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NOTHING TO HIDE, EVERYTHING TO GAIN: TRANSPARENCY AND FDI

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The present paper explores the ways to improve public service transparency in order to attract foreign investment and maximize the benefits it brings to the host countries. The role of the international community is considered.

Introduction

According to Augusto Lopez-Claros—the Chief Economist of the World Economic Forum (www.weforum.org), we live in the era of free capital mobility. It offers an unprecedented choice of FDI destinations. While the foreign investors compete among themselves for specific sites and deals (mergers and acquisitions), even more so the individual countries do compete for FDI (Oman, 1999). Following a recent decline in the global FDI (WIR, 2003) enhancing the attractiveness of a country has become a priority.

Efficient government administration, minimum red tape, fairness and clarity of law, approval and audit procedures constitute just one but very important element of country's competitiveness and popularity among investors. According to one estimate (PWC, 2001), the lack of transparency increases significantly the cost of capital destined for a particular economy and in three years during the late 90-ties cost just the several "opaque" countries a total of $131 billion in lost FDI diverted to more transparent nation-states. To make things worse, poor transparency can create a double jeopardy: not only less FDI are coming in but in addition the local capital might go abroad to more transparent markets.

And yet, while in the short run such aspects of country's competitiveness like labor productivity, infrastructure and technology cannot be altered dramatically, public governance may be improved more rapidly.

The Issue

While somewhat different definitions of "transparency" are being used by international organizations (OECD, the World Bank, IMF, APEC, WTO), in the strict sense of the word it boils down to a clear unambiguous information on rules, procedures and accountability of decision making process. The broadened notion of transparency (perhaps not the best designation for what we are trying to describe) goes beyond the "nothing to hide" postulate and pragmatically means facilitating the decision process of business parties. Such an approach emphasizes augmented benefits to the investors and reflects the concept of public service. Even though in view of so many aspects involved, developing a definition of the broader concept of transparency is a complex task, a pragmatic view of transparency can be approximated while using the following questions which reflect the business perception of the topic:

1. Was my company promptly directed to sources of information on the regulations pertaining to the investment project?

2. Was the information clear, current and comprehensive?

3. Were the additional questions and objections addressed thoroughly?

4. Was the government decision consistent with the analogous ones in the recent past?

5. Did it cost us much effort to deal with the government?

6. Have the rules significantly changed after the project was on-stream? If so, has our company been consulted beforehand?

The issues highlighted above also delineate the dimensions along which the improvement can be accomplished and measured.

In the author's view, the process of improvement in the transparency in public services is a sequence along the path of:

Competence> Sophistication of the analysis> Transparency >Friendliness.

Competence means that the foreign investor will negotiate with the officials capable of evaluating the impact of the considered project upon various aspects of the economy: national and local as well as the particular sectors. It also can assure the proper understanding of the investor's situation in terms of the economic and financial issues of the endeavor and the corresponding risks.

Sophistication should translate into a proper judgment with respect to the attractiveness of a specific enterprise as such[1] and in comparative way as related to other proposals. Consequently, sophistication is needed to ponder a strategic decision on the appropriate project-by project use of additional incentives based upon the government's bargaining power.

Only upon satisfying the first two postulates, advocating transparency makes practical sense. Otherwise, all the merits of "openness" of the authorities' rules and practices will be forfeited if the forthcoming information reflects an erratic decision pattern, lack of expertise and experience.

Making the case for improved transparency of the public service is not difficult. Indeed, apart from theoretical arguments, business surveys (EC, 2002, EIU, 2002, JETRO, 2001) attested to the importance of the problem. If transparency is so badly needed and beneficial for the potential investors and presumably in the best interest of the host countries, why is the progress so slow? First, a caveat is in order. In operational terms, measuring transparency is by far a more complicated task than, say, quantifying the GDP. Various methodological problems emerge as to what should be measured and how[2]. Also, the trend need not be uniform. While in some countries the improvement may take place, in some others the situation can be quite satisfactory to begin with, whereas in still other countries the condition might deteriorate. A thorough evaluation would certainly call for a separate academic treatise. Having said that, one cannot help the impression that based upon the review of the procedures (OECD, 2002) and surveys of business people the level of transparency in many countries could be much better.

Impediments for transparency

Understanding the impediments may help to grasp the nature of the problems and indicate the ways to address them.

Whereas the list below is not necessarily exhaustive, the problems with transparency seem to originate from the following causes:

1. <u>Machiavellianism</u>. Lack of transparency is a source of power of the officials. It facilitates arbitrariness and helps to mask bribery. It has also created a bonanza for intermediaries and consultants helping to operate in a maze. They as well might constitute a lobby resisting change.

