HOW THE PFI MAY CONTRIBUTE TO A MORE COHERENT INTERNATIONAL POLICY FRAMEWORK ON INVESTMENT?

Philippe Gugler, Lamia Ben Hamida

Session 1.1: Investment policy
How the PFI may contribute to a more coherent international policy framework on investment?

Philippe Gugler*, Lamia Ben Hamida**

ABSTRACT
This paper examines how the Policy Framework for Investment (PFI) may contribute to a more coherent international policy framework on investment. A detailed analysis of the PFI and its possible benefit at both national and international investment policy levels shows that putting the PFI into action helps (a) to improve the national policy environment for investment (foreign and domestic) and thus enhances economic growth and a country’s competitiveness, and (b) to ensure coherence across policy areas (national and international), a necessary precondition to achieving greater economic growth.

KEY WORDS
PFI; FDI; Coherence; National competitiveness

* Professor Dr Philippe GUGLER, Leader of the NCCR Individual Project IP11 “Multilateral Rules on Trade and Investment”, Dean of the Faculty of Economics and Social Sciences University of Fribourg, Chair of Economics and Social Policy, Department of Economics, University of Fribourg, Bd de Perolles 90, CH – 1700 Fribourg, Switzerland, phone: (+41) 26-300-8226, e-mail: (philippe.gugler@unifr.ch).

** Lamia BEN HAMIDA is currently working on her Ph.D thesis “Inward Foreign Direct Investment and Intra-Industry Spillovers: The Swiss Case” at the University of Fribourg, under the supervision of Prof. Philippe Gugler and with the collaboration of Prof. Laurent Donzé as a second advisor. Her thesis aims at analyzing the main key factors determining FDI intra-industry spillover benefits (lamia.benhamed@unifr.ch).

NCCR TRADE WORKING PAPERS are preliminary documents posted on the NCCR Trade Regulation website (<www.nccr-trade.org>) and widely circulated to stimulate discussion and critical comment. These papers have not been formally edited. Citations should refer to a “NCCR Trade Working Paper”, with appropriate reference made to the author(s).
1. Introduction

The global flows of inward and outward foreign direct investment (FDI) worldwide have increased considerably over the past two decades and multinational corporations (MNCs) are increasingly considered as being the most important agents worldwide. This is because they have the ability to affect substantially the economic development of host and home countries and are widely assumed to be the providers of knowledge, capital, capabilities and markets, the creators of jobs, the suppliers of foreign currency and the competition stimulator among other things (Dunning, 1992). A wide variety of national and international policy rules and principles govern many aspects of MNCs operations – policy actions are important "to the extent that they shift firm-level choices from one discrete governance structure toward another" according to Rugman and Verbeke (2004). The number of international investment agreements, instruments for the promotion and protection of foreign investment, has sharply increased over the past two decades, taking the form of a patchwork of bilateral, regional, interregional, and plurilateral treaties. The bilateral investment treaties (BITs) concluded between two countries, such as the US and the European Bilateral Investment Treaties, represent the core of the current agreements (Gugler, 2006). In 2005 alone, 162 international investment agreements were concluded, getting the total number of agreements concluded since the early 1960s to almost 5,500. Most BITs have been concluded between developed and developing countries (figure 0). Whereas earlier agreements almost exclusively fell into this category, the number of BITs involving two developing countries is now increasing. In the past five years, the share of such agreements has almost doubled, from 14 per cent to 26 per cent (UNCTAD, 2006a).

The regional and plurilateral agreements are also a popular means of formalising international rules on investment. These treaties involve a number of countries as for example the European Union model, the North American Free Trade Agreement (NAFTA), and more recently the Framework Agreement on the ASEAN Investment Area involving 10 south-east Asian countries. This agreement, signed in 1998, aimed at establishing the ASEAN Investment Area to enhance the attractiveness of the region for direct investment flows. The degree of integration and cooperation required by these agreements differs depending on the treaty and the Member States (Gugler and Tomsik, 2006a). The EU agreements are argued to be the most integrated and are characterised by their strong impact on FDI among member countries and investment in and from developing countries. The NAFTA agreements involve lesser degrees of integration but have a great impact on FDI regulations.

