Investment for Development

INVESTMENT POLICY CO-OPERATION WITH NON-OECD ECONOMIES

Annual Report 2005

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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FOREWORD

Investment for Development is a new annual OECD publication. Its launch is an expression of the Organisation's commitment to follow up on the strategy to support development through investment that was outlined in the 2002 United Nations Monterrey Consensus. This approach attaches central importance to promoting private investment, both foreign and domestic, and creating the policy environments needed to unleash the full benefits from investment, in terms of economic growth, poverty reduction and sustainable development. Advancing this agenda is a priority of the OECD Investment Committee.

To this end, the Investment Committee has developed an extensive co-operation programme with non-member economies. The framework guiding this co-operation is the *OECD Initiative on Investment for Development,* launched in Johannesburg in 2003. The methodology adopted is based on the OECD's long-standing and unique peer learning method and guided by the generally accepted OECD standards and tools. The Investment Committee and its non-member government partners in the *Initiative* do not pursue this mandate alone but have also developed partnerships with the Development Assistance Committee and other OECD committees, business and civil society stakeholders and international organisations with expertise in the field, such as the World Bank.

Expectations regarding the benefits of this broad approach to investment policy are high and include: increased investment policy transparency and openness; responsible international business practices; more effective and thus better outcomes from international investment agreements; more effective support by OECD donors for developing countries' investment policy capacity building; and improved FDI statistics for policy making.

The purpose of this new publication is to record these activities and to make their results available to a broader public. The first volume provides an overview of the progress to date with the *Initiative on Investment for Development.* It is organised around three pillars of co-operation:

- *Global events.* The annual Global Forum on International Investment provides a multilateral platform for collaborative work on investment with the broad non-member constituency.
- *Regional initiatives.* Recent examples include the MENA Initiative for Governance and Investment for Development and the NEPAD-OECD Africa Investment Initiative. These projects are based on the successful model developed by the OECD Investment Compact for South East Europe to ensure local ownership of a reform agenda, effective implementation of policy action priorities and continued monitoring of progress.
- *Sustained dialogue with individual countries.* Peer reviews of China and Russia have been completed and a dialogue with India has been initiated. In addition, Brazil and eight other non-members have adhered to the OECD Declaration on International Investment and Multinational Enterprises and directly participate in the work of the OECD Investment Committee.

This volume also includes a joint report by the Development Assistance and Investment Committees presented to the 2005 OECD Ministerial Meeting and a study of African experience on improving aid effectiveness in support of investment for development.

Manfred Schekulin
Chair, OECD Investment Committee

Note by the Editor

Investment for Development is a new annual publication. It contains material prepared over the past year under the aegis of the OECD Investment Committee working in partnership with non members, the Development Assistance Committee, other OECD Committees and other international organisations.

Queries concerning the contents of this publication should be addressed to the Investment Division of the OECD Directorate for Financial and Enterprise Affairs (Jonathan Coppel, Editor, Tel: 33-1 45 24 88 17; email: jonathan.coppel@oecd.org; Pamela Duffin, Communications Officer, email: pamela.duffin@oecd.org).

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Chapter 1.

OECD Initiative on Investment for Development:

OVERVIEW OF PROGRESS

The OECD Initiative on Investment for Development supports developing countries' sustained efforts to attract and generate more and better investment. Proposed at the OECD Ministerial in May 2003, the Initiative was launched by the OECD Investment Committee in Johannesburg in November 2003 at the Global Forum on International Investment.

This progress report documents work on the Policy Framework for Investment. The Framework is non-prescriptive. It provides a checklist of policy issues to support an attractive environment for both domestic and foreign investment. The report also notes progress under the Initiative in building policy capacity through peer learning and in joint work with the OECD Development Assistance Committee on using ODA more effectively to mobilise investment for development.

This chapter is an update of the Progress Report prepared by the OECD Investment Committee for the 3-4 May 2005 OECD Council at Ministerial Level.

Investment for development: The OECD's contribution to a global effort

The Monterrey Consensus called for mobilising private investment…

In 2000, the United Nations Millennium Declaration committed the international community to sparing "no effort to free our fellow men, women and children from the abject and dehumanising conditions of extreme poverty, to which more than a billion of them are currently subjected." In support of this objective, the 2002 United Nations Monterrey Consensus ascribed critical importance to mobilising private investment, both domestic and foreign, for achieving important development objectives, including the Millennium Development Goals (MDGs).

…but domestic and international capital flows still fall short of development needs.

With ten years to go until the 2015 target for achieving the MDGs, it has become clear during the course of OECD and other work with non-members that many goals will not be achieved unless investment in developing countries increases rapidly and dramatically. Africa, with most of the world's least developed countries (LDCs), remains marginalised. Investment flows to India have started increasing only in recent years. Even China which has become the world's largest recipient of foreign direct investment receives modest proportions relative to its size from OECD countries. Among transition economies, the Russian Federation has made progress in opening its economy further to foreign investment, but it continues to attract small international investment flows.

Strengthening capacity for attracting investment requires sustained efforts…

Strengthening capacity across a wide range of areas that contribute to an attractive environment for investment takes time, and often the rewards of these reforms only materialize years after they have taken place. It is in part for these reasons that developing and developed countries have recognised the need for more co-operation on investment issues, as called for by the Monterrey Consensus.

…which the OECD Initiative on Investment for Development aims to support.

The *OECD Initiative on Investment for Development* supports developing countries' sustained efforts to attract and generate more and

better investment. Proposed at the OECD Ministerial in May 2003, the *Initiative* was launched by the OECD Investment Committee in Johannesburg in November 2003 at the Global Forum on International Investment. It received further strong support at the 2004 Global Forum hosted by India. The *Initiative* includes three closely inter-related projects: i) the development of a *Policy Framework for Investment*; ii) building policy capacity based on OECD peer learning methods; and iii) using ODA more effectively to support partner countries' efforts to mobilise private investment.

OECD Ministers reaffirmed their commitment to the Initiative.

In the 2005 OECD Ministerial Statement, Ministers reiterated their support to the *Initiative* and commitment to helping countries build sound investment environments using a wide range of policies including trade, competition, tax, public and corporate governance. We are supporting efforts to use ODA better to help developing countries improve their enabling environment and promoting the observance of the OECD Guidelines for Multinational Enterprises, thereby enhancing the positive contribution of responsible international business to development."

Members worked closely with non-member partners to advance the Policy Framework for Investment

A non-prescriptive tool for improving the investment environment…

Members and non-member partners have agreed to work on the development of a *Policy Framework for Investment* as a checklist of policy issues in support of government efforts to create an environment that is attractive to domestic and foreign investors and that enhances the benefits of investment to society. The *Framework* recognises that the needs of countries at different levels of development call for a flexible and non-prescriptive approach. The *Framework* could also serve as a reference point for other international organisations, investment promotion agencies, donors as they assist developing country partners in improving the investment climate, and businesses, trade unions, and non-governmental organisations in their dialogue with governments.

… is being developed through a partnership process.

A Task Force, open to any interested OECD member and non-member governments, has been established to oversee the development of the *Framework*. In addition to Chile, Argentina, Brazil and the other six non-member adherents to the OECD Declaration on International Investment,

China, India, Russia, South Africa and other influential non-member players have participated in Task Force meetings and regional consultations (Annex 1). A dedicated Webpage and electronic discussion group have been established for the dissemination of documents as they develop as well as contributions from members of the Task Force in order to ensure the fullest participation of all interested governments.

A comprehensive policy coherence approach…

The Task Force has identified nine ten policy "building blocks" which will make up the *Framework*: investment policy; investment promotion and facilitation; trade policy; competition policy; tax policy; corporate governance; and corporate responsibility (and market integrity more generally); human resource development policy; infrastructure development policy; and public governance. In addition to host-country policy action, the contribution of international co-operation, including through regional integration, and home-country policy action, including effective implementation of OECD instruments such as the Anti-Bribery Convention and the Guidelines for Multinational Enterprises, is also being addressed.

…which benefits from support by a wide range of policy communities.

The Task Force is benefiting from expertise of the Trade, Competition, Fiscal Affairs and Public Governance Committees, the Steering Group on Corporate Governance and other relevant OECD bodies. The OECD Development Assistance Committee (DAC) is contributing to strengthening the development dimension of the *Framework*. By By April July 2005, the trade and, competition and tax chapters were became nearing near completion, including trade policy issues addressed to home country governments and roles for competition authorities in investment regulatory impact analysis (Annex 2).

Work is entering a decisive phase.

Through the process of extensive consultations outlined above, draft checklists for nine policy areas will be developed in time for the Global Forum on International Investment to take place in October 2005 in Brazil, with a view to finalising the *Framework* by the next OECD Ministerial. Once this first phase is complete, in partnership with the World Bank and other organisations, work will begin on promoting use of the *Framework* whether for the purpose of country self-evaluation, through regional peer reviews or in multilateral forum dialogues. The *Framework* is intended as a living tool which will be reviewed in light of developments and users' needs.

Shared policy values were put into practice through peer dialogue and capacity building

The Initiative fostered investment policy co-operation programmes with non-members.

The *Initiative* also marked OECD's intention to more actively share with non-members its long experience with peer learning and consensual approaches towards the development of "best practice" and building implementation capacity. Investment policy co-operation programmes have intensified, using the horizontal approach to creating a sound investment environment encouraged by the *Policy Framework for Investment*.

Peer dialogue with main players deepened…

Over the last two years, OECD policy reviews were collaboratively undertaken with China and Russia, and the resulting recommendations made public. Closer investment policy co-operation with India and South Africa has been underway.

…and regional investment initiatives were launched.

The MENA (Middle East & North Africa)-OECD Initiative on Governance and Investment for Development was launched in 2004, using the model followed by the OECD Investment Compact for South East Europe to ensure local ownership of the reform agenda, follow-through on policy priorities, and monitoring of progress. The recent OECD-NEPAD-OECD Africa Investment Initiative announced in Johannesburg November 2003 launched work on the emerging integrity framework to improve investment policy transparency, openness and effectiveness, including integrity-enhancing measures and good practices towards FDI incentives for African development. OECD Ministers at the 2005 Meeting supported to strengthen this Initiative for Africa which was noted by the G8 at its 2005 Gleneagles meeting as a positiven OECD's positive contribution to G8 and African countries efforts in this area. The OECD-Asia Investment Initiative launched in Shanghai in 2002 held its first OECD-Asia multi-stakeholder conference in Jakarta in July 2005 on Investment for Asian Development.

Enhancing the role of ODA in mobilising investment for development

Donor and investment communities worked together to promote better use of ODA to leverage investment.

The *OECD Initiative on Investment for Development* brought together the OECD donor and investment policy communities to draw lessons on how ODA can be better used to create a sound investment environment in developing countries. This dialogue has been developed through discussions, including at the Global Forum for International Investment in India, October 2004, the NEPAD-OECD Investment Policy Roundtable in Uganda, May 2005, and the OECD Conference on Investment for Asian Development in Indonesia, July 2005, and is expected to be further advanced through consultations with non-members and other stakeholders.

Joint action in future

Investment for Development: an overarching strategy for furthering OECD co-operation with the developing world.

The *Initiative* reflects the high importance attached by OECD members to working with non-members to promote investment for development. It will serve as an overarching strategy that provides organisation and policy guidance in the context of outreach and capacity building efforts of the OECD. It will continue to expand on several fronts: promoting the *Policy Framework for Investment* in partnership with other international organisations, peer dialogue with leading developing countries and emerging regional partners, and developing good practice for donors on mobilising investment for development.

Annex 1

Task Force meetings, regional consultations and Global Forum discussions on the Policy Framework for Investment

November 2003-December 2005

November 2003: Global Forum on International Investment, Johannesburg, South Africa (launch of the Initiative on Investment for Development)

17 June 2004: First plenary meeting of the Task Force, OECD Headquarters, Paris.

23 September 2004: Exploratory discussion of draft background trade policy chapter in the Working Party of the Trade Committee, OECD Headquarters, Paris.

19-21 October 2004: Consultation of the Task Force, Global Forum on International Investment, New Delhi, India (focus on trade and competition chapters)

8-9 November 2004: Second discussion of draft background trade policy chapter in the Working Party of the Trade Committee in light of the New Delhi Global Forum consultation, OECD Headquarters, Paris.

15-16 February 2005: Discussion of the draft background competition policy chapter in the Competition Committee with non-member participants and in light of the New Delhi Global Forum consultation, OECD Headquarters, Paris.

18 February 2005: Exploratory discussion of a draft trade policy checklist in the Working Party of the Trade Committee, OECD Headquarters, Paris.

22-23 March 2005: Exploratory discussion of a draft background corporate governance-focussed chapter in the Steering Group on Corporate Governance, OECD Headquarters, Paris.

5 April 2005: Final discussion of the draft trade policy checklist in the Working Party of the Trade Committee, OECD Headquarters, Paris.

8 April 2005: Second plenary meeting of the Task Force, OECD Headquarters, Paris (discussion of draft trade and competition checklists and exploratory discussion of draft background tax chapter and checklist).

31 May 2005: Exploratory discussion of the draft background tax policy chapter in Working Party 2 of the Committee for Fiscal Affairs, OECD Headquarters, Paris.

25-26 May 2005: Regional Consultation on the Policy Framework for Investment, Uganda (with NEPAD).

13 June 2005: Third plenary meeting of the Task Force, OECD Headquarters, Paris (exploratory discussion of the draft background investment policy, investment promotion and facilitation, and public governance chapters).

5-6 July 2005: Regional Consultation on the Policy Framework for Investment, Indonesia.

20 September 2005: Discussion of the revised background documents on investment policy, investment promotion and facilitation in the Investment Committee, OECD Headquarters, Paris.

29-30 September 2005: Discussion of the revised draft background public governance chapter in the Public Governance Committee, OECD Headquarters, Paris.

October 2005: Global Forum on International Investment, Rio de Janeiro, Brazil (focus on bringing together all the chapters of the Policy Framework for Investment and discussing how to start using it for capacity building).

14-15 November 2005: APEC-OECD Seminar on "Working Together on Investment for Development", Korea.

13 December 2005: Plenary meeting of the Task Force, OECD Headquarters, Paris.

Annex 2

Policy Framework for Investment Documentation as of September 2005

(www.oecd.org/investment)

Document	Date
OECD Initiative on Investment for Development: Towards a Policy Framework for Investment	Sept 2004
Competition Policy: Background	Mar 2005
Trade Policy: Background	Mar 2005
OECD Initiative on Investment for Development: Progress Report	Mar 2005
Competition Policy for Investment: A Draft Checklist	May 2005
Trade Policy for Investment: A Draft Checklist	May 2005
Tax Policy: Background	Mar 2005
Corporate Governance: Background	Sept. 2005
Tax Policy for Investment: A Draft Checklist	June 2005
Investment Promotion and Facilitation: Background	May 2005
Investment Policy: Background	May 2005
Public Governance: Background	June 2005
Infrastructure Development Policy: Background	Sept 2005
Human Resource Development Policy: Background	Sept 2005

Chapter 2.

Global Forums on International Investment

FROM MEXICO AND SHANGHAI
TO JOHANNESBURG AND NEW DELHI[*]

The UN 2002 Monterrey Consensus, and since then, the OECD Ministerial, the New Partnership for Africa's Development (NEPAD) and the Johannesburg World Summit have all underscored the need to make international investment a priority area so that poor countries are not further left behind. A key challenge, therefore, is how to frame investment policies in a way that supports and reinforces economic development. The annual OECD Global Forum on International Investment (GFII) is one of the main OECD Investment Committee's programmes aimed at addressing this challenge.

[*] This article was prepared by Jonathan Coppel, OECD Investment Division.

The OECD Global Forums seek to deepen and extend relations with a large number of non-OECD members and other stake holders by sharing OECD expertise in investment policy, particularly in those domains that require multilateral co-operation and solutions.[1] Their openness incites the international investment community to come together to exchange views and ideas on emerging issues in a receptive and inclusive context. This peer learning and consensual approach to gaining a deep understanding of best practices across a wide range of policy domains is indeed the well-tested *modus operandi* of the OECD and is a unique strength of the Organisation. It is especially apt for investment policy, since many policy domains bear directly or indirectly on the investment climate. The OECD Investment Committee through the Global Forums on International Investment is thus taking an active role in helping to achieve the Millennium Development Goals (MDG) by sharing its expertise in establishing and organising platforms so that all stakeholders and players can work towards maximising the potential benefits of investment from a development perspective.

Mexico, 2001

The inaugural Forum took place in Mexico City in November 2001 in the context of a global economic slowdown and falling foreign direct investment. However, the meeting was distinctly forward-looking, as reflected in the title of the conference: *New Horizons and Policy Challenges for Foreign Direct Investment*. Three main messages emerged from the Mexico Forum. First, foreign direct investment is needed more than ever to achieve sustained development and poverty reduction, especially in those parts of Africa and Asia where FDI inflows have been virtually absent. Second, attracting higher levels of FDI needs to move beyond the traditional policy of liberalising FDI. A more holistic approach is needed. One that embraces a broader set of policies and institutions, which serve to establish a favourable context for investment. Competition, trade, tax, governance and human resource development are some of the policy domains relevant for building an enabling environment for investment. The third message is to fully recognise and elevate the importance that needs to be given to building the capacity to formulate and implement coherent and effective policies in these domains. This is largely a shared responsibility of governments in both developing and developed countries, of businesses and of international organisations. Further, the Forum background papers and discussion provided input to the UN International Conference on Financing for Development which took place in Mexico in March 2002 and fed into the investment work in other multilateral organisations.

Shanghai, 2002

In 2002 China, one of the fastest growing and highest profile destinations for foreign investment inflows hosted the GFII. China is easily the largest non-OECD recipient of inward FDI, but if these inflows are expressed as a share of GDP, or to population, their relative scale is small given China's huge potential. More generally, the distribution of inward FDI inflows among non-OECD developing countries is very unequal. This means that the benefits from international investment, in terms of increased production capacity and enhanced productivity through intensified competition, technology transfer, human resource development and better management systems can be concentrated in a small number of countries and in the hands of a few. Nor do the benefits accrue automatically. It was therefore opportune that the December 2002 GFII held in Shanghai focussed on how to tap a developing economies full potential to attract FDI for development.

Participants to the China GFII concluded that the three principal players in international investment: the host and home countries and businesses all have a role to take in order to realise the full benefits from FDI. The national investment climate in the host country plays a big part in business decisions on where to locate international investment spending. In this respect, the Forum identified transparency and the rule of law, notably regarding efforts to stamp out corruption, protect intellectual property and enforce competition policies as pre-requisites for the attraction of foreign corporations. Transparency, together with a stable macroeconomic environment, an effective and non-discriminatory regulatory framework for investment and quality infrastructure and education systems are also important to ensure the benefits from international investment in terms of economic and social development. The Forum examined how the experiences and priorities among these policies and best practices differ across regions and countries. Concerning the role of the 'home country', the Forum examined the linkages between development aid and trade policies and FDI, and how non-OECD countries can better integrate into rules-based international frameworks for investment. Finally, multinational enterprises (MNE) can contribute to local development through technology diffusion, other knowledge transfers and ethical business practices. A full session of the Forum was devoted to how best this can be done and the tools available to assist MNEs in this endeavour. Stakeholders, however, cannot act in isolation. Above all, stronger partnerships between governments, businesses, multilateral organisations and civil society are needed in order to translate good intentions into tangible actions and results. The Global Forum also launched the OECD-Asia Investment Initiative (see Chapter 3).

Johannesburg, 2003

The political, institutional and legal environment – the governance infrastructure of a country – is perhaps the single most important factor in attracting international investment. The role played and how to improve the governance infrastructure were the themes expanded upon in the November 2003 GFII, hosted by the South African Government in Johannesburg. The Forum was divided into three sessions. The first explored the case for good public governance for inciting investment and maximising its benefits to host country societies. Country case studies, OECD and other research underpinned the debate. The second session focussed on transparency and rule making as a key driver of economic performance and investors' decisions. The discussion centred on what achieving transparency means from an investment policy perspective and what can be learnt from different experiences around the world. The final session explored avenues for building capacity for policy transparency through the joint efforts of host countries, OECD countries and the international business community. It reviewed and made use of an implementation tool developed by the Investment Committee in 2003, the "Framework for Investment Policy Transparency". The Johannesburg Forum also endorsed the OECD's Initiative on Investment for Development, which identifies the specific policy approaches relevant to the investment climate, offers benchmarks in these fields so that national governments can assess their own performance and sets out a path for engaging non-member partners and other players to develop and promote the strategy. The latter includes the use of peer reviews of investment policies as an instrument for building analytical capacity and encouraging reforms where needed. The Global Forum also launched the NEPAD-OECD Africa Investment Initiative, which is discussed in further detail in the following chapter.

New Delhi, 2004

Making the OECD's Initiative on Investment for Development operational was one of the themes of the 2004 GFII hosted by the Government of India in New Delhi. Other themes, also related to the Initiative on Investment for Development, covered the appropriate roles of government and business for corporate responsibility and reaping the most from foreign aid through investment development synergies. In short, the unifying thread of the Forum was investment for development through the forging of partnerships.

The New Delhi GFII resulted in a number of positive outcomes. It marked a major step forward in the development of the OECD's Policy

Framework for Investment (PFI), an instrument designed to improve the investment climate and inspired by the values that underpin the Monterrey Consensus.[2] Specifically, the Forum discussed the broader context of international avenues to promote investment and private sector development and focussed on two of the policy areas identified by the Task Force developing the PFI: trade policy and competition policy. The deliberations at the Forum thus provided input and helped to refine earlier versions of these two important building blocks of the PFI. Discussions on the linkages between official development assistance (ODA) and investment identified a number of areas for pursuing synergies, such as using ODA to: enhance a country's investment climate; to give a fillip to public-private partnerships; and to correct market failures that interfere with commercial risk management. Concerning corporate responsibility, there was strong support for the OECD Guidelines for Multinational Enterprises and agreement that the subject should continue to figure prominently in future GFII agendas.

Rio de Janeiro, 2005

Following strong support at the 2004 GFII, the PFI will be the focus of the 2005 Forum, hosted by the Brazilian Government in Rio de Janeiro in late October. The theme of the Forum will be ways of putting the PFI into action. The main issues discussed were the other building blocks of the PFI, how to strengthen developing country perspectives in the PFI and how to assist countries to implement policies favouring a sound investment environment. Particular attention will be given to the factors that make for successful private-public partnerships.

In summary, investment, both domestic and cross-border, is recognised as a powerful driver of growth and of the integration of nations at different levels of development into the world economy. It is, therefore, in the interests of everyone to nurture an investment climate that brings forth a higher level of investment and unleashes its full potential to advance development. The Global Forums on International Investment from Mexico to Brazil represent one of the effective vehicles for drawing on OECD and other expertise and within a wider development agenda to ultimately fulfil the MDG.

Notes

1. Full details on the Global Forums can be downloaded from the OECD website at: www.oecd.org/daf/investment/development.

2. The PFI is a non-prescriptive checklist of issues for consideration by governments engaged in domestic reform, regional co-operation or international policy dialogue aimed at creating an environment that is attractive to domestic and foreign investors and that enhances the benefits of investment to society. It embodies a flexible approach, since the needs of countries at different levels of development vary, complements other international initiatives, such as the OECD Guidelines for Multinational Enterprises and offers constructive policy guidance across a range of areas in order to maximise the contribution of investment to development. See Chapter 1 for further details.

Chapter 3.

Regional Investment Initiatives: Going for Results

3.1. THE MENA-OECD INVESTMENT PROGRAMME: TOWARDS EMPLOYMENT AND GROWTH THROUGH INVESTMENT

3.2. NEPAD-OECD AFRICA INVESTMENT INITIATIVE

3.3 INVESTMENT COMPACT FOR SOUTH EAST EUROPE

3.4. EMERGING ASIA

The OECD has established in partnership with other players in the domain of investment a series of regional initiatives that seek to promote and support policy reforms aimed at improving the investment climate and maximising the benefits of private investment for development. The programmes also play an important role in providing capacity-building capabilities for policy makers in these regions.

To date four main initiatives have been launched: the NEPAD-OECD Africa Investment Initiative, the MENA-OECD Investment Programme of the MENA Initiative on Governance and Investment for Development, the Investment Compact for South East Europe and an OECD programme with Asia.

This chapter summarises how these programmes operate, the results achieved so far and future directions.

3.1. The MENA-OECD Investment Programme: Towards Employment and Growth through Investment*

The MENA-OECD Investment Programme seeks to mobilise investment as a driving force for growth, stability and prosperity throughout the Middle East and North Africa region. The biggest challenge for MENA countries lies in strengthening the process of change, maintaining, supporting and tracking the progress of policy implementation as well as providing capacity-building assistance. The Investment Programme thus aims to help upgrade investment policy standards, attract more and better investment and support capacities for policy makers in the MENA region. This report explains how the Investment Programme is organised and reviews the progress made towards a more liberal investment climate in the MENA region.

Introduction

Launched in 2004, the *MENA Initiative on Governance and Investment for Development* was initiated by countries in the Middle East and North Africa (MENA). The OECD was invited, alongside its key partners, to provide policy advice on public governance and investment policies. OECD expertise lies in designing and helping to implement comprehensive investment reform strategies, drawing on its successes with other regional and country-specific programmes.

The *MENA Initiative* has been organised into two programmes:

- the *Public Governance Programme* is aimed at modernizing government structures and processes in MENA countries;
- the *Investment Programme i*s aimed at improving the policies and environment for investment.

The key objective of the *MENA-OECD Investment Programme* is to mobilise investment —foreign, regional and domestic— as a driving force for economic growth and employment throughout the Middle East and

* Prepared by Alexander Böhmer, OECD Investment Division. This section has been developed under the OECD Secretariat's responsibility and does not necessarily reflect the views of the OECD, its members and MENA country governments participating in the Initiative.

North Africa region. The *Investment Programme* supports reform efforts of MENA governments to enhance the investment climate by:

- strengthening country capacity for designing, implementing and monitoring investment policy reforms;
- creating a network for policy dialogue among investment policy makers from MENA and OECD countries;
- creating a favourable environment for employment creation through financial sector development and an entrepreneurship culture;
- improving intra-governmental policy co-ordination and co-operation between ministries;
- reinforcing the impact of development initiatives supported by international, regional and bilateral funds.

There are a number of players and initiatives in the MENA region, involving bilateral donors, pan-Arab regional groupings, and multilateral organisations. However, these tend to deal with only a subset of the comprehensive investment and governance agenda and do not include all MENA countries. The OECD complements and facilitates, rather than substitutes for, these activities and provides an integrated framework as well as participation of all MENA countries.

The *Investment Programme* co-operates with the EU-funded ANIMA programme, the European Investment Bank (EIB) and the United Nations Industrial Development Organisation (UNIDO) particularly on matters related to investment promotion. In addition, the OECD efforts are supported by other international institutions, such as the World Bank, UNDP, as well as regional institutions including the Arab League, Inter-Arab Investment Guarantee Cooperation, the G 8 Investment Task Force/Arab Business Council, the Union of Arab Banks and the Arab investors' Union. Co-ordination with these partners in the region will remain a continuing feature throughout the *Investment Programme*. A key feature of the Initiative is to take a targeted and concrete approach, working closely together with the business community in the region and beyond.

The regional component: Policy dialogue for reform

The *Investment Programme* offers a forum for results-oriented policy dialogue among MENA and OECD practitioners. This partnership serves to share know-how on best practices and lessons learned in implementing investment reforms.

Building on the OECD model of peer review, policy experts work together to design innovative solutions, tailored to the specific policy environments of each MENA country.

The regional dialogue is structured around five comprehensive investment reform areas which have been identified by MENA countries. Each reform area is implemented by a Regional Working Group, led by a MENA country and co-chaired by a member country of the OECD. The five groups are:

- Promote transparent and open investment policies (Jordan);
- Encourage Investment Promotion Agencies and Business Associations to act as driving forces for economic reform (Dubai, UAE);
- Provide a tax framework for investment and assessing incentives (Bahrain, Egypt);
- Promote policies for financial sector and enterprise development for economic diversification (Saudi Arabia);
- Improve corporate governance (Lebanon).

The domestic component: Towards an investment reform agenda

Another essential part of the *Investment Programme* is constituted by its national component consisting of the Country Teams, which are charged with developing the National Investment Reform Agenda for each participating country. The Reform Agendas build on existing national, bilateral and multilateral reform incentives with a view to reinforcing their effectiveness.

A Framework for Assessment will ensure a timely and results-oriented implementation of the Reform Agenda. The institutional setting of the *Investment Programme* is providing a framework for peer dialogue among MENA countries and with their peers in OECD countries.

Experience with the South East Europe Investment Compact and other regional programmes suggest a number of practical steps to be followed when developing and implementing National Investment Reform Agendas. For the *Investment Programme,* it was decided that the Investment Reform Agenda defines at least one reform target in each of the policy areas covered by the five Working Groups outlined above. These reform priorities are concrete and measurable. They can be chosen, for example, out of the thematic coverage of Working Group 1, including issues such as the successive elimination of sectoral limitations, foreign ownership ceilings, prior government approval and minimum capital requirements or new

legislation on promoting integrity in business transactions and reforms of competition regulations. Jordan, Bahrain, Egypt, Morocco, Tunisia and the United Arab Emirates have already developed proposals for an Investment Reform Agenda, other countries are still in the process of doing so.

Progress in investment liberalisation in MENA countries

The MENA countries have in recent years adopted policies aimed at attracting foreign investment as part of efforts to move away from relatively closed and dirigiste economic strategies and to reap the benefits of the increasing globalisation of production. Foreign investment is also seen as essential in helping to diversify energy-rich MENA economies away from dependence on oil exports, which renders them vulnerable to fluctuations in global energy demand. In some cases, countries are reversing their perspective after attempting in earlier decades to finance development at home by investing their trade surpluses abroad. All MENA countries now find themselves engaging in a competition for investment capital with other developing regions – and with each other – which is constantly stimulating them to improve their investment environment.

Barriers to the establishment and operation of partly or wholly foreign-owned enterprises have been steadily lowered. Restrictions on foreign ownership of enterprises have been relaxed, as have those on foreign ownership of land and real estate and on foreign purchases of shares on local stock markets. In some MENA countries, foreigners may participate in the privatisation of state-owned enterprises. Investment screening and approval procedures have been simplified. Foreign exchange regimes have been liberalised to some extent; in particular, all the MENA countries except Egypt and Syria have obtained IMF Article VIII status, indicating that they have removed restrictions on payments and transfers relating to current transactions, including repatriation of profits. The willingness of most MENA countries to commit themselves to protecting foreign investments is demonstrated by the increasing number of investment treaties they have signed in recent years and by the number of countries that have made serious efforts to increase the transparency of their foreign investment regimes.

However, MENA countries remain generally less open to foreign investment than OECD member countries and other developing regions. Certain sectors remain closed to foreign investment entirely or are subject to ceilings on foreign ownership of domestic shares. Some stock markets in the region are effectively closed to foreign participation. MENA countries vary in the degree to which foreign investors may freely repatriate capital. Despite improvements, screening procedures for proposed investment projects remain in place in a number of countries are often unduly complex

and time-consuming. Even in those MENA countries where foreigners may now acquire land and real estate for business purposes, the process is often more burdensome for foreigners than for local residents. Investment incentives in several MENA countries involve performance requirements such as export minima. Limitations on market access and national treatment related to mode 3 of GATS (the supply of a service through the commercial presence of the foreign supplier in the territory of another WTO member) appear to be extensive in the ten WTO members in MENA by comparison with other regions. Transparency of foreign investment regimes varies widely between MENA countries: one indication of this is the relative paucity of information made available to outsiders by some of the countries.

Probably partly as a result of this limited openness to foreign investment, FDI has increased in recent years, but not as rapidly as in some other developing regions. Net FDI inflows in those MENA countries for which relevant figures are available grew to US$7.4 billion in 1998, but subsequently fell to only US$2 billion in 2003, while in the latter year all other developing world regions received far more FDI, according to the World Bank. The proportion of FDI inflows (measured gross) to GDP in an overlapping sample of MENA countries has fluctuated without growing appreciably, and in the case of some countries has exhibited a downward trend. FDI inflows per capita in MENA countries in the period 1998-2000 averaged US$21 per year, far lower than the comparable figure of US$1 321 for OECD countries in 2000.[1] During this time a wide variation was displayed between MENA countries, where FDI inflows ranged from US$0.2 per year per capita in Algeria to US$155.2 in Saudi Arabia, with Yemen experiencing an outflow averaging US$12. Moreover, FDI inflows played a relatively modest role in MENA economies in 1998-2000, when the average MENA FDI to GDP ratio was only 0.9 per cent, the same as for Sub-Saharan African countries, and markedly below the 3 per cent recorded in Latin America and East Asia.

This relatively poor FDI attraction performance is the result of a number of factors, including market size, macroeconomic stability, location, labour costs, infrastructure provision or security issues. However, probably one of the most important factors is the high cost of entry resulting from the complex procedures involved in setting up a foreign-owned enterprise in MENA countries. One recent study shows that the business environment in MENA economies is now about average in international comparison, reflecting progress over the last years, but MENA has lost significant ground compared to world progress in reducing impediments to business development.[2] Restrictions on investment on nationality grounds rank highly in business surveys on investment constraints (Box.1).

Lack of transparency constitutes an additional obstacle to inward investment in MENA countries, which vary widely in the availability of up-to-date, accurate and relevant information. For example, while some countries provide detailed reports in response to a survey on investment restrictions by the IMF, others supply cursory responses – frequently just one word – devoid of usable content. Similarly, the range of national government Internet sites providing information to foreign investors extends from sophisticated sites containing relevant laws and regulations, details of establishment procedures, contact information and other useful content (usually in English or French as well as in Arabic) to sites with no relevant information.

Box 1. Investment constraints in MENA countries

In one recent survey on intra-regional investment barriers*, potential investors listed the following constraints on investment in MENA countries (in order of importance):

- Legal system enforcement
- Laws restricting business to nationals
- Prohibited foreign ownership of real estate
- Limitation on foreign ownership
- Government corruption and red tape
- Tax system and fees

* Zarrouk, J. (2003), 'A Survey of Barriers to Trade and Investment in Arab Countries', in Galal, A. and Hoekman, B., eds., Arab Economic Integration: Between Hope and Reality, Egyptian Center for Economic Studies, Brookings Institution, Washington D.C.

