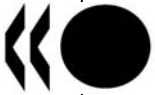


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**OECD INITIATIVE ON INVESTMENT FOR DEVELOPMENT**

**POLICY FRAMEWORK FOR INVESTMENT**

**(Report by the Investment Committee)**

Unclassified

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**POLICY FRAMEWORK FOR INVESTMENT:  
REPORT BY THE INVESTMENT COMMITTEE**

1. The Policy Framework for Investment (the *Framework*) is one of the three components of the OECD Initiative on Investment for Development which Council mandated the Investment Committee to lead [C(2003)205].<sup>1</sup> Work on the *Framework* received renewed support from the 2005 OECD Ministerial Statement on Development [C/MIN(2005)2]. This report on the *Framework* was approved on 11 April 2006 by the OECD Investment Committee, which also agreed to transmit it to Council.

**The context**

2. The objective of the *Framework* is to mobilise private investment that supports steady economic growth and sustainable development. It thus aims to contribute to the prosperity of countries and their citizens as well as to support the fight against poverty.

3. The *Framework* should be seen in the broader context of the United Nations Millennium Declaration and recent multilateral efforts to strengthen the international and national environments in which business is conducted, including the Doha Development Agenda and the Johannesburg Declaration on Sustainable Development. It aims to advance the implementation of the United Nations Monterrey Consensus, which emphasised the vital role of private investment in effective development strategies.

4. The *Framework* has been designed as a non-prescriptive tool, providing a checklist of important public policy issues for consideration by any government interested in creating an environment that is more attractive to investors, both domestic and foreign, and in enhancing the development benefits of investment to society.

5. The *Framework* builds a shared understanding among OECD and non-member governments of what constitutes good policy practices for investment. It draws on the OECD's experience and instruments dealing with the different policy areas that are covered and its Committees' global and regional dialogue with non-member economies. It complements recent OECD initiatives directed to governments and the business sector, including the *OECD Guidelines for Multinational Enterprises* revised in 2000.

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<sup>1</sup> The mandate followed the 2003 OECD Ministerial support for such an initiative. The other components of the OECD Initiative on Investment for Development are: enhancing the role of official development assistance in mobilising investment for development, and building policy capacity through the OECD peer dialogue method [see *OECD Initiative on Investment for Development: Progress Report*, C(2005)50].

## **A partnership process**

6. The work was conducted by an ad hoc Task Force established under the aegis of the Investment Committee, consisting of officials from the 30 OECD and 26 non-OECD member governments<sup>2</sup> and the EC. Japan and Chile chaired jointly the Task Force<sup>3</sup>. The World Bank, UNCTAD and other international organisations were participants in the Task Force.

7. The Task Force held five meetings in Paris, from June 2004 to March 2006, and conducted consultations abroad on the *Framework* under the auspices of the OECD Global Forums on International Investment held in India and Brazil and regional investment initiatives (in Uganda with NEPAD; in Korea with APEC; in Indonesia with ASEAN, UNESCAP and ADB; and the South East Europe Investment Compact).

8. BIAC, TUAC and representatives of non-governmental organisations were invited to participate in the meetings of the Task Force and made submissions. A broader public consultation was arranged through the OECD's Internet website in January-February 2006.

## **Horizontal project**

9. Annex 2 contains the text of the *Framework* developed by the Task Force as approved by the Investment Committee at its meeting on 10 April 2006.

10. The *Framework* proposes a set of questions for governments to consider in ten policy fields identified in the Monterrey Consensus as critically important for the quality of a country's environment for investment, including by small enterprises and foreign investors. These are: investment policy; investment promotion and facilitation; trade; competition; tax; corporate governance; infrastructure and financial sector development; human resource development; responsible business conduct; and public governance. The *Framework* also addresses the contribution of international co-operation, including home-country policy initiatives.

11. The questions for governments proposed by the *Framework* are supported by Annotations and complemented by references to selected policy resources. In addition, a *Review of good practices in OECD and non-OECD economies* in the ten policy areas was assembled to serve as analytical background<sup>4</sup> and will be published in parallel with the *Framework* under the responsibility of the Secretariat.

12. In addition to the Investment Committee, nine OECD bodies have been involved in developing or reviewing the chapters of the *Framework*. These are: Development Assistance Committee, Trade Committee, Competition Committee, Committee on Fiscal Affairs, Steering Group on Corporate Governance, Education Committee, Employment, Labour and Social Affairs Committee, Working Group on Bribery in International Business Transactions, and Public Governance Committee.

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<sup>2</sup> Non-OECD economies which have participated in Task Force meetings at the OECD include: Argentina, Bahrain, Brazil, Chile, China, Chinese Taipei, Egypt, Estonia, India, Indonesia, Israel, Jordan, Latvia, Lithuania, Malaysia, Morocco, Mozambique, Pakistan, Philippines, Romania, Russia, Senegal, Slovenia, South Africa, Tanzania and Vietnam.

<sup>3</sup> The co-chairs were Mr. Escobar, Senior Advisor to the Finance Minister of Chile, and Mr. Megata, Investment Committee Bureau member and Deputy Permanent Representative of Japan to the OECD.

<sup>4</sup> DAF/INV/TF(2006)2/REV1.

## Future use of the Framework

13. The *Framework* is not a volume of ready-made prescriptions, nor is it binding. Rather, it is a flexible tool with which to frame and evaluate the important policy challenges countries face in pursuit of development. Its core purpose is to encourage policy makers to ask appropriate questions about their economy, their institutions and their policy settings in order to identify their priorities, to develop an effective set of policies and to evaluate progress.

14. A preliminary list of avenues for future use of the *Framework* by governments and other interested parties is outlined in Annex 1<sup>5</sup>. Strong support was expressed by the Task Force's OECD and non-OECD government participants and non-member partners more generally for using the *Framework* in the following ways:

- A tool for co-ordinated self assessment and action-plan development within governments;
- A blueprint for regional dialogues in the context of NEPAD, APEC, SEE Investment Compact and other initiatives;
- An aid for peer reviews of individual governments' policies, including OECD investment policy reviews;
- A reference for donors' programmes;
- A reference for public-private dialogue;
- A reference point for co-operation and co-ordination between international organisations on investment issues.

15. The *Framework* synthesises, for the first time, in a single comprehensive instrument, the main substantive elements of the OECD's investment outreach work, and will strengthen its impact in the future.

16. The World Bank, UNCTAD and other international organisations are invited to co-operate with the OECD in the dissemination and effective use of the *Framework*.

17. Bilateral donor institutions can contribute to building legal, institutional and policy capacities in developing countries, including for improving investment environments. DAC has developed policy guidance for donors on using ODA to promote private investment for development [C(2006)70], which is another component of the OECD Initiative on Investment for Development and complements the *Framework*.

18. The *Framework* is conceived as an evolving instrument. It will be reviewed by OECD, non-OECD partners and stakeholders in light of changes in circumstances and experience gained in using the *Framework*.

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<sup>5</sup> Annex 1 does not constitute a new work programme proposal that would commit the budget of the Organisation or substitute for existing OECD bodies' country reviews and other co-operation programmes. Any implications for follow-up work after completion of the *Framework*, which have not have been factored in output results already agreed by OECD Council, will be taken up in the context of the Investment Committee's work programme submission as part of the normal process of preparation for the OECD's PWB 2007-08.

**Proposed action**

19. In light of the preceding, the Council is invited to adopt the following draft conclusions:

THE COUNCIL

- a) adopted the Report C(2006)68 on *OECD Initiative on Investment for Development: A Policy Framework for Investment*;
- b) reaffirmed Members' strong commitment to the implementation of the Millennium Declaration and the Monterrey Consensus and recognised the central role of private investment for growth, poverty eradication and sustainable development worldwide;
- c) welcomed the work by OECD and non-OECD member participants in the Investment Committee's Task Force on the *Policy Framework for Investment* as set forth in Annex 2 and potential avenues for its future use as identified in Annex 1;
- d) invited OECD and non-member governments and stakeholders to make use of the *Policy Framework for Investment* in policy evaluation and dialogue in the context of national development strategies and international co-operation;
- e) encouraged continuing co-operation of the OECD with the World Bank, the United Nations and other interested institutions, as well as active engagement of business, labour and other civil society organisations, to support effective use and future development of the *Policy Framework for Investment*;
- f) noted that *Using ODA to Promote Private Investment for Development: Policy Guidance for Donors* [C(2006)70], approved by the Development Assistance Committee (DAC), as another component of the OECD Initiative on Investment for Development, complements the *Framework*, and welcome donors' assistance in building capacities in developing countries for improving investment environments;
- g) agreed that the *Framework* should be reviewed by the Investment Committee and non-member partners, in co-operation with other OECD bodies and international institutions and in consultation with stakeholders, in light of experience gained in using the *Framework* in principle in two years' time;
- h) agreed to declassify and transmit the Report C(2006)68 to Ministers at the Council meeting on 23-24 May 2006.

## ANNEX 1. AVENUES FOR USE OF THE POLICY FRAMEWORK FOR INVESTMENT

1. The *Policy Framework for Investment* is designed to be used for self-evaluations by governments and peer reviews, regional co-operation and multilateral policy dialogue, and as a reference in donors' programmes, for co-ordination among interested international organisations and in private-public sector dialogue. While responsibility for the implementation of the *Framework* rests with governments, the Investment Committee, working with non-member partners, the World Bank and other organisations, the OECD bodies concerned and its stakeholders, will assist in dissemination of the *Framework* and the development of methodologies and capacities for its effective use in accordance with different country and regional circumstances and national development strategies.

2. Avenues for future use of the *Framework* already in train or identified include the following:

### ***Regional investment initiatives***

3. *NEPAD, South East Europe, APEC.* Parties to NEPAD-OECD Africa Investment Initiative look forward to using the *Framework* as an organising principle for self-evaluations and peer dialogues in the framework of the Initiative, as provided for in the strengthened terms of this Initiative (approved by OECD Council in November 2005 -- C(2005)139/REV1). The Investment Compact for South East Europe has been involved over the past five years in investment reform issues cutting across a broad range of policy areas; pursuant to the call by the June 2005 Investment Compact Ministerial, the governments and the private sector in the region are currently working within the Investment Compact to use the *Framework* in the process of monitoring the results. The joint APEC/OECD investment seminar held in the context of the APEC summit in Korea in November 2005 gave broad support for using the *Framework* approach in co-operation with the OECD to strengthen APEC work and dialogue on investment. This support was reiterated by actual and future APEC chairs -- Australia, Korea and Vietnam -- in December 2005. Since, a proposal for joint work on an APEC-OECD Integrated Framework is under consideration in APEC.

4. *Other regional avenues.* In addition to channels provided through co-operation with APEC, a launch event of the *Framework* directed to ASEAN and the Asian region more generally will be arranged in the second half of 2006, with support from Japan and other countries. Participants in the MENA-OECD Investment Programme will wish to consider the Framework to help in future overall evaluation of the Programme and to structure further dialogue in specific areas. The United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) Secretariat has expressed interest in using the *Framework* in the context of its own activities and in working with the OECD on methodologies to this effect. Central America Free Trade Agreement (CAFTA) officials at the 2005 Global Forum in International Investment expressed a similar interest, taking advantage of capacity building arrangements embodied in this Agreement. Co-operation with the OECD on use of the *Framework* in the context of South America was supported by the United Nations Economic Commission for Latin America and the Caribbean at the Forum and is being given serious consideration by the Inter-American Development Bank. The OECD Investment Committee will collaborate with the OECD Development Centre, regional development banks, and international organisations such as the World Bank and UNCTAD (see also paragraphs 7 and 8) to support regional dissemination of the *Framework*.

### ***Investment policy peer reviews***

5. The *Framework* articulates the many aspects of sound investment regimes covered by the OECD investment policy country reviews. It also provides robust templates for peer dialogue in areas only superficially covered in the past in country and other investment outreach programmes, in particular infrastructure development and government policies to promote recognised concepts and principles for responsible business conduct.

6. At the OECD, a first test of the *Framework* in a country-specific context will be made in reviews that will be carried out as part of existing China, Russia and other co-operation programmes on investment. It will also be used to assess the investment environments of non-Members applying to adhere to the OECD Declaration on International Investment and Multinational Enterprises.

### ***Co-operation with other international organisations***

7. The World Bank has been a key partner within the Task Force in the development of the *Framework*. It contributed background material for the chapter of the *Framework* on infrastructure and financial sector development and its chapter on human resources development; it officially co-sponsored the 2005 OECD Global Forum on International Investment entirely devoted to the *Framework*. The OECD will continue to work with the World Bank to implement the above-mentioned regional investment initiatives. The UNCTAD Secretariat has also outlined a wide range of possibilities for co-operation with the OECD, including its desire to conduct joint investment policy reviews of selected economies using the *Framework* as a benchmark.

8. Looking ahead, the Investment Committee is also considering a proposal for the creation of a web-based *International Investment Dialogue* as a joint initiative of the OECD, World Bank and other interested organizations that would facilitate co-ordination and dissemination of *Framework*-relevant work.

### ***Donor engagement***

9. The joint report by the Development Assistance and Investment Committees on the role of ODA to mobilise investment for development presented to the 2005 OECD Ministerial [C(2005)61] pointed to the need for donors to be more strategic, better co-ordinated and guided by more systematic learning of what works and does not work to address binding constraints at national and sector levels that are holding back investment. More specific policy guidance for donors has since been developed within the DAC [C(2006)yy] in consultation with a range of stakeholders including the Investment Committee. DAC highlights the *Framework* as a tool that complements its guidance for identifying such constraints.

10. The new strengthened NEPAD-OECD Africa Investment Initiative in particular has been recognised as an important opportunity to strengthen donor engagement.

### ***Review and exchanges of policy experience***

11. The OECD Global Forum on International Investment can play an important role in promoting the use of the *Framework*, reviewing experience and assessing its policy impact.

12. For this purpose, the Global Forum and overall monitoring of the *Framework* would be strengthened through the creation of a steering group of OECD and non-OECD officials who participated in the Task Force. Co-chaired by a non-OECD senior representative and the chair of the OECD Investment Committee's Advisory Group on non-Members, the steering group would meet at OECD and work through EDG between Global Forums.

13. Overall evaluation of the impact of the *Framework* would be undertaken by the Global Forum and its steering group. The indicators for outreach work performance endorsed on an experimental basis by the Investment Committee in 2005 would be among the evaluation tools available.

14. In addition, at its Annual Meeting, the Global Forum would be invited to review and adopt the *Annual Report on Investment for Development*. Its first edition was published in 2005 under the Secretariat's responsibility. Conceived as an accountability tool, the next editions would be published under the joint responsibility of the Investment Committee and the other governments participating in the Global Forum.

## ANNEX 2. TEXT OF THE POLICY FRAMEWORK FOR INVESTMENT

### PREAMBLE

The objective of the *Policy Framework for Investment* is to mobilise private investment that supports steady economic growth and sustainable development, and thus contribute to the prosperity of countries and their citizens and the fight against poverty.

The economic and social benefits of private investment, both domestic and international and in its many forms, from physical assets to intellectual capital are widely recognised. Private investment expands an economy's productive capacity, drives job creation and income growth, and in the case of international investment, is a conduit for the local diffusion of technological and enterprise expertise and spurs domestic investment, including through the creation of local supplier linkages. Such benefits can act as a powerful force for development and poverty eradication. Yet, while many countries have succeeded in achieving high rates of domestic private investment and attracting substantial international investment as an integral part of their development strategy, others have not been as successful in realising the benefits of investment. The benefits of investment do not necessarily accrue automatically or evenly across countries, sectors and local communities. Countries' continuous efforts to strengthen national policies and public institutions, and international co-operation, to create sound investment environments matter most.

The *Policy Framework for Investment* is a tool, providing a checklist of important policy issues for consideration by any government interested in creating an environment that is attractive to all investors and in enhancing the development benefits of investment to society, especially the poor. In this way, the *Framework* aims to advance the implementation of the United Nations Monterrey Consensus, which emphasised the vital role of private investment in effective development strategies.

The *Framework* should be seen in the broad context of the United Nations Millennium Declaration and recent multilateral efforts to strengthen the international and national environments in which business is conducted, including the Doha Development Agenda and the Johannesburg Declaration on Sustainable Development. In common with those initiatives, it promotes transparency and appropriate roles and responsibilities for governments, business and others with a stake in promoting development and poverty reduction, and builds on universally shared values of democratic society and respect for human rights, including property rights.

The *Framework* is not a volume of ready-made prescriptions, nor is it binding. Rather, it is a flexible tool with which to frame and evaluate the important policy challenges countries face in pursuit of development. Its core purpose is to encourage policy makers to ask appropriate questions about their

economy, their institutions and their policy settings in order to identify their priorities, to develop an effective set of policies and to evaluate progress.

A task force of government officials from about 60 OECD and non-OECD economies decided and developed the *Framework's* content and structure, with the partnership of the World Bank, the United Nations and other international institutions and informed by regional consultations in Africa, Asia, Latin America and South East Europe. Business, labour and other civil society organisations also contributed their perspectives to the development of the *Framework*. Apart from macroeconomic stability, political predictability, social cohesion and upholding the rule of law, which are pre-conditions for sustainable development, the task force selected ten policy domains, based on an assessment of the strength of the linkages between each policy field and the investment environment. The ten chapters draw on good practices from OECD and non-OECD experiences and cover: investment policy; 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.