Despite the huge number of international investment treaties, the current policy framework of investment is still unsatisfactory as existing investment rules are highly fragmented\(^1\) and lack coherence. This results in an increasingly complex international framework of FDI and a continual increase in the number of international investment disputes arising from the interpretation and the implementation of these agreements in both developed and developing countries. A search for a coherent general framework for investment has so far been the major concern of international organisations and institutions. A comprehensive set of multilateral rules on FDI (multilateral agreement on investment (MAI)) could allow for stable, transparent, and consistent environments for multinationals, whatever their ownership structures and locations of

---

\(^1\) Fragmentation reduces the total amount of FDI, increases market distortions and rent-seeking and favours corruption (Folly and Brunner, 2006).
foreign production. The global application of broadly similar investment disciplines would remove the complexity arising for investors from the existing framework of bilateral and regional agreements on investment and facilitate compliance (Gugler, 2006). Moreover, as the UNCTAD (2005a) noted, the MAI negotiations set out to provide high standards for the liberalisation of investment regimes and investment protection between countries (between OECD members and, eventually, other interested non-member States).

Efforts to create a multilateral framework for FDI have so far met with no success. The first attempt at MAI, which was in the Havana Charter, failed to enter into force in 1948, and was followed by three other unsuccessful attempts: in the United Nations, in the Organisation for Economic Cooperation and Development (OECD), and most recently in August 2004, in the World Trade Organization (WTO). However, although the MAI proposal was abandoned, the project to create a general framework on investment is still alive (Graham, 2000) and appears, although this is not explicitly expressed, on the future investment agenda.

Besides the MAI, in 2003, in Johannesburg the OECD Investment Committee launched the negotiations, mainly with non-member economies, on developing a new framework for regulating the investment environment called the Policy Framework for Investment (hereafter PFI). The initiative of the PFI calls upon a detailed analysis of (national and international) investment issues, so as to create the policy environments needed to mobilise private investments (domestic and foreign) that support economic growth. The objective of the PFI is to provide policy guidance for investment mainly to support sustained efforts by developing countries to attract and generate more and better investment and thus continue to reap the demonstrated benefits of foreign and domestic investment flows.

How might the PFI contribute to enhancing the coherence of the international framework on foreign direct investment is the main question addressed in this paper? The approach taken is to investigate the key dimensions helping the development of the PFI and simultaneously to discuss the potential policy-level benefit that could emerge from such an investment framework. Accordingly, section 1 presents the PFI; section 2 analyses the possible effects of the PFI on national investment policies and countries’ competitiveness; and section 3 examines the possible effects of the PFI on international investment policies.

2. The Policy Framework for Investment Initiative

a) Definition and objectives

Proposed at the OECD Ministerial in May 2003, the Initiative of the PFI was launched by the OECD Investment Committee in Johannesburg in November 2003 at the Global Forum on International Investment. It represents an overarching strategy for cooperation between the

---

2 It is worth noting that WTO holds two major treaties that address the process of liberalisation of investment at the multilateral level and address some of the same issues that the MAI would have covered: the General Agreement on Trade in Services (GATS) and the Agreement on Trade-Related Investment Measures (TRIMs).

3 In addition to the Investment Committee, nine other OECD working groups have been involved in developing or reviewing the PFI: the Development Assistance Committee; the Trade Committee; the Competition Committee; the Committee on Fiscal Affairs; the Steering Group on Corporate Governance; the Education Committee; the Employment, Labour and Social Affairs Committee; the Working Group on Bribery in International Business Transactions; and the Public Governance Committee.
OECD and developing countries on investment issues – so far, the development of the PFI has involved the participation of 60 governments of which 30 are member countries. The PFI provides guidance on investment policy directed to governments and the business sector to help improve investment environments; it aims to mobilise private investment both domestic and international, from physical assets to intellectual capital, which supports economic growth of mainly developing countries. It thus aims to contribute to the prosperity of countries and their citizens and support the fight against poverty (OECD, 2006a).

Between June 2004 and March 2006, the development and use of the PFI received further strong support at three meetings: the Global Forum hosted by India in 2004, the OECD Ministerial in 2005, and most recently at the Global Forum hosted by Turkey in 2006 where presentations on the experiences of different countries with the PFI were considered. The presentations included the experience of Egypt – which pioneered use of the PFI to improve its investment environment, Costa Rica – which is exploring the possibilities of applying the PFI, and Romania – which has been engaged in the Investment Reform Index (IRI).

As assured by OECD (2006a), the OECD and non-member partners will continue to work together, in cooperation with the World Bank, the United Nations and other interested institutions and with the active engagement of business, labour and other civil society organisations, to support effective use and future development of the PFI.

The PFI consists of a checklist of policy areas germane to a country’s prosperous investment setting. It serves as a reference point for investment promotion to any government interested in developing an environment attractive to all investors – from small and medium-sized enterprises (SMEs) to multinational enterprises (MNEs) – and subsequently in enhancing the resulting investment benefits.

