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**A POLICY FRAMEWORK FOR INVESTMENT: DRAFT PREAMBLE,  
CHECKLISTS AND PRELIMINARY ANNOTATIONS**

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## PREAMBLE (FIRST DRAFT)

1. The *Policy Framework for Investment* is intended to assist governments in their efforts to create an environment that attracts domestic and foreign investment taking into account the broader interests of the communities in which investors operate. With an effective set of policies in place, private investment contributes to growth and job creation, promotes innovation and sustainable development and acts as a driving force for poverty reduction.
2. The *Framework* aims to advance implementation of the United Nations Monterrey Consensus adopted in 2002, which ascribes 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 financial markets. The Monterrey Consensus also tasks governments with the protection of property rights and the promotion of sound corporate governance frameworks, competition and open trade policies. The policy areas covered in the Framework are identified in the Monterrey Consensus as underpinning a healthy investment environment.
3. The *Framework* helps countries to develop a sound investment environment by fostering an informed process of policy formulation and implementation across government agencies. Based on best practices drawn from OECD and non-OECD experiences, it proposes a set of policy considerations in ten inter-related areas that contribute to such an investment environment. Governments can take these policy considerations into account in country self-evaluation and peer reviews, regional co-operation and multilateral discussions. The *Framework* can also provide a reference point for international organisations' capacity building programmes, investment promotion agencies, donors as they assist developing country partners in improving the investment environment, and business, labour and other non-governmental organisations in their dialogue with governments.
4. The *Framework* seeks to support governments in identifying objectives and setting priorities consistent with their own broader development strategies. It has been formulated so that its different elements can be flexibly adapted to the particular economic, social, legal and cultural circumstances that exist in countries at different levels of development. In addition to host-country policy action, it also addresses the contribution of international co-operation, including through regional integration, and home-country policy action.
5. The *Framework* is to 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 and the Monterrey Consensus, the Doha Development Agenda and the Johannesburg World Summit on Sustainable Development Declaration. It shares the same universal values of transparency and appropriate assumption of responsibilities by governments, business and other actors underpinning these efforts. The *Framework* is a component of the OECD Initiative on Investment for Development launched in Johannesburg in November 2003, which received reiterated support from the 2005 OECD Council at Ministerial level as part of the Organisation's follow-up to implementation of the UN Millennium Declaration and the Monterrey Consensus.

6. The *Framework* also builds on OECD instruments addressing good government practices, including the Declaration on International Investment and Multinational Enterprises, the Codes of Liberalisation and the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, and complements recent OECD initiatives directed to the business sector, including the OECD Guidelines for Multinational Enterprises.

7. The *Framework* was developed as a partnership process, through a task force of government officials from more than 50 OECD and non-OECD economies meeting at the OECD and conducting regional consultations in Africa, Asia, Latin America and South East Europe. Business, labour and other non-governmental organisations contributed to the work of the Task Force. The *Framework* is a living instrument which will be reviewed by OECD and non-member partners in light of changes in circumstances as it is used for policy evaluation and international co-operation by governments, the OECD and other organisations.

8. The *Framework* consists of ten chapters, one for each of the policy areas covered. These are: investment policy; investment promotion and facilitation; trade policy; competition policy; tax policy; corporate governance; corporate responsibility and market integrity; human resource development; infrastructure development and financial services; and public governance. Each chapter identifies questions pertinent to the quality of the investment environment (Part I). Each chapter is accompanied by annotations, which provide context and information from an investment perspective (Part II). The documents referenced in each chapter provide additional analytical background and practical policy guidance, including examples of country experience with the issue at hand.

## **PART I: THE POLICY FRAMEWORK FOR INVESTMENT**

### **Draft Foreword**

This Part brings together 10 sets of questions covering the main policy domains identified in the Monterrey Consensus as having a strong impact on the investment environment, beside macroeconomic stability. 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 national development agendas and institutional arrangements.

Clearly there are other policy area, such as the environment, energy and innovation policies that bear on the business climate 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 PFI. The first is policy coherence, with the questions in each of the chapters targeting the need for a whole-of-government approach to linkages between policy fields and the investment climate. For example, investment protection and openness standards underlying the investment policy chapter, which are grounded on established international law, are of wide applicability, in areas such as SME development policy; competition and tax policies are important to ensure that investment policy efforts are not frustrated by unnecessary barriers to entry or abusive taxation; liberal trade policy in both home and host countries contributes to realising the benefits of open investment policy; corporate responsibility initiatives by governments to help investors comply with domestic laws and international standards enhance the effectiveness of these policies.

The second principle is the importance of a transparent approach to policy formulation and implementation. Transparency reduces uncertainty and risk for investors and the transaction costs associated with making an investment, and facilitates private actors' positive input into policy adjustment. How transparency 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 climate is the third principle that applies across the PFI. 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 in order to identify early on new challenges and to be able to quickly respond to them.

## Chapter 1. Investment policy

- 1.1 What steps have been taken to ensure that laws and regulations dealing with investment, as well as the processes associated with their implementation and enforcement and for handling investors' comments, are clear and transparent?
- 1.2 Has the Government established an effective titling program for land and other forms of property, and what is the national scope of its coverage?
- 1.3 Have laws and regulations for the protection of intellectual property rights and effective enforcement mechanisms been adopted? Is the level of protection adequate to 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 an effective system of contract enforcement in place? Is this system widely accessible to all segments of society? Have alternative systems of dispute settlement been established, including mediation, to ensure the widest possible scope of protection, at the lowest possible cost?
- 1.5 Does the government maintain a policy of timely and adequate compensation for expropriation? Have explicit and well-defined limits on the ability to expropriate been established, such as guidelines on what constitutes public interest? What channels exist for reviewing the exercise of this power or for contesting it?
- 1.6 While recognising the rights of governments to regulate **and to deliver public services**, and aside from specific commitments in international investment agreements, has the government established a timetable to progressively provide for national treatment/MFN? How are exceptions to national treatment/MFN evaluated with respect to their costs and benefits and are these exceptions transparent and time bound? Have the costs and harm to domestic investors of exceptions to national treatment/MFN been evaluated and taken into consideration?
- 1.7 Has the government entered into international treaties on the promotion and protection of investment? To what extent are steps for their timely ratification in place? Are existing international treaties periodically reviewed with a view to determining whether their provisions and membership match the general level of ambition of the government with respect to transparency, investment protection, non-discrimination and progressive liberalisation towards creating a more attractive environment for investment?
- 1.8 Has the government become a signatory to 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 World Bank International Centre for Settlement of Investment Disputes?

## Chapter 2. Investment promotion and facilitation

- 2.1 Does the government have a clear strategy for developing a sound, broad-based business environment within which investment promotion and facilitation measures will be effective?

- 2.2 Has an investment promotion agency been established? To what extent has the structure, mission, and legal status of the IPA been informed by best practice in countries with a longer history of strategic investment promotion?
- 2.3 Has the IPA been given sufficient resources and funding? Does it enjoy adequate political support? Is the structure and role of the IPA regularly reviewed with a view to ensuring its continued relevance in the face of new economic challenges and opportunities?
- 2.4 Has the government sought to streamline administrative procedures or considered the one-stop shop approach? In its capacity as a facilitator for investors, does the IPA place sufficient emphasis on the needs of established investors?
- 2.5 Does the IPA have a mandate to promote the benefits of investment within government and civil society? To what extent does it maintain effective dialogue mechanisms with investors? Is it consulted by government authorities on regulations having an impact on investment?
- 2.6 What mechanisms have been established for the evaluation of the costs and benefits of investment incentives, their appropriate duration, their transparency, and their extra-jurisdictional consequences?
- 2.7 What steps has the government taken to promote linkages, in particular between foreign affiliates and local enterprises? What measures or programmes have been put in place to address the specific capacity constraints faced by SMEs, including with respect to access to credit?
- 2.8 Has the government explored and made use of the various international and regional initiatives aimed at building capacity with respect to investment promotion, such as those offered by FIAS, MIGA and UNCTAD? Has the IPA joined regional and international networks?
- 2.9 Have the various initiatives aimed at promoting investment through linkages, such as UNIDO's Subcontracting and Partnership Exchanges and the Asia-Africa Investment Technology Promotion Centre, been fully taken advantage of?

