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OECD
ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The Policy Framework for Investment

Introduction

Private investment is essential for ensuring economic growth, sustainable development and poverty reduction. It increases the productive capacity of an economy, drives job creation, brings innovation and new technologies, and boosts income growth. But the amount of private investment, particularly in African and developing economies, falls short of development needs. And the benefits of investment in emerging and transition economies are unevenly shared among sectors and regions.

In OECD countries, investment protectionism in response to recent security and public interest concerns is not the solution; the economic outlook in developed countries depends on international investment dynamism.

The Policy Framework for Investment (PFI) was developed to help governments overcome this “private investment deficit”. Founded on the 2002 United Nations Monterrey Consensus on Financing for Development which ascribes to governments the responsibility for creating the right conditions for private investment to flourish, the PFI aims to support development and the fight against poverty and to promote responsible participation of all governments in the global economy.

The PFI represents the most comprehensive multilaterally-backed approach to date for improving investment conditions. It addresses some 82 questions to governments in 10 policy areas to help them design and implement good policy practices for attracting and maximising the benefits of investment. The PFI is based on the common values of rule of law, transparency, non-discrimination, protection of property rights in tandem with other human rights, public and corporate sector integrity, and international co-operation.

The PFI was endorsed by OECD ministers in 2006, when they called on the OECD to continue to work with non-member governments and other inter-governmental organisations to promote its active use. This Policy Brief looks at the PFI and how it can help build prosperity in the global economy. ■

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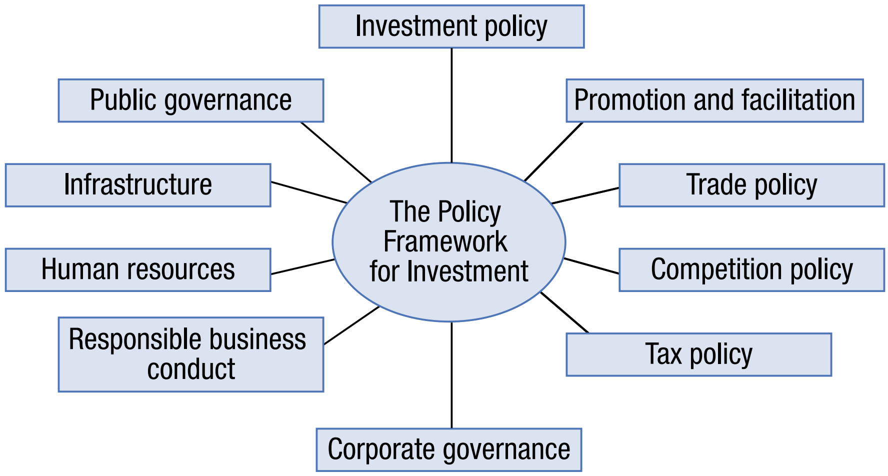
What is the PFI?

The PFI is not a set of rules or obligations imposed on governments, but a tool to help them identify the important issues that any government should consider if it wants to create an environment attractive to all investors and to enhance the development benefits of investment to society. It covers 10 policy areas (see Box) which are widely recognised, including in the Monterrey Consensus, as underpinning a healthy environment for all investors, from domestic small and medium-sized enterprises to multinational enterprises. These policy areas are: investment policy; investment promotion and facilitation; trade; competition; tax; corporate governance; policies for promoting responsible business conduct; human resource development; infrastructure and financial sector development; and public governance. While the main focus is on domestic policy issues, the PFI also addresses ways in which international co-operation can play a positive role in each of these policy areas.



The PFI gives a list of questions under each theme to help governments determine whether their policies are likely to encourage investment. The questions are supported by annotations and complemented by references to OECD and other selected policy resources, such as the World Bank's Investment Climate Surveys Database.

While the questions vary from theme to theme, three principles apply throughout the PFI: policy coherence, transparency and accountability, and regular evaluation of policies.

Policy coherence: A broad range of different policy areas contribute to the quality of the investment environment and the PFI encourages coherence between policies affecting investment by taking a cross-cutting, horizontal approach. For example, a good investment policy can be supported and complemented by promoting and facilitating investment, developing key infrastructure and ensuring that the tax system functions well. Depending upon a country's particular circumstances and level of development, relationships among the different chapters of the PFI will have greater or lesser relevance. Indeed, by highlighting the range of different policy areas that together influence the quality of the investment environment, the PFI can be used as a first-step diagnostic instrument for identifying potential "weak links" in a country's policy framework where reforms might be called for.

