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**OECD GLOBAL FORUM ON
INTERNATIONAL INVESTMENT**

Turkish Treasury

Enhancing the Investment Climate: the Case of Infrastructure

**Hosted by the Government of Turkey and organised by the
OECD Investment Committee in partnership with the World Bank**



SUMMARY REPORT

The OECD Global Forum on International Investment (GFII) was opened by the OECD Deputy Secretary-General and Turkey's Minister of State and Chief Negotiator for EU Affairs. The GFII was attended by representatives from governments, international organizations, business, labour and civil society. The number of registered participants was 208, including a Minister of Finance (Turkey), a Minister of Trade (Costa Rica), 5 OECD ambassadors, and approximately 20 Directors or Deputy Directors of investment promotion agencies. The OECD Secretariat delegation was headed by Deputy Secretary General Richard Hecklinger and Deputy Director Rainer Geiger. The World Bank was an official sponsor of the Conference, providing financial assistance for participants from developing countries.

Executive summary of discussions

The first GFII session centred on the use of the PFI took place in Istanbul, on 6-7 November 2006. This session featured presentations by three countries at different levels of engagement in PFI-based exercises. Costa Rica, represented by Trade Minister Marco Vinizio Ruis, is in the early planning stages, and the Minister indicated that his main purpose in attending the GFII was to learn more about options for using the PFI from countries that had already started doing so. Egypt, represented by Mr. Ziad Ahmed Bahaa El Din, the Chairman of the General Authority for Investment and Free Zones (GAFI), was one of these countries.

Within the context of the on-going process for Egypt's adherence to the OECD Declaration for International Investment and Multinational Enterprises, Egypt began a PFI-based self evaluation in mid-2006 using the chapters on investment, investment promotion and facilitation and trade policy. The results of this first-ever self-evaluation highlighted policy challenges faced by Egypt for improving its investment climate as well as methodological issues that future users of the PFI should be mindful of.

The challenges faced by Egypt that emerged from the self evaluation include a licensing system that continues to burden businesses, dispute settlement mechanisms that operate adequately for large investors but that remain difficult or even out of reach for SMEs, the related challenge of providing adequate financing for SMEs, and further opportunities to encourage internationally competitive investment by reducing various obstacles to trade. The representative from Egypt also indicated that their efforts to establish a "one-stop shop" had not been a panacea.

Methodological lessons learned by Egypt concerned issues of inter-agency co-ordination. Although the representative from Egypt acknowledged that interagency co-operation can be difficult, he also identified

this inherent requirement of the PFI process as one of its particular strengths. By requiring a certain amount of interagency cooperation, the PFI can serve to sensitise agencies whose mandate is not specifically aimed at improving the investment climate to their potential impact (either positive or negative).

Another methodological issue raised by Egypt concerned the role of investment promotion agencies (IPAs) in PFI-based work. Investment promotion agencies face an inherent conflict when it comes to providing critical answers to PFI questions. This frank assessment (by the head of Egypt's IPA) of the potential for conflict of interest for IPAs engaged in PFI-based assessments would seem to suggest the need for balancing mechanisms (e.g. the involvement of ministries with broad economic portfolios) when -- as will often be the case -- an IPA is given coordinating responsibility for a PFI self-assessment.

The next presentation, by the Deputy Director of the OECD Directorate for Financial and Enterprise Affairs, was on the Investment Reform Index (IRI), a policy tool developed within the context of the South East Europe Investment Compact initiative. This presentation showcased how the IRI is structured and how it has been used as a metric for evaluating reform efforts. The IRI methodology, which could be applied to future uses of the PFI, encourages structured policy debate between the public and private sectors, and exchanges of good practices between policy experts. The IRI's combination of comparative scoring, an emphasis on government participation and the provision of concrete guidance on how to apply good practices has created a strong impetus for effective policy reform.

