion of responsible business conduct provide a rich source of policy guidance.

### 7.6 How does the government, in its management of state-owned companies and through its business relations with private sector suppliers, ensure a level playing field for investors?

In some cases, issues of responsible business conduct fall directly on the shoulders of government. These include state-owned enterprises, where the government, acting on behalf of its citizens, is full or part owner of a company, and government procurement, where the government becomes a de facto partner of business.

The government responsibilities engaged in these cases tend to resemble closely the corporate responsibilities about which the *OECD Guidelines* provide recommendations. Through their stakes in state-owned companies, governments (like their private enterprise counterparts) face the challenges of

---

[3] In some cases, usually referred to as 'weak governance zones', governments are unable or unwilling to assume their law enforcement responsibilities. In these situations, the guidance provided in international instruments such as the OECD Guidelines for Multinational Enterprises are particularly valuable for companies.

tending to the interests of their citizens (the ultimate owners of the government stake in the company) as well as to the interests of other shareholders (for companies with mixed public/private ownership), employees, business partners and local communities. Likewise, through their purchasing and contracting they form partnerships with companies which can be used as a channel for promoting compliance with law and adherence to widely accepted international instruments (e.g. in anti-corruption, human rights).

### 7.7 Does the government participate in inter-governmental co-operation in order to promote international concepts and principles for responsible business conduct, such as the *OECD Guidelines for Multinational Enterprises*?

Multilateral instruments dealing with responsible business conduct communicate and promote concepts and principles for appropriate business conduct. Thirty-nine countries have committed to promoting responsible business conduct of their multinational enterprises -- wherever they operate in the world -- under the *OECD Guidelines for Multinational Enterprises*. The Guidelines draw on the broader framework of international declarations and conventions (e.g. the Universal Declaration of Human Rights, the International Labour Organisation's declarations and conventions). While the Guidelines recommendations are addressed to business, governments through their network of National Contact Points are responsible for promoting the Guidelines, handling enquiries and helping to resolve issues that arise in specific instances.

By promoting inter-governmental co-operation in this field, governments can help to broaden awareness of basic principles for appropriate conduct. Increased global acceptance of common principles for business conduct also helps to reduce the likelihood that observing appropriate corporate responsibility principles could become a competitive disadvantage for investors.

Further Policy Resources

- OECD, Guidelines for Multinational Enterprises: Revision 2000.
- OECD, Annual Report on the Guidelines for Multinational Enterprises (various years).
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD, Environment and the OECD Guidelines for Multinational Enterprises (2005)
- OECD, Corporate Responsibility: Private Initiatives, Public Goals (2001)
- OECD (forthcoming), Risk Management Tool for Investors in Weak Governance Zones.

## Annotations to Chapter 8. Human resource development

**8.1 Has the government established a coherent and comprehensive human resource development (HRD) policy framework consistent with its broader development and investment strategy and its implementation capacity? Is the HRD policy framework responsive to new economic developments and does it engage the main stakeholders? Are periodic assessments made of the impact of HRD policies on the investment environment?**

Human resource development has multiple dimensions, covering educational attainment, workforce skills, population health and the set of employment policies that connect people to business enterprises with appropriate skills and the ability to adapt quickly to new challenges. Each of these areas is a key driver in creating a favourable environment for investment. However, because they are all closely inter-related, HRD policies, and whether they are consistent with a country's broader development and investment policies (see Chapter 1), cannot be framed in isolation. It is important, therefore, to tackle low HRD through a coherent and comprehensive strategy that takes full account of the policy linkages and a country's implementation capacity. Special emphasis also needs to be attached to the flexibility of the policy framework to respond to the new skill needs created by changing technologies and economic structures. For this to happen, close co-operation between policy makers and the main stakeholders is needed.

**8.2 What steps has the government taken to increase participation in basic schooling and to improve the quality of instruction so as to leverage human resource assets to attract and to seize investment opportunities?**

There is a consensus that education at the primary and lower secondary levels are the minimum necessary to attract investment and ultimately to boost economic development. Formal educational attainment also provides the foundations for further learning and safeguards the capacity to seize future investment opportunities. Despite positive trends in school enrolment, many countries under invest in human capital, due in part to a range of market failures and poverty. In these circumstances, without policy intervention, investment in early childhood, primary and lower secondary education will be sub optimal, feeding under-skilled workers into the labour market, disconnected with the requirements of business.