Transparency and accountability: Policy transparency – making sure that policies are clearly and publicly explained – reduces uncertainty and risk for investors, as well as the transaction costs associated with making an investment. It also facilitates public-private dialogue. Accountability reassures investors that government agencies are exercising their powers responsibly. Each chapter of the PFI deals with a specific public policy domain and takes up the question of how transparency and accountability foster an environment where investment can flourish.

Regular evaluation of the impact of existing and proposed policies on the investment environment is the third principle that underpins the PFI. The questions under the 10 themes have been developed to be flexible so that governments at different levels of development can use them. In this way, the PFI recognises the dynamic nature of development and the need for an approach that can be adapted in accordance with changing needs and conditions. The PFI attaches particular emphasis to the adaptability of the institutional framework and the role of periodic evaluations so as to identify new challenges early on and to be able to respond quickly to them. ■

Who developed it?

The PFI was developed by a Task Force established by the OECD and consisting of government officials from about 60 OECD and non-OECD economies, with participation of the World Bank and other international organisations. Business, labour and non-governmental organisations participated in the work of the Task Force. The Task Force was open to any government interested in participating in the work. In order to ensure the fullest possible representation, in addition to meetings held at the OECD in Paris, regional consultations took place in Africa, South America, South East Asia, South Asia, and South East Europe. A one-month web-based public consultation to solicit views on the PFI from a broader public constituency was held in January 2006. In support of these extensive consultations over a two-year period, 10 different specialised OECD bodies were involved in providing support and in developing and reviewing material for the PFI. The Task Force completed the PFI in April 2006, and the OECD Council, the Organisation's governing board, endorsed it on 11 May 2006. ■

Who is it for?

The PFI is intended to be used by any government interested in pursuing policy reforms aimed at improving the investment environment. The PFI thus complements recent OECD initiatives directed to the business side of the equation, such as the *OECD Guidelines for Multinational Enterprises*.

The PFI can also be used in dialogues between governments, the business community, and other civil society partners as well as aid donors. ■

How is it used?

The PFI was designed as a flexible instrument that governments can adapt to their specific circumstances, objectives and needs while at the same time providing a common platform for dialogue and peer learning. The flexibility is evident in the variety of ways governments are already using the PFI, such as regional investment initiatives, investment policy peer reviews, and by international organisations working with developing countries.

Regional investment initiatives

Regional initiatives have provided several opportunities for putting the PFI quickly into action:

The Africa Investment Initiative, a joint endeavour of the New Partnership for Africa's Development (NEPAD) and the OECD, uses the PFI as an organising

Box.

THE TEN CHAPTERS OF THE PFI

The PFI covers 10 policy areas identified in the Monterrey Consensus as influencing the quality of the investment environment. These are:

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

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

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

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

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

Corporate governance: The degree to which corporations observe basic principles of sound corporate governance is a determinant of investment decisions, influencing the confidence of investors, the cost of capital, the overall functioning of financial markets and ultimately the development of more sustainable sources of financing. The questions in this chapter of the PFI provide a brief introduction to some of the key corporate governance issues that policy-makers and others should address to principle for self-evaluations and peer dialogues. This helps African countries to learn from other countries' experiences where progress has been made in reforming the investment environment and also serves as a basis for inspiring reform efforts in other African countries, thereby contributing to regional development goals.

The joint ministerial statement issued by the Asia-Pacific Economic Co-operation (APEC) forum annual summit in Korea in 2005 noted the many areas identified in the PFI where APEC and the OECD could strengthen co-operation on investment for development.

The Investment Compact for South East Europe (SEE) has followed policy approaches similar to the PFI during the past five years and the Regional Framework for Investment adopted by SEE Ministers in June 2006 draws on the PFI as well as on accumulated experience under the Investment Compact.

Other plans for putting the PFI into action in Asia, Latin America, and the Middle East-North Africa region (MENA) are also under consideration.

