OECD EURASIA COMPETITIVENESS PROGRAMME

Initiative for South Caucasus and Ukraine
Enhancing Investment, Competitiveness and Private Sector Development in the South Caucasus and Ukraine

Working Group on Investment Climate Policy and Promotion
3 July 2009, Bodrum, Turkey
1. GDP and FDI trends in the South Caucasus and Ukraine
2. The Initiative
3. The need to address Investment Climate, Policy and Promotion
4. Sector –priorities and sector–specific policy barriers
5. Next steps
GDP growth in the region is impacted by the financial crisis
Average GDP growth falling in 2009

Growth in BSEC-CA Countries
1998 - 2008

GDP Growth
2007-2009

LOW & LOWER-MIDDLE INCOME BSEC: Albania, Armenia, Azerbaijan, Georgia, Moldova, Ukraine

UPPER-MIDDLE & HIGH INCOME BSEC: Bulgaria, Greece, Romania, Russia, Serbia, Turkey

CENTRAL ASIA: Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, Uzbekistan

Source: OECD Development Centre / IMF

Source: EBRD; e. estimate; p. projection
Reliance on external financing is increasing
On average 13% of GDP for BSEC region

Source: OECD Development Centre / IMF
How to support the quantity and quality of FDI?

FDI in USD Million

- Central Europe
- SEE
- South Caucasus and Ukraine

Central Europe: First Wave of FDI

SEE: Second wave of FDI

SCU: Third wave?

Source: EBRD Transition report 2008, OECD Analysis
FDI growth is slowing down after a period of high growth

South Caucasus and Ukraine:
FDI Net Inflows 1999-2009 (in US$ million)

FDI growth a third lower than regions like South East Europe

Source: EBRD Transition report 2008
FDI inflows impacted by the financial crisis

South Caucasus and Ukraine: FDI Net Inflows per capita 2007-2009 (in US$)

Source: EBRD Transition report 2008, OECD Analysis

FDI growth a third lower than regions like South East Europe

Source: EBRD Transition report 2008, OECD Analysis
Quantitative and qualitative assessment of country credit risk (index from 0 to 7), based on risk indicators such as:

- the payment experience;
- the financial situation;
- the economic situation;
- political risk and/or other risk factors.

Measurement of likelihood that a country will service its external debt.

Source: OECD 2009
Heritage Foundation 2009 index of economic freedom

Methodology

The *Index of Economic Freedom* is built upon analysis of 10 specific components of economic freedom, some of which are themselves composites of additional quantifiable measures. The 10 component scores are equally weighted and averaged to get an overall economic freedom score for each country.

<table>
<thead>
<tr>
<th>Index of Economic Freedom</th>
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<tbody>
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<td>• Business Freedom</td>
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<td>• Trade Freedom</td>
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<td>• Fiscal Freedom</td>
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<td>• Government Size</td>
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<td>• Monetary Freedom</td>
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<td>• Investment Freedom</td>
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<td>• Financial Freedom</td>
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<td>• Property Rights</td>
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<tr>
<td>• Freedom From Corruption</td>
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<tr>
<td>• Labour Freedom</td>
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</tbody>
</table>

Source: Heritage Foundation 2009 Index
Overall high level of economic freedom but relatively low level of investment freedom

Heritage Foundation 2009 index of economic freedom (Scale 0-100)

Attract investments through policy reform.

Source: Heritage Foundation 2009 Index
## Measuring FDI potential and FDI performance

### Methodology

**Indicators to measure inward FDI potential**

- GDP per capita
- Rate of GDP growth over the previous 10 years
- Share of exports in GDP
- Average number of telephone lines
- Commercial energy use per capita
- Share of R&D spending in GDP
- Share of tertiary students in the population
- Country risk
- World market share in exports of natural resources
- World market share of imports of components for automobiles and electronic products
- World market share of exports of services
- The share of world FDI inward stock

**Measurement of Inward FDI performance**

The Inward FDI Performance Index ranks countries by the FDI they receive relative to their economic size. It is the ratio of a country’s share in global FDI inflows to its share in global GDP.

