OECD

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Encouraging Modern Governance and Transparency for Investment: Why and How?

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ENCOURAGING MODERN GOVERNANCE AND TRANSPARENCY FOR INVESTMENT
BIAC Statement to the OECD Global Forum on International Investment

I. Private sector investment depends on modern governance

The evidence is increasing: good governance is a vital prerequisite for the attraction of foreign direct investment (FDI) as well as for the encouragement of the local private sector. Although macro economic policies, market size and risk environment are important determinants of private sector investment decisions, there is a growing consensus that the quality of business regulation and the institutions that enforce it are equally important. The success of many emerging market economies has been decisively stimulated by a good regulatory environment.

As a matter of fact, for investing businesses quite often, the critical focus of their choice (to invest or not to invest), centres around the reliability and clarity of the host government's administration and decision-making process. Investors ask themselves questions such as:

- How layered and complex is the government decision making mosaic?
- Is someone truly in charge? Can they be identified? And, will they make a timely and binding decision?
- Are there different levels of government (local, state, federal, or regional) involved that are supportive of each other?

Prerequisites of modern governance supportive of investment

For every country (no matter what its size, level of development, location, language or resources) attracting investment is a competitive exercise. Thus, all countries and local communities alike must be able to offer business the right incentives, including a transparent and predictable policy framework, if they want to be chosen as the site for a new or expanded operations base.

Good governance implies the basic ingredients for attracting investment which hold true for all parts of a country's policy mosaic. Most of these elements rely on effective and reliable delivery of these basics by governments.

Good governance for attracting private sector investment, especially FDI, requires as a minimum the following:

- The absence of administrative measure, i.e. screening and approval requirements for foreign investments and the general absence of ownership, control or performance requirements as a condition of entry.

- More specifically, the content of national laws, such as planning regulations, corporate disclosure requirements or labour relations, must be framed in a manner that is stimulating to private investment.

- Host states should offer constitutional guarantees for the peaceful enjoyment of private property and may want to reinforce these by the conclusion of bilateral investment treaties with home governments of investors, requiring international minimum standards of treatment for foreign investors.

- While efficient and transparent customs legislation and procedures are prerequisites for entering the market, a high standard intellectual property law and vigorous enforcement enhances the chance to attract high-quality FDI.

- Finally, an established and reliable banking and legal system as well as a predictable regulatory and fiscal environment including the efficiency, accountability and predictability of the judicial system.

Furthermore, other criteria that enhance investment opportunities, which are also associated with good governance at all levels of the public sector, are just as important as the requirements mentioned earlier when attracting business to a region or a community. These "softer elements" can be thought of as infrastructural in nature, but to a business looking to invest they are a necessary support to the successful establishment of a new or expanding business.

These "softer elements" encompass:

- the availability for appropriate road, rail and air links;

- a reliable supplier network for inputs and maintenance needs;

- a skilled and flexible work force to draw on;

- an educational backdrop that allows for appropriate skills enhancement and

- a safe and healthy environment to attract permanent employees and their families.

Doing business requires high-quality regulation

Modern public sector management implies more than reducing barriers. It also requires a quality regulatory environment conducive to business. However, studies show that less developed countries tend to have a higher regulated environment often inhibiting business potential to unfold. In fact, it is the quality of business regulation and the institutions that enforce it which are the major determinants for private sector investment.

For business, the core test for good regulation is the ability of governments to choose the most efficient and effective policy tool, be it a regulatory or a non-regulatory one.

Unfortunately, bureaucracies in OECD and non-OECD countries tend to be conservative and risk adverse and the incentives for government officials to be innovative in regulatory approaches are low. From a business point of view, every new regulatory measure impacting on the business environment should pass a three step necessity test:

- Whether there are other possible solutions to regulation (self-regulation, voluntary agreements)?

- Whether the identified policy objective can be performed by private parties?

- What were the considerations that led to the rejection of non-regulatory options?

It is important that alternatives to command-and-control regulation are transparent and can be discussed publicly involving independent business organisations as major stakeholders.

Regulatory Impact Analysis (RIA) is another crucial requirement for modern rule-making. The OECD leads the discussion and issued in 1997 the publication "Regulatory Impact Analysis: Best Practices in OECD countries". These recommendations should be implemented by OECD and non-OECD governments and RIAs should be carried out on a regular basis.

II. Transparency as basic parameter of modern governance

Government policies and practices regulating investment can be a major barrier to the free flow of capital. A first priority for business therefore remains the continuing reduction and final elimination of investment barriers such as screening procedures or any form of performance requirements.

In no way does that imply that business wants to question the right of sovereign states to regulate, as their democratic policy-making process requires them to do. As a matter of fact, one of the main aspects of being a successful investor is the adaptability to the regulatory environment with which one is confronted.

However, there is one crucial qualification to this statement. Business needs transparency of the regulations with which it is confronted as well as predictability. Transparency and predictability should be basic parameters of any investment regime. In fact, the evidence from the business community shows that transparency of laws and regulations are cited as core business demands for improving market access for trade and investment, as well as the subsequent treatment of foreign goods or investment by a host country.