The PFI helps policy-makers to ask proper questions about their policy settings; make out priorities; build up an effective set of guidelines; and evaluate economic and social development. It proposes guidance in ten policy fields identified by the 2002 United Nations Monterrey Consensus on Financing for Development as critically important for improving the quality of a country’s environment for investment (figure 2). The ten chapters are: investment policy; 

4 Task force meetings, regional consultations and global forum discussions on the Policy Framework for Investment are described in detail in OECD (2006d, page 27, annex 2).

5 At that time, Egypt had implemented only the first three chapter of the PFI: investment policy, investment promotion and facilitation, and trade policy.

6 As defined in OECD (2006e), IRI is “a comparative evaluation of progress in investment reform and implementation on seven key dimensions ranging from investment policy and promotion to human capital. It is based on a set of structured indicators and a collaborative process that incorporates feedback from SEE governments, the private sector, and other international organizations”.

7 The Framework is intended “as a non-prescriptive checklist of issues for consideration by any interested governments engaged in domestic reform, regional co-operation or international policy dialogue aimed at creating an environment that is attractive to domestic and foreign investors and that enhances the benefits of investment to society” (OECD, 2004). The PFI is considered as a framework for a dialogue between governments, international organizations, business, labour, and civil society (Schekulin, 2006).

8 The PFI is comprehensive, but does not claim to be exhaustive. Other policy areas, such as the environment, energy, rural development, innovation, entrepreneurship of women and gender balance, also have a bearing on the business environment. While the Framework does not identify these topics as stand-alone chapters, many questions explicitly capture their importance in the investment environment and for economic development (OECD, 2006a)
investment promotion and facilitation; trade policy; competition policy; tax policy; corporate governance; policies for promoting responsible business conduct; human resource development; infrastructure and financial sector development; and public governance. Each chapter includes a number of questions covering the policy issues it addresses – overall the PFI addresses some 82 questions to government. The technique of questions, as noted by the OECD (2006a), is employed to “facilitate flexible approaches to self-assessment and to priority setting by governments in accordance with their own circumstances, development agendas and institutional arrangements. The questions also help to define the respective responsibilities of government, business and other stakeholders, and to pinpoint areas where international co-operation can most effectively redress weaknesses in the investment environment”. These questions are supported by annotations, providing the context of the chapters and information from an investment perspective, and are complemented by references to selected policy resources. Three principles are employed throughout the policy areas of the PFI:

- a coherence across the diverse policy domains of PFI applied across countries for both domestic and foreign investors;
- a transparency in the formulation and implementation of the PFI – this attribute in government procurement is no doubt beneficial for the domestic market; it attracts investment by lessening the risks to the investor and reducing operating costs (Evenett, 2003);
- a regular evaluation of the impact of investment policies so as to leverage the potential benefit of those policies – the PFI lays particular emphasis on the adaptability of the institutional framework and the role of periodic evaluations to allow new challenges to be identified early on and to be able to respond quickly to them (OECD, 2006b).

b) PFI chapters: an overview

As noted above, the PFI addresses ten policy areas consisting of 82 rules to help governments to improve the conditions of investment for maximizing its potential benefits. The PFI considers different factors influencing the investment environment, such as trade, competition taxes, corporate governance, infrastructure, and human resources. The first two chapters of the PFI are directly linked to investment issues: chapter one entitled “investment policy” addresses questions about the principle aspects of investment policy and international investment issues. It consists of nine questions which examine how investment policy may contribute to the establishment of an attractive investment environment and then enhance the benefits of such investment. It is argued in this chapter on the one hand that transparent information on how governments implement and change rules and regulations on investment is the main determinant of investment decision. On the other hand, it is important to protect the technology property rights of each investor by enforcing the implementation of rules and regulations on this aspect. Chapter two “Investment promotion and facilitation” involves nine questions regarding the optimal policy actions for trying to attract foreign investors in order to promote economic development. The investment promotion

---

9 The questions of the Framework are developed to be flexible to enable them to take into account the dynamic nature of economic development.
and facilitation measures are considered as part of the overall investment promotion strategy, wherein the investment promotion agency (IPA) plays an important role in promoting investment.