**8.3 Is the economic incentive to invest in human capital sufficient to encourage individuals to continue higher education, supporting the improvement in the investment environment that flows from better human resources? What measures are being taken to ensure the full benefit of a countries' investment in its own human resources accrues, including the attraction of nationals who have completed their studies abroad? What mechanisms exist to promote closer co-operation between education institutions and business and to anticipate future labour force skill requirements?**

Higher secondary and tertiary educated workers are essential to help secure the full benefits of business investment. In contrast with basic education, graduates are usually able to internalise the benefits in the form of a higher wage. However, there is a danger that the benefits to society and to the local business community are forfeited to the extent that skilled workers permanently emigrate. This risk is greater in small-sized economies than in the larger ones, where return migration is common. One way to lower the incentive for skilled workers to migrate and to reap the full benefit of a countries' investment in its own human resources is to pay attention to the size of the financial returns from higher education. Labour market policies that result in compressed wage structures and costly graduate programmes in terms of time taken and tuition fees can unduly crimp the size of the financial returns that subsequently accrue. More generally, a better business environment lifts the financial returns to investing in education and favours return migration.

Higher education institutions themselves play a key role in equipping youngsters with the workforce skills needed by business. But these needs change quickly and often learning institutions are slow to respond. In this regard, stronger links between universities, businesses, trade unions and other stakeholders can help reshape course offerings to stay closely in line with evolving demands for specific skills. Co-operation can also bring other benefits favouring the investment environment, such as fostering an environment conducive to innovation and the quick diffusion of new knowledge.

### 8.4 To what extent does the government promote training programmes and has it adopted practices that evaluate their effectiveness and their impact on the investment environment? What mechanisms are used to encourage businesses to offer training to employees and to play a larger role in co-financing training?

While formal education equips individuals with the skills needed to learn, new recruits tend to lack the firm-specific knowledge that businesses require to unlock an employees full productive potential. Transmitting these firm-specific skills is the domain of on-the-job training and specialized off-site training. However, as with basic education, market failures lead to too little training by businesses and the limited training that is undertaken is often concentrated within a narrow group of individuals. The shortage of trained workers is thus an obstacle to expanding investment and makes it particularly hard to attract high-skill intensive industries. The macroeconomic costs in terms of lost potential output can also be sizeable, given the productivity gains linked to training and because of the positive spillovers that multinational enterprises transmit to local firms. Policy instruments to support training are many and include co-financing arrangements, tax incentive schemes and subsidies. Evaluations of these instruments are likely to be country specific. What is important from the investment environment perspective is to ensure stable training programmes that are in line with business requirements and coupled with evaluations to favour those schemes with a proven track record of high rates of return.

### 8.5 Does the government have a coherent strategy to tackle the spread of pandemic diseases and procedures to evaluate public health expenditures aimed at improving public health outcomes and, through inter-linkages, the investment environment?

Pandemic diseases are a human tragedy, ravaging societies through the premature loss of lives and entrapping many others in poverty. They negatively influence investment decisions too, risking a vicious cycle between poor health, lower investment, job creation and entrepreneurship and hence slower economic growth. However, the links between health, education and economic growth can equally work in a virtuous way. Apart from the human gains, better population health raises the ability and the incentive to invest in education, and promotes investment, because of the effect of good health on worker productivity and because foreign businesses tend to avoid sending expatriate employees into areas where their health could be damaged and where access to health care is limited. Designing the policies with limited resources that favour a virtuous cycle between health, investment and sustainable development is hard to get right. The lessons that have been drawn from successful experiences underscore the importance of a coherent and comprehensive package of policies. There is also a need for regular evaluations of public health programmes to assess their effectiveness, since what works well in one country may not always be the case in a different country.

### 8.6 What mechanisms are being put in place to ensure enforcement of core labour standards?

Core labour standards relate to fundamental principles and basic human rights in the workforce and are distinct from labour standards regarding work conditions and employment protection laws. Specifically, they aim to eliminate all forms of forced or compulsory labour, to abolish child labour, to uphold the principle of non-discrimination in respect of employment and occupation and to ensure the freedom of association and the right to collective bargaining. These core labour standards are a key element in the healthy functioning of market economies, create a level playing field for all investors, foreign and domestic and improve economic performance, in part because they sharpen the incentive for workers to improve skills and to the younger generation to accumulate human capital. Most countries have ratified the ILO core labour standard conventions, but compliance with and enforcement of the standards is uneven across countries. In some cases, such as within special export processing zones, governments deliberately waive components of the core labour standards for fear that their presence may deter investment. However, there is no unequivocal empirical support for this concern. Indeed, multinational enterprises are more likely to invest in countries with stricter safeguards and enforcement of basic human and worker rights than in those countries where such rights are absent or poorly enforced. In short, there is a need to raise awareness of the problems associated with low compliance with the core labour standards, to reinforce efforts to improve enforcement and compliance with them and to promote tools that foster responsible business practices, such as the *OECD Guidelines for Multinational Enterprises*.