### Chapter 3. Trade policy

- 3.1 How great are policy uncertainties for investors and what steps are available to mitigate or reduce such uncertainties and increase predictability? Are interested parties, including investors involved in trading activities, consulted with respect to planned changes to trade policy?
- 3.2 Has the government exploited existing opportunities to increase the size of the “relevant market” for investors through regional trade agreements?
- 3.3 Are trade policies creating a bias favouring or disadvantaging some industries? If so, do these industries play an important role in business value-chains (such as telecommunications)? How much is trade policy bias discouraging investment through negative effects on value-chains?
- 3.4 Which trade policies (tariffs, non tariff barriers, other regulations, etc.) raise the cost of inputs and therefore discourage investment that depends upon sourcing at competitive prices? Are some border barriers reducing access to imports with the most advanced technologies?
- 3.5 If home trade policies curtail developing country exports, who bears and how high are the costs, and are such policies the least restrictive way of accomplishing the regulatory goals?
- 3.6 Which policy measures impact upon services trade? Are impediments to services trade impeding investment (and trade in goods) by disrupting important services components of international value-chains (e.g. financial services)?
- 3.7 Certain sectoral weaknesses in developing countries can serve to impede trade until these weaknesses are addressed (e.g. adequate financing for exporters, adequate insurance for importers). How could home country trade policies help to overcome such capacity constraints to the benefit of interested investors and traders in both the home and host countries?

#### **Chapter 4. Competition policy**

- 4.1 Are the competition laws clear, transparent, and non-discriminatory? What actions have competition authorities taken to help businesses understand and abide by competition law? For example, have the authorities issued guidelines that explain the approach they will take in enforcing the law(s)? Are agency and court decisions published, along with a statement of the reasoning behind them? How are changes in competition law communicated to market participants?
- 4.2 Do competition authorities have the resources and necessary political support to implement the competition laws effectively?
- 4.3 To what extent and how have competition authorities addressed anticompetitive practices by incumbents that inhibit investment?
- 4.4 Do competition authorities have the capacity and the resources to evaluate the impact of other policies and decisions on the ability of investors to contest the market? What channels of communication and co-operation have been established between competition authorities and other relevant government agencies?
- 4.5 With respect to industrial policies, aimed, inter alia, at creating champions, have competition authorities assessed the costs and benefits of such policies? Are industrial policies periodically reviewed by competition authorities?
- 4.6 What has been the role of competition authorities in the privatization process? Have competition considerations been adequately addressed?
- 4.7 Have competition authorities been given the capacity to deal with international competition issues, such as international mergers and acquisitions, abuse of dominance, and cartels, and does the competition authority have adequate channels for communication and cooperation with other competition agencies with respect to international competition issues?

## Chapter 5. Tax policy

- 5.1 What is the current tax burden on domestic profit, on average, taking into account statutory provisions, tax-planning opportunities and compliance costs?
- 5.2 Has the government evaluated the level of tax burden that would be acceptable generally to investors? Is this level consistent with the actual tax burden?
- 5.3 If framework conditions and/or market characteristics are weak, is it reasonable to assume that a low tax burden can impact investment decisions?
- 5.4 Is the tax burden on business appropriate with reference to the set of policy goals and objectives of the tax system?
- 5.5 Where the tax burden on business income differs by firm size, ownership structure, industrial sector or location, can these differences be justified? Is the tax system neutral as between 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 main tax provisions generally consistent with international norms?
- 5.7 Have unintended tax-planning opportunities created by targeted tax incentives been explored and taken into account in assessing the cost-effectiveness of such incentives? Have other problems associated with targeted tax incentives been evaluated and taken into account in assessing their cost-effectiveness?
- 5.8 Are tax expenditure accounts reported, tax incentive evaluations carried out, and sunset clauses used to properly manage and inform the budget process?
- 5.9 Are tax policy and tax administration officials working with counterparts in other countries to expand their tax treaty network and counter abusive cross-border tax planning strategies that artificially reduce the domestic host country tax base?

## Chapter 6. Corporate governance

- 6.1 What steps have been taken to ensure a clear and transparent division of responsibilities between different supervisory and enforcement agencies? Has this been translated into a coherent and consistent regulatory framework, backed by effective enforcement?
- 6.2 Do national characteristics of the corporate ownership and control structures call for strengthening any particular aspects of the corporate governance framework, for example minority rights or equitable treatment of shareholders?
- 6.3 What are the procedures and institutional structures for legal redress in cases of violation of shareholder rights? Do the systems for providing legal redress function efficiently and effectively enough to serve as a credible deterrent to such violations?
- 6.4 What procedures and institutions are in place to ensure that investors' property rights are recognized and respected, including through secure methods of ownership registration?
- 6.5 What procedures and institutions are in place to ensure that shareholders have the ability to significantly influence the company? For example, are there sufficient notification procedures for general shareholders meetings and adequate procedures for proxy voting to effectively allow voting for those unable to directly participate?
- 6.6 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?
- 6.7 What measures are in place to monitor and prevent abusive related party transactions and inhibit other ways for corporate insiders and controlling owners to extract private benefits?
- 6.8 How does the corporate governance framework ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders?
- 6.9 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?
- 6.10 Has a review been undertaken in order to assess the national corporate governance system against the OECD Principles of Corporate Governance? Has the result of that assessment been made public?
- 6.11 For state-owned enterprises (SOEs), how is the ownership function within the state administration structured to ensure adequate organisation and efficient procedures to enable the state to act as an active and informed owner, while not interfering in day-to-day management of SOEs?
- 6.12 What are the processes in place to ensure that SOE board members are nominated in a transparent manner and based on their competencies and experience?
- 6.13 What procedures and institutions are in place to ensure accountability to both the government and the public, and in the case of listed SOEs, to other shareholders, including through adequate reporting by the ownership entity and SOEs themselves on their performance and achievement of their objectives?

## **Chapter 7. Corporate responsibility and market integrity**

[draft Chapter scheduled for completion on the time for the Task Force's meeting on 13-14 December 2005]

## Chapter 8. Human resource development

- 8.1 Has the government established a coherent and comprehensive HRD policy framework consistent with its broader development and investment strategy? 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 climate?
- 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 business investment opportunities?
- 8.3 Is the economic incentive to invest in human capital sufficient to encourage individuals to continue higher education? Are there policy-induced obstacles that act to lower the financial returns to higher formal education, limiting the improvements to the investment climate that flow from better human resources? What mechanisms exist to promote closer co-operation between higher education institutions and business and to anticipate future labour force skill requirements?
- 8.4 Does the government support training programmes and has it adopted practices that evaluate their effectiveness and their impact on the investment climate? 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 the costs and benefits of public health expenditures aimed at improving public health outcomes and through interlinkages indirectly the investment climate?
- 8.6 What mechanisms and steps 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 policy reforms have been introduced that balance social objectives, the goal of a competitive workforce and the incentives for business to invest and expand?
- 8.8 Do laws and regulations restrict the deployment of workers from an enterprise investing in the host country? What steps have been taken to identify and to unwind unduly restrictive practices covering the deployment of workers from the investing enterprise and to reduce delays in granting work visas to these employees?
- 8.9 Does the government support in programmes designed to assist large-scale labour adjustment and indirectly the investment climate 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 do not stymie an adaptable workforce and excessively damage the ability of enterprises to modify their operations and investment planning?

## Chapter 9. Infrastructure and financial services

- 9.1 What processes does the government use to evaluate its infrastructure investment development needs? How do governments ensure private investors in infrastructure operate with clear guidelines for the disbursement of public funds and in relation to transparency and procedural fairness for all investors? Are the regulatory agencies that oversee infrastructure investment and the operations of enterprises with infrastructure investments independent from political pressure?
- 9.2 What measures has the government adopted to protect investors' rights in infrastructure projects 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 services at fair and reasonable prices and to maintain public support for private involvement in the provision of infrastructure services?
- 9.3 Are state-owned infrastructure agencies operated on a commercial basis? What mechanisms do public infrastructure agencies use to decide how much to invest in infrastructure, where to allocate infrastructure investments and how to administer them?
- 9.4 In the telecommunications sector, to what extent 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?
- 9.5 To what extent 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 and which instruments are used 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?
- 9.6 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 and do they take into consideration investor needs and the links between different modes of transport infrastructure?
- 9.7 Has the government evaluated the investment needs in water required to support its development goals? To what extent have public-private partnerships been promoted as a means to finance water infrastructure investments? Does the government use independent assessments of public water investment programmes to enhance their credibility and to help attract additional finance and new investors?
- 9.8 How has the government sought to attract private sector investment in the development of the financial services sector, offering a wide range of products to a broad cross-section of the economy? What steps has the government taken to identify and remove obstacles to new private investors and competition entering the domestic banking sector? What role do foreign banks play in the development of the domestic financial sector, and how does the government address concerns that foreign competition could harm the stability of the banking sector?
- 9.9 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 movable property as collateral and to expand business access to external sources of credit to fund

investment? What data protection and credit reporting laws have been enacted to facilitate the flow of information, to promote bank lending and to reduce default rates? What approach has the government taken to limit the risk of systemic crises in the financial sector, damaging the investment environment?