The third chapter of the PFI involves seven questions dealing with “trade policy” and its impact on investment in host and home countries. It aims to determine which trade policies (including both export and import rules) could help a country (home or host) to foster investment and growth. It seeks to address the problem of how to reduce trade policy uncertainty and cost, enhance transparency in trade policies, and improve communication of such policy decisions. The fourth chapter is “competition policy” and the fifth deals with “tax policy”. Competition policy addresses the questions of how to promote competitive environments to attract investors, both domestic and foreign, to operate efficiently with maximum investment benefits for a country’s economic development. In this respect, seven questions are developed, most of which examine the content of the competition policies and how a government may adjust them to make them clearer, more transparent, and non-discriminatory; the provision of adequate resources, political support and independence necessary to enable competition authorities to implement competition laws effectively; and to what extent and how such authorities could address the anti-competitive practices of firms (including MNCs and state-owned firms) that can negatively affect investment. Tax policy addresses questions of how to adjust taxes to improve the investment environment. It consists of nine questions intended to address the level of tax burden that would be in accordance with a government’s development objectives and its investment attraction strategy, and also subject to framework condition and market characteristics; how the tax burden on domestic or foreign profits could fulfil the objective of the tax system while at the same time not hindering investment decisions; and how governments could expand their tax treaty network to counter abusive cross-border tax planning strategies, especially reducing the scope for double taxation of income.

“Corporate governance” is the subject of the sixth chapter of the PFI. It contains nine questions addressing the role of corporate governance in promoting a sounder environment for investment – the key elements of corporate governance required to achieve an attractive investment environment. This chapter calls for effective corporate governance to promote overall economic performance and transparent and efficient markets, and to ensure equitable treatment of shareholders who have a strong influence on the firm. The next chapter addresses the “policies for promoting responsible business conduct” and how they can be adjusted to help attract the investment essential for sustainable economic development. Such policies consist of providing an enabling environment with a clear separation of government and business roles, promoting dialogues on norms for business conduct, supporting private initiatives for responsible business conduct, and participating in international cooperation in support of responsible business conduct.

The three remaining chapters address issues related to human resource development, infrastructure and financial sector development, and public governance. Chapter eight contains ten questions that examine the role of “human resource development” in promoting investment. – Developing and maintaining skilled human resources appear among the key elements of a

---

10 A country’s tax regime is a key policy instrument that may have either a negative or a positive influence on investment (OECD, 2006c).

11 Surely the most important case for positive government action regarding MNCs lies in the field of taxation (Caves, 2004).
promising investment promotion strategy. Issues addressed in this chapter include: how to improve the quality of schooling, how to encourage individuals to invest in higher education, to what extent governments promote training programmes, and how to support job creation. Chapter 9 calls for sound policies on the development of infrastructure and of an effective financial sector to expand opportunities for investment. The first five questions of this chapter look at how to improve the quality of the transport infrastructure, what kind of new transport facilities a government should develop, how to improve the telecommunications sector, and to what extent a government ensures the principle of transparency for all investors bidding for infrastructure contracts. The three remaining questions address how to improve the stability of the financial sector, how to protect the rights of borrowers and creditors, and the extent to which governments tolerate the participation of foreign institutions in the development of their financial sector. Finally, chapter ten consists of nine questions regarding the relationship between public governance and investment. It calls for good public governance rules that fit well with the investment strategy. This involves many factors that are addressed in this chapter: implementation and enforcement of international anti-corruption and integrity standards, reducing unnecessary administrative burdens including those on investors, ensuring compliance through monitoring and international cooperation, and of course, ensuring transparency and effective implementation of the laws and regulations.

3. Effects of the PFI on national investment policies and countries’ competitiveness

As noted above, the PFI calls for a regular analysis of national and international investment rules with the aim of creating attractive policy environments, necessary to mobilise private investment both domestic and foreign that support economic growth. It is argued that both national and international investments significantly influence a country’s competitiveness (Porter, 1990). The PFI enables policy-makers to review their investment policy in order to develop an effective set of regulations, essential for economic progress. The PFI is considered to be a non-prescriptive, flexible, operational and practical guide for them (OECD, 2005). Transparent information on how governments implement and change rules and regulations on investment is the main determinant of an investment decision, although as noted in OECD (2006c), it is not easy to perform and implement the transparency-enhancing reforms. Transparency is important for both the small and medium-sized firms that tend to enter new markets and for foreign investors looking for new environments. It helps investors assess potential investment opportunities on a more informed and timely basis, and to shorten the period before an investment becomes productive (OECD, 2006c).

Therefore, putting the PFI into action significantly affects a country’s policy framework for investment and hence its competitiveness. Possible effects may be either directly related to the investment regulations or to other aspects of policy that in turn influence the investment environment, such as policies on trade, tax, human resources, and infrastructure. All of these policies need to be coherent with one another to effectively achieve greater economic growth.