### 8.7 To what extent do labour market regulations support job creation and the government's investment attraction strategy? What initiatives have been introduced that support policy coordination, balancing social objectives, the goal of a competitive workforce and the incentives for business to invest?

Interventions in the labour market aim to improve market efficiency and achieve social objectives. From an investment environment perspective the issue is how well such interventions achieve their goals without compromising other determinants of economic performance. Badly designed labour market regulations can reduce the opportunities and incentives for businesses to make new investments and expand. There are two main areas of intervention where governments face a trade-off between promoting social goals and the government's investment attraction strategy. The first relates to wage formation institutions that result in labour costs which are too high to spur job creation, and in underutilised labour resources, preventing economies from making full benefit from its investments in HRD. The second source of trade-off relates to interventions that escalate non-wage labour costs, which employers are unable to pass on to employees through lower monetary remuneration, making some businesses economically unviable. Better policy design can, however, help to limit the size of the tradeoffs and in some cases meet both social objectives and support the government's investment attraction strategy.

### 8.8 Do laws and regulations restrict the deployment of skilled workers from an enterprise investing in the host country? What steps have been taken to unwind unduly restrictive practices covering the deployment of workers from the investing enterprise and to reduce delays in granting work visas?

Foreign investment often requires the deployment of experienced staff from more established parts of the organisation to ensure the smooth introduction of new facilities and the local implementation of corporate practices. Some countries, however, put tight limits on the number of foreign employees granted work visas, and frequently bureaucratic processes cause long delays in issuing work permits. These practices raise the cost of doing business and can discourage investment. As well as harming the investment environment, the country loses the opportunity of hosting skilled workers – a 'brain gain' – and the local diffusion of knowledge and international business practices that it brings. Evaluations of the costs and benefits of the policies that govern the deployment of skilled workers from an enterprise investing in the host country should take into account these broader economic considerations.

**8.9 Does the government support programmes designed to assist large-scale labour adjustment and indirectly the investment environment by better positioning firms to seize new investment opportunities? Do the incentive mechanisms in these schemes encourage broad support for change? What role is business encouraged to play in easing the transition costs associated with labour adjustment?**

Every economy is prone to upheaval, often linked to new technologies that lead to different work practices, opening fresh business opportunities and making others no longer viable. It is this process of 'creative destruction' that leads to higher economic output, and those firms that are able to adapt their operations quickly are better placed to face new competition and to expand. The capacity to adjust quickly is thus a factor in the overall business environment. The transition period, however, can be a costly and traumatic experience for those employees affected, especially in countries that have inadequate or non-existent social insurance mechanisms. This can cause resistance to change and, because of factors such as rent seeking by interest groups, influence political processes to stall reforms that would otherwise benefit society as a whole. The recommendations and mechanisms for dialogue of the *OECD Guidelines for Multinational Enterprises* concerning employment and industrial relations offer a tool that governments and businesses can use to build support for change (see also the chapter on Policies for promoting responsible business conduct). Governments can also limit the dislocation costs by providing support for retraining and redeployment initiatives and policies that encourage businesses to engage themselves in easing the transition costs associated with labour adjustment.

**8.10 What steps are being taken to ensure that labour market regulations support an adaptable workforce and maintain the ability of enterprises to modify their operations and investment planning?**

Investments in HRD help to maintain an adaptable and skilled workforce. However, this source of dynamism may fail to benefit the business environment if other interventions in the labour market create a context that blunts the process of workforce reorganisation. Innovative approaches to maintain labour market dynamism while also providing workers with adequate security exist. These include making the cost of job protection more predictable, for instance by reducing the complexity of legal procedures in the event of job redundancy. Another approach is to shift the focus of interventions away from protecting the job and toward income support, coupled with re-employment services – 'flexi-security' –, though implementation in a developing country perspective is a major challenge.

