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OECD-ASEAN Training on Investment Policy Making

Investment policy: the treatment of foreign investors

Module 2

Investment Policies

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BETTER POLICIES FOR BETTER LIVES

Outline

- How states discriminate against foreign investors
- Screening
- Sectoral restrictions
- OECD FDI regulatory restrictiveness index

Non-discrimination

Governments discriminate in many ways among firms, both as a matter of policy and sometimes inadvertently: between public and private, large and small, or domestic and foreign (national treatment) – and sometimes even among foreign firms.

Four principal ways in which governments discriminate against foreign investors:

- **Screening** (all projects or only those above a threshold or foreign equity share or all foreign investments
- **Equity restrictions** (by sector or overall, for acquisitions or greenfield projects)
- Restrictions on **key personnel** (managers, directors, technical experts)
- **Operational restrictions** (land ownership, profit/capital repatriation, branching, reciprocity, minimum capital requirements, etc.)

Screening of foreign investment

When foreign investors require government approval for their investment projects beyond the licensing requirements which apply to domestic investors

Countries are gradually removing their general screening mechanisms

- For OECD countries 15% still screen FDI, compared to 75% 30 years ago
- Still quite common elsewhere, but some countries such as Indonesia do not screen foreign investment separately
- Nevertheless, biggest reformers since 1997 have all reduced their screening significantly

Screening is becoming more focused

- National security: US, EU, China
- Strategic sectors: often linked to natural resources

Different approaches to screening

Elements of approval decision

- National security, competition, net benefit or economic needs test
- Burden of proof on investor (Canada) or host government (Australia)
- Tied to the provision of incentives
- *Ex post* notification or *ex ante*
- Threshold, specific sectors, mergers and greenfield
- Centralised or at provincial or local level

Good practices for screening

- Are the criteria for approval clear?
- Are they within the competence of the agency to assess?
- Are the reasons for rejecting a project published?
- How much discretion does the authority have?
- Do decisions have to be rendered within a specified time?
- Can the investor appeal a decision?
- Is there a system for monitoring commitments once the investor is established?
- Are screening policies subject to periodic review on their effectiveness and necessity?

Costs/benefits of screening

Benefits

- Secures domestic support for an open investment regime (although countries that screen tend to have more restrictions in other areas as well)
- Helps to ensure that incentives are not wasted
- May be necessary for major projects with significant potential social or environmental impacts – both domestic and foreign

Costs

- Administrative cost to government
- Costs to investor: time, legal fees, delays and uncertainty
- All else held equal, screening mechanisms are associated with lower levels of foreign direct investment

Screening can discourage investment

2009 New Zealand Treasury review:

In some cases, experience with the screening regime is completely deterring investors from investing in New Zealand, and some are even actively discouraging other investors considering investing in New Zealand.

- Based on a sample of almost 60 countries, those with screening mechanisms in place tend to receive less investment – all else held equal

Sectoral restrictions (1)

- By far the most important obstacle to FDI overall
- Negative list or positive list
- Only apply when there is scope for private investment
- Can take many forms:
  - Prohibition on investment
  - Maximum foreign equity share (5-99%)
  - Joint venture requirement
  - Mergers and takeovers, greenfield

Sectoral restrictions (2)

- Extractive industries: oil, gas, mining
- Infrastructure sectors: telecoms, transport
- Agriculture, fishing
- Services: finance, professional services, retail, media
- Government: health, education, defence

- Very few restrictions in the manufacturing sector: cigarettes, alcohol, etc.