Source: UNCTAD 2004-07, Ranking of 141 countries
Good FDI performance and average FDI potential

FDI Performance and Potential

- **High FDI Performance**
  - Front-runners: Hong Kong, China
  - Below potential: Luxembourg, Norway

- **Low FDI Performance**
  - Under-performers: Azerbaijan, Turkey
  - Above potential: Egypt, Moldova, Georgia

FDI Potential is measured through a wide set of indicators such as:
- GDP per capita and growth
- Share of global exports
- Share of R&D spending
- Country risk
- Share of world FDI stock

FDI Performance is measured through the ratio of a country’s share in global FDI inflows to its share in global GDP.

Improvement of FDI attractiveness through policy reform

Source: UNCTAD 2004-07, Ranking of 141 countries, OECD Analysis
The OECD Initiative for The South Caucasus

Enhancing Regional Business Climate
- Prioritisation of policies to improve the business climate
- Policy Working Groups
- Competitiveness report on the South Caucasus and Ukraine

Improving National Competitiveness
- OECD Business Climate Development Strategy
- Surveys of investors and private sector perception
- Evaluation of policy reforms
- Supporting in implementing reforms
Deliverables in the form of study and implementation

- Policy dialogue through regional working groups
- Report on competitiveness in the South Caucasus and Ukraine
- Country specific business climate implementation
Governance: Strong collaboration with regional bodies and EU

Co-chairs: Poland and Sweden

Policy Working Groups*:
- Investment climate policy and promotion
- Financial Market Development and Impact of Central Banks
- Human capital for financial and business services

Country specific projects

OECD donors and partners

SCU country economic teams

International Organisations and private sector representatives

Private Sector Council

Eurasia Expert Council

Co-chaired by Poland and Sweden in collaboration with EU presidency
Partners and collaboration with: Black Sea Economic Cooperation (BSEC) and UNDP

* Note: Tentative groups being discussed with countries of the region – Focus on policy barriers
Determining policy priorities across the region

Which policy dimensions are of priority to improve investment, competitiveness and private sector development in the South Caucasus and Ukraine region?

**Investment Policy and Promotion** is priority area to address.

Source: OECD Survey
Suggested policy working groups

**Which key areas need to be address to enhance investment and competitiveness in SCU?**

- **Human Capital for financial and business services**
- **Financial Markets Development and Impact of Central Banks**
- **Investment climate policy and promotion**

**Sustained Competitiveness**

- **How to tailor human capital policies and practices to support financial and business services?**
- **How to address the impact of the financial crisis, especially in terms of access to finance?**
- **How to support FDI by removing policy barriers and supporting specific sectors?**
OECD Policies for Competitiveness Assessment Framework

Which key topics should be addressed within each Policy Working Group?

“Policies for Competitiveness” Dimensions

1. Investment Climate Policy and Promotion
2. Financial Markets Development
3. Human Capital for financial and business services
4. Others

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Sub dimension</th>
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<tbody>
<tr>
<td>Investment Climate Policy and Promotion</td>
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<table>
<thead>
<tr>
<th>Sub dimension</th>
<th>Indicators</th>
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<tr>
<td>Investment Promotion and Facilitation</td>
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<table>
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<tr>
<th>Indicators</th>
<th>Level of Reform</th>
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<td>Level 1</td>
<td>Level 2</td>
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<td>Level 3</td>
<td>Level 4</td>
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<td>Level 5</td>
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Example of Indicators

- Strategy
- Implementing Agency
- Monitoring and Evaluation
- Sub-national coordination
- FDI-SME linkages
- Client relationship management (CRM)
- Policy Advocacy
- Aftercare services
- Free Economic Zones

Source: OECD PfC Assessment Framework
### Investment climate policy and promotion