Further Policy Resources

- FIAS, Investment Climate Surveys Database (http://rru.worldbank.org/InvestmentClimate/).
- International Labour Organization (ILO) Conventions (http://www.ilo.org/).
- ILO, Declaration on Fundamental Principles and Rights at Work (1998) (http://www.ilo.org/dyn/declaris/declarationweb.indexpage).
- OECD, Declaration on International Investment and Multinational Enterprises.
- United Nations Development Programme (UNDP), The National Human Development Report (NHDR) Workspace (http://hdr.undp.org/nhdr/).
- United Nations Educational, Scientific and Cultural Organization (UNESCO), instruments and other policy resources, (www.unesco.org).
- World Health Organisation research tools available at: http://www.who.int/research/en/ .
- World Bank, Doing Business database (http://www.doingbusiness.org/).

## Annotations to Chapter 9. Infrastructure and financial services

**9.1 What processes does the government use to evaluate its infrastructure investment needs? Does the government have clear guidelines and transparent procedures for the disbursement of public monies funding infrastructure projects? Are the regulatory agencies that oversee infrastructure investment and the operations of enterprises with infrastructure investments independent from undue political interference? How does the government decide which state-owned infrastructure agencies should operate on a commercial basis?**

Good infrastructure attracts investment by connecting firms to their customers and suppliers, in effect enlarging the size of the market. It also enables businesses to specialise and take advantage of modern production techniques and organisational structures. Decisions on how much, where and what kind of infrastructure to build are politically charged issues. This reflects the fact that traditionally governments have built, owned and managed infrastructure capital and because infrastructure is vital to economic development and more broadly to societies. Governments thus need procedures to decide how much to spend on infrastructure, how to allocate spending, including among different transport infrastructure modes and how to administer it. This requires a capability to undertake cost-benefit analyses, financial reporting, sound decision-making processes that give weight to the results of cost-benefit analyses, while allowing a socially acceptable balancing of competing interests and efficient agencies for maintaining and delivering new infrastructure investments. Traditionally, governments organised these functions through ministries. Experience has shown, however, that infrastructure investment performance and delivery has improved if government infrastructure agencies are given managerial independence and made accountable for their performance. (These issues are treated in more detail in the chapter on Public Governance.) Some governments have taken extra steps, such as making the state-owned agency subject to company law, appointing directors with commercial experience, and requiring the agency to prepare audited financial reports according to high-quality accounting standards. (See also the chapter on Corporate Governance.)

Even expected high return infrastructure projects may fail to get started due to limited public finances. Private investors can ease the call on public funds to finance a country's infrastructure maintenance and development. Governments can also delegate the management of infrastructure projects to private investors. To reap efficiency gains via these techniques and to attract private investors the disbursement of public funds needs to be based on clear guidelines, managed transparently and with procedural fairness for all investors to help ensure a level playing field. Well developed and functioning financial markets also support the expansion of infrastructure investment (questions 9.7 and 9.8 consider selected aspects of financial market development policies).

**9.2 What measures has the government adopted to uphold the principle of procedural fairness for investors bidding for infrastructure contracts, to protect investors' rights from unilateral changes to contract terms and conditions, and have provisions been established allowing disputes to be settled through domestic or international arbitration? What steps have been taken to attract investors to supply infrastructure at fair and reasonable prices and to maintain public support for private involvement in the provision of infrastructure services?**

Infrastructure provision is characterised by long-lived immobile investments and large economies of scale. Once built, a road or hydroelectric dam cannot sensibly be dismantled and moved elsewhere, and it rarely makes sense to have two competing roads between the two same points. In these circumstances, investors in infrastructure are vulnerable to changes in government regulations that undermine their profitability, and consumers of infrastructure services are exposed to the potential abuse of market power in infrastructure networks. Such a situation risks compromising public support for private investor involvement in infrastructure and private investors themselves may be discouraged from engaging in the supply of infrastructure services. Against this background, it helps to pre-establish in contracts regulator (representing users) and infrastructure investor rights. Allowing disputes to be heard by domestic or international arbitration and independent regulatory agencies can also help to allay concerns about posterior government decisions that impinge on the economic viability of infrastructure investment. By reducing the risks faced by infrastructure providers, the returns that investors require to go forward with infrastructure investment are lowered. This is likely to help to raise private investment in infrastructure, offering services at competitive prices and to maintain public support for private investor involvement in the provision of infrastructure services.