---

12 Porter’s theory also recognises spillover benefits as a key determinant of national economic growth.
13 A detailed analysis of the difficulties in the implementation of transparency reforms is given by the OECD (2006c).
14 Most new locations have different regulatory systems, culture, and administrative structures.
15 Noting that the Framework attempts to make a regular evaluation of the impact of its policies to leverage their potential benefit.
a) Direct effects of the PFI on national investment rules

This section attempts to evaluate the impact of the policy issues addressed in chapters 1 and 2 of the PFI on a country’s investment policies and competitiveness. Policies dealing with the principles of protection (the protection of capital and intellectual property rights) and investment promotion are the core elements of these chapters.

Questions 2, 3, 4, and 5, of chapter 1 of the PFI stress the importance of protecting the investment property of every investor whether foreign or domestic firstly by enforcing the promotion and protection of technology property rights and secondly, by ensuring the effectiveness of contract enforcement involving the policy of timely and adequate compensation for the expropriation of private property for a broader public interest. Rules on investment protection are intended to protect domestic and foreign-owned properties against host and home government actions that are detrimental to investors’ interests. Secure investment rights are among the important prerequisites for a healthy investment environment and an important incentive for investors, especially MNCs, to set up affiliates. For example, intellectual property rights give businesses an incentive to invest in research and development, and ultimately lead to the creation of innovative products and processes (OECD, 2006c). Faith efforts to protect investment should be undertaken by countries to encourage innovation and investment by both foreign and domestic firms and to enhance competitiveness. For example, Egypt – the first country to employ the PFI – puts a great emphasis on the implementation of laws and regulations ensuring comprehensive protection of investors’ intellectual property rights.

The PFI also argues that information on how to implement and change rules and regulations on investment protection should be transparent and non-discriminatory among existing and potential investors. Improving measures to promote investment is another important objective of the PFI. Chapter 2 addresses the investment promotion and facilitation measures, including incentives, as part of the overall investment promotion strategy. The development of such a strategy requires strong political support from government – from the highest levels to the front-line agencies and ministers responsible for implementing the policy. The PFI introduces the investment promotion agency (IPA) for promoting investment and discusses the characteristics of a successful IPA and highlights the importance of evaluating the costs and benefits of investment incentives, their correct duration, their transparency and their impact on the economic interests of other countries. IPA is recognised as a fundamental element in building a credible corporate governance framework that plays, as we shall see later, an important role in attracting investors.

---

16 It is argued that a natural corollary of the protection of property rights is the need for compensation when a government expropriates private property in the broader public interest.

17 As stated by the Egyptian Ministry of Investment when discussing during the OECD Forum (2006) its successful implementation of the PFI, the general principle of non-discrimination is well established in Constitution and in juridical practice.

18 Blomström and Kokko (2003) stress that financial incentives should be provided not only for foreign firms to attract them to invest in domestic markets, but also for domestic firms to enhance their absorptive capacity and enable them to benefit from foreign presence.

19 A clear discussion on the characteristics of a successful IPA is given in OECD (2006c) and in Morriset (2003).
Chapter 2 also covers investment linkages between businesses and how to promote them, especially those between foreign affiliates and local firms. Dunning and Gugler (1994) emphasise the importance of the transnationalisation of research and development and state that some of the international research and development operations are realised via cooperative agreements, joint ventures and strategic alliances. Successful cooperations contribute to developing a sounder investment environment and subsequently to economic growth.

b) Indirect effects of the PFI on investment policies

This section attempts to evaluate the impact of the policy issues addressed in chapters 3 to 10 of the PFI on a country’s investment policies and competitiveness. Eight policies dealing with the enhancement of competition, trade, appropriate taxation, promotion of responsible business conduct, human resource development, improvement of infrastructure, and corporate and public governance frameworks represent the core elements of these chapters. Regulating trade policies in favour of investment is the major concern of chapter 3 of the PFI. Questions addressed in this chapter relate to methods of reducing trade policy uncertainty and costs, enhancing transparency, and increasing trade policy profitability for investors (both domestic and foreign). These measures help to provide a more stable environment in which firms can plan their investment programmes (OECD, 2006a). The Egyptian Ministry of Investment announced, when discussing during the OECD Forum (2006) its successful implementation of the first three chapters of the PFI, that Egypt’s government has taken many actions to adjust its trade policies to create a better investment environment. For example, investors are consulted on planned changes in trade policy; business council representatives participate in national committees on trade negotiations; weighted average tariff rates are well below Egypt’s WTO tariff bindings; and export finance, technical support, and marketing support are available for investors.