MENA countries as partners in international investment agreements

While macro economic policies and market size are important determinants of private sector investment decisions, the quality of business regulation and the institutions that enforce it and the risk environment are therefore equally important. The success of many emerging market economies has been decisively stimulated by an improved regulatory investment environment and targeted investment promotion measures.

However, in international scoreboards many MENA countries are still perceived as carrying a high risk. This is especially the case in those countries where investors have the perception of a high likelihood of policy reversals and policy uncertainty. In these countries, there is a particularly strong argument for establishing a regulatory environment favourable for the

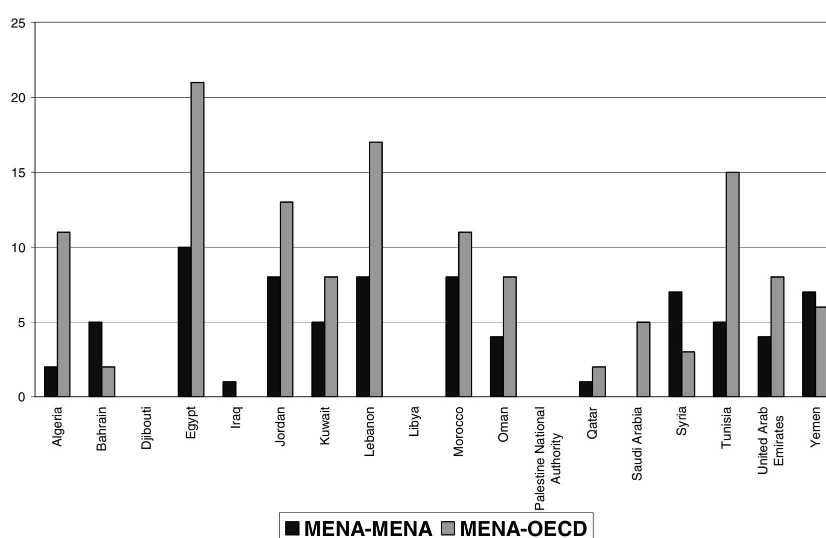
attraction of foreign investment not only through national laws and regulations, but also by entering into binding international investment agreements (IIAs).[3] This enhances international investors' perception that the regulatory structure of an investment regime is stable and predictable.

IIAs can take various forms and the MENA region is experiencing all variations, be they investment provisions in free trade agreements (FTAs) and regional integration agreements (RIAs), multilateral agreements or bilateral investment Treaties (BITs).

Bilateral investment treaties

BITs have constituted an important pillar of investment protection at the international level.

Figure 1. MENA countries have more BITs with OECD countries than among themselves



Source: OECD/UNCTAD 2004

MENA countries have been following the trend, with an increasing number of BITs concluded, underlining the elevated attitude MENA countries attach to foreign direct investment. The numbers of MENA BITs increased from the mid-1990s onwards, peaking at 45 new treaties in 2001.With few exceptions, MENA countries finalise more BITs with

OECD countries than among themselves (Figure 1). MENA countries participating in the *Investment Programme* have concluded around 130 bilateral investment treaties with OECD countries. Figure 1 also shows that Gulf Corporation Council (GCC) countries rely to a lesser extent on BITs with OECD or other MENA countries than Maghreb and Mashrek countries. This possibly reflects the fact that GCC countries are resource rich, giving them a stronger negotiation position vis-à-vis foreign investors and hence less of an incentive to enter into binding agreements.

Free trade and regional integration agreements

Paralleling the increase in BITs negotiations there is also an upward trend in the conclusion of FTAs and RIAs containing market access for investors, investment protection and promotion provisions. MENA countries participating in the *Investment Programme* have concluded or were negotiating during 2003 and 2004 with OECD countries 20 bilateral, regional and inter-regional agreements containing FDI provisions.

MENA countries' own initiatives include the Arab Free Trade Area which aims to establish an FTA among 18 members of the Arab League by 2008. In the past, as well, there have been serious efforts led by the Arab League for establishing regional investment agreements. For instance, the Agreement on Arab Economic Unity was signed in 1957,[4] stipulating a guarantee of freedom of movement of capital. Further, in 1970 the Agreement on Investment and Free Movement of Arab Capital Among Arab Countries was signed by Egypt, Iraq, Jordan, Kuwait, Sudan, Syrian Arab Republic and the Arab Republic of Yemen. While this Agreement reiterated the principle of each state's sovereignty over its own resources, it already contained standard non-discrimination, expropriation and free transfer of funds provisions.[5]

Then in 1980 the Unified Agreement for the Investment of Arab Capital in the Arab States - a regional and enforceable investment regime - was signed. The Agreement has been ratified by all member States of the League except Algeria and the Comoros. It aimed at setting up an Arab Investment Court to hear cases brought under the Agreement, contains provisions, subject to exceptions, on national treatment, free transfer and expropriation, and deals with responsibilities of investors.[6] In addition, the countries of the GCC are currently negotiating or considering establishing FTAs with the EU, India and China. Japan signed in July 2004 a framework agreement on economic co-operation with the GCC countries, which may envisage FTA negotiations. Finally, Tunisia, Morocco, Egypt and Jordan only recently signed the Agadir Agreement, committing them to negotiate an FTA by 2006.

More regional agreements are foreseen with the United States, where the US Trade Representative (USTR) has engaged in intensive negotiations with a number of Arab countries to develop bilateral trade agreements, which it expects to form the basis for a Middle East Free Trade Area (MEFTA) by 2013.[7] In pursuing this goal, the US administration announced a six-step process for MENA countries to become part of MEFTA. These steps are: to join the WTO; to possibly participate in the Generalised System of Preferences; to establish trade investment framework agreements; to establish BITs; to establish FTAs; and to participate in trade capacity building. Morocco, Jordan and Bahrain have concluded FTAs with the United States and similar agreements with Oman and the United Arab Emirates are currently being explored.

MENA countries are also strengthening their ties with the European Union by negotiating and implementing the Euro-Mediterranean Partnership Agreements. Currently the EU is engaged in FTA negotiations with the countries of the GCC. Table 1 summarises the existing FTAs with MENA countries.

Table 1. Free Trade Agreements and other agreements signed or ratified by MENA countries

Algeria	EU	2002	Association Agreement
Jordan	EU	2002	Association Agreement
	Singapore	2004	FTA
	USA	2000	FTA
Kuwait	USA	2004	Concerning the Development of Trade and Investment Relations
Lebanon	EU	2000	Association Agreement
Morocco	EU	2000	Association Agreement
	USA	2004	FTA
Qatar	USA	2004	Concerning the Development of Trade and Investment Relations
Saudi Arabia	USA	2003	Concerning the Development of Trade and Investment Relations
Tunisia	EU	1998	Association Agreement
Yemen	USA	2004	Concerning the Development of Trade and Investment Relations
Council of Arab Economic Unity		1970	Agreement on Investment and Free Movement of Arab Capital Among Arab Countries
League of Arab States		1980	Unified Agreement for the Investment of Arab Capital in the Arab States

Multilateral rules

Furthermore, almost all MENA countries have joined the major multilateral agreements covering investment related aspects. As of 30 November 2004, ten of the 18 MENA countries participating in the *Investment Programme* were members of the World Trade Organisation. As such they are obliged to implement the obligations of GATS, TRIPs and TRIMs. The General Agreement on Trade in Services (GATS) provides for

certain investors a right of establishment if the member of the GATS makes specific commitments on market access. TRIPs accords national treatment and Most Favoured Nation (MFN) status to foreign firms' intellectual property rights and TRIMs provide that certain categories of trade related investment measures are not in accordance with the principles of the GATT. Table 2 shows that another 3 countries currently have observer status in the WTO, bringing the number of MENA countries without WTO membership or observer status to 5.

All MENA countries have signed the convention establishing the Multilateral Investment Guarantee Agency (MIGA) and can profit from its risk mitigation facilities. In order to be eligible for a guarantee granted by MIGA to an investor in its territory, the MENA country's investment policy must be in accordance with the 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment. The operational regulations of MIGA further state that "an investment will be regarded as having adequate legal protection if it is protected under the terms of a bilateral investment treaty between the host country and the home country of the investor."[8]

Table 2: Status of the MENA countries in the WTO

Country	WTO Member	Observer	Not Observer
Algeria			x
Bahrain	1995	x	
Djibouti	1995		
Egypt	1995		
Iraq			x
Jordan	2000		
Kuwait	1995		
Lebanon		x	
Libya			x
Morocco	1995		
Oman	2000		
Palestine National Authority			x
Qatar	1996		
Saudi Arabia		x	
Syria			x
Tunisia	1995		
United Arab Emirates	1995		
Yemen		x	

Notes

1. Calculated from IMF, *International Financial Statistics* FDI inflow and population figures.

2. The World Bank (2005), Middle East and North Africa, Economic Developments and Prospects.

3. The term 'IIAs' is used in a broad sense describing legally binding bilateral, regional and multilateral instruments containing exclusively or partially investment protection and promotion provisions.

4. Members were Iraq, Jordan, Kuwait, Lebanon, Libyan Arab Jamahirija, Morocco, Saudi Arabia, Sudan, Syrian Arab Republic, Tunisia, United Arab Republic, and the Arab Republic of Yemen. Mauritania, Palestine and Somalia subsequently also became signatories to the Agreement, UNCTAD, 1996, vol. III.

5. Articles 3-7 of the Agreement, UNCTAD, 1996, vol.II.

6. UNCTAD, 1996, vol.II.

7. For details see, *Mary Jane Bolle*, Middle East Free Trade Area: Progress Report, CRS Report for Congress, 2005.

8. MIGA Operational Regulations, para.3.16, 27 ILM 1227 (1988).

3.2. NEPAD-OECD Africa Investment Initiative

The Africa Investment Initiative aims at mobilising private investment for poverty reduction, job creation and sustainable development in Africa, by supporting African countries' own efforts to advance national reform agendas, regional and international policy dialogue, and implementation and monitoring capacity building.

The Communiqué on Africa adopted by G8 Heads of State in July 2005 at Gleneagles states that "African countries need to build a much stronger investment climate: we will continue to help them do so, including through the promotion of a stable, efficient and harmonised legal business framework", noting "the improvement of the investment climate through the OECD/NEPAD Investment Initiative". The Africa Investment Initiative was an outcome of the Global Forum on International Investment hosted by the South African government in November 2003 and was backed by a public NEPAD-OECD Statement. The Initiative received renewed support from the 2005 OECD Ministerial; Ministers expressed a commitment to increasing OECD investment policy co-operation programmes with Africa.

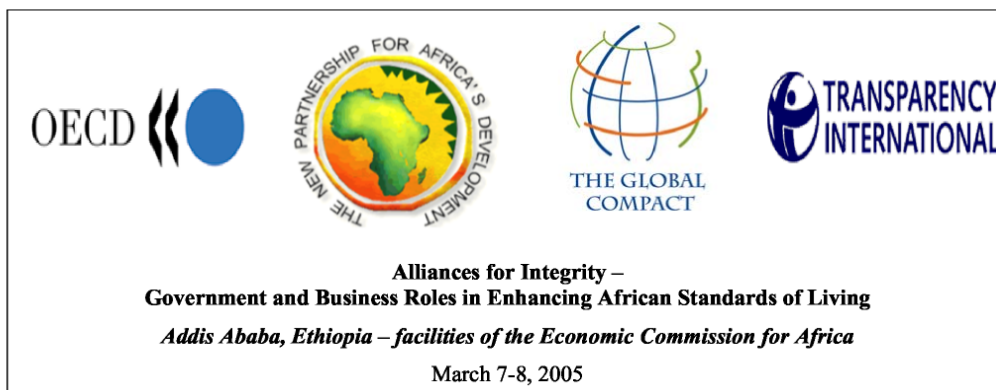
The Initiative takes advantage of the following OECD comparative strengths: i) A partnership approach to policy capacity building based on exchange of practical experience among African and OECD country governments and peer learning; ii) The availability of multilaterally-backed investment policy benchmarks which can serve as reference points as African countries develop their own instruments for self-evaluation, action plans and implementation; iii) Mobilisation of other fields of OECD expertise; iv) Effective access to business and other civil society stakeholder input.

Many African countries have made progress in improving the business environment for attracting more and better investment. However, more needs to be done. Governments face serious challenges as they seek to improve investment environments. These include inter alia creating a level playing field for all investors – both foreign and domestic; enhancing transparency and procedural fairness in investment regulations; ensuring public sector and market integrity; facilitating regional integration and private participation in infrastructure; and building policy implementation capacities.

The Initiative supports the current momentum in Africa for further reform in these areas. OECD's investment policy co-operation with Africa is to be seen in the broader context of other international efforts. It will complement, not substitute for, individual OECD members, G8, EU and other initiatives, and reinforce OECD follow-ups to the UN Millennium Declaration and Monterrey Consensus foreseen in the Statement adopted at the May 2005 OECD Ministerial. The Initiative builds on established partnerships and synergies with World Bank, African Development Bank, UNCTAD and other relevant organisations.

The first joint NEPAD-OECD Investment Committee undertaking under the Initiative was a conference on 7-8 March 2005 in Addis Ababa (Ethiopia) on the theme of "Alliance for Integrity – Government and Business Roles in Enhancing African Standards of Living". It showed that a promising African framework for public and business sector integrity was emerging, contributed African inputs into OECD work in this area, and reinforced Africa-OECD partnership. This dialogue was followed by a NEPAD-OECD Investment Policy Roundtable, "Investment for Africa Development: Making It Happen", held in Entebbe (Uganda) on 25-26 May 2005. The Roundtable initiated country investment policy self-evaluation, discussed the merits of competition for FDI by means of special financial and other incentives, and was supportive of the Committee's work on the Policy Framework for Investment – a tool for a "whole of government" approach to improving the investment climate. These dialogues paved the way for a strengthened investment policy co-operation programme with NEPAD on Africa.

Summaries of these dialogues, together with conclusions jointly released by NEPAD and OECD Co-chairs of the Entebbe Roundtable and an overview of a preliminary inventory of African countries' measures towards international investment are reproduced in this section.



Jointly organised by the Investment Committee of the Organisation for Economic Co-operation and Development (OECD), the New Partnership for African Development (NEPAD) and the United Nations Global Compact in partnership with Transparency International

CONFERENCE ON ALLIANCES FOR INTEGRITY – GOVERNMENT AND BUSINESS ROLES IN ENHANCING AFRICAN STANDARDS OF LIVING

Summary Report*

Background

More than 90 participants representing African business, civil society and labour organizations, international organizations and governments, gathered in Addis Ababa on 7-8 March for "Alliances for Integrity – Government and Business Roles in Enhancing African Standards of Living". About 70 of the participants were Africa-based – they included representatives from business, business associations, state-owned enterprises, trade unions, civil society, national governments and regional organisations. Co-organized by the OECD Investment Secretariat, the UN Global Compact, the New Partnership for Africa's Development (NEPAD) and Transparency International, the conference took place at the facilities of the Economic Commission for Africa (ECA). On the OECD side, the conference was organised by the Investment Division, with the participation of Corporate Affairs and Anti-corruption Division.

* Prepared by Kathryn Gordon, OECD Investment Division.

The main objective of the two-day conference was to strengthen alliances between business, civil society and governments to promote integrity and foster positive frameworks for investment and job creation. In the words of Peter Eigen, Chairman of Transparency International, "Africa is on the path to liberate itself for a second time, not from colonialism, but from corruption, poverty and violence." Participants showed a clear sense of urgency to seize on the present momentum.

K.Y. Amoako, Executive Director of the Economic Commission for Africa (ECA) called attention to the important African initiatives. In June, UNECA will publish its African Governance Report 2005 surveying the progress in 28 countries based on information gathered by hundreds of researchers. The fight against corruption, he noted, "cuts across all the main issues Africa faces today -- Aids, trade and debt -- it is necessary to find synergies to overcome them all." The Report of the Commission for Africa cites the role of NEPAD, the OECD integrity instruments (including many references to the OECD Guidelines for Multinational Enterprises, a government-backed code of conduct for international business) and the UN Global Compact as the basis for partnerships that aim to improve public and private governance in Africa. Both the promise of and difficult challenges facing NEPAD's African Peer Review Mechanism ("APRM") were noted, as was the signing up of several African governments to the Extractive Industry Transparency Initiative ("EITI"). Against this backdrop, the conference participants focused their efforts on the root causes of corruption and on identifying areas where business, civil society and government can best work together to find solutions.

Emerging national, regional and international frameworks

Africa has started to move forward in the fight against corruption – the discussions revealed clear awareness of the issue as well as various national, regional and international initiatives. Although experience with these initiatives has been variable, the emerging framework was viewed as holding great promise for the countries of Africa, 32 of which have signed the UN Convention. Discussion focused on the emerging framework supporting transparency and integrity at the national, regional and international levels.

The UN and African Union Conventions and the ongoing work in support of the OECD Anti-Bribery Convention were seen as support for the fight against corruption in Africa, but many questions were raised as to the process of implementation and monitoring. How, if at all, will the NEPAD APRM link into the monitoring of the conventions? Why are signatories allowed to invoke an "opt out" clause in the African Union Convention?

How will a possible monitoring system of the UN convention link into the system of the other conventions? How can OECD home governments improve their anti-corruption record with respect to development assistance and export credit programmes? The multitude of questions and the diverging opinions in the discussion that ensued indicate that actors from all walks of life will need to work together to see that the momentum is seized and used to maximum advantage. While the discussion identified much scope for cooperation and mutual reinforcement, it also underlined the urgent need for more dialogue and cooperation among the four international organizations. This will be necessary if the many remaining obstacles to a process of concerted and successful reform are to be overcome in many African countries.

Voluntary initiatives

Samuel Sitta, Executive Director of the Tanzania Investment Center, described the process in his country which started with a country-wide assessment of the current situation leading to the development of numerous institutions mandated with fighting corruption. He mentioned open communication and genuine 'ownership' from the country enacting reforms - both with the public and government - as essential elements in the process. Similarly, several participants from a variety of other African countries reiterated the need for changing the mentality of the bureaucracy and limiting its discretion, strengthening the judiciary system and a coherent tax structure.

Both Bunmi Oni, Chief Executive Officer of Cadbury Nigeria, and Soji Apampa, Managing Director of SAP Nigeria, described the Convention on Business Integrity in Nigeria, a voluntary anti-corruption initiative which requires companies to publicly denounce corruption, adopt a code of conduct and a road map for its implementation. The convention also includes a peer review system – involving a group of highly committed companies and one government ministry -- to promote compliance.

Rory More O'Ferrall, Director External Affairs of De Beers Group of Companies, described the Kimberly Process. It was the result of a joint effort by the South African government, the diamond industry and civil society organizations to stem the flow of conflict diamonds - rough diamonds that are used by rebel movements to finance wars.

The success of these initiatives demonstrated the potential power of collective action and voluntary approaches, particularly in cases where business, civil society and governments work together.

The informal and state-owned enterprise sectors

All participants acknowledged the importance of the informal sector in the daily lives of Africans. However, there was general agreement that this sector – especially the many large and well organised companies that flourish there – were focal points for corruption. Bunmi Oni called the informal sector a "Weapon of Mass Diversion" and noted that the informal economy grows from the failure of the formal system. What emerged from the discussion was the notion that, in Africa today, there are many different types of informal economies. A participant from Sierra Leone described the "shadow state" in her country where the informal sector operates in the absence of any system of checks and balances (e.g. civil society, professional associations).

Martin Kisuu of Deloitte Touche Tohmatsu East Africa outlined another example where the informal sector is embedded into the formal structure with key business leaders and politicians holding ownership of informal networks, importing goods, funnelling proceeds through bank accounts and using the money to buy property and invest in legal operations. While Mr. Kisuu believed that this type of informal sector could be reached by anti-corruption efforts, he criticized the lack of political will to do so. He also underlined the role of middlemen who acted as brokers between the business and the political class. The roles of agents, middlemen and facilitation payments were identified by all participants as issues where there was urgent need for further action.

State-owned enterprises (SOEs) were also seen as a focal point for corrupt practices in many African economies. The Addis Ababa conference provided an opportunity to survey country experiences with SOEs (countries covered were the DRC, Ethiopia, Namibia, Nigeria, Senegal, South Africa and Tanzania). The sector was described by conference participants as "obstacle to development" and as a "liability to the African economy" and participants urged governments to assume their responsibilities for concerted reform of the sector. Thus, the Addis Ababa conference underscored the significance that African actors attach to improving standards of conduct in the SOE sector.

Although the *tour de table* showed some differences among countries in terms of the degree of privatisation realised to date, the overall picture painted was one of serious, but strikingly similar problems (including inefficiency and corruption, especially political corruption). SOE governance problems mentioned by conference participants include:

- *Regulator and ownership roles of the state not separated.* SOE relations with Ministries and top political actors are generally close.

This gives rise to conflicts of interest in the formulation of a number of policies, including regulation, competition and procurement. Many SOEs enjoy monopoly powers in their sectors.

- *Ineffective Boards of Directors.* Boards of directors often do not have de facto rights to exercise their responsibility to set the strategic direction of the company and to ensure that management acts in the best interest of the shareholders (for example, real control may reside outside the Board with political parties or top government officials). Board appointments are made on the basis of political connections, not business competence. SOE Board nominations can be a channel for political patronage and Boards are often beset with conflicts of interest.
- *Slack Internal Management Systems and Other Controls.* SOEs' internal control systems are often defective or non-existent. SOEs are frequently "excluded from the Auditor General's purview" and sometimes hire their own auditors, who do not follow international audit standards and are subject to conflicts of interest.
- *Low standards of disclosure.* One participant suggested that SOEs, because they act in trust for the public, should adhere to higher transparency standards than privately owned companies. In reality, however, the average standard of information disclosure observed by SOEs in most countries surveyed is low.

The conference acknowledged that prime responsibility for SOE reform lies with governments. The participants also agreed that state-owned enterprises present integrity risks for any private company wishing to conduct business for them. Some felt that business transactions should be evaluated on a case-by-case basis to ensure that the reputation of the company would not be undermined because of its relations with SOEs. Others favoured looking at the degree to which SOEs adhere to international governance standards (the OECD Corporate Governance Principles and the second King Report on Corporate Governance for South Africa were mentioned) and then taking steps to promote improvements in SOE governance.

Regions with weak governments or no governments

While participants described a variety of different levels of corruption, the situation which appeared to be most challenging were those in which the state itself was so weak and ineffective that it had no capacity to address the issue at all. Sierra Leone and Liberia were described as dramatic examples of failed states where millions of dollars in aid or trade revenues had disappeared without a trace.

Lemma Argaw, the Auditor General of Ethiopia, highlighted the need to develop integrity-enhancing institutions, particularly in the area of internal and external audit. He explained that the Institute of General Auditors had as its main objective to assure the integrity of internal audits through the development of tools and standards. This type of professional association, he noted, had a direct impact on creating greater transparency in both the public and the private sectors. Mr. Kisuu also underlined the role of external auditors and the importance of integrity policies by the accounting firms.

The discussion on the situation in the DRC made it clear that companies themselves are at a loss on how to operate in zones with no effective government. Accordingly, Mr. O'Ferrall called for the development of a practical code of conduct which sets out criteria for how companies should operate in regions with weak governance. He went further to argue for the need for proper mechanisms to deal with breaches of such standards and international monitoring.

One of the goals of the conference was to collect African inputs into the OECD Investment Committee's work on the development of a risk management tool for investors in weak governance zones. The development of this tool – scheduled for publication in mid-2005 -- is part of the Committee's follow up on the UN Expert Panel's references to the OECD Guidelines for Multinational Enterprises in its reports to the UN Security Council on illegal exploitation of natural resources in the Democratic Republic of Congo. The conference provided inputs in the area of appropriate corporate governance practices when supporting institutions are weak and in structuring business relations with state-owned enterprises.

Conclusions and next steps

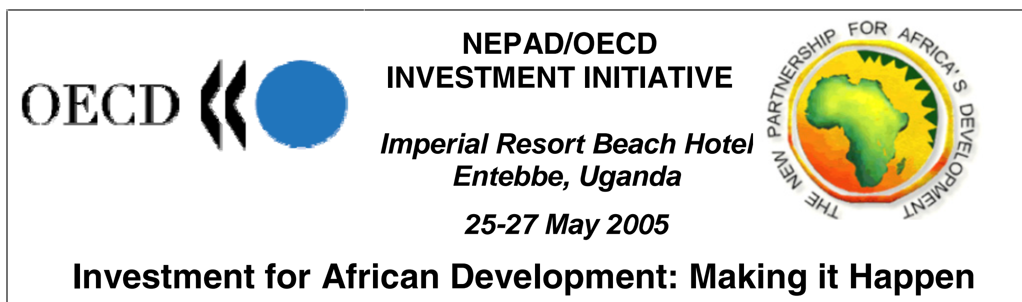
Speaking for the institutions charged with implementing the OECD Guidelines for Multinational Enterprises, Anna-Maj Hultgaard (Swedish Ministry for Foreign Affairs and Chair of the Working Party of the OECD Investment Committee) promised to integrate conference participants' comments into the risk management tool being developed by the OECD Investment Committee as follow up to the UN process on illegal exploitation of natural resources in the DRC. Conference participants will have an opportunity to comment on the draft after it has been discussed by the Investment Committee in April 2005.

NEPAD reiterated their commitment to work on fighting corruption, an issue they have incorporated into their peer review process while

expressing possible difficulties inherent to it. In addition, they expressed interest in working with the OECD, the Global Compact and the business community especially through their Investment Climate facility. The possibility of a jointly organized conference to bring together all African countries that have ratified the UN Convention against Corruption was also presented.

The UN Global Compact is planning to put a stronger emphasis on Africa and is opening its first regional office in South Africa in March. Furthermore, follow up meetings to exchange experiences and foster learning on the implementation the 10th principle against corruption will be held in various African countries.

In his concluding remarks, Peter Eigen emphasised the fact that all sectors and actors shared responsibility for the problems created by corruption and failed governance. Governments of the North, he stated, had acknowledged the negative effect of their companies and organizations in the supply side, and, through national legislation and international instruments such as the UN and the OECD Convention and the OECD Guidelines for Multinational Enterprises, had put into place mechanisms to combat corruption. He went on to state that in Africa, through the African Union Convention and the NEPAD process, governments were also tackling the demand side. He called upon participants and the many organizations they represent, to work together to further such efforts. In Africa, he noted, leadership can only come from Africa itself.



Roundtable organised under the joint auspices of NEPAD and the OECD Investment Committee, sponsored by the Government of Uganda, with the co-operation of JICA and JETRO of Japan

CONFERENCE ON INVESTMENT FOR AFRICAN DEVELOPMENT: MAKING IT HAPPEN

Summary Report*

The NEPAD/OECD Investment Policy Roundtable, "Investment for African Development: Making It Happen", on 25-27 May in Entebbe (Uganda) was the second joint NEPAD-OECD undertaking after the Addis Ababa Conference in March 2005, following the launch of the NEPAD-OECD Africa Investment Initiative in Johannesburg in November 2003. The Roundtable was co-chaired by OECD Deputy Secretary-General Kiyotaka Akasaka and Director in NEPAD Secretariat, Victor W. Mathale. The co-chairs issued a joint conclusion at the end of the Roundtable (Annex 1 to this report), including options for further investment policy cooperation between NEPAD and OECD.

Some 160 persons attended the Roundtable during its 2 ½ days, with 115 people in the Room at the busiest time (Wednesday). The participation (through government representatives, organisations and private companies) was mostly from eastern and southern Africa, but Central and Western Africa (Cameroon and Senegal) was also represented. The World Bank, United Nations Economic Commission for Africa, African Development Bank, SADC, COMESA, the Investment Climate Facility for Africa and Transparency International also participated.

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The Roundtable was composed of three main parts. On the first day, the challenges in creating a sound enabling environment for private investment in Africa were discussed. The discussions on the second day, organised in partnership with INICA, focused on the specifics of encouraging private participation in the infrastructure sectors. The third (half) day took the form of a special seminar, jointly organised with JICA and JETRO of Japan, focusing on Asian experiences with investment for development and their relevance for Africa. The following summary of the main events highlights three aspects of the discussions: the introductory remarks by key participants, the outcomes of the main agenda items and the potential implications for future work. Opening speeches, presentations and conclusions are posted on the web page created for the event (www.oecd.org/daf/investment/development).

Introductory remarks and discussions

Deputy Secretary-General Akasaka, in his welcoming speech, highlighted the importance of investment for development and introduced the participants to ongoing OECD initiatives in the area, including the Policy Framework for Investment and the Africa Investment Initiative. He underscored OECD’s commitment to working with regional partners, including NEPAD, and maximising the African ownership of prospective joint investment policy undertakings in the region.

Victor Mathale of NEPAD Secretariat delivered a keynote address in which he expressed an optimism regarding the mobilisation of investment for African development. He noted recent success stories (e.g. mobile telephony in Africa) and expressed the conviction that there is a political momentum to make 2005 “the year of Africa”. He agreed that much needs to be done to enhance the investment climates of African countries, including raising transparency and enhance the public governance mechanisms underpinning it; addressing institutional impediments to private business persist, including red tape and outdated administrative structures; establishing the rule of law much more firmly in many countries; and addressing the pervasive corruption in most of the continent’s countries.

President Yoveri Museveni of the Republic of Uganda addressed the Roundtable and participated in a discussion session. During his lengthy presentation, the President repeatedly stressed the importance of international trade and investment over more “traditional” forms of aid. Noting the deteriorating terms of trade on many of the continent’s traditional export goods and the remaining import restrictions in OECD countries, he highlighted the AGOA and other similar initiatives as one of

the more positive recent developments. He stressed a need for Uganda to attract foreign direct investment (FDI), *inter alia* to ensure a greater local element in processing its commodities; to upgrade its infrastructure, especially in power generation and land transport; and to achieve its longer-term development strategies such as attracting the regional headquarters of international corporations to Kampala.

Main agenda items

A self-evaluation of two countries' regulatory approach to FDI took place. Tanzania and Uganda had volunteered to make presentations against the background of an analytical note tabled by the OECD Secretariat. There was a great interest "from the floor" in engaging in such an exercise and the Tanzanian authorities in particular put a great effort into responding to the challenge. Peer discussion and self-evaluation tend to be relatively rare in Africa, but this event demonstrated a definite interest in engaging in such channels for capacity building. The feeling among participants was that a more inclusive process of evaluation and self-evaluation, followed by the publication of jointly agreed proceedings, might be a useful undertaking to raise transparency around African countries' investment policies and create international awareness of the progress already achieved. NEPAD Secretariat expressed an interest in becoming associated with such a process, and its published end-products, should it go ahead (see NEPAD-OECD Co-Chairs' Concluding Remarks in Annex 1).

The Policy Framework for Investment was introduced to the participants by the Co-chair of the project's Task Force Shuichiro Megata. Following this, the first-ever regional consultation on the Policy Framework in the African context took place. The issue of the cost-effectiveness of competition to attract FDI by means of financial and other specific incentives received special attention. Options for avoiding undesirable effects of this form of competition were explored, including a proposal for harmonisation at sub-regional level using initiatives such as the East Africa Community. The consultation included discussion of the draft paper on Investment Facilitation and Promotion and an exploratory discussion of the impact of corporate governance on the investment climate. The discussion of corporate governance attracted great interest among the African participants, including its linkages with public governance and corporate social responsibility. There was considerable interest in the Policy Framework among the regional participants, many of whom commended the inclusive nature of the process and the Framework's equal focus on foreign direct and purely domestic private investment. Participants also heard a presentation of the Investment Climate Facility for Africa (initiated by Commonwealth Business Council but co-sponsored by

NEPAD) including how the Initiative hopes to address many of the challenges identified by the Policy Framework.

The sessions on Private Participation in Infrastructure took as their starting point a discussion of three habitual obstacles to such undertakings in Africa, namely regulatory uncertainties, finance and project design. The experiences from selected ongoing projects were reviewed in two breakout sessions focusing on land transport (Northern Corridor and Maputo Corridor) and telecommunication (Ugandan deregulation; EASsy/COMTEL). The discussions between corporate and public participants, in particular, were very lively. One tentative conclusion is that the problems with infrastructure investment are enveloped in the broader concerns about the quality of the enabling environment for investment – including governance and the rule of law. Another conclusion is that the cross-border nature of many infrastructure projects creates a host of additional challenges, from regulatory inconsistency, to red tape, to free-rider problems. There was broad agreement that it will be worthwhile to jointly monitor such projects as they go ahead.

The special seminar on Asian Experiences with Investment for Development was organised around two major presentations, one by Mr. Katsumi Hirano of JETRO, Johannesburg and the other by Dato J. Jegathesan of Malaysia. Mr. Hirano argued that industrialisation and development in Africa is held back by the double challenge or comparatively high labour costs and the absence so far of a jump in agricultural productivity. Dato Jegathesan repeated his earlier (2000) advice to the Ugandan government that a "Big Push" strategy involving all levels and branches of government is necessary for the success of investment and private-sector led development strategies. Based on Malaysian experiences, private sector development requires the support of all relevant pieces of legislation and regulation. Investors are unlikely to come unless they are welcomed throughout the administration and supported by appropriate public governance structures.

Prospective follow-up to the Roundtable

As invited by the OECD Council, building on the positive outcomes of the Roundtable and following up on Japan's proposal at the OECD 2005 Ministerial Meeting, a scoped and budgeted proposal for strengthening the NEPAD-OECD Africa Investment Initiative will be considered by the Investment Committee for endorsement, at its meeting in September. DAC will be consulted for donors' views on the proposal and will be invited to discuss further steps donors would be prepared to take in support of the

Initiative. The two policy communities may wish to discuss potential areas for joint action as the Initiative matures.

As regards the concrete outcomes of the Roundtable and the discussions in Entebbe a couple of observations suggest themselves:

- *NEPAD co-operation.* NEPAD Secretariat has confirmed a keen interest in deepening investment policy co-operation with OECD in the future.