The *Framework* is comprehensive, but does not claim to be exhaustive. Other policy areas, such as the environment, energy, rural development, innovation, women entrepreneurship and gender balance bear on the business environment as well. While the *Framework* does not identify these topics as stand-alone chapters, many questions explicitly capture their importance on the investment environment and for economic development.

The *Framework*, by fostering an informed process of policy formulation and implementation at all levels of government, can be used in a variety of ways as part of their national development strategies. Self-evaluation, peer reviews, regional co-operation and multilateral discussions can all benefit from the insights offered in the *Framework* and will contribute to identify where to prioritise investment policy reforms. It also provides a reference point for international organisations' capacity building programmes, for investment promotion agencies, for donors as they assist developing country partners in improving the investment environment and for business, labour and other non-governmental organisations in their dialogue with governments. Its various elements can be flexibly adapted to the particular economic, social, legal and cultural circumstances and needs in economies at different stages of development. The *Framework* also addresses the potential contribution that governments can make by international co-operation, including through regional integration and home-country policy initiatives.

The OECD, working with non-members, partner organisations, donors and stakeholders, will assist in methodologies, including indicators of progress, and institutional capacity building for the effective use of the *Framework* in light of different circumstances and needs.

The *Framework* is a component of the OECD Initiative on Investment for Development, launched in Johannesburg in November 2003, which received support at OECD Ministerial level. The *Framework* builds on the OECD's experience and instruments dealing with the different policy areas that are covered and its Committees' global and regional dialogue with non-member economies. It complements recent OECD initiatives directed to governments and the business sector, including the *OECD Guidelines for Multinational Enterprises* revised in 2000, and can work in synergy with the OECD Development Assistance Committee's *Policy Guidance for Donors on using ODA to Promote Private Investment for Development*, which is another component of the OECD Initiative.

The *Framework* and its scope will be reviewed by the OECD and its non-member partners and stakeholders in light of experience with its use, to strengthen its effectiveness over time.

## PART I: THE POLICY FRAMEWORK FOR INVESTMENT

This Part of the *Framework* brings together ten sets of questions covering the main policy domains selected by the task force and similarly identified in the Monterrey Consensus as having the strongest impact on the investment environment. The technique of using questions is intended to facilitate flexible approaches to self-assessment and to priority setting by governments in accordance with their own 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.

The questions are accompanied by annotations, which provide context and information from an investment perspective in Part II. The documents referenced and policy resources listed in each chapter provide additional analytical background and practical policy guidance, including examples of country experience with the issue at hand. In addition, the companion volume *Policy Framework for Investment: a review of good practices in OECD and non-OECD economies* brings together analytical background material for each of the ten policy domains.

Three principles apply throughout the *Framework*. The first is policy coherence, with the questions in each chapter following an integrated approach to the interaction between various policy areas and the investment environment. For example, standards for investment protection and openness are of wide applicability to international as well as domestic investors including small- and medium-sized enterprises (SMEs); effective competition and tax policies are important to ensure that investment, in particular in small businesses, is not deterred by unnecessary barriers to entry, dissuasive taxation, and poor legal compliance; and open trade policies contribute to realising the benefits of an open investment policy. The public governance chapter focuses on the conditions for a sound regulatory framework within and across policy domains.

The second principle is the importance of a transparent approach to policy formulation and implementation, with government agencies accountable for their activities. Transparency reduces uncertainty and risk for investors and the transaction costs associated with making an investment, and facilitates public-private dialogue. Accountability reassures investors that government agencies are exercising their powers responsibly. How transparency and accountability in specific public policy domains fosters an environment where investment flourishes is thus a theme taken up in the questions in each of the chapters.

Regular evaluation of the impact of existing and proposed policies on the investment environment is the third principle that applies across the *Framework*. In this regard, the questions seek to help evaluate how well government policies uphold established good practices in terms of fair treatment for all investors (foreign or domestic based, small or large in size) and opening opportunities to invest, taking into account the wider interests of the community in which investors operate. The questions attach a particular emphasis to the adaptability of the institutional framework and the role of periodic evaluations so as to identify early on new challenges and to be able to respond quickly to them.

## Chapter 1. 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.*

- 1.1 What steps has the government taken to ensure that the laws and regulations dealing with investments and investors, including small and medium sized enterprises, and their implementation and enforcement are clear, transparent, readily accessible and do not impose unnecessary burdens?
- 1.2 What steps has the government taken towards the progressive establishment of timely, secure and effective methods of ownership registration for land and other forms of property?
- 1.3 Has the government implemented laws and regulations for the protection of intellectual property rights and effective enforcement mechanisms? Does the level of protection encourage innovation and investment by domestic and foreign firms? What steps has the government taken to develop strategies, policies and programs to meet the intellectual property needs of SMEs?
- 1.4 Is the system of contract enforcement effective and widely accessible to all investors? What alternative systems of dispute settlement has the government established to ensure the widest possible scope of protection at a reasonable cost?
- 1.5 Does the government maintain a policy of timely, adequate, and effective compensation for expropriation also consistent with its obligations under international law? What explicit and well-defined limits on the ability to expropriate has the government established? What independent channels exist for reviewing the exercise of this power or for contesting it?
- 1.6 Has the government taken steps to establish non-discrimination as a general principle underpinning laws and regulations governing investment? In the exercise of its right to regulate and to deliver public services, does the government have mechanisms in place to ensure transparency of remaining discriminatory restrictions on international investment and to periodically review their costs against their intended public purpose? Has the government reviewed restrictions affecting the free transfer of capital and profits and their effect on attracting international investment?
- 1.7 Are investment policy authorities working with their counterparts in other economies to expand international treaties on the promotion and protection of investment? Has the government reviewed existing international treaties and commitments periodically to determine whether their provisions create a more attractive environment for investment? What measures exist to ensure effective compliance with the country's commitments under its international investment agreements?
- 1.8 Has the government ratified and implemented binding international arbitration instruments for the settlement of investment disputes?

## Chapter 2. Investment promotion and facilitation

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

- 2.1 Does the government have a strategy for developing a sound, broad-based business environment and within this strategy, what role is given to investment promotion and facilitation measures?
- 2.2 Has the government established an investment promotion agency (IPA)? To what extent has the structure, mission, and legal status of the IPA been informed by and benchmarked against international good practices?
- 2.3 Is the IPA adequately funded and is its performance in terms of attracting investment regularly reviewed? What indicators have been established for monitoring the performance of the agency?
- 2.4 How has the government sought to streamline administrative procedures to quicken and to reduce the cost of establishing a new investment? In its capacity as a facilitator for investors, does the IPA take full advantage of information on the problems encountered from established investors?
- 2.5 To what extent does the IPA promote and maintain dialogue mechanisms with investors? Does the government consult with the IPA on matters having an impact on investment?
- 2.6 What mechanisms has the government established for the evaluation of the costs and benefits of investment incentives, their appropriate duration, their transparency, and their impact on the economic interests of other countries?
- 2.7 What steps has the government taken to promote investment linkages between businesses, especially between foreign affiliates and local enterprises? What measures has the government put in place to address the specific investment obstacles faced by SMEs?
- 2.8 Has the government made use of international and regional initiatives aimed at building investment promotion expertise, such as those offered by the World Bank and other intergovernmental organisations? Has the IPA joined regional and international networks?
- 2.9 To what extent has the government taken advantage of information exchange networks for promoting investment?

### Chapter 3. 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.*

- 3.1 What recent efforts has the government undertaken to reduce the compliance costs of customs, regulatory and administrative procedures at the border?
- 3.2 What steps has the government taken to reduce trade policy uncertainty and to increase trade policy predictability for investors? Are investors and other interested parties consulted on planned changes to trade policy?
- 3.3 How actively is the government increasing investment opportunities through market-expanding international trade agreements and through the implementation of its WTO commitments?
- 3.4 How are trade policies that favour investment in some industries and discourage it in others reviewed with a view to reducing the costs associated with these distortions?
- 3.5 To what extent do trade policies raise the cost of inputs of goods and services, thereby discouraging investment in industries that depend upon sourcing at competitive world prices?
- 3.6 If a country's trade policy has a negative effect on developing country exports, what alternative means of accomplishing public policy objectives has the government considered, taking into account the dampening effect that such a restrictive trade policy also has on investment?
- 3.7 To what extent does trade policy support and attract investment through measures that address sectoral weaknesses in developing countries (e.g. export finance and import insurance)?

## Chapter 4. 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.*

- 4.1 Are the competition laws and their application clear, transparent, and non-discriminatory? What measures do the competition authorities use (e.g. publishing decisions and explanations on the approach used to enforce the laws) to help investors understand and comply with the competition laws and to communicate changes in the laws and regulations?
- 4.2 Do the competition authorities have adequate resources, political support and independence to implement effectively competition laws?
- 4.3 To what extent, and how, have the competition authorities addressed anti-competitive practices by incumbent enterprises, including state-owned enterprises, that inhibit investment?
- 4.4 Do the competition authorities have the capacity to evaluate the impact of other policies on the ability of investors to enter the market? What channels of communication and co-operation have been established between competition authorities and other relevant government agencies?
- 4.5 Does the competition authority periodically evaluate the costs and benefits of industrial policies and take into consideration their impact on the investment environment?
- 4.6 What is the role of the competition authorities in case of privatizations? Have competition considerations having a bearing on investment opportunities, such as not permitting market exclusivity clauses, been adequately addressed?
- 4.7 To what extent are competition authorities working with their counterparts in other countries to co-operate on international competition issues, such as cross-border mergers and acquisitions, bearing on the investment environment?

## Chapter 5. 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.*

- 5.1 Has the government evaluated the level of tax burden that would be consistent with its broader development objectives and its investment attraction strategy? Is this level consistent with the actual tax burden?
- 5.2 What is the average tax burden on domestic profits, taking into account statutory provisions, tax-planning opportunities and compliance costs?
- 5.3 Is the tax burden on the business enterprises of investors appropriate with reference to the policy goals and objectives of the tax system?
- 5.4 If framework conditions and market characteristics for investors are weak, has the government evaluated the limitations of using tax policy alone to influence favourably investment decisions?
- 5.5 Where the tax burden on business income differs by firm size, age of the business entity, ownership structure, industrial sector or location, can these differences be justified? Is the tax system neutral in its treatment of foreign and domestic investors?
- 5.6 Are rules for the determination of corporate taxable income formulated with reference to a benchmark income definition (e.g. comprehensive income), and are the main tax provisions generally consistent with international norms?
- 5.7 Have targeted tax incentives for investors and others created unintended tax-planning opportunities? Are these opportunities and other problems associated with targeted tax incentives evaluated and taken into account in assessing their cost-effectiveness?
- 5.8 Are tax expenditure accounts reported and sunset clauses used to inform and manage the budget process?
- 5.9 Are tax policy and tax administration officials working with their counterparts in other countries to expand their tax treaty network and to counter abusive cross-border tax planning strategies?

## Chapter 6. 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. These questions 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.*

- 6.1 What steps have been taken to ensure the basis for a corporate governance framework that promotes overall economic performance and transparent and efficient markets? Has this been translated into a coherent and consistent regulatory framework, backed by effective enforcement?
- 6.2 How does the corporate governance framework ensure the equitable treatment of shareholders?
- 6.3 What are the procedures and institutional structures for legal redress in cases of violation of shareholder rights? Do they function as a credible deterrent to such violations? What measures are in place to monitor and prevent corporate insiders and controlling owners from extracting private benefits?
- 6.4 What procedures and institutions are in place to ensure that shareholders have the ability to influence significantly the company?
- 6.5 By what standards and procedures do companies meet the market demand for timely, reliable and relevant disclosure, including information about the company's ownership and control structure?
- 6.6 How does the corporate governance framework ensure the board plays a central role in the strategic guidance of the company, the effective monitoring of management, and that the board is accountable to the company and its shareholders? Does the framework also recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises?
- 6.7 What has been done, and what more should be done in terms of voluntary initiatives and training to encourage and develop a good corporate governance culture in the private sector?
- 6.8 Has a review been undertaken of the national corporate governance system against the OECD Principles of Corporate Governance? Has the result of that review been made public?
- 6.9 How is the ownership function of state-owned enterprises (SOEs) structured to ensure a level playing field, competitive market conditions, and independent regulation? What are the processes in place to ensure the state does not interfere in day-to-day management of SOEs and that board members may effectively carry out their role of strategic oversight, rather than to serve as a conduit for undue political pressure? How are SOEs effectively held accountable to the government, the public, and to other shareholders (if any)?

## Chapter 7. 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.*

- 7.1 How does the government make clear for investors the distinction between its own role and responsibilities and those ascribed to the business sector? Does it actively assume its responsibilities (e.g. by effectively enforcing laws on respecting human rights, environmental protection, labour relations and financial accountability)?
- 7.2 What steps does the government take to promote communication on expected responsible business conduct to investors? How does the government endeavour to protect the rights framework that underpins effective communication?
- 7.3 Does the government ensure that an adequate framework is in place to support the financial and non-financial disclosure that companies make about their business activities? Is this framework flexible enough to allow scope for innovation, for tailoring practices to the needs of investors and their stakeholders?
- 7.4 How can the government support companies' efforts to comply with the law?
- 7.5 How does the government through partnership (e.g. by participating in the development of standards that lower costs of adopting responsible business policies) and through promotion (e.g. by improving the information on responsible business practices to customers and the public) help to strengthen the business case for responsible business conduct?
- 7.6 Does the government participate in inter-governmental co-operation in order to promote international concepts and principles for responsible business conduct, such as the *OECD Guidelines for Multinational Enterprises*, the *ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policies* and the *United Nations Global Compact*?

## Chapter 8. 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.*

- 8.1 Has the government established a coherent and comprehensive human resource development (HRD) policy framework consistent with its broader development and investment strategy and its implementation capacity? Is the HRD policy framework periodically reviewed to ensure that it is responsive to new economic developments and engages the main stakeholders?
- 8.2 What steps has the government taken to increase participation in basic schooling and to improve the quality of instruction so as to leverage human resource assets to attract and to seize investment opportunities?
- 8.3 Is the economic incentive sufficient to encourage individuals to invest in higher education and life-long learning, supporting the improvement in the investment environment that flows from better human resources? What measures are being taken to ensure the full benefit of a country's investment in its own human resources accrues, including the attraction of nationals who have completed their studies abroad? What mechanisms exist to promote closer co-operation between education institutions and business and to anticipate future labour force skill requirements?
- 8.4 To what extent does the government promote training programmes and has it adopted practices that evaluate their effectiveness and their impact on the investment environment? What mechanisms are used to encourage businesses to offer training to employees and to play a larger role in co-financing training?
- 8.5 Does the government have a coherent strategy to tackle the spread of pandemic diseases and procedures to evaluate public health expenditures aimed at improving public health outcomes and, through inter-linkages, the investment environment?
- 8.6 What mechanisms are being put in place to promote and enforce core labour standards?
- 8.7 To what extent do labour market regulations support job creation and the government's investment attraction strategy? What initiatives have been introduced that support policy coordination, balancing social objectives, the goal of a competitive workforce and the incentives for business to invest?
- 8.8 Do laws and regulations restrict the deployment of skilled workers from an enterprise investing in the host country? What steps have been taken to unwind unduly restrictive practices covering the deployment of workers from the investing enterprise and to reduce delays in granting work visas?
- 8.9 Does the government support programmes designed to assist large-scale labour adjustment and indirectly the investment environment by better positioning firms to seize investment opportunities? Do the incentive mechanisms in these schemes encourage broad support for change? What role is business encouraged to play in easing the transition costs associated with labour adjustment?
- 8.10 What steps are being taken to ensure that labour market regulations support an adaptable workforce and maintain the ability of enterprises to modify their operations and investment planning?

## Chapter 9. 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.*

- 9.1 What processes does the government use to evaluate its infrastructure investment needs? Does the national government work in cooperation with local and regional governments to establish infrastructure investment priorities? Does the government have clear guidelines and transparent procedures for the disbursement of public monies funding infrastructure projects? Are the regulatory agencies that oversee infrastructure investment and the operations of enterprises with infrastructure investments independent from undue political interference?
- 9.2 What measures has the government adopted to uphold the principle of transparency and procedural fairness for all investors bidding for infrastructure contracts, to protect investors' rights from unilateral changes to contract terms and conditions? What steps have been taken to attract investors to supply infrastructure at fair and reasonable prices, to ensure that investor-state contracts serve the public interest and to maintain public support for private involvement infrastructure?
- 9.3 In the telecommunications sector, does the government assess market access for potential investors and the extent of competition among operators? Does the government evaluate whether telecommunication pricing policies are competitive, favouring investment in industries that depend on reliable and affordable telecommunications?
- 9.4 Has the government developed a strategy to ensure reliable access to electricity services by users, and economic incentives to invest and supply electricity? What programmes exist to ensure on a least-cost basis access to electricity services by a wide range of users? Are these programmes time-bound and based upon clear performance targets?
- 9.5 What processes are followed to inform decisions on the development of new transport facilities, as well as the maintenance of existing investment in transport infrastructure? Are the requirements for all modes of transport regularly reviewed, taking into consideration investor needs and the links between different modes of transport infrastructure?
- 9.6 Has the government evaluated the investment needs in water required to support its development goals? To what extent is the private sector involved in water management, supply and infrastructure financing?
- 9.7 What process does the government use to evaluate the capacity of the financial sector, including the quality of its regulatory framework, to support effectively enterprise development? What steps has the government taken to remove obstacles, including restrictions on participation by foreign institutions, to private investment in the development of the financial sector?
- 9.8 What laws and regulations are in place to protect the rights of borrowers and creditors and are these rights adequately balanced? Is a registry system in place to support the use of property as collateral and to expand business access to external sources of credit? What data protection and credit reporting laws have been enacted to facilitate the flow of information and improve financial sector stability, thereby enhancing the investment environment?

