NEPAD-OECD AFRICA INVESTMENT INITIATIVE ROUNDTABLE

About the PFI Toolkit and an example of the Policy Guidance

OECD Directorate for Financial and Enterprise Affairs, Investment Division

Background note for the Regional Roundtable on
Strengthening Investment Climate Assessment and Reform in NEPAD Countries

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NOTE TO READER

The Policy Framework for Investment (PFI) is an instrument to help governments to increase competitiveness and investment through the design and implementation of government policies that improve the business climate.

The PFI was developed by a task force of officials from 60 OECD and non-member governments in association with some ten OECD Committees and Working Groups. The PFI was endorsed by OECD ministers in 2006, and they called on the OECD to continue to work with non-member governments and other inter-governmental organisations to promote its active use. The G-8 2007 Heiligendamm Summit Declaration also welcomed the PFI as a *valuable mechanism in defining a shared understanding of healthy investment climates* and invited the OECD, UNCTAD and other organizations such as the World Bank to use the PFI.

The PFI Users Toolkit project is in response to a need for specific and practical implementation guidance revealed from the experience of the countries that have already piloted, or plan to pilot using the PFI. It is a project currently under development that is to involve government users, co-operation with other organizations and expertise from OECD Committees. Development of the Toolkit will involve a process, starting in 2008 of vetting and testing the guidance and resources provided among users, experts in the policy areas covered by the PFI and interested stakeholders.

Against this background, this note provides readers with information on the purpose and planned structure of the Toolkit, the process for its development and how the Toolkit relates to the PFI itself. It also offers an initial draft of an example of the policy guidance the Toolkit will provide to users.

Given the planned process for the development of the PFI Users Toolkit, this note by the OECD Secretariat should be seen as work in progress.

The text of the Policy Framework for Investment and more information on the PFI can be accessed at: www.oecd.org/daf/investment/pfi.

ABOUT THE TOOLKIT

(First Draft)

Introduction

Investment is a key driver of economic growth and poverty reduction. Countries and regions with strong policies for investment mobilize capital. Yet in many economies, there are substantial impediments to investment. These impediments to investment come in many guises. But they have one thing in common: they are the unintended result of government policy or, in some cases, the lack of it. This Toolkit outlines a process and guidance for governments using the PFI - the most comprehensive multilaterally backed approach to date for improving investment conditions – to increase competitiveness and investment through the design and implementation of government policies to improve the business climate.

A sound investment climate is not an end in itself, however. This Toolkit explains how and why governments can benefit from using the PFI, and makes clear the economic consequences for investment of existing government policies, laws and regulations. The PFI and this Users Toolkit do not, however, prescribe what the policies for investment should be, because prescriptive policies depend heavily on the country or region's economic circumstances and institutional capabilities; "one size does not fit all". Rather, it is through the process of using the PFI, learning from good practices and the experience of others that a government's preferred investment-climate reform policies and the strategy for their implementation emerges.

What is the purpose of this Toolkit?

The specific purpose of this Toolkit is to offer PFI users detailed guidance, which enables an analysis of where progress is most advanced and where the most significant investment bottlenecks lie and thus the priorities for reform, how to design policy practices which minimise trade-offs and take into account the impact of policy decisions on investment conditions, and the wider national interest and a menu of methodologies for measuring progress in improving investment conditions.

What makes this Toolkit different?

To understand how this Toolkit is different from others, it is first necessary to appreciate how the PFI differs from other instruments designed to improve the investment environment. It does so in three important ways:

- First, its scope is not limited to foreign direct investment. Over ¾ of the PFI questions are relevant to both foreign and domestic investment.

- Second, the PFI is unique by its comprehensive approach to investment conditions and because it focuses on the interactions and linkages between policy areas, i.e. policy coherence. For example, it is possible that changing one aspect of, say trade policy could worsen the overall investment climate, yet changing at the same time those aspects that interact with other policy fields, like competition policy could improve investment conditions substantially.