## Chapter 10. Public governance

- 10.1 Is there a consistent and coherent approach to regulatory reform that sets out principles dealing with regulatory policies? How is regulatory policy co-ordinated in order to ensure consistency and coherence across different levels of government (national, sub-national, local)? Is there a legal basis for government action, thus providing certainty to investors?
- 10.2 What inter-ministerial mechanisms are in place for managing and co-ordinating regulatory reform and integrating competition and market openness considerations for attracting investment? Do the existing institutional capacities ensure consistent and coherent application of principles of quality regulation?
- 10.3 Are the economic and social impacts of regulations reviewed in a way that they foster investment for development? Is regulatory impact assessment (RIA) used to help avoid unnecessary investment restrictiveness? Is RIA used to help increase transparency, taking into account investors' points of view?
- 10.4 What public consultation mechanisms and procedures, including prior notification, have been established and are these open to regulated parties and other stakeholders, non-governmental organisations, the private sector, advisory bodies, accreditation bodies, standards-development organisations and other governments?
- 10.5 Are administrative burdens, including with respect to trade, measured and quantified? Is there a government program to encourage the reduction of administrative burdens? Are e-government and other information and communication technologies used to promote administrative simplification, quality services, transparency and accountability, and how widely?
- 10.6 Do legislation and regulations implement international anti-corruption and integrity standards? Do penal, administrative and civil law provisions provide a consistent legislative and regulatory framework for fighting corruption as well as promoting integrity? What standards have been developed to guide public officials' behaviour?
- 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 specific mechanisms been developed to address risk areas for corruption? Is guidance provided to help public officials meet expected standards in daily practice? Does human resources management, in particular in recruitment and career promotion, enhance ethical behaviour?
- 10.8 Do review mechanisms exist at domestic level to assess the application and enforcement of laws and regulations on anti-corruption and integrity? Do the mechanisms ensure that civil society organisations and the media actively support public scrutiny over public officials' behaviour?
- 10.9 Is the government a signatory of or a Party to international initiative(s) 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 the mechanisms in question monitor the application in practice and enforcement of the anti-corruption laws implementing the Conventions?

## PART II. ANNOTATIONS (PRELIMINARY ELEMENTS OF TEXT)

### Annotations to Chapter 1. Investment policy<sup>1</sup>

#### **1.1 What steps have been taken to ensure that laws and regulations dealing with investment, as well as the processes associated with their implementation and enforcement and for handling investors' comments, are clear and transparent?**

For domestic and foreign investors alike, knowledge about rules and regulations – including how these are implemented and how they may be changed – is a critical determinant in the investment decision. Transparency and predictability may be even more critical for foreign investors having to cope with host country regulatory systems, cultures and administrative frameworks that are very different from their own. The importance of transparency and predictability has motivated a number of initiatives aimed at helping governments achieve greater transparency, such as the OECD Framework for Investment Policy Transparency. Transparency provisions have been enshrined in virtually all modern international agreements dealing with investment, including the various agreements of the WTO, regional agreements such as the NAFTA and most recent bilateral investment treaties (BIT).

Governments have a wide range of avenues for promoting investment policy transparency, including: consultation with interested parties; legislative simplification and codification; plain language drafting; registers of existing and proposed regulation; electronic dissemination of regulatory material; and review of administrative decisions.

#### **1.2 Has the Government established an effective titling program for land and other forms of property, and what is the national scope of its coverage?**

Secure rights to land and other forms of property are an important pre-requisite for a healthy investment environment. They reduce the risk of fraud in transactions, and encourage various types of investment to enhance the value and productivity of the property in question (as well as investment associated with environmental stewardship). Titling can also improve access to credit since registered title allows lenders to verify ownership for the purposes of collateral. Governments can encourage investment across all segments of the economy, from rural farmers to large-scale manufacturing, by maintaining land and property registries.

#### **1.3 Have laws and regulations for the protection of intellectual property rights and effective enforcement mechanisms been adopted? Is the level of protection adequate to 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?**

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<sup>1</sup> For a more detailed examination of the issues covered in this chapter of the PFI, refer to the background document “A Policy Framework for Investment: Investment Policy”, [DAF/INV/TF(2005)8/REV1].

One particular form of property that has presented particular challenges for policy makers concerns intellectual property rights. The incentive to develop innovative products is provided by granting creators of new inventions, software programs, or other products a patent, copyright, or other similar right to their creation. In addition to the granting of such rights, their enforcement through, for example, efforts to curb counterfeiting, is an important feature of any intellectual property regime. At the same time, intellectual property rights need to strike a balance between society's interests in fostering innovation and in keeping prices to consumers low and, especially in the case of essential medicines, in sufficient supply.

Intellectual property rights are a matter of concern not only for large firms and multinational enterprises (MNE) with significant research and development programmes. Small and medium sized enterprises (SME) are a driving force behind innovation and the new economy. Their innovative and creative capacity, however, is not always fully exploited as SMEs tend to under-utilise the intellectual property system – partly due to their lack of awareness. Governments can help by, for example: promoting a greater use of intellectual property system; developing 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; providing comprehensive web-based information and basic advice on intellectual property issues to SME support organisations.<sup>2</sup>

**1.4 Is an effective system of contract enforcement in place? Is this system widely accessible to all segments of society? Have alternative systems of dispute settlement been established, including mediation, to ensure the widest possible scope of protection, at the lowest possible cost?**

Protecting and promoting property rights, including through the establishment of an efficient land registry system and a framework for the protection of intellectual property, encourages investment in part by giving owners confidence in the value of what they own. However, it is ultimately the possibility of using an asset in a given market transaction that gives the asset its value. Therefore, it is equally important that investors have trust in the integrity of the markets through which transactions involving these assets take place.

A functioning judiciary system and sound legal framework play a central role in ensuring the enforcement of contracts and the protection of property rights. In many countries, arbitration, mediation, and conciliation have also played an important role in providing parties to disputes a choice of the most appropriate avenue, allowing a broader cross-section of property holders access to some form of dispute settlement, and lowering costs.

**1.5 Does the government maintain a policy of timely and adequate compensation for expropriation? Have explicit and well-defined limits on the ability to expropriate been established, such as guidelines on what constitutes public interest? What 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 BITs 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 can raise difficult policy issues that usually involve a careful

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<sup>2</sup> On the promotion of SMEs more generally, refer to chapter 2 on investment promotion and facilitation.

balancing of interests and judgement on the part of policy makers, in addition to the inherent negative impact of expropriation on the investment climate. 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. In general, 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 indirect expropriations. However, governments need to remain mindful that certain regulatory action may be tantamount to expropriation.

**1.6 While recognising the rights of governments to regulate and to deliver public services, and aside from specific commitments in international investment agreements, has the government established a timetable to progressively provide for national treatment/MFN? How are exceptions to national treatment/MFN evaluated with respect to their costs and benefits and are these exceptions transparent and time bound? Have the costs and harm to domestic investors of exceptions to national treatment/MFN been evaluated and taken into consideration?**

"National Treatment" is the 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. 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.

To provide MFN treatment 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. 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) come at a cost, such as a reduction in competition and efficiency losses. 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. infant industry protection for an industry that is no longer an infant) remains valid and whether the costs outweigh the benefits. Such considerations are especially important in service sectors that play an intermediary role supporting a wide range of economic activities and that contribute to productivity and growth across the economy (e.g. telecommunications).