2. <u>Camouflage</u>. Low transparency provides a smokescreen for ignorance and poor preparedness of the decision-makers.

3. <u>Secretiveness</u>. The administrative culture of excessive secrecy as a way of protecting the state.

4. <u>Authoritarianism</u>. Poor understanding of the concept of the public service—order giving instead of assistance providing.

5. <u>Economic regime</u>. The issue of transparency should not be isolated from that of the structure of economic activities in the domain of the state and of the private sector. To an extent, (McArthur. and. Sachs, 2002*)* less government involvement in direct economic operations equals less conflict with the private sector and brings more transparency. Hence, less pockets of potential conflict are created.

6. <u>Nationalism.</u> While the 5 issues above refer to local and foreign investors alike, there is often a perception that, foreign companies, especially big multinationals have more clout dealing with the host governments and get preferential treatment. Lesser transparency is then seen as the equalizing factor.

Each of the above causes might require different remedies and varying time frame in order to succeed. Determination to fight corruption in its various forms can help address the first issue. Appropriate training and scrutiny of the officials might reduce the second reason for transparency. The third, fourth and fifth points relate to the development of democracy and the privatization processes and are particularly relevant in the context of the transition economies. The sixth has to do with the proper understanding of the globalisation processes and international competitiveness. Eradication of the "zero sum game" mentality will eventually change that perception.

Some lesser known implications

Whereas poor transparency hinders FDI in general, there are some important implications of the lack of transparency with respect to the investment volume and structure. With low level of transparency local businesses are in a privileged position as they know the intricacies of the system (see Habib and Zurawicki, 2001). In a similar vein, foreign investors already established in a host country have an advantage over newcomers.

Hence, there can be more of reinvested profits rather than new investments. That means discouraging new foreign investors but also suggesting to them some forms of connectivity with the local partners to overcome the disadvantage--joint venturing and hiring more locals not because of their professional expertise but rather owing to their knowledge of dealing with the "system." Also, based upon author's previous research on corruption and FDI (Habib and Zurawicki, 2002), it can be hypothesized that the investors from countries with level of corruption similar to that of the host country, have an edge over companies used to higher standards in their traditional markets.

Accordingly, the geographic structure of incoming FDI would be affected—less transparent economies would receive relatively more FDI from their homologs rather than from the more transparent countries. In that context, it is also critical to decide who and how evaluates transparency. For the insiders, the veils might be rather translucent while still remaining pretty opaque for the outsiders.

Whereas from the investors' standpoint more transparency is better, it is also appropriate to keep in mind the scope and the limits to government transparency in view of the sometimes adversarial positions of the authorities and investors. The latter frequently seek to obtain all kinds of incentives (tax reduction, real estate, job creation and training subsidies) from the hosting authorities who have the discretion to offer them as they see it fit and to keep the location competitive vis a vis other candidates. Consequently, openness about the margin for concessions, past practices etc. might weaken the clout of the authorities. Accordingly, the issue of transparency cannot be separated from the contents of the information available. Logically, the benefits of transparency increase with the degree of specificity of data accessible. Not always governments can afford to tell "all the truth".

A closely related question is whether in considering the transparency of the government agencies one takes the transparency of the MNCs and smaller investors for granted. While the transparency of the MNCs represents a separate topic, the issue is whether the transparent host country government should stipulate the reciprocity on behalf of the investors. If so, how to implement and enforce such a policy? After all, not all the investors are known to the authorities, and do reveal their actual intentions. However, how much and what type of data to be furnished by the investors will just cause an unnecessary nuisance and infringe upon confidentiality of business operations is an open question. Clearly, the two issues are interrelated.

Looking for remedies

Valuable ideas have been offered by experts from international organizations (e.g. OECD, 2003, various documents by WTO). The following suggestions are intended to add a practical twist for the purpose of implementation.

1. First and foremost, it is imperative to provide compelling evidence that the transparency matters. Any such findings should have the quality seal of both the reputable international organization and academe. This should help overcome inertia, the neglect of the issue and resistance to change among some governments and politicians. They might perceive that their countries compete for FDI on a regional rather than the global basis and tend to measure up their systems to that of the neighbors—comparisons might not

turn negative results. International organizations need to sponsor systematic research efforts and widely disseminate the results.