As noted previously, ensuring an appropriate tax burden, developing human resources, improving infrastructure quality state, and promoting responsible business conduct are also among the key determinants influencing the investment environment, and hence economic growth. Those policies should be consistent with the government’s development objectives and its investment promotion strategy. The PFI highlights the importance of paying attention to the expectations of investors – taxpayers – when reforming or setting up the tax system. Given that public expenditures (infrastructure, education, public governance and competition policies) that are of critical importance to investors are largely supported by tax revenues, investors are generally willing to accept paying higher taxes if in return they are able to, inter alia, recruit skilled employees; have access to high-quality infrastructure; and secure their access to capital and profits. Tax incentives (such as tax holidays and partial profit exemptions) typically addressed to new investors are also recognised in the PFI as central to attracting investors, both domestic and foreign, and creating an

---

20 One of the roles of IPA is to facilitate the recognition of potential investment opportunities by promoting partnerships between domestic and foreign firms (OECD, 2006a).

21 The localisation of the R&D activities of affiliates of MNCs in host countries plays an important role in increasing the size and the extent of FDI spillover benefits. Such benefits enhance the productivity of domestic firms which largely invest in the absorptive capacity (Ben Hamida and Gugler, 2006). Foreign investment is assumed to facilitate domestic technological change via technology spillovers, and hence to increase the rate of growth of the host country’s income (Wang, 1990).

22 Porter et al. (2006) recognise the role of high quality infrastructure in enhancing national competitiveness.
enabling environment for investment. The environment is further improved when uncertainties over expectations concerning responsible business conduct are reduced. The PFI emphasises the need for government and business roles to remain distinct.

Ensuring good and effective corporate and public governance is another point discussed in the PFI – it plays an important role in attracting investors, both foreign and domestic, and so enhances the benefits of investment. Implementing good corporate governance requires transparency, protection of the investor’s legitimate expectations, freedom from coercion and harassment, and due process and procedural property and good faith (UNCTAD, 2005b). Thereby, a sounder investment environment is guaranteed, with equitable treatment of shareholders and stakeholders23 (both domestic and foreign). Investment is improved and its potential benefits are maximised when the actions of government are credible; i.e. when it can be trusted by investors and stakeholders and be held accountable (OECD, 2006c).

The PFI further stresses the importance of the regular evaluation of all policies on investment environment and economic development. It identifies the Regulatory Impact Assessments (RIA) as the best tool decision-makers can use to examine and assess the likely costs and benefits of their decisions. The results of the RIA should be documented and communicated promptly and effectively to the public; this satisfies one of key dimensions of good public governance necessary for the development of a sound investment environment that supports economic growth.

Regular evaluation of the impact of policies related directly or indirectly to investment concerns also competition policy authorities, to test for the ability of investors to enter the market.24 Such authorities are also involved in ensuring that competition laws and their application are clear, transparent, and do not discriminate between foreign and domestic investors. In addition, they play an important role in cases of privatization, where the major concern is to avoid replacing public monopolies with private ones (notably MNCs, with the increased flows of FDI the last two decades (UNCTAD, 2003)).

4. Effects of the PFI on the international investment policy framework

Besides national investment policies, the quality of a country’s investment environment is also strongly influenced by international investment commitments (OECD, 2006c). The PFI encourages the investment policy authorities of different economies to work together to expand international treaties on investment issues. Policies in those treaties should ensure compliance with international investment laws and be in accordance with each country’s investment strategy. Thereby, coherence across policies followed by different countries could be to some extent assured.25

---

23 The corporate governance framework also encourages fruitful cooperation between corporations and shareholders.

24 The PFI calls for cooperation and good communication between competition authorities and other government agencies.

25 Gugler and Tomsik (2006b) claim that “the investment provisions in the compared agreements do not fully address the numerous investment issues as for example legal security, policy coherence, and the transparency of government commitments”. 
The effects of PFI on the international policy framework include both direct and indirect international investment measures, as described below. The indirect effects occur via inter alia, trade policy, tax policy, and infrastructure policy.

a) Direct international investment measures

This section examines policy actions dealing with an international dimension, addressed in chapters 1 and 2 of the PFI. In particular it looks at international treaties related to investment protection and promotion measures and the principle of non-discrimination among national and international investors.

One of the key objectives of the PFI is to increase the number of international commitments covering investment policies. International agreements contribute to promotion and facilitation of investment through instilling confidence, especially for foreign investors (OECD, 2006c). In the first two chapters, the PFI highlights the importance of considering policies for promoting and protecting investment in international investment agreements. The Egyptian Ministry of Investment has declared that Egypt is currently developing a bilateral and regional investment agreement model to be adopted vis-à-vis counterpart countries, and which ensures compliance with international investment laws and regulations from one side, and investment promotion and facilitation for investors from the other side. In question 7 of chapter 1 the PFI calls for country members to adhere to international property protection agreements; a certain standard of protection has to be provided over all the members and the non-discrimination principle governs the rules of protection of intellectual property rights. Egypt has recently signed the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and the Egyptian Ministry of Investment has stated that it is currently sticking to its TRIPS commitments.