Following this overview of the IRI, Mrs. Cornelia Simion, the Director of Romania's Business Environment Unit, presented Romania's experience with the IRI. In contrast with Egypt's qualitative self-assessment approach, the IRI could be described as a quantitative regional benchmarking approach. The IRI covers many of the same policy areas as the PFI, for which specific indicators have been developed to allow a quantitative assessment of where countries in South East Europe stand with respect to their policy reforms. In this regard, Egypt and Romania highlighted the broad range of implementation options for the PFI depending upon the objectives of the countries involved. Furthermore, despite their very different approaches, both Egypt and Romania indicated strong satisfaction with how their respective initiatives have worked, emphasising one of the underpinning philosophies of the PFI, namely that one size does not fit all.

In short, the PFI self-evaluation session of the Istanbul GFII had two concrete outcomes. First, Costa Rica indicated that it favoured starting with the "Egyptian approach". The underlying objective of a PFI-based self-assessment would be to build on the policy reforms of recent years and to help develop what the Minister referred to as Costa Rica's areas of "real competitiveness" (as opposed to areas of economic activity that have traditionally relied upon tax or other incentives). Second, Egypt indicated its plans to extend its self-assessment to all ten chapters of the PFI. Originally the pilot project in Egypt was intended to cover only the first three chapters. However, in light of Egypt's positive experience during the pilot study, the government decided to extend its self-assessment to the whole PFI.

The second day of the GFII focused on infrastructure and was organised in accordance with the structure of the draft OECD instrument, *Principles for International Investor Participation in Infrastructure*. The draft Principles were introduced to participants by Investment Committee Chair Manfred Schekulin, and comments were invited. The first part of the discussion, recognising that many less successful infrastructure projects in the past have faltered on institutional weaknesses, rather than project design, focused on the link between the investment climate and infrastructure investment. The second part explored the options for establishing a climate of cooperation between investors, authorities and stakeholders to enhance the chances of success in the duration of such long-term contractual relationships. The final part of the discussion focused on the challenge of ensuring responsible business conduct in the infrastructure sector, including in developing countries and countries with weak public and corporate governance.

Participants agreed with the notion that the general investment climate is among the most important prerequisites for the success of privately-invested infrastructure projects. The outcome of projects depends strongly on the quality of the political, economic and regulatory environment in which it takes place. The quality of the legal environment is of paramount importance, for unless the rule of law is firmly established, and regulation consistently enforced, investment is fraught with risk. The fight against corruption – on both the supply and demand side – is considered a *sine qua non* for success.

Several discussants cautioned against a temptation to see private investment in infrastructure as a panacea and argued that the Principles should not be read as an unconditional endorsement of privatisation. The choice between public and private provisioning should ultimately rely on an assessment of which approach serves better the public interest. In a similar vein, civil society representatives opined that the public interest is intrinsically linked with sustainable development and warned that the Principles, while relevant in their own right, could be losing an important dimension by focusing more narrowly on the process of private investor involvement.

Authorities need to ask themselves other important questions at the outset of an infrastructure project. For example, a transfer of infrastructure services to the private domain gives rise to the question: how much subsidisation will be needed, and available, to render services affordable to households. Finally, authorities need to ensure that the involvement of private investors in infrastructure does not lead to a breakdown in budgetary discipline through off-budget financing and failure to account for guarantees and contingent liabilities.

Authorities need also to consider how much risk their private partners shall be expected to undertake, and how to obtain a realistic balance between risks and returns. A difference of perspectives became obvious as private sector representatives, on the one hand, argued that infrastructure projects in the past have faltered because public authorities shifted risks that were essentially political onto their private partners. On the other hand, civil society representatives warned that the Principles can not be seen to indicate that the public sector invariably bears ultimate responsibility and private investors are expected mainly to perform self-justice and due diligence.

Several delegates noted the inevitable “politisation” of infrastructure projects. Private investors are often invited into national infrastructure sectors at a point where basic services are already at risk. A shift to cost-recovery pricing to finance the new capital spending is often seen by existing consumers as a denial of well-earned rights, and authorities have sometimes felt a necessity to associate themselves with this criticism. A policy of transparency and inclusive dialogue with all stakeholder groups produce the best long-term results.