**FDI Policy**
- Non-discrimination
  - Restrictions to national treatment
  - Review of restrictions to national treatment
  - Approval procedures
  - Admittance of business personnel
  - Transfers of FDI related capital
  - FDI incentives
  - Performance requirements
- Property rights
  - Land ownership
  - Titling and cadastre
  - Intellectual property
- Investor protection
  - Expropriation guarantees
  - International agreements
  - Arbitration

**Promotion and Facilitation**
- Framework
  - Strategy
  - Institutional support
  - Monitoring and evaluation
  - National and sub-national coordination
- Investment promotion services and activities
  - FDI-SME linkages
  - One stop shop
  - Client relationship management
  - Policy advocacy
  - Aftercare services
  - Free Economic Zones

**Transparency**
- Publication avenues and tools
- Prior notification and stakeholder consultations
- Procedural transparency

Source: OECD PIC Assessment Framework
# Investment climate policy and promotion

## 1 FDI Policy

<table>
<thead>
<tr>
<th>1.1 Non-discrimination</th>
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<tr>
<td>1.2 Property rights</td>
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<td>1.3 Investor protection</td>
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</table>

## 1.1 Non-discrimination

### 1.1.2 Review of restrictions to national treatment

<table>
<thead>
<tr>
<th>Level</th>
<th>Description</th>
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<tbody>
<tr>
<td>Level 1</td>
<td>The government does not undertake any reviews of its restrictions to national treatment.</td>
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<tr>
<td>Level 2</td>
<td>The government has committed to designing a process to review restrictions to national treatment.</td>
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<td>Level 3</td>
<td>The review process consists of benchmarking the scope of restrictions to national treatment in its laws and practices with other similar economies.</td>
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<tr>
<td>Level 4</td>
<td>Level 3 plus the process involves periodically reviewing the list of restrictions based on an analysis of their costs and benefits and a regulatory impact analysis.</td>
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<tr>
<td>Level 5</td>
<td>Level 4 plus the review process includes the canvassing of views and observations of national and international investors and other relevant stakeholders.</td>
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Source: OECD PfC Assessment Framework
The need to focus on Investment Promotion and Facilitation

Overall high level of reform

Source: OECD Survey
The need to focus on priority sectors
Focusing scarce resources on country priorities

In which sectors do SCU countries perceive to have a competitive advantage?

Level of priority

Agriculture
Tourism
Energy
Health
Construction
ICT
Basic metals and metal products
Machinery
Chemicals
Mining Industry
Textile and garments
Financial services

Taking a sector approach by focusing on Agribusiness

Source: OECD Survey
Sector-specific policy barriers to remove

Which policy barriers limit the development and promotion of the selected sectors?

Major barrier
Moderate barrier
Minor barrier
No barrier

Cost of financing
Macroeconomic Instability
Skills and education of available workers
Legal system and business disputes
Transportation
Anti-competitive practices
Tax administration
Economic and regulatory policy uncertainty
Business licensing and operating permits
Telecommunications
Corruption
Customs and trade regulations
Tax rates
Labour regulations
Access to Land
Electricity
Crime, theft and disorder

Source: OECD Survey
Next steps / Proposed work agenda

1. Setting-up **SME-FDI Linkage** Programmes
2. Developing **Guidelines for Free Economic Zones Management**
3. Developing an **Investment Promotion Strategy**: Taking a policy/sector-approach
4. Building an **FDI Restrictiveness** Index
5. Strengthening **policy advocacy** in Investment Promotion
Setting up a supplier Linkage programme: A Five-Stage Approach

**Phase 1: Linkage Strategy definition**
- Establish the programme objectives
- Perform a self-assessment
- Prioritise and identify a pilot sector
- Identify relevant foreign and local participants

**Phase 2: Structure and organisation**
- Establish a coordinating mechanism/body with key stakeholders
- Define the planning and budget
- Create a specific linkage programme unit
- Develop a foreign investors database

**Phase 3: Diagnostic analysis and promotional activities**
- Conduct a first strategic audit
- Define a development plan with each participating firm
- Promote the supplier linkage programme

**Phase 4: Monitoring and evaluation**
- Define an indicator-based monitoring mechanism
- Evaluate and extend the programme to other sectors

**Phase 5: Sustaining SME-MNC linkages**
- Support industry clusters

Source: OECD
Free Economic Zones are a stated policy priority
Developing guidelines for Free Economic Zones management

Are there any government initiated programmes to bring together companies belonging to the same industry (e.g. a cluster or free economic zone)?