- Third, the PFI recognizes that putting in place a sound investment climate is not a one-off event where the obstacles to investment are identified and remedied. Structural shifts, such as new technologies, or changes in other policy settings, including in other countries will frequently bear on the investment climate in ways that are not always anticipated. And sometimes these changes will have implications on policies for investment, necessitating the adoption of different policy practices and regulatory reform. Investment climate reform is a process of continuous improvement and the emphasis in the PFI is on policy governance.

These characteristics create several challenges for using the PFI effectively. For example, the PFI does not examine how to deal with trade-offs, or guide which issues deserve priority. Nor does it explain how to put in place a structured process in order to elicit where the binding impediments to investment lie and how to appraise their economic significance. The Toolkit has been especially designed so that PFI users can manage these challenges. It complements existing specialized diagnostic and capacity building resources in policy areas such as competition, taxation etc.

The Toolkit is divided into four parts:

- *About the Toolkit* overviews the purpose of the Toolkit, its scope, structure and how to use it;

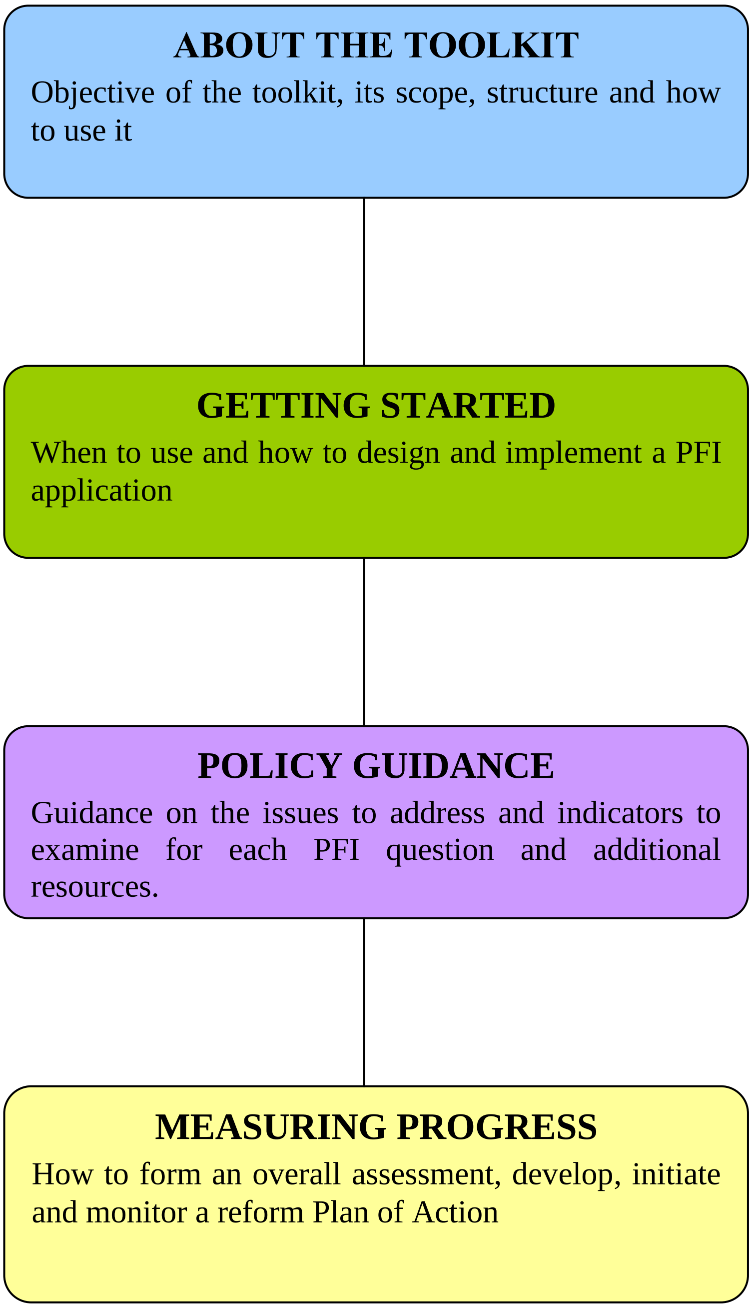
- *Getting Started* explains the rationale for using the PFI, describes the benefits that result from its PFI, elucidates the ways in which the PFI can be implemented and how to choose between these options, explains the PFI's analytical framework and core principles and outlines the key steps in devising a process for using the PFI;