There are many ways of discouraging foreign investors. While obvious market entry restrictions and discrimination against foreign investors are thankfully on the decline, there are few limits to bureaucratic ingenuity. Deliberately non-transparent regulatory systems may well serve as equally efficient hidden barriers to investment.

Fundamentally, internationally-agreed rules and procedures governing transparency, and the enforcement thereof, enhance a government’s commitment to the rule of law and contribute favourably to its overall business climate. For business, knowing what the rules of the game are, how the rules are implemented and how they may be changed creates an enabling environment which enhances the quantity and quality of trade and investment.

Especially for countries where investors have the perception of a high risk of policy reversals and policy uncertainties, there is a strong argument to establishing transparency not only through national laws and regulations but also by entering into binding international agreements. This enhances international investors' perception that the regulatory structure of an investment regime is stable and predictable. Many such credibility-enhancing instruments are in place world-wide already (OECD Code for the Liberalisation of Capital Movements, OECD National Treatment Instrument, BITs, FTAs, WTO provisions) and must be used more widely to lock in transparency requirements in national investment regimes.

From a business point of view, transparency:

- Reduces the risk and uncertainty premium associated with cross border trade, investment and service transactions.

- Enables firms - foreign and domestic - who risk the capital of their shareholders and the savings of their employees accumulated in pension plans, to make better, less risky decisions as to where and how capital resources will be deployed.

- Promotes stability. When transparent rules are accompanied by transparent procedures for introducing changes in rules, business can plan and invest on a long term basis. Long term investment brings greater benefits to a recipient country than does short term investment.

- Reduces opportunities for bribery and corruption, i.e. “the hidden tax” that benefits the privileged few at the expense of the population at large.

- Helps to insure that rules and any exemptions are not hidden barriers to trade, investment, and services.

- Helps to delineate the line between the promotion and application of public policy objectives and where those objectives may become a burden or barrier to trade, investment and services, whether or not intended.

- Fills in the "gaps” on trade, investment and service rules where obligations may be “thin” or limited, e.g. in BITs, licensing requirements, physosanitary and sanitary measures.

- Reduces opportunities for governments to place firms in a situation of “conflicting requirements” - being subject to differing rules on the same subject matter by a home country or host country.

- Helps to level the playing field among competing firms - foreign, domestic and state owned – allowing firms and their workers to compete and be rewarded on the basis of their best offerings.

- Promotes democratic values by providing the greatest opportunity for the views of the populace to be heard and acted upon.

Investment regimes and Transparency

Investors seek markets which are stable, transparent and predictable to give them the confidence to take the risks inherent in investing capital. International provisions on transparency for investment, demonstrating commitment to multilateral disciplines, would not and cannot by themselves produce investment flows. They can aim at making positive investment decisions easier, though. Thus, transparency should be a cornerstone of multilateral efforts enhancing investment.

All national provisions affecting rights of entry and post-investment operations such as sectors restricted to domestic investors, conditions applying to joint ventures, taxation, etc. should be made publicly available and subjected to scrutiny and judicial review.

Governments, at all levels, should take steps to insure that:

- Existing rules and regulations are readily accessible to members of the public;
- Notice is provided to the public at an early stage of proposals that introduce new rules or change existing rules;
- Proposals to change existing rules or to introduce new rules provide sufficient time for the public to submit comments in a pre-determined manner;
- The public is provided with an explanation as to the reason(s) why the rules are being changed/introduced and the goals and objectives that are intended to be met;
- The public is invited to submit comments prior to decisions being taken;
- Points of inquiry are established to respond to the public for information (single window approach);
- The new rules or changes in existing rules are clear and understandable to insure predictability of success and to provide affected individuals with the necessary information to comply and
- A reasonable period of time is provided to allow affected persons to prepare for implementation.

The analysis of costs and benefits of regulation should be clear and defensible. BIAC would recommend that an independent agency be charged with oversight responsibility across the regulatory spectrum.

Trade procedures and Transparency

For businesses, investment is strongly inter-linked with trade. BIAC believes that lack of transparency, especially in customs regulations is still one of the main difficulties for traders accessing foreign markets. Often administrative obligations are not made public, sometimes because they are in violation of WTO rules. Traders are defenceless against customs arbitrariness, as customs' power to delay clearance of goods at borders is practically unrestrained, even in many developed countries. BIAC is therefore in favour of any measure which would allow a move towards increasing transparency and minimising non-auditable discretionary powers of customs and other government agencies involved in administering trade.

Customs authorities especially should therefore seek to make regulations and documentation as transparent as possible. Significant improvements in transparency and predictability could be sought in the following areas:

- obligation on customs authorities to let operators know in advance what information they must provide on currency, value, origin and other essential aspects for customs clearance and
- greater flexibility in application of transition clauses when duties and customs rules are modified.

BIAC feels that transparency for trade procedures could be greatly enhanced by establishing international binding rules on a right of independent judicial or administrative review of customs decisions. Other measures to improve transparency include the single window concept, the concentration of official controls in the hands of one agency, co-ordination of controls in time and place, simplification and reduction of the amount of data required and the use of international standards.

Efforts in the current Doha Round on trade liberalisation to deal with these issues under the heading of "Trade Facilitation" should be taken seriously by governments.