## Chapter 10. 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.*

- 10.1 Has the government established and implemented a coherent and comprehensive regulatory reform framework, consistent with its broader development and investment strategy?
- 10.2 What mechanisms are in place for managing and co-ordinating regulatory reform across different levels of government to ensure consistent and transparent application of regulations and clear standards for regulatory quality?
- 10.3 To what extent are regulatory impact assessments used to evaluate the consequences of economic regulations on the investment environment? Are the results of these assessments made public on a timely basis?
- 10.4 What public consultation mechanisms and procedures, including prior notification, have been established to improve regulatory quality, thereby enhancing the investment environment? Are the consultation mechanisms open to all concerned stakeholders?
- 10.5 To what extent are the administrative burdens on investors measured and quantified? What government procedures exist to identify and to reduce unnecessary administrative burdens, including those on investors? How widely are information and communication technologies used to promote administrative simplification, quality services, transparency and accountability?
- 10.6 To what extent have international anti-corruption and integrity standards been implemented in national legislation and regulations? Do penal, administrative and civil law provisions provide an effective legislative and regulatory framework for fighting corruption, including bribe solicitation and extortion as well as promoting integrity, thereby reducing uncertainty and improving business conditions for all investors?
- 10.7 Do institutions and procedures ensure transparent, effective and consistent application and enforcement of laws and regulations on anti-corruption, including bribe solicitation and extortion, and integrity in the public service? Have standards of conduct by public officials been established and made transparent? What measures are used to assist public officials and to ensure the expected standards are met? Are civil society organisations and the media free to scrutinize the conduct of public officials' duties? Are "whistle-blower" protections in place?
- 10.8 Do review mechanisms exist to assess the performance of laws and regulations on anti-corruption and integrity?
- 10.9 Is the government a party to international initiatives aimed at fighting corruption and improving public sector integrity? What mechanisms are in place to ensure timely and effective implementation of anti-corruption conventions? Do these mechanisms monitor the application and enforcement of the anti-corruption laws implementing the conventions?

## PART II. ANNOTATIONS<sup>6</sup>

### Annotations to Chapter 1. Investment policy

#### **1.1 What steps has the government taken to ensure that the laws and regulations dealing with investments and investors, including small and medium sized enterprises, and their implementation and enforcement are clear, transparent, readily accessible and do not impose unnecessary burdens?**

Transparent information on how governments implement and change rules and regulations dealing with investment is a critical determinant in the investment decision. Transparency and predictability are especially important for small and medium sized enterprises that tend to face particular challenges to entering the formal economy. It is also important for foreign investors who may have to function with very different regulatory systems, cultures and administrative frameworks from their own. A transparent and predictable regulatory framework dealing with investment helps businesses to assess potential investment opportunities on a more informed and timely basis, shortening the period before investment becomes productive. The importance of transparency and predictability has thus motivated a number of initiatives, such as the OECD Framework for Investment Policy Transparency, that aim to help governments to achieve greater transparency. Transparency provisions have also been enshrined in virtually all modern international investment agreements, including the agreements of the WTO, regional agreements such as the NAFTA and most bilateral investment treaties of recent vintage. More generally, governments can promote investment, by: consulting with interested parties; simplifying and codifying legislation; using plain language drafting; developing registers of existing and proposed regulation; expanding the use of electronic dissemination of regulatory material; and by publishing and reviewing administrative decisions.

#### **1.2 What steps has the government taken towards the progressive establishment of timely, secure and effective methods of ownership registration for land and other forms of property?**

Secure, transferable rights to agricultural and other types of land and other forms of property are an important pre-requisite for a healthy investment environment and an important incentive for investors and entrepreneurs to shift into the formal economy. They are also a fundamental element in building a credible corporate governance framework (for further details, see the chapter on corporate governance). They entitle the investor to participate in the eventual profits that derive from an investment and reduce the risk of fraud in transactions. These rights carry an intrinsic economic value and investors need to be confident that their entitlement to these rights are properly recognised and protected. Well-defined and secure ownership, including effective register of what constitute public properties, encourages new investment and the upkeep of existing investments. Land titles, for example, give an incentive to owners to promote productivity enhancing investments. Reliable land titling and property registrars also help individuals and businesses to seek legal redress in case of violation of property rights and offers a form of collateral that

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<sup>6</sup> More detailed analysis and information for each of the policy domains is available in the OECD Secretariat background document *Policy Framework for Investment: A review of good practices in OECD and non-OECD economies* (forthcoming).

investors can use to improve access to credit. Improved access to credit lowers one of the main obstacles to new investment, especially among small and medium-sized enterprises.

**1.3 Has the government implemented laws and regulations for the protection of intellectual property rights and effective enforcement mechanisms? Does the level of protection encourage innovation and investment by domestic and foreign firms? What steps has the government taken to develop strategies, policies and programs to meet the intellectual property needs of SMEs?**

Intellectual property rights give businesses an incentive to invest in research and development, and ultimately lead to the creation of innovative products and processes. They also give the holders of such rights the confidence to share new technologies, such as in the context of joint ventures. Successful innovations are in time diffused within and across economies, bringing higher productivity and growth. Investment is thus, both a pre-condition for the creation and diffusion of innovation activity. The intellectual property right protection instruments used by governments to encourage investment in research and development include patent and copyright laws, which give the owner, for a pre-determined period of time exclusive right to exploit the innovation. How effective these instruments are in terms of encouraging investment in innovation activity also depends on how well the rights are enforced. Efforts to curb non-compliance, for instance counterfeiting, are therefore an important feature of any intellectual property regime. At the same time, intellectual property right regimes need to strike a balance between society's interests in fostering innovation and in keeping markets competitive and, especially in the case of essential medicines, in sufficient supply (see also the chapter on competition policy and question 8.5 of the chapter on human resource development).

The intellectual property rights regime is not only a matter of concern to large firms and multinational enterprises with significant research and development programmes, but also to small- and medium-sized enterprises (SME). SMEs are a driving force behind innovation, yet their potential to invest in innovation activities are not always fully exploited. SMEs tend to under utilise the intellectual property system, partly due to their lack of awareness. (On the promotion of investment by SMEs, see also the chapter on Investment Promotion and Facilitation.) Measures that extend access to the intellectual property regime system may thus help to attract investment in research and development and to transmit the positive spillovers to society that such investment embodies. Governments can help by, for example: promoting a greater use of the intellectual property system; developing specific strategies, policies and programs to meet the intellectual property needs of SMEs; improving the capacity of relevant public, private and civil society institutions, such as business and industry associations, to provide intellectual property-related services to SMEs; and by providing information and advice on intellectual property issues to SME support organisations.

**1.4 Is the system of contract enforcement effective and widely accessible to all investors? What alternative systems of dispute settlement has the government established to ensure the widest possible scope of protection at a reasonable cost?**

Ultimately, it is the possibility of buying and selling assets through market transactions that reveals the value of an asset. It is, therefore, important that investors have trust in the integrity of the markets. As a central pillar of any system, this requires a legal framework, capable of ensuring the enforcement of contracts, the protection of property rights and the resolution of disputes. In many cases, however, recourse to the judiciary system can be slow and expensive, discouraging potential investors. Confidence in the integrity of markets can also be favoured through the development of alternative dispute settlement procedures, such as arbitration, mediation and conciliation hearings organised by industry bodies or specialised agencies. These are particularly useful options for settling disagreements, at least at the first instance level, between transacting parties at a reasonable cost.

**1.5 Does the government maintain a policy of timely, adequate, and effective compensation for expropriation also consistent with its obligations under international law? What explicit and well-defined limits on the ability to expropriate has the government established? What independent channels exist for reviewing the exercise of this power or for contesting it?**

A natural corollary of the protection of property rights is the need for compensation when a government expropriates property. This need is uncontested and, indeed, is reflected in all bilateral investment treaties and recent regional international agreements dealing with investment. Notwithstanding the widespread acceptance of the need for timely, adequate and effective compensation, the power of government to expropriate raises policy issues that usually involve a careful balancing of interests and judgement on the part of policy makers, in addition to the inherent negative impact of expropriation on the investment climate. To avoid negative effects on the investment climate, governments are encouraged to consider whether similar results can be achieved through other public policy means. If a government decides to expropriate land or other property, this decision ought to be motivated by a public purpose, observe due process of law, be non-discriminatory and guided by transparent rules that define the situations in which expropriations are justified and the process by which compensation is to be determined. Some recent agreements provide that except in rare circumstances, non-discriminatory regulatory actions that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, are not considered to constitute expropriations. However, governments need to remain mindful that, consistent with longstanding international norms, certain regulatory action may constitute expropriation.

**1.6 Has the government taken steps to establish non-discrimination as a general principle underpinning laws and regulations governing investment? In the exercise of its right to regulate and to deliver public services, does the government have mechanisms in place to ensure transparency of remaining discriminatory restrictions on international investment and to periodically review their costs against their intended public purpose? Has the government reviewed restrictions affecting the free transfer of capital and profits and their effect on attracting international investment?**

The non-discrimination principle provides that all investors, both foreign and domestic, are treated equally.

The concept of "national treatment" provides that a government treat enterprises controlled by the nationals or residents of another country, no less favorably than domestic enterprises in like situations. The OECD Code of Liberalisation of Capital Movements, for instance, provides that non-resident investors be allowed to establish a subsidiary or branch or take participation in an existing domestic enterprise on conditions equivalent to those offered to resident investors. The OECD National Treatment Instrument applies a similar principle for operations by foreign controlled enterprises once established in the country.

Non-discrimination also means that an investor or investment from one country is treated by the host country "no less favourably" with respect to a given subject matter as an investor or investment from any third country (referred to as Most Favoured Nation or MFN in international agreements) in like situations. As with the application of the national treatment principle, MFN commitments towards investment vary considerably across agreements.

Policies that favour some firms over others (i.e. any policies that derogate from national treatment or MFN) involve a cost. They can, for instance, result in less competition and efficiency losses, thereby damaging the investment environment. For this reason, exceptions to non-discrimination need to be evaluated with a view to determining whether the original motivation behind an exception (e.g. protection based on the infant industry argument) remains valid, supported by an evaluation of the costs and benefits.

A broad consideration of the costs and benefits is especially important in service sectors that support a wide range of economic activities across the economy (e.g. telecommunications).

For a firm to be able to make, operate, and maintain investments in another country, the ability to transfer investment-related capital, including repatriating earnings and liquidated capital, is important. Many governments allow such free transfers, albeit without prejudice to their ability to take measures to prevent evasion of tax and other applicable laws and regulations and policy measures aimed at addressing serious balance of payment difficulties in accordance with their rights and obligations under their international investment agreements. Measures that restrict transfers can adversely affect investor confidence and, concomitantly, inflows of international investment.

**1.7 Are investment policy authorities working with their counterparts in other economies to expand international treaties on the promotion and protection of investment? Has the government reviewed existing international treaties and commitments periodically to determine whether their provisions create a more attractive environment for investment? What measures exist to ensure effective compliance with the country's commitments under its international investment agreements?**

International agreements can promote investment by reducing restrictions on a broadly defined range of investments, by making the regulatory environment more predictable, thereby reducing the policy risks faced by investors, both domestic and foreign, and through other basic disciplines, such as limits on trade-related investment measures, expropriation procedures consistent with international law standards and guarantees for the free transfer of capital in a convertible currency. Performance requirements, such as local content, export performance, and other trade related investment measures, tend to discourage and distort investment by imposing additional costs on firms, which in fact is why they often go hand in hand with incentives to invest. (See also the chapter on Investment Promotion and Facilitation.)

**1.8 Has the government ratified and implemented binding international arbitration instruments for the settlement of investment disputes?**

A key feature of international agreements concerns the channels through which disputes are heard and resolved. Most international investment agreements contain provisions by which governments consent to permit investors to seek the settlement of investment disputes with the host country government through binding international arbitration (in limited instances contingent upon provisions on the exhaustion of local remedies). These commitments, giving recourse to impartial channels of dispute settlement, provide an additional layer of protection to investors and, most importantly, signal a government's commitment to the rule of law, bolstering the confidence of investors that their property rights are secure (see also questions 1.2 and 1.4). International arbitration is carried out through ad hoc or institutional instruments, e.g. pursuant to the 1966 Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). The Convention has been ratified by 143 states and is supported by the International Centre for Settlement of Investment Disputes (ICSID), which administers arbitration proceedings under international investment agreements. The ICSID Convention provides for a self-contained mechanism, including enforcement. For non-ICSID arbitral awards, the 1958 New York Convention for the Recognition and Enforcement of Foreign Arbitral Awards makes arbitral awards rendered in one party to the Convention enforceable in any other party to the Convention and has been ratified by 135 states. Regional instruments for international arbitration can also play an important role (e.g. the MERCOSUR Olivos Tribunals). There is a need to extend support to governments that lack experience in dispute settlement.

Governments, including those in all OECD member countries, also consider that additional transparency in investment arbitration, in particular in relation to the publication of arbitral awards, subject to necessary

safeguards for the protection of confidential business and governmental information, is desirable to enhance effectiveness and public acceptance of international investment arbitration, as well as contributing to the further development of a public body of jurisprudence. They generally share the view that, especially insofar as proceedings raise important issues of public interest, it may also be desirable to allow third party participation, subject however to clear and specific guidelines.

#### Further Policy Resources

- APEC (1994), Non-Binding Investment Principles.
- Foreign Investment Advisory Service (FIAS) (<http://www.fias.net/>).
- FIAS, Investment Climate Surveys Database (<http://rru.worldbank.org/InvestmentClimate/>).
- FIAS, Private Sector Toolkits (<http://rru.worldbank.org/Toolkits/>).
- International Centre for Settlement of Investment Disputes (ICSID), ICSID Convention, Regulations and Rules (<http://www.worldbank.org/icsid/>).
- OECD (2003), A Framework for Investment Policy Transparency.
- OECD (2003), Assessing FDI Incentive Policies: a Checklist.
- OECD Codes of Liberalisation of Capital Movements and Current Invisible Operations: Users' Guide (2003). [www.oecd.org/daf/investment/instruments](http://www.oecd.org/daf/investment/instruments)
- OECD, Declaration on International Investment and Multinational Enterprises. [www.oecd.org/daf/investment/instruments](http://www.oecd.org/daf/investment/instruments)
- OECD, The National Treatment Instrument (2005). [www.oecd.org/daf/investment/instruments](http://www.oecd.org/daf/investment/instruments)
- OECD, International Investment Law: A Changing Landscape (2005).
- United Nations Commission on International Trade Law (UNCITRAL), (<http://www.uncitral.org/>).
- United Nations Conference on Trade and Development, (<http://www.unctad.org/>).
- World Bank (1992), Guidelines on the Treatment of Foreign Direct Investment.
- World Bank, Doing Business database (<http://www.doingbusiness.org/>).
- World Intellectual Property Organization (WIPO) (<http://www.wipo.int/portal/index.html.en>).
- World Trade Organization Legal Instruments (<http://www.wto.org/>).

## Annotations to Chapter 2. Investment promotion and facilitation

### **2.1 Does the government have a strategy for developing a sound, broad-based business environment and within this strategy, what role is given to investment promotion and facilitation measures?**

Specific measures to promote and facilitate investments can be successful if they take place within the context of, and not substitute for, broader policies for improving the investment environment, which are dealt with in other chapters. As a country establishes a sound investment environment, investment promotion and facilitation measures can be useful instruments to attract new investors, especially in smaller, more remote markets or in those countries with a recent history of macroeconomic and political instability. Effective investment promotion also serves to highlight profitable investment opportunities, by identifying local partners and by raising the positive image of the economy.

### **2.2 Has the government established an investment promotion agency (IPA)? To what extent has the structure, mission, and legal status of the IPA been informed by and benchmarked against international good practices?**

The rapid growth in the number of IPAs reflects the growing importance that governments ascribe to investment promotion. Centralising foreign investment promotion and facilitation activities, such as information dissemination and policy advocacy, within a single agency can be more cost effective and provides an opportunity to present a coherent impression of a country's attractiveness to investors. The growth in the number of IPAs also means that a rich body of experience has been developed with respect to different approaches to investment promotion agencies and across countries at different levels of development. Countries that have recently established IPAs, or are contemplating doing so, can use this experience to inform the design of the IPA following international good practices. This approach helps to ensure the full effectiveness of the IPA and to avoid repeating past mistakes.