- *Vis-à-vis African countries.* The representatives of six countries, namely Cameroon, Mozambique, Senegal, Tanzania, Uganda and Zambia have expressed to the Secretariat a wish to participate in a "pilot group" of countries and host future dialogue events where the NEPAD-OECD Africa Investment Initiative will be carried forward.

- *Other international organisations.* The World Bank also indicated a willingness to participate and assist in future investment-related activities by OECD in Africa. Also, at the event of the Roundtable a representative of the Investment Climate Facility for Africa expressed an interest in “co-sponsoring” some of OECD’s prospective activities, notably in the context of the Policy Framework for Investment project.

Annex 1

Concluding remarks by Co-Chairs: Mr Mathale, Director-NEPAD Secretariat, and Mr Akasaka, OECD Deputy Secretary-General*

This Roundtable organised under the joint auspices of NEPAD and the OECD Investment Committee reinforced the impetus of the Africa-OECD Investment Initiative launched in Johannesburg in November 2003.

The aim of the Roundtable was to assess public policies and help build capacities to attract private investment for African development. It follows up to the first conference jointly held by NEPAD and OECD in Addis Ababa last March on the emerging African framework for promoting public and corporate sector integrity.

Roundtable participants found that while grave problems continue to affect a number of African countries, many have been making progress in the recent period in mobilising private investment, both foreign and domestic, for growth and job creation. Clearly, sound policies matter and have been paying off.

Participants felt that OECD countries have a major economic contribution to make to African development. Trade and investment is the surest solution to growth and job creation. This was also stressed by the President of Uganda in his address to the Roundtable.

Roundtable participants identified various avenues through which African countries can build on their current efforts, and on contributions from OECD and other international organizations, to further improve the investment climate. Technical assistance and funding are put forward by development institutions and other undertakings such as Investment Climate Facility for Africa and recent proposals by Japan and the European Union. But “peer” review as encouraged by NEPAD and used by the OECD since its inception – in conjunction with multilaterally endorsed policy principles – can be used to the advantage of African countries to strengthen their own policy agenda and capacities.

Promoting “whole of government”, coherent approaches to investment across tax, competition, trade, corporate governance and the other public policies, together with timely and effective implementation, were key challenges discussed by Roundtable participants. The Roundtable provided an opportunity for further consultation on OECD Investment Committee’s work which is being undertaken with its African and other partners on

* These remarks concern the first two days of the Conference only.

developing a *Policy Framework for Investment* – a non-prescriptive and comprehensive checklist of policy issues for consideration by governments wishing to improve the investment climate.

The need to address obstacles for more active private sector participation in infrastructure was the subject of particular attention by Roundtable participants, and the discussion focused on regulatory, capacity constraints and lack of adapted financing mechanisms. One or two specific projects critical to the business environment to East Africa will be monitored by an informal contact group and could inform on-going work on investment frameworks and processes.

A public record of the Roundtable discussion will be made. Other follow-ups could include the following:

- the network of Africa and OECD country officials and other practitioners which has been established throughout this and previous events will continue to serve as a steering committee for the work in the context of the NEPAD-OECD Investment Initiative;
- co-operation between NEPAD and OECD Investment Committee in the coming 2 to 3 years should focus on the quality of regulatory governance in the area of private investment. Creating a level playing field for all investors, a predictable regulatory environment and due process for businesses were considered of central importance and to benefit both foreign and domestic investment.
  - African countries will be invited to correct, complete and jointly review the stocktaking of FDI measures presented at the Roundtable, with a view to making it public as a contribution to transparency and improving perception of Africa;
  - Self-evaluation of investment policy effectiveness by volunteering countries and peer dialogue on options for further action were initiated at the Roundtable and should be deepened and expanded to more countries and regions in Africa. It was suggested that tools such as the *Policy Framework for Investment* can serve as useful reference points in this evaluation and dialogue process.
- OECD development agencies will be invited to engage in the Initiative. One lesson from a recent OECD Development and Investment Committees' report to 2005 OECD Ministerial is that in the area of supporting developing countries' efforts for improving the investment climate, ODA can be more focused and better co-ordinated.

The results of this strengthened work programme under the Initiative will be fed within the broader Mutual Review process involving NEPAD and OECD.

Annex 2

Regulatory environment for foreign direct investment: Preliminary inventory of available information for selected African countries*

African countries have become more accommodating toward FDI over the last 10-15 years, as evidenced *inter alia* by changes in their regulatory regimes. The reorientation was set in the context of a more general shift in attitudes toward the private sector, and it reflects an increasing realisation (also found in the Monterrey Consensus) that private international capital flows are likely to be a key source of development finance in the future. The changing stance toward FDI has also given rise to a proliferation of investment promotion agencies, special economic zones and other targeted mechanisms by which African countries aspire to attract foreign investors.

However, considerable national differences persist and important hurdles still need to be overcome in most countries. Also, while it is fair to say that in terms of overall statutory FDI regulation African countries are on average not more restrictive than other developing nations, some of the remaining obstacles are both severe and particular to the continent. Prominently among these figures *land ownership*, where most African countries continue to apply restrictions that – whether discriminatory or of a more general nature – act as an important deterrent to foreign investors. Another remaining obstacle is the prevalence of *sectoral restrictions* with the purpose of protecting small businesses and artisan production, which likewise have as an unintended consequence to hold back the creation of a market economy and foreign-local corporate linkages in large segments of African societies.

Going beyond the statutory rules, investors in Africa are acutely concerned with the *transparency* of regulation. First, as demonstrated

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by the "fact finding" exercise below, it can be difficult to find reliable, detailed information about the regulatory regimes of some countries. Second, a number of countries appear to apply a high degree of administrative and/or political discretion to the regulatory process (e.g. the granting of investment licences based on undisclosed or changing criteria) rather than rely on largely rules-based systems. Third, when sovereign governments exert their right to regulate by changing key pieces of legislation, they often do so without engaging in the prior consultations with concerned parties that are commonly considered as an integral part of political and regulatory transparency.

Finally, concerns about the *consistency of implementation* are high on the list of investors' concerns about regulation. The issue of regulatory discretion raises important integrity issues in addition to transparency, and there is anecdotal evidence from many countries of even "hard" regulation being applied selectively. Corruption is often cited as a major concern in this respect. So is excessive red tape and slow administrative procedures, which – as for instance documented by the World Bank's Investment Climate Assessments – encourage investors to seek recourse to informal mechanisms.

I. Context of this inventory

The joint statement issued by NEPAD and OECD at the launch of the NEPAD-OECD Africa Investment Initiative in Johannesburg in November 2003 [www.oecd.org/dataoecd/2/37/20686317.pdf] proposed that OECD investment policy co-operation with Africa take as a starting point the formulation of "key policy benchmarks" that could lead to regional roundtables and, as appropriate, policy reforms.

In response to this mandate, the present inventory highlights regulations and practices that discourage FDI in some Sub-Saharan African countries. The countries reviewed in this preliminary version are: Botswana, Ethiopia, Ghana, Kenya, Mauritius, Mozambique, Nigeria, Senegal, South Africa, Tanzania and Uganda.

This material is entirely based on information that is already in the public domain in the official language (English and French) of the OECD. The information was mostly obtained from IMF,[1] UNCTAD,[2] the World Bank Group,[3] US Department of Commerce,[4] Direction des Relations Economiques Extérieures française (DREE), the International Chamber of Commerce and official government web sites from the countries under review. In other words, it is unlikely that policy makers will find

information in the paper that they do not have available in some form elsewhere (and multinational enterprises often acquire similar information via international consultancy companies).

The material serves two distinctive purposes: First, it is intended to act as a tool for dynamic policy discussion by allowing a simple benchmarking of regulatory regimes across the region. Second, it draws attention to the central issue of investment policy transparency by highlighting information that is readily available in the public domain while at the same time pointing to information gaps.

II. Overview of regulatory practices toward FDI

Tables 1 and 2 (sometimes jointly referred to as "the matrix") summarise information collected by the OECD Secretariat on 11 African countries' regulatory and other practices towards foreign direct investors. They provide an inventory of available public information in the two official languages of the OECD (French and English) which evaluates the various national investment climates against the benchmarks set by the OECD Codes of Liberalisation of Capital Movements and Current Invisible Operations, and the National Treatment instrument (www.oecd.org/daf/investment/instruments).

The two tables that make up the matrix address different aspects of discriminatory treatment of foreign direct investors. Table 1 focuses on actual restrictions to FDI, whether in the form of general or specific limits to access, or post-entry limitations on foreign-invested companies' commercial operations. Table 2 describes other measures, including those that aim at attracting investors by means of subsidisation, and measures to enhance regulatory transparency. Some cells in the matrix are marked "ND" (no data) because the relevant information was not found in the available sources. Where this is the case, authorities in the respective countries may wish to consider making this information more easily available to the general public.

The inventory is intrinsically a work in progress that will be, first further completed and/or improved according to governments' feedbacks, and second updated following regulatory changes in the region. Once completed with accurate and up to date information, the inventory should contribute to measure progress on FDI policy transparency and openness in the region, and initiate a political dialogue among Sub-Saharan African countries on best practices to attract FDI and maximise its economic benefits.

i) Restrictions on FDI

a) General restrictions on entry

According to the information reviewed for the present paper, African countries have generally simplified their procedures for entry of FDI (participation in existing firms and greenfield investment) since the early 1990s. FDI is no longer routinely screened in most countries, and some now apply policies of guaranteeing a transparent registration of projects meeting proper criteria. However, many countries still impose general restrictions on entry, either by prohibiting foreign investment below a certain size, through minimum capital investment or by requesting prior approval or licensing from which domestic investors are exempted (Table 1).

Previous restrictions on foreign purchase of domestic shares (in capital markets) have been relaxed in several countries. Without prejudice to restrictions on FDI laws, non-residents are now in principle allowed to own up to 100 per cent of domestic enterprises in all the countries under review, except in Ghana, Kenya and Mauritius where foreign ownership cannot exceed a fixed threshold.

Accepting the obligations of the Article VIII of the IMF's Article of Agreement compels countries to remove restrictions on payments and transfers for international current transactions, and to adopt multilateral payment system free of restrictions and discriminations.[5] Ethiopia, Nigeria and Mozambique have not yet accepted Article VIII. They continue to avail themselves of the transitional agreements of Article XIV, which allows countries to provisionally keep the restrictions they were imposing before joining the IMF.[6]

Most countries have put rules in place guaranteeing investors an unrestricted remittance of dividends, profits and liquidation proceeds, on condition that payment of taxes and other liabilities has been made according to local regulations.[7] The exceptions include Ethiopia[8] and Mozambique[9] which request prior authorisation for transfer of funds.

b) Specific restrictions on entry

All countries under review have retained restrictive practices toward some specific categories of FDI. They discourage foreign investment in certain sectors either to stimulate local entrepreneurship, to protect sectors deemed to be of strategic interest, or to maintain the monopoly position of state enterprises. As a general rule, the majority of countries tend to discriminate against foreign investors in activities judged to be particularly suited to national or local entrepreneurs; such practices are found in sectors like small-scale manufacturing and mining, some trading activities and proximity services.

Table 1. Regulatory treatment of FDI in African countries: restrictions on investment
(2003-2004 information)

	Botswana	Ethiopia	Ghana	Kenya	Mauritius	Mozambique	Nigeria	Senegal	South Africa	Tanzania	Uganda
a) General restrictions on entry											
1. Entry of FDI	X	X	X	X	X	X			X	X	X
2. Foreign purchase of shares			X	X	X						
3. IMF Article VIII status		No				No	No				
4. Liquidation proceeds transfer abroad		X				X					
b) Specific restrictions on entry											
5. Sectoral limitations to FDI											
a. financial services		X	X	X	X				X	X	X
b. other services	X	X	X	X	X	X		X		X	X
c. primary sectors	X	X	X		X		X			X	X
d. manufacturing	X	X	ND				X				
6. Acquisition of real estate for FDI purposes	X	X	X	X	X	X	X				X
c) Post-entry restrictions											
7. Exceptions to national treatment of established foreign controlled enterprises											
a. access to local finance										X	ND
b. access to subsidies	X			ND		X				ND	X
c. access to privatisation	X	X	X	ND		ND			ND		ND
d. access to public procurement		ND		X		ND			X		ND
e. taxation				X		X			X		
f. discriminatory licensing in public utilities	X	ND	ND	ND	ND	ND		ND	ND	ND	ND
8. Other discriminatory practices											
a. nationality-based restrictions on boards	ND		ND	ND	ND	X		ND		ND	ND
b. discriminatory private practices	ND	ND	ND	ND	ND	ND	ND		ND		X
c. entry of key personnel	ND	X	X	X	X	X	X	X	X	X	X
9. Performance requirements	Yes	No	Yes	Yes	No	No	Yes	Yes	Yes	No	Yes

Note: X = restriction; ND = no data; " " = no restriction.

Foreign participation in financial services is restricted and/or subject to more burdensome licensing requirements than applied to domestic investors in six countries. The other countries do not report discriminatory regulation against foreign entrepreneurs wishing to invest in financial activities. More generally, progress has been made in transferring financial services from the public to the private domain. Ethiopia is the only country which still exclusively reserves the provision of financial services for the government and for Ethiopian nationals.

To boost local entrepreneurship and self employment, most governments ban or restrict foreign participations in certain kinds of other services, especially the ones that do not call for specialised expertise. Examples include barber shops and beauty salons, retail and wholesale trading, radio-television and telecommunication, transportation, bars and restaurants. In the primary sector foreign entrepreneurs are in most cases not allowed to invest in small scale mining, in construction companies and in some agricultural activities. Furthermore, regulations also deny national treatment to non-domestic entrepreneurs wishing to invest in the manufacturing sector in many countries. One prime example, mirrored in many OECD countries' legislation, is military equipment, but some of the more Africa-specific exceptions include the production of commodities, goods such as bread, school furniture and bricks.

Most countries reviewed, except South Africa and Senegal, deny national treatment to foreign investors in regard to real estate purchases. In these countries (except Mauritius that requires foreign investors to obtain ministerial authorisation, which may or may not be a serious obstacle) land is either officially owned by the state, or has various kinds of ownership status, and its purchase is restricted to nationals. Foreign investors can acquire the right to use land only through leasehold contracts, generally renewable, but not exceeding 99 years in total. In addition, the extensive network of government agencies and traditional communities involved in granting land rights and, in some countries, problems with identifying the true owners of a piece of land, raise the costs, risks and administrative burden on foreign investors.

c) Post-entry restrictions

The countries reviewed report relatively few statutory practices favouring domestic companies over existing foreign owned enterprises. On the contrary, it appears from the information reviewed that foreign businesses may enjoy in practice easier access to local financing because of their better collateral capabilities, and may obtain official support for projects deemed to be critical for the national development strategy. Practices limiting foreigners' access to local funds have been identified in Tanzania.

On the issue of subsidies, countries in the sample mostly provide investment incentives in the form of tax reductions and do not release information on regulations and practices discriminating against foreign investors. Incentives are granted to encourage investment in particular sectors (e.g. export activities are generally exempted from paying duty) or geographic locations. However, some of them (e.g. Botswana and Mozambique) do not offer incentives to small foreign investors and others do not grant incentives to foreigners investing in activities deemed accessible to domestic entrepreneurs (e.g. Uganda).

None of the countries under review have signed the WTO's Government Procurement Agreement.[10] However, concrete information documenting discriminatory practices against foreign-owned enterprises in tenders for public procurement is available for only two of them, namely Kenya and South Africa.

With the exception of Kenya, Mozambique and South Africa where domestic-owned companies pay a lower corporate income tax than foreign-owned enterprises, national tax legislation does apparently not discriminate against foreign investors in the countries in the sample.

Information about nationally-based restrictions on boards is scarce in the public domain, and such information as is available is commonly assumed to provide a partial picture. Ethiopia and Nigeria declare that they have no discriminatory practices on their books and, on available evidence, South Africa does not impose any restriction on board composition. On the other hand, in Mozambique, national legislation stipulates some sorts of limitation on board participation by foreign individuals.

Immigration and other regulation make the entry of key personnel difficult throughout the countries under review. The process of getting work permits for foreign employees is both expensive and time-consuming. On top of the immigration regulation, most countries also apply strict rules to the employment of expatriates, and generally allow foreign employees only in proportion to the capital invested. Conversely, some countries (e.g. Ethiopia) encourage immigration of persons with special skills to compensate for a lack of a qualified workforce in certain sectors.

Seven of the countries under review are recorded as imposing performance requirements**,** as conventionally defined, on foreign-owned enterprises. But information collected suggests that some of the other countries also implement practices "*encouraging*" various forms of transfers from multinational companies, and/or utilisation of domestic inputs in the production process.

ii) Regulatory practices other than restrictions

d) Practices encouraging FDI

The degree to which countries offer incentives to attract FDI in addition to what is available to domestic enterprises is mostly hard to establish on the basis of publicly available information. It is not clear from the various sources consulted whether the information is not available or purposely not reported. Five countries do disseminate information about specific incentives to foreign enterprises (Table 2).

Table 2. Regulatory practices toward FDI other than restrictions
(2003-2004 information)

	Botswana	Ethiopia	Ghana	Kenya	Mauritius	Mozambique	Nigeria	Senegal	South Africa	Tanzania	Uganda
d) Practices encouraging FDI											
10. FDI-targeted tax and other incentives	Yes	Yes	Yes	ND	No	ND	ND	ND	Yes	Yes	ND
11. Number of bilateral investment treaties (of which with OECD members)	10 (4)	20 (8)	25 (7)	5 (4)	33 (8)	12 (5)	13 (8)	18 (8)	31 (18)	16 (10)	16 (7)
12. Number of bilateral tax treaties (of which with OECD members)	4 (2)	2 (1)	3 (3)	10 (8)	31 (8)	2 (1)	12 (9)	10 (4)	41 (23)	9 (6)	7 (5)
e) Enhancing policy transparency											
13. National authorities											
a. publication of regulations	Yes	Yes	Yes	ND	Yes	ND	Yes	Yes	Yes	Yes	ND
b. notification prior to regulatory changes	ND	ND	ND	ND	ND	ND	ND	ND	ND	ND	ND
c. negative lists of restricted sectors	No	Yes	No	No	No	No	Yes	-[11]	-[12]	No	No
d. "silent and consent" authorisation	ND	ND	ND	ND	ND	Yes	ND	ND	-[13]	ND	ND
f) Other measures											
14. Measures at sub-national level	ND	ND	Yes	ND	ND	Yes	Yes	Yes	ND	ND	ND

Note: Yes = practice is applied; "-" = not relevant; ND = no data.

To increase foreign entrepreneurs' confidence on their commitment to protect their investments all countries in the sample have signed bilateral investment treaties (BIT) with a number of OECD member countries. BITs with non-OECD members have also proliferated, mostly between African countries and some of the more advanced economies (and most active

outward investors) in the developing world. However, except for Mauritius and Ghana, the countries under review have not been very active in signing bilateral investment treaties with other Sub-Saharan African countries.

In addition to the BITs, investors place great emphasis on the presence of bilateral tax treaties (BTTs), which provide them with greater certainty about the fiscal implications of cross-border transactions. Apart from South Africa, selected countries have relatively few BTTs with OECD member countries. Mauritius stands out as by far the most active player regarding BTTs with non-OECD countries. Most of its BTTs are signed with other African countries and are formally motivated by a desire to seek greater regional integration. (Readers are, however, reminded that the information provided in this survey exclusively comes from open sources. Certain other sources, such as the International Bureau of Fiscal Documentation, report more BTTs[14] than can be found in the public domain.)

e) Enhancing investment policy transparency

This subsection is largely based on the information divulged by national investment policy authorities, including investment promotion agencies, on their websites. It appears that the countries under review, with a couple of exceptions, could do more to diffuse relevant information to foreign investors. On issues as vital to investors as national practices for notification prior to regulatory changes and "silent and consent" authorisation no information has been found for the large majority of countries. The main exceptions are Mozambique, which has a formal silent-and-consent mechanism in place, and Uganda, which is in the process of introducing a mechanism for consultations prior to regulatory change.[15]

Practices for publication of regulations vary widely among the sampled countries. A majority of the countries under review publish some material, but few official web sites provide full texts of laws and regulations and the documents are generally difficult to access because they tend to be spread among several web sites and lost between unrelated information. Based on the OECD Secretariat's review of websites, most of them seem to give preference to showcasing success stories and advertising future projects rather than to providing concrete documentation and data for investors.

Ethiopia and Nigeria are the only countries to publish an exhaustive list of sectors in which foreign investment is restricted. For the other countries no formal lists appear to be in the public domain – though for the purpose of compiling Table 1 the OECD Secretariat has identified sectors in which FDI is restricted based on various other sources of information.

f) Other measures

At the sub-national level, Ghana, Mozambique, Nigeria and Senegal provide various kinds of incentives, mainly through tax rebates, to investors establishing in rural areas or in less developed parts of the country. However, the degree to which these reflect regional policy-making as opposed to the priorities of national priorities is not always clear.

iii) Restrictions in the service sectors: Evidence from GATS schedules

Another way of identifying practices and regulations that discourage FDI inflows to the service sectors is to examine the WTO General Agreement on Trade in Services (GATS) schedule of horizontal commitments related to mode 3 provision of services[16] (Table 3).

The information in Table 3 is not directly comparable with the findings of Table 1. It is limited to the service sector, and only six of the countries under review are signatories to GATS. Moreover, in GATS countries have an incentive to announce commitments that are less permissive than their actual regulatory practices in order to “keep their options open”.

At first glance the schedules of commitments contain far less restrictions than the part of the inventory matrix shown in Table 1. For instance, only one of the six countries under review that are members of GATS has reported restrictions on land ownership for investors, whilst the in-depth inventory of their regulations demonstrated that nearly all countries impose some form of restrictions. Conversely, some countries have provisions in their schedules of commitments that are not reflected in actual regulatory restrictions according to the various sources of information the OECD Secretariat has consulted.

It appears from Table 3 that the most “restrictive” country by far is Mauritius, which imposes limits on both market access and national treatment in the areas of authorisation, land ownership restrictions, remittances (a provision not reflected in actual restrictions, according to Table 1) and local employment.

The most common restriction placed on investors according to this measure is the imposition of local employment requirements. Such provisions are in place in all six countries – and in the case of Mauritius, Nigeria and South Africa in the form of an exception from national treatment as well as market access. Apart from this, the most common form of restriction in the service sector is the imposition of authorisation and notification requirements, a fact also reflected in the economy-wide entry restrictions recorded in Table 1.

Table 3. Horizontal limits to Market Access (MA) and National Treatment (NT) based on GATS schedules of commitments related to mode 3 delivery of services of selected countries

Type of measure	Botswana		Ghana		Kenya		Mauritius		Nigeria		South Africa	
	Limit on MA	Limit on NT	Limit on MA	Limit on NT	Limit on MA	Limit on NT	Limit on MA	Limit on NT	Limit on MA	Limit on NT	Limit on MA	Limit on NT
1. Authorisation/notification requirements	x				x		x	x				
2. Equity requirements			x									
3. Restrictions on land ownership							x	x				
4. Debt-equity requirements												x
5. Restrictions on remittances		x					x	x				
6. Subsidies												
7. Local employment requirements	x		x		x		x	x	x	x	x	x
8. Foreign exchange requirements												
9. Sectoral limits												
10. Technology transfer requirements												
11. Local content requirements												
12. Unbound												

Notes

1. Annual report on exchange arrangements and exchange restrictions, 2004.
2. Country investment policy reviews for Botswana, Ethiopia, Ghana, Mauritius, Tanzania and Uganda.
3. World Bank Foreign Investment Advisory Services, Pilot Investment Climate Assessment for Mozambique and Nigeria.
4. Country Commercial Guides for Botswana, Ethiopia, Ghana, Kenya, Mauritius, Mozambique, Nigeria, Senegal, South Africa, Tanzania and Uganda.
5. IMF Press Release No. 03/122 July 23, 2003.
6. IMF Annual report on exchange arrangements and exchange restrictions, 2004.
7. However, a regular complaint from foreign-owned enterprises is that the latter condition introduces an element of regulatory discretion that in some cases renders the stated commitment to unrestricted remittance irrelevant.
8. Ethiopia Business Development and Service Network (EBDSN), www.bds-ethiopia.net.
9. US Department of Commerce.
10. See www.wto.org.
11. Does not apply as there are no sectoral restrictions.
12. Does not apply as there are no sectoral restrictions.
13. Does not apply as no authorisation is required.
14. International Bureau of Fiscal Documentation, Tax Treaties Database, 2004.
15. UNCTAD – Uganda investment policy review, 2000.
16. Mode 3 is the supply of a service through the commercial presence of the foreign supplier in the territory of another WTO member.

3.3 Investment Compact for South East Europe

The South East Europe Compact for Reform, Investment, Integrity and Growth ("The Investment Compact") promotes and supports policy reforms aiming at improving the investment climate in South East Europe and thereby encouraging private direct investment and the development of a strong private sector. The programme, launched in 2000, is a key component of the Stability Pact under Working Table II on Economic Reconstruction, Development and Co-operation. The beneficiary countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, Moldova, Romania and Serbia and Montenegro. The main objectives of the IC are the following: (i) Improve the climate for business, investment and employment; (ii) Attract and encourage private investment; (iii) Ensure private sector involvement in the reform process; (iv) Instigate and monitor the implementation of policy reform.

The Investment Compact conducts its work through two main regional working groups: the SEE Investment Forum, dealing with Investment Policy and Promotion and the SEE Enterprise Forum, dealing with Enterprise and Entrepreneurship Development and SME Support. These regional groups are chaired and lead by SEE countries on a rotating basis (Bosnia and Herzegovina and Albania are the current chairs respectively for the above groups). Other active regional working groups established within the framework of the Investment Compact are the SEE Competition Initiative Initiative – now in the form of the SEE Competition Authorities Network (SEECAN) – the Regulatory Reform Initiative Steering Group and the SEE Corporate Governance Round Table, again regional groups that are lead by SEE countries with OECD/EU country support.

The Investment Compact has instigated private sector policy advisory groups and maintains a close co-operation with organisations representing private investors. These include the Foreign Investor Councils (FICs) in each SEE country as well a Regional Network of FICS, the Business Advisory Council (BAC) to the Stability Pact for SEE and the Business and Industry Advisory Council (BIAC) to the OECD, and with Chambers and organisations representing local investors and the small business sector. The Investment Compact is supported by 12 OECD countries and works in close co-operation with a number of multilateral (EC, EBRD, World Bank) and bilateral organisations operating in South East Europe.

STABILITY PACT WORKING TABLE II
Investment Compact for South East Europe

CONFERENCE ON MAXIMISING THE IMPACT OF INVESTMENT ON EMPLOYMENT AND HUMAN RESOURCES: MINISTERIAL STATEMENT

Sofia, 10 June 2005

The Fourth South East Europe Ministerial Conference was hosted by Bulgaria and organised by the Austrian and Bulgarian Co-Chairs of the Investment Compact and the OECD

1. Ministers and representatives of South East Europe affirm their commitment to maintain the progress in fulfilling the Declarations of previous Investment Compact Ministerial meetings with the aim of strengthening economic advancement and consolidating social progress across the region and thereby underpin closer integration with the European Union.

2. Ministers commend the joint regional action undertaken to date within the framework of the Investment Compact and resolve to continue to strengthen regional leadership and regional cooperation to improve the environment in South East Europe for business and investment.

3. Ministers express their appreciation to Bulgaria for its lead role as Regional Co-chair of the Investment Compact, to Bosnia and Herzegovina for chairing the South East Europe Investment Forum and to Albania for chairing the South East Europe Enterprise Forum as well as to the European Commission, EBRD, OECD countries and other international institutions for their partnership and support to these regional led initiatives.

4. Ministers consider the expansion of intra and extra regional trade and investment as key elements for economic development in the region, contributing to the competitiveness of their economies and employment creation. Trade and investment are closely interrelated and should be considered under a common, comprehensive policy approach, as highlighted

by this joint meeting with the Stability Pact Trade Working Group and by Ministerial Statements on Investment and Trade Policy respectively, in South East Europe.

5. Ministers share the view that effective and regular consultation with the private sector, at national, regional and European level, contributes significantly to improving the quality of government policy, to securing better policy implementation and to maximising the benefits of private investment. They welcome the Business Statement presented at the Ministerial Conference by the Bulgarian International Business Association, the SEE Regional Network of Foreign Investor Councils, the Business Advisory Council for South East Europe and the Business and Industry Advisory Committee to the OECD and reaffirm their commitment to continue the process of private sector consultation in an open and constructive manner.

6. Ministers welcome the measurable progress on many policy and business climate fronts made over the last year and note the record level of regional FDI in excess of € 8 billion achieved by the region in 2004, a doubling of the average of previous years. In addition to continuing privatisation, they consider that strengthened efforts should focus on attracting green-field investment, expansion of existing investment and the development of export oriented activities.

7. Ministers agree that raising the level and quality of employment in the countries of South East Europe is one of the most urgent policy issues for the region and underline the positive effects of investment on employment creation. They express their appreciation for the work on the impact of FDI on employment creation in South East European countries which has been performed by the Hungarian Institute for World Economy. They welcome the conclusions resulting from that work and call for further consideration of these issues by the Investment Compact including continued co-operation with the Stability Pact's Initiative for Social Cohesion.

8. Ministers call for increased attention to human resource development, in the context of investment and employment strategies. Education systems should take into account prospective labour market trends and needs that imply a strong orientation towards vocational training.

9. Ministers underline the need for continued focus on enterprise creation and enterprise development across all sectors of the economy and welcome the recent Enterprise Performance Policy Assessments jointly conducted by the OECD Investment Compact and the EBRD, in consultation with the European Commission. Ministers agree to intensify their actions to remove barriers to investment and simplify the regulatory environment for private companies, along the lines indicated by the diagnostic studies and the country

action plans elaborated with the support of the OECD and the Foreign Investment Advisory Service of the World Bank Group. They note that concrete progress has been made in a number of countries of the region to streamline and simplify company registration and other procedures affecting business.

10. In particular, Ministers recognise that further efforts are needed to simplify the regulatory regime concerning the issuing of licenses and permits, in redesigning the systems for inspections and auditing by state bodies, in enhancing public sector operations and improving the communication with the business sector, as highlighted by the updated progress report on regulatory reform undertaken by the OECD Investment Compact. Continued efforts are needed in order to systematically improve the quality of regulations affecting the business environment.

11. Ministers recognise the progress in providing National Treatment to foreign companies in the SEE area and call for review of the remaining exceptions by the Investment Compact and for report back by the time of the next Ministerial Meeting.

12. Ministers agree that further action is required to eliminate remaining intra-regional barriers to investment and trade. In this context, they express strong interest in the work initiated by the OECD Investment Committee for the elaboration of a Policy Framework for Investment. They mandate the Investment Compact to prepare a regional investment framework which they will consider at the 2006 meeting. This regional framework should draw upon OECD principles and consolidate the progress achieved by the Investment Compact in policy areas related to investment.

13. Ministers reconfirm the importance of national reform strategies to improve the investment climate, which requires effective policy coordination through country teams and the setting of critical time bound targets. They welcome the efforts of the Investment Compact to strengthen the monitoring process on the achievement of targets and the use of peer review procedures, with OECD country participation, which will take into account agreed benchmarks and ratings. They call upon the Investment Compact Project Team to coordinate the development of a new set of targets and to present an evaluation at their 2006 meeting.

14. Ministers acknowledge the important role played in the promotion of regional economic co-operation by the Stability Pact and strategic initiatives such as the Investment Compact for South East Europe and call for continued partnership from the international community in building on the progress achieved.

15. Ministers thank the co-chairs of the Investment Compact – Austria, Bulgaria and the OECD – and the Stability Pact Special Co-ordinator for their continued efforts and support for the preparation of the 2005 Ministerial Meeting, and the Bulgarian Minister of Economy for having hosted it. They agree to reconvene in 2006.

ADOPTED in Sofia, on the 10th day of June in the year two thousand and five:

Albania
Anastas Angjeli
Minister of Economy of Albania

Bosnia and Herzegovina
Hamdo Tinjak
State Secretary
Ministry of Foreign Trade and Economic Relations

Bulgaria
Milko Kovachev
Minister of Economy

Croatia
Vladimir Vrankovic
State Secretary
Ministry of Economy, Labour and Entrepreneurship

Macedonia
Sasa Andonovski
Vice-Minister of Economy

Moldova
Igor Dodon
Vice-Minister of Economy and Trade

Romania
Iuliu Winkler
Minister for Trade

Serbia and Montenegro
Danilo Vucetic
Ambassador
Embassy of Serbia and Montenegro in Sofia

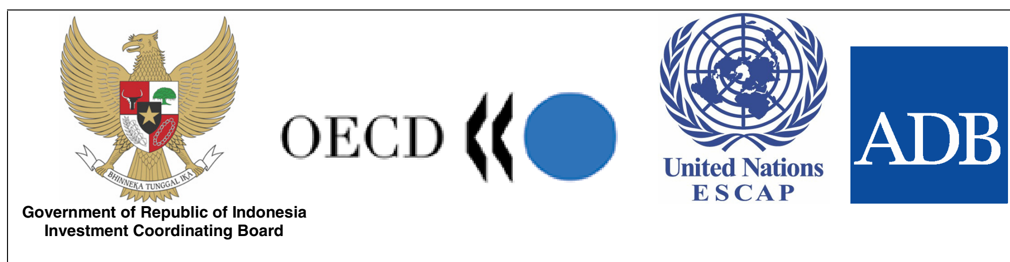
Serbia
Vlatko Sekulovic
Vice-Minister
Ministry of International Economic Relations

Montenegro
Gordana Djurovic
Minister for International Economic Relations and European Integration

UNMIK
Andreas Wittkowsky
Head of Economic Policy Office

3.4. Emerging Asia

The OECD-Asia Investment Initiative emerged from an exploratory meeting in Shanghai on 6 December 2002, against the background of countries in the region being increasingly concerned about maintaining high levels of foreign direct investment inflows and the implications of China attracting a major share of these inflows. The expected outcome from the Investment Committee's policy dialogue with Asian economies is to contribute to an improved investment environment in the region and to retaining and maximising benefits of private sector investment for Asian development.