- *Policy Guidance* offers specific guidance for each of the policy chapters of the PFI on what constitutes good practices, explains how policies, laws and regulations influence investor decisions and identifies the circumstances and the information the PFI user needs to scrutinize in order to make an assessment of how a country performs vis-à-vis good practice. It also provides users with links to websites and references to a wealth of additional information and tools and resources that offer more in-depth policy guidance on specific issues; and

- *Measuring Progress* sets out a menu of methodologies on how to interpret and analyse the facts and information collected from the *Policy Guidance* part of this Toolkit to form an assessment of a country's strengths and weaknesses in its investment climate and thus pinpoint the investment climate policy reform priorities, to benchmark performance and to measure progress.

The Figure below illustrates this structure at a glance. For a detailed sitemap of the various sections available in this Toolkit, see the Contents page.

The PFI Users Toolkit At-A-Glance



Who will find this Toolkit useful?

The PFI is a flexible instrument and this Toolkit has, therefore, been designed to meet the needs of multiple PFI applications. These applications may, for instance, include:

- In depth self-assessments of a country or region's policies for investment, co-ordinated from the centre of government, i.e. cabinet office, Prime Ministers department, and Finance and Economics ministries;

- Peer reviews of a country's investment climate at the national or regional level; and

- Examination of how policy practices in a selected area bear on the investment climate. For example, the relationship between the design of regulatory policies and their impact on business investment decisions.

- Thematic-based investment climate assessments. For instance, an evaluation of the investment conditions specific to mobilizing investment by SMEs.

This Toolkit furthermore provides a platform for stakeholder organizations using the PFI to engage and contribute to policy dialogues related to investment climate reform and private sector development. These stakeholders may, for instance, include business organizations, NGOs, trade unions and the media.

This Toolkit can likewise provide useful support to development agencies, bilateral and multilateral, engaged in funding and supporting national and regional governments private sector development and investment climate reform programmes.[1]

How to use this Toolkit?

When using this Toolkit, it should be borne in mind that there is no blueprint for mobilizing investment. Each PFI user has to develop their own strategy, based on your institutional capacity and specific economic context, and tailored to your needs and resources.

Given the breadth and diversity of policy practices that impinge on investment conditions it is not possible to address each policy domain in detail. However, users of the Toolkit will find links and references to a wealth of additional tools and resources that provide more in-depth policy guidance in areas such as tax administration, fighting corruption and on issues such as designing an investment promotion agency.

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[1] The OECD Development Assistance Committee has developed in consultation with a range of stakeholders, including the Investment Committee a set of best practices for donors using Official Development Assistance to mobilise private investment. It is entitled Promoting Private Sector Development: the Role of ODA and can be downloaded from www.oecd.org/dac/guidelines.

In a sense, therefore, the Toolkit is similar to a knowledge library and should be used accordingly. It is unlikely that PFI applications will necessitate using each part of the Toolkit and every chapter of the policy guidance. For example, countries that use the PFI on a regular basis and have determined where priorities for reform lie are only likely to focus on a few specific areas of the Toolkit's policy guidance. And not every PFI application will wish to score how it is performing (Part 4).

Users should thus not be put off by the Toolkit's length. The modular approach of the Toolkit's design enables users to access only those parts that are necessary to your PFI application. At a minimum, this will typically involve using the guidance related to *Getting Started* and the chosen Policy chapters. The modular approach, however, means there is some repetition in this Toolkit.

What is the relationship between this Toolkit and the PFI?

The OECD in co-operation with non-member countries and in partnership with other international organizations and stakeholders working on investment conditions in support of private sector development have developed, under the auspices of the OECD Investment for Development Initiative, a package of resources specifically designed to meet the needs of policy makers and investment-climate reform practitioners.