**9.3 In the telecommunications sector, does the government assess market access for potential investors and the extent of competition among operators? Does the government evaluate whether telecommunication pricing policies are competitive, favouring investment in industries that depend on reliable and affordable telecommunications?**

Modern telecommunications are vital to the investment environment. They enable firms to communicate rapidly and cheaply with distant suppliers and customers, improving productivity. In particular, they underpin many service sectors, such as the financial, insurance and transportation markets. As the relative importance of the service sectors is rising, access to competitive, high quality telecommunication services has become, and will continue to be an important element of the investment environment. Overall, the cost of telecommunication services has dropped sharply over the past two decades, driven by technological advances and regulatory reforms. However, progress has been uneven across countries, as well as within countries. With the fast pace and regime changing nature of innovations in the telecommunications sector, governments need to regularly and impartially evaluate the continued relevance and impacts of their regulatory arrangements on communication services and prices. In particular, communication providers are no longer natural monopolies, and with the advent of cellular telephony, investments are less immobile. These developments reduce the policy-related risks of investment in the communication sector and raise the scope to inject greater competition among operators. (See also the chapter on Competition Policy.)

**9.4 Has the government developed a strategy to ensure reliable access to electricity services by users, and economic incentives to invest and supply electricity? What programmes exist to ensure on a least-cost basis access to electricity services by a wide range of users? Are these programmes time-bound and based upon clear performance targets?**

Access to a reliable electricity supply at a reasonable price is vital for firms. When electricity services are characterised by temporary losses of supply and fluctuations in voltage that damage machinery, firms tend to rely on self-supply, which is generally more expensive than a regular supply from a utility. Some estimates put the cost borne by users at equivalent to 5 per cent of annual sales. Poor electricity supply thus makes existing investments less productive and discourages new investment. Part of the reason for under investment in electricity infrastructure is lack of an economic incentive. Where governments have introduced reforms to tariff structures and allowed new entry, investment in the electricity infrastructure has generally followed. But competitive market prices may mean for some users and in some locations that prices charged are no longer affordable. In these circumstances and when governments aim to ensure access to the electricity network at affordable prices as a social goal, programmes based on instruments that maintain an economic incentive to invest in electricity supply and achieve their objective at least cost are preferable.

**9.5 What processes are followed to inform decisions on the development of new transport facilities, as well as the maintenance of existing investment in transport infrastructure? Are the requirements for all modes of transport regularly reviewed, taking into consideration investor needs and the links between different modes of transport infrastructure?**

Transport infrastructure creates opportunities for firms to buy and sell in different markets and is a driver of globalisation. With barriers to international trade falling and cross border commerce growing (see chapter on Trade Policy), the importance of an efficient transport infrastructure to attract investors is increasing. Further, lower international transport costs would itself spur trade, providing a stimulus to investment in other sectors. Reducing transport costs requires paying attention to all transport modes and the linkages among the modes. Ports and airports, for example, are more valuable when served by good roads and railways. Transport costs are also affected by indirect factors, such as whether telecommunications systems allow companies to track their goods in transit and how quickly goods are cleared through customs. In addition to developing new transportation links and services, maintenance of existing facilities is needed to ensure they continue to function properly. Frequently, however, countries allocate funds for new projects and neglect the upkeep of previous transport infrastructure investments. While there is no simple approach to address this imbalance, making decision processes more transparent by publishing and communicating the principles used to allocate funds can help to better reveal the opportunity cost of the options and choices made.

**9.6 Has the government evaluated the investment needs in water required to support its development goals? To what extent is the private sector involved in water management, supply and infrastructure financing?**

Fresh water supplies and sanitation are a key infrastructure resource. Water is essential for a healthy population, is an input used in many businesses and the water industry itself requires large investments. Yet large parts of the world are under-provided in this area and long-term projections identify large needs for water infrastructure investments to meet the growth in demands from agriculture, business and households. Private sector provision of water is limited in many countries and where governments have pursued projects with private participation, these schemes have often met resistance to set water tariffs at commercial rates. As a result, private water projects are prone to contract disputes, with many water supply contracts subsequently renegotiated. While renegotiations do not necessarily indicate systematic problems or project failures, they do raise questions about the appropriate modalities for private participation in water, particularly in concessions with significant investment commitments. Shifting the financing burden of water infrastructure services from taxpayers to users would reduce water demand and hence investment needs, help to put the sector on a more financially sustainable basis, promote better governance by increasing the demands for accountability and help to support the creation of public-private partnerships to finance water infrastructure investments.