CONFERENCE ON INVESTMENT FOR ASIAN DEVELOPMENT: LESSONS SO FAR, CHALLENGES FOR THE FUTURE

Summary Report*

5-6 July 2005

The conference on "Investment for Asian Development: Lessons so Far, Challenges for the Future", held on 5-6 July 2005 in Jakarta, Indonesia was the first major output of the OECD-Asia Investment Initiative. It was organised under the auspices of the OECD Investment Committee in co-operation with UNESCAP and the Asian Development Bank (ADB), and hosted by the Government of the Republic of Indonesia.

A wide cross-section of experts in investment policy attended the event, with approximately 200 participants, primarily from East and South East Asian economies including Indonesia, Chinese Taipei, Japan, Malaysia, Philippines, Singapore, Thailand, and Vietnam. Eleven OECD member countries were represented. About half of the participants were government officials and the others were either from business or NGOs and intergovernmental organisations. In addition to the co-organisers, UNIDO and ASEAN participated actively in the proceedings. The conference was co-chaired by Mr. Chris Legg, General Manager, Treasury, Australia, and Mr. M.M. Azhar Lubis, Head of Information and Planning Bureau, Investment Coordinating Board (BKPM), Indonesia.

The Joint Concluding Remarks by the Co-Chairs is reproduced in Annex 1.

The conference was organised into four sessions, each addressing one element of the investment agenda of the Monterrey Consensus. These were

* This summary has been prepared by Hans Christiansen, Michael Gestrin and Takeshi Koyama from the OECD Investment Division.

the challenge of upgrading the investment climate, the appropriate roles for governments of host and home countries, including investment promotion agencies and development agencies, the role for international and regional organisations, and the specific role of the OECD Policy Framework for Investment in a development context.

Introductory remarks

The conference was opened by H.E. Muhammad Lutfi, Chairman of the Investment Coordinating Board. His welcoming speech was followed by opening remarks from OECD Deputy-Secretary General Kiyotaka Akasaka and H.E. Aburizal Bakrie, Coordinating Minister for Economic Affairs, Government of the Republic of Indonesia.

Mr. Lutfi emphasised the need to address investment climate fundamentals, including increased transparency for investors and the fight against corruption. He pointed out that in recent years Indonesia has made considerable progress in this domain, notably through improvements that strengthen democratic institutions and through ongoing efforts to reform investment law. Mr. Akasaka's remarks focussed on a number of investment and development challenges that continue to afflict the Asian continent, including high poverty rates, receding levels of development assistance and growing policy competition to attract investment. He also highlighted the spectacular progress that has been achieved in many economies, including the five Asian "tigers" and, most recently, China.

H.E. Dr. Marie Elka Pangestu, Minister of Trade, Government of the Republic of Indonesia, delivered the keynote address. The address outlined the changes in thinking in Indonesian political and policy circles with respect to private investment. The Minister argued that the private sector is no longer perceived as a "supplement" to public spending, but rather as a key element in development efforts. This change in part reflects shifts in business operations towards increased international production. In the new environment, traditional models of economic development such as the "flying geese" paradigm may have lost some of their relevance, with important policy ramifications. The Minister concluded by challenging the conference to address a number of issues related to the Indonesian government's present efforts at liberalisation and administrative simplification in relation to private investment.

Implementing the Monterrey Consensus

The first session took as its starting point the role of private investment, stressed in the Monterrey Consensus. It focussed on some of the foremost

initiatives by international organisations and East Asian governments to improve investment climates. Four presentations agreed on a need for policy-makers to pursue a broad-based approach to promoting investment. Priority areas include macroeconomic stability, the pursuit of good public governance and corporate responsibility, fighting corruption, enhancing transparency, liberalising international capital flows, providing adequate infrastructure and human resources, and capacity building through international co-operation. These common elements were found to be strongly synergistic with ongoing OECD efforts. For instance, the Investment for Development Initiative and the OECD Guidelines for Multinational Enterprises received special attention, as supportive of capacity building in areas that bear on the investment climate.

Improving the investment climate

The second session drew strongly on the input of "practitioners" – business representatives and investment promotion agencies. In addition to many of the issues identified in the first session, several speakers noted the importance of having political support for reforms, especially those that favour increased transparency and accountability as a counter to resistance by those who stand to lose from such reforms. Indeed, high level political support was identified as an important element in Indonesia's improved investment climate. Another issue brought up in this session was the importance of a transparent, broad-based tax system. Tax incentives were also addressed, but several speakers, while acknowledging that these might sometimes play a role, emphasised that they remain secondary in importance to the fundamentals of a sound investment climate.

Making the most from ODA-investment synergies

The third session considered the role of international co-operation for improving the investment climate, in particular linking official development assistance (ODA) and investment. Three case studies were presented. Each found that ODA can be successfully used to encourage private investment for development. Shortcomings in the approaches so far were also discussed. Some participants noted that efforts by donors could sometimes be co-ordinated better and that more concerted efforts could be made to embed the potential synergies between ODA and private investment in development strategies. Among the specific experiences discussed in the session, the importance of ODA-based strategies in changing public sector perceptions toward private investment were highlighted. Several participants also mentioned the potential for development agencies to assist investment by encouraging private involvement in the development of infrastructure.

Getting the policy framework right

The fourth session served as a regional consultation on the evolving Policy Framework for Investment (PFI). Two draft chapters of the PFI were discussed: the first on investment policy and the second on investment promotion and facilitation. The first part of the discussions elaborated on the complementarities of the PFI with APEC's Non-binding Investment Principles and the ADB-OECD Anti-Corruption Initiative for Asia-Pacific. An important challenge, common to all three initiatives, concerns their adaptability to the particular needs of countries at different levels of development. The discussants mostly agreed with the draft PFI chapter on investment policy that three issues of major importance to investment-policy makers are: transparency; the protection of property rights, including intellectual property; and non-discrimination.

During the second part of the discussions, the issue of investment incentives was discussed in detail. There was broad agreement on the potential usefulness of investment promotion and facilitation, provided such efforts are anchored by the fundamentals emphasised in the previous sessions. Authorities should, however, remain vigilant with respect to the possible harm that overly aggressive promotion can give rise to, including market distortions and unintended additional administrative burdens. Within South East Asia, regional competition for investment is a key challenge. Evidence presented at the conference suggested that China's performance in attracting FDI is not above what models predict relative to the size of the economy and that FDI expansion in China and other countries in the region is not a zero-sum game. Participants identified international co-operation as an important avenue for avoiding wasteful incentive strategies. ASEAN is evolving as an important player in this regard, and participants noted a benefit of using the OECD Checklist for FDI Incentive Policies for cost-effectiveness assessment. International investment agreements were also identified as an avenue for ensuring that countries don't become engaged in a regulatory "race to the bottom". They also expressed an interest in the example of the OECD Investment Committee acting as a forum for consultations.

Conclusions and perspectives

In their joint concluding remarks, the co-chairs reviewed the common ground that had emerged during the conference. The key points were:

- The primacy of persevering with governance reform as one of the surest means for Asian nations to continue to attract investment for growth, poverty reduction, and sustainable development;

- Priority areas for investment climate enhancement include regulatory transparency and predictability, anti-corruption measures in the public sector and responsible business practices, revisiting restrictions on foreign investment and barriers to competition, reducing the complexity and cost of approval and registration processes for doing business, and promoting regional integration and quality infrastructure;
- To the extent that countries use tax or other incentives, the costs of these, including their market distorting effects, should be evaluated against the expected benefits;
- The synergies between ODA and investment, which appear stronger when strategies are anchored in a domestic reform process. They can also have a significant leverage effect when focussed on building corporate law and other regulatory and administrative capacities; and
- The potential for further co-operation between Asian countries and the OECD in the context of on-going work to develop the Policy Framework for Investment, as well as in the context of OECD-type peer reviews and dialogue. Indonesia and other interested Asian countries will be invited to act as pilots. Partnership with regional organisations and other intergovernmental organisations such as APEC, UNESCAP and ADB.

H.E. Dr. Marie Elka Pangestu, Minister of Trade, closed the conference. She took note of the conference's main findings, emphasising their relevance in the context of ongoing efforts to reform Indonesia's investment laws. The Minister noted the extent to which views on investment policy have converged over the years. This is evident by the broad agreement among participants on issues such as national treatment, which only a few years ago would have been highly contentious. She took this as testament to the importance of a broad-based international dialogue on investment policy issues, not least as an increasing number of countries face similar policy challenges.

Annex 1

Joint Concluding Remarks by OECD and Indonesian Government Co-Chairs

Mr. Chris Legg, Treasury, Australia, and Mr. M.M. Azhar Lubis, Investment Coordinating Board (BKPM), Government of Republic of Indonesia

Promoting "Investment for Asian Development" was the objective of the OECD conference organised in partnership with UNESCAP and ADB and hosted by the Indonesian Government in Jakarta on 5-6 July, 2005.

The Conference reviewed Asian countries' efforts to improve their enabling environments for private investment – both foreign and domestic -- and found that reforms have been paying off. Indonesia and most South East Asian economies are re-gathering pace after the slump that followed the Asian crisis. The Conference also acknowledged the important policy challenges being addressed by Indonesia and other Asian governments as they seek to reap the full benefits of international investment in today's globalising economy, and supported the direction of change.

Persevering with governance reform was considered to be the surest means for Asian nations to continue to attract investment for growth, poverty reduction and sustainable development. Priority areas include regulatory transparency and predictability, anti-corruption measures in the public sector and responsible business practices, revisiting remaining restrictions to foreign investment and barriers to competition more generally, reducing the complexity and cost of approval processes for doing business, promoting regional integration and quality infrastructure. At the same time, the importance of building and preserving a community consensus in favour of foreign investment was recognised while any continuing restrictions such as maintaining negative lists are tightly focused.

The value of such reform efforts was seen to go beyond their positive impact on foreign investment: they in effect provide a level playing field which allows local, smaller enterprises to expand and seize the business opportunities offered by globalisation. Investment promotion agencies can play an important facilitating role and be an advocate of the benefits of reform for all investors.

Participants took note that Asian countries are using tax and other special incentives to attract investment and that some countries, like Indonesia, consider recourse to such incentives may continue to be needed to increase their attractiveness for FDI. The OECD Checklist on FDI

Incentive Policies provides a tool to assist governments in assessing the cost-effectiveness of their incentive measures.

The Conference explored how the international community -- development agencies, OECD and other international organisations -- may assist Asian country governments in advancing their investment attraction agendas.

Participants discussed how official development assistance (ODA) may best be used to support countries' efforts to enhance their investment climates. A recent joint OECD Development Assistance and Investment Committees' report, tabled at the Conference, finds that ODA in the area of supporting private investment can be more focused and better co-ordinated. Studies of selected Asian experiences commissioned by OECD and reviewed at the Conference suggest that ODA/investment synergies approaches work best when anchored in a domestic reform process and can have a significant leverage effect when focusing on building corporate law and other regulatory reform capacities. The lessons learnt from the Conference will be conveyed to the OECD donor community and its partners as they develop further guidance on enhancing aid effectiveness in the field of investment.

Participants saw merit in considering options for Asian countries taking fuller advantage of OECD-type peer review and dialogue as an effective mechanism for investment policy capacity building, especially when internationally accepted benchmarks are available and used. In this context, special attention was given to the Policy Framework for Investment (PFI) that the Investment Committee is presently developing with Asian and other non-member partners at OECD. The PFI is intended as a comprehensive and non-prescriptive tool for promoting a coherent, "whole-of-government" approach to investment.

The viewpoints of the Asian participants in the Conference will be brought to the attention of the Task Force that is responsible for developing the PFI. After its completion in mid 2006, it is expected that the PFI will serve as the basis for self-evaluation and peer dialogue. It was suggested that combining best practices from the trade policy and the investment policy chapters of the PFI will open particularly promising prospect for peer dialogue in the Asian context. In this process, Indonesia and other interested Asian countries will be invited to act as pilots, and close partnership with regional economic organisations such as the co-organisers UNESCAP and ADB, as well as APEC and ASEAN, will be sought. The APEC-OECD Seminar "Working Together on Investment for Development" to be held in Korea in November 2005 will be one important step in the further development of Asia/OECD partnership.

CHAPTER 4.

China, India and Russia: The Continuing Dialogue

An element of the OECD Investment for Development Initiative includes dialogue with the major non-member players in the field of international investment. Three large countries currently involved with the OECD Investment Committee are China, India and the Russian Federation.

The co-operation focuses on promoting transparent and open investment policy and effective implementation, improvement of FDI data quality and maintaining appropriate standards in support of sustainable development.

This chapter outlines the country programmes of co-operation with the People's Republic of China and the Russian Federation. It also summarises in detail the recently established dialogue between the Government of India and the OECD Investment Committee, with information on the nature of the barriers to inward FDI and progress made in removing these obstacles and in creating a favourable investment environment.

4.1. China

Co-operation between the OECD and China began in 1999. It has since developed extensively and is strongly supported by the Investment Committee to promote transparency, openness and effective implementation and enforcement of policies towards investment. The OECD gives its patronage to the annual China International Fair for Investment and Trade in Xiamen.

Based on active co-operation with the Ministry of Commerce of the People's Republic of China and contributions by OECD Members and private practitioners, the OECD Investment Policy Review of China: Progress and Reform Challenges was published in July 2003 and launched shortly afterwards at press conferences in China, Hong Kong (China), Japan and the United States. It showed that China could attract more and better FDI by adopting more open investment policies and recommended a number of policy options, including the relaxation of formal restrictions on foreign enterprise ownership, the streamlining of investment approval procedures and improvements in the institutional framework such as stronger enforcement of intellectual property rights, greater transparency in the formulation of legislation and a more effective legal system. The report included a foreword by Madam Ma Xiuhong, the Deputy Minister of Commerce in charge of foreign investment.

In 2005 work on policy towards cross-border mergers and acquisitions commenced with a pilot project in North-East China focusing on the development and implementation of national policies on cross-border mergers and acquisitions in the region. These policies, embodied in laws passed in 1998-2003, have been aimed largely at involving multinational enterprises based outside China in the restructuring of state-owned enterprises (SOEs) in North-East China, which is the country's original industrial heartland. A well-attended conference was held in Changchun, the capital of Jilin province, in February to launch the project. The conference was jointly chaired by MOFCOM, the OECD and local government leaders. This was followed by an OECD fact-finding mission to Beijing and to China's three North-East provinces in April involving a wide range of interviewees from both public and private sectors in China and OECD Member countries. The results of the mission will be included in a background report to be presented to a multi-stakeholder conference in Beijing in December after it has been reviewed by the Chinese and OECD

governments and commented on by an advisory group of independent experts. The conference will acknowledge the progress made by the Chinese government in developing a regulatory framework for cross-border mergers and acquisitions then examine remaining obstacles to such transactions and propose policy options to deal with them.

In 2006 the Investment Committee will initiate a project with China on OECD Member country and Chinese government approaches to corporate responsibility. This project responds to China's increasingly apparent need to develop concepts and mechanisms to promote good corporate citizenship in the context of both rapid economic growth in China and increasing investment by Chinese enterprises abroad. It also stems from the need of OECD-based multinational enterprises to be able to compete with Chinese enterprises (both in China and in the rest of the world) on a level playing field. Civil society organisations in China will be invited to participate with the OECD and with the Chinese government in an exchange of views on major areas of corporate responsibility. The objective is to reach common understandings of corporate responsibility standards and to work with existing initiatives to promote stronger and better-informed commitment to good corporate behaviour on the part of all enterprises operating in China and all Chinese enterprises operating abroad. Prominence will be given to the OECD Guidelines for Multinational Enterprises in this dialogue.

A second project in the Investment Committee's programme of work for 2006 will cover Chinese and OECD Member country government approaches to international investment agreements. China has since the 1980s been highly active in negotiating bilateral investment treaties and is continuing to engage in consultations with OECD Member country governments with a view to negotiating new treaties or to renegotiating existing treaties. In such consultations it is important that all sides share an understanding of the concepts employed.

4.2. Russian Federation

The Russian Federation and the Investment Committee have been intensifying investment policy co-operation over the past five years in recognition of the importance of foreign investment policies in Russia's overall reform strategy, the critical role of international investment for economic diversification and modernisation as well as the need for Russia to harmonise its policies with international best practices as a part of the country's integration into the world economy and international system. The co-operation programme uses the peer review mechanism to assist Russia in assessing the compatibility of its investment policies with OECD standards and eventually preparing its adherence to OECD investment instruments.

The main focus of the 2003-2004 programme was the Investment Policy Review of the Russian Federation: Progress and Reform Challenges that examined the country's' progress in enhancing its general economic environment and developing its legal framework for investment. The Review by the OECD Investment Committee took place in June 2004, with the Russian delegation headed by the Deputy Minister of Economic Development and Trade and the First Deputy Chairman of the Central Bank. The publication of the Review was launched to the press in Moscow in December 2004 and posted on OECD and Russian Ministry websites. The Review remarked several positive developments such as the gradual overhaul of the tax system, the land reform and the introduction of the new customs and foreign exchange legislation, but it also noted a persisting lack of investor confidence and a number of investment impediments, in particular foreign ownership restrictions in several key sectors, such as energy and financial services, excessive administrative burden on enterprises and widespread corruption and rent-seeking behaviour. The policy options proposed by the 2004 Investment Policy Review include removing remaining regulatory barriers to foreign investment, improving public and corporate governance, simplifying and making more transparent regulations and administrative procedures and ensuring a better compliance with federal laws and regulations at sub-federal government levels.

Based on these recommendations, the 2005-2006 co-operation programme concentrates on Russia's investment policy implementation and its foreign exchange and capital control reforms. In both areas, the OECD investment instruments are used as the benchmarks to measure Russia's achievements and as the reference tools to enhance its policy enforcement capacity. The activity seeks to involve the Russian authorities, foreign

investors and practitioners during the whole duration of the projects, including in the final peer review process within the Investment Committee.

The starting point of the project on foreign investment policy is an investor survey commissioned by the OECD to provide foreign investors' views on Russia's compliance with basic principles of foreign investment policy transparency as embodied in the OECD Framework for Investment Transparency and the OECD Checklist for FDI Incentive Policies. In parallel, the Investment Policy Division of the Ministry of Economic Development and Trade accepted to co-ordinate a self-evaluation of Russian foreign investment policy, especially with respect to access to information and consultation procedures involving foreign investors. Using the recently developed methodology, the project will also measure the level of Russia's foreign investment liberalisation compared to OECD and some non-OECD countries. The exchange of views with the business community and sharing experiences with OECD countries should help identifying best policy options to boost the investment climate in Russia through better transparency and coherence of foreign investment-related policy.

The project on foreign exchange and capital control reforms takes advantage of OECD members' experience with full liberalisation and good practices undertaken within the framework of the OECD Code of Liberalisation of Capital Movements. The review will assess the implementation of Russia's recent foreign exchange legislation as well as regulations and other measures supporting orderly abolition of remaining capital controls, including financial sector supervision, statistical reporting, anti-money laundering and other safeguards. The exercise will assist Russian authorities in increasing transparency, procedural fairness and consistency of foreign exchange regulations.

4.3. India

Summary of Dialogue between the Government of India and the OECD Investment Committee*

The dialogue was a continuation of co-operation on investment policies between India and the OECD following the OECD-India Investment Roundtable and Global Forum on International Investment held back-to-back in New Delhi in October 2004.

A high-level delegation of the Government of India held a dialogue with the Investment Committee on 7 April 2005 in response to an invitation by the Committee to the Government of India to discuss India's policies towards investment. The delegation was led by Mr Ashok Jha, Secretary to the Government of India and head of the Department of Industrial Policy and Promotion in the Ministry of Commerce and Industry.

India made a presentation on the background and specifics of measures to liberalise investment in India since 1991 and reiterated the Government of India's commitment to continuing economic and investment policy reform. The presentation was amplified and extended in responses to questions from Investment Committee members. The text below is a consolidation of presentation and responses. Annexes 1 to 6 contain details of foreign direct investment opening and restrictions supplied by the Government of India at the invitation of the Committee.

The economic context of investment liberalisation in India

The Indian delegation presented recent economic achievements of the country as follows:

The Indian economy has experienced sustained economic expansion during the reform period, with real annual GDP growth averaging 6.2% since 1991 and reaching 6.9% in the 2004-2005 fiscal year. Goldman Sachs forecasts 5% average annual GDP growth up to 2050. Services now account for over half of GDP. Exports reached USD75 billion in the 2004-2005 fiscal year and foreign investment approximately USD16 billion in the 2003-2004 fiscal year. India has mature capital markets and a well-developed banking system.

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* Prepared by Ken Davies, OECD Investment Division.

India's improved economic performance is based on sound macroeconomic management. The tax structure has been rationalised, policies on inward and outward investment have been liberalised, the rupee has been made fully convertible on trade account and the Fiscal Responsibility and Budget Management Act will ensure that the government budget deficit is brought to zero by 2008. Industrial policy has been to de-license and deregulate. Trade policy has been to lift quantitative restrictions and reduce customs duties, resulting in a doubling of India's share in global merchandise trade in five years.

India is now not just a centre for knowledge-based sectors, but is a major and highly competitive manufacturing centre, having become a major producer of automobile components, motorcycles, optical media and steel. India's competitive edge is its highly skilled manpower. India has more than 380 universities and 1,500 research institutions. The number of knowledge workers in software and service industries increased from 56,000 in 1990-1991 to 650,000 in 2003 and is forecast to reach 2 million in 2008.

The overall regulatory regime for FDI

India's opening to foreign investment has been rapid since 1991. Before then up to 40% foreign ownership of enterprises had been allowed on a selective basis. These restrictions have been steadily lifted, so that 100% foreign ownership is now permitted in many sectors. Further opening has occurred recently in several sectors, including infrastructure, domestic airlines and telecommunications.

Foreign investment in many sectors is now available via the automatic route, i.e. with no prior government permission required, merely an obligation to inform the Reserve Bank of India[1] within 30 days of inward remittances or the issue of shares to non-residents. In other cases, prior approval must be obtained from the Foreign Investment Promotion Board (FIPB), which generally issues a decision within 4-6 weeks.

India provides post-establishment national treatment to investment and has signed BITs with 57 countries. India has not signed regional trade agreements apart from the South Asian Free Trade Agreement (Safta). The country is now starting to enter into comprehensive economic agreements.

A foreign investor can choose any form of business, including joint venture, wholly-foreign-owned subsidiary or branch. All investments, profit and dividends of foreign investors may now be freely repatriated. Foreign investors may acquire immovable property incidental to or required for their activity. Companies incorporated in India are treated as Indian companies

for taxation purposes and India has signed double taxation avoidance agreements with 65 countries.

Five states account for 80% of FDI inflows because they are more receptive to FDI. There is now increasing competition between states for FDI.

Outward investment policies have also been liberalised since 1992. Indian corporates are now allowed to invest up to 100% of their net worth overseas. As a result, there was over USD3 billion in outward investment in each of the 2002-2003 and 2003-2004 fiscal years. During these two years, Indian corporates made over 100 major acquisitions overseas. Over 55% of this outward investment was in manufacturing.

Sectoral issues

Market opportunities now exist in rapidly expanding sectors, including telecommunications, information technology, electricity generation and road building. However, FDI restrictions persist in a number of sectors. Restrictions generally take three forms, which may be applied separately or together: 1) foreign ownership ceilings, 2) prior approval by the FIPB (as opposed to the automatic route), 3) special approval by sector-specific government authorities. [See Annexes 3-6 for details.]

Press Note 18

Press note 18, which restricts investment projects proposed to be engaged in by a foreign investor who is already involved in the same field,[2] has been substantially modified. The restriction has been removed for all new joint ventures. For joint ventures formed earlier it is now restricted to new investments in the same field, not, as previously, in related fields. For example, an investor with a joint venture in plate glass may not freely make another investment in plate glass but faces no restriction in investing in the manufacture of glass tumblers. [See Annex 1 for further details.]

Prospects for further reform

Economic reform is continuing

The Indian authorities emphasised that economic reform is an “ongoing exercise”. The “entire gamut of activities in the economic sphere” is being looked at for possible reform, including taxation, customs, labour laws and exit policies. Key areas for reform now include: 1) agriculture, which employs 60% of the population, so it is important to stimulate demand and invest in it; 2) entry and exit barriers for companies, which are being looked at with a view to rationalisation; 3) the financial sector.

However, social factors induce the government to consider carefully the pace of reform. There is no social safety net, so care has to be taken to protect jobs. Much growth in the organised sector has been jobless growth; job growth has been mainly in the unorganised sector. There are 430 million people in the workforce and 8 million are added each year, so India needs to add 8 million jobs a year just to sustain existing employment.

Taxation reform

Twenty-one Indian states agreed to adopt VAT from 1 April 2005. Tax constitutes 30-35% of final prices. Introducing VAT will cut indirect taxation so that tax will be only 14% of final prices.

Tariff reductions

Peak customs duties were cut in this year's budget from 20% to 15% and will be further cut to 5-8% in the next few years. Tariffs have fallen sharply since 1991: peak tariffs were then 300% and have been cut to 15% in February 2005. In answer to a question from the Committee whether India intended to bring its tariffs in line with those of ASEAN, the Indian authorities noted that ASEAN does not have uniform tariffs, and that these vary from near-zero tariffs in Singapore to relatively high tariffs in Indonesia. India is considering reducing the peak tariffs to a 5-8% range and eventually to zero. While peak tariffs will be 5-8%, tariffs on many products could be zero.

Financial-sector reform

Continual financial-sector reforms are individually small, but collectively "noteworthy". The Fiscal Responsibility Act will keep the "fiscal deficit under close watch". FDI in private-sector banks is being liberalised.

Further liberalisation of FDI is being considered

There are many sectors in which the Indian government considers it can further liberalise FDI. The first step is to raise ownership ceilings where these exist, e.g. from 26% to 50% or even 100%. The government will also consider whether it is necessary to maintain a legal requirement for FIPB approval in various sectors where FDI is not permitted via the automatic route. The Government of India planned to complete a review of all FDI policies by 15 May 2005. This review was to include the whole retail sector, where FDI via the automatic route is already permitted in the "cash and carry" business-to-business retail sector.

A law on Special Economic Zones which is expected to be enacted soon is intended to provide a liberalised climate and incentives, including tax

exemptions, for FDI in such zones. Special Economic Zones will not be export-processing zones, as they will not be limited to exporting. However, duty-free imports will only be available for exporting, so if items are sold locally, duty will first have to be paid on their inputs.

The Government of India is trying to reduce bureaucracy in FDI administration. The central government has set up an investment implementing agency, which meets approximately monthly and talks to both actual and potential investors grouped by sector or by country of origin. Difficulties are sorted out across the table in such meetings, to which state government representatives are also invited.

The Investment Committee asked if foreign investors who chose the FIPB route for investment projects in India even when such projects qualified for the automatic route did so because they did not have confidence in the legal system. The Indian delegation answered that foreign investors who chose the FIPB route instead of using the automatic route do not do so for legal protection, but because (they themselves say) they prefer to have a piece of paper. Judges in India are, he said, independent, so the judicial process in itself has nothing to do with choosing the FIPB route. The Secretariat was subsequently notified that only approximately 5% of planned foreign investment projects are submitted to the FIPB even when they qualified for the automatic route and that this share is diminishing.

In answer to questions by the Investment Committee on India's modest FDI performance so far relative to the size of the Indian economy, the Indian authorities considered that FDI inflows do not depend solely on the policy framework, which is a necessary but not a sufficient condition. The main other reasons for insufficient FDI inflows include: 1) inadequate physical infrastructure, so India is now focusing on this; 2) tax policies, so indirect taxes (i.e. VAT) are now being examined; 3) labour reform, in particular the exit policy.

Public-private partnerships in infrastructure

Infrastructure projects may not be financially viable on their own, while public-private partnerships (PPPs) in infrastructure can bring in private-sector resources and technical and managerial capabilities. The Indian authorities described PPPs as the "cornerstone of infrastructure projects". In 1991 India had expected that opening up infrastructure to foreign investment would attract huge inflows, but found that there was "no-one knocking on the door" because such projects were unprofitable unless user charges were set too high for consumers. It was therefore realised that there is a need to make infrastructure projects viable in terms of revenue, and not just offer capital grants.

There is an estimated 10-15% "viability gap" in most sectors which the government offers to fund because it is not able to bear the full cost of infrastructure investment. Viability gap funding is available for transport, power and water-related infrastructure projects and for international convention centres. Such funding takes various forms, including capital grants, operational and management support, and interest subsidies. Support is linked to predefined milestones. The Indian Government is considering funding the viability gap up to 20% to reduce financial risk.

Future co-operation between India and the Investment Committee

India is a member of the Committee's Task Force overseeing the development of the Policy Framework for Investment. It also actively contributed to the OECD Annual Roundtable on Corporate Responsibility on *OECD Guidelines for Multinational Enterprises and Developing Countries: Building Trust* held in June 2005 in conjunction with the annual meeting of the National Contact Points for the OECD Guidelines for Multinational Enterprises.

In addition to continuing to attend outreach events, the Committee invited India to consider the possibility of observership at OECD meetings, including peer reviews in areas of common interest, and closer association with OECD investment instruments in future.

The Government of India also expressed interest in sharing India's most recent approaches to bilateral investment treaties (BITs) and investment chapters of trade agreements and contributing experience on international investment in infrastructure and public utilities, including through public-private partnerships (PPPs).

Notes

1. The Reserve Bank of India (RBI) is India's central bank.

2. "Press note 18" is the common name for a Government of India regulation published in press release number 18 in 1998. The regulation states that the automatic route will not be available for FDI or technology collaborations if the foreign investor has, or had, a joint venture, technology transfer or trademark agreement in the same or an allied field. In such cases, the foreign investor must apply to the FIPB, explaining why a new venture is necessary and must prove that the new proposal will not jeopardise the interests of the existing (or earlier) partner or other stakeholders.

Annex 1

Guidelines pertaining to approval of foreign/technical collaborations under the automatic route with previous ventures/tie-up in India

Press Note 1 (2005)[1]

The Government has reviewed the guidelines notified *vide* Press Note 18 (1998 series) which stipulated approval of the Government for new proposals for foreign investment/ technical collaboration where the foreign investor has or had any previous joint venture or technology transfer/trademark agreement in the same or allied field in India.

New proposals for foreign investment/technical collaboration will henceforth be allowed under the automatic route, subject to sectoral policies, as per the following guidelines:

i) Prior approval of the Government will be required only in cases where the foreign investor has an existing joint venture or technology transfer/trademark agreement in the 'same' field. The onus to provide requisite justification as also proof to the satisfaction of the Government that the new proposal will or will not in any way jeopardise the interests of the existing joint venture or technology/trademark partner or other stakeholders would lie equally on the foreign investor/ technology supplier and the Indian partner.

ii) Even in cases where the foreign investor has a joint venture or technology transfer/ trademark agreement in the 'same' field prior approval of the Government will not be required in the following cases:

   a. investments to be made by Venture Capital Funds registered with the Security and Exchange Board of India (SEBI); or

   b. where in the existing joint-venture investment by either of the parties is less than 3%; or

   c. where the existing venture/ collaboration is defunct or sick.

iii) In so far as joint ventures to be entered into after the date of this Press Note are concerned, the joint venture agreement may

1. Information supplied by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India.

embody a 'conflict of interest' clause to safeguard the interests of joint venture partners in the event of one of the partners desiring to set up another joint venture or a wholly owned subsidiary in the 'same' field of economic activity.

These guidelines shall come into force with immediate effect.

Umesh Kumar, Joint Secretary to the Government of India

Annex 2

Sectors[1] under automatic route for FDI up to 100%[2]

Most manufacturing activities.

Non-banking financial services.

Drugs and pharmaceuticals that do not attract compulsory licensing or involve the use of recombinant DNA technology.

Food processing.

Electronic hardware.

Software development.

Film industry.

Advertising.

Hospitals.

Private oil refineries.

Pollution control and management.

Exploration and mining of minerals other than diamonds and precious stones.

Management consultancy.

Venture capital funds/companies.

Setting up/development of industrial parks/model towns/Special Economic Zones.

Petroleum products pipelines.

Electricity generation (except atomic energy).

Electricity transmission.

Electricity distribution.

Mass rapid transport systems.

Roads and highways.

Toll roads.

Vehicular bridges.

Ports and harbours.

Hotels and tourism.

Township housing, built-up infrastructure and construction development projects.

Advertising and films.

Computer-related services.

Research and development services.

Construction and related engineering services.

Pollution control and management services.

Urban planning and landscape services.

Architectural services.

Health-related services and social services.

Travel-related services.

Road transport services.

Maritime transport services.

Internal waterways transport services.

1. This list of sectors is illustrative only. Sectors not on the list may also be subject to automatic approval up to 100% foreign ownership. Some of the sectors on this illustrative list, e.g. non-banking financial services, may be subject to various additional requirements as shown in Annexes 3-6.

2. Information supplied by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India.

Annex 3

Sectoral FDI Restrictions[1]

Airports

Up to 100% FDI is permitted, but government approval is required above 74%.

Atomic minerals

The following three activities are permitted to receive FDI/NRI[2] investments through FIPB (as per detailed guidelines issued by the Department of Atomic Energy, vide Resolution No. 8/1(1)/97-PSU/1422 dated 6 October 1998: PB):

a. Mining and mineral separation.

b. Value addition *per se* to the products of a above.

c. Integrated activities [comprising of both a and b above.]

The following FDI participation is permitted:

i. Up to 74% in both pure value addition and integrated products.

ii. For pure value addition projects as well as integrated projects with value addition up to any intermediate stage, FDI is permitted up to 74% through joint venture companies with central/state PSUs in which equity holding of at least one PSU is not less than 26%.

iii. In exceptional cases, FDI beyond 74% will be permitted subject to clearance of the Atomic Energy Commission before FIPB approval.

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1. Information supplied by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India.

2. Non-Resident Indian. An Indian Citizen who stays abroad for employment/ carrying on business or vacation outside India or stays abroad under circumstances indicating an intention for an uncertain duration of stay abroad is a non-resident, including persons posted in UN organisations and officials sent abroad by the government on temporary assignments. Non-resident foreign citizens of Indian Origin are treated on par with non-resident Indian citizens.