There was general agreement that successful private involvement in infrastructure is feasible only when both the public and the private participants are willing to enter into a bona fide partnership for a considerable period of time. This gives rise to a number of issues, including: (i) a need for authorities to make policy objectives, as well as the expectations to individual projects, clear; (ii) an output-based project definition in which the general public rather than the public sector is seen as the client; (iii) a need to secure a high degree of transparency in the public-private partnership, including in the context of political change, where all project-relevant data are fully disclosed.

Strong and enforceable contracts are vital to successful projects, but they cannot cover all aspects of a partnership. Renegotiations of contracts are a normal consequence of long-term partnerships, but they should nevertheless be kept to a minimum. The best way of balancing the “sanctity of the contract” with the necessary flexibility may be to include contractual stipulations specifying under what circumstances revisions to the original agreement shall be considered. Political and regulatory changes are a fact of life and

need to be accepted as such by infrastructure investors. However, they should they take place in an open and transparent fashion including stakeholder involvement.

The discussion of responsible business conduct (RBC) opened with a presentation of the *OECD Guidelines for Multinational Enterprises* and their relevance to the infrastructure sector. Participants agreed that RBC may be particularly challenging in the case of the large scale – and often environmentally and socially charged – investment projects of the infrastructure sector, particularly in poor countries and countries with weak governance. The possibility of encouraging RBC through financing channels – e.g. as part of project finance or ethical investment vehicles – on the basis of instruments such as the *Equator Principles* was also discussed.

Three particular areas of concern arose during the discussions. In the construction phases, occupational health and safety is of high priority. Construction is one of the relatively few segments of the labour market where serious accidents and injuries remain commonplace. In weak governance zones responsible investors need to consider safety measures that exceed regulatory requirements. Consultations with affected communities, timely measures to protect the environment and a participatory approach to expropriation and resettlement programmes are also seen as very important.

The issue of corrupt and other irregular practices received particular attention. The scale of many infrastructure projects creates an incentive to offer and solicit bribes in the awards phases, and it makes them a potential source of patronage throughout their duration. In addition, allegations that infrastructure operators have brought political pressures to bear on the authorities of some countries to privatise infrastructure assets contrary to the public interest are problematic from a corporate ethics perspective.

Much of the discussion focused on the difficulties with responsible business conduct, and the Guidelines in particular, outside the OECD area. Several participants argued that developing country governments, in addition to strengthening their legal and regulatory frameworks, may need to establish more formal structures for addressing corporate ethics. Some pointed to the “National Contact Points” of OECD countries as a model and, potentially, a vehicle for international cooperation.

Prior to the Global Forum, a Country Roundtable on Turkey took place. Participants discussed which experiences to draw from regarding Turkey’s efforts at structural reform in recent years, including work on the Turkish investment climate. Most of the delegates felt that a successful programme of macroeconomic stabilisation has been at least as important to Turkey’s recent upswing in inward investment as concrete steps toward improving the investment climate. Both a spectacular drop in inflation and a reduction of the general government budget deficit to almost zero have enhanced the predictability of the macroeconomic environment. A concomitant pick-up in economic growth and the rollout of a privatisation programme have attracted investors as well.

There was a shared view at the Turkey Roundtable that recent success should not lead to complacency. Countries and regions develop investment promotion strategies, and establish investment promotion agencies at a rapid pace: the result is a heightened competition for direct investment. This is further compounded by the fact that countries increasingly target “high-value FDI” in prioritised sectors and hence find themselves chasing the same projects as a large number of other nations. The conclusion of this is that small differences between countries’ enabling environments for investment are likely to become increasingly important for the location of international investment projects. Against this background, participants encouraged Turkey to continue its process of structural reform, including in areas such as the commercial code, licensing procedures and fees, corporate governance and access to land.