**1.7 Has the government entered into international treaties on the promotion and protection of investment? To what extent are steps for their timely ratification in place? Are existing international treaties periodically reviewed with a view to determining whether their provisions and membership match the general level of ambition of the government with respect to transparency, investment protection, non-discrimination and progressive liberalisation towards creating a more attractive environment for investment?**

International agreements promote investment in much the same way as the protection of title to property encourages investment. International agreements legally commit governments to certain policies. This involves some foregone policy flexibility for the government that undertakes such commitments. However, it also makes the regulatory environment faced by investors (both domestic and foreign) more predictable. For example, many international agreements dealing with investment contain limits on the use of trade-related investment measures (TRIMs), such as balance of payment or trade-balancing

requirements. TRIMs tend to discourage investment by imposing costs on firms (indeed, this is why they often go hand in hand with various incentives to invest). By agreeing to limits on the use of TRIMs in international agreements, the risks and uncertainty associated with these policy instruments is reduced

**1.9 Has the government become a signatory to 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 World Bank International Centre for Settlement of Investment Disputes?**

9. An important feature of international agreements concerns the channels through which disputes are 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,<sup>3</sup> allows firms from one member state to pursue their investment disputes against other member states through binding international arbitration. Just as a sound domestic system for contract enforcement promotes investment by bolstering the confidence of investors that their property rights are secure (refer to question 1.4), 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. 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 (provisional): Investment Policy

- 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). ([http://www.oecd.org/document/8/0,2340,en\\_2649\\_34887\\_16818696\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/8/0,2340,en_2649_34887_16818696_1_1_1_1,00.html))
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD, The Code of Liberalisation of Capital Movements (2004). ([http://www.oecd.org/document/63/0,2340,en\\_2649\\_34887\\_1826559\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/63/0,2340,en_2649_34887_1826559_1_1_1_1,00.html))
- OECD, The Code of Liberalisation of Current Invisible Operations (2004). ([http://www.oecd.org/document/63/0,2340,en\\_2649\\_34887\\_1826559\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/63/0,2340,en_2649_34887_1826559_1_1_1_1,00.html))
- OECD, The National Treatment Instrument (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/>).

<sup>3</sup> Of which 142 had ratified the Convention as of 25 May 2005.

## **Annotations to Chapter 2. Investment promotion and facilitation<sup>4</sup>**

### **2.1 Does the government have a clear strategy for developing a sound, broad-based business environment within which investment promotion and facilitation measures will be effective?**

Measures to promote and facilitate investment can be successful if they take place within the context of a broader strategy for improving the investment environment, which involves mainstreaming investment across a broad range of policy areas that affect the investment climate, such as those covered in the PFI. Without an appropriate business climate for investment, promotional efforts might actually make foreign investment less likely.

However, once a country has established a generally sound investment climate, investment promotion can serve to highlight profitable opportunities for investors, identify local partners in the host economy, and generally raise the investment profile of the country.

### **2.2 Has an investment promotion agency been established? To what extent has the structure, mission, and legal status of the investment promotion agency been informed by best practice in countries with a longer history of strategic investment promotion?**

Centralising many of the functions of government relating to foreign investment promotion and facilitation within a single agency is a popular method of organising and implementing a government's strategic investment promotion policies. At least 160 national and more than 250 sub-national IPAs existed as of 2004, compared with only a handful two decades earlier. The life cycle of an IPA typically follows: (1) image building; (2) investment generation; and (3) linkage promotion. At the same time, the IPA serves two additional functions at each stage of the life cycle: (a) information dissemination and investment facilitation; and (b) policy advocacy.

For those countries that have not yet established an IPA, the rapid growth in the number of IPAs worldwide suggests that many governments have found these to be a useful policy instrument in their efforts to improve the investment climate. Furthermore, the growth in the number of IPAs also means that a rich body of experience has been developed with respect to investment promotion, covering countries at different levels of development and the different approaches that countries have pursued. For countries that have recently established IPAs or are contemplating doing so, this experience should be leveraged in order to maximise the effectiveness of the IPA, as well as to avoid mistakes that have been made in the past.

### **2.3 Has the IPA been given sufficient resources and funding? Does it enjoy adequate political support? Is the structure and role of the IPA regularly reviewed with a view to ensuring its continued relevance in the face of new economic challenges and opportunities?**

Experience suggests that strategic investment promotion cannot succeed if it is only a half-hearted effort. The promotion agency must have active support at the highest political level if it is to convince investors that it can meet its commitments. The IPA must also be staffed with qualified and motivated employees, ideally with private sector experience.

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<sup>4</sup> For a more detailed examination of the issues covered in this chapter of the PFI, refer to the background document "A Policy Framework for Investment: Investment Promotion and Facilitation", [DAF/INV/TF(2005)7/REV1].

Agencies with links to the president or prime minister and with private sector participation 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 Has the government sought to streamline administrative procedures or considered the one-stop shop approach? In its capacity as a facilitator for investors, does the IPA place sufficient emphasis on the needs of established investors?**

One-stop shops provide information on the necessary steps to start a business in that country – in effect a “tourist office for investors” -- which can deliver substantial savings in time and costs for users by providing seamless, integrated and easily accessible points of contact. To the extent that informational barriers hinder the global flow of direct investment, a one-stop shop – whether as an office or a website – can help to facilitate such flows.

Investment facilitation is not just about helping firms navigate administrative barriers. Once the country starts to attract the interest of investors, the process of country visits, negotiations, advice, legal and regulatory matters, visits with existing investors, financing, location choice, property, recruitment, training, and post-investment facilitation must all be provided in a professional way to the investor. One-stop shops can make it easier for the government to centralise the quality provision of these services.

Because potential investors often seek out existing foreign investors, particularly from their own country or sector, to ascertain their experience in the host economy, satisfying existing investors should be a centrepiece of promotion agencies’ strategies.

**2.5 Does the IPA have a mandate to promote the benefits of investment within government and civil society? To what extent does it maintain effective dialogue mechanisms with investors? Is it consulted by government authorities on regulations having an impact on investment?**

Successful investment promotion is an exercise in persuasion: persuading foreign firms to invest and to seek out local partners; local consumers and workers to accept the presence of foreign firms; and convincing all branches of government of the advantages of less and more efficient regulation of business. As the interlocutor between the government and the foreign investor, the IPA is well placed to act as the chief advocate for foreign investment within the government and the main source of feedback to government policymakers on the concerns of foreign investors.

**2.6 What mechanisms have been established for the evaluation of the costs and benefits of investment incentives, their appropriate duration, their transparency, and their extra-jurisdictional consequences?**

The usage of financial<sup>5</sup> and other specific incentives directed at attracting foreign investors is no substitute for pursuing the appropriate general policy measures and the broader objective of encouraging investment regardless of source. In some circumstances, incentives may serve either as a supplement to an already attractive enabling environment for investment or as a compensation for proven market imperfections that cannot be otherwise addressed.

However, authorities engaging in incentive-based strategies face the important task of assessing these measures’ relevance, appropriateness and economic benefits against their budgetary and other costs, including long-term impacts on domestic allocative efficiency. Authorities need also to consider their

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5. Refer also to Chapter 5 on tax policy.

commitments under international agreements. The relevance and appropriateness of FDI incentive strategies should be examined at regular intervals. Transparency and accountability at all levels of government greatly increases the success of such evaluations. Investment incentives have effects beyond the jurisdiction that offers them, which need to be carefully considered. Some forms of competition among states for FDI may lead to sub-optimal results for all states, including waste of economic resources and social costs.

**2.7 What steps has the government taken to promote linkages, in particular between foreign affiliates and local enterprises? What measures or programmes have been put in place to address the specific capacity constraints faced by SMEs, including with respect to access to credit?**

Countries benefit from FDI in part because the intangible assets (proprietary technology, management and marketing skills) transferred between the parent and its foreign affiliates spill over into the local economy. These spillovers arise largely through linkages between foreign investors and local firms, whether as suppliers, customers, partners or competitors.

Broad-based policies aimed at creating a sound enabling environment for business underpin the ability of SMEs to benefit from such linkages. Open trade and investment regimes combined with an active competition policy generally provide a fertile environment for the transfer of technology. The more a firm is forced to compete, the more technology it will have to transfer to its affiliates in order for them to be competitive. At the same time, the host government can undertake measures to improve the absorptive capacity of the local economy in order to enhance technology transfers, such as through education and training and investments in human capital. Countries that succeed in continuously fulfilling the evolving skills needs of industry will have a very strong competitive advantage in attracting new investment and moving up the skill and value chain in the type of industry attracted.

Small and medium sized enterprises account for over 95 per cent of the business population, often driving innovation, and underpinning sustainable economic growth and job creation. They also tend to suffer most when the policy framework for investment is weak, they have more difficulties gaining access to credit, and they often lack the capacities required to develop relevant linkages with customers and suppliers.

**2.8 Has the government explored and made use of the various international and regional initiatives aimed at building capacity with respect to investment promotion, such as those offered by FIAS, MIGA and UNCTAD? Has the IPA joined regional and international networks?**

Various international organisations participate in capacity building with regional IPAs. In addition, the World Association of Investment Promotion Agencies (WAIPA) provides networking opportunities among IPAs and facilitates the exchange of best practice. WAIPA also assists IPAs in advising their respective governments on the formulation of appropriate investment promotion strategies.