Agriculture (including Plantation)

No FDI/NRI investment is permitted other than the tea sector, where FDI is FDI up to 100% is permitted up to 100% , including in plantations, with prior government approval and subject to the following conditions:

Compulsory divestment of 26% of equity in favour of the Indian partner/Indian public within a period of five years, and

Prior state government approval is required in case of any future land use change. The above dispensation would be applicable to all fresh investments (FDI) made in this sector.

Broadcasting

(a) TV Software Production

100% foreign investment allowed subject to:

i. All future laws on broadcasting and no claim of any privilege or protection by virtue of approval accorded, and

ii. Not undertaking any broadcasting from Indian soil without government approval.

(b) Setting up hardware facilities such as uplinking, HUB, etc.

Private companies incorporated in India with permissible FII/NRI/PIO[3] equity within the limits (as in the case of the telecommunications sector FDI limit up to 49% inclusive of both FDI and portfolio investment) to set up uplinking hub (teleports) for leasing or hiring out their facilities to broadcasters.

Footnote: As regards satellite broadcasting, all TV channels irrespective of management control to uplink form India provided they undertake to comply with the broadcast (programme and advertising) code.

3. Person of Indian origin. For the purpose of availing of the facilities of opening and maintenance of bank accounts and investments in shares/ securities in India, a foreign citizen (other than a citizen of Pakistan or Bangladesh) is deemed to be of Indian Origin, if: i. he, at any time, held an Indian passport; ii. he or either of his parents or any of his grand parents was a citizen of India by virtue of the Constitution of India or Citizenship Act, 1956 (57 of 1955). A spouse (not being a citizen of Pakistan or Bangladesh) of an Indian Citizen or of a person of Indian Origin is also treated as a person of Indian origin for the above purpose.

(c) Cable Network

Foreign investment is allowed up to 49% (inclusive of both FDI and portfolio investment) of paid-up share capital. Companies with a minimum of 51% of paid-up share capital held by Indian citizens are eligible under the Cable Television Network Rules (1994) to provide cable TV services.

(d) Direct-to-home (DTH)

Companies with a maximum of foreign equity including FDI/NRI/FII of 49% are eligible to obtain a DTH licence. Within the foreign equity, the FDI component may not exceed 20%.

(e) Terrestrial Broadcasting FM

The licensee shall be a company registered in India under the Companies Act. All share holding should be held by Indians except for the limited portfolio investment by FII/NRI/PIO/OCB[4] subject to such ceiling as may be decided from time to time. The company shall have no direct investment by foreign entities, NRIs and OCBs. As of now, foreign investment is permissible up to 20% portfolio investment.

(f) Terrestrial TV

No private operator is allowed in terrestrial TV transmission.

Coal and lignite

i. Private Indian companies setting up or operating power projects as well as coal or lignite mines for captive consumption are allowed FDI up to 100%.

ii. 100% FDI is allowed for setting up coal processing plants subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing.

4. Overseas corporate body. Overseas Corporate Bodies predominantly owned by Individuals of Indian Nationality and origin resident outside India (OCBs) include overseas Companies, partnership firms, societies and other corporate bodies which are owned, directly or indirectly to the extent of at least 60% by individuals of Indian Nationality or Indian Origin resident outside India as also overseas trusts in which at least 60% of the beneficial interest is irrevocably held by such persons. Such ownership interest should be actually held by them and not in the capacity as nominees.

iii. FDI up to 74% is allowed for exploration or mining of coal or lignite for captive consumption.

iv. In all the above cases, FDI is allowed up to 50% under the automatic route subject to the condition that such investment shall not exceed 49% of the equity of a PSU.

Domestic airlines

(Detailed guidelines have been issued by the Ministry of Civil Aviation.)

In domestic airlines

i. FDI up to 49% is permitted under the automatic route, subject to no direct or indirect equity participation by foreign airlines.

ii. 100% investment by NRIs is permitted under the automatic route.

Defence and strategic industries

FDI, including NRI investment, is permitted up to 26% with prior government approval, subject to licensing and security requirements. Detailed guidelines for the participation of private-sector and foreign investors in this sector are given in Annex 4.

Drugs and pharmaceuticals

FDI up to 100% is permitted on the automatic route for manufacture of drugs and pharmaceuticals, provided the activity does not attract compulsory licensing or involve use of recombinant DNA technology, and specific cell/tissue targeted formulations.

Establishment and operation of satellites

FDI up to 74% is permitted with prior government approval.

Housing and real estate

NRIs are allowed to invest in the following activities:

a. Development of serviced plots and construction of built-up residential premises.

b. Investment in real estate covering construction of residential and commercial premises including business centres and offices.

c. Development of townships.
d. City and in regional level urban infrastructure facilities, including both roads and bridges.
e. Investment in the manufacture of building materials, which is also open to FDI.
f. Investment in participatory ventures in a to e above.
g. Investment in housing finance institutions, which is also open to FDI as an NBFC.

Investing companies in infrastructure and services sectors

In respect of companies in the infrastructure/services sector, where there is a prescribed cap for foreign investment, only the direct investment will be considered for the prescribed cap and foreign investment in an investing company will not be set off against this cap provided the FDI in such a company does not exceed 49% and management of the investing company is with the Indian owners. The automatic route is not available.

Insurance

FDI up to 26% in the Insurance sector is allowed on the automatic route subject to obtaining a licence from the Insurance Regulatory and Development Authority (IRDA).

Lotteries, gambling and betting

The Government has reiterated prohibition of foreign direct investment (FDI)/foreign technical collaboration (FTC) in any form in the lottery business, gambling and betting sector. Foreign technology collaboration including franchise/trading/brand name, management contract, etc., in the lottery business, gambling and betting sector is also prohibited.

Mining

For exploration and mining of diamonds and precious stones FDI up to 74% is allowed via the automatic route. For exploration and mining of gold and silver and minerals other than diamonds and precious stones FDI up to 100% is allowed via the automatic route. Press Note No. 18 (1998 series) dated 14 December 1998 and Press Note No. 1 of 2005 dated 12 January 2005 are not applicable for setting up 100% owned subsidiaries in the mining sector, subject to a declaration from the applicant that he has no existing joint venture for the same area and/or the particular mineral.

Non-banking financial companies

a. FDI/NRI investments are allowed in the following NBFC activities shall be as per the levels indicated below:

   i. Merchant banking.
   ii. Underwriting.
   iii. Portfolio management services.
   iv. Investment advisory services.
   v. Financial consultancy.
   vi. Stock broking.
   vii. Asset management.
   viii. Venture capital.
   ix. Custodial services.
   x. Factoring.
   xi. Credit reference agencies.
   xii. Credit rating agencies.
   xiii. Leasing and finance.
   xiv. Housing finance.
   xv. Foreign exchange broking.
   xvi. Credit card business.
   xvii. Money changing business.
   xviii. Micro credit.
   xix. Rural credit.

b. Minimum capitalisation norms for fund-based: NBFCs:

   i. For FDI up to 51%: USD 0.5 million to be brought up front.
   ii. For FDI above 50% and up to 75%: USD 5 million to be brought up front.
   iii. For FDI above 75% and up to 100%: USD 50 million out of which USD 7.5 million to be brought up front and the balance in 24 months.

c. Minimum capitalisation norms for non-fund based activities: A minimum capitalisation norm of USD 0.5 million is applicable in respect of all permitted non-fund based NBFCs with foreign investment.

d. Foreign investors can set up 100% operating subsidiaries without the condition to disinvest a minimum of 25% of its equity to Indian

entities, subject to bringing in USD 50 million as in b iii above (without any restriction on the number of operating subsidiaries without bringing in additional capital).

e. Joint Venture operating NBFCs that have 75% or less than 75% foreign investment will also be allowed to set up subsidiaries for undertaking other NBFC activities, subject to the subsidiaries also complying with the applicable minimum capital inflow i.e. b i and B ii above.

f. FDI in the NBFC sector is put on automatic route subject to compliance with the guidelines of the Reserve Bank of India. The RBI will issue appropriate guidelines in this regard.

Petroleum (other than refining)

a. FDI is permitted up to 100% via the automatic route for petroleum products marketing. FDI in this sector is permissible subject to the existing sectoral policy and regulatory framework in the oil marketing sector.

b. FDI up to 100% is permitted via the automatic route in oil exploration in both small and medium-sized fields subject to and under the policy of the Government on private participation in (i) exploration for oil and (ii) the discovered fields of national oil companies.

c. FDI is permitted up to 100% via the automatic route for petroleum products pipelines subject to and under the government policy and regulations thereof.

d. FDI up to 100% is permitted via the automatic route for Natural Gas/LNG pipelines with prior government approval.

e. 100% wholly-owned subsidiary (WOS) is permitted for the purpose of market study and formulation.

f. 100% wholly-owned subsidiary (WOS) is permitted for investment/financing.

g. For actual trading and marketing, a minimum of 26% Indian equity is required over 5 years.

Petroleum (refining)

a. FDI is permitted up to 26% in the case of public sector units (PSUs). PSUs will hold 26% (Refining) and the balance of 48% by the public. The automatic route is not available.

b. In the case of private Indian companies, FDI is permitted up to 100% via the automatic route.

Postal services

FDI up to 100% is permitted in courier services with prior government approval excluding distribution of letters, which is reserved exclusively for the state.

Print media

The following participation in Indian entities publishing newspapers and periodicals is permitted:

a. FDI up to 100% in publishing/printing scientific and technical magazines, periodicals and journals.

b. FDI up to 26% in publishing newspapers and periodicals dealing with news and current affairs, subject to verification of antecedents of the foreign investor, keeping editorial and management control in the hands of resident Indians and ensuring against dispersal of Indian equity.

Detailed guidelines have been issued by the Ministry of Information and Broadcasting.

Private sector banking

74% from all sources via the automatic route subject to guidelines issued by the RBI. Consolidated guidelines are in Annex 5.

Telecommunications

i. Basic, cellular, value added services and global mobile personal communications by satellite: FDI is limited to 74% subject to licensing and security requirements adherence by the companies (who are investing and the companies in which the investment is being made) to the licence conditions for foreign equity cap and lock-in period for transfer and addition of equity and other licence provisions.

ii. In ISPs with gateways, radio-paging and end-to-end bandwidth, FDI is permitted up to 74% with FDI, beyond 49% requires Government approval. These services are subject to licensing and security requirements.

iii. No equity cap is applicable to manufacturing activities.

iv. FDI up to 100% is allowed for the following activities in the telecommunications sector:

   a. ISPs not providing gateways (both for satellite and submarine cables).

   b. Infrastructure providers providing dark fibre (IP Category I).

   c. Electronic mail

   d. Voicemail.

The above are subject to the following conditions:

a. FDI up to 100% is allowed subject to the condition that such companies divest 26% of their equity in favour of the Indian public in 5 years, if these companies are listed in other parts of the world.

b. The above services are subject to licensing and security requirements, wherever required.

c. Proposals for FDI beyond 49% shall be considered by the FIPB on a case-by-case basis.

Trading

Trading is permitted via the automatic route with FDI up to 51% provided it is primarily exporting activities, and the undertaking is an export house/trading house/super trading house/star trading house. However, via the FIPB route:

i. 100% FDI is permitted in the case of trading companies for the following activities:

   a. Exports.

   b. Bulk imports with ex-port/ex-bonded warehouse sales.

   c. Cash-and-carry wholesale trading.

   d. Other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group and for third party use or onward transfer/distribution/sales.

ii. The following kinds of trading are also permitted, subject to the provisions of foreign trade policy:

   a. Companies for providing after-sales services (i.e. not trading per se).

b. Domestic trading or products of JVs is permitted at the wholesale level for such trading companies who wish to market manufactured products on behalf of their joint ventures in which they have equity participation in India.

c. Trading of high-tech items/items requiring specialised after-sales service.

d. Trading of items for the social sector.

e. Trading of high-tech, medial and diagnostic items.

f. Trading of items sourced from the small-scale sector under which, based on the technology provided and laid-down quality specifications, a company can market that item under its brand name.

g. Domestic sourcing of products for export.

h. Test marketing of such items for which a company has approval for manufacture provided such test marketing facility will be for a period of two years, and investment in setting up manufacturing facilities commences simultaneously with test marketing.

i. FDI up to 100% is permitted for e-commerce activities subject to the condition that such companies divest 26% of their equity in favour of the Indian public in 5 years, if these companies are listed in other parts of the world. Such companies will engage only in business-to-business (B2B) e-commerce and not in retail trading. FDI is not permitted in retail trading activity.

Township Development

FDI up to 100% is allowed via the automatic route in townships, housing, built-up infrastructure and construction-development projects which include, but are not restricted to, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure subject to conditions and guidelines as in Annex 6.

Venture Capital

As per Schedule VI under the FEMA Regulation, a registered Foreign Venture Capital Investor (FVCI) may invest in Indian Venture Capital Undertakings (IVCU) or in a VCF after approval from the RBI.

Annex 4

Guidelines for Consideration of Foreign Direct Investment (FDI) Proposals by the Foreign Investment Promotion Board (FIPB)[1]

The Guidelines are meant to assist the FIPB to consider the proposals in an objective and transparent manner. These do not in any way restrict the flexibility or bind the FIPB from considering the proposals in their totality or making recommendations based on other criteria or special circumstances or features it considers relevant. Besides, these are in the nature of administrative guidelines and are not in any way legally binding in respect of any recommendation to be made by the FIPB or decisions to be taken by the government in cases involving FDI.

These guidelines are issued without prejudice to the government's right to issue fresh guidelines or change the legal provisions and policies whenever considered necessary.

These guidelines stand modified to the extent changes have been notified by the Secretariat for Industrial Assistance from time to time.

The following guidelines are laid down to enable the FIPB to consider the proposals for FDI and formulate its recommendations:

- All applications shall be put before the FIPB within 15 days and it should be ensured that comments of the administrative ministries are placed before the Board either prior to or in the meeting of the Board.
- Proposals should be considered by the Board keeping in view the time frame of 30 days for communicating the government's decision (i.e. approval of FM/CCEA or rejection, as the case may be).
- In cases in which either the proposal is not cleared or further information is required, in order to obviate delays presentation by the applicant in the meeting of the FIPB should be resorted to.
- While considering cases and making recommendations, the FIPB should keep in mind the sectoral requirements and the sectoral policies vis-à-vis the proposal(s).
- The FIPB shall consider each proposal in totality (i.e. if it includes apart from foreign investment, technical collaboration/industrial licence) for

1. Information supplied by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India.

composite approval or otherwise. However, the FIPB's recommendation shall relate only to the approval for foreign financial and technical collaboration and the foreign investor will need to take other prescribed clearances separately.

- The Board shall examine the following while considering proposals submitted to it for consideration:

    i. Whether the items of activity involve an industrial licence or not and, if so, the considerations for grant of an industrial licence must be gone into.
    ii. Whether the proposal involves technical collaboration and, if so, the source and nature of technology sought to be transferred.
    iii. Whether the proposal involves any mandatory requirement for exports and, if so, whether the applicant is prepared to undertake such an obligation (this is for items reserved for the small-scale sector as also for dividend balancing, and for 100% EOUs/EPZ units).
    iv. Whether the proposal involves any export projection and, if so, the items of export and the projected destinations.
    v. Whether the proposal has a concurrent commitment under other schemes, such as the EPCG Scheme, etc.
    vi. In the case of export-oriented units (EOUs), whether the prescribed minimum value addition norms and the minimum turnover of exports are met or not.
    vii. Whether the proposal involves relaxation of local restrictions stipulated in the industrial licensing policy.
    viii. Whether the proposal has any strategic or defence-related considerations.
    ix. Whether the proposal has any existing joint venture or technology transfer/trademark agreement in the same field in India, and, if so, whether this agreement is sick or defunct; the investment by either party is less than 3% and investment is by the FVCI, the detailed circumstance in which it is considered necessary to set up a new joint venture/enter into a new technology transfer (including trademark), and proof that the new proposal shall not in any way jeopardise the interest of the existing joint venture or technology/trademark partner or other stakeholders.

Guidelines

1. While considering proposals, the following may be prioritised:

   a. Items/activities covered under the government route (i.e. those which do not qualify under the automatic route).

   b. Items falling in the infrastructure sector.

   c. Items which have an export potential.

   d. Items which have large-scale employment potential, especially for rural people.

   e. Items which have a direct or backward linkage with agribusiness/farm sector.

   f. Items which have greater social relevance, such as hospitals, human resource development, life-saving drugs and equipment.

   g. Proposals which result in the induction of technology or infusion of capital.

2. The following should be especially considered during the scrutiny and consideration of proposals:

   a. The extent of foreign equity proposed to be held (keeping in view sectoral caps, if any – e.g. 24% for SSI units, 49% for air taxi/airline operators, 74% in basic/cellular/paging in the telecommunications sector, etc.).

   b. The extent of equity with composition of foreign/NRI/resident Indians.

   c. The extent of equity from the point of view of whether the proposed project would amount to a holding company/a wholly-owned subsidiary/a company with dominant foreign investment (i.e. 75% or more) joint venture.

   d. Whether the proposed foreign equity is for setting up a new project (joint venture or otherwise) or whether it is for the enlargement of foreign/NRI equity or whether it is for fresh induction of foreign equity/NRI equity in an existing Indian company.

   e. In the case of fresh induction of foreign/NRI equity and/or cases of enlargement of foreign/NRI equity in existing Indian companies, whether there is a resolution of the board of directors supporting the said induction/enlargement of foreign/NRI equity and whether there is a shareholders agreement or not.

   f. In the case of induction of fresh equity in existing Indian companies and/or enlargement of foreign equity in existing Indian companies, the reason why the proposal has been made and the modality for induction/enhancement [i.e. whether by increase of paid-up

capital/authorised capital, transfer of shares (hostile or otherwise) whether by rights issue, or by what modality].

g. Issue/transfer/pricing of shares will be as per SEBI/RBI guidelines.
h. Whether the activity is an industrial or a service activity or a combination of both.
i. Whether the item of activity involves any restriction by way of reservation for the small-scale sector.
j. Whether there are any sectoral restrictions on the activity (e.g. there is a ban on foreign investment in real estate while it is not so for NRI investment).
k. Whether the item involves only trading activity and, if so, whether it involves export or both export and import, or also includes domestic trading, and, if domestic trading, whether it also includes retail trading.
l. Whether the proposal involves import of items which are hazardous, banned or detrimental to the environment (e.g. import of plastic scrap or recycled plastics).

3. In respect of activities to which equity caps apply, the FIPB may consider recommending higher levels of foreign equity as compared to the prescribed caps, keeping in view the special requirements and merits of each case.

4. In respect of other industries/activities, the Board may consider recommending 51% foreign equity on examination of each individual proposal. For higher levels of equity up to 74% the Board may consider such proposals keeping in view considerations such as the extent of capital needed for the project, the nature and quality of technology, the requirements of marketing and management skills and the commitment to exports.

5. The FIPB may consider recommending proposals for 100% foreign-owned holding/subsidiary companies based on the following criteria:
   a. Where only a "holding" operation is involved, all subsequent/downstream investments to be carried out shall require prior approval of the government.
   b. Where proprietary technology is sought to be protected or sophisticated technology is proposed to be brought in.
   c. Where at least 50% of production is to be exported.
   d. Proposals for consultancy.
   e. Proposals for industrial model towns/industrial parks or estates.

6. In special cases, where the foreign investor is unable initially to identify an Indian joint venture partner, the Board may consider and recommend proposals permitting 100% foreign equity on a temporary basis on condition that the foreign investor

shall divest to the Indian parties (either individuals joint venture partners or the general public or both) at least 26% of its equity within a period of 3-5 years.

7. Similarly in the case of a joint venture where the Indian partner is unable to raise resources for expansion/technological upgrading of the existing industrial activity, the Board may consider and recommend an increase in the proportion/percentage (up to 100%) of foreign equity in the enterprise.

8. In respect of trading companies, 100% foreign equity may be permitted in the case of activities involving the following:
   i. Exports.
   ii. Bulk imports with ex-port/ex-bonded warehouse sales.
   iii. Cash-and-carry wholesale trading.
   iv. Other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group.

9. In respect of companies in the infrastructure/services sector where there is a prescribed cap for foreign investment, only the direct investment should be considered for the prescribed cap and foreign investment in an investing company should not be set off against this cap provided the foreign direct investment in such an investing company does not exceed 49% and the management of the investing company is with the Indian owners.

10. No condition specific to the letter of approval issued to a foreign investor shall be changed or additional condition imposed subsequent to the issue of a letter of approval. This shall not prohibit changes in general policies and regulations applicable to the industrial sector.

11. Where in case of a proposal (not being 100% subsidiary) foreign direct investment has been approved up to a designated percentage of foreign equity in the joint venture company the percentage shall not be reduced while permitting induction of additional capital subsequently. Also in the case of approved activities, if the foreign investor(s) concerned wish to bring in additional capital on later dates keeping the investment to such approved activities, the FIPB shall recommend such cases for approval on an automatic basis.

12. As regards any proposal for private-sector banks, the application shall be considered only after "in principle" permission has been obtained from the RBI.

13. The restrictions prescribed for proposals in various sectors that obtain at present[2] should be kept in view while considering proposals.

2. i.e. those in Annex 3 of this paper.

Annex 5

Guidelines for Foreign Direct Investment (FDI) in the Banking Sector[1]

(Press Note No. 2 of 2004 series)

1. Limits for FDI via the automatic route in private-sector banks:

   a. In terms of the Press Note No. 2 (2004 series) dated 5 March 2004 issued by the Ministry of Commerce and Industry, Government of India, FDI up to 74% from all sources is permitted in private-sector banks via the automatic route, subject to conformity with the guidelines issued by the RBI from time to time.

   b. For the purpose of determining the above-mentioned ceiling of 74% FDI via the automatic route in respect of private-sector banks, the following categories of shares will be included:

      i. FDI investment under the Portfolio Investment Scheme (PIS) by FIIs, NRIs and shares acquired prior to 16 September 2003.

      ii. IPOs.

      iii. Private placements.

      iv. ADRs/GDRs.

      v. Acquisition of shares from existing shareholders [subject to d below].

   c. It may be clarified that as per the Government of India guidelines, the issue of fresh shares via the automatic route is not available to those foreign investors who have a financial or technical collaboration in the same field. This category of investors requires FIPB approval.

   d. It may be further clarified that, as per the Government of India guidelines, the automatic route is applicable to the transfer of existing shares in a banking company from residents to non-residents within the sectoral equity cap. This category of investors require FIPB approval followed by "in principle" approval by the Exchange Control Department (ECD) of the RBI. The "fair price" for transfer of existing shares is determined by the RBI broadly on the basis of SEBI guidelines for listed shares and the erstwhile CCI guidelines for unlisted shares.

1. Information supplied by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India.

After receipt of "in principle" approval, the resident seller can receive funds and apply to the ECD of the RBI to obtain final permission for transfer of the shares.

e. Under the Insurance Act, the maximum foreign investment in an insurance company has been fixed at 26%. Application for foreign investment in banks which have joint ventures/subsidiaries in the insurance sector should be make to the RBI. Such applications will be considered by the RBI in consultation with the Insurance Regulatory and Development Authority (IRDA).

f. Foreign banks having a branch presence in India are eligible for FDI in the private-sector banks subject to the overall cap of 74% mentioned above with the approval of the RBI.

2. The limit for FDI in public sector banks:

FDI and portfolio investment in nationalised banks are subject to overall statutory limits of 20% as provided under Section 3 (2D) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/80. The same ceiling also applies in respect of such investments in the State Bank of India and its associate banks.

3. Voting rights of foreign investors:

In terms of the statutory provisions under the various banking acts, the voting rights, when exercised, are stipulated under:

- Private sector banks – Section 12 (2) of the Banking Regulation Act 1949]

  No person holding shares, in respect of any share held by him, shall exercise voting rights on poll in excess of 10% of the total voting rights of all the shareholders.

- Nationalised banks – [Section 3 (2E) of the Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970/80]

  No shareholder, other than the Central Government, shall be entitled to exercise voting rights in respect of any shares held by him in excess of 1% of the total voting rights of all the shareholders of the nationalised banks.

- State Bank of India (SBI) – [Section 11 of the State Bank of India Act 1955]

  No shareholder, other than the RBI, shall be entitled to exercise voting rights in excess of 10% of the issued capital. (The Government, in

consultation with the RBI, can raise the above voting rate to more than 10%.)

- SBI Associates—[Section 19 (1) and (2) of the SBI (Subsidiary Bank) Act 1959]

  No person shall be registered as a shareholder in respect of any shares held by him in excess of two hundred shares.

  No shareholder, other than the SBI, shall be entitled to exercise voting rights in excess of 1% of the issued capital of the subsidiary bank concerned.

4. Approval of the RBI and reporting requirements:

   i. Under extant instructions, transfer of shares of 5% or more of the paid-up capital of a private-sector banking company requires prior RBI acknowledgment. For FDI of 5% or more of the paid-up capital, the private-sector banking company has to apply on the prescribed form to the Department of Banking Operations and the Department in the Regional office of the RBI where the Bank's Head Office is located.

   ii. Under the provisions of the FEMA 1999, any fresh issue of shares of a banking company, either via the automatic route or with the specific approval of the FIPB, does not require further approval of the Exchange Control Department (ECD) of the RBI from the exchange control angle. The Indian banking company is only required to undertake two-stage reporting to the ECD as follows:

      a. In the first stage, the Indian company has to submit a report within 30 days of the date of receipt of the amount of consideration indicating the names and addresses of foreign investors, the date of receipt of funds and their rupee equivalent, the name of the bank through which funds were received and details of Government approval, if any.

      b. In the second stage, the Indian banking company is required to file within 30 days from the date of issue of the shares, a report on form FC-GPR together with a certificate from the Company Secretary of the company concerned certifying that various regulations have been complied with. The report will also be accompanied by a certificate from a Chartered Accountant indicating the manner of arriving at the price of shares issued.

5. Conformity with SEBI regulations and Companies Act provisions.

Wherever applicable, FDI in banking companies should conform to the provisions regarding shareholding and share transfer, etc., as stipulated by SEBI, Companies Act, etc.

6. Disinvestments by Foreign Investors

In terms of regulations 10 and 11 of RBI Notification No. FEMA/20.2000-RB dated 3 May 2000 issued under FEMA 1999, disinvestments by foreign investors are governed by the following rules:

i. The sale of shares by non-residents on a stock exchange and the remittance of the proceeds thereof through an authorised dealer does not require RBI approval.

ii. The sale of shares by private arrangement requires prior RBI approval. The RBI grants permission for the sale of shares at a price that is market-related and is arrived at in terms of the guidelines in the above-mentioned regulation 10.

7. All commercial banks which either have foreign investments or intend to have foreign investments must observe the above guidelines.

Annex 6

Guidelines for FDI in the Development of Township, Housing, Building, Infrastructure and Construction Projects[1]

(Press Note No. 2 of 2005 series)

With a view to catalysing investment in townships, housing, built-up infrastructure and construction-development projects as an instrument to generate economic activity, create new employment opportunities and add to the available housing stock and built-up infrastructure, the Government has vide Press Note No. 2 (2005 series) decided to allow FDI up to 100% via the automatic route in townships, housing, built-up infrastructure and construction-development projects (which include, but are not restricted to, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure), subject to the following guidelines:

a. The minimum area to be developed under each project shall be as below:

   i. In the case of development of serviced housing plots, a minimum land area of 10 hectares.

   ii. In the case of construction-development projects, a minimum built-up area of 50,000 square metres.

   iii. In the case of a combination project, any one of the above two conditions will suffice.

b. The investment will be further subject to the following conditions:

   i. Minimum capitalisation of USD 10 million for wholly-owned subsidiaries and USD 5 million for joint ventures with Indian partners. The funds must be brought in within six months of commencement of business of the Company.

   ii. The original investment may not be repatriated before a period of three years from completion of minimum capitalisation. However, the investor may be permitted to exit earlier with prior approval of the Government through the FIPB.

1. Information supplied by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India.

c. At least 50% of the project must be developed within a period of five years from the date of obtaining all statutory clearances. The investor shall not be permitted to sell undeveloped plots. For the purpose of these guidelines, "undeveloped plots" shall mean where roads, water supply, street lighting, drainage, sewerage and other conveniences as applicable under prescribed regulations have not been made available. It will be necessary for the investor to provide this infrastructure and obtain a completion certificate from the concerned local body/service agency before being allowed to dispose of serviced housing plots.

d. The project shall conform to the norms and standards, including land use requirements and provision of community amenities and common facilities, as laid down in the applicable building control regulations, bye-laws, rules and other regulations of the State Government/Municipal/Local Body concerned.

e. The investor shall be responsible for obtaining all necessary approvals, including those of the building/layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under applicable rules/bye-laws/regulations of the State Government/Municipal/Local Body concerned.

f. The State Government/Municipal/Local Body concerned, which approves the building/development plans, shall monitor compliance of the above conditions by the developer.

Paragraph iv of Press Note 4 (2001 series) issued by the Government on 21 May 2001 and Press Note 3 (2002 series) issued on 4 January 2002 stand superseded.

Annex 7

Glossary of Abbreviations

CCI	Competition Commission of India
EOU	Export-oriented unit
EPCG	Export promotion capital goods
EPZ	Export promotion zone
FII	Foreign institutional investor
FIPB	Foreign Investment Promotion Board
FVCI	Foreign venture capital investor
IRDA	Insurance Regulatory and Development Authority
IVCU	Indian venture capital undertaking
JV	Joint venture
NBFC	Non-bank financial company
NRI	Non-Resident Indian.
OCB	Overseas corporate body.
PIO	Person of Indian origin. For the purpose of availing of the facilities of opening and maintenance of bank accounts and investments in shares/ securities in India, a foreign citizen (other than a citizen of Pakistan or Bangladesh) is deemed to be of Indian Origin, if: i. he, at any time, held an Indian passport; ii. he or either of his parents or any of his grand parents was a citizen of India by virtue of the Constitution of India or Citizenship Act, 1956 (57 of 1955). A spouse (not being a citizen of Pakistan or Bangladesh) of an Indian Citizen or of a person of Indian Origin is also treated as a person of Indian origin for the above purpose.
PPP	Public-private partnership
PSU	Public sector unit
RBI	Reserve Bank of India (India's central bank)
Safta	South Asian Free Trade Agreement

SEBI	Security and Exchange Board of India
SSI	Small-scale industry
VCF	Venture capital fund
WOS	Wholly-owned subsidiary

Chapter 5.

Mobilising Private Investment for Development: The Role of ODA

This chapter on the role of official development assistance (ODA) in mobilising private investment includes a joint report by the Development Assistance Committee (DAC) and the Investment Committee, as part of the broader OECD Initiative on Investment for Development. The report has two main parts, namely the policy lessons that the two Committees made available to the 2005 OECD Ministerial Meeting and a synthesis of the analytical evidence underpinning the policy lessons.

The report focuses on the role of ODA to support the efforts of developing countries to improve their investment climate, including through policy capacity building. The experiences with intervention in areas such as regulatory reform, upgrading of infrastructure and strengthening the trade/investment linkage are reviewed. More targeted approaches to enhancing investment are also analysed, including ODA as a means of supporting public-private partnerships in developing countries and linkages between foreign-owned and domestic enterprises.

In the next phase of this project, to be completed in time for the DAC High-Level Meeting and the OECD Ministerial Council Meeting in 2006, further consultation and dialogue with relevant stakeholders is proposed to verify the policy lessons and to derive from them more concrete and pragmatic policy guidance for donors on how to use ODA more effectively to mobilise investment for development.

The second report in this chapter is an overview study that examines the experience of using ODA to mobilise more domestic and foreign investment in the African context.

5.1. Report on Policy lessons[1]

At the United Nations Millennium Summit, the world's leaders vowed to "spare no effort to free [their] fellow men, women and children from the abject and dehumanising conditions of extreme poverty to which more than a billion of them are currently subjected". Five years on, and with only ten years to go until 2015, it is apparent on current trends that the Millennium Development Goals (MDGs) may not be achieved in many developing countries, especially in Africa. Decisive action and more sustained and strategic approaches are consequently required, by developing countries and development agencies, and can legitimately be expected.

As the Monterrey Consensus emphasised, mobilising domestic resources, attracting international capital flows and promoting international trade are critical for generating the higher, more sustainable and more inclusive economic growth patterns needed to meet the MDGs. Sub-Saharan Africa needs to sustain an annual economic growth rate of more than 7% over the next ten years - more than double its recent performance - if it is to reach the first MDG of halving the proportion of people living on less than a dollar a day. A critical role for official development assistance (ODA) is thus to support such growth patterns by catalysing domestic resource mobilisation, promoting foreign direct investment (FDI) and increasing the contribution of trade to development and poverty reduction.

By supporting developing countries' own efforts to provide an attractive environment for private investment, ODA can play an important catalytic role and help leverage additional private financing for development. This is particularly important at a time when ODA has reached its highest level ever, and further increases are expected, but when progress towards the MDGs is too slow. A more concerted effort by development agencies to help partner countries mobilise domestic and foreign investment will not only allow donors to achieve more development with

1. This joint report by the Development Assistance and Investment Committees was presented as background documentation for the OECD Ministerial Council Meeting on 3-4 May 2005.

their ODA, it is one of the most direct and substantial means of delivering a sustainable reduction in poverty and achievement of the MDGs. Care must be taken to ensure that donors do not find themselves subsidising or redirecting investment that would have happened anyway, or creating an uneven playing field.

In response to the Monterrey Consensus' emphasis on the importance of mobilising private investment for development to enhance growth and reduce poverty, the Development Assistance Committee (DAC) and the Investment Committee have been carrying out a joint project on ODA/investment synergies. The work forms part of a broader OECD Initiative on Investment for Development, launched in Johannesburg in November 2003 and designed as a contribution to implementing the Monterrey Consensus and achieving the MDGs. This project is timely, as many developing countries and development agencies are intensifying efforts to reduce poverty by mobilising more and better investment.