The package contains three elements: A Review of Good Practices, providing case studies and the analytical support for the PFI, the second element, which is a checklist of questions and annotations that underpin a sound investment climate. This PFI Users Toolkit is the third element. It supports the implementation of the PFI, offering specific detail on what constitutes good policy practices in the areas that bear on the investment climate, the information that the PFI user needs to scrutinize in order to make an assessment of how their country or region performs vis-à-vis good practice and a menu of methodologies that can be used to benchmark and measure progress.

Depending on your function in a project, you will find different elements of the package relevant to your work. To help you identify the relevant resource, the table below explains the relationship between the PFI products, their content, target audience and how each was developed.

Relationship between PFI products

Level	Content	Target audience	Development process
Review of Good Practices Analytical support for checklist questions	Analytical background material on each of the ten chapters of the PFI.	Investment climate policy experts, donors, NGOs focussed on private sector development and academics in the fields of growth, development economics and policies for investment.	Consultant experts in each of the Framework's policy areas, in consultation or partnership with the relevant specialised OECD Committee. Each chapter was extensively vetted through regional expert meetings and through a web-based public consultation.
Policy Framework for Investment Checklist of questions and annotations	A set of questions and annotations in ten policy fields identified in the 2002 UN Monterrey Consensus on Financing for Development as important for the quality of a country's investment environment.	High level representatives and decision-makers in government departments and regulatory bodies, legislators, investment promotion agencies, public and private development agencies, donors and investors.	Developed as a partnership process involving a dedicated task force open to any interested government. Officials from 60 governments were involved, with participation by the World Bank, other international organisations, as well as business, trade union and civil society organisations.
PFI Users Toolkit Operational guidance	A set of structured guidelines on how to operationalise the PFI questions, together with references to case studies and existing tools providing in depth treatment of the policy fields covered.	Officials from government departments, especially at centres of government, e.g. Prime Minister's office, as well as practitioners and operational level staff from regulatory bodies, investment promotion agencies, public and private development agencies and donors.	Consultant experts in each of the Framework's policy areas. Draft operational guidance tested and adapted in OECD regional investment programmes. Updated regularly, based on country and policy area experiences from practitioners applying the PFI.

Source: OECD, Investment Division

How was this Toolkit developed?

This Toolkit was developed by the OECD Secretariat and consultant policy experts in each of the policy domains covered by the PFI and reviewed by the OECD Investment Committee. Other OECD bodies, with the support of their secretariat, were involved in the policy guidance chapters. These bodies are: the Trade Committee, the Competition Committee, the Committee on Fiscal Affairs, the Steering Group on Corporate Governance, the Education Committee and the Working Group on Bribery in International Business Transactions.

The Toolkit has also benefitted from extensive comments and reactions from pilot users in several international fora, such as the Investment Committee's Global Forum on International Investment. These meetings helped us to vet the user-friendliness, relevance and practicality of specific parts of the guidance in different economic and geographical contexts. Further events of this sort are planned for those areas of the Toolkit, which have not yet been "road-tested".

Your feedback and how to find out more about the PFI?

We are interested in hearing how your organization is using the PFI and this Toolkit. Your questions, comments and feedback will help us to improve the PFI and how it is used. We also welcome your suggestions for case studies, research papers, data sets, websites and other resources of relevance for investment-climate reform practitioners. All correspondence can be emailed to: pfi@oecd.org, or mailed to:

OECD Investment Division
2, rue André Pascal
75775 Paris, CEDEX 16,
France

Your suggestions and ideas will be assimilated and made available in the latest version of the Toolkit, available at the www.pfitoolkit.org website. Further information on the PFI can also be accessed from the OECD website at: www.oecd.org/daf/investment/pfi.

The following is a draft of the policy guidance part of the Toolkit covering the PFI Investment Policy questions (Chapter 1), taking question 1.1 (Laws and Regulations) as an example.

Investment Policy

Investment policy in the PFI relates to a country's laws, regulations and practices that directly enables or discourages investment, and which enhance the public benefit from investment. They cover, for instance, policies for transparent and non-discriminatory treatment of investors, expropriation and compensation laws and dispute settlement practices.