The Foreign Investment Advisory Service within the World Bank Group provides investment climate diagnostic studies at the request of host governments. FIAS investment promotion assistance consists of recommendations for a combination of policy, regulatory and procedural reform; institutional frameworks for investment promotion; and methods for monitoring effectiveness.

UNCTAD's Advisory Services on Investment and Training (ASIT) has 30 years of experience in providing training aimed at increasing IPA capacity.

## 2.9 Have the various initiatives aimed at promoting investment through linkages, such as UNIDO's Subcontracting and Partnership Exchanges and the Asia-Africa Investment Technology Promotion Centre, been fully taken advantage of?

In addition to capacity building initiatives, other international initiatives are in place for helping 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, OEM and partnerships between main contractors, suppliers and subcontractors. The SPX Network provides detailed, standardised, updated and certified data on approximately 20,000 manufacturing companies worldwide. To date, more than 60 SPXs have been set up with UNIDO's assistance in more than 30 countries.

10. Forum based activities such as the Tokyo International Conference on African Development (TICAD) process have also been contributing in this effort. The Asia-Africa Investment Technology Promotion Center (AAITPC) was established by TICAD in 2003. The activities of the Center are funded by the Japanese Government and implemented through UNIDO in order to promote Asian investment in Africa by providing opportunities between businesses in the two regions. Recently, the TICAD process established a network to facilitate exchanges of business-related information via information technologies (the TICAD Exchange Website) and interaction in both public and private sectors for the promotion of trade and investment between Asia and Africa.

### Further Policy Resources (provisional): Investment Promotion and Facilitation

- Asia Africa Investment and Technology Promotion Centre (The Hippalos Centre) (<http://www.unido-aaipc.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](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](http://www.oecd.org/document/17/0,2340,en_2649_34197_1809105_1_1_1_1,00.html))
- OECD, Centre for Entrepreneurship, SMEs and Local Development ([http://www.oecd.org/department/0,2688,en\\_2649\\_33956792\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/department/0,2688,en_2649_33956792_1_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) ([http://www.oecd.org/document/16/0,2340,en\\_2649\\_34197\\_32020176\\_1\\_1\\_1\\_1,00.html](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](http://www.oecd.org/department/0,2688,en_2649_34417_1_1_1_1_1,00.html))
- OECD LEED Trento Centre for Local Development ([http://www.oecd.org/document/21/0,2340,en\\_2649\\_33956792\\_18647829\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/21/0,2340,en_2649_33956792_18647829_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<sup>6</sup>

#### **3.1 How great are policy uncertainties for investors and what steps are available to mitigate or reduce such uncertainties and increase predictability? Are interested parties, including investors involved in trading activities, consulted with respect to planned changes to trade policy?**

Uncertainty increases the rates of return required by investors and can thereby discourage certain investments. Trade policymakers that improve transparency and signal upcoming policy changes in discussion with businesses and other constituents will reduce uncertainty. The international community may also be monitoring developments through benchmark scorecards and peer reviews, many of which reflect trade policies.

#### **3.2 Has the government exploited existing opportunities to increase the size of the “relevant market” for investors through regional trade agreements?**

WTO-consistent regional trade agreements may help smaller economies attract investment by creating larger markets and enhancing dynamic gains from trade such as through exploiting economies of scale. Trade-creating and investment-creating agreements need to be with partners and on terms such that parties to the agreements improve their abilities both to source from the most globally competitive suppliers and to export their most globally competitive products.

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<sup>6</sup> For a more detailed examination of the issues covered in this chapter of the PFI, refer to the background document “A Policy Framework for Investment: Trade Policy”, [DAFFE/IME/TF(2004)4/REV1].

**3.3 Are trade policies creating a bias favouring or disadvantaging some industries? If so, do these industries play an important role in business value-chains (such as telecommunications)? How much is trade policy bias discouraging investment through negative effects on value-chains?**

Picking winners and losers is difficult and trade policies that favour some industries may reduce economic growth. Favoured industries may procure resources needed by other more globally competitive enterprises. It may be best to put in place an enabling framework that allows competitive industries to develop and flourish rather than try to impose competitive advantages through trade policy. Trade policies are particularly prone to political economy influences. The benefits of, say, a protective tariff may flow to a few producers, yet the costs are incurred more broadly amongst consumers including export-oriented producers. Such costs are often not transparent and although small to any one constituent, overall they may be large and damaging to an economy. Hence if an industry is to be targeted, transparent subsidies (as long as they are consistent with obligations under the WTO Agreement on Subsidies and Countervailing Measures) may be preferable to the opaque use of trade policies. If trade policies are used, it may be best to structure the benefits generally, irrespective of the industry. Policies that have little or no bias (such as uniform tariffs) allow entrepreneurs to choose projects compatible with comparative advantages for the host country.

**3.4 Which trade policies (tariffs, non tariff barriers, other regulations, etc.) raise the cost of inputs and therefore discourage investment that depends upon sourcing at competitive prices? Are some border barriers reducing access to imports with the most advanced technologies?**

To sell goods and services in global markets, an entrepreneur needs to source capital and intermediate goods and services at internationally competitive prices and qualities. Trade policies can obstruct this access and may reduce the returns to the project, investment and economic growth for the host's constituents. Some countries have policies that require a minimum proportion of the inputs for a project to be sourced locally. Such policies may be inconsistent with WTO obligations arising from the TRIMs (Agreement on Trade-Related Investment Measures) but even if they are not, policy makers should evaluate their potential dampening effects on investment.

**3.5 If home trade policies curtail developing country exports, who bears and how high are the costs, and are such policies the least restrictive way of accomplishing the regulatory goals?**

A home country's trade policies may reduce the developing country's exports and therefore its ability to purchase imports and source investment, including from abroad. Given the lower income in developing countries, the entrepreneurial talent in the developing countries may need to export and sell to a home country's market at least initially. Curtailing a host country exports may impede host country development.

Competition is frequently a trade policymaker's best ally. Curbing importation generally and in particular products with price and quality advantages, will likely hurt the home country's consumers. Also, many imports are intermediary products used by the home country's industries. Curbs on such products might deter creation or expansion of the home country's enterprises including multinational enterprises which may best utilise developing host country exports. In the past, some host countries have sought to encourage economic growth by imposing import substitution using tariff and trade policies generally; most of those attempts have now been abandoned.

**3.6 Which policy measures impact upon services trade? Are impediments to services trade impeding investment (and trade in goods) by disrupting important services components of international value-chains (e.g. financial services)?**

The value of trade-in-services through all four modes<sup>7</sup> has expanded both as proportion of total trade and in sheer 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) can not only benefit the host country from which the service originates but concurrently make the home's multinational enterprises globally competitive. Reviewing and possibly 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.

**3.7 Certain sectoral weaknesses in developing countries can serve to impede trade until these weaknesses are addressed (e.g.adequate financing for exporters, adequate insurance for importers). How could home country trade policies help to overcome such capacity constraints to the benefit of interested investors and traders in both the home and host countries?**

Correcting market failures in some host countries may require help from home countries. For example, some may not have well-established securities markets or financial systems that are able to cope with the demands of global value chains. Trade financing can often best be provided by home countries. Under such conditions, some home policy support may be appropriate. But this scenario may become rare as capital markets continue to deepen and broaden.

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7 Services can be traded either by modes: (1) cross-border supply; (2) consumption abroad; (3) commercial presence (FDI); or (4) temporary movement of natural persons. The four modes are often intrinsically linked. Any effort to liberalise one, say FDI, may be ineffective if there are barriers to trade-in-services in another mode.

Further Policy Resources (provisional): Trade Policy

- 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<sup>8</sup>

### **4.1 Are the competition laws clear, transparent, and non-discriminatory? What actions have competition authorities taken to help businesses understand and abide by competition law? For example, have the authorities issued guidelines that explain the approach they will take in enforcing the law(s)? Are agency and court decisions published, along with a statement of the reasoning behind them? How are changes in competition law communicated to market participants?**

For competition policy to be effective, businesses (and other parts of government for whom it might be relevant) need to understand the “rules of the game.” Competition law and policy should be transparent and implementation should be predictable. Transparency means that businesses and other interested parties have access to all necessary information, such as the laws themselves (and any changes to them), guidance with respect to interpretation of the law, and information on decisions, including reasons for particular outcomes. Transparency reduces firms’ costs of compliance and promotes confidence by reassuring investors that they are being treated fairly and that government is exercising its power responsibly. Predictability improves the investment environment by reducing the risks that businesses and investors associate with inconsistent application of laws and regulations. While no two situations are exactly the same, under reasonably similar circumstances decisions should be consistent with each other. In support of greater predictability, competition authorities could look at international best practices for guidance, i.e. OECD recommendations.