### **2.3 Is the IPA adequately funded and is its performance in terms of attracting investment regularly reviewed? What indicators have been established for monitoring the performance of the agency?**

Experience suggests that unless there is a full commitment to investment promotion agencies by the government, they are less likely to succeed in attracting new investors. They need to be adequately funded in order to attract and retain qualified and motivated staff, ideally with private sector experience. Experience also suggests that agencies with links to the centre of government and with private sector representation on the board have higher visibility and credibility and hence a better record in attracting foreign investment. They are also more dynamic and adaptable to changing economic circumstances, a critical issue for countries undergoing major economic transformation.

### **2.4 How has the government sought to streamline administrative procedures to quicken and to reduce the cost of establishing a new investment? In its capacity as a facilitator for investors, does the IPA take full advantage of information on the problems encountered from established investors?**

Long delays and costly procedures to establish a new business entity is one of the obstacles to new investment and entrepreneurial activity. Many governments have introduced reforms to quicken and simplify the process of starting a new business. One common approach to this challenge has been the establishment of a 'one-stop shop'. These allow investors to access information on the necessary steps to start or expand a business and provide services to speed up the granting of necessary permits and licenses. 'One-stop shops' also provide easy access to other information that helps to facilitate investment, both

domestic and foreign, for instance, on legal and regulatory matters, on financing options, location choice, or recruitment and training. ‘One-stop shops’ make it easier for the government to centralise the quality provision of these services. This can deliver substantial savings in time and cost to potential and existing investors, thereby facilitating new investment.

**2.5 To what extent does the IPA promote and maintain dialogue mechanisms with investors? Does the government consult with the IPA on matters having an impact on investment?**

Investment promotion agencies can play an important role facilitating effective communication between investors and the government. As the interlocutor between the government and the foreign investor, the IPA is often the main source of feedback to government policymakers on the concerns of investors. Conversely, through its regular contact with government and the relevant government agencies, the IPA can be an effective communication channel for investors on government activities having an impact on the investment environment.

**2.6 What mechanisms has the government established for the evaluation of the costs and benefits of investment incentives, their appropriate duration, their transparency, and their impact on the economic interests of other countries?**

The use of financial and other incentives to attract foreign investors (also see the chapter on Tax Policy) is not a substitute for pursuing policy measures that create a sound investment environment, for domestic and foreign investors alike. In the absence of a solid investment environment, competition among countries for FDI may lead to no overall increase in investment and divert public resources away from more productive uses. In some circumstances, however, incentives may complement an already attractive enabling environment for investment or serve as a partial rectification for market imperfections that cannot be addressed by direct policy reforms. Nonetheless, authorities engaging in incentive-based strategies to attract investment must periodically evaluate their relevance, appropriateness and economic benefits against their budgetary and other costs, including long-term impacts on resource allocation. In doing so, authorities also need to consider their commitments under international agreements, since investment incentives can have effects beyond the countries that offer them, including bidding contests leading to a waste of resources. Many governments, including all OECD member countries, consider that it is inappropriate to encourage investment by lowering health, safety or environmental standards or relaxing core labour standards.

**2.7 What steps has the government taken to promote investment linkages between businesses, especially between foreign affiliates and local enterprises? What measures has the government put in place to address the specific investment obstacles faced by SMEs?**

Many governments aim to attract foreign direct investment, because it can bring additional benefits to its citizens through the diffusion of new technologies and human resource and management expertise. These spillovers can materialise more quickly when foreign investors and local enterprises establish close linkages and are especially helpful to harness the potential of local small- and medium-sized enterprises (SMEs). These linkages can be fostered through efforts to establish a sound investment environment. For instance, open trade and investment regimes in the context of a strong competition policy provide a fertile environment for the transfer of technology (see also the chapters on Investment Policy, Trade Policy and Competition Policy). Close linkages and the broader benefits of foreign investment are also supported by government efforts to improve human resource development, through investments in education, training and public health (see the chapter on Human Resource Development policy).

Promoting linkages between foreign and local enterprises is a particular challenge for SMEs. SMEs are the largest investor community group, accounting for over 95 per cent of the business population. SMEs tend

to have more difficulties gaining access to credit and in forming investment linkages with foreign affiliates. As a result, the take-up of profitable investment opportunities may be delayed, or even foregone.

**2.8 Has the government made use of international and regional initiatives aimed at building investment promotion expertise, such as those offered by the World Bank and other intergovernmental organisations? Has the IPA joined regional and international networks?**

Many international organisations work with IPAs, facilitating the exchange of best practices on investment promotion strategies and assisting in building policy capacity. For instance, the World Association of Investment Promotion Agencies (WAIPA) assists IPAs in advising their governments on the formulation of investment promotion strategies; the Foreign Investment Advisory Service, within the World Bank Group provides investment climate diagnostic studies at the request of host governments, consisting of recommendations for a combination of policy, regulatory and procedural reform, institutional frameworks for investment promotion and methods for monitoring effectiveness; and UNCTAD's Advisory Services on Investment and Training (ASIT) is experienced in instruction programmes for IPA staff to improve capacity.

**2.9 To what extent has the government taken advantage of information exchange networks for promoting investment?**

One of the roles of IPAs is to facilitate the recognition of potential investment opportunities by promoting partnerships between domestic and foreign enterprises. A number of initiatives exist to help governments and IPAs in their linkage-promotion efforts. For example, the UNIDO Subcontracting and Partnership Exchanges (SPXs) act as technical information, promotion and matchmaking centres for industrial subcontracting. The SPX Network currently provides detailed, standardised, updated and certified data on approximately 20,000 manufacturing companies worldwide, thereby favouring the establishment of partnerships between contractors, suppliers and subcontractors. To date, more than 60 SPXs have been set up with UNIDO's assistance in more than 30 countries. Further, a number of regional forum based information exchange networks exist. For example, the Tokyo International Conference on African Development (TICAD) established, through UNIDO, the Asia-Africa Investment Technology Promotion Centre (AAITPC) to promote Asian investment in Africa. It provides an information technology platform (the TICAD Exchange Website) to share business related information on investment opportunities between Asia and Africa.

### Further Policy Resources

- Asia Africa Investment and Technology Promotion Centre (The Hippalos Centre) (<http://www.unido-aaitpc.org>).
- FIAS, Private Sector Toolkits (<http://rru.worldbank.org/Toolkits/>)
- International Finance Corporation (IFC) (<http://www.ifc.org/>).
- IFC Small and Medium Enterprise (SME) Toolkit ([www.ifc.org/ifcext/sme.nsf/Content/SME\\_Toolkit](http://www.ifc.org/ifcext/sme.nsf/Content/SME_Toolkit)).
- Multilateral Investment Guarantee Agency (MIGA): Investment Promotion Toolkit (<http://www.fdipromotion.com/toolkit/user/index.cfm>).
- OECD (2003), Assessing FDI Incentive Policies: a Checklist.
- OECD, Bologna Charter on SME Policies ([www.oecd.org/document/17/0,2340,en\\_2649\\_34197\\_1809105\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/17/0,2340,en_2649_34197_1809105_1_1_1_1,00.html))
- OECD, Declaration on International Investment and Multinational Enterprises (<http://www.oecd.org/daf/investment/instruments>).
- OECD, Istanbul Ministerial Declaration on Fostering the Growth of Innovative and Internationally Competitive SMEs (OECD).
- OECD (2002), SEE Investment Compact, Strategic Investment Promotion: Successful Practice in Building Competitive Strategies. ([www.oecd.org/document/16/0,2340,en\\_2649\\_34197\\_32020176\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/16/0,2340,en_2649_34197_32020176_1_1_1_1,00.html))
- OECD LEED Programme (Local Economic and Employment Development ) ([www.oecd.org/department/0,2688,en\\_2649\\_34417\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/department/0,2688,en_2649_34417_1_1_1_1_1,00.html))
- TICAD (Tokyo International Conference on African Development) (<http://www.ticad.net/>).
- TICAD Exchange network (<http://www.TICADEXchange.org>).
- United Nations Industrial Development Organization (UNIDO) (<http://www.unido.org>).
- World Association of Investment Promotion Agencies (WAIPA) (<http://www.waipa.org/>).

### Annotations to Chapter 3. Trade policy

#### **3.1 What recent efforts has the government undertaken to reduce the compliance costs of customs, regulatory and administrative procedures at the border?**

The relationship between international trade, domestic and foreign investment has evolved over time. Today, international investment is more motivated by productivity enhancing opportunities and relatively less linked to accessing local markets, or extracting natural resources. In these circumstances, trade policies and customs procedures not conforming to internationally recognised standards delay cross-border deliveries and increase business costs. This makes it harder to harness efficiency gains from global supply chains, lowering rates of return and discouraging investment. Often trade policy procedures can be simplified through harmonised requirements and regulatory co-operation (e.g. to enable pre-arrival clearance of shipments), with benefits for the overall investment environment. More generally, however, because of the linkages between trade and investment and because policy objectives are best achieved via a coherent set of initiatives, trade policies cannot be framed in isolation. It is, therefore, important to assess periodically the impact of customs, regulatory and administrative procedures on the investment environment.

#### **3.2 What steps has the government taken to reduce trade policy uncertainty and to increase trade policy predictability for investors? Are investors and other interested parties consulted on planned changes to trade policy?**

Investors compensate for greater risk and uncertainty by adjusting upwards the rate of return required to undertake an investment project, leading to less overall investment. In the trade policy domain, uncertainty may be created by spontaneous government decisions that obstruct the smooth functioning of international supply chains and cause less stable pricing structures. Transparency in trade policy making, for instance, via public consultations with businesses and other constituents and better communication of policy decisions helps to provide a more stable environment in which enterprises can plan their investment programmes.

#### **3.3 How actively is the government increasing investment opportunities through market-expanding international trade agreements and through the implementation of its WTO commitments?**

WTO-consistent trade agreements attract investment by creating larger markets, and by raising the potential to exploit scale economies make investments more profitable. Further, regional trade agreements usually include provisions in the fields of investment that complement domestic efforts to create a sound investment environment. Typically, trade agreements that are consistent with WTO requirements enable enterprises to source suppliers, and sell their output at globally competitive prices and thereby create additional investment opportunities.

#### **3.4 How are trade policies that favour investment in some industries and discourage it in others reviewed with a view to reducing the costs associated with these distortions?**

Governments sometimes use trade policy instruments, such as import tariffs, to promote investment in targeted industries. Overall, however, the impact of such practices is likely to harm the investment environment. Favoured industries compete for resources with other enterprises, crowding out investment in activities that are more productive. Moreover, to the extent the output of the targeted industry is an input to others, external competitiveness is cramped, reducing profitability and the attractiveness of additional investment in these export-oriented sectors. These costs are often long-lived, since they are not transparent

and usually are spread among many producers and consumers, giving a limited incentive to pressure governments for reform.

If the government seeks to promote investment in a specific industry through trade policies, this should be done in a transparent manner and consistent with existing international obligations, such as the WTO Agreement on Subsidies and Countervailing Measures. The first best approach, however, is to maintain a trade regime that allows competitive industries to develop and flourish, rather than try to develop competitiveness behind trade policies that seek to somehow favour some industries over others. This does not necessarily imply removing all import protection.

### **3.5 To what extent do trade policies raise the cost of inputs of goods and services, thereby discouraging investment in industries that depend upon sourcing at competitive world prices?**

The majority of international trade involves transactions from business to business. Modern business supply chains concern hundreds of domestic and international producers. This specialisation of production attracts investment, because it results in productivity gains and lower production costs. Trade policies that hinder reliable access to intermediate goods and services and which raise their cost can hold back this process. Some countries, for example, require a minimum proportion of investment project inputs to be sourced locally, regardless of their cost competitiveness. Such policies may be inconsistent with WTO obligations arising from the Agreement on Trade-Related Investment Measures (TRIMs). Policy makers should consider evaluating their potential dampening effects on investment.

Internationally traded services are a particularly important input for many industries and a strategic component of global value chains. Services can be traded either by modes: (1) cross-border supply; (2) consumption abroad; (3) commercial presence; or (4) temporary movement of natural persons. The four modes are intrinsically linked. The value of trade-in-services through all four modes has expanded both as proportion of total trade and in magnitude for both developed and developing countries. These service exports often grew from international investment and work outsourced from home multinational enterprises. Their export cannot only benefit the host country from which the service originates, but concurrently make the home's multinational enterprises globally competitive. Reviewing and liberalising existing regulations of home countries may lead to benefits for host countries. Liberalisation in mode 4 can allow entrepreneurial talent to find niches and circulate that entrepreneurial talent to and from host and home countries. If effective policies are in place, mode 4 liberalisation may mutually benefit the home and host country.

### **3.6 If a country's trade policy has a negative effect on developing country exports, what alternative means of accomplishing public policy objectives has the government considered, taking into account the dampening effect that such a restrictive trade policy also has on investment?**

The beneficiaries of restrictive trade policies are concentrated while those that incur a cost are dispersed among many businesses and consumers. Indeed, a home country's trade policies may reduce a developing country's exports and therefore its ability to purchase imports and attract investment, including from abroad. Further, part of the overall cost is borne by actual and potential trading partners and may include a less attractive investment environment. Governments should consider these costs when evaluating specific trade policy measures. More generally, the investment environment is helped if trade policy options are informed by analysis that identifies the least trade and investment restricting instruments.

**3.7 To what extent does trade policy support and attract investment through measures that address sectoral weaknesses in developing countries (e.g. export finance and import insurance)?**

The magnitude of trade and investment flows also depends on the existence of other markets that facilitate cross-border transactions. These include markets that hedge and transfer the risk attached to exchange rate movements, payment default, transit insurance as well as the financing of international commerce. These are sophisticated markets and in many countries, they do not exist or are under-developed. Experience shows that putting in place the conditions needed to support the development of such markets can take considerable time. (Selected issues related to the development of the financial sector are discussed in chapter 9.) In the interim, correcting for market failures in host countries may require help from home countries. For example, in the absence of a developed financial sector and while being careful to avoid trade distortions and ensure a level playing field, trade financing and insurance can often best be provided by home countries to developing countries.

Further Policy Resources

- APEC-OECD Integrated Checklist on Regulatory Reform ([www.oecd.org/gov](http://www.oecd.org/gov)).
- OECD, Declaration on International Investment and Multinational Enterprises.
- 2005 Arrangement on Officially Supported Export Credits ([www.oecd.org/trade](http://www.oecd.org/trade)).
- United Nations Commission on International Trade Law (UNCITRAL) (<http://www.uncitral.org/>).
- World Trade Organization Legal instruments (<http://www.wto.org/>).

## Annotations to Chapter 4. Competition policy

### **4.1 Are the competition laws and their application clear, transparent, and non-discriminatory? What measures do the competition authorities use (e.g. publishing decisions and explanations on the approach used to enforce the laws) to help investors understand and comply with the competition laws and to communicate changes in the laws and regulations?**

For competition policy to be effective, businesses and other stakeholders need to understand the “rules of the game.” This requires that competition laws and policies be transparent and their implementation predictable. It also requires that rulings on competition cases be made based on non-discriminatory criteria and consistently. In other words, while no two situations are the same, under reasonably similar circumstances decisions ought to be consistent with each other. Transparency can be promoted by, for instance, ensuring that businesses and other interested parties have access to all necessary information, by offering guidance on the interpretation of the competition laws and by publishing reasons for judiciary and regulatory agency decisions. Transparency and predictability help to improve the investment environment, because they reduce the risk of inconsistent application of laws and regulations and lower uncertainty faced by investors and others. (Also see the chapter on Investment Policy.) In addition, transparency reduces firms’ costs of compliance and promotes confidence by reassuring investors that they are being treated fairly and that government is exercising its powers responsibly.

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

The distinction between adopting a new law or policy and effectively implementing it can represent the difference between success and failure. Effective policy implementation requires that the competition authority have the resources and political support to do the job properly. Competition authorities must often challenge vested interests, such as private firms with monopolistic positions in the market or state-owned firms that fall under the regulatory authority of other parts of government. In the absence of a strong political commitment, efforts to promote competition, and hence investment, are in such cases likely to fail. Furthermore, a strong commitment to policy implementation and oversight at the political level can help to protect competition authorities themselves from regulatory capture. Political support for competition policy, which includes supplying sufficient resources for effective enforcement, is an important determinant of the potential contribution of competition policy to an attractive investment environment. Institutional settings vary widely, complicating the assessment of the degree of political support for competition policy, or of its vulnerability to special-interest intervention. Criteria that might be considered could include the status of the competition authorities within the government structure and the institutional arrangements for insulating enforcement decision-makers from political direction or influence.