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promote a sounder environment for investment. For a more complete assessment, policy-makers should turn to the OECD Principles of Corporate Governance and the assessment methodology developed by the OECD Steering Group on Corporate Governance, and if possible ask the World Bank for an assessment under the programme of the Reports on Observance of Standards and Codes (ROSC) for Corporate Governance.

Policies for promoting responsible business conduct: Public policies promoting recognised concepts and principles for responsible business conduct, such as those recommended in the *OECD Guidelines for Multinational Enterprises*, help attract investments that contribute to sustainable development. Such policies include: providing an enabling environment which clearly defines respective roles of government and business; promoting dialogue on norms for business conduct; supporting private initiatives for responsible business conduct; and participating in international co-operation in support of responsible business conduct.

Human resource development: Human resource development is a prerequisite needed to identify and to seize investment opportunities, yet many countries under-invest in human resource development due in part to a range of market failures. Policies that develop and maintain a skilled, adaptable and healthy population, and ensure the full and productive deployment of human resources, thus support a favourable investment environment.

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

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

Investment policy peer reviews

In addition to using the PFI as an organising principle for dialogue with other countries, the OECD will use the Framework as a template for a thorough and coherent review of investment policies of particular countries, for example non-OECD countries that apply to adhere to the OECD Declaration on International Investment and Multinational Enterprises.

Co-operation with other international organisations

Many inter-governmental organisations, including the World Bank and the United Nations, are involved in efforts by governments to improve their investment climates. That is why these two organisations participated in the development of the PFI. For example, the World Bank contributed background material on infrastructure and financial sector development as well as human resources development and officially co-sponsored the 2005 OECD Global Forum on International Investment, which was entirely devoted to the PFI. The United Nations Conference on Trade and Development (UNCTAD) has proffered options for using the PFI within the context of their investment-related activities, including as the basis for investment policy reviews. The OECD will continue to work with other inter-governmental organisations to maximise the positive results of putting the PFI into action in developing countries.

Donor engagement

The PFI is part of the OECD's Initiative on Investment for Development, which has also developed Policy Guidance for Donors on using official development assistance to promote private investment for development.

OECD work on the role of official development assistance to mobilise investment for development has highlighted the need for bilateral donors to review their approaches. In particular, the donors need to be more strategic, better co-ordinated and guided more systematically by the lessons learnt from what works and does not work to address national and sectoral level constraints that are holding back investment. The Organisation is also developing policy guidance for participation by international investors in infrastructure projects. This work builds upon the PFI, and complements OECD work on aid-supported infrastructure and poverty reduction.

The NEPAD-OECD Africa Investment Initiative has been recognised as a particularly important opportunity to strengthen donor practices and engagement.

Global Forum on International Investment

The OECD Global Forum on International Investment will play an important role in promoting the use of the PFI, reviewing experience and assessing its policy impact. It will enable countries that have used the PFI, either individually or in the context of the various regional initiatives outlined above, to share their experiences. This body of policy experience will guide future uses of the PFI as well as inform reviews of the Framework and the development of any methodologies aimed at helping governments maximise the development benefits from the PFI.

The PFI is seen as an evolving tool for governments and will be reviewed by the OECD, non-OECD partners and stakeholders in light of changes in circumstances and experience gained in using it. ■

For more information

For further information on the PFI, contact *pierre.poret@oecd.org* +33 1 45 24 88 56. For more general inquiries about the OECD's work on investment, contact *investment@oecd.org*.

The OECD Policy Briefs are available on the OECD's Internet site:
www.oecd.org/publications/Policybriefs

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For further reading

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- OECD (2006, forthcoming). **Investment for Development: Annual Report**.
- MENA-OECD Investment Programme: *www.oecd.org/mena/investment*.
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- OECD (2006). **OECD Investment Policy Reviews China: Open Policies towards Mergers and Acquisitions**.
- OECD (2006). **OECD Investment Policy Reviews Russian Federation: Enhancing Policy Transparency**.
- OECD (2005). **2005 Annual Report on the Guidelines for Multinational Enterprises: Corporate Responsibility in the Developing World** *www.oecd.org/daf/investment/guidelines*.
- DAC Policy Guidance for Donors on Using ODA to Promote Private Investment for Development, *www.oecd.org/dac/investment*.

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