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

The distinction between adopting a new law or policy and effectively implementing it can represent the difference between success and failure. Effective implementation requires that the competition authority have the necessary resources and political support to do the job properly. Competition authorities must often challenge powerful 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 strong political commitment supporting those challenges, efforts to promote competition, and hence investment, in such cases are likely to fail. Furthermore, strong commitment and oversight at the political level can help to protect competition authorities themselves from becoming captured by particular interests. Political support for competition policy, which includes supplying enough 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 means for insulating enforcement decision-makers from political direction or influence.

### **4.3 To what extent and how have competition authorities addressed anticompetitive practices by incumbents that inhibit investment?**

Incumbent firms (domestic, foreign, state-supported or state-owned) can sometimes discourage investment by abusing their market power. For example, if an incumbent maintains exclusionary arrangements with retail or wholesale distributors, and access to this distribution network is essential,

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<sup>8</sup> For a more detailed examination of the issues covered in this chapter of the PFI, refer to the background document “A Policy Framework for Investment: Competition Policy”, [DAFFE/IME/TF(2004)3/REV1].

then there are potential implications for competition and, hence, the investment environment (assuming that the cost of establishing a second distribution network is prohibitive). In most jurisdictions, predatory offences involve selling products below an appropriately defined measure of cost with a view to recouping losses (by setting prices at monopoly levels) after weaker rivals have been eliminated or would-be new entrants have been deterred. Predatory behaviour can have both an immediate and a long-term impact on new investment insofar as the threat of predatory behaviour by a powerful incumbent who has a record or reputation for such conduct could discourage prospective investors. These exclusionary practices, if uncorrected, could discourage investment, not only in competition with the dominant incumbent, but also in industries that are upstream and downstream from it. The legal and practical capacity and demonstrated willingness of competition authorities to prevent, correct or sanction such anticompetitive exclusionary practices can have a significant bearing on competition and, hence, on investment opportunities.

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

Within the context of efforts by governments to create an environment which is attractive to investors (both foreign and domestic), a key challenge consists in identifying and eliminating unwanted impediments to new investors. In addition to impediments that originate in the actions of incumbent firms (mentioned above), a wide array of government policies and regulations can also discourage new investment. Some government policies and regulations discourage investment directly, such as, for example, government prohibitions on investment in certain sectors. Other policies and regulations are less direct but nonetheless can also be prohibitive. For example, trade restrictions can make a national market too small for certain investments that require minimum economies of scale to be viable. Indeed, almost any area of government policy making can influence the quality of the investment environment. Consequently, without prejudice to the authority of government to regulate and the authority of other agencies in the conduct of their responsibilities, it is generally desirable to involve competition policy authorities in the development and consideration of laws or regulations that have potential implications for competition and, hence, the investment environment.

Ensuring policy coherence across different policy areas is in the spirit of the Policy Framework for Investment but can present particular challenges. A good example of the sorts of trade-offs that competition authorities have to deal with involves policies towards intellectual property rights (IPR). IPR and competition policies share the common goal of promoting technical progress to the ultimate benefit of consumers. The relationship is complex, though: firms are more likely to innovate if they are at least somewhat protected against free-riding, but they are also more likely to innovate if they face strong competition. Legitimate use of IPR temporarily restricts direct competition with the item subject to the IPR. The protection of IPR is an example of a limit to competition at one level that is generally considered beneficial to competition at another level. The difficulty for competition policy lies in determining at what point such limits produce negative marginal returns to consumers by discouraging new investment. The importance for developing countries of issues linking competition policy with intellectual property rights, including issues associated with the impact of licensing in home countries on competition in host countries, have been emphasised by Members of the Task Force as an area requiring further careful consideration.

**4.5 With respect to industrial policies, aimed, inter alia, at creating champions, have competition authorities assessed the costs and benefits of such policies? Are industrial policies periodically reviewed by competition authorities?**

Within the context of their development strategies, some governments have sought to promote “champions,” which, by definition, involves granting preferential treatment to some firms over others on the basis of nationality.<sup>9</sup> Champions often involve significant state involvement (both financial and with respect to management), and are usually granted some form of exclusivity (*i.e.*, protection from trade and investment-based competition) in the national market. The arguments for national champions usually rely on considerations of dynamic (versus static) efficiency. They include arguments to the effect that economies of scale cannot be attained without restrictions on competition, these economies of scale allow for more spending on research and development, and, by extension, only once such economies of scale have been reached can firms realistically expect to be able to compete on international markets. The issue of national champions has been contentious. It underlies one of the key difficulties in incorporating dynamic efficiency objectives into competition policy – how to find the right balance between static and dynamic efficiencies. If competition is reduced too much, potential dynamic gains could either be completely eroded or simply not realised in the first place due to “slack” – the inefficient use of resources within firms that do not face enough external market discipline.

Setting aside the question whether governments should promote champions, competition authorities should be involved in decisions about them because they bear directly upon the competitive structure of an economy and, by extension, its attractiveness from an investment perspective. Competition authorities have come to play an increasingly important advocacy role. In the case of industrial policies aimed at creating national champions, this advocacy role should involve an evaluation of the costs associated with limits on competition and exemption from competition law enforcement.

**4.6 What has been the role of competition authorities in the privatization process? Have competition considerations 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. The motivation for many privatizations has been the recognition that many activities can be run more effectively and efficiently by the private sector. However, a concern of governments and competition authorities has been to avoid replacing public with private monopolies. This challenge has sometimes been complicated by conflicting objectives associated with privatizations, namely 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. Bidders for publicly owned companies, including MNEs, will be willing to pay more if they believe that they are buying a monopoly position in a particular market. However, as with the provision of exclusivity as a form of incentive to attract FDI, the primary consideration of competition authorities should be the long-term competitive benefits that FDI can bring to an economy rather than possible short-term budgetary wind-falls.

A special case of this issue concerns the granting of market exclusivity to foreign investors as a form of FDI incentive. From the perspective of the firm offered this type of concession, the advantage lies in being able to exercise market power in the market in question (*i.e.*, the firm enjoys some control over pricing and can therefore charge above marginal cost). From the perspective of government, the appeal of this type of incentive is that, at least on the surface, there is no immediately obvious financial cost and

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<sup>9</sup> Such as protection from competition through restrictions on FDI and trade protection, exemptions from competition law enforcement, and various fiscal advantages.

a firm that is granted some form of exclusivity is likely to be willing to pay more for the assets in question than would otherwise be the case. The ultimate costs of this type of incentive are borne by the customers of the supplier in the form of the supra-competitive prices the latter is able to charge and by the economy more generally in the form of the forgone benefits of subsequent investment, including FDI (*i.e.*, subsequent investment that is barred as part of the exclusivity contract granted to the original investor).

Competition authorities should be involved in decisions concerning privatizations and the use of exclusivity as an incentive because they bear directly upon the competitive structure of an economy. Their advocacy role should involve, at a minimum, an evaluation of the costs associated with arrangements that lead, either tangentially or by design, to monopolies. Merger control powers might be applied to prevent or correct anti-competitive dispositions of privatised assets; however, it could be more efficient for the competition policy authorities to be involved in decisions about privatisation well before transactions reach that stage.

**4.7 Have competition authorities been given the capacity to deal with international competition issues, such as international mergers and acquisitions, abuse of dominance ,and cartels, and does the competition authority have adequate channels for communication and cooperation with other competition agencies with respect to international competition issues?**

With the rapid increase in cross-border investment over the past decade, competition authorities are increasingly dealing with competition issues that span borders, such as international mergers and acquisitions and international cartels. While competition law and policy is generally blind to the nationality of the firms involved in particular investigations or cases, competition issues that have an international dimension can have particular resource and capacity implications for competition authorities. For example, can competition authorities examine anticompetitive practices that might originate outside of the national market, such as international cartels? In some of these instances, co-operation with competition agencies in other countries is likely to be useful if not essential. For effective co-ordination in applying competition law efficiently to matters with international dimensions, the competition authority should have adequate channels for communication and co-operation with other competition agencies.

Further Policy Resources (provisional): Competition Policy

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

## Annotations to Chapter 5. Tax policy<sup>10</sup>

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

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

### **5.2 Has the government evaluated the level of tax burden that would be acceptable generally to investors? Is this level consistent with the actual tax burden?**

A central issue in gauging what host country tax burden would be expected to be acceptable generally to investors is whether the country offers attractive risk/return opportunities, taking into account framework conditions, market characteristics and location-specific profits of the host country, ignoring tax considerations.