Today, everyone accepts that jobs and self employment constitute an important pathway out of poverty. As the private sector is the main source of employment, vigorous and sustained economic growth, fuelled by investment and entrepreneurship, is needed to provide jobs and incomes for the poor. This will also help generate the revenues that governments need to expand access to the health, education and infrastructure services that will increase productivity and lead to more rapid economic growth that involves and benefits the poor. The logic of spending ODA to mobilise investment is that it can facilitate this process by correcting market failures and tackling structural impediments. The challenge for ODA is to stimulate genuinely additional investment.

Collectively, development agencies already spend a significant share of their aid on activities that contribute to mobilising more and better private investment – 26% of all foreign assistance, according to one analysis of mostly OECD/DAC data. Their activities include initiatives at the macroeconomic level (e.g. inflation and fiscal sustainability), the enabling environment level (e.g. relevant legislation, governance and infrastructure) and at the enterprise level (e.g. investment and trade promotion and facilitation and capacity development for policy making and implementation). It is not clear, however, that these various activities are sufficiently strategic in their overall effect. To improve the impact and effectiveness of this ODA, more focus, strategic targeting and co-ordination is needed behind a clearer objective to achieve the MDGs by increasing the quantity and buttressing the development benefits of investment.

To guide future interventions and help focus attention on areas with the greatest impact on mobilising more and sustainable investment in poor

countries, more detailed assessment is required of what works best in terms of using ODA to mobilise investment, what doesn't work and why. While DAC members do evaluate specific aspects of their support for private sector and infrastructure development, very few assessments of the overall effect of these activities on mobilising investment have been conducted. Joint assessments at a more aggregate and programme level could gauge how the individual and collective actions of donors are impacting on critical factors for mobilising investment.

Drawing on the evidence reviewed by the two Committees, some preliminary policy lessons emerge on the role of ODA in mobilising private investment for development:

a) *Build on partner countries' own development objectives.* The starting point for donors' interventions is to support partner countries' own plans for providing a healthy investment environment. These should be incorporated into a Poverty Reduction Strategy (PRS) or a similar national development plan. Where available, diagnoses of the investment climate should inform the preparation of development plans. This approach provides a framework for more co-ordinated and comprehensive support by the donor community.

b) *Address impediments to private investment.* The private sector needs a policy and institutional environment that allows it to thrive, thus major obstacles to the growth of and investment by private businesses need to be identified and addressed. In many developing countries, perceived risks to doing business are too high, basic services such as infrastructure are deficient, government regulations are applied unpredictably, the costs and complexities of starting and doing business are often excessive and corruption can be widespread. There is a need for greater efforts to consult with other stakeholders, including the private sector – domestic enterprises as well as foreign entrants – for their assessment of where governments and donors can best help. Development agencies can support processes instigated by developing countries to address binding constraints that impede growth and promote reforms, including at the sectoral level. Internationally agreed good practice can serve as a point of reference for such analyses and for benchmarking progress. Depending on the specific situation in each developing country, donors could take a more strategic and focussed approach to their interventions, prioritising activities in such areas as:

   i Legal systems. The development of legislation for company incorporation, contracts and other areas related to economic activities provides the backbone for private sector activity in the formal economy and needs to be backed up by strong

implementation mechanisms and judicial recourse. For example, ineffective or unpredictable dispute settlement mechanisms are often cited as hindering investment in developing countries. Nevertheless, few donors appear active in this area which merits greater attention in order to help mobilise investment.

ii Regulatory reforms. These have a cross-cutting impact and a catalytic effect on improving the enabling environment but require expertise in a range of specific subjects including taxation, competition policies and investment policy transparency and openness. These are areas where many DAC members have not been active, yet they are critical for facilitating the task of doing business. To enhance their capacities to promote reforms in these domains, development agencies can facilitate the "South-South" transfer of knowledge and experience by officials from other developing countries who have already implemented reforms or mobilise contributions from experts in other government agencies at home. As such interventions need to be sensitive to the local institutional and cultural context, "South-South" approaches are often more effective and sustainable than heavy reliance on experts from donor countries.

iii Institutional change. Reform is possible only where governments see the need for change and take measures to improve their capacity to mobilise investment and stimulate economic growth. The ability of reforms to deliver desired outcomes depends critically on the ability of institutions to "own" and implement reform processes and their sustainability hinges on broad stakeholder support. Development agencies can help support these processes by stimulating debate around reform issues; they can also facilitate dialogue with private sector organisations, civil society and even the local media in these processes. The sequencing of reforms is also crucial and needs to take account of both feasibility and urgency of reform.

iv Human and institutional capacity. Developing capacity lies at the heart of efforts to deliver more favourable conditions for private investment. Firms require people with well developed professional, entrepreneurial and vocational skills. It is similarly important to build up human capacity in key government institutions, including agencies responsible for promoting domestic and foreign investment. Development agencies should address the complexity and difficulty of the capacity

development agenda in their dialogue with partner countries on strengthening human and institutional capacity.

v Infrastructure. In many developing countries, the poor state of economic infrastructure (notably transport, telecommunications, energy and water) is a critical constraint on the scope for productive investment. There is significant underinvestment in infrastructure because providers are often discouraged by weaknesses in the enabling environment. Actions to address these can consequently have a large impact if they help to create a virtuous circle of improvements in the enabling environment leading to new infrastructure investments. There is renewed interest by partner countries and the donor community to tackle infrastructure needs, including at regional levels. Donors are working to avoid problems encountered in the past by working within the context of sector strategies and medium-term expenditure frameworks, by involving stakeholders in planning and decision-making, by focusing attention on maintenance and service delivery to users, by making adequate provision for financing recurrent costs and by targeting support to those areas where there are major bottlenecks to growth and investment.

vi Financial markets. In many developing countries, creating a more favourable environment for domestic savings is necessary to mobilise capital for productive investment (and also to help reduce the vulnerability of poor people to negative shocks). Difficulties encountered in this area include structural problems, institutional shortcomings and discretionary policies. ODA can be used to help develop financial sector regulation and supervision, in both the bank and non-bank sectors, as well as to help integrate microfinance institutions into the mainstream financial system.

c) *Combine ODA and private investment in a sustainable manner.* In general, the use of concessional funds to mobilise private investment has to be carefully considered, inter alia with a view to not damaging local capital markets or undermining market-determined private flows. Among the various approaches, there is an interest in how to develop ODA-backed public-private partnerships (PPPs) that can encourage investment, not least in the infrastructure sector. PPPs hold much promise as a means of bringing together public and private - as well as local and international - resources and expertise, but much is required from all involved to move from expectation to reality. To avoid some of the pitfalls that have been encountered to date, more attention is needed at the time contracts are

negotiated, to ensure that PPPs maintain an appropriate balance between political and commercial risks and do not depend on commitments that the public partner cannot meet. Development agencies can assist in exploring responses such as promoting sector and public service delivery reforms, channelling support through partner country systems, output-based aid and mitigating non-commercial risks. In addition, other challenges to deal with include the pricing of basic services, affordability issues and financing maintenance and operating costs. The latter raises issues regarding the design and duration of subsidies.

d) *Promote supply-side responsiveness.* Improving the enabling environment is essential but, in itself, not sufficient. To maximise the quantity as well as the development impact of private investment, complementary supply-side measures are also required to strengthen the capacity of local firms to take up the opportunities that arise from an improved investment climate and greater international linkages. ODA can support strategies to encourage entrepreneurship, support business development services and services that expand access to knowledge and technological innovation. ODA can also be used to promote greater access to financial services and increase the capacity of local firms to partner directly with foreign corporate presence. The latter is particularly important for increasing the development impact of FDI but again, much has still to be done to scale up the many good examples that do exist to maximise the synergy between local and foreign enterprises.

e) *Reduce disincentives to formality.* Much private sector activity in developing countries takes place in the informal economy. There is a need to understand better the disincentives to formality, and to understand how risk and vulnerability can result in suboptimal strategies for informal enterprises, so as not to impede movement over time to the formal economy. This is an important issue for donors to address in their dialogue with partner countries on promoting growth and increasing employment, especially in the formal sector. There are also supply-side implications as it is easier for local firms in the formal economy to forge linkages with and reap the benefits from international integration.

To mobilise private investment for development, most of what needs to be done is the responsibility of developing country governments and investors themselves. ODA can help by facilitating these processes. But, as a scarce resource, aid should be used where it is most likely to make a difference. ODA clearly has a contribution to make to improve the enabling environment for more and better investment. This includes helping partner

countries implement commonly accepted good standards for investment policies and conditions, and facilitating adequate supply-side responses. To mobilise private investment, the evidence suggests that ODA programmes should take account of the following considerations:

- To be effective, interventions must build on strong local ownership and commitment. ODA support works better when conditioned on broad-based domestic support, including a willingness to undertake and implement necessary reforms. ODA can be instrumental in building a community for such undertakings.
- To maximise the contribution of investment, interventions need to address binding constraints, including in the provision of infrastructure. A thorough assessment is needed to identify key obstacles and to prioritise resources to overcome them.
- Aid efficiency is a prime concern. It is important to use partner countries' own planning, procurement and financial systems for the delivery of ODA, conditioned on their efficiency and integrity. A more strategic and co-ordinated approach by development agencies will also improve the collective impact of ODA programmes.

In the next phase of this project, further consultation and dialogue with relevant stakeholders is proposed to verify these policy lessons and to derive from them more concrete and pragmatic policy guidance for donors on how to use ODA more effectively to mobilise investment for development. That work should seek to identify lessons of experience based on donors' project and programme evaluations as well as draw on the policy guidance for donors on growth and poverty reduction currently being developed by the DAC's Network on Poverty Reduction (Povnet). It is intended, subject to meeting resource needs, to present this guidance to the DAC High-Level Meeting and the OECD Ministerial Council Meeting in 2006.

5.2. Synthesis of the Evidence*

1. The Importance of Mobilising Private Investment for Development

Progress in reducing poverty has been too slow in many developing countries. With just a decade left to 2015, it will be a challenge to reach the goals contained in the United Nations Millennium Declaration, especially in sub-Saharan Africa. More rapid economic growth will be required to achieve the first goal of halving the proportion of people living on less than one United States dollar (USD) a day; sub-Saharan Africa, for example, needs to sustain an annual economic growth rate of more than 7% over the next ten years, more than double its recent performance. A better economic performance will also make achievement of the six social and environmental MDGs more sustainable. In most developing countries, accelerating growth will require greater involvement of poor men and women in the process – as consumers, workers and entrepreneurs – and an increase in their productive capacity through expanded access to education, health and infrastructure services.

The private sector is the main engine of growth in market economies. It thrives and delivers sustained growth when a number of factors combine to produce a conducive environment for the private sector to develop. Private investment is a crucial pre-requisite for economic growth because it allows entrepreneurs to set economic activity in motion by bringing resources together to produce goods and services. Rapid and sustained growth is facilitated by a virtuous circle whereby entrepreneurship and investment lead to higher productivity, making it possible to invest larger sums in the future. In the course of this process, jobs are created and new technologies are introduced, especially through international trade and investment linkages. Competitive and well-functioning markets are crucial because they promote and reward innovation and diversification, foster firm entry and exit and help to ensure a level playing field for all private sector actors. They also have an important role in making the growth process more socially and geographically inclusive, which expands the opportunities for poor people to participate in and benefit from growth. Successful mobilisation of private investment is thus increasingly important for creating

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employment, raising growth rates and reducing poverty. Not only the expansion of private production capacity matters for economic growth; the productivity gains that result from capital deepening and modernisation are important as well.

1.1. Paving the way for more private investment

Investors, from micro-entrepreneurs to multinational companies, make their investment decisions based on the risk-adjusted returns they foresee. This is important in the development context because, as indicated by a number of empirical studies, the returns *per se* from investing in developing countries (including, notably, least-developed countries) tend to be higher than elsewhere. In the course of an economic growth process, the rates of return will eventually come down, but presently one of the greatest challenges in developing countries is reducing the risks, real and especially perceived, facing private investors. In a high-risk environment, economic activities are normally confined to a few sectors (not least the resource-intensive ones) and regions. The pattern of economic growth can consequently result in large segments of the population being bypassed, including the poor.

Sources and perceptions of risk differ between local and foreign companies, between large and small firms, between private and state-owned enterprises and between those operating in the formal and the informal economies. As a result, actions to diminish risks have a variable impact on investment decisions, depending on the specific circumstances of the business concerned. At the same time, a number of risk factors and related weaknesses in the enabling environment discourage business activity generally, including discrimination, corruption, weak rule of law, high transactions costs, a heavy regulatory burden, lack of transparency and administrative inefficiency.

Domestic resources are the main source of funds for private investment in developing countries, and will remain so. However, in developing countries much domestic business takes place in the informal economy[1], which tends to exacerbate many of the risk factors mentioned above, and the companies found there may not always be the best suited to compete in an increasingly globalised economy. Moreover, many developing countries face constraints on their access to external finance or domestic financing limitations due to weak credit intermediation. In this situation, foreign assistance, FDI and remittances can serve as important complementary or supplementary sources of capital. With the emergence of different investor groups, care must be taken to maintain a level playing field to ensure that no group is unduly disadvantaged.

To encourage more private investment, developing countries need to pursue strategies that alleviate binding constraints on growth, in the right sequence and in the right manner. Institutional reforms have a key role in sustainably mobilising additional private investment for development, as highlighted in Box 1. Through their ODA programmes, development agencies can help to leverage this additional financing for development by supporting developing countries in their efforts to implement such reforms. While the Monterrey Consensus stressed that "a substantial increase in ODA and other resources will be required if developing countries are to achieve the internationally agreed development goals and objectives" including the MDGs, it also recognised that "ODA can be critical for improving the environment for private sector activity and can thus pave the way for robust growth" (United Nations, 2002).

1.2. The development benefits of FDI

The Monterrey Consensus identified private international capital flows, including foreign direct investment, as "vital complements to national and international development efforts" and emphasised the need "to create the necessary domestic and international conditions to facilitate direct investment flows". FDI has proved to be a resilient source of private international capital flows. However, many developing countries, especially the least-developed countries, have yet to benefit from sizeable FDI inflows. Nevertheless, FDI can constitute a significant proportion of overall capital formation and developing countries offer considerable opportunities for additional investment.

The case for encouraging FDI rests on the conviction that it offers developmental benefits that other sources of finance can not (see Box 2). In addition, FDI can create linkages that increase local value creation and result in substantial indirect employment creation in local companies that supply inputs to multinational enterprises (MNEs), either directly or through sub-contracting for other local companies. In many cases, the local supply companies are farmers, particularly outgrowers, or small and medium-sized enterprises.

Among the main determinants of a country's ability to attract FDI, a number of factors have been identified, many of which can be improved through appropriate ODA-backed interventions. The determinants include: i) market size and growth prospects; ii) regulatory and policy frameworks; iii) natural and human resource endowments; iv) physical, financial and technological infrastructure; and v) openness to international trade and access to international markets.[2]

Box 1. The role of institutions in mobilising investment

All societies rely on institutions to implement and enforce the "rules of the game" which ideally ensure that markets function efficiently and allow stable, secure and fair transactions for all private sector actors. The whole set of rules and organisational structures associated with the creation of opportunities for private sector development is consequently extremely important. However, in many developing countries, market imperfections exist that tend to be detrimental to poor people's economic and social opportunities. Country-specific institutional and policy reforms are at the core of donors' and developing countries' efforts to mobilise investment and to maximise its development impact:

- Institutions influence *market outcomes* – job opportunities and wage levels, returns on goods sold and accessibility and affordability of goods and services - because they determine the formal and informal rules governing market exchanges as well as the governance exercised over those rules. Institutional changes and policies can lower certain risks and costs of doing business, removing obstacles to investment and potentially leading to more rapid and more pro-poor patterns of economic growth.
- By reducing the *time and costs associated with doing business* in the formal economy, institutional changes and policies affecting entrepreneurship and investment can help reduce informality. As well as evading taxes, firms and entrepreneurs operating informally face a more risky business environment and lack access to short-term finance and most kinds of risk capital.
- Appropriate institutions and infrastructure can help developing countries *integrate into regional and global markets*. Better international linkages, through trade and FDI, can lead to rapid economic growth. Providing there are sufficient incentives for business, greater integration allows the economy to focus resources on sectors of competitive advantage and stimulates productivity by enabling private sector actors to access larger and rapidly growing markets.
- Appropriate institutions can foster *sustainable development* by helping to ensure that private sector actors take account of social and environmental impacts while maximising wealth creation.

A recent World Bank Group evaluation found that its strategies for improving the investment climate have suffered from a lack of knowledge about what types of institutional arrangements will work in different environments, and about the dynamic process of change that is needed to carry out reforms. As the feasibility of reforms depends on the political economy of the reform process, and their sustainability hinges on broad stakeholder support, it is important to assess the capacity and incentives facing public sector organisations implementing reforms and to be aware of the likely winners and losers. (World Bank Group, 2004). Current work in the DAC Network on Governance (Govnet) to prepare a Good Practice Paper on Capacity Development will help to address this need for clearer guidance on how to approach institutional reforms. The Govnet is also developing tools (through Drivers of Change and Power analysis) which will help donors set realistic expectations for the sequencing of institutional change and how to assess different entry points to support change.

Box 2. Development advantages of FDI

An OECD survey of the experiences with direct investment for development has documented the following advantages of FDI (OECD, 2002):

- *International integration.* Inward direct investment contributes to a country's further integration into the global economy by boosting foreign trade flows. By gaining access to MNEs' international networks of related enterprises, developing countries become better equipped to benefit from their comparative advantages.
- *Direct impact on economic efficiency.* The entry of large, well-financed and/or managerially sophisticated enterprises into a developing country can have important effects on economic efficiency – especially if large segments of the commercial sector were previously shielded. Two of the main channels are:
  - *Enterprise restructuring.* When an existing enterprise is acquired – for instance through privatisation – a direct impact usually occurs as a result of the acquiring MNEs' efforts to raise productivity, reduce costs, introduce new management methods and develop new activities. In addition, efficiency gains may occur in unrelated enterprises, *inter alia* through demonstration effects and competition.
  - *Competition.* The entry of foreign enterprises often acts as a spur to domestic competition, thereby leading to higher productivity, lower prices and a more efficient resource allocation. However, this needs to be balanced against the risk that the entry of MNEs could raise the levels of concentration in an economy to the point of imperilling competition.
- *Spillovers and externalities.* The presence of foreign-owned enterprises can have important effects on previously unrelated parts of the economy. Two of the main channels are:
  - *Technology transfers.* The spread of new technologies as one of the most important channels through which foreign corporate presence can produce positive externalities. The evidence of spillovers is strongest and most consistent in the case of "vertical backward linkages" – i.e. MNEs' interactions with domestic suppliers and subcontractors. Foreign-owned enterprises often put great effort into providing technical assistance, training and other information to raise the quality of suppliers' products.
  - *Human capital.* MNEs in developing countries are consistently found to provide more training to their staff than comparable domestic enterprises. However, as they also enjoy a comparably high degree of staff loyalty, the spillovers through migration of labour are limited. One of the main sources of human capital spillovers is probably the entrepreneurship of individuals previously employed as specialist staff by MNEs.

Box 2 (cont.)

An important indirect benefit of FDI in developing countries is its effect on public governance. International investment is guided by formal and informal rules, ranging from customary law, to the obligations laid down in investment agreements, to commonly agreed best practices. The values that are thus promoted – including non discrimination, transparency and due process – cannot be taken for granted in all countries. By promoting them on a trans national basis, sound FDI policy contributes to creating a better business environment for domestic enterprises as well.

2. How ODA can mobilise private investment

In 2003, net ODA from DAC member countries reached USD 69 billion, its highest level ever (in nominal and real terms). This corresponded to 0.25% of DAC member countries' combined gross national income (GNI).[3] If commitments by donors are delivered, including those made in 2002 at the Monterrey conference, by 2006 net ODA should reach USD 88 billion (at 2003 prices and exchange rates), or 0.30% of GNI[4]. This expected additional ODA is welcome but will still not be enough to help achieve the MDGs; a report released recently by the UN Millennium Project suggested that ODA levels need to rise to 0.44% of GNI in 2006 and 0.54% of GNI by 2015, if the goals are to be achieved (UN Millennium Project, 2005). There is consequently an urgent need, as identified in the Monterrey Consensus, to mobilise other resources, including by intensifying "efforts to … [p]romote the use of ODA to leverage additional financing for development, such as foreign investment, trade and domestic resources."

Donors already spend a significant share of their aid on activities that contribute to mobilising private investment for development. According to an analysis of mostly OECD/DAC data prepared for the World Bank, bilateral and multilateral donors spent an average of USD 21 billion a year between 1998 and 2002 improving the investment climate in developing and transition countries, about 26% of all foreign assistance[5]. The bulk of this went to infrastructure development and was mostly provided as loans. Not all of it was formally motivated by a need to bolster private investment, but all of it contributed to enhancing the enabling environment for investment. In addition, donors spent an average of USD 3 billion a year on firm-level assistance, principally support for microfinance and business development services (Migliorisi and Galmarini, 2004).

Development agencies' actions impact on key determinants for mobilising private investment through a considerable array of activities at the "macro", "meso" and "micro" levels. In each of these domains, a wide

range of aid instruments is used, including grants, concessional and non-concessional loans, equity stakes, guarantees, debt relief and technical co-operation. Developing human and institutional capacity in partner countries is always a central concern.[6]

At the "macro" level, macroeconomic stability and debt sustainability are fundamental for promoting economic growth and, in that sense, act as a pre-condition. International financial institutions in particular are working with developing countries in these domains. Similarly, efforts in a variety of areas where DAC members are more substantially engaged (e.g. peace and security, market access and health and education) are of broad relevance for development and their impact goes well beyond that of mobilising investment. While acknowledging the critical contribution of ODA in these areas for underpinning investment, these broader aspects of development co-operation are not addressed in further detail in this project.

The importance of the "meso" level enabling environment for mobilising investment has long been understood and donors, both bilateral and multilateral, are involved in making the enabling environment more supportive of efforts by the private sector to set economic activities in motion. Working with the relevant policy communities, development agencies are active in a wide range of areas at this level including the regulatory framework (e.g. investment legislation, competition policies, tax policies, trade policies and financial markets), governance and infrastructure. Activities in these areas are discussed further below.

Improvements to the enabling environment help to mobilise investment but, in themselves, are not enough to maximise the investment potential in developing countries. One challenge that has received a lot of recent attention is encouraging direct and indirect linkages between large international investors and small domestic enterprises. For this reason, development agencies also work at the "micro" level, to strengthen the ability of enterprises in developing countries to respond to the lowered trade barriers and new opportunities arising from a better enabling environment and greater international integration. Several activities at this level are discussed further below, including investment promotion and facilitation, promotion of business partnerships between firms in industrialised and developing countries and support for the development of local businesses.

Although public financing will remain important for new physical infrastructure investments in many developing countries, especially for roads and water and sanitation, the scope for private participation remains substantial. But, this can be problematic because investing in infrastructure projects in many parts of the world is not financially viable from a private sector perspective. Even where profitability could in principle be obtained,

private operators often hesitate in view of the significant commercial and political risks involved. In this setting, and as discussed further below, there is growing attention to expanding the use of PPPs in utilities, using ODA to enhance the quality of projects, reduce some risks and raise profitability.

2.1. Improving the enabling environment

Reforming institutions and changing policies are complex processes and need to be approached sensitively. The experience of the last 15 years has shown that the impact of reforms is heavily dependent on circumstances and specific country contexts. Reforms consequently need to be tailor-made, based on rigorous economic and social analysis that recognises a country's institutional characteristics. For changes to succeed, analyses of who stands to win and lose and what their specific interests are can help reveal how vested interests may be overcome. Resistance can be contained through evidence-based dialogue, piloting reforms and compensating losers. OECD Members and non-member partners have agreed to work on the development of a Policy Framework for Investment as a checklist of issues in support of government efforts to create an attractive investment environment. The Framework could "… serve as a reference point for other international organisations, investment promotion agencies, donors as they assist developing country partners in improving the investment climate, and businesses, trade unions and non-governmental organisations in their dialogue with governments"[7].

2.1.1. Legal and regulatory framework

The development of legal systems for company incorporation, contracts and other areas related to economic activities provides the backbone for private sector activity in the formal economy. In addition, systems in which individual laws are consistent and non-discriminatory, and where rights can be defended and disputes settled, is important for a country's internal stability and external credibility. Ineffective or unpredictable dispute settlement mechanisms are often cited as hindering investment in developing countries. Nevertheless, few donors appear active in this area which merits greater attention in order to help mobilise investment. In certain regions, a range of developing countries have entered into investment protection agreements with OECD and other capital exporting countries.

DAC members actively support efforts by developing countries to reform their regulatory framework by funding assistance with policy, legal and regulatory changes as well as services that improve the enabling

environment. The specific experience of Viet Nam, a country that has made extensive use of ODA in its legislative process, is provided in Box 3.[8]

Governments face a challenge in determining tax policies and setting tax rates in ways and at levels that do not hold back economic growth. At the same time, tax revenues are needed to finance the delivery of health, education and infrastructure services. Developing countries' statutory tax rates do not differ considerably from those of industrialised countries but their tax revenues are reduced by high levels of informality coupled with poor administration and corruption. This puts a disproportionate burden on those who do comply and on activities where taxes are more easily collected (e.g. trade-related activities). It also results in a distortion of competition and the sending of wrong signals to entrepreneurs. Supporting the simplification of tax structures and strengthening tax administrations are avenues donors pursue with developing countries to help increase the tax revenues needed to underpin sustainable growth patterns through investments in health, education and infrastructure services.

The legal and regulatory reform challenge also includes promoting a process of economic growth that is consistent with a wider range of social and environmental objectives and avoids an international contest for investment resulting in a "race to the bottom". Sound environmental policies and regulations generally do not discourage investment because they tend to reduce the financial, legal and reputation risks that investors face. Well designed, ODA-backed efforts that raise environmental standards in developing countries are consequently likely to have a positive impact on mobilising private investment.

2.1.2. Public and corporate governance

Good governance is a prerequisite for well functioning markets, attractive investment conditions and a sustainable allocation of investment capital. The principle elements of good governance, as identified by the OECD's Public Management Committee, are accountability, transparency, efficiency and effectiveness, responsiveness, forward vision and the rule of law. Many DAC members promote better governance in developing countries by encouraging and supporting change processes and political reforms. Actions are spread across the main public governance areas and all levels of government. The importance of well functioning public institutions for economic development is also widely recognised and promoted.

Transparency should be promoted both with regards to the acts of public authorities and within the business community – including by tackling corruption. Emerging lessons with regards to fighting corruption stress the importance of focusing on the needs of partner practitioners and a stronger

awareness of corruption as a development issue. Development agencies could usefully synthesise experiences in this area and make more transparent evaluations of them. To ensure credibility, donors should not only treat corruption and other un-transparent practices as investment-climate issues but also make an effort to address them via supply-side measures.

To mobilise more investment, many developing countries must overcome major barriers to improve their corporate governance. Developing economies tend to be dominated, on the one hand, by large, family-owned, state-owned or foreign-owned corporations that do not have widely traded shares on local stock markets and, on the other hand, by a large, non-listed sector. Countries seeking to improve the overall investment climate and promote economic growth have taken steps to move beyond this reality by enacting legal and institutional reforms as well as voluntary initiatives to improve corporate governance.

The OECD works with the World Bank Group to build capacity in the area of corporate governance. Over the last five years the Regional Roundtables on Corporate Governance have brought together decision-makers and stakeholders of some 40 non-OECD countries to develop reform plans that draw upon the OECD Principles of Corporate Governance. The Global Corporate Governance Forum, co-funded mainly by development agencies, has helped to broaden the regional coverage of the initiative.

An additional issue for foreign investment is that international businesses operate to high ethical standards, consistent with applicable law. In this respect, the OECD Guidelines for Multinational Enterprises provide a set of principles of good corporate conduct, and a reference point for stakeholders. Another recent example is multilateral development agencies' adoption of voluntary guidelines for the financial sector.

2.1.3. Physical infrastructure

Insufficient, inappropriate and poorly maintained physical infrastructure is a major bottleneck to economic growth and investment in developing countries, particularly the poorest ones. The availability of relevant infrastructure therefore has a major impact on the enabling environment for private sector activities and expanding physical infrastructure, including at a regional level, can generate high returns. For most firms and entrepreneurs, energy, water supplies and telecommunications are vital while transport infrastructure allows companies to move beyond local markets to buy from and sell to other countries in the region or around the world. Under-investment in public utilities, inefficient management and under-pricing have in many developing countries caused energy shortages which have held back economic growth.

Box 3. The role of ODA in mobilising private investment in Viet Nam

Far-reaching reforms over the last 20 years have turned Viet Nam into one of the region's success stories – in terms of economic growth, private sector development and mobilising foreign direct investment – and the number of people living in poverty has halved, driven mostly by large declines in urban poverty. However, despite significant labour mobility, there has been limited movement out of agriculture, limited movement into formal employment and poverty rates among ethnic minorities remain high. It has been argued that an achievement of the Vietnamese government's ambitious poverty reduction goals for 2010 will only be realised if growth rates can be maintained at the high levels of the past and the rise of inequality can be limited (Klump and Bonschaub*,* 2004).

Viet Nam registered an average annual growth rate of 7.5% over the last decade, notwithstanding the Asian financial crisis in 1997. Progress dates back to the introduction of the government's *Doi Moi* economic reform process in the late 1980s, which was instrumental in jumpstarting private investment and bringing previously unregistered businesses into the formal economy. ODA played a key role in the process. Over the last decade, Viet Nam has been a major recipient of ODA and much of that assistance has focused on areas supportive of private investment. Most of this assistance financed physical infrastructure, but another important activity was developing expertise in relevant policy areas.

Some of the main findings from an examination of Viet Nam's experience of using ODA to mobilise investment are:

- The experiences with using ODA to support reforms of the legal system, institutions and governance have been mixed, but they include a few spectacular success stories. Foremost among these is the enactment of the new Enterprise Law in 2000. The Law, which includes greatly simplified registration procedures, is seen as a major factor behind the establishment of 73 000 new enterprises in the last three years, and the creation of close to 1.7 million jobs. These achievements have been made in a context of a strong political commitment to reform. ODA support for regulatory reform in other areas of potentially great importance to investment has produced little or no results owing to conflicting objectives among different parts of the public sector.

- ODA for physical infrastructure has focused on the twin objectives of modernising Viet Nam's road infrastructure and up-grading its insufficient power generation capacity. A couple of ODA-backed road construction projects around Hanoi and Ho-Chi-Minh City stand out with respect to mobilising investment. Formally motivated by a need to connect the country's two largest cities with the coast and the hinterland, they also led to a considerable creation of enterprises that had previously been held back by the scarcity and cost of industrial land in the metropolitan areas.

Box 3 (cont.)

- Development agencies have also helped up-grade human capital in several ways relevant to investors. One example of targeted approaches is bilateral donors' support for technical and vocational education that, after initial inertia within the education system, has been effective in alleviating skills shortages. At the most general level, "tacit learning" seems to have been a major factor. The interaction with foreign actors – investors as well as development agencies – has greatly enhanced the understanding of decision makers at all levels of government of the demands of a market economy and the elements of a sound business environment.

Overall, a few observations offer themselves. First, ODA can be highly effective in mobilising private investment – though in the case of Viet Nam the effect may have been compounded by a considerable "latent entrepreneurship" already present in the communist economy. Second, ODA in support of institutional reforms can, at a low cost, greatly encourage private investment. However, the effectiveness is contingent upon local buy-in and broad-based commitment to reform. Third, more costly approaches such as ODA for physical infrastructure can have great effects as well, but their geographic scope needs to be carefully considered. Infrastructure projects "spread thinly" seem to produce much less of an impact on mobilising investment than efforts to enhance the infrastructure of regions in which investors are already showing an interest. Fourth, the impact of ODA on mobilising investment goes beyond the sum of individual projects. The use of ODA to enhance the business climate triggers a learning process through which a large segment of society becomes better equipped to act in a market-based economy.

As with other investors, incentives for providers of infrastructure to invest in developing countries are affected by the enabling environment. Actions that encourage infrastructure investments can consequently have a potentially large impact if they help to create a virtuous circle of improvements in the enabling environment leading to new infrastructure investments that in turn encourage further investment. However, as part of this process, adequate provisions need to be made for financing the maintenance and operating costs of new infrastructure.

A significant share of DAC member countries' bilateral ODA finances activities related to infrastructure. In 2003, the share was 9% (down from 12% in 2002). To strengthen the growth and poverty reduction impact of infrastructure, guiding principles for donors are being developed by the DAC Povnet's Infrastructure Task Team. Among the specific issues being addressed are providing co-ordinated support to partner country-led strategies and plans, improving the impact of infrastructure on pro-poor growth, ensuring sustainability and increasing financial resources.

Some aid for infrastructure activities is provided as grants but concessional and non-concessional loans are also common in this sector. In addition, many DAC members have set up funds to provide risk capital for the implementation of infrastructure and other projects and have mechanisms for providing insurance to mitigate certain political and other non-commercial risks (this is discussed further below).

2.1.4. International integration

Better access to international trade is an important source of economic development in its own right, but it is also pertinent in the context of mobilising private investment for development. A large, and by some measures increasing, share of international trade either takes place between related enterprises or in the context of links between end-of-line producers and their global network of suppliers and sub-contractors. In other words, to a potential investor, the quality of the business environment depends strongly on his/her subsequent ability to import and export.

Additionally, unleashing exports expands access for foreign exchange, allows firms to exploit economies of scale, lowers costs and allows the diffusion of technology. Official and unofficial constraints to the movement of goods, particularly across borders, remain a frequent problem. Developing countries still tend to have higher barriers to free trade than industrial countries (average tariffs of 13% for developing countries compared to only 4% for industrialised countries). Impediments to trade tend to be larger among developing countries themselves than between developing countries and the rest of the world. This is particularly problematic for countries with small home markets whose best chance of attracting market-seeking investment is to broaden the "relevant market" to include neighbouring countries. It should, however, be recognised that lower tariffs and non-tariff barriers in industrialised countries would generate significant global welfare gains, including for developing countries.