The quality of a country's investment policies directly influences the decisions of investors, be they small or large, domestic or foreign. Transparency, property protection and non-discrimination are core investment policy principles that underpin efforts to create a quality investment environment for all. Investors are also concerned with the way that investment policy is formulated and changed. Investors will avoid circumstances where policies are modified at short notice, where governments do not consult with industry on proposed changes and where laws, regulations and procedures are not clear, not readily available and un-predictable.

The PFI Investment Policy chapter identifies through eight questions the most important issues relevant for judging the effectiveness of a country's investment policies and practices. The issues are often directly relevant to the specific needs of foreign investors, but the issues apply in most instances to domestic investors as well. This section of the Toolkit offers the PFI user additional detail on why these investment policy questions are important, and specific guidance on the topics to scrutinise in order to form an opinion on how well a country's investment policies perform vis-à-vis good practices.

The eight key PFI questions on Investment Policy relate to:

Laws and Regulations
Effective Ownership Registration
Intellectual Property Rights
Contract Enforcement and Dispute Resolution
Expropriation Laws and Review Processes
Equivalent Treatment for National and International Investors
International Co-operation and Periodic Review
International Arbitration Instruments

Laws and Regulations

PFI Q:1.1 asks "What steps has the government taken to ensure that the laws and regulations dealing with investments and investors, including small- and medium-sized enterprises, and their implementation and enforcement are clear, transparent, readily accessible and do not impose unnecessary burdens?"

Rationale for the question

Investment involves many risks. Risks are associated with market demand, technology, competition, inflation, borrowing costs, weather and other factors. An attractive investment climate cannot avoid all these risks, but it should avoid unnecessary policy-induced risks and regulatory surprises. Businesses will interpret environments that contain unpredictable regulatory or legal changes as an additional risk. Some industries, such as oil extraction are lucrative enough that business is prepared to operate in more risky environments. But many other industries that operate on lower profit margins, particularly the manufacturing industries that are necessary for a diversified growth, have the ability to choose only the best, most stable locations to establish operations.

Two key features of high-performing investment policy regimes are transparency and predictability. Effective communication of meaningful information, prior notification and consultation of regulatory changes and uniform administration and application of laws and regulations reduces business risks and anxieties. It also helps combat bribery and corruption (See also PFI Policy Guidance on Public Governance) and ultimately promotes patient investment.

Transparency and predictability are especially important for small- and medium-sized enterprises that face particular challenges relating inter alia to entering the formal economy. Transparent investment laws and regulations are also 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. Public authorities may not always be aware of these benefits or simply take them for granted. This PFI question, therefore, addresses the efforts required to promote clear, transparent investment laws and regulations.

Key considerations and guidance on policy practices to scrutinise

An assessment of Question 1.1 calls for an examination of the following considerations and policy practices.

- *Availability of Relevant Information to Investors* Attracting investment requires a consistent, predictable system of laws, regulations and administrative practices. And to reassure all market participants that business operates on a level playing field, investment laws and regulations and their enforcement should be codified, written in plain language and clear to all. Investors should also be able to easily obtain meaningful information on all the regulatory measures which may materially affect their investments. Investment measures may include laws, policies, regulations, international agreements, administrative practices and rulings and judicial decisions. Their sheer number, complexity and the potentially broad ramifications of business operations, however, may not always make this possible. It is nevertheless in governments' interests to provide "essential" information on how to start a business and inform investors, inter alia, about ownership and exchange control restrictions, administrative requirements, taxation, investment incentives, monopolies and concessions, intellectual property protection and competition policy as well as environmental and social requirements and corporate responsibilities. There are various means of communicating investment laws and regulatory information to investors. They include official gazettes, government websites, online compendiums, e-gateways, as well as formal and informal contacts by government departments and regulatory agencies. While new communication technologies simplify information dissemination between governments and stakeholders, the internet is not an end in itself; information must be collected and up-dated on a regular basis.