In addition the PFI encourages the use of international and regional initiatives aimed at building expertise in promoting investment, such those offered by the World Bank group (the Multilateral Investment Guarantee Agency “MIGA”). As described by the OECD (2006c, Box 2.4), the MIGA serves as a handbook on investment promotion that can be used by IPAs and investment consultancies among others. Egypt for example uses systems designed by MIGA in its investment promotion structure. The Egyptian Ministry of Investment declares that the structure is benchmarked against global best practices like those of the IPAs of Ireland, Singapore, Malaysia, and the Czech Republic.

The principle of non-discrimination is also an important element addressed in the PFI, especially as it relates to international investment. With this principle in mind, the PFI calls for equal national treatment for both domestic and foreign investors and it highlights the importance of considering the principle in international agreements. Otherwise, policies favouring certain firms over others carry a cost arising from less competition and reduced efficiency leading to damage to the investment environment (OECD, 2006c).

---

26 The degree of FDI liberalisation and protection in a international investment agreement on services is determined mainly by the scope and extent of the countries’ national policies at the time of negotiation (UNCTAD, 2005c).

27 A strict evaluation of the costs and benefits is then required when deciding to not maintain the principle of non-discrimination – for example, when protecting infant industry (OECD, 2006c).
b) **Indirect international investment measures**

This section examines the effects of the PFI on the development and the implementation of international conventions subject to negotiations of treaties related to, inter alia, trade, taxes, competition, responsible business conduct, public governance and others, that support a favourable investment environment.

In chapter 3, question 3, the PFI points out the importance of WTO-consistent regional trade agreements (RTAs) in expanding investment opportunities and calls on governments especially in smaller economies to use them so that they will be able to attract foreign and domestic investors by creating larger markets. RTAs are assumed to generate both market-seeking and efficiency-seeking investment (OECD, 2006c). Egypt, according to the Egyptian Ministry of Investment, is seeking to liberalise its trade regime, on an MFN basis through WTO negotiations and unilateral tariff reduction.\(^{28}\) Egypt seeks meaningful multilateral liberalisation, and supports greater multilateral trade liberalisation in mode 4.\(^{29}\)

In chapter 4, the PFI stresses the role of international cooperation between countries on competition issues such as international mergers and acquisitions (M&A) in boosting the investment environment, since M&A are increasingly considered to be the most important mode of foreign entry. Such cooperation would ensure that competition policies, through their various barriers to entry, no longer impede foreign and domestic investment, at least for those country members involved in the cooperation.

In chapter 5, the PFI calls upon tax authorities to formulate corporate taxable income determination rules with reference to a benchmark definition of income wherein the main tax provisions should be consistent with international norms; i.e. not more taxing than those commonly found elsewhere. Also tax policy and tax administration officials should work with their counterparts in other countries to expand their tax treaty network and to counter abusive cross-border tax strategies, such as double taxation. A modern competitive, stable and transparent tax system, one that links host and home country tax systems through a well-established tax treaty network to avoid double taxation, can send a strong positive signal to investors, both domestic and foreign (OECD, 2005).

As promoting sound corporate governance and responsible business conduct, as noted above, appear among the prerequisites for creating a good investment environment, the PFI encourages governments in different countries to participate in inter-governmental cooperation to promote international concepts and principles for responsible business conduct, such as adhering to the OECD guidelines for multinational enterprises. It also encourages policy-makers to cooperate with international organizations such as the OECD and World Bank and use their principles of corporate governance for a more complete assessment: “if countries are to reap the full benefits of the global capital market, and if they are to attract long-term ‘patient’ capital, corporate governance arrangements must be credible, well understood across borders and adhere to internationally accepted principles” (OECD, 2006c).

---

28 The Egyptian Ministry of Investment adds that Egypt is also WTO-plus in its regional and bilateral related agreements.

29 Certainly, supporting the movement of natural persons (mode 4) is a good way to promote FDI, but the support of commercial presence (mode 3) is also important, even more so than mode 4.
Finally, with regard to public governance, the PFI calls for international and regional cooperation in the fight against corruption. This would improve public sector integrity too, as corruption can also be addressed in international business, for example, by addressing the bribes from foreign to public officials. Governments are encouraged to ensure the effective implementation of anti-corruption conventions. “Regional initiatives against corruption and in support of public sector integrity serve to help governments establish similar rules and to level the playing field, which in turn is beneficial for the investment climate” (OECD, 2006c).