In many countries, a virtuous circle of trade liberalisation, investment and welfare enhancement has been observed. Trade liberalisation is not a panacea, however. In some cases, trade reforms have brought few gains, and to be fully effective in attracting investment, trade policy needs to be accompanied by other policies which enable capital and labour to move to higher productivity activities and facilitate the entry and exit of firms.

Through their ODA programmes, DAC members are helping developing countries to derive benefits from economic liberalisation by strengthening their trade-related institutions. In addition, donors are strengthening the capacity of developing countries to fulfil obligations and exercise privileges as part of the multilateral trading system. Frequently, donors' support

enables developing countries to improve their positions in bilateral and multilateral trade negotiations, translate commitments made into national legislation and design and implement trade promotion strategies.

2.1.5. Financial markets

In many developing countries, creating a more favourable environment for domestic savings is necessary to mobilise capital for productive domestic investments but also to help poor people reduce their vulnerability to negative shocks. Developing countries can face a number of difficulties in this area including structural problems (e.g. state intervention and monopolies), institutional shortcomings (e.g. with insolvency, with collateral, title and property rights and dealing with informality and micro loans) and discretionary policies (e.g. directed lending and subsidised credits). Promoting and liberalising foreign ownership of domestic banks can increase competition, thereby enhancing efficiency in local financial markets, and may also contribute to lowering the probability of systemic banking crises. DAC members may assist with financial market deepening, through support for financial sector regulation, supervision and development in both the bank and non-bank sectors, as well as helping to integrate microfinance institutions into the mainstream financial system. Development of local financial markets can also facilitate and reduce the costs associated with transferring remittances.

2.2. Developing supply-side responses

2.2.1. Investment promotion and facilitation

A major component of a country's efforts to promote and facilitate investment is a comprehensive investment promotion policy which is consistent with domestic industrial policies and export promotion policies. Experience in OECD countries in these areas indicates that investment and export promotion policies need to be market oriented and designed to overcome specific market failures. Targeted approaches are rarely sustainable. Strengthening relevant institutions in developing countries may equally be important and it may be necessary to reform policies or institutions that restrict competition or investment. Assisting with the building up of human capacity in key government institutions, such as agencies responsible for promoting domestic and foreign investment, is another avenue pursued by development agencies.

Many DAC members have also established mechanisms to provide risk capital for private investment in developing and transition countries through development finance institutions. These schemes, which provide funds on a

broadly market basis, are important for financing projects that otherwise may be hampered by perceptions of excessive risk. There is often a requirement that development finance institutions invest a certain proportion of their funds in the poorest countries. This objective is rarely attained, however. A review of the obstacles that development finance institutions from donor countries encounter when considering investments in least-developed countries and sub-Saharan Africa could be useful to reveal systemic issues that constitute major impediments, including for investors less predisposed to enter these markets. (For an overview of the challenges facing investors in Africa, see Box 4) Most DAC members also facilitate investments by offering insurance against political risks such as losses due to war or civil war, expropriation and nationalisation and inconvertibility of profits and dividends.

Public funds, in the form of ODA, can also be combined with private funds to reduce lending risks to levels where competitive, long-term debt finance can be offered to finance commercially viable and developmentally sound private sector infrastructure projects in developing countries.

2.2.2. Supporting local business development

Firms require people with well developed entrepreneurial and vocational skills as well as access to knowledge and services that aim to promote technological innovation, if they are to operate efficiently and successfully and to grow and expand. Through their ODA programmes, several development agencies support entrepreneurial education and vocational training, as a means of promoting private sector development. However, in the field of education and training more generally, many donors have been focussing increasingly on basic education in recent years. Although most kinds of education can be potentially relevant for facilitating business and investment in a medium-term perspective, this trend may have resulted in entrepreneurial education and vocational training receiving less support than they merit.

Businesses also require access to a wide range of services to support their operations including accounting, audit, quality assurance, telecommunications, internet, business planning, legal advice, training, production engineering, market research, labelling and packaging and design services. These services help to increase productivity, improve competitiveness, expand market access and accelerate enterprise growth. In many developing countries, such services are not available to the same extent that they are in industrialised countries, or may hardly be available at all.

Box 4. ODA and investment synergies in Africa

A synthesis of experiences with using ODA in support of the investment climate in Africa* concludes that development agencies have generally been active in most of the areas suggested in this chapter. The study also suggests that certain changes in priorities and implementation may have taken place in recent years.

For example, assistance to upgrade legal and regulatory frameworks for investment, as well as the public and corporate governance improvements needed to put them into practice, has moved to the centre. Trade capacity building and technical assistance in the context of international trade negotiations have also gained in importance, spurred *inter alia* by the Doha development agenda. In the area of physical infrastructure, development agencies have placed increasing emphasis on involving the private sector in the financing and implementation of projects. In enterprise financing, a long-standing priority of donors in Africa, the emphasis is shifting from the provision of loans and guarantees towards more comprehensive approaches to financial sector reform. In other relevant areas (the study specifically mentions human capital development) activities have been long underway but have generally not been directed at assisting investment and private sector development.

Based on recent African experiences, a number of lessons for developing countries and their development partners can be proposed, among which:

- *Building a "demand for reform".* Reform is possible only where governments see the need for change and take measures to improve their capacity to mobilise investment and stimulate economic growth. However, development agencies can help to stimulate debate around reform issues; they can also facilitate the involvement of private sector organisations, civil society and even the local media in these processes.

- *A need for political commitment.* ODA-based efforts to mobilise investment in Africa have only worked well when they were driven, owned and managed by domestic agents. Developing country governments need to exhibit a commitment to reform from the highest level down.

- *Building domestic institutions.* Development agencies need to consider, and have been paying more attention to, how they can build stronger domestic institutions, although the difficulty with doing this is also widely acknowledged.

- *A sequenced approach.* Moving from analysis to reform, finding appropriate starting points for reform, and establishing a mutually agreed upon sequence of reform interventions have been major challenges for investment-oriented ODA in Africa.

Box 4 (cont.)

- *Collaborative monitoring, adjustments and co-ordination.* Development agencies recognise the value of using well-established and strategically focussed institutional frameworks for managing aid. Also, investment-oriented ODA has its own needs for good co-ordination. Sound co-ordination increases credibility with the partner country and improves efficiency and effectiveness of donor efforts.

- *Sub-national levels of reform.* Increasing attention is paid to the role of sub-national levels of government. While on the one hand this involves support for reforms that enhance the decentralisation of government services, it can also address the roles of local and provincial governments in improving sub-national investment climates.

- *The role of the local private sector.* Recent experiences have shown that the competitiveness of the domestic private sector is important – not only in fostering an indigenous business environment, but increasingly also to attract FDI.

* See also: OECD (2005), *Mobilising investment for development: ODA and investment synergies in Africa*, a background paper prepared specifically for this project tabled at the NEPAD-OECD Investment Policy Roundtable in Entebbe on 25-27 May 2005.

Many DAC members have promoted the expansion of business services, especially for micro, small and medium-sized enterprises, but concerns about sustainability have led several DAC members to move away from direct service delivery in favour of brokering services through local consulting firms and business associations. Business services, which may involve both large and small enterprises, are thus viewed as a tool to promoting private sector development and not an end in themselves. To ensure sustainability, donors should abstain from getting directly involved and becoming part of the system, allowing interventions to be driven by market forces.

There has been a tendency for DAC members to move away from supporting government institutions for research and extension while local public funding available has also been diminishing, as a result of structural adjustment programmes. The private sector and non-governmental organisations were expected to fill the gap but this has not happened in many regions and sectors, including agriculture. There could be a need to redress this situation by developing and supporting, including with some public funds, new mechanisms for local technology development.

DAC members have also set up facilities to establish or promote business partnerships between companies in industrialised and developing countries by providing information on foreign markets or matching firms with related needs or interests. These facilities may take the form of public-private partnerships (PPPs), involving either individual enterprises or

business associations. These activities may nevertheless require some rethinking, in part to take account of greater access to information through information and communications technologies. A rapid internationalisation of both exporters in developing countries and importers in industrialised countries has taken place and external barriers in the form of high tariffs and restrictive quotas have also decreased considerably. As a result, to increase market penetration, it is now more important to focus on up-grading quality, competitiveness and stability in exporting countries.

2.3. Direct support for investment: ODA-backed public-private partnerships

Developing countries have been engaging in PPPs[9] in infrastructure for some 15 years, with actual investments growing from USD 18 billion in 1990 to a peak of USD 131 billion in 1997. The main areas of activity have been telecom services (46% of total private investment) and energy generation and distribution (33%). But private participation in infrastructure has declined since 1997. While this is partly due to a corporate retrenchment following financial crises in the second half of the 1990s, it also reflects a more widespread disappointment on the part of investors and public authorities.

The reasons that PPPs have sometimes performed below expectations vary from case to case. However, many of the difficulties experienced have been linked to more general weaknesses in the enabling environment for investment. PPPs may therefore in many cases be considered as second-best to addressing more fundamental weaknesses or a stop-gap while appropriate measures take effect.

Difficulties with enforcing contracts lie at the heart of many problems experienced with PPPs. One common complaint from developing country governments is that investors have reneged on their contractual obligations, especially regarding the coverage of services. On the other hand, enterprises often complain that public authorities have failed to provide an environment in which they can deliver their services according to sound commercial principles. The latter problem often manifests itself as a lack of willingness by public authorities to accept the social and political cost of private operators' measures to boost productivity and set tariffs at market levels. ODA can help address such issues (see box 5).

Another major problem faced by companies is governments reneging on past agreements (sometimes made by a previous government) or changing the rules of the game in the middle of a contract. This is an important reason behind the insistence of the international private sector for schemes to mitigate such political risks that are a result of weak governance. This

highlights the need to address underlying governance issues, if additional investment is to be mobilised sustainably. In the meantime, risk mitigation schemes can be a bridging solution.

The PPP model has also been used to provide a broader range of services in developing countries that indirectly benefit investment. These include the implementation of social and environmental standards, social enhancement and public health.

Box 5. Using ODA to enhance the effectiveness of PPPs

Three channels have been suggested through which ODA can help address some specific issues related to PPPs by enhancing the environment for such partnerships and contributing to more socially and commercially satisfactory outcomes:

- *Risk mitigation.* Most foreign investors already have access to market-based insurance against risks such as "regulatory takings" through home country export credit agencies and multinational bodies such as the Multilateral Investment Guarantee Agency (MIGA). However, risks go well beyond this and they are so high in some cases that PPPs are unlikely to take place in the absence of subsidised risk mitigation. Discussion continues as to the appropriateness of extra risk coverage being provided by bilateral development agencies, which benefit *inter alia* from the fact that they (unlike more market-based insurance schemes) partner directly with the authorities in developing countries.
- *Technical assistance and capacity development.* ODA can be used to fund a host of educational and experience-exchange programmes to build authorities' capacity to deal with PPPs, including contract negotiation. An alternative to building capacities in-house is to support the outsourcing of regulatory functions to external specialists. A recent survey indicates that as many as three fourths of national regulators contract out certain tasks to external parties.
- *Output-based aid.* Even if host country regulatory capacities and risks can be dealt with satisfactorily, a number of infrastructure projects will have positive economic but negative financial rates of return. This gap can be bridged by ODA, for instance through targeted subsidies to the service providers or by subsidising consumption during a transitory period to full cost recovery pricing. Such "output-based aid" can be highly effective in meeting specific targets – contingent upon the clarity of objectives and project design. Several development agencies provide grant-based instruments to promote cost-recovery pricing while supporting those least able to pay the full price for services.

3. Using ODA better to mobilise investment: Emerging findings

There is a strong case for promoting synergies between ODA and investment. Private investment, domestic as well as foreign, is critical for development. A key role for ODA is to leverage private investment and generate a significant multiplier effect, potentially allowing development agencies to achieve more “development” with their ODA. However, the logic of spending ODA thus is to correct real market failures, tackle structural impediments to investment and mobilise genuinely additional investment. Care must be taken to ensure that donors do not find themselves subsidising or redirecting investment that would have happened anyway, or creating an uneven playing field. The most fruitful context for ODA-backed strategies to encourage investment is in support of on-going reform efforts in developing countries. As a scarce resource, aid should be used where it is most likely to make a difference.

3.1. What to do?

Improving the *enabling environment for investment* is fundamental, hence the importance of developing countries' own efforts to promote sound economic management, good governance, anti-corruption, modern infrastructure and an environment within which the private sector can thrive on a sustainable basis. The processes emerging in many low-income countries around the preparation and monitoring of Poverty Reduction Strategy Papers (PRSPs) or their equivalents present opportunities to promote ownership and to institutionalise interaction between representatives of the state, the private sector and civil society in the definition of development objectives. To date, however, most PRSPs have not sufficiently considered the range of policy actions required to enhance the impact of economic growth on poverty reduction and so need to address more directly the issues of promoting entrepreneurship and mobilising investment.

As shown by the evidence assembled for this report, development agencies can, through their ODA programmes, play a catalytic role in supporting developing countries’ efforts to provide an environment within which the private sector can develop in a sustainable and dynamic way:

- Development agencies can provide developing countries with the analytical support required to use diagnostic tools, including assessments of their investment climate, that reveal weaknesses in the enabling environment and other binding constraints on growth. This may require help with data collection and analysis, so as to generate the

reliable information needed for informed decision making on the highest priority actions and the appropriate sequence of reforms.

- Through capacity development and technical assistance, ODA can be used to support legal and regulatory reforms - as well as to address corruption and excessive bureaucracy. The difficulty for development agencies is that while such activities can have very high returns, outcomes are uncertain and may take a long time to realise. Alternatively, serious bureaucratic impediments to business can persist for long periods, but quickly disappear once given attention and publicity. Activities may fail if they do not generate sufficient enthusiasm, commitment and ownership in developing countries. Development agencies should consequently promote and support processes of stakeholder engagement, involving representatives of the state, the private sector and civil society, that can lead to appropriate and locally-owned reforms.
- Institutional changes (e.g. the rule of law, public and corporate governance, integrity and transparency) can lead to large improvements in the investment climate, sometimes with relatively modest amounts of ODA. However, sustainable reforms have rarely been imposed from the outside and a positive outcome mostly depends on policy processes driven, owned and managed by developing countries themselves. Successful ODA-based strategies to mobilise investment consequently depend on both a strong political commitment to undertake reforms and an ability to implement them. There is a need to understand better what necessary pre-conditions should be in place before developing countries will engage in processes to introduce the sometimes difficult reforms that will ultimately have a substantial and sustainable impact on improving the investment climate.
- In many developing countries, the poor state of infrastructure is a critical constraint to the scope for private investment. Large amounts of aid are used to support the development of physical infrastructure. However, considering the high costs involved, a particular effort should be made to focus on the main impediments at national and regional levels to development of the private sector, particularly those identified by partner country governments and the private sector itself, and to avoid the well-known problems of the past by focussing on sustainable service delivery to users. On-going work in the DAC Povnet is pointing to some key messages and implementation lessons learnt by donors to strengthen the contribution of infrastructure to growth and poverty reduction. These include: i) making better and more co-ordinated use of sector programmes for transport, energy, etc.; ii) adequately addressing local

private sector involvement, gender-specific needs and wider risk and vulnerability issues; iii) ensuring sustainability by strengthening local capacities and resources and ensuring cost recovery through appropriate methods of tariff collection; and iv) increasing financial resources for infrastructure including through developing more effective ways of leveraging resources for district and community-based infrastructure.

To maximise the quantity as well as the development impact of private investment, complementary *supply-side measures* are also required as they can strengthen the capacity of local firms to take up the opportunities that arise from an improved investment climate and greater international linkages. For instance, the provision of microfinance and business development services is important for small and local enterprises to be able to seize business opportunities. By supporting entrepreneurial education and vocational training, ODA can help ensure that local businesses have the staff needed for them to operate efficiently and successfully and to grow and expand. To improve access to knowledge and innovation, mechanisms can be developed that set research priorities better by promoting participatory technology development and that better diffuse information on new technology. Supporting moves by firms into the formal economy can have a large and sustainable impact on expanding employment, accelerating growth and generating tax revenues, as well as on enabling local firms to more easily partner directly with, and benefit from, the presence of foreign-owned enterprises.

A direct way of promoting ODA/investment synergies is to involve aid in individual investment projects, for instance through *public-private partnerships*. To date, the record with PPPs has been mixed, particularly in small markets. More efforts may be needed to ensure that market distortions do not occur, and that contracts do not require too much from the private partner and do not depend on commitments that the public partner cannot meet in the long run. Addressing weaknesses in the investment climate will also be helpful, as many of the more sobering experiences with PPPs so far appear to have reflected general weaknesses in the regulatory framework and public governance. Experience with PPPs has been particularly disappointing in water and sanitation, a critical area for many aspects of development. Development agencies can assist in exploring responses such as promoting sector and public service delivery reforms, channelling support through partner country systems, output-based aid or private firms paying a rent to use publicly funded capital investments. The issues of pricing of basic services and mitigating non-market risks could also be addressed in a more effective way.

Some important *caveats* need to be taken into account when designing ODA activities to mobilise investment. For instance, in many developing

countries the uncritical emulation of other countries' regulatory systems has been found to be inappropriate. OECD and other internationally recognised good practices and standards have served as useful reference points in support of reforms that produce significant economic and social benefits in the medium term. However, reforms are in practice difficult to introduce if, in the short term, they entail threats to vested interests and re-allocation of capital and labour resources. It is important to target the structural causes of investment impediments, even while taking measures to deal with their immediate symptoms. Thus, where there is a strong case to support political risk mitigation schemes, it should not be forgotten that weak governance is at the heart of the problem. There is growing recognition that carefully constructed interventions that draw on deep knowledge of local law and social practices can be effective, but results may not become apparent for several years. From this perspective, the tying of technical assistance to the provision of services by nationals of the donor country can be problematic, as it often results in interventions that are not sufficiently sensitive to the local ideological, institutional and cultural composition and as it generally does not build sustainable technical capacities in developing countries. In general, the use of concessional funds to mobilise investment should be carefully thought through if it is not to damage sustainable local capital markets or undermine market-determined private flows.

3.2. How to do it?

While DAC members spend a lot of ODA, directly or indirectly, promoting private investment in developing countries, it is not clear that these various activities are sufficiently strategic in their overall effect. A stronger co-operative effort seems needed both within DAC members' administrations and between bilateral and multilateral donors, particularly at the field level, behind a clearer strategic objective to mobilise investment for development. Donors could usefully transfer lessons from experience in other areas, such as the education and health sectors, in terms of the value of more co-ordination within the donor community in support of developing country-led strategies, including PRSPs. An informative finding from a recent study is that developing country governments often prefer to work with multilateral agencies on enabling environment issues because they are considered to be more neutral, and without commercial considerations influencing approaches and activities (White, 2004). Specific activities may consequently be more appropriately carried out by bilateral or multilateral donors. Another interesting finding, from evaluations of the PRSP process, is that many donors believe that they are working to promote investment within the PRSP context, a view not fully shared by their developing country partners.

Some other considerations that development agencies may wish to take into account include:

- Established good practices for the management and implementation of development co-operation programmes could be applied more systematically to activities that impact on mobilising investment. Tailoring activities to partner countries' needs and ensuring the participation of all stakeholders on the basis of ownership by the developing countries themselves are important guiding principles.

- There is a need for greater efforts by developing countries and donors to consult with and listen to the private sector – domestic enterprises as well as foreign entrants – especially in terms of what enterprises say they most need and where governments and donors can best help. To facilitate interaction between different stakeholders at the partner country level, development agencies can foster the emergence of change agents and facilitators who are able to institutionalise stakeholder engagement but also to build constituencies for change and overcome vested interests. To ensure that changes are sustained, donors should not intervene directly but aim to change the system, without becoming part of the system.

- A comprehensive approach to supporting private sector development is essential. The private sector may fail to develop despite massive support because there may be several binding constraints but not all of them are targeted. Multi-faceted, multi-sectoral approaches are likely to succeed better than single-factor, focussed and project-like interventions. Integrating a private sector development perspective into country programme strategies will help mobilise investment but is also a useful way of raising awareness in development agencies of the crucial role that the private sector can play in achieving the MDGs. There is also a need to understand better what the disincentives to formality are in developing countries so that these can be reduced and not hold back natural tendencies for movement over time from the informal to the formal economy.

- The sequencing of reform interventions is important. The use of ODA to mobilise private investment involves a multilayered interdisciplinary process, which spans a substantial period of time. Beginning with achievable changes and building on success is important for building up momentum for further reforms. The process needs to involve collaborative monitoring and adjustments, as well as strong institutional mechanisms for accountability.

- To mobilise investment, development agencies need to draw on a broad range of expertise from a range of sources. Development agencies are experienced in dealing with developing country authorities and facilitating development processes and these efforts can benefit from leveraging the expertise of government agencies at home that habitually deal with policies for the business sector. Development agencies can similarly facilitate the transfer of knowledge and experience by officials from other developing countries who have already implemented reforms, through triangular or "South-South" co-operation. Such interventions nonetheless need to be sensitive to the local ideological, institutional and cultural context.
- Efforts to use ODA to mobilise investment need to involve all levels of government in developing countries and activities to expand access to infrastructure and reform institutions should have a broad impact throughout the partner country. Development agencies need to ensure that their activities have an impact on strengthening local as well as national levels of government. Some targeted interventions at local levels may thus be warranted, in addition to activities at the national level. Support for decentralisation initiatives can consequently be important to complement other activities that aim to mobilise investment for development.

Donors' past experience with support for private sector development has provided evidence of some pitfalls that can be avoided. For example, interventions have led to market distortions, sometimes because they have been guided by the preferences of a few public or private actors in developing countries. This risk is compounded by the fact that, while donors recognise the significance of high quality institutions and the role of macro factors, micro-level interventions have often predominated. New approaches have attempted to avoid this problem, *inter alia* through policy dialogue with partner countries that highlights the importance of "market deepening" and internally driven institutional change.

These issues could be relevant for development finance institutions from donor countries as well. The evidence is that these organisations can, with a very modest injection of public funding, catalyse significant private investment on a sustainable basis. However, issues of how far they achieve addionality and concerns over possible competition with fully private investment funds may exist in the more viable sectors and economies.

To guide future interventions and help development agencies focus on areas with the greatest impact on mobilising more and sustainable investment flows to poor countries, more detailed information is required on the impact and efficiency of using ODA to mobilise investment, to

understand better what works, what doesn't work and why. While DAC members evaluate specific aspects of their support for private sector and infrastructure development, very few assessments of the overall impact and efficiency of these activities on mobilising investment have been conducted. Joint assessments at a more aggregate level would be especially appropriate as they could gauge how the various and collective actions of donors are impacting on critical factors for mobilising more and better investment throughout partner countries.

Notes

1. In Africa, as much as 78% of non-agricultural employment is estimated to be informal and the rates in many South Asian and Latin American countries are not much lower.

2. For empirical evidence of the importance of these factors in a large selection of developing and transition countries, see OECD (2004), *ODA and investment for development: What guidance can be drawn from investment climate scoreboards?* Working Papers on International Investment 2004/5, OECD, Paris, a paper prepared specifically for this project.

3. In addition to ODA, DAC member countries provided USD 7.1 billion in net "official aid" (OA) to transition countries in 2003. Net "other official flows" (OOF) were negative in 2003 (USD -1.1 billion) due to substantial offsetting entries for the cancellation of mainly export credit debt. OOF consists mainly of development lending that is not concessional enough to qualify for recording as ODA or OA (because the grant element is less than 25%) and trade-related transactions (e.g. export credits).

4. Preliminary estimates show that net ODA from DAC member countries increased further in 2004 to reach USD 79 billion (USD 72 billion at 2003 prices and exchange rates). This corresponded to 0.25% of GNI.

5. World Bank's analysis included ODA, "official aid" to transition countries and "other official flows".

6. For further information on how ODA can mobilise private investment, see: *OECD (2004), ODA and investment for development: Review of ODA uses and experience*, OECD Papers Volume 4, No. 7, a paper prepared specifically for this project.

7. OECD Initiative on Investment for Development: Progress Report by the OECD Investment Committee, 28 April 2005.

8. See also: OECD (2004), *Mobilising investment for development: Role of ODA – The 1993-2003 experience in Viet Nam*, Working Papers on International Investment 2004/6, OECD, Paris, a paper prepared specifically for this project.

9. In this report, PPPs principally refer to business relationships involving private resources (capital, management and know-how) to expand the provision or production of infrastructure services or utilities (such as water and sanitation or waste collection). In practice, the focus is often on foreign participation.

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5.3. The African Experience*

Introduction and Executive Summary

The Monterrey Consensus found that "a substantial increase in [official development assistance (ODA)] and other resources will be required if developing countries are to achieve the internationally agreed development goals and objectives, including those contained in the Millennium Declaration" and that "private international capital flows are vital complements to national and international development efforts". There is consequently a need to intensify efforts to "[p]romote the use of ODA to leverage additional financing for development, such as foreign investment, trade and domestic resources".

Africa presents many challenges for donors and African governments that are committed to mobilising domestic and foreign investment for better development. Africa is the only continent that has grown poorer in the past 25 years, that has had its share of world trade halved in a generation and that received less than 1% of the world's foreign direct investment (FDI). More recently though, countries such as Ghana, Mozambique and Uganda have shown that high levels of economic growth can be achieved and sustained and that significant inroads into reducing poverty can be made.

Africa has been a major recipient of ODA from around the world. In 2003, official grants to Sub-Saharan Africa rose to 3% of gross domestic product (GDP) and were projected to remain at that level in 2004. The present overview study was commissioned by the OECD Secretariat to learn from the experiences of using ODA to mobilise more domestic and foreign investment in countries in Africa, with a specific focus on Sub-Saharan Africa.

* This overview study was prepared by Simon White, Southern African IDEAS, acting as an external consultant to the OECD Investment Division with the financial support of the World Bank. The study was part of the background analytical work developed in support of the Development Assistance and Investment Committees' joint consideration of the role of ODA to support the efforts of developing countries to improve their investment climate, including through policy capacity building. It was also presented at the roundtable on *Investment for African Development: Making it Happen* at Entebbe in May 2005, organised under the auspices of NEPAD and the OECD Investment Committee.

Based on the analysis undertaken for this study, donor agencies working in Africa were found to support the following development themes that impact on mobilising private investment:

- *Improving the policy, legal and regulatory framework for investment and growth.* This includes support for the design, implementation and monitoring of policy reforms; the improvement of the legal and regulatory framework for private sector development and investment; the privatisation of state-owned enterprises; the improvement of markets, particularly those that help the poor successfully participate in the economy; the introduction and application of competition policy, laws and institutions.

- *Improving governance.* This spans the public and private sectors. Reducing corruption, improving transparency, promoting democracy, and improving the administration of government services are important aspects of donor efforts to improve governance in public institutions. Within the private sector, donors are supporting the design and enforcement of corporate governance principles and codes of conduct, while also facilitating processes that improve private sector representation and dialogue between government and the private sector.

- *Improving infrastructure and utilities.* While donor support for infrastructure is not new, this review highlights ODA that endeavours to involve the private sector. Donor support in creating opportunities and mechanisms for private investments into infrastructure development and maintenance represents a potent opportunity for the mobilisation of domestic investment and the attraction of investments from elsewhere in Africa as well as the broader international investment community.

- *Facilitating international trade.* There appears to have been a boon in donor activity geared toward improving trade for developing countries, including in Africa. Whereas once donors directed their support to improving the export capacity of selected industries, they have begun to take a more systemic and comprehensive approach. This has involved support for trade-related institutions, improving the legal and regulatory regime for trade, creating new foreign trading opportunities, and supporting African countries comply with international standards and protocols, along with their capacity to participate effectively in trade negotiations.

- *Improving financial services.* Many donors have supported the establishment of financial schemes in Africa over the years. However, in more recent times, donors have taken a more comprehensive and systemic approach to this work. Rather than setting up loan schemes or

guarantee facilities, greater attention is being given to the functioning of financial markets and identifying those features that limit access to finance by the poor. Thus, attention has turned to improving financial regulation and management, as well as to the performance of commercial financial institutions.

- *Developing human capital and entrepreneurship.* Many donors are involved in supporting programmes that develop human resources in African countries (e.g., through education, vocational training, health). These kinds of interventions have been longstanding. While this kind of ODA contributes to the long-term capacity of a country to compete in the global economy (e.g., with a skilled and productive workforce), this review focuses more on those measures that have supported the promotion of entrepreneurship and enterprise development.
- *Providing incentives for private investment, guarantees and risk mitigation.* Donor agencies also undertake micro level interventions to improve investment in Africa through the provision of incentives for private investment, investment guarantees and risk mitigation. Because Africa suffers from a negative perception among many foreign investors, increasing attention is given to the ways investor perceptions can be changed and programmes that reduce risk.

There are a number of instruments and mechanisms donor agencies use to support reforms in African countries. These include a variety of instruments that address the investment climate and the business environment in which private firms operate. While donor instruments for reform may not appear to differ from other fields of ODA (e.g. budget support, capacity building, technical assistance), achieving results in investment-oriented ODA requires these instruments to be applied in a specific manner. Investment-oriented ODA mostly needs to focus on engaging all stakeholders (public and private) in sustainable processes of reform. While in some cases investment-oriented ODA may involve fewer funds than certain other development fields, the time required to design and implement reform can be substantial.

A large number of mechanisms for the design and implementation of donor-supported reforms are described in this annex. The way in which donors monitor their programmes and measure impact is also reviewed. Finally, a number of lessons learnt in the practice of investment-oriented ODA in Africa over the last decade are suggested. Investment-oriented ODA should:

- *Build a demand for reform.* The motivation for reform must come from governments that have to see the need for change and to take measures

themselves to improve their capacity to mobilise investment and stimulate economic growth. Donors can take measures to stimulate debate around reform issues in an effort to build a stronger and broader demand for reform. They may facilitate the involvement of private sector organisations, civil society and even the local media in these processes.

- *Be based on political commitment.* Sustainable reforms only work when they are driven, owned and managed by domestic agents. To achieve success, governments need to exhibit a commitment to reform from the highest to the lowest level.
- *Build the analytical capacity of host governments.* Donor agencies are paying greater attention to the capacity of governments to undertake their own analysis and to monitor the progress of reforms. There is a need for capacity building programmes for government as well as private sector organisations.
- *Be sequenced.* Moving from analysis to reform, finding appropriate starting points for reform, and establishing a mutually agreed upon sequence of reform interventions is a major challenge for investment-oriented ODA in Africa.
- *Involve collaborative monitoring and adjustments.* Donors recognise the value of good long-term relations with government, especially through the use of a well-established and strategically focussed institutional frameworks for managing aid.
- *Be coordinated.* Investment-oriented ODA has some specific needs for good co-ordination. Sound co-ordination increases credibility with the host country, including of the relevant reform processes, and improves efficiency and effectiveness of donor efforts.
- *Help build strong domestic institutions.* Many donor agencies are paying more attention to how they can build stronger domestic institutions, although the difficulty of doing this is also acknowledged.
- *Take into account the local private sector.* Recent donor experiences in improving investment climates have shown that the competitiveness of the domestic private sector is an important ingredient in mobilising investment and stimulating economic growth.
- *Involve sub-national levels of reform.* As a complement to interventions at the national level, attention is also being paid to the role of sub-national levels of government, in particular local government. While on the one hand this involves support for reforms that enhance the

decentralisation of government services, it can also address the roles of local and provincial governments in improving sub-national investment climates.

- *Recognise the importance of perceptions.* Because reform is a political process some donors have developed interventions to help local actors deal with change, build on success and keep their eye on the big picture of reform.

1. Background and purpose

The Monterrey Consensus recognised that "a substantial increase in ODA and other resources will be required if developing countries are to achieve the internationally agreed development goals and objectives, including those contained in the Millennium Declaration" (para. 41). Private international capital flows, says the Monterrey Consensus (para. 20), are "vital complements to national and international development efforts" and ODA "plays an essential role as a complement to other sources of financing for development, especially in those countries with the least capacity to attract private direct investment" (para. 39). But in addition, and as the Monterrey Consensus recognised, "ODA can be critical for improving the environment for private sector activity and can thus pave the way for robust growth"(para. 39). There is consequently a need to intensify efforts to "[p]romote the use of ODA to leverage additional financing for development, such as foreign investment, trade and domestic resources" (para. 43).

Governments in Africa committed to achieving the MDGs face many challenges. Africa is the only continent that has grown poorer in the past 25 years, that has had its share of world trade halved in a generation and that received less than one per cent of direct foreign investment.[1] The HIV/AIDS pandemic has had a major impact, in some countries it has set development back decades. More recently though, countries such as Ghana, Mozambique and Uganda have shown that high levels of economic growth can be achieved and sustained and that significant inroads into reducing poverty can be made.

1.1. Official development assistance in Africa

Africa has been a major recipient of ODA from around the world. The International Monetary Fund (2004) suggests that in 2003 official grants to Sub-Saharan Africa rose to 3% of GDP and were projected to remain at that level in 2004.[2] However, some countries are expected to receive sharply higher levels of foreign assistance in 2004. One-quarter of the countries in

Sub-Saharan Africa are expected to receive grants exceeding 6% of GDP (e.g., Ethiopia and Uganda).

The question addressed in this annex concerns the impact ODA has on the capacity of African states to reduce poverty and achieve the MDGs by increasing their levels of domestic and foreign investment and expanding opportunities for higher, more sustainable and more inclusive growth processes. How directly and explicitly should donor agencies focus on supporting activities that affect the potential for investment and growth? For most donors the answer to this question will depend on evidence that shows how ODA can increase investment, which will subsequently create economic growth and reduce poverty.

Dollar and Easterly (1999) found that the links between aid, investment and growth are tenuous. "Aid does not necessarily finance investment and investment does not necessarily promote growth". Aid is not the main determinant for investment and growth and there appear to be a number of links between these domains that influence the impact of aid on investment and growth in Africa. The first of these is the economic policies established by governments. The second is the poor quality of public services, closed trade regimes, financial repression, and macroeconomic mismanagement. Thirdly, foreign aid cannot easily promote lasting policy reform in countries where there is not a strong domestic movement in that direction.