### **4.3 To what extent, and how, have the competition authorities addressed anti-competitive practices by incumbent enterprises, including state-owned enterprises, that inhibit investment?**

Incumbent enterprises can sometimes discourage investment by abusing their market power. For example, if an incumbent maintains exclusive distribution arrangements with its retailers or wholesalers, and the cost of establishing an alternative network is prohibitive, new entry and new investment may be impeded. Likewise, if a producer sells a product below cost (appropriately defined) with a view to recouping losses incurred after rivals have exited the industry, or would-be new entrants have been deterred. A credible threat of predatory pricing behaviour discourages prospective investors and can discourage investment in upstream and downstream industries. The demonstrated willingness of competition authorities to prevent, correct and sanction anticompetitive practices can thus have a significant positive bearing on the investment climate.

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

Some government policies and regulations directly discourage investment, for example, through prohibitions or restrictions on investment in certain sectors. Other policies and regulations are less direct, but can also discourage investment. Trade restrictions, for instance, can make a national market too small for those investments where economies of scale need to be reaped to be viable. One of the key challenges to establishing a sound investment environment is to identify and remove the unnecessary impediments to new investment. In this context, and without prejudice to the authority of government to regulate and the authority of other agencies in the conduct of their responsibilities, it is desirable to involve the competition policy authorities. This would help when laws and regulations are being developed to better appreciate competition policy perspectives, which through inter linkages bear on the investment environment.

More generally, ensuring coherence across policy areas is a principle of the Policy Framework for Investment. But it can present difficult trade-offs, notably in the domain of competition policy. For example, intellectual property rights (IPR) reward investments in creative and innovative activities with exclusive rights, limiting direct competition for a period. In the absence of IPR, such investment would be smaller, or non-existent. The difficulty for policy lies in balancing the considerations of competition policy and ensuring an incentive to create and innovate through, for instance, investments in research and development. There are also cross border considerations, including issues associated with the impact of licensing in home countries on competition in host countries, an area which has been identified as requiring further consideration.

**4.5 Does the competition authority periodically evaluate the costs and benefits of industrial policies and take into consideration their impact on the investment environment?**

Some governments promote particular firms, often referred to as “national champions”, as part of an industrial development strategy. This often includes significant state involvement, in terms of direct or indirect financial assistance (also see the chapter on Tax Policy) and the granting of special treatment, for instance, through restrictions on foreign direct investment, trade barriers and exemption from competition laws. The arguments for national champions have been contentious. Evaluations on the effectiveness of such schemes, in terms of attracting investment, ought to be broad-based, taking into consideration their impact on the investment decisions of other investors and more broadly on the investment environment. The competition authorities are often well placed to conduct such an exercise, at least in terms of assessing the impact on markets from granting exemptions from competition law.

**4.6 What is the role of the competition authorities in case of privatizations? Have competition considerations having a bearing on investment opportunities, such as not permitting market exclusivity clauses, been adequately addressed?**

Competition authorities have sometimes found themselves at the margins of policy formulation in areas not directly associated with competition law or policy, per se. This has been the case, for example, with respect to the wave of privatizations that swept through many regulated sectors during the 1990s, which was a major driver of increased flows of foreign direct investment. A concern of governments and competition authorities has been to avoid replacing public monopolies with private ones. This challenge has sometimes been exacerbated by the pursuit of conflicting objectives. More specifically, the desire to create more efficient industry structures, on the one hand, and the desire to sell state owned assets at the highest possible prices, on the other. The latter has sometimes led governments to grant market exclusivity to foreign investors, a non-transparent incentive to FDI and a restraint on the degree of competition. It is

desirable for competition authorities to play an active role during privatisations. They ought to focus on competition considerations, including the potential benefits that private investment, both domestic and foreign, can bring to an economy, rather than the possible short-term budgetary windfalls. Their advocacy role capabilities should also extend to include an evaluation of the costs associated with arrangements that lead, either tangentially or by design, to monopolies. While merger control powers could be applied to prevent or correct anti-competitive dispositions of privatised assets, it would be more efficient for the competition policy authorities to be involved in decisions about privatisation well before transactions reach that stage.

**4.7 To what extent are competition authorities working with their counterparts in other countries to co-operate on international competition issues, such as cross-border mergers and acquisitions, bearing on the investment environment?**

With the rapid increase in cross-border investment, competition authorities are increasingly dealing with competition issues that span borders, such as international mergers and acquisitions and international cartels. Invariably, investigation of competition cases with an international dimension requires co-operation with the competition authorities in other countries. Establishing formal working relationships and channels of communications can speed up the investigation of such cases, reducing the period of uncertainty, benefiting the investment environment.

Further Policy Resources

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

## Annotations to Chapter 5. Tax policy

### **5.1 Has the government evaluated the level of tax burden that would be consistent with its broader development objectives and its investment attraction strategy? Is this level consistent with the actual tax burden?**

How much tax revenue governments raise depends on their broader objectives. In this context, a central issue in gauging what level of tax burden would be consistent with the government's investment attraction strategy is whether the country offers appealing risk/return opportunities, taking into account framework conditions, market characteristics and location-specific profits, independent of tax considerations. Governments are encouraged to give recognition to the reasonable expectations of taxpayers when designing or reforming the tax system. Investors are generally willing to accept a higher tax burden the more attractive are the risk/return opportunities. On the returns side, potential investors examine the level of business costs, such as those attached to complying with regulations and administrative practices (see chapters on Public Governance and on Competition Policy) and pay attention to factors, such as the ability to recruit skilled labour (see chapter on Human Resource Development). On the risks side, potential investors examine the level of non-diversifiable risks associated with securing access to capital and profits (see chapter on Infrastructure and Financial Sector Development). Absolute and comparative assessments with regard to competing tax jurisdictions are also relevant for investor location decisions.

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

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

### **5.3 Is the tax burden on the business enterprises of investors appropriate with reference to the policy goals and objectives of the tax system?**

In deciding the tax burden to impose on the domestic profits of business enterprises, governments weigh the objectives guiding overall tax policy design, including efficiency and equity concerns, compliance costs and revenue requirements. Where different goals suggest different tax burden levels, an appropriate balancing of competing objectives is desirable, initially taking revenue requirements as given.

### **5.4 If framework conditions and market characteristics for investors are weak, has the government evaluated the limitations of using tax policy alone to influence favourably investment decisions?**

Policy-makers are encouraged to reflect on the disappointing experience of economies that have attempted to rely on a low tax burden - typically targeted at foreign investment - to boost investment. Where framework conditions or market characteristics are weak, first consideration should be given to addressing the sources of a weak investment environment. Realistic expectations should be made of how much additional investment a reduced tax burden would bring forth and the scale of tax-planning opportunities created. Where a low tax burden is to be achieved through the use of special tax incentives, evaluations of their potential to attract investment ought to take into consideration the possibility that tax incentives may discourage investment by contributing to project cost and risk and induce a misallocation of resources.

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

Tax systems may purposefully impose a non-uniform effective tax rate on businesses, based on criteria such as the size and age of an enterprise, its ownership structure (e.g. domestic versus foreign-owned), the type of business activity or its location. In other cases, certain firms may be specifically targeted to receive preferential tax treatment. Where tax relief is targeted, policy makers should examine the arguments in favour and against such preferential treatment, be able to weigh up these arguments and be in a position to justify differential tax treatment. (On the issue of fair treatment of investors, see the Chapter on Investment Policy.) Where justifications are weak, first consideration should be given to a non-targeted approach, so as not to induce a misallocation of resources.

**5.6 Are rules for the determination of corporate taxable income formulated with reference to a benchmark income definition (e.g. comprehensive income), and are the main tax provisions generally consistent with international norms?**

With any corporate tax system, investors expect the calculation of corporate taxable income to adequately reflect business costs, via basic tax provisions such as loss carry-forward rules that are not more onerous than those commonly found elsewhere. Investors also view negatively the double taxation of income within the corporate sector, and generally expect zero taxation of or tax relief on, inter-corporate dividends, particularly when these are paid along a corporate chain.

**5.7 Have targeted tax incentives for investors and others created unintended tax-planning opportunities? Are these opportunities and other problems associated with targeted tax incentives evaluated and taken into account in assessing their cost-effectiveness?**

Tax holidays and partial profit exemptions, typically targeted at ‘new’ companies, offer significant scope for tax relief unintended by the tax authorities. Other forms of targeted tax relief may also create unintended scope for tax planning, and result in revenue losses well in excess of levels originally anticipated (e.g. where the relief spills over to benefit non-targeted taxpayer groups). While notoriously difficult to predict, policy makers are encouraged to consult widely to sharpen estimates of the revenue losses from a given incentive.

To varying degrees, depending partly on the instrument used, reduced taxation will provide tax relief in respect of investment that would have been undertaken in the absence of such relief (‘windfall gains’ to investors, or, in the case of FDI, foreign treasuries). Targeted tax incentives may also create unintended distortions to the allocation of productive capital and to corporate financing and repatriation policies. Targeted tax incentives may not bring about as much reduced complexity as expected, and may encourage corruption if provided with excessive administrative discretion. (See chapter on Public Governance.) Finally, the use of certain tax incentives may be inconsistent with international obligations. Policy-makers are encouraged to factor in these considerations when considering the pros/cons of a non-targeted approach.

Where strong political pressure is felt for introducing tax incentive relief, despite analysis indicating limited investment response relative to the revenue losses (to existing qualifying and non-qualifying investors) and administrative costs entailed – implying failure to meet a cost-benefit test – policy makers should argue the case for exploring options to address the impediments to investment directly.

**5.8 Are tax expenditure accounts reported and sunset clauses used to inform and manage the budget process?**

Tax expenditure analysis measuring revenue foregone by targeted tax incentives and other departures from a benchmark tax system should be a feature of fiscal policy in countries where attracting investors and addressing public governance issues (see chapter 10 on Public Governance) are high on the policy agenda. Such accounts should be subject to public scrutiny and be considered alongside corresponding direct expenditures to inform the budget process.

For proper management of public finances, tax incentives targeted to boost investment should be assessed in advance and, if introduced, evaluated on a periodic basis to gauge whether such measures continue to pass a cost-benefit test. To enable a proper evaluation and assessment, the specific goals of a given tax incentive need to be made explicit at the outset. Further, if tax incentive legislation is introduced, “sunset clauses” calling for the expiry of the incentive (e.g. 3 years after implementation) should be included to provide an opportunity to assess whether the incentive should be extended or not.

**5.9 Are tax policy and tax administration officials working with their counterparts in other countries to expand their tax treaty network and to counter abusive cross-border tax planning strategies?**

A wide tax treaty network is helpful to countries seeking to raise and attract investment. They provide investors with increased certainty over their tax treatment, reduce the scope for double taxation of income, and they operate to improve profits and reduce risk. Tax treaties also provide a framework for the exchange of information among tax authorities to counter more aggressive forms of tax planning in relation to foreign and domestic source income.

Further Policy Resources

- OECD (2003), Assessing FDI Incentive Policies: a Checklist.
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD (1992), Model Agreement for Simultaneous Tax Examinations.
- OECD, Model Agreement on Exchange of Information on Tax Matters.
- OECD Model Tax Convention on Income and on Capital (Latest: 2005 edition).
- OECD (2001), Recommendation of the Council on the Use of the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes.
- OECD (2001), Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

## Annotations to Chapter 6. Corporate governance

### **6.1 What steps have been taken to ensure the basis for a corporate governance framework that promotes overall economic performance and transparent and efficient markets? Has this been translated into a coherent and consistent regulatory framework, backed by effective enforcement?**

An effective corporate governance framework requires an effective legal, regulatory and institutional foundation, which all market participants can rely upon when they enter into contractual relations. (See also the chapters on Investment Policy and Public Governance.) This legal, regulatory and institutional foundation typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of a country's specific economic circumstances, history and traditions. The desirable mix between legislation, regulation, self-regulation, voluntary standards, etc. will therefore vary from country to country.

In this context, designing the regulatory and legal framework that underpins the corporate governance system needs to be flexible enough to meet the needs of corporations operating in widely different circumstances. Another key consideration is the need for effective enforcement and implementation. Among other things, this requires that the allocation of responsibilities for supervision, implementation and enforcement among different authorities be clearly defined so that the competencies of complementary bodies are respected and used most effectively.

### **6.2 How does the corporate governance framework ensure the equitable treatment of shareholders?**

Equity investors are entitled to certain property rights. For example, an equity share in a publicly traded company can be bought, sold or transferred, and entitles the investor to participate in the company's profits. It also provides a right to obtain information about and influence the company, primarily by voting at shareholder meetings. All these rights carry an intrinsic economic value. In order for investors to buy equity, they therefore need to be confident that their entitlement to these and other rights that they have purchased are properly recognised and protected.

The ownership structure has important implications for the corporate governance framework. In many economies, major shareholders control most companies, in some cases through differential voting rights or complex ownership and control structures that allow them to maintain control with relatively little equity. In other cases, ownership is controlled by the state, raising additional governance challenges (see question 6.9). Controlling shareholders have strong incentives to monitor closely the company and its management, and can have a positive impact on the governance of the company. However, their interests may also conflict with the interest of minority shareholders. This conflict is most destructive when the controlling shareholders extract private benefits at the expense of minority shareholders.

All shareholders pay the cost of poor corporate governance in the form of lower valuations, reduced access to equity finance, and difficulties with respect to succession planning and accessing outside talent. Moreover, the economy pays through reduced productivity, as investment funds are allocated less efficiently. To reduce these costs, some controlling shareholders take voluntary measures to improve their own corporate governance and to improve their reputations with other shareholders. The creation of institutions like special stock market tiers and voluntary corporate governance codes can facilitate these voluntary measures by allowing companies to signal credibly to markets that they have high standards of corporate governance. However, while such measures can play an important role in improving corporate governance arrangements, they might leave shareholders and other stakeholders with uncertainty concerning their status and implementation. When codes and principles are used as a national standard or

as an explicit substitute for legal or regulatory provisions, market credibility requires that their status in terms of coverage, implementation, compliance and sanctions is clearly specified. In the long run, controlling shareholders may actually benefit from legally binding and effectively enforced measures to improve investor protection.

**6.3 What are the procedures and institutional structures for legal redress in cases of violation of shareholder rights? Do they function as a credible deterrent to such violations? What measures are in place to monitor and prevent corporate insiders and controlling owners from extracting private benefits?**

Certain types of corporate activities involve inherent conflicts of interest on the part of the participating parties. It is, therefore, important for the market to know if such activities are carried out with due regard to the interests of all shareholders and to establish effective methods to obtain redress for grievances. The confidence of shareholders and potential investors is enhanced when the legal system provides mechanisms for shareholders to bring lawsuits at a reasonable cost and without excessive delay. However, there is some risk that a legal system, which enables any investor to challenge corporate activity in the courts, can become prone to excessive litigation. A balance must be struck between allowing investors to seek remedies for infringement of ownership rights and avoiding excessive litigation, which may also cause management and boards to become excessively risk averse.

An effective judiciary is also essential for providing a credible deterrent to abuse of shareholder rights. In countries with a weak judiciary, lengthy legal processes with unpredictable outcomes undermine the incentives for shareholders to pursue their rights and discourage potential investors. Another dimension for the redress of abusive violations of shareholder rights is through prevention. To this end, and more generally, it is essential that companies fully disclose material related party transactions to the market, including whether they have been executed at arms-length and on normal market terms. In discussing the content and coverage of such measures, consideration should be given to a workable definition of related parties. It will also be necessary to address the individual's responsibility for announcing a conflict of interest and the role of the board of directors in assessing the material implications of such a conflict.

**6.4 What procedures and institutions are in place to ensure that shareholders have the ability to influence significantly the company?**

Participation in general shareholder meetings is a fundamental right of all shareholders, both foreign and domestic, that is critical to their ability to influence the company. The procedures for notification of shareholder meetings and for casting votes should be designed to facilitate and encourage participation. This requires, inter alia, timely notification and voting systems that enable shareholders to engage in the decision making process at reasonable cost.

Access to information and reliable proxy procedures is a particular challenge in the case of foreign investors who hold their shares through chains of intermediaries. This can give rise to special challenges with respect to determining the entitlement of foreign investors to use their voting rights and the process of communicating with such investors. The obvious risks are that information from the company does not reach the ultimate shareholder and that the opinion of the ultimate shareholder does not reach the shareholder's meeting. It is, therefore, important to address to what extent the legal and regulatory framework clarifies the duties and procedures for informing about the shareholders' meeting, and the procedures for voting of shares that are held by foreign owners.

**6.5 By what standards and procedures do companies meet the market demand for timely, reliable and relevant disclosure, including information about the company's ownership and control structure?**

Present and potential shareholders require access to regular, reliable and comparable information in sufficient detail for them to exercise their ownership rights on a fully informed and equal basis. A disclosure regime that promotes transparency is thus a pivotal feature of a market-based corporate governance system. It underpins confidence in the stock market and is a powerful tool for influencing the behaviour of companies and for protecting investor rights. Insufficient or ambiguous information will hamper the ability of the markets to function. It will increase the cost of capital and discourage investment.