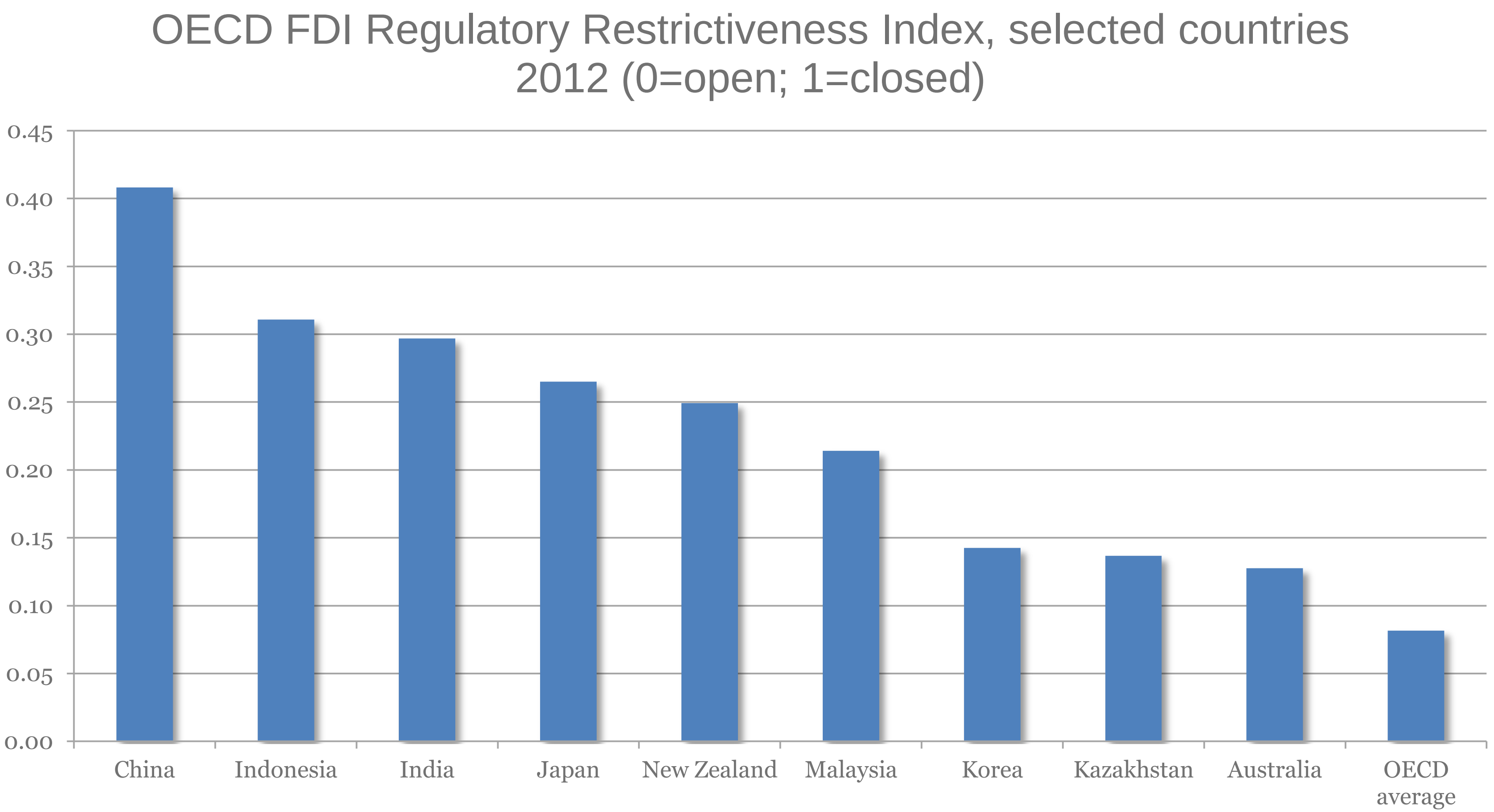
Other restrictions

- Land
- Minimum capital requirement
- Local content
- Technology transfer
- Export requirement
- Key personnel, board of directors
- Capital repatriation
- Government procurement

OECD FDI *Regulatory Restrictiveness Index*

- Measures only statutory restrictions on FDI (*i.e*. where national treatment is not applied)
- Does not include the degree of implementation, institutional quality or state ownership
- Covers equity restrictions, screening, restrictions on key personnel and operational restrictions
- Scores currently available for almost 60 countries, covering 22 sectors.
- Time series available for some countries