**Armenia** is planning to set-up a free economic zone near Zvartnots airport in Yerevan to facilitate the export of Armenian products by home producers.

**Azerbaijan** endorsed a new law on “Special Economic Zones” and announced plans to create a Special Economic Zone near a new port area (to be completed in 2012). Furthermore, Azerbaijan intends to create Regional Innovation Zones with the aim to turn the country into a regional information and communication technology hub.

**Georgia** endorsed a new law on “Free Industrial Zones” and plans to set-up a FIZ near the Black Sea Port of Poti.

In **Ukraine**, 11 Special (free) economic zones were created between 1998 and 2000, however, there expansion was stopped in 2005 and incentive regimes were harmonized with the rest of the economy. Imports of raw material into the zones for further processing are still eligible for VAT exemptions and duty free.

Intended Free Economic Zones projects have raised huge expectations in the local business communities.

Source: OECD Survey
Strategy: Taking a policy and sector approach

Example of sectors for discussion and capabilities they contribute towards

2 overall criteria in short-listing high-level sectors: “sector attractiveness” and “country benefits and fit” (including consideration of export sophistication and product connectedness)

<table>
<thead>
<tr>
<th>Capabilities</th>
<th>Agri-business</th>
<th>Business Services</th>
<th>Health services</th>
<th>Chemicals</th>
<th>Telecom</th>
<th>Utilities</th>
<th>Transport &amp; logistics</th>
<th>Metallurgy</th>
<th>Construction</th>
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<td>Human Capital</td>
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Note (1): Stability of Institutions has been excluded from this framework
Restrictions to foreign investments persist across the region

How to measure FDI restrictiveness?

Investment laws generally permit FDI across the region and provide for national treatment. However, general restrictions exist, such as:

- Restrictions to foreign land ownership;
- Lack of transparency of investment regulations, licensing procedures and in privatization processes;
- State control over key sectors, such as energy and communication and restriction of sectors related to national security;
- Regulation of foreign exchange and capital transactions (registration /approval requirements, quantitative limits);
- Complex and burdensome regulations.

Level of investment freedom remains relatively low.

Source: World Heritage Foundation / OECD 2009
Application of FDI Regulatory Restrictiveness Methodology

Review of restrictions to national treatment

- FDI Regulatory Restrictiveness is measured on a scale of 0-to-1 scale, with 0 representing full openness and 1 a prohibition of FDI;
- The indicator aims to measure deviations from ‘national treatment’, i.e. discrimination against foreign investment, rather than the institutional environment in general;
- The index covers 9 sectors and 11 sub-sectors, not covering energy other than electricity;
- The measures are limited to overt regulatory restrictions on FDI, ignoring non-policy restrictions;
- When used in combination with other factors, the index can contribute to explaining variations among countries in attracting FDI.

Measures have proved useful both for policymakers and researchers interested in assessing policies towards FDI.

Source: OECD
Strengthening Policy Advocacy for Investment Promotion
Developing guidelines for Investment Promotion Agencies

- Is policy advocacy defined in the investment promotion strategic plan?
- Does the IPA have a policy advocacy unit staffed by experts in the field of investment policy?
- Does the policy advocacy unit hold regular consultations with foreign investors to gauge their views on the regulatory environment?
- Does the policy advocacy unit undertake annual assessments of the impact of FDI?
- Does the IPA have defined policy advocacy role when it comes to liberalisation and design of measures directed at FDI?
- What results can the IPA showcase as a result of its policy advocacy efforts?

Enabling Investment Promotion Agencies to play an advocacy role vis-à-vis the investor community and government counterparts.