A discussion about the content of disclosure standards and the dissemination procedures will naturally address numerous trade-offs that relate to the completeness, quality and cost of establishing and disseminating the information. In order to determine what information should be disclosed at a minimum, many countries apply the concept of materiality. Material information can be defined as information whose omission or misstatement could influence the economic decisions taken by users of information. In the course of developing a strong disclosure regime, the channels, timing and procedures for disseminating corporate information can be just as important as the content of the information itself. There is no use in issuing material information if it does not reach the market and the concerned authorities in a cost-effective, easily accessible, predictable and timely fashion.

A particular transparency issue in many markets relates to the complex ownership and control structures. Transparent reporting regarding ownership is essential in order to curb, among other things, abusive transactions among related parties. The OECD template on Options for Obtaining Beneficial Ownership and Control Information serves as a reference for improving the availability of such information.

**6.6 How does the corporate governance framework ensure the board plays a central role in the strategic guidance of the company, the effective monitoring of management, and that the board is accountable to the company and its shareholders? Does the framework also recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises?**

The board should play a central role in the governance of the company. The board is chiefly responsible for guiding corporate strategy, for monitoring managerial performance - replacing it if necessary - overseeing systems designed to ensure that the corporation obeys the applicable laws and achieving an adequate return for shareholders. It should also monitor and manage potential conflicts of interest of management, board members and shareholders. In addition, boards have a duty to act in the best interests of the company and its shareholders, and are expected to take due regard of, and deal fairly with, other stakeholder interests, including those of employees, creditors, customers, suppliers and local communities. Corporations should recognise that the contributions of stakeholders constitute a valuable resource for building competitive and profitable companies, contributing to the long-term success of the corporation. The rights of stakeholders as established by law or by mutual agreement should be respected.

Regardless of how the board members are chosen, in order to effectively fulfil their responsibilities, they must be able to exercise informed, objective and independent judgement, acting as representative of all shareholders. Some of their responsibilities are formalised as a duty of care and loyalty, and it is important that these concepts be firmly anchored in law and jurisprudence, and in the understanding and practices of the board members themselves. In some countries, companies have found it useful to articulate explicitly the responsibilities that the board assumes and those for which management is accountable.

**6.7 What has been done, and what more should be done in terms of voluntary initiatives and training to encourage and develop a good corporate governance culture in the private sector?**

In dealing with corporate governance issues, countries use a varying combination of legal and regulatory instruments, voluntary codes and initiatives, depending in part on history, legal traditions, efficiency of the courts, the political structure of the country and the stage of enterprise development. Many countries, hoping to minimize compliance costs and to provide greater flexibility within a market framework, have developed and sought to promote greater use of voluntary codes and initiatives to improve their corporate governance. In addition, some countries have sought to implement their codes through “comply or explain” provisions that do not require compliance, but require an explanation when the provision is not followed. In some countries, stock exchanges have imposed corporate governance requirements through their listing requirements. Corporate governance institutes or institutes of boards of directors have also been established in many countries, with an aim to promote awareness and to train directors to understand better corporate governance objectives and requirements. Some institutes have also engaged in media training programmes as another avenue for increasing public understanding of corporate governance.

**6.8 Has a review been undertaken of the national corporate governance system against the OECD Principles of Corporate Governance? Has the result of that review been made public?**

This short checklist is not a substitute for a full review of the corporate governance system of a country, and countries should consider undertaking a full review against the OECD Principles of Corporate Governance. The World Bank has completed 48 corporate governance reviews of some 40 developing and transition economies, known as Reports on Observance of Standards and Codes (ROSCs), using the *OECD Principles* as the reference for these exercises. Subject to the agreement of the country’s government to have the review publicly disclosed, the World Bank publishes these ROSCs on its web site at [http://www.worldbank.org/ifa/rosc\\_cg.html](http://www.worldbank.org/ifa/rosc_cg.html). In addition, the OECD, as part of its work to develop a consistent methodology for such reviews, has initiated a pilot review of an OECD country’s experience in implementing the *Principles*. Public discussion and disclosure of these reviews can provide a useful basis for building awareness of and support for changes to strengthen the corporate governance framework and environment for investment.

Policy dialogue among the range of policy-makers, institutions and other parties concerned with improving corporate governance has proven to be an effective way of building consensus for corporate governance improvements on a national and regional basis. The Regional Roundtables on Corporate Governance (in Asia, Eurasia, Latin America, Southeast Europe and Russia) continue to meet regularly to promote implementation of White Paper recommendations setting out action plans for change. These and other regional policy dialogue programmes (in Africa, the Middle East and North Africa, and the Caribbean), with the support of the Global Corporate Governance Forum and local partners, have helped to build consensus for regional and country-based action, and for follow-up on implementation. Participation in such regional policy dialogue helps to access international expertise and build capacity – and political will – for change.

**6.9 How is the ownership function of state-owned enterprises (SOEs) structured to ensure a level playing field, competitive market conditions and independent regulation? What are the processes in place to ensure that the state does not interfere in day-to-day management of SOEs and that board members may effectively carry out their role of strategic oversight, rather than to serve as a conduit for undue political pressure? How are SOEs effectively held accountable to the government, the public, and to other shareholders (if any)?**

How the ownership function of the state is organised – that is, the functioning of the entities responsible for establishing and implementing the state’s ownership policies - can influence the overall investment environment. In particular, it is important that the ownership function is clearly identified and separated from other state functions, including regulatory oversight. This helps to ensure a level playing field for all investors, especially with regard to complying with laws and regulations. It also helps to ensure that the state, while being an active and informed owner, does not interfere in the day-to-day management of SOEs, leaving their boards with full operational autonomy to realise their defined objectives and fulfil their function of strategic guidance and monitoring of management. Board members should be nominated through transparent processes, based on competencies and experience, and it should be clear that their duty is to act in the best interests of the company as a whole. They should not act as individual representatives of the constituencies that appointed them.

Transparency and accountability go hand-in-hand with autonomy. They reassure investors that government agencies, including SOEs, exercise their powers responsibly and help to instil confidence that investors entering new markets compete on an equal basis. Following some basic corporate governance principles can help SOEs to raise their standards of accountability and transparency. For example, reporting by the ownership entity and SOEs themselves on their performance and achievement of their objectives should be based on the same high-level accounting and auditing standards as for listed companies. This also requires that SOEs develop efficient internal audit procedures and are subjected to an annual independent external audit based on international standards. Adequate disclosure of material information is also important to foster accountability, in particular relating to any financial assistance received from the state, commitments made on behalf of the state and any material transactions with related entities. Such transactions are often an important source of an uneven playing field for investors, particularly in weak institutional environments. Publishing annually an aggregate report on SOEs, focusing on their financial performance and their valuation, and giving an overview of their evolution also helps to ensure accountability of SOEs to the public.

Further Policy Resources

- OECD, Principles of Corporate Governance (2004). See <http://www.oecd.org/daf/corporate-affairs>
- OECD, Principles of Corporate Governance Assessment Methodology (2006 – forthcoming).
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD, Experiences from the Regional Corporate Governance Roundtables. (2004).
- OECD, Guidelines on Corporate Governance of State-Owned Enterprises (2005).
- OECD, Options for Obtaining Beneficial Ownership and Control Information (2002).
- OECD, Survey of Corporate Governance Developments in OECD Countries (2004).
- World Bank, Reports on the Observance of Standards and Codes (ROSCs), Corporate Governance, [http://www.worldbank.org/ifa/rosc\\_cg.html](http://www.worldbank.org/ifa/rosc_cg.html)

## Annotations to Chapter 7. Policies for promoting responsible business conduct

### 7.1 How does the government make clear for investors the distinction between its own role and responsibilities and those ascribed to the business sector? Does it actively assume its responsibilities (e.g. by effectively enforcing laws on respecting human rights, environmental protection, labour relations and financial accountability)?

The core mission of business is to identify and manage investment projects that yield competitive returns to suppliers of capital. In fulfilling this core function, responsible business conduct also consists above all of complying with legal and regulatory requirements; in addition, it includes responding to societal expectations that might be communicated through channels other than law (see Question 7.2.). The role of governments is to look after the collective interests of their citizens. As part of this role, they work with companies, trade unions and other civil society organisations to create enabling environments for responsible business conduct. If this enabling environment is well designed, including through a clearly communicated distinction between the respective roles and responsibilities of government and business, uncertainty over expectations concerning responsible business conduct are lowered, thus encouraging investment, and private and public sector actors will be encouraged to play mutually-supporting roles in enhancing economic, social and environmental well-being.<sup>7</sup> Government and business roles need to remain distinct and they cannot substitute for one another – each sector needs to assume its responsibilities.

### 7.2 What steps does the government take to promote communication on expected responsible business conduct to investors? How does the government endeavour to protect the rights framework that underpins effective communication?

Law-making is the key channel for communicating societal expectations to companies, thus creating a stable, predictable environment conducive to investment. Expectations concerning responsible business conduct are also communicated through a multitude of other channels and these also affect the quality of the investment environment. Such communication can take place within the workplace, with local communities, with trade unions in the course of industrial relations and collective bargaining, through discussions with investors, dialogue with other civil society organisations, via the press and so forth. These two-way communication channels provide inputs that can be valuable for setting company policies and evaluating performance. These other channels complement the information communicated to companies through formal legal and regulatory processes.

Governments play several roles in ensuring that these other communication processes work well. While the protection of human rights (e.g. political, social, civil, labour and property) is a fundamental objective in itself, it is also a pre-condition for effective communication to take place. This removes threats of rights violations so that many voices, including those of investors, can be heard. Thus, the protection of the rights framework is a key responsibility of governments.

Government-backed instruments for responsible business conduct – such as the *OECD Guidelines for Multinational Enterprises* -- are also important channels for communicating with business. The *Guidelines* cover the range of areas dealing with responsible business conduct, including human rights, supply chain management, employment and industrial relations, the environment, combating bribery, consumer interests, science and technology, disclosure of information, competition and taxation. They are not aimed at introducing differences of treatment between multinational and domestic enterprises; they reflect good

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<sup>7</sup> In some cases, usually referred to as ‘weak governance zones’, governments are unable or unwilling to assume their responsibilities. In these situations, the guidance provided in international instruments such as the *OECD Guidelines for Multinational Enterprises* are particularly valuable for companies.

practice for all. While it is acknowledged that small- and medium-sized enterprises may not have the same capacities as larger enterprises, governments adhering to the Guidelines nevertheless encourage them to observe the Guidelines recommendations to the fullest extent possible.

**7.3 Does the government ensure that an adequate framework is in place to support the financial and non-financial disclosure that companies make about their business activities? Is this framework flexible enough to allow scope for innovation, for tailoring practices to the needs of investors and their stakeholders?**

Clear and complete information on enterprises is important to a variety of users ranging from shareholders and the financial community to other constituencies such as employees, local communities, special interest groups and society at large.

Rules and guidance for reporting by companies are already well developed in most countries (see also Question 6.5), although the framework for non-financial reporting, particularly in relation to voluntary initiatives, is still evolving. Governments can enhance the quality of the investment environment by ensuring that an adequate framework is in place, whether through legislation or self-regulation, to support clear communication of all relevant rules and guidance for both financial and non-financial disclosures. When disclosures are mandatory, governments need to ensure that the application and enforcement of these requirements is non-discriminatory. At the same time, governments should seek to avoid unnecessary regulatory burdens and to allow innovation and adaptation to particular company circumstances to take place.

**7.4 How can the government support companies' efforts to comply with the law?**

Effective and transparent enforcement of the law motivates compliance in a particularly straightforward way – by creating costs for non-compliance (e.g. the costs of investigations, legal costs, fines, imprisonment and damage to reputation) and by having a "deterrent" effect. Complying with law can be a challenge and requires the knowledge of specific business circumstances and deployment of managerial expertise and of formal management systems.

Governments can facilitate and motivate companies' efforts by seeking out companies' views on laws and enforcement practices. They can also provide conciliation and ombudsman facilities so that investors and others have the right to complain about government decisions that they believe are unjust. In addition, governments can acknowledge and support private initiatives to enhance compliance by providing guidance on appropriate compliance management practices.

**7.5 How does the government through partnership (e.g. by participating in the development of standards that lower costs of designing responsible business policies) and through promotion (e.g. by improving the information on responsible business practices to customers and the public) help to strengthen the business case for responsible business conduct?**

The 'business case' for responsible behaviour is often clear-cut. For example, environmentally friendly production processes can decrease costs. Likewise, careful control of labour practices in supply chains can boost productivity at production sites and protect brand capital in consumer markets (i.e. it can improve profitability and help the company to manage business risks). The existence of a business case depends very much on particular circumstances (for example, the desire to protect brand capital would not be relevant for companies positioned in non-branded market segments). To the extent that the business case exists, private initiatives are self-enforcing (that is, government intervention is not required to make them happen).

Governments can act to reinforce the business case by providing information about responsible practices (e.g. good performance in the environmental field) and by lowering the costs of developing and adopting responsible practices, such as through support for industry initiatives (e.g. the International Association of Oil and Gas Producers Guidelines on Reputational Due Diligence). They can also promote internationally accepted concepts and principles, such as those embodied in the *OECD Guidelines for Multinational Enterprises*. The numerous initiatives and experiences of governments aimed at developing closer partnerships with investors on issues relating to the promotion of responsible business conduct, including through their purchasing, contracting and other business relations with private companies, provide a rich source of policy guidance.

**7.6 Does the government participate in inter-governmental co-operation in order to promote agreed concepts and principles for responsible business conduct, such as the *OECD Guidelines for Multinational Enterprises*, the *ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policies* and the *United Nations Global Compact*?**

Governments are cooperating with each other and with other actors to strengthen the international legal and policy framework in which business is conducted. The post-war period has seen the development of the framework, starting with the adoption in the 1948 of the Universal Declaration of Human Rights. Multilateral instruments dealing with responsible business conduct, such as the OECD Guidelines, the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policies and the United Nations Global Compact, draw on this broader framework of international declarations and conventions. They communicate and promote agreed concepts and principles for appropriate business conduct. Thirty-nine countries have committed to promoting responsible business conduct of their multinational enterprises -- wherever they operate in the world -- under the *OECD Guidelines for Multinational Enterprises*. While the Guidelines recommendations are addressed to business, governments through their network of National Contact Points are responsible for promoting the Guidelines, handling enquiries and helping to resolve issues that arise in specific instances. OECD has encouraged non-Member economies to adhere to the OECD Declaration on International Investment and Multinational Enterprises, which the OECD Guidelines are part of.

By promoting inter-governmental co-operation in this field, governments can help to broaden awareness of basic principles for appropriate conduct. Increased global acceptance of common principles for business conduct also helps to reduce the likelihood that observing appropriate responsible business conduct principles could become a competitive disadvantage for investors.

Further Policy Resources

- OECD, Guidelines for Multinational Enterprises: Revision 2000.
- OECD, Annual Report on the Guidelines for Multinational Enterprises (various years).
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD, Environment and the OECD Guidelines for Multinational Enterprises (2005).
- OECD, Corporate Responsibility: Private Initiatives, Public Goals (2001).
- OECD (forthcoming), Risk Awareness Tool for Investors in Weak Governance Zones.
- ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policies: Revised 2000.
- United Nations Global Compact, (<http://www.un.org/depts/ptd/global.htm>).

## Annotations to Chapter 8. Human resource development

### **8.1 Has the government established a coherent and comprehensive human resource development (HRD) policy framework consistent with its broader development and investment strategy and its implementation capacity? Is the HRD policy framework periodically reviewed to ensure that it is responsive to new economic developments and engages the main stakeholders?**

Human resource development has multiple dimensions, covering educational attainment, workforce skills, population health and the set of employment policies that connect people to business enterprises with appropriate skills and the ability to adapt quickly to new challenges. Each of these areas is a key driver in creating a favourable environment for investment. However, because they are all closely inter-related, HRD policies, and whether they are consistent with a country's broader development and investment policies (see Chapter 1), cannot be framed in isolation. It is important, therefore, to tackle low HRD through a coherent and comprehensive strategy that takes full account of the policy linkages and a country's implementation capacity. Special emphasis also needs to be attached to the flexibility of the policy framework to respond to the new skill needs created by changing technologies and economic structures. For this to happen, close co-operation between policy makers and the main stakeholders is needed.

### **8.2 What steps has the government taken to increase participation in basic schooling and to improve the quality of instruction so as to leverage human resource assets to attract and to seize investment opportunities?**

Access to basic education for girls and boys is a human right and educational attainment at the primary and lower secondary levels is a minimum necessary condition for development. Broad access to basic education also underpins a healthy investment environment. Formal educational attainment also provides the foundations for further learning and safeguards the capacity to seize future investment opportunities. Despite positive trends in school enrolment, many countries under invest in human capital, due in part to a range of market failures and poverty. In these circumstances, without policy intervention, investment in early childhood, primary and lower secondary education will be sub optimal, feeding under-skilled workers into the labour market, disconnected with the requirements of business.