FDI Index scores, Asia & Pacific

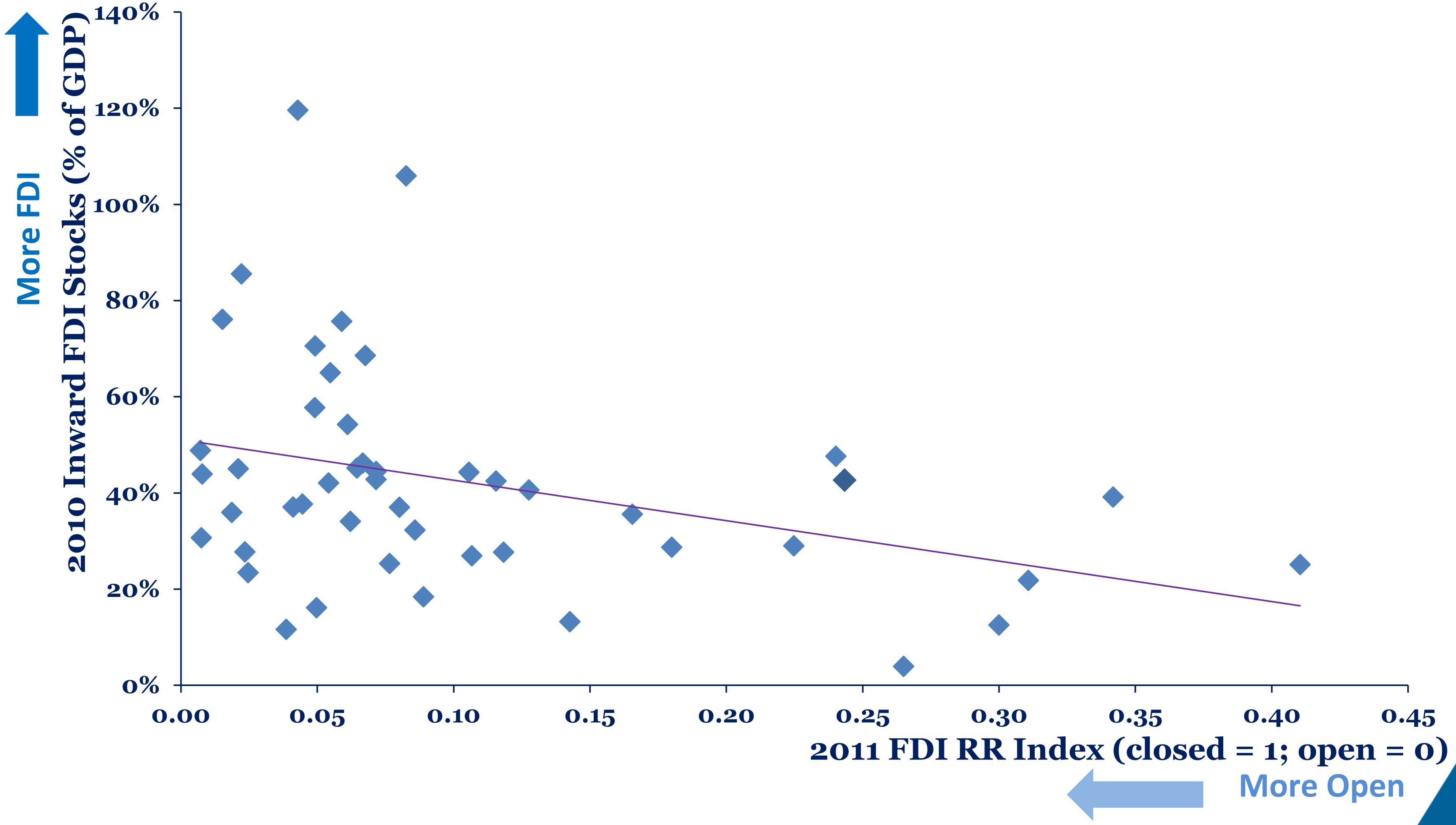


FDI restrictions matter

For the countries covered by the index, based on scores from 1997 to 2012:

A 10% improvement in the FDI Index score is associated with up to a 3.2% increase in the stock of FDI

Fewer FDI restrictions mean more FDI



Principles for non-discrimination

- Enshrine national treatment (NT) as a general principle in national law and in international agreements
- State clearly where NT does not apply: negative list
- Establish clear lines of responsibility for implementing regulations on foreign entry and operations and a clear mechanism for evaluating restrictions and modifying them, if necessary
- Justify the rationale for each restriction and measure the results against that rationale
- If screening exists, state clearly who is responsible for deciding and upon what basis. Limit the amount of discretion and allow for the possibility of appeal

Conclusion

- Policies matter for FDI
- Governments should be transparent about the conditions for entry of foreign investors
- Discretion should be kept to a minimum
- Investors should be consulted about changes in the law
- Policies should be assessed regularly.
  - Are they achieving their objectives?
  - Could other policies do so at less cost?
- Unhappy investors tend to be more vocal than happy ones

Non-discrimination: Issues for discussion

- Negative list? Stocktaking of restrictions?
- Rationale for exceptions to national treatment?
- Responsibility for setting policy and/or approvals?
- Acquisitions vs greenfield investments?
- Do foreign investors face financial restrictions (minimum capital requirements, repatriation restrictions)?
- Do foreign-established firms have access to government procurement?
- Restrictions on key personnel?
- Minimum capital requirements?
- Local content or other performance requirements?

For further information

Policy Framework for Investment (and User's Toolkit)

www.oecd.org/daf/inv/mne/pfi.htm

www.oecd.org/investment/toolkit/

FDI Index

www.oecd.org/investment/fdiindex.htm

Investment Policy Reviews

www.oecd.org/investment/countryreviews.htm

ASEAN-OECD Investment Programme

www.oecd.org/daf/inv/mne/seasia.htm