Important to potential investors are questions over costs and non-diversifiable risks associated with securing access to capital and profits, adjusting to macro-economic conditions, and complying with laws and administrative practices. Also centrally important to investors are considerations of output demand and factor input supply. Another fundamental issue is the degree to which the host country offers location-specific profits (profits that require a physical location in the host country).

Investors are generally willing to accept a higher host country tax burden the more attractive are the risk/return opportunities the host country presents, taking into account host country framework conditions, market characteristics and opportunities for location-specific economic profits. Absolute and comparative assessments with regard to competing jurisdictions are relevant.

### **5.3 If framework conditions and/or market characteristics are weak, is it reasonable to assume that a low tax burden can impact investment decisions?**

Policy-makers are encouraged to reflect on the disappointing experience of transition economies that have attempted to rely on a low tax burden (typically targeted at foreign investment) to boost investment. Where framework conditions and/or market characteristics are relatively weak, realistic expectations should be made of additional investment that would accompany a reduced tax burden, and of tax-planning opportunities created. Where a low tax burden is to be achieved through the use of special tax incentives, the potential should be assessed for the incentives to *discourage* investment by contributing to project cost and risk.

### **5.4 Is the tax burden on business appropriate with reference to the set of policy goals and objectives of the tax system?**

In deciding the tax burden to impose on domestic profit, the analysis should weigh in the various objectives guiding overall tax policy design, including efficiency concerns, equity or redistribution

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<sup>10</sup> For a more detailed examination of the issues covered in this chapter of the PFI, refer to the background document "A Policy Framework for Investment: Tax Policy", [DAF/INV/TF(2005)4].

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.

**5.5 Where the tax burden on business income differs by firm size, ownership structure, industrial sector or location, can these differences be justified? Is the tax system neutral as between foreign and domestic investors?**

Tax systems may impose a non-uniform effective tax rate on different businesses, depending on their size, ownership structure (e.g. domestic versus foreign-owned), business activity or location. Certain firms may be specifically targeted to receive preferential tax treatment. Where tax relief is targeted, policy makers should examine and weigh arguments in favour and against such treatment, and ensure that the different treatment can be properly justified in order to respond to pressures for a broader target group. Where justifications are weak, consideration should be given to a non-targeted approach.

**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 main tax provisions generally consistent with international norms?**

In dealing with any given corporate tax system, investors expect basic tax provisions that adequately reflect business costs, including loss carry-forward provisions 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 paid along a corporate chain. In short, policy makers are encouraged to ensure that recognition is taken of reasonable expectations of main design features of the tax system.

**5.7 Have unintended tax-planning opportunities created by targeted tax incentives been explored and taken into account in assessing the cost-effectiveness of such incentives? Have other problems associated with targeted tax incentives been 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 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. 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 investment impediments directly.

#### **5.8 Are tax expenditure accounts reported, tax incentive evaluations carried out, and sunset clauses used to properly manage and inform the budget process?**

Tax expenditure analysis measuring revenue foregone by targeted tax incentives and other departures from a benchmark tax system should be a cornerstone of fiscal policy in countries where attracting capital and addressing public governance issues remain high on the political agenda. Such accounts should be subject to public scrutiny and be considered alongside corresponding direct expenditures to properly inform the budget process.

For proper management of public finances, tax incentives targeted at investment should be assessed in advance and following implementation if introduced, to gauge whether such measures pass or fail a cost-benefit test. To enable such evaluations, the specific goals of a given tax incentive need to be made explicit at the outset to enable a proper assessment of the degree to which stated goals are met.

When introducing tax incentive legislation, “sunset clauses” should be included calling for the expiry of the incentive (e.g. 3 years after implementation), to provide an opportunity for assessment in order to establish whether the incentive should be extended or not.

#### **5.9 Are tax policy and tax administration officials working with counterparts in other countries to expand their tax treaty network and counter abusive cross-border tax planning strategies that artificially reduce the domestic host country tax base?**

A wide tax treaty network is helpful to countries seeking investment in several ways. By providing investors with increased certainty over tax treatment, and reducing scope for double taxation of income, tax treaties operate to improve profits and minimize risk. At the same time, tax treaties providing a framework for exchange of information amongst tax authorities to counter more aggressive forms of tax-planning in relation to foreign source income as well as domestic source income (that may be stripped out to tax havens through the use of special corporate structures and financing and repatriation strategies).

#### Further Policy Resources (provisional): Tax Policy

- 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<sup>11</sup>

- 6.1 What steps have been taken to ensure a clear and transparent division of responsibilities between different supervisory and enforcement agencies? Has this been translated into a coherent and consistent regulatory framework, backed by effective enforcement?
- 6.2 Do national characteristics of the corporate ownership and control structures call for strengthening any particular aspects of the corporate governance framework, for example minority rights or equitable treatment of shareholders?
- 6.3 What are the procedures and institutional structures for legal redress in cases of violation of shareholder rights? Do the systems for providing legal redress function efficiently and effectively enough to serve as a credible deterrent to such violations?
- 6.4 What procedures and institutions are in place to ensure that investors' property rights are recognized and respected, including through secure methods of ownership registration?
- 6.5 What procedures and institutions are in place to ensure that shareholders have the ability to significantly influence the company? For example, are there sufficient notification procedures for general shareholders meetings and adequate procedures for proxy voting to effectively allow voting for those unable to directly participate?
- 6.6 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?
- 6.7 What measures are in place to monitor and prevent abusive related party transactions and inhibit other ways for corporate insiders and controlling owners to extract private benefits?
- 6.8 How does the corporate governance framework ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders?
- 6.9 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?
- 6.10 Has a review been undertaken in order to assess the national corporate governance system against the OECD Principles of Corporate Governance? Has the result of that assessment been made public?
- 6.11 For state-owned enterprises (SOEs), how is the ownership function within the state administration structured to ensure adequate organisation and efficient procedures to enable the state to act as an active and informed owner, while not interfering in day-to-day management of SOEs?
- 6.12 What are the processes in place to ensure that SOE board members are nominated in a transparent manner and based on their competencies and experience?

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<sup>11</sup> For a more detailed examination of the issues covered in this chapter of the PFI, refer to the background document "A Policy Framework for Investment: Corporate Governance", [DAF/INV/TF(2005)5].

**6.13 What procedures and institutions are in place to ensure accountability to both the government and the public, and in the case of listed SOEs, to other shareholders, including through adequate reporting by the ownership entity and SOEs themselves on their performance and achievement of their objectives?**

Further Policy Resources (provisional): Corporate Governance

- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD Guidelines on Corporate Governance of State Owned Enterprises (2005)
- OECD Principles of Corporate Governance (2004)

**Annotations to Chapter 7. Corporate responsibility and market integrity**

[Chapter scheduled for completion by 14 December 2005]

## Annotations to Chapter 8. Human resource development<sup>12</sup>

### **8.1 Has the government established a coherent and comprehensive HRD policy framework consistent with its broader development and investment strategy? 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 climate?**

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 climate 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 strategy, 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. 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 business 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 business 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? Are there policy-induced obstacles that act to lower the financial returns to higher formal education, limiting the improvement in the investment climate that flows from better human resources? What mechanisms exist to promote closer co-operation between higher 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 encourage investment in human capital is to pay attention to the size of the financial returns from higher education. Labour market policies that result in

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<sup>12</sup> For a more detailed examination of the issues covered in this chapter of the PFI, refer to the background document "A Policy Framework for Investment: Human Resource Development Policy", [DAF/INV/TF(2005)11].

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 climate lifts the financial returns to investing in education.

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 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 climate, such as fostering an environment conducive to innovation and the quick diffusion of new knowledge.

**8.4 Does the government support training programmes and has it adopted practices that evaluate their effectiveness and their impact on the investment climate? 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 business 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 climate 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 the costs and benefits of public health expenditures aimed at improving public health outcomes, and through interlinkages indirectly the investment climate?**

Pandemic diseases are a human tragedy, ravaging societies through the premature loss of lives and entrapping many others in poverty. They negatively influence business 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 business 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 context.

## **8.6 What mechanisms and steps 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 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 policy reforms have been introduced that balance social objectives, the goal of a competitive workforce and the incentives to business to invest and expand?**

Interventions in the labour market aim to improve market efficiency and achieve social objectives. From an investment climate 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 their 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 workers from an enterprise investing in the host country? What steps have been taken to identify and to unwind unduly restrictive practices covering the deployment of workers from the investing enterprise and to reduce delays in granting work visas to these employees?**

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 climate, 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 workers from an enterprise investing in the host country should take into account these broader economic considerations.