**9.7 How has the government sought to attract private investment in the development of the financial services sector, offering a wide range of products to a broad cross-section of enterprises? What steps has the government taken to remove obstacles, including restrictions on participation by foreign institutions, to new investors entering the financial sector? To what extent do the authorities take advantage of information sharing and other international co-operative arrangements to facilitate adequate supervision of foreign financial institutions operating in the country?**

Developed financial markets provide payment services, mobilize savings, and allocate financing to firms wishing to invest. When these markets work well, they give firms the ability to seize promising investment opportunities, especially small and innovative enterprises and entrepreneurs that need external funding to expand and develop their business ideas. Well-functioning financial markets also impose discipline on firms to perform, boosting efficiency, both directly and by facilitating new entry into product markets. They also enable firms and households to manage better risks. Based on experience, the key factors that support the development of sophisticated financial markets include macroeconomic stability; competition in financial services, including from foreign enterprises (see the chapter on Competition Policy); secure rights of borrowers, creditors, and shareholders; the flow of information; and prudential oversight of risk taking. A large, vibrant and competitive financial sector also carries risks in terms of systemic instability, with consequences for macroeconomic and investment performance. These risks need to be managed in a way that does not shrink financial intermediation.

**9.8 What laws and regulations are in place to protect the rights of borrowers and creditors and are these rights adequately balanced? Is a registry system in place to support the use of property as collateral and to expand business access to external sources of credit? What data protection and credit reporting laws have been enacted to facilitate the flow of information and improve financial sector stability, thereby enhancing the investment environment?**

Governments can support the development of financial markets by ensuring that borrowers and creditors have clearly defined rights and can enforce them. A strong legal environment and enforcement capabilities are especially important for access to external finance, a source that is often difficult for new, small, and medium enterprises to tap. But rights need to be well balanced. When creditor rights are weak, financial intermediaries will be less willing to extend credit to firms and when shareholder rights are weak, investors will be less willing to extend equity finance. Well-defined property ownership rights that investors can pledge as collateral also increase access to finance, allow firms to borrow on a longer-term basis and at a lower cost. Property registry systems can thus serve a useful role in the development of financial intermediation and help to boost investment activity. Better and more information flows also help. But collecting information can be costly and expensive to interpret. Often specialised agencies, such as credit bureaus can collect information on creditors and their risk profile more cost effectively than the financial institutions themselves. Governments can create a supportive environment for creditor information collection by enacting and enforcing data protection and credit reporting laws that allow the sharing of information, while protecting consumer rights. Prudential authorities also need to collect information from financial institutions to monitor, evaluate and respond to risks of systemic crises in the financial sector damaging the investment environment. Given the close integration of financial intermediaries in global capital markets, performing these functions will likely require that the home country supervisory and prudential authorities be prepared to enable information exchange arrangements with their counterparts in the host country.

Further Policy Resources

- FIAS, Investment Climate Surveys Database (http://rru.worldbank.org/InvestmentClimate/).
- FIAS, Private Sector Toolkits (http://rru.worldbank.org/Toolkits/).
- International Finance Corporation (IFC) (http://www.ifc.org/).
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD (2001), Recommendation of the Council Concerning Structural Separation in Regulated Industries.
- World Bank, Doing Business database (http://www.doingbusiness.org/).

## Annotations to Chapter 10. Public governance

### 10.1 Has the government established a coherent and comprehensive regulatory reform framework, consistent with its broader development and investment strategy?

Regulatory policy is about the process by which regulations are drafted, updated, implemented and enforced. Nothing contributes more to investor scepticism about regulation than regulatory failures: the impression that rules respond to special interest pressures, and the recognition that rules do not achieve their objectives. The quality of public services, which is shaped by regulation inside government as well as regulation for private-sector providers, thus has a significant influence on the climate for business and investment. As markets become more open, the need for well-designed regulatory institutions is likely to rise, with special attention to the proper sequencing of regulatory reforms. From an investors' perspective, regulatory policy should preferably take the form of a statement setting out principles that provide strong guidance and benchmarks for action by officials, and what the investors can expect from government regarding regulation.

### 10.2 What mechanisms are in place for managing and co-ordinating regulatory reform across different levels of government to ensure consistency and a transparent application of regulations?

Diversity in institutional systems and institutional traditions influences the design of regulatory policy. Nevertheless, during the regulatory process, the need for some form of central mechanism to promote coherent and consistent regulatory quality appears to be essential. In this context, an oversight body that works as an "engine of reform" can help to focus the interest of investors in support of regulatory quality development. To avoid duplications and contradictions, all appropriate official bodies should be informed and consulted when preparing a new measure or planning a reform. In highly integrated economies, this process may require an understanding of the regulatory practices and policies in other jurisdictions. Further, quality regulation that enhances the investment environment needs a strong involvement and a sense of "ownership" by regulators responsible for their design and implementation. Special interests, close identification with the objectives of outdated regulation, countervailing pressures from different parts of society, and coherence when applying regulations and regimes across multiple areas, are challenges for regulatory institutions.