5. Conclusions

The PFI core objective is to provide investment policy guidance directed to governments to help them to improve the investment environment and thus continue to reap the demonstrated benefits of foreign and domestic investment flows. It represents an overarching strategy for the cooperation of the OECD with developing countries on investment (national and international) issues. The PFI proposes guidance in ten policy fields identified as the most important elements influencing the investment environment. These include investment policy, trade policy, and competition policy – recognised as the perquisites for the sound multilateral liberalisation of investment – as well as other issues broadly influencing the investment environment, such as tax policy, human resource development and corporate governance among others.

The PFI helps policy-makers asking appropriate questions about their policy settings, allowing them to identify priorities, and then building up an effective set of regulations. It calls for a regular analysis of national and international investment rules to enable them, over time, to create the attractive policy environments necessary to mobilise private investment, both domestic and foreign, that supports economic growth and a country’s competitiveness. All of these rules need to be coherent if higher rates of economic growth are to be effectively achieved.

Putting the PFI into action thus has significant effects on both the national and international policy framework for investment. The PFI encourages investment policy authorities from different economies to work together to expand international treaties on investment issues. It helps to ensure compliance of the policies in these treaties with international investment laws and hence facilitates the establishment of coherent international rules among economies. The policies of international treaties should also be in accordance with each country’s own investment strategy. Thereby, coherence across policies used by different countries is to some extent assured.

Ensuring coherence across policy areas affecting investment is one of the principles of the PFI. Nonetheless it can present difficult trade-offs, notably in the domain of competition policy. One example is intellectual property rights, which reward investments in creative and innovative activities with exclusive rights, limiting direct competition for a period (OECD, 2006c). In addition, PFI strategy is more oriented towards policies ensuring the promotion and protection of foreign investment and less concerned with the liberalisation regulations. Future work aiming at examining the relationship between PFI policy issues and the existing international commitments on FDI could be fruitful.

30 In the MAI, the non-discrimination rules concerning fiscal treatment were removed from the text as many problems may arise from the application of the MAI principles on taxation in their entirety (Folly and Brunner, 2006).

31 Unlike the MAI, the PFI is concerned with policies aiming at improving countries’ competitiveness and their long-term economic development. It does not directly focus on investment liberalisation.
References


Figure 1: Total BITs concluded, by the end of 2005, by country group.


SEE&CIS: South East Europe and the Commonwealth of Independent States.

Figure 2: The Policy Framework for Investment.

Source: OECD (2006b).
The PFI covers 10 policy areas identified in the Monterrey Consensus as influencing the quality of the investment environment. These are:

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

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

**Trade policy**: Policies relating to trade in goods and services can support more and better quality investment by expanding opportunities to reap scale economies and by facilitating integration into global supply chains, boosting productivity and rates of return on investment.

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

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

**Corporate governance**: The degree to which corporations observe basic principles of sound corporate governance is a determinant of investment decisions, influencing the confidence of investors, the cost of capital, the overall functioning of financial markets and ultimately the development of more sustainable sources of financing. The questions in this chapter of the PFI provide a brief introduction to some of the key corporate governance issues that policy-makers and others should address to promote a sounder environment for investment. For a more complete assessment, policy-makers should turn to the OECD Principles of Corporate Governance and the assessment methodology developed by the OECD Steering Group on Corporate Governance, and if possible ask the World Bank for an assessment under the programme of the Reports on Observance of Standards and Codes (ROSC) for Corporate Governance.

**Policies for promoting responsible business conduct**: Public policies promoting recognised concepts and principles for responsible business conduct, such as those recommended in the OECD Guidelines for Multinational Enterprises, help attract investments that contribute to sustainable development. Such policies include: providing an enabling environment which clearly defines respective roles of government and business; promoting dialogue on norms for business conduct; supporting private initiatives for responsible business conduct; and participating in international co-operation in support of responsible business conduct.
**Human resource development**: Human resource development is a prerequisite needed to identify and to seize investment opportunities, yet many countries under-invest in human resource development due in part to a range of market failures. Policies that develop and maintain a skilled, adaptable and healthy population, and ensure the full and productive deployment of human resources, thus support a favourable investment environment.

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

**Public governance**: Regulatory quality and public sector integrity are two dimensions of public governance that critically matter for the confidence and decisions of all investors and for reaping the development benefits of investment. While there is no single model for good public governance, there are commonly accepted standards of public governance to assist governments in assuming their roles effectively.