- *Prior Notification and Consultation* Prior notification and consultation are important to building trust, and reflect a commitment to professionalism. Where changes to investment laws and regulations are needed they should occur within a standardised system that begins with public hearings, policy papers outlining the reasons why changes are needed, circulation of draft regulatory changes to all concerned stakeholders, and processes for revision and recirculation based on these public inputs. Such investment law and regulatory change regimes should be enshrined in law and systematically adhered to. These processes are important, both because changes to investment laws and regulations can make businesses economically unviable, and because policy is more likely to be sound and not produce unintended side-effects if it is formed in a structured and transparent manner that permits input from all interested parties. Involving investors and other stakeholders in the process of relevant regulatory changes also contributes to the legitimacy and effectiveness of the new regulatory investment measures made. Various notification and consultation avenues can be used. In addition to statutory notification or consultation requirements, governments may improve the reach of dissemination and the speed of notification through posting proposed regulatory changes on the internet or through other electronic dissemination methods. Because regulatory changes can come from many ministries or levels of government, the notification system should be coordinated and comprehensive. Exceptions and qualifications to transparency and accessibility should clearly be defined and delimited. Examples include protection of confidential information or commercial interests, national security and public order, and pursuit of monetary and exchange rate policies. Special care should be given, however, to limit their application to the minimum extent possible and ensure that they are used within their legitimate purposes.

- *Public Appeals Processes* To increase procedural transparency and avoid regulations that impose undue burdens and discretionary power of officials, changes in implementing regulations and administrative decisions should be subject to an open and predictable public appeals process, empowered to protect investment guarantee provisions written into investment contracts or in investment protection treaties. Procedural transparency also implies a right to complain or appeal and the existence of prompt and impartial review and remedies. This may involve providing a clear description or other necessary explanation of the administrative requirements, statutory delays for rendering decisions and the possibility of presenting additional facts and arguments.

These considerations and practices suggest the PFI user should form an assessment on the transparency of a country's investment laws and regulations using the following criteria and indicators:

1. Information on investment laws and regulations is provided: (a) through a legally stipulated and codified system; (b) which applies to primary and secondary legislation; (c) to both national and sub-national levels of government; and (d) exceptions and qualifications to making information available are clearly defined and delimited. Information on investment laws and regulations is made available to investors. Print, internet and other electronic communication technologies are systematically used to disseminate information on a country's investment laws and regulations. Efforts are made to use clear and plain language and to simplify the dissemination of relevant information through the use of centralised and regularly updated information portals. Transparency requirements under international agreements, such as notification of regulation changes, responding to special enquiries and requests for consultation are promptly respected.

2. Changes in investment laws and regulations are clear and transparent when based on: (a) a codified prior consultation procedure available and accessible to all stakeholders; (b) which applies to all ministries, whose decisions can materially affect the investment climate (e.g. tax authorities, customs assessors, foreign exchange and financial systems regulators, company/securities regulators, labour, environment and other sectors) with clear accountability procedures on how comments are handled; and (c) communication of new laws and regulations is timely, widely disseminated and electronic information distribution systems are frequently updated. There is a formal system for dealing fairly with unintended negative impacts of regulatory changes and the reasoned decisions of the appeals process are publicly available. Regulatory institutions are designed and managed in a manner that avoids favouritism or accusations that decisions are politically motivated.

Further resources

The following resources support the PFI user needing additional information on investment laws and regulations:

- The OECD Framework for Investment Policy Transparency helps governments to achieve greater investment policy transparency. The focus is on the information gaps and special needs of foreign investors, but they apply in most instances to domestic investors as well. The resource can serve as a basis for conducting self evaluation and sharing experiences among public officials. See http://www.oecd.org/dataoecd/15/13/16793978.pdf
- The World Bank Cost of Doing Business project studies the cost, length and complexity of various aspects of the investment climate and provides a score of how long it takes in each country for business to complete key regulatory tasks. Longer and more complex

processes are one measure of unpredictability and often of an indicator of lack of transparency. See www.doingbusiness.org

- The World Bank has a set of Guidelines for foreign direct investment premised on the principles of equal treatment and open competitive markets. The Guidelines offer a source on which national legislation governing the treatment of private foreign direct investment may draw, to the extent they do not conflict with existing bilateral and multilateral treaties and other international instruments. See http://ita.law.uvic.ca/documents/WorldBank.pdf