### 10.3 To what extent are regulatory impact assessments used to evaluate the consequences of economic regulations on the investment environment?

Regulatory Impact Assessments (RIA) examine and measure the likely benefits, costs and effects of new or changed regulations. It is a tool that provides decision-makers with quantitative data and a framework in which they can assess their options and the likely economic consequences of their decisions. A poor understanding of the problems at hand, or of the side effects of government action can undermine regulatory efforts and result in regulatory failures. RIA is used to identify problems and to ensure that government action is justified and appropriate in economic, social and environmental terms. Many countries rely on RIAs to avoid regulations that impose unnecessary restrictions on investment. Although the RIA process is not explicitly conceived in terms of market openness considerations, it provides a systematic approach for assessing the impacts of a proposed regulation and helps inform regulatory decision-making. Where appropriate, therefore, the investment impacts of a regulatory reform proposal would normally be assessed in the context of all other relevant factors. In the absence of a broader requirement to assess the impacts of a proposed regulation on market openness (or indeed an explicit requirement to select a regulatory approach based on market openness considerations), RIAs offer a potentially useful tool for considering the impacts of regulation on investment decisions.

**10.4 What public consultation mechanisms and procedures, including prior notification, have been established to improve regulatory quality, thereby enhancing the investment environment? Are the consultation mechanisms open to all concerned stakeholders?**

Regulations should be developed in an open and transparent fashion, with appropriate procedures for effective and timely inputs from interested national and foreign parties. This should include potential domestic and foreign investors as well as affected business, trade unions, other civil society, wider interest groups and other levels of government. The way comments from interested parties are handled by government enhances the credibility of the process and the prospects of regulatory compliance by the economic actors. Consultation helps to ensure that the affected parties understand the nature of new regulations, why it is needed and what is expected of them. Inadequate consultation may result in poor quality regulation and/or uncertainty among businesses and investors about how they will be affected. This is likely to deter new investment as potential investors seek out opportunities where there is more regulatory certainty and quality.

**10.5 To what extent are the administrative burdens on investors measured and quantified? What government procedures exist to identify and to reduce unnecessary administrative burdens, including those on investors? How widely are information and communication technologies used to promote administrative simplification, quality services, transparency and accountability?**

Administrative simplification is the most commonly used regulatory reform tool. It is aimed at reducing and streamlining government formalities and paperwork – the most visible component of which is often permits and licences. There is evidence in many countries that the administrative burden imposed on businesses is significant, with small to medium size enterprises particularly affected. It is also important to consider the cumulative effect of all the regulations to which enterprises are subject, not just those that have been introduced recently. Increasingly, governments are making use of information and communication technologies as a means of reducing administrative burdens and 'red tape'. Excessive 'red tape' adds to business costs, can impede market entry and lower competitive pressures (also see the chapter on Competition Policy) and reduces the incentive to innovate. In addition, it creates uncertainty that can disrupt business planning and hinder the ability of businesses to respond quickly to new market opportunities. Ultimately, this discourages new investment, both domestic and foreign and weakens economic performance.

**10.6 To what extent have international anti-corruption and integrity standards been implemented in national legislation and regulations? Do penal, administrative and civil law provisions provide a consistent legislative and regulatory framework for fighting corruption as well as promoting integrity, thereby reducing uncertainty and improving business conditions for all investors?**

Anti-corruption and integrity standards include both preventive and repressive measures. Governments should enact provisions, mostly in criminal law, but also in the civil and administrative codes, to prevent and sanction corruption of domestic public officials.

Over the last decade, many governments have developed standards of conduct to address conflicts between public officials' private interests and their public duties. Governments originally focussed on traditional sources of influence, such as gifts or hospitality offered to public officials, and personal or family relationships. Due to the increased co-operation between the public and private sectors, many countries have also established in recent years standards of conduct for tackling other forms of conflict-of-interest, such as business interests (e.g. in the form of partnerships, shareholdings), affiliations with other organisations and post-public employment. In order to address risks to good governance arising from conflicts of interest, the OECD has developed a framework for reviewing and modernising a country's conflict-of-interest policy with the 2003 Recommendation on Guidelines for Managing Conflict of Interest in the Public Service, as well as a Toolkit to help public officials put them into practice.