### **8.3 Is the economic incentive sufficient to encourage individuals to invest in higher education and life-long learning, supporting the improvement in the investment environment that flows from better human resources? What measures are being taken to ensure the full benefit of a countries' investment in its own human resources accrues, including the attraction of nationals who have completed their studies abroad? What mechanisms exist to promote closer co-operation between education institutions and business and to anticipate future labour force skill requirements?**

Higher secondary and tertiary educated workers are essential to help secure the full benefits of business investment. In contrast with basic education, graduates are usually able to internalise the benefits in the form of a higher wage. However, there is a danger that the benefits to society and to the local business community are forfeited to the extent that skilled workers permanently emigrate. This risk is greater in small-sized economies than in the larger ones, where return migration is common. One way to lower the incentive for skilled workers to migrate and to reap the full benefit of a countries' investment in its own human resources is to pay attention to the size of the financial returns from higher education. Labour market policies that result in compressed wage structures and costly graduate programmes in terms of time taken and tuition fees can unduly crimp the size of the financial returns that subsequently accrue. More

generally, a better business environment lifts the financial returns to investing in education, reduces the incentive to emigrate and favours return migration.

Higher education institutions themselves play a key role in equipping young people with the workforce skills needed by business. But these needs change quickly and often learning institutions are slow to respond. In this regard, stronger links between universities, businesses, trade unions and other stakeholders can help reshape course offerings to stay closely in line with evolving demands for specific skills. Co-operation can also bring other benefits favouring the investment environment, such as fostering an environment conducive to innovation and the quick diffusion of new knowledge.

**8.4 To what extent does the government promote training programmes and has it adopted practices that evaluate their effectiveness and their impact on the investment environment? What mechanisms are used to encourage businesses to offer training to employees and to play a larger role in co-financing training?**

While formal education equips individuals with the skills needed to learn, new recruits tend to lack the firm-specific knowledge that businesses require to unlock an employee's full productive potential. Transmitting these firm-specific skills is the domain of on-the-job training and specialized off-site training. However, as with basic education, market failures lead to too little training by businesses and the limited training that is undertaken is often concentrated within a narrow group of individuals. The shortage of trained workers is thus an obstacle to expanding investment and makes it particularly hard to attract high-skill intensive industries. The macroeconomic costs in terms of lost potential output can also be sizeable, given the productivity gains linked to training and because of the positive spillovers that multinational enterprises transmit to local firms. Policy instruments to support training are many and include co-financing arrangements, tax incentive schemes and subsidies. Evaluations of these instruments are likely to be country specific. What is important from the investment environment perspective is to ensure stable training programmes that are in line with business requirements and coupled with evaluations to favour those schemes with a proven track record of high rates of return.

**8.5 Does the government have a coherent strategy to tackle the spread of pandemic diseases and procedures to evaluate public health expenditures aimed at improving public health outcomes and, through inter-linkages, the investment environment?**

Pandemic and epidemic diseases, such as malaria and HIV/AIDS are a human tragedy, ravaging societies through the premature loss of lives and entrapping many others in poverty. They negatively influence investment decisions too, risking a vicious cycle between poor health, lower investment, job creation and entrepreneurship and hence slower economic growth. However, the links between health, education and economic growth can equally work in a virtuous way. Apart from the human gains, better population health raises the ability and the incentive to invest in education, and promotes investment, because of the effect of good health on worker productivity and because domestic and foreign businesses tend to avoid sending employees into regions where their health could be damaged and where access to health care is limited. Designing the policies with limited resources that favour a virtuous cycle between health, investment and sustainable development is hard to get right. The lessons that have been drawn from successful experiences underscore the importance of a coherent and comprehensive package of policies. In addition to ensuring broad access to essential medicines there is a need for regular evaluations of public health programmes to assess their effectiveness, since what works well in one country may not always be the case in a different country.

## **8.6 What mechanisms are being put in place to promote and enforce core labour standards?**

Core labour standards relate to fundamental principles and basic human rights in the workforce and are distinct from labour standards regarding work conditions and employment protection laws. Specifically, they aim to eliminate all forms of forced or compulsory labour, to abolish child labour, to uphold the principle of non-discrimination in respect of employment and occupation and to ensure the freedom of association and the right to collective bargaining. These core labour standards are a key element in the healthy functioning of market economies, create a level playing field for all investors - foreign and domestic, small and large - and improve economic performance, in part because they sharpen the incentive for workers to improve skills and to the younger generation to accumulate human capital. Most countries have ratified the ILO core labour standard conventions, but compliance with and enforcement of the standards is uneven across countries. In some cases, such as within special export processing zones, governments deliberately waive components of the core labour standards for fear that their presence may deter investment. However, there is no unequivocal empirical support for this concern. Indeed, multinational enterprises are more likely to invest in countries with stricter safeguards and enforcement of basic human and worker rights than in those countries where such rights are absent or poorly enforced. In short, there is a need to raise awareness of the problems associated with low compliance with the core labour standards, to reinforce efforts to improve enforcement and compliance with them and to promote tools that foster responsible business practices, such as the *OECD Guidelines for Multinational Enterprises*.

## **8.7 To what extent do labour market regulations support job creation and the government's investment attraction strategy? What initiatives have been introduced that support policy coordination, balancing social objectives, the goal of a competitive workforce and the incentives for business to invest?**

Interventions in the labour market aim to improve market efficiency and achieve social objectives. From an investment environment perspective the issue is how well such interventions achieve their goals without compromising other determinants of economic performance. Badly designed labour market regulations can reduce the opportunities and incentives for businesses to make new investments and expand. There are two main areas of intervention where governments face a trade-off between promoting social goals and the government's investment attraction strategy. The first relates to wage formation methods, such as administered wages, that result in labour costs too high to spur job creation, and in underutilised labour resources, in particular female employment, preventing economies from making full benefit from its investments in HRD. The second source of trade-off relates to interventions that escalate non-wage labour costs, which employers are unable to pass on to employees through lower monetary remuneration, making some businesses economically unviable. Another of the possible consequences is to give workers and employers an incentive to shift to the informal sector, or to stay there. Better policy design can, however, help to limit the size of the tradeoffs and in some cases meet both social objectives and support the government's investment attraction strategy. For instance, the wage formation process and its responsiveness to labour market conditions could be reinforced through more effective co-ordination among the parties involved in negotiations. In this context, trade unions play an important role in co-ordinating and representing the interests and preferences of workers. Their impact on investment depends on having a constructive dialogue between freely elected associations of workers and employers.

**8.8 Do laws and regulations restrict the deployment of skilled workers from an enterprise investing in the host country? What steps have been taken to unwind unduly restrictive practices covering the deployment of workers from the investing enterprise and to reduce delays in granting work visas?**

Foreign investment often requires the deployment of experienced staff from more established parts of the organisation to ensure the smooth introduction of new facilities and the local implementation of corporate practices. Some countries, however, put tight limits on the number of foreign employees granted work visas, and frequently bureaucratic processes cause long delays in issuing work permits. These practices raise the cost of doing business and can discourage investment. As well as harming the investment environment, the country loses the opportunity of hosting skilled workers – a ‘brain gain’ – and the local diffusion of knowledge and international business practices that it brings. Evaluations of the costs and benefits of the policies that govern the deployment of skilled workers from an enterprise investing in the host country should take into account these broader economic considerations.

**8.9 Does the government support programmes designed to assist large-scale labour adjustment and indirectly the investment environment by better positioning firms to seize new investment opportunities? Do the incentive mechanisms in these schemes encourage broad support for change? What role is business encouraged to play in easing the transition costs associated with labour adjustment?**

Every economy is prone to upheaval, often linked to new technologies that lead to different work practices, opening fresh business opportunities and making others no longer viable. It is this process of ‘creative destruction’ that leads to higher economic output, and those firms that are able to adapt their operations quickly are better placed to face new competition and to expand. The capacity to adjust quickly is thus a factor in the overall business environment. The transition period, however, can be a costly and traumatic experience for those employees affected, especially in countries that have inadequate or non-existent social insurance mechanisms. This can cause resistance to change and, because of factors such as rent seeking by interest groups, influence political processes to stall reforms that would otherwise benefit society as a whole. The recommendations and mechanisms for dialogue of the *OECD Guidelines for Multinational Enterprises* concerning employment and industrial relations offer a tool that governments and businesses can use to build support for change (see also the chapter on Policies for promoting responsible business conduct). Governments can also limit the dislocation costs by providing support for retraining and redeployment initiatives and policies that encourage businesses to engage themselves in easing the transition costs associated with labour adjustment.

**8.10 What steps are being taken to ensure that labour market regulations support an adaptable workforce and maintain the ability of enterprises to modify their operations and investment planning?**

Investments in HRD help to maintain an adaptable and skilled workforce. However, this source of dynamism may fail to benefit the business environment if other interventions in the labour market create a context that blunts the process of workforce reorganisation. The key issue for policy is how to reconcile the employers’ need for flexibility in hiring and firing with that of workers for employment security. The OECD Jobs Strategy has highlighted innovative approaches to maintain labour market dynamism while also providing workers with adequate security. These include improving the efficiency of job protection regulations, for instance through implementation procedures that are quick and predictable, and shifting the focus of interventions toward income support, coupled with re-employment services. Their implementation in a developing country perspective is a major challenge and often requires development co-operation support.

#### Further Policy Resources

- FIAS, Investment Climate Surveys Database (<http://rru.worldbank.org/InvestmentClimate/>).
- International Labour Organization (ILO) Conventions (<http://www.ilo.org/>).
- ILO, Declaration on Fundamental Principles and Rights at Work (1998) (<http://www.ilo.org/dyn/declaris/declarationweb.indexpage>).
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD, *OECD Jobs Strategy: Lessons from a Decade's Experience*, forthcoming.
- United Nations Development Programme (UNDP), The National Human Development Report (NHDR) Workspace (<http://hdr.undp.org/nhdr/>).
- United Nations Educational, Scientific and Cultural Organization (UNESCO), instruments and other policy resources, ([www.unesco.org](http://www.unesco.org)).
- World Health Organisation research tools available at: <http://www.who.int/research/en/>.
- World Bank, Doing Business database (<http://www.doingbusiness.org/>).

## Annotations to Chapter 9. Infrastructure and financial sector development

### **9.1 What processes does the government use to evaluate its infrastructure investment needs? Does the national government work in cooperation with local and regional governments to establish infrastructure investment priorities? Does the government have clear guidelines and transparent procedures for the disbursement of public monies funding infrastructure projects? Are the regulatory agencies that oversee infrastructure investment and the operations of enterprises with infrastructure investments independent from undue political interference?**

Good infrastructure attracts investment by connecting firms to their customers and suppliers, in effect enlarging the size of the market. It also enables businesses to specialise and take advantage of modern production techniques and organisational structures. Decisions on how much, where and what kind of infrastructure to build are politically charged issues. This reflects the fact that traditionally governments have built, owned and managed infrastructure capital and because infrastructure is vital to economic development and more broadly to societies. Governments thus need procedures to decide how much to spend on infrastructure, how to allocate spending, including among different transport infrastructure modes and how to administer it. This requires a capability to undertake cost-benefit analyses, financial reporting, sound decision-making processes that give weight to the results of cost-benefit analyses, while allowing a socially acceptable balancing of competing interests and efficient agencies for maintaining and delivering new infrastructure investments. Traditionally, governments organised these functions through ministries. Experience has shown, however, that infrastructure investment performance and delivery has improved if the regulatory authorities and government infrastructure agencies are given operational independence and made accountable for their performance. (These issues are treated in more detail in the chapter on Public Governance.) Some governments have taken extra steps, such as making the state-owned agency subject to company law, appointing directors with commercial experience, and requiring the agency to prepare audited financial reports according to high-quality accounting standards. (See also the chapter on Corporate Governance.)

Even expected high return infrastructure projects may fail to get started due to limited public finances. Mobilising private investors to finance and participate in a country's infrastructure maintenance and development, such as through public-private partnerships, can ease the call on public funds and supplement resources for investment in infrastructure development. Governments can also delegate the management of infrastructure projects to private investors. To reap efficiency gains via these techniques and to attract private investors the disbursement of public funds needs to be based on clear guidelines, which are effectively and transparently managed and with procedural fairness for all investors to help ensure a level playing field. Well developed and functioning financial markets also support the expansion of infrastructure investment (questions 9.7 and 9.8 consider selected aspects of financial market development policies).

### **9.2 What measures has the government adopted to uphold the principle of transparency and procedural fairness for investors bidding for infrastructure contracts, to protect investors' rights from unilateral changes to contract terms and conditions? What steps have been taken to attract investors to supply infrastructure at fair and reasonable prices, to ensure that investor-state contracts serve the public interest and to maintain public support for private involvement in infrastructure?**

Infrastructure provision is characterised by long-lived immobile investments and large economies of scale. Once built, a road or hydroelectric dam cannot sensibly be dismantled and moved elsewhere, and it rarely makes sense to have two competing roads between the two same points. In these circumstances, investors

in infrastructure are vulnerable to changes in government regulations that undermine their profitability, and consumers of infrastructure services are exposed to the potential abuse of market power in infrastructure networks. Such a situation risks compromising public support for private investor involvement in infrastructure and private investors themselves may be discouraged from engaging in the supply of infrastructure services. Against this background, it helps to pre-establish in contracts regulator (representing users) and infrastructure investor rights. Strict adherence by governments to established timetables associated with tendering processes is important for investors. Competitive and transparent contracting processes are also in the public interest and underpin public confidence. When stabilisation clauses are used, governments need to balance their usefulness against the risk of circumscribing host government's right to regulate. Allowing disputes to be heard by domestic courts, international arbitration panels, or independent regulatory agencies can also help to allay investor concerns about posterior government decisions that impinge on the economic viability of infrastructure investment and about the dual role of governments as contractual parties and regulators in investor-state contracts. By reducing the risks faced by infrastructure providers, the returns that investors require to go forward with infrastructure investment are lowered. This is likely to support economic development by raising private investment in infrastructure, offering services at competitive prices and helps to maintain public support for private investor involvement in the provision of infrastructure services, including through public private partnerships.

**9.3 In the telecommunications sector, does the government assess market access for potential investors and the extent of competition among operators? Does the government evaluate whether telecommunication pricing policies are competitive, favouring investment in industries that depend on reliable and affordable telecommunications?**

Modern telecommunications are vital to the investment environment. They enable firms to communicate rapidly and cheaply with distant suppliers and customers, improving productivity. In particular, they underpin many service sectors, such as the financial, insurance and transportation markets. As the relative importance of the service sectors is rising, access to competitive, high quality telecommunication services has become, and will continue to be an important element of the investment environment. Overall, the cost of telecommunication services has dropped sharply over the past two decades, driven by technological advances and regulatory reforms. However, progress has been uneven across countries, as well as within countries. With the fast pace and regime changing nature of innovations in the telecommunications sector, governments need to regularly and impartially evaluate the continued relevance and impacts of their regulatory arrangements on telecommunication services and prices. In particular, telecommunication providers are no longer natural monopolies, and with the advent of wireless telecommunication services new investments are needed. Coupled with a predictable and independent industry regulator, these developments reduce the policy-related risks of investments in the telecommunication sector and raise the scope to inject greater competition among operators. (See also the chapter on Competition Policy.)

**9.4 Has the government developed a strategy to ensure reliable access to electricity services by users, and economic incentives to invest and supply electricity? What programmes exist to ensure on a least-cost basis access to electricity services by a wide range of users? Are these programmes time-bound and based upon clear performance targets?**

Access to a reliable electricity supply at a reasonable price is vital for firms. When electricity services are characterised by temporary losses of supply and fluctuations in voltage that damage machinery, firms tend to rely on self-supply, which is generally more expensive than a regular supply from a utility. Some estimates put the cost borne by users at equivalent to 5 per cent of annual sales. Poor electricity supply thus makes existing investments less productive and discourages new investment. Part of the reason for under investment in electricity infrastructure is lack of an economic incentive. Where governments have introduced reforms to tariff structures and allowed new entry, investment in the electricity infrastructure

has generally followed. But competitive market prices may mean for some users and in some locations that prices charged are no longer affordable. In these circumstances and when governments aim to ensure access to the electricity network at affordable prices as a social goal, programmes based on instruments that maintain an economic incentive to invest in electricity supply and achieve their objective at least cost are preferable.

**9.5 What processes are followed to inform decisions on the development of new transport facilities, as well as the maintenance of existing investment in transport infrastructure? Are the requirements for all modes of transport regularly reviewed, taking into consideration investor needs and the links between different modes of transport infrastructure?**

Transport infrastructure creates opportunities for firms to buy and sell in different markets and is a driver of globalisation. With barriers to international trade falling and cross border commerce growing (see chapter on Trade Policy), the importance of an efficient transport infrastructure to attract investors is increasing. Further, lower international transport costs would itself spur trade, providing a stimulus to investment in other sectors. Reducing transport costs requires paying attention to all transport modes and the linkages among the modes. Ports and airports, for example, are more valuable when served by good roads and railways. Transport costs are also affected by indirect factors, such as whether telecommunications systems allow companies to track their goods in transit and how quickly goods are cleared through customs. In addition to developing new transportation links and services, maintenance of existing facilities is needed to ensure they continue to function properly. Frequently, however, countries allocate funds for new projects and neglect the upkeep of previous transport infrastructure investments. While there is no simple approach to address this imbalance, making decision processes more transparent by publishing and communicating the principles used to allocate funds can help to better reveal the opportunity cost of the options and choices made.

**9.6 Has the government evaluated the investment needs in water required to support its development goals? To what extent is the private sector involved in water management, supply and infrastructure financing?**

Fresh water supplies and sanitation are a key infrastructure resource. Water is essential for a healthy population, is an input used in many businesses and the water industry itself requires large investments. Yet large parts of the world are under-provided in this area and long-term projections identify large needs for water infrastructure investments to meet the growth in demands from agriculture, business and households. Private sector provision of water is limited in many countries and where governments have pursued projects with private participation, these schemes have often met resistance to set water tariffs at commercial rates. As a result, private water projects are prone to contract disputes, with many water supply contracts subsequently renegotiated. While renegotiations do not necessarily indicate systematic problems or project failures, they do raise questions about the appropriate modalities for private participation in water, particularly in concessions with significant investment commitments. Shifting the financing burden of water infrastructure services from taxpayers to users would assist sustainable development by reducing water demand and hence investment needs, help to put the sector on a more financially sustainable basis, promote better governance by increasing the demands for accountability and help to support the creation of public-private partnerships to finance water infrastructure investments. The user pay principle does not forsake a government's ability to put in place policies designed to ensure access to water as a social goal. Devolution of responsibility as well as the financial means to fulfil that responsibility is also crucial.

**9.7 What processes does the government use to evaluate the capacity of the financial sector, including the quality of its regulatory framework, to support effectively enterprise development? What steps has the government taken to remove obstacles, including restrictions on participation by foreign institutions, to private investment in the development of the financial sector?**

Developed financial sectors provide payment services, mobilize savings, and allocate financing to firms wishing to invest. When they work well, they give firms the ability to seize promising investment opportunities, especially small and innovative enterprises and entrepreneurs that need external funding to expand and develop their business ideas. Well-functioning financial markets also impose discipline on firms to perform, boosting efficiency, both directly and by facilitating new entry into product markets. They also enable firms and households to manage better risks.

Based on experience, the key factors that support the development of modern financial sectors include macroeconomic stability; competition in financial services, including from foreign enterprises (see the chapter on Competition Policy); secure rights of borrowers, creditors, and shareholders; transparency and the flow of information; and prudential oversight of risk taking in accordance with international standards. Allowing foreign investors participation in the domestic banking sector does not prejudice the non-discriminatory application of existing policies to facilitate the financing of rural and disadvantaged areas. Host countries' authorities should also take advantage of information sharing arrangements to facilitate adequate supervision of foreign financial institutions operating in the countries, and generally international co-operation initiatives designed to support the development of a domestic financial sector (see Further Policy Resources). A large, vibrant and competitive financial sector with adequate prudential safeguards minimizes risks in terms of systemic instability, with consequences for macroeconomic and investment performance.

**9.8 What laws and regulations are in place to protect the rights of borrowers and creditors and are these rights adequately balanced? Is a registry system in place to support the use of property as collateral and to expand business access to external sources of credit? What data protection and credit reporting laws have been enacted to facilitate the flow of information and improve financial sector stability, thereby enhancing the investment environment?**

Governments can support the development of financial sectors by ensuring that borrowers and creditors have clearly defined rights and can enforce them. A strong legal environment and effective enforcement capabilities are especially important for access to external finance, a source that is often difficult for small- and medium-sized enterprises and female entrepreneurs to tap. These rights need to be well balanced. When creditor rights are weak, financial intermediaries will be less willing to extend credit to firms and when shareholder rights are weak, investors will be less willing to extend equity finance. Well-defined property rights that investors can pledge as collateral also increase access to finance, allow firms to borrow on a longer-term basis and at a lower cost.

A good legal framework should support the use of all kinds of assets and rights as collateral, while as far as possible eliminating formal requirements to create collateral and should foster transparency and predictability for commercial transactions. The legal framework should also be supported by publicly open, affordable and efficient registry systems. Well functioning registry systems are critical tools in the development of financial intermediation and help to boost investment activity. Better and more information flows also help. But collecting information can be costly and expensive to interpret. Often specialised agencies, such as credit bureaus can collect information on borrowers and their risk profile more cost effectively than the financial institutions themselves. Governments can create a supportive environment for creditor information collection by enacting and enforcing data protection and credit reporting laws that allow the sharing of information, while protecting consumer rights. Prudential authorities also need to

collect information from financial institutions to monitor, evaluate and respond to risks of systemic crises in the financial sector damaging the investment environment. Given the close integration of financial intermediaries in global capital markets, performing these functions will likely require that the home country supervisory and prudential authorities be prepared to enable information exchange arrangements with their counterparts in the host country.

#### Further Policy Resources

- Basel Committee on Banking Supervision (<http://www.bis.org/bcbs/index.htm>)
- European Commission, Guidelines for Successful Public-Private Partnerships
- FIAS, Investment Climate Surveys Database (<http://rru.worldbank.org/InvestmentClimate/>).
- FIAS, Private Sector Toolkits (<http://rru.worldbank.org/Toolkits/>).
- IMF Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles (<http://www.imf.org/external/np/mae/mft/index.htm>)
- International Association of Insurance Supervisors (<http://www.iaisweb.org/>)
- International Finance Corporation (IFC) (<http://www.ifc.org/>).
- International Organisation of Securities Commissions (IOSCO) (<http://www.iosco.org/>)
- OECD, Declaration on International Investment and Multinational Enterprises.
- OECD (2001), Recommendation of the Council Concerning Structural Separation in Regulated Industries.
- Public-Private Infrastructure Advisory Facility (<http://www.ppiaf.org/>)
- United Nations (2004), UNCITRAL – Model Legislative Provisions on Privately Financed Infrastructure Projects,
- World Bank and IMF Handbook on Financial Sector Assessment (<http://www.imf.org/external/pubs/ft/fsa/eng/index.htm>)
- World Bank, Doing Business database (<http://www.doingbusiness.org/>).

## Annotations to Chapter 10. Public governance

### **10.1 Has the government established and implemented a coherent and comprehensive regulatory reform framework, consistent with its broader development and investment strategy?**

Regulatory policy is about the process by which regulations are drafted, updated, implemented and enforced. Nothing contributes more to investor confidence about regulation than regulatory predictability and the recognition that rules achieve their objectives. The quality of public services, which is shaped by regulation inside government as well as regulation for private-sector providers, thus has a significant influence on the climate for business and investment. As markets become more open, the need for well-designed regulatory institutions is likely to rise, with special attention to the proper sequencing of regulatory reforms and the building of sufficient institutional capacities for their effective implementation and prioritisation. From an investors' perspective, regulatory policy should preferably take the form of a statement setting out principles that provide strong guidance and benchmarks for action by officials, and what the investors can expect from government regarding regulation.

### **10.2 What mechanisms are in place for managing and co-ordinating regulatory reform across different levels of government to ensure consistent and transparent application of regulations and clear standards for regulatory quality?**

Diversity in institutional systems and institutional traditions influences the design of regulatory policy. Nevertheless, during the regulatory process, the need for some form of central mechanism to promote coherent and consistent regulatory quality appears to be essential. In this context, an oversight body that works as an "engine of reform" can help to focus the interest of investors in support of regulatory quality development. To avoid duplications and contradictions, all appropriate official bodies should be informed and consulted when preparing a new measure or planning a reform. In highly integrated economies, this process may require an understanding of the regulatory practices and policies in other jurisdictions. Further, quality regulation that enhances the investment environment needs a strong involvement and a sense of "ownership" by regulators responsible for their design and implementation. Special interests, close identification with the objectives of outdated regulation, countervailing pressures from different parts of society, and coherence when applying regulations and regimes across multiple areas, are challenges for regulatory institutions.

### **10.3 To what extent are regulatory impact assessments used to evaluate the consequences of economic regulations on the investment environment? Are the results of these assessments made public on a timely basis?**

Regulatory Impact Assessments (RIA) examine and measure the likely benefits, costs and effects of new or changed regulations. It is a tool that provides decision-makers with quantitative data and a framework in which they can assess their options and the likely economic, social and environmental consequences of their decisions. A poor understanding of the problems at hand, or of the side effects of government action can undermine regulatory efforts and result in regulatory failures. RIA is used to identify problems and to ensure that government action is justified and appropriate in economic, social and environmental terms. Many countries rely on RIAs to avoid regulations that impose unnecessary restrictions on investment. The RIA process provides a systematic approach for assessing the impacts of a proposed regulation and helps inform regulatory decision-making. In the absence of a requirement to assess the impacts of a proposed regulation on market openness (or indeed an explicit requirement to select a regulatory approach based on market openness considerations), RIAs offer a potentially useful tool for considering the impacts of regulation on investment decisions. Policy guidelines for improving the regulatory framework, such as the

APEC-OECD Integrated Checklist on Regulatory Reform, are also important for evaluating the consequences of economic regulation on the investment environment.

**10.4 What public consultation mechanisms and procedures, including prior notification, have been established to improve regulatory quality, thereby enhancing the investment environment? Are the consultation mechanisms open to all concerned stakeholders?**

Laws and regulations should be developed in an open and transparent fashion, with appropriate parliamentary control and procedures for effective and timely inputs from interested national and foreign parties. This should include potential domestic and foreign investors as well as affected business, trade unions, other civil society, wider interest groups and other levels of government. The way comments from interested parties are handled by government enhances the credibility of the process and the prospects of regulatory compliance by the economic actors. Consultation helps to ensure that the affected parties understand the nature of new regulations, why it is needed and what is expected of them. Inadequate consultation may result in poor quality regulation and/or uncertainty among businesses and investors about how they will be affected. Apart from less efficient regulation, this is likely to deter new investment, as potential investors seek out opportunities where there is more regulatory certainty and quality.

**10.5 To what extent are the administrative burdens on investors measured and quantified? What government procedures exist to identify and to reduce unnecessary administrative burdens, including those on investors? How widely are information and communication technologies used to promote administrative simplification, quality services, transparency and accountability?**

Administrative simplification is the most commonly used regulatory reform tool. It is aimed at reducing and streamlining government formalities and paperwork – the most visible component of which is often permits and licences. There is evidence in many countries that the administrative burden imposed on businesses is significant, with small- to medium-sized enterprises particularly affected. The informal economy often reflects administrative burdens that businesses, especially small firms, cannot meet. The right level of regulation, including attention to compliance costs when regulations are designed (through the RIA process), can help remove incentives for informal economic activity, with benefits for government, workers, and investors. It is also important to consider the cumulative effect of all the regulations to which enterprises are subject, not just those that have been introduced recently. Increasingly, governments are making use of information and communication technologies as a means of reducing administrative burdens and ‘red tape’. Excessive ‘red tape’ adds to business costs, can impede market entry and lower competitive pressures (also see the chapter on Competition Policy) and reduces the incentive to innovate. In addition, it creates uncertainty that can disrupt business planning and hinder the ability of businesses to respond quickly to new market opportunities. Ultimately, this discourages new investment, both domestic and foreign and weakens economic performance.

**10.6 To what extent have international anti-corruption and integrity standards been implemented in national legislation and regulations? Do penal, administrative and civil law provisions provide an effective legislative and regulatory framework for fighting corruption, including bribe solicitation and extortion as well as promoting integrity, thereby reducing uncertainty and improving business conditions for all investors?**

Anti-corruption and integrity standards include both preventive and repressive measures. Governments should enact provisions, mostly in criminal law, but also in the civil and administrative regulations, to prevent and sanction corruption of domestic public officials.

Over the last decade, many governments have developed standards of conduct to address conflicts between public officials' private interests and their public duties. Governments originally focussed on traditional sources of influence, such as gifts or hospitality offered to public officials, and personal or family relationships. Due to the increased co-operation between the public and private sectors, many countries have also established in recent years standards of conduct for tackling other forms of conflict-of-interest, such as business interests (e.g. in the form of partnerships, shareholdings), affiliations with other organisations and post-public employment. In order to address risks to good governance arising from conflicts of interest, the OECD has developed a framework for reviewing and modernising a country's conflict-of-interest policy with the 2003 Recommendation on Guidelines for Managing Conflict of Interest in the Public Service, as well as a Toolkit to help public officials put them into practice.

**10.7 Do institutions and procedures ensure transparent, effective and consistent application and enforcement of laws and regulations on anti-corruption, including bribe solicitation and extortion and integrity in the public service? Have standards of conduct by public officials been established and made transparent? What measures are used to assist public officials and to ensure the expected standards are met? Are civil society organisations and the media free to scrutinize the conduct of public officials' duties? Are "whistle-blower" protections in place?**

Application and enforcement of laws and regulations on anti-corruption and integrity involves many public institutions. Agency specific guidelines and practical measures (e.g. staff rotation, specific training or briefing etc.) may need to be developed to enforce anti-corruption and integrity standards in parts of the public service that are particularly exposed to corruption. Specific risk areas include law enforcement, public procurement, export credit, development assistance as well as customs and tax administration.

Codes of conduct are often developed to provide standards of conduct in a single concise document. These should be made available and adequately communicated to all public officials. Socialisation mechanisms such as training and counselling further raise awareness among employees and help develop their skills for meeting expected integrity standards in daily practice. In addition, human resource management policies should provide suitable conditions and incentives for public officials, such as basing recruitment and promotion on merit, providing an adequate remuneration and taking ethical considerations into account in recruitment and performance appraisal.

Reporting suspicion of misconduct by public officials can be either required by law and/or facilitated by organisational rules. Whistle blowing, the act of raising concerns about misconduct within an organisation, is a key element of good governance to ensure transparency and accountability. A range of institutions and procedures such as Ombudsman, Inspector General, complaint procedures and help desks or telephone lines could enable public officials and citizens to expose wrongdoing. Their effectiveness also depends on public confidence that people who make bona fide reports about wrongdoing receive proper protection against retaliation.

**10.8 Do review mechanisms exist to assess the performance of laws and regulations on anti-corruption and integrity?**

Solid and independent review is essential to help ensure enforcement of laws and regulations on anti-corruption and integrity. In general, the legislative branch undertakes reviews of public service activities. Other common types of evaluation range from external independent investigation by the Ombudsman or the Inspector General to specific judicial or ethics reviews. In addition, monitoring compliance may be based on internal controls, widely used to detect individual irregularities and systemic failures and is likely to be accompanied by independent scrutiny. This scrutiny keeps public officials accountable for their actions, ultimately, to the public.

Transparency in government operations is considered both as an instrument for ensuring accountability and combating corruption, and for promoting democratic participation by informing and involving citizens. In recent years, citizens' access to official information has significantly improved, in particular with the development of Freedom of Information legislation and the growing use of electronic procedures. Coupled with an increasingly active media and well-organised interest groups, this has led to more vigilant public scrutiny over public officials' behaviours.

**10.9 Is the government a party to international initiatives aimed at fighting corruption and improving public sector integrity? What mechanisms are in place to ensure timely and effective implementation of anti-corruption conventions? Do these mechanisms monitor the application and enforcement of the anti-corruption laws implementing the conventions?**

Governments have realised that corruption cannot be addressed at the domestic level alone. Only concerted, internationally coordinated action can make a meaningful contribution to stamping out corruption. Governments have consequently adopted a number of international and regional anti-corruption instruments. Although these instruments may have different focuses, they generally aim at ensuring a holistic approach that encompasses preventive measures as well as repressive provisions to fight domestic and foreign corruption. Moreover, they contain provisions regarding mutual legal assistance, which facilitate the detection, the investigation and sanctioning of corruption.

There is also a role for international co-operation in the fight against corruption. For example, the OECD Convention of Combating Bribery of Foreign Public Officials in International Business Transactions aims to stop the flow of bribes to public officials in host countries. Other intergovernmental organisations such as the United Nations, the World Bank, the Asian Development Bank and the International Monetary Fund have likewise developed policies aimed at fostering good governance and sanctioning corruption and related malpractices.

Further Policy Resources

- APEC Principles to Enhance Competition and Regulatory Reform (1997).
- APEC-OECD Integrated Checklist on Regulatory Reform: Addressing Regulatory, Competition Policy, and Market Openness Policy Issues.
- IMF (2005), *Guide on Resource Revenue Transparency*
- OECD (2005), *Modernising Government: The Way Forward*.
- OECD (2003), *A Framework for Investment Policy Transparency*.
- OECD, DAC Draft Ten Principles of Good International Engagement in Fragile States.
- OECD, *Declaration on International Investment and Multinational Enterprises*.
- OECD (2004), *DAC Guidelines: Security System Reform and Governance: Policy and Good Practice*.
- OECD (2001), *OECD Best Practices for Budget Transparency*.
- OECD (1997), *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*.
- OECD (2003), *OECD Guidelines for Managing Conflict of Interest in the Public Service*.
- OECD (2005), *OECD Guiding Principles for Regulatory Quality and Performance*.
- United Nations Convention against Corruption (UNCAC) (2003).
- OECD (1998), *OECD Recommendation on Improving Ethical Conduct in the Public Service*.
- United Nations, *International Covenant on Civil and Political Rights*, December 1966
- United Nations, *International Covenant on Economic, Social and Cultural Rights*