While these findings may appear to argue against directing ODA towards better investment and growth, they in fact show that the "combination of private investment, good policies, and foreign aid is quite powerful" and "disbursing aid into good policy environments would be an improvement on current practices". Burnside and Dollar (2004) argue that donors should focus on the policy and institutional determinants of investment and growth when designing their interventions. Indeed, a robust conclusion from a number of recent academic studies covering a diverse sample of countries is that "aid is effective in promoting growth and, by implication, in poverty reduction" (McGillivray, 2003).

Thus, if donors are to apply their resources in an investment-oriented manner, they should focus on strategic interventions that improve policies and the way governments manage the economy. They should help African countries to reform their policies and institutions. Arcand, Guillaumont *et al.* (2001) argue that foreign aid does have an effect on the process of reform in Africa, "but its impact is a function of the circumstances faced by a given country as well as of the manner in which aid is allocated". Devarajan, Dollar *et al.* (2001) in their study on aid and reform in Africa found that most major policy reforms were driven by the political economy and were preceded by economic and political crises. Moreover, a large amount of aid

to countries with bad policy was found to sustain those poor policies. They argue that donors have not discriminated effectively among different countries and different phases of the reform process; instead they tend to provide the same package of assistance everywhere and at all times.

This brief review highlights the challenge for ODA in Africa, which endeavours to increase investment and economic growth. It sets the scene for an investigation into the ways donor agencies design and implement aid that improves the prospects for investment and growth.

In the last decade, donor agencies have increasingly recognised the importance of the private sector as an engine for economic growth. Many agencies have formulated programmes that support private sector development programmes containing interventions that can help developing countries promote the development of a larger, more diverse and more competitive private sector.[3] Within this context, an increasing amount of attention has also been given to the role of markets for development. Since private sector development revolves around access to markets and the capacity of domestic entrepreneurs to identify and pursue new market opportunities, this area of work has been found to be extremely relevant to pro-poor development approaches.[4] Similarly, with the new age of globalisation ushering in a more closely integrated world economy, the international flows of private investment have become a more potent resource for economic growth.[5]

This focus on the private sector, markets and mobilising investment has been accompanied by a better understanding of the factors that contribute to the creation of a more diverse, competitive and robust private sector. While attention has long been given to addressing the internal constrains of enterprise growth (e.g., through the provision of financial and business development services), greater attention is now given to the broader conditions in which private enterprises are required to operate.

In Africa, the private sector is characterised by its non-dynamic aspect and informality. Improving governance is a prime concern for African countries, but it is also important to foster the emergence of a dynamic private sector that can take advantage of better governance conditions and a more stable macroeconomic environment.

The *World Development Report 2005* (World Bank 2004a) focuses on the role of investment climates for economic growth and poverty reduction: "Improving the investment climate – the opportunities and incentives for firms to invest productively, create jobs, and expand – is the key to sustainable progress in attacking poverty and improving living standards" (p. 19). One of the primary actors in bringing about a good investment climate is government. Government policies and behaviours exert a strong

influence on the behaviour of firms through because of the way they affect costs, risks and barriers to competition. Thus, working with governments – and bringing the private sector and other key actors into dialogue with governments – is important factor for donors wishing to improve the investment and growth opportunities for developing countries, including countries in Africa.

The OECD has recently described this as a "new private sector development agenda". The new agenda is broader than the old one. It moves from directly helping the poor (e.g., to establish their own enterprises or to provide micro-finance programmes), to the development of "market outcomes that may be more or less pro-poor". It suggests, therefore, that the focus of donor support should be on "institutions and policies that influence market outcomes" (OECD 2004a). This focus was confirmed in a recent World Bank Group evaluation of its assistance for improving the investment climate that highlighted the importance of reforms at the institutional level, even more than at the policy level (World Bank Group, 2004b).

1.2. Looking for synergies between ODA and investment in Africa

The purpose of this study is to examine the range of activities donor agencies undertake that work to improve the investment attractiveness and capacity of countries in Africa, even if this was not the formal or main objective pursued. While the promotion of a stronger investment climate in Africa influences many policy domains, the present study focuses on those domains in which donor agencies appear to be most active.

While some agencies focus their efforts on a narrower range of themes, most appear to agree that improving levels of investment in African countries requires reforms in a number of areas or development themes. DFID, for example, states it is increasingly adopting a multidisciplinary approach involving enterprise, economic, governance, livelihoods and infrastructure perspectives (DFID, White *et al.* 2004).

Donor agencies vary in their views on which fields or development themes are the most appropriate or most significant to address when supporting reforms that improve investment. For example the World Bank's Operations Evaluation Department have categorised areas of investment climate reform into "core" and "non-core" themes.[6] Core investment climate themes include regulation and competition policy, corporate governance, legal institutions for a market economy, judicial and other dispute resolution mechanisms, and personal and property rights. Non-core themes include tax policy and administration, infrastructure services for private sector development, export development and competitiveness, trade facilitation

and market access, and other financial and private sector development (World Bank Group, 2004b).

The OECD distinguishes between "meso" level interventions – those dealing with the regulatory framework, infrastructure and governance – and "micro" level interventions – such as investment promotion and facilitation and the development of local businesses. While improvements to the "meso" enabling environment help, in themselves they are not enough to maximise the investment potential in developing countries. Strategies are consequently also required to promote appropriate "micro" or supply-side responses to increase the capacity of local firms to take up the opportunities that arise from an improved investment climate and greater international linkages (OECD, 2004b).

Owing to the magnitude of activity in Africa by both bilateral and multilateral donors, including activities that can be considered "investment-oriented", the present study focuses mainly on meso level interventions. Many of these areas present new opportunities for donors to increase the impact and sustainability of their efforts. These include the following:

- Policy, legal and regulatory framework: including private sector policy development and implementation, legal and regulatory reform, privatisation policies and programmes, making markets work better, and competition policy and law.
- Public and corporate governance: including interventions that improve public sector governance as well as corporate sector governance.
- Infrastructure and utilities: special attention is given to those interventions that support the mobilisation of private investment (foreign and local) into the development and maintenance of infrastructure and utilities.
- Openness to external trade: rather than supporting firms to become more active in foreign markets (supply-side or micro level interventions), this study addresses the broader conditions in which foreign trade is facilitated and regulated.
- Improving financial services: rather than supporting new financial schemes (again, a supply-side response) greater attention is given in this study to the regulation and improvement of financial markets.

Some micro level interventions are nevertheless also addressed in this annex, mainly those that improve human capital and entrepreneurship as well as ODA that creates incentives for private investment and provides guarantees and risk mitigation.

The range of donor activities presented in the annex is not exhaustive. Africa is a large continent with many countries and with more donor activity that any other region in the world.[7] Thus, the donor activities presented in this annex are used to illustrate the new approaches many donors are taking to supporting reforms in African countries that will lead to more investment and growth.

This study has also sought to take into account the various instruments and mechanisms donors have used to design, implement and monitor their interventions. It has endeavoured to gauge the short- and long-term effect of these strategies have had on foreign and domestic investments and set these against the costs of implementation. While all donor agencies find it difficult to determine the impact of specific interventions, including investment-oriented activities, there are lessons that seem to be emerging.

The present annex is organised in the following manner. The next section considers the specific challenges that need to be addressed by African governments if they are to improve their prospects for investment and growth. Section III reviews the range of investment-oriented ODA provided to African countries. The information presented in this section highlights the major trends and direction bilateral and multilateral donors are taking in number of key development themes. Section IV looks at donor practice. It examines the instruments donors use to support reforms and then the kinds of mechanisms that are used for this purpose. Finally in this section, the claims of effectiveness are examined. Section V draws the findings of the previous two sections together to highlight the lessons that can be learnt from investment-oriented ODA. It then draws conclusions from the findings contained in this annex.

2. Facing the challenges to improving investment in Africa

Most donor agencies have a long history of involvement in Africa. The programmes they offer to reduce poverty have varied over the years and, in some cases, were closely linked with geopolitical concerns or responding to the interests of domestic constituencies. In many cases, donors are now looking to improve the effectiveness of their aid and to find better ways to improve the lives of the poor in Africa. Take for example the Commission for Africa. When launching the Commission, British Prime Minister Tony Blair described the social and economic distress of Sub-Saharan Africa as the "scar on the conscience of the world". The Commission seeks to raise the profile of the development agenda in Africa and to take a fresh look at the responses that are required by developed countries. The immediate aim of the Commission is to determine how the Millennium Development Goals can be achieved in Africa and to bring recommendations to the Group of

Eight when it meets in the United Kingdom in 2005. Gordon Brown, the British Chancellor of the Exchequer, has similarly called for a new "Marshal Plan for Africa".

Within Africa itself, governments are taking new initiatives to address the social and economic problems they face. Initiatives such as the New Partnership for Africa's Development (NEPAD), although still in its formative stage, show that there is increasing recognition that taking local responsibility for getting the conditions right is the key to sustainable reform and development.

In recent years great attention has been given to understanding the reasons behind the comparative low growth of Africa (see Bloom & Sachs, 1998; Collier & Gunning, 1999a and 1999b; Easterly & Levine, 1997; Jenkins & Thomas, 1999; Temple, 1999). Why, for example, did African growth outperform growth in Asia in the period 1960-73, only to be left behind Asia from the 1970s onwards?[8] There is no simple answer to this question. Africa's development challenge is embedded in a range of sub-challenges facing African governments, the private sector and the international donor community. Among these is a specific set of challenges that have to be addressed if countries in Africa are to increase their levels of investment and grow their economies. What follows is a brief survey of these challenges:

- **The challenge for a more diverse, more competitive and robust private sector.** There is growing evidence that the main reason for slow growth and the lack of industrialisation in Africa is because of the absence of the private sector, especially the manufacturing sector (Bloom & Sachs 1998; Collier & Gunning 1999a; 1999b; Easterly & Levine 1997; Jenkins & Thomas 1999; Temple 1999). The mobilisation of domestic investment and the attraction of foreign investment require a diverse, competitive and robust private sector. In some countries of Africa this means government should get out of running business itself (i.e., privatisation), while in other cases there are legal and regulatory barriers to competition that should be removed. Overall, African governments need to establish a macroeconomic framework that is conducive to the development of the private sector.
- **The challenge for a better investment climate.** Wage levels, says the World Bank, are not the primary obstacles to African competitiveness. "Competitiveness must come from increased productivity and largely from lower non-labour costs and greater development of worker skills… the emphasis on improving productivity must include the business environment factors that drive up non-labour costs and drive down productivity in Africa". This includes factors associated with weak

financial systems, macro economic instability, concentrated market structure, infrastructure and service deficiencies, over-regulation, corruption, and poor security (Eifert & Ramachandran, 2004).

Various African Country Assistance Strategies of the World Bank Group have emphasised the need to improve the enabling environment for business and make progress on privatisation. Furthermore, the recent World Bank evaluation of Poverty Reduction Strategy Papers (PRSPs) found that most PRSPs to date have not considered the full range of policy actions required for growth and poverty reduction. Consequently there is scope for PRSPs to address more directly the actions required to enhance the investment climate (World Bank 2004b).

- **The challenge of good governance.** The governance challenge in Africa is very broad. It includes the need for better public governance in state institutions, as well as the need for better corporate governance. The challenge of good public governance includes the requirements to reduce corruption, increase transparency and accountability, and improve public services. Collier and Gunning (1999b) claim that poor service delivery has handicapped firms in Africa as a result of unreliable transport and power, inadequate telecommunications networks, and unreliable courts.
- **The challenge of human resource development and entrepreneurship.** The level of human capital is extremely low is Sub-Saharan Africa. This is so in absolute terms and also when one controls for its structural determinants (Schultz, 1999). Thus, the development of the human resource is a major challenge. It is one that affects the potential of African countries to improve their productivity and competitiveness in the global marketplace. Sadly, a major deterioration in human capital is expected from the HIV/AIDS epidemic, which chiefly affects working adults, including those who are well educated. It is also interesting to note that many of Africa's brightest and most skilled do not live in Africa – having left for better education and employment opportunities in Europe and the United States they have become part of the large Africa Diaspora.

  However, Arcand, Guillaumont *et al.* (2001) claim that there are three reasons to be optimistic that these human resource problems are improving: (1) school enrolments, which fell in the 1980s, appear to be rising again; (2) the depreciation of numerous currencies has made it easier to invest in education because of its high labour component; and (3) the level of foreign aid toward human resource development has increased. The promotion of entrepreneurship is also a critical challenge

for African countries wishing to develop domestic enterprises and help these enterprises compete in national, African and international markets.

- **The challenge of inadequate infrastructure.** The impacts of many reforms in African countries have been undermined by inadequate infrastructure. The failure to address this challenge has increased the cost of doing business in African countries. For example, manufacturing firms in Zimbabwe need to hold high levels of inventories, despite high interest rates, due to unreliable delivery of inputs tied to poor transportation infrastructure.
- **The challenge of open trade.** African countries are part of an increasingly integrated world economy. They are faced with new challenges that are brought about by the liberalisation of trade and the removal of subsidies. This creates many threats to African economies that have shown themselves to be extremely vulnerable to external shocks. However, it also creates opportunities for increases in foreign investment flows that can be channelled toward economic growth. The challenge is to effectively manage these processes. This issue concerns the move toward more integrated African economies that create better investment flows within and across Africa, as well as with other developing countries. FIAS (2004a) claim that "south-south" FDI flows have expanded from 17% of FDI to developing countries in 1995 to 30% in 2001, the latest year for which figures are available. For example China and South Africa are becoming major players in Africa with about 2.7 billion US dollars (USD) and USD 1.6 billion respectively of FDI invested there in 2001.

The above challenges are but a collection of those that are most relevant to the investment and growth prospects of African countries. While most of these challenges are not new, the urgency to address them has reached a critical point. The failure to do this will further marginalise African countries at a time when integration and participation in the world economy has become a prerequisite for achieving sustained economic growth and sufficient social development.

3. Review of donor activities in supporting investment in Africa

This section reviews the range of ODA interventions that improve private investment in African countries. Due to the high volume of activities in Africa by bilateral and multilateral donors, the findings presented here cannot claim to be comprehensive. Therefore, the purpose of this section is

to highlight examples of ODA that could be considered investment-oriented and contribute to mobilising investment in African countries.

The most recent OECD/DAC figures indicate that bilateral and multilateral donors provided USD 26 billion of net ODA to Africa in 2003. Table 1 below shows the change in ODA from 2001 to 2003.

Table 1. ODA by DAC Members to Africa, 2002-2003

(USD million)

	2001	2002	2003
Africa – South of Sahara	13 812	18 404	23 749
Africa – North of Sahara	2 395	2 348	2 066
Africa – Total	16 681	21 250	26 308

Source: OECD/DAC.

Fifty-four per cent of ODA in Africa was allocated to Social Infrastructure and Services (comprising Education, Health and Population, Water, Government and Society, Employment/Housing/Other), 21% to Economic Infrastructure and Services (comprising Transport, Energy, and Communications/Banks/Business) and 13% to Production (comprising Agriculture, Industry/Trade/Tourism).[9]

Table 2 shows the top ten donors to Africa in 2001-02. The top ten African recipients of ODA in 2002 are listed in Table 3.

Donor agencies contribute to improving the opportunities for investment in Africa in a broad range of areas, referred to in this annex as "development themes". As described in Section I, donor agencies vary in their views on which fields or development themes are the most appropriate or most significant to address when supporting reforms that improve investment. The OECD distinguishes between meso level and micro level interventions (OECD, 2004b).

Meso level interventions, refer to donor-supported reforms dealing with the regulatory framework, infrastructure and governance. While these interventions provide opportunities for donors to increase the impact and sustainability of their efforts, as later sections will show this is dependent on the way in which these interventions are designed and implemented.

Table 2. Top ten donors in Africa, 2001-2002

Donor	Value of aid to Africa (USD million)	% All Donors	% of Total Donor
United States	3 189	14	25
European Commission	2 750	12	29
IDA (World Bank)	2 617	12	48
France	2 603	12	56
United Kingdom	1 048	8	29
Germany	1 009	5	28
Netherlands	956	4	37
Italy	811	4	81
SAF+ESAF (IMF)	769	3	81
Japan	700	3	10
Other	5 844	26	31
Total	**22 296**	**100**	**32**

Source: OECD/DAC 2002.

Table 3. Top ten recipients of aid in Africa, 2001-2002

Country	Value (USD million)	% All African countries	
Mozambique	2 058	9	HIPC
Ethiopia	1 307	6	HIPC
Egypt	1 286	6	
Tanzania	1 233	6	HIPC
Cote d'Ivoire	1 069	5	HIPC
Congo, Dem. Rep.	807	4	HIPC
South Africa	657	4	
Ghana	653	4	HIPC
Zambia	641	3	HIPC
Uganda	638	3	HIPC
Other Africa	11 949	54	26 other HIPC
Total	**22 296**	**100**	

Source: OECD/DAC 2002.

The following meso level interventions are described in this section:

- Policy, legal and regulatory framework (subsection a, below): including private sector development policy and implementation, legal and regulatory reform, privatisation policies and programmes, making markets work better, and competition policy and law.
- Public and corporate governance (subsection b): including interventions that improve public sector governance as well as corporate sector governance.

- Infrastructure and utilities (subsection c): special attention is given to those interventions that support the mobilisation of private investment (foreign and local) into the development and maintenance of infrastructure and utilities.
- Openness to external trade (subsection d): rather than supporting firms to become more active in foreign markets (supply-side or micro-level interventions), this annex addresses the broader conditions in with foreign trade is facilitated and regulated.
- Improving financial services (subsection e): rather than supporting new financial schemes (again, a supply-side response) greater attention is given in this annex to the regulation and improvement of financial markets.

Micro level interventions, also know as supply-side responses, include donor-supported investment promotion and facilitation and the development of local businesses. In many cases, donors have been active in these fields for some time. However, recent innovations at this level have shown the importance of synergies between meso and micro level interventions. Micro level interventions addressed in this annex focus mainly on those that improve human capital and entrepreneurship (see 3.6) as well as ODA that creates incentives for private investment and provides guarantees and risk mitigation (see 3.7).

3.1. Improving the policy, legal and regulatory framework for investment and growth

The policy, legal and regulatory framework for investment and growth is a broad multifaceted sphere of government activity that has been given greater attention by donor agencies. The role of government in the design of policies and programmes has become particularly important to donors wishing to improve private investment in African countries. This is inline with the findings of research on ODA and growth, cited earlier, in which the importance of good policies and laws is highlighted. There are six sub-themes that receive donor attention, which are described below.

3.1.1. Policy development and implementation

Donor agencies have been assisting selected African governments to improve the quality of their policy frameworks and their implementing institutions. While government policy affects all the development themes described in this annex, the emphasis on this aspect of ODA is the adoption and implementation of macroeconomic policy frameworks that promote the private sector development and investment.

Different countries have different starting points. Tsikata (2001), for example, describes the challenges faced by Ghana and Tanzania in their donor-supported policy reform programmes. Since independence, Ghana was an open free-market economy, which encouraged private sector development.[10] However, political instability and economic mismanagement created a demand for policy reforms and capacity building that were very different to Tanzania. Tanzania began its early period of independence as a socialist state, which – with the support of various Nordic donors – encouraged community-based initiatives. Later, with the rejection of socialism, Tanzania faced a completely new set of policy reform demands such as the privatisation of previously nationalised enterprises and the opening of the economy to private interests.

The World Bank Group (WBG) has been the most prominent provider of this kind of support to governments in Africa. However, depending on the specific issue, other donor agencies, including bilateral donors, have provided ODA of this nature. The Swedish International Development Agency (Sida), for example, has supported private sector development programmes in Ethiopia, Uganda and Zambia, while GTZ has support private sector development in Ghana and Tunisia.

3.1.2. Legal and regulatory reform

Improving the legal and regulatory framework for private sector activities in African countries has been a growing theme of investment-oriented ODA. In most cases, the emphasis of donor efforts here is on the simplification and improvement of business laws and regulations and the development of more accessible commercial justice systems.

Various African Country Assistance Strategies of the WBG have emphasised the need to improve the legal and regulatory framework for private sector development (World Bank Group 2004b). As a result, a number of agencies within the WBG are active in this field in Africa.

The Foreign Investment Advisory Service (FIAS) is a joint service of the International Finance Corporation (IFC) and the World Bank that helps developing country governments improve the foreign direct investment environment in their countries. It is increasing its role in Africa and is already very active on the continent. To attract more private investment, diversify their economies and reduce poverty, FIAS claim that African governments urgently need to tackle the key constraints that affect the investment climate. On this basis, FIAS claims it has intensified its engagement in the region by extending its assistance to critically impoverished and even post-conflict countries.

FIAS has developed a Sub-Saharan Africa strategy, which is being implemented in countries such as Gabon, The Gambia, and Zambia. This approach enables FIAS to address a large number of issues in the countries' legal and regulatory framework in a progressive manner – typically starting with a general diagnostic of the business environment and then digging deeper with a thorough review of administrative barriers to investment or an analysis of the corporate tax system. This sequences the reform effort and enables subsequent reviews to build on each other. Many countries have already made basic investment law reforms and FIAS advice has moved toward the next generation of products, such as incentive structures, simplifying maze-like administrative systems, and creating investment agencies that focus on promotion rather than regulation. FIAS conducted 15 advisory projects in Sub-Saharan Africa during 2003-2004 – see Box 1.[11]

Box 6. FIAS in Gambia

In 2003, FIAS received a request from the government for assistance in determining major impediments to investment, with an emphasis on exports. The government asked FIAS to carry out a general diagnostic analysis, to be followed by an administrative barriers study and a review of taxes.

FIAS carried out the diagnostic study to identify major constraints and to establish a framework for public-private dialogue and subsequent pieces of work to be carried out in a three- to four-year program of assistance.

The study revealed that constraints found in the export sector also existed in all sectors and that the environment for FDI was hampered by a general lack of implementation capacity within responsible agencies. General problems included poor intergovernmental coordination, lack of public-private dialogue, and a large amount of discretion in administrative decisions, such as implementation of investment incentives. The study also identified major weaknesses in infrastructure, legal frameworks, the judicial system, and tax and customs administration.

The FIAS report is now being used by the government as a catalyst for engaging the private sector in a dialogue about economic policy and for developing an explicit action plan. The diagnostic's broad focus provides the context for the design of follow-up studies in the areas of administrative procedures and taxes.

Source: FIAS (FIAS 2004a, p. 15).

Some examples of FIAS's work in Africa in the field of legal and regulatory reform include: Lesotho where FIAS provides technical assistance to the Government of Lesotho for the modernisation of the company registration functions in the Office of the Registrar General and for the reform of the manufacturing and trade licensing system. In Zambia FIAS is carrying

out an administrative barriers project, to provide inputs for a reform program aimed at improving the business environment, increasing investment and ultimately contributing to the reduction of poverty (FIAS, 2004b).

FIAS has also developed a programme for working with frontier and post-conflict countries (e.g., Sierra Leone and the Democratic Republic of Congo). This programme breaks down large reviews in two to three phases so that the countries' reform efforts can focus on a few priority recommendations and a smaller number of governmental agencies involved.

USAID's work in legal and regulatory reform in Africa takes a number of forms. It includes improvements in business regulation in countries such as Ghana, Kenya, Madagascar, Mali, Nigeria and Zambia, as well as contract enforcement and dispute resolution in Ghana, Madagascar, Mozambique, Senegal and Zambia (United States Agency for International Development, 2004b).

DFID have been active in eastern and southern Africa in efforts to improve the legal and regulatory framework for private sector reform. DFID is supporting a better investment climate in Africa through its work with NEPAD (NEPAD Business Group, Small Business Project *et al*., 2004) and has been supporting comparative reviews of the business environments in a number of African countries (Small Business Project, 2003). DFID has also supported commercial justice reform in Uganda, while GTZ have supported legal and regulatory reform for micro, small and medium-sized enterprises in Nigeria and Mozambique. As well as supporting the work of FIAS in Africa, Sida supports specific country-based programmes such as tax reform in Zambia.

The Business Environment Strengthening for Tanzania (BEST) programme is a multi-donor programme launched in 2003. Its components include: (1) achieving better regulation; (2) improving commercial dispute resolution; (3) changing the culture of government; and (4) empowering private sector advocacy. Under the first component, BEST will establish a Better Regulation Unit within the President's Office – Planning and Privatisation to drive forward regulatory reform and to ensure better regulation-making in the future; repeal or reform of specific regulations already identified as imposing an unnecessary burden on businesses in the following areas (e.g., central and local taxation, land planning, allocation and site development, labour laws, businesses licensing and registration, import and export procedures, and sector-specific regulations affecting priority sectors including agriculture); enact a Deregulation Act to repeal or reform legislation that imposes an unnecessary burden on business; and, introduction of Regulatory Impact Assessments as part of the legislative process in Tanzania. Four donor agencies have collaborated to support the

BEST programme: Royal Netherlands Embassy, DANIDA, DFID and Sida. These donors contribute a total of USD 19 million over a five-year period (Government of Tanzania, 2003).

UNIDO has also undertaken work in a number of countries in Africa to improve the legal and regulatory framework for women and rural entrepreneurs.[12] In Mozambique, for example, UNIDO supported the establishment of a *Balcåo Unico* (BU), or one stop shop, in Quélimane. The BU facilitates correct and efficient applications of rules and regulations in order to stimulate private sector-led growth (UNIDO, 2003).

3.1.3. Privatisation policies and programmes

Many donor agencies have been supporting the reform and privatisation of state-owned enterprise and banks to reduce the fiscal pressure on governments and to facilitate private sector development by unblocking sectors of economy dominated by inefficient public enterprise. However, various African Country Assistance Strategies of the World Bank Group have emphasised the need to make better progress on privatisation (World Bank Group, 2004b).

USAID supports privatisation in Nigeria and South Africa. In Nigeria, USAID has most recently worked with the National Privatization Program by providing technical assistance to the Bureau for Public Enterprises to streamline and expand its operations. In South Africa, USAID assisted the government's Municipal Infrastructure Investment Unit in the creation of a sustainable framework for private infrastructure investment. Ultimately, this framework will enable local governments to provide much-needed infrastructure services, primarily in the water and sanitation field, to their rapidly growing constituencies. USAID is also supporting the development of public-private partnerships to develop needed infrastructure, such as the Gautrain, which will provide rapid-rail transit between Johannesburg and Pretoria (Kleinberg, 2005).

Sida has supported the privatisation of the Maputo port in Mozambique and many other DAC members provide programmes in selected sectors and countries in Africa promoting privatisation. Further reference is made to these programmes in section 3.3 when donor support for infrastructure and utilities is presented.

3.1.4. Making markets work better

Because private sector development and the movement of private investments are directed by the performance of markets, a growing number of donors are supporting initiatives to improve the conditions for

participation in markets. Markets are recognised as powerful mechanisms that drive development and pro-poor growth. In some cases donor support has a strong emphasis on helping the poor gain access to markets. In other cases this involves helping African countries address the challenges created by a more integrated world economy.

Donor agencies such as DFID have become more engaged in supporting programmes that promote access to markets and the capacity of potential entrepreneurs to identify and pursue new market opportunities, this area of work is extremely relevant to pro-poor development approaches (DFID, 2000). In Nigeria, DFID has established a new programme to extend rural market development and agricultural supply chains. Two specific areas of market development dealt with below are financial markets and markets for business development services.

Sida established the Export Promotion of Organic Products from Africa (EPOPA) programme in 1994. The programme has projects present in Uganda and Tanzania.[13] EPOPA has projects in Uganda and Tanzania and aims to give smallholder farmers a better livelihood through developing local and national business. The increase in agricultural production benefits rural communities, and as a result local farmers. Smallholder farmers benefit from better prices for their crops and a more transparent price setting from the exporter who buys more directly and pays in cash.

USAID increasingly finds that value chains and sectoral approaches provide useful frameworks for enhancing dynamic economic growth, investment, and opportunities for the poor. USAID's approach is based on developing solutions to economic development using current market structures and frameworks. Through this approach, sustainability issues are addressed at the start of the program, rather than at a later stage, as was common with previous programs. For example in Kenya USAID has developed a programme to address barriers and deficiencies in the horticulture and tree fruit sectors. This programme has relied exclusively on local private sector actors, with the objective of increasing skills and capabilities. The programme is structured to keep local partner costs low and enable a gradual reduction of the subsidy required to provide needed services (Kleinberg, 2005).

3.1.5. Competition policy and law

Another market-related theme of investment-oriented ODA is the establishment, improvement and implementation of appropriate competition policy regimes to maximise the benefits of competition and guard against anti-competitive practices such as cartels and the misuse of market power, which are some of the causes of market failure.

The OECD has established the Global Forum on Competition (GFC), which has become an important vehicle for helping to strengthen the role of competition policy around the globe – with OECD members and non-members. The GFC is achieving this by facilitating dialogue, providing a channel for the dissemination and discussion of good OECD practices and helping to identify priority areas for capacity building and technical assistance in developing countries. In 2003, a peer review was done with South Africa – the first peer review of a developing country at the GFC.

In a recent report of the GFC (2004) it was recommended that, due to the competencies required when helping a developing country to establish competition laws and policies, bilateral donor agencies should ensure that their own competition authorities play a significant role in these assistance programmes. At a minimum, the GFC suggests, competition agencies could become more involved in planning their countries' assistance activities in the competition field.

DFID encourages the adoption of appropriate competition law regimes. Projects implemented by country offices located in Africa include the revision of Tanzania's competition law, as well as a peer review of South Africa's competition law regime. DFID has also undertaken a project known as "7-Up". This was a comparative study of the competition regimes of seven developing countries, four in Sub-Saharan Africa and three in south Asia. This two-year project was undertaken through a combination of in-country research, case studies and national and regional meetings. It has helped build national capacity and promoted awareness of the role of competition law and policy in national economic strategies. It highlighted the need for policy changes, and created an international network of competition experts who have contributed to ongoing discussions on international competition issues (DFID, White *et al.*, 2004). DFID has also prepared a variety of resources on this subject that can be used by programme partners (DFID, 2003b).

FIAS undertook a competition policy study in Burkina Faso covering the cotton, fruits and vegetables, and cattle/leather sectors. It has also held a regional conference on Competition Policy in Tanzania, while in South Africa FIAS is planning a series of small, focused studies on regulation, trade, and competition policy that will span two to three years (FIAS, 2004a).

Investment-oriented ODA in this development theme has become more focussed. Donor skills and knowledge required to bring about sustainable policy and institutional change are growing. Much more needs to be learnt in this area and long-term impacts are hard to measure, but it appears that there is much to be gained from further interventions in this theme. A

critical concern is the way donors work with domestic partners. The need for trust, mutually agreed reform processes, and regular monitoring is clear.

The drafting of new policies, laws and regulations is not enough. Nor is it adequate to create new or different organisations, such as regulatory units and commercial courts. New policies need to be implemented; laws and regulations should be consistent across all portfolios; organisations need to be run efficiently and transparently. In the push for deregulation and smaller government, greater attention should be given to helping African governments understand the importance of good regulation and strong governments.[14] Donors need to work closely with national counterparts over a sustained period of time to achieve this. They are also required to work with private sector and civil society counterparts to ensure they are properly equipped to engage with governments on these matters.

Some donors may view these interventions as discrete and strategically focussed programmes that bring about quick wins. However, achieving a desirable impact through these interventions is not a short-term process. While a new policy may be produced in, say, two-to-three years, its implementation and the other efforts that are required to ensure other policies and laws do not compete with or undermine the effect for the new policy will take much longer.

3.2. Improving public and corporate governance

Governance as a theme for investment-oriented ODA has been growing in importance and relevance. Where once economic growth and governance were treated almost as independent, it is now clear that these issues are closely connected. Indeed, improvements in governance have been found to contribute to economic growth (Kaufmann & Kraay, 2002).

One of the major governance challenges is choosing a place to start. As described earlier, the failure of public governance is a major obstacle to economic growth in Africa and there are many layers of failures in governance that need to be addressed. Mason (2002) argues that the setting of priorities among governance reforms requires a broad frame of reference that recognises the political and economic context in which reforms are formulated. "It is clear" he says, "that establishing basic political legitimacy and order is an essential first step for countries with collapsed states. This task inevitably must take precedence over other important, but less urgent, reforms such as public expenditure management, civil service reform, and decentralisation of public services" (e.g., Sierra Leone). While other countries are in need of basic institutions to ensure some degree of political stability, basic physical protection of citizens, and initiatives that increase the legitimacy and authoritativeness of government, laws, and public

policies (e.g., Burkina Faso). While others have enough institutional coherence to think more about expanding public services to their poor majorities, diminishing the most development-averse forms of corruption, and setting up systems for better management of public resources (e.g., South Africa).

3.2.1. Improving public sector governance

Investment-oriented ODA dealing with public sector governance focuses on a range of issues. Among these are programmes to reduce corruption, improve transparency and public administration in general. Agencies such as Sida and the ILO have drawn the clear connection between poor governance and the growth of the informal economy, which is substantial in Africa (Becker, 2004; ILO, 2002) (see also Annex 1).

In some cases, improvements in governance have been tied to privatisation and civil service restructuring programmes. This may include the substantial range of programmes that support the decentralisation of government services and the development and strengthening of government reporting and accountability mechanisms. The promotion of public-private partnerships is also relevant as are other programmes that engage the private sector in a broader range of development efforts. However, Eifert, Gelb, *et al.* (2005) claim that privatisation programmes have not been completely successful at eliminating rent-seeking and patronage.

DFID's governance work in Africa comprises reforms that improve governance in the public sector, i.e., improvements in the ways governments' manage the business environment, such as by becoming more transparent and accountable (DFID, 2002).

An issue that appears to have become more important to donor agencies within this field is the need for the private sector to become a more articulate and consistent advocate for reform. Private sector demand for reform is often considered lacking and donor agencies have worked with private sector organisations to assist them in expressing these demands. Tsikata (2001) claims that in most African countries, "public discourse on economic development and reform remains inadequate and the means of sanctioning poor government performance are equally meagre" (p. 16).

USAID supports improved public sector governance through addressing the supply of local skills in economic analysis and improving mechanisms for policy decision-making. USAID is increasing the supply of locally trained economists through supporting graduate-level institutions across the continent. USAID is also supporting the development of