If a particular government is not willing to address the issue of transparency, there is not much the international community can do in the short run but educate (international lenders might have some clout, though). Realizing the scope of self-penalty can send a powerful signal. However, showing the clear connection is more complex a task than it might appear. For practical reasons, the governments and publics realize their disadvantage in the context of specific cases when a targeted investment project ends up in another country of the region. Even then, it can appear that the diversion is due to some specific incentives offered--tax, subsidies--rather than stemming from lesser perceived transparency. The sheer fact that the respective country was in the running might convey a comforting message that the transparency level is "tolerable." To shake up such lethargy, a powerful and credible international message needs to be sent.

2. Comparative and thorough country-by-country rankings of those aspects of transparency which specifically relate to FDI can further mobilize governments and parliaments to implement corrective measures. Many observations do not take into account distinct hurdles facing foreign investors as opposed to more general obstacles. Lesser familiarity with the economic environment of the target country, its market conditions or even language barrier are just some of the problems confronting foreign companies. However, as transparency is only one of the components of the attractiveness of a country, potential impact on FDI should be put into perspective and reasonable expectations developed. Improving transparency alone might not produce overly optimistic results. Relying on general comparative international analyses of government transparency is not going to provide individual countries with the insights into the specific problem areas in their local environment. This can be rather accomplished by seeking a continuous feedback from the foreign investors involved in the host country business. Designing and implementing an appropriate two-way communication system is a very important no matter how challenging a task.

3. A set of detailed universal principles and recommendations addressing good public governance and transparency needs to be developed under the auspices of a respected international organization. There is enough material to draw on from numerous public service manuals, bilateral investment treaties, and practical experience of the countries with high level of transparency. Agreeing on the mutually acceptable and clear set of rules will help establish an important standard. As an example, governments should in good faith respect commitments of the previous ones and, as a principle, promise not to change mid-course the stipulations of the existing agreements with foreign investors.

4. Monitoring countries' actual practices and sharing the information among the international business community will provide a valuable input for potential investors. Developing the international ledger of "best practices" would also be helpful[3]. By the same token, satisfied investors constitute the best reference for the host country. Indeed, many investment promotion agencies use such testimonials to strengthen their case. At the same time, as their objective is to market the country, such agencies are not best suited to offer negative information. Therefore, the Chambers of Commerce (local and international) need to a greater extent be involved in collecting evaluative comments from the business community and exchange them with the government (investment) agencies.

5. In practical terms, a general and universally applicable model of the "information about information" could be developed first. For example, the investment promotion agency should be designated as the first and central point of contact and made responsible for handling inquiries and connecting to the pertinent departments of the government—national and provincial. The model should include specific stipulations as to what type of information to provide and make generally accessible[4]. Outlining desirable in-depth gauges and qualitative reports of importance to foreign investors should prove very useful. The more material available through that first point of contact, the better—also in

consideration of the efficient use of the government human resources. Furthermore, standardized information put on the web site is by its very nature non-discriminatory—that by itself strengthens the perception of transparency. It may be recommended that a register of the approvals of the FDI projects as well as the outcomes of the tenders of bids be established, kept up to date and available via the Internet. It is crucial that the contents of the web sites and additional brochures and documents be available in foreign languages and edited in a possibly simple way.

6. Regarding the governments of less affluent countries who might lack resources to implement the above measures, the international organizations could pitch in providing technology and manpower assistance for setting up web sites, translation of the contents into foreign languages, developing links to other relevant sites and providing managerial training.

7. Host countries should clarify what represents reasonable time frames for responding to inquiries and pledge adherence to such timetables.

8. A forum for regular international meetings of the government officials responsible for enhancing transparency should be established in order to share the experience and facilitate learning.

9. Officials of the individual governments should be encouraged to communicate regularly with the international business press regarding current policy with respect to FDI and future initiatives.

While the above catalogue is far from exhaustive, it can hopefully assist in the first step of alleviating the problem.

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[1] For example, as paving the way for subsequent investments or enhancing the image of the location by being associated with the investment by a prestigious company.

[2] In some ratings (PWC) transparency is a composite index lumping the clarity of the rules with corruption, effectiveness of the legal system, nature of the economic policy and the government structure. In other (WEF) it is as well a function of the independence of the legal system, degree of protection of private property, lack of discrimination towards business and even the impact of the organized crime.

[3] Specialized business organizations are actually doing it, business press publishes reports—(in the office--also some scanty activity has been undertaken by World Association of Investment Promotion Agencies (WAIPA).

[4] Based upon author's own survey of the contents of the national foreign investment agencies web sites it appears that they seldom go beyond quoting general economic indicators to provide reasons for FDI.