### 10.7 Do institutions and procedures ensure effective and consistent application and enforcement of laws and regulations on anti-corruption and integrity in the public service? Have standards of conduct by public officials been established and what measures are used to assist public officials to meet the expected standards? What role do civil society organisations and the media play in favouring the open scrutiny of the conduct of public officials' duties?

Application and enforcement of laws and regulations on anti-corruption and integrity involves many public institutions. Agency specific guidelines and practical measures (e.g. staff rotation, specific training or briefing etc.) may need to be developed to enforce anti-corruption and integrity standards in parts of the public service that are particularly exposed to corruption. Specific risk areas include law enforcement, public procurement, export credit, development assistance as well as customs and tax administration.

Codes of conduct are often developed to provide standards of conduct in a single concise document. These should be made available and adequately communicated to all public officials. Socialisation mechanisms such as training and counselling further raise awareness among employees and help develop their skills for meeting expected integrity standards in daily practice. In addition, human resource management policies should provide suitable conditions and incentives for public officials, such as basing recruitment and promotion on merit, providing an adequate remuneration and taking ethical considerations into account in recruitment and performance appraisal.

Reporting suspicion of misconduct by public officials can be either required by law and/or facilitated by organisational rules. Whistle blowing, the act of raising concerns about misconduct within an organisation, is a key element of good governance to ensure transparency and accountability. A range of institutions and procedures such as Ombudsman, Inspector General, complaint procedures and help desks or telephone lines could enable public officials and citizens to expose wrongdoing. Their effectiveness also depends on public confidence that people who make bona fide reports about wrongdoing receive proper protection.

### 10.8 Do review mechanisms exist to assess the performance of laws and regulations on anti-corruption and integrity?

Solid and independent review is essential to help ensure enforcement of laws and regulations on anti-corruption and integrity. In general, the legislative branch undertakes reviews of public service activities. Other common types of evaluation range from external independent investigation by the Ombudsman or the Inspector General to specific judicial or ethics reviews. In addition, monitoring compliance may be based on internal controls, widely used to detect individual irregularities and systemic failures and is likely to be accompanied by independent scrutiny. This scrutiny keeps public officials accountable for their actions, ultimately, to the public.

Transparency in government operations is considered both as an instrument for ensuring accountability and combating corruption, and for promoting democratic participation by informing and involving citizens. In recent years, citizens' access to official information has significantly improved, in particular with the development of Freedom of Information legislation and the growing use of electronic procedures. Coupled with an increasingly active media and well-organised interest groups, this has led to more vigilant public scrutiny over public officials' behaviours.

**10.9 Is the government a party to international initiatives aimed at fighting corruption and improving public sector integrity? What mechanisms are in place to ensure timely and effective implementation of anti-corruption conventions? Do these mechanisms monitor the application and enforcement of the anti-corruption laws implementing the conventions?**

Governments have realised that corruption cannot be addressed at the domestic level alone. Only concerted, internationally coordinated action can make a meaningful contribution to stamping out corruption. Governments have consequently adopted a number of international and regional anti-corruption instruments. Although these instruments may have different focuses, they generally aim at ensuring a holistic approach that encompasses preventive measures as well as repressive provisions to fight domestic and foreign corruption. Moreover, they contain provisions regarding mutual legal assistance, which is a major obstacle in the fight against corruption.

There is also a role for international co-operation in the fight against corruption. For example, the OECD Convention of Combating Bribery of Foreign Public Officials in International Business Transactions aims to stop the flow of bribes to public officials in host countries. Other intergovernmental organisations such as the United Nations, the World Bank, the Asian Development Bank and the International Monetary Fund have likewise developed policies aimed at fostering good governance and sanctioning corruption and related malpractices.

Further Policy Resources

- APEC Principles to Enhance Competition and Regulatory Reform (1997).
- APEC-OECD Integrated Checklist on Regulatory Reform: Addressing Regulatory, Competition Policy, and Market Openness Policy Issues.
- OECD (2005), Modernising Government: The Way Forward.
- OECD (2003), A Framework for Investment Policy Transparency.
- OECD, DAC Draft Ten Principles of Good International Engagement in Fragile States.
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD (2004), DAC Guidelines: Security System Reform and Governance: Policy and Good Practice.
- OECD (2001), OECD Best Practices for Budget Transparency.
- OECD (1997), OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.
- OECD (2003), OECD Guidelines for Managing Conflict of Interest in the Public Service.
- OECD (2005), OECD Guiding Principles for Regulatory Quality and Performance.
- United Nations Convention against Corruption (UNCAC) (2003).
- OECD (1998), OECD Recommendation on Improving Ethical Conduct in the Public Service.