**8.9 Does the government support in programmes designed to assist large-scale labour adjustment and indirectly the investment climate 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 climate. 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. 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 do not stymie an adaptable workforce and excessively damage 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 climate if other interventions in the labour market create a context that blunts the process of workforce reorganisation. One notable example concerns the regulation of the hiring and firing of workers, also referred to as employment protection legislation (EPL). Strict EPL raises the cost of doing business, and especially exiting a business. Strict EPL may, therefore, discourage business from innovating and adopting new productivity enhancing technologies and deters investment. On the positive side, strict EPL tends to lead to long-lasting work relationships, which encourage businesses to provide training, raising labour productivity. However, according to OECD work and in line with World Bank studies found that the overall impact of EPL on FDI is negative. This suggests that governments should seek other ways to protect workers from income loss that have less deleterious effects on the business climate. In this regard, approaches that shift the focus of interventions away from protecting the job and toward income insurance offer promise, though implementation in a developing country perspective is a major challenge.

Further Policy Resources (provisional): Human Resource Development

- 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](http://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<sup>13</sup>

### **9.1 What processes does the government use to evaluate its infrastructure investment development needs? How do governments ensure private investors in infrastructure operate with clear guidelines for the disbursement of public funds and in relation to transparency and procedural fairness for all investors? Are the regulatory agencies that oversee infrastructure investment and the operations of enterprises with infrastructure investments independent from short-term political pressure?**

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. To draw the maximum benefit from infrastructure, decisions on infrastructure investments need to be expertly informed by credible cost-benefit evaluations of the options and their economic sustainability. However, 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.

### **9.2 What measures has the government adopted to protect investors' rights in infrastructure projects 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.

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<sup>13</sup> For a more detailed examination of the issues covered in this chapter of the PFI, refer to the background document "A Policy Framework for Investment: Infrastructure and Financial Services", [DAF/INV/TF(2005)10].

**9.3 Are state-owned infrastructure agencies operated on a commercial basis? What mechanisms do public infrastructure agencies use to decide how much to invest in infrastructure, where to allocate infrastructure investments and how to administer them?**

Governments are major financiers and providers of road infrastructure and in sectors where most infrastructure investment is private, complementary public investment is often important. Governments thus need procedures to decide how much to spend on infrastructure, how to allocate spending 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. 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.

**9.4 In the telecommunications sector, to what extent 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 climate. 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 climate. 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 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.

**9.5 To what extent 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 and which instruments are used 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 as 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.

**9.6 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 and do they take 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, 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.

**9.7 Has the government evaluated the investment needs in water required to support its development goals? To what extent have public-private partnerships been promoted as a means to finance water infrastructure investments? Does the government use independent assessments of public water investment programmes to enhance their credibility and to help attract additional finance and new investors?**

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 very 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.

**9.8 How has the government sought to attract private sector investment in the development of the financial services sector, offering a wide range of products to a broad cross-section of the economy? What steps has the government taken to identify and remove obstacles to new private investors and competition entering the domestic banking sector? What role do foreign banks play in the development of the domestic financial sector, and how does the**

**government address concerns that foreign competition could harm the stability of the banking sector?**

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 financial enterprises; 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.

**9.9 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 movable property as collateral and to expand business access to external sources of credit to fund investment? What data protection and credit reporting laws have been enacted to facilitate the flow of information, to promote bank lending and to reduce default rates? What approach has the government taken to limit the risk of systemic crises in the financial sector, damaging 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.

Further Policy Resources (provisional): Infrastructure and Financial Services

- 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<sup>14</sup>

### **10.1 Is there a consistent and coherent approach to regulatory reform that sets out principles dealing with regulatory policies? How is regulatory policy co-ordinated in order to ensure consistency and coherence across different levels of government (national, sub-national, local)? Is there a legal basis for government action, thus providing certainty to investors?**

Regulatory policy is an explicit policy for a dynamic, continuous and consistent “whole of government” approach to pursue regulatory quality. Regulatory policy is about the process by which regulations are drafted, updated, implemented and enforced, set in a broader context of public policy objectives. The evaluation of policy therefore includes not only the social, environmental and economic impact of regulations, but also the links between regulatory processes or systems on the one hand, and those outcomes on the other. 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 often do not achieve their objective.

From an investors’ perspective, regulatory policies 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. Thus, domestic and foreign stakeholders would have a statement of government policy for reference, in addition to other obligations that may govern regulatory action.

### **10.2 What inter-ministerial mechanisms are in place for managing and co-ordinating regulatory reform and integrating competition and market openness considerations for attracting investment? Do the existing institutional capacities ensure consistent and coherent application of principles of quality regulation?**

Diversity in institutional systems and institutional traditions has an impact in regulatory policy. Nevertheless, during the regulatory process, the need for some form of central mechanism to promote regulatory quality appears to be essential if durable progress is to be made. 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.

Quality regulation that enhances the investment environment needs a strong involvement and a sense of “ownership” by regulators in charge of 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 Are the economic and social impacts of regulations reviewed in a way that they foster investment for development? Is regulatory impact assessment (RIA) used to help avoid unnecessary investment restrictiveness? Is RIA used to help increase transparency, taking into account investors’ points of view?**

Regulatory Impact Assessment (RIA) examines and measures the likely benefits, costs and effects of new or changed regulations. It is a useful regulatory tool that provides decision-makers with valuable empirical data and a comprehensive framework in which they can assess their options and the

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<sup>14</sup> For a more detailed examination of the issues covered in this chapter of the PFI, refer to the background document “A Policy Framework for Investment: Public Governance”, [DAF/INV/TF(2005)9/REV1].

consequences their decisions may have. 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 define problems and to ensure that government action is justified and appropriate in economic, social and environmental terms.

Many countries rely on RIA to avoid unnecessary investment restrictiveness. Though not expressly conceived or formulated in terms of market openness considerations per se, the RIA process does provide a systematic approach for assessing the impacts of a proposed regulation and helps inform regulatory decision-making. Where appropriate, therefore, investment impacts would normally be assessed in the mix of other factors deemed relevant in a given regulatory scenario. 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), RIA thus emerges as a potentially useful tool for considering investment impacts of various regulations.

**10.4 What public consultation mechanisms and procedures, including prior notification, have been established and are these open to regulated parties and other stakeholders, non-governmental organisations, the private sector, advisory bodies, accreditation bodies, standards-development organisations and other governments?**

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 of course include potential domestic and foreign investors as well as affected business, trade unions, 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 is important to ensure that 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 Are administrative burdens, including with respect to trade, measured and quantified? Is there a government program to encourage the reduction of administrative burdens? Are e-government and other information and communication technologies used to promote administrative simplification, quality services, transparency and accountability, and how widely?**

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 means of reducing administrative burdens. Enabling administrative simplification has become in many countries a key driver of their e-government programmes.

Excessive ‘red tape’ adds to business costs, can impede market entry, reduce incentives to innovate and reduce competitive pressures within the economy. 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 international, weakens competitive pressures within the economy and economic performance will suffer.

**10.6 Do legislation and regulations implement international anti-corruption and integrity standards? Do penal, administrative and civil law provisions provide a consistent legislative and regulatory framework for fighting corruption as well as promoting integrity? What standards have been developed to guide public officials' behaviour?**

Anti-corruption and integrity standards include both preventive as well as 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 specific standards of conduct to address conflicts between public officials' individual 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 specific 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 specific mechanisms been developed to address risk areas for corruption? Is guidance provided to help public officials meet expected standards in daily practice? Does human resources management, in particular in recruitment and career promotion, enhance ethical behaviour?**

Application and enforcement of laws and regulations on anti-corruption and integrity involves many institutions across the public service. 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.

11. 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.

**10.8 Do review mechanisms exist at domestic level to assess the application and enforcement of laws and regulations on anti-corruption and integrity ? Do the mechanisms ensure that civil society organisations and the media actively support public scrutiny over public officials' behaviour?**

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. Additionally, 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 signatory of or a Party to international initiative(s) 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 the mechanisms in question monitor the application in practice 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 eradicating 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.

International co-operation in the fight against corruption is an example of the interface of private and public sector integrity where home countries have made a contribution to public sector integrity in host countries by targeting the "supply side". 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 also developed policies aimed at fostering good governance and sanctioning corruption and related malpractices, variously addressing both the "demand" and "supply" sides.

Further Policy Resources (provisional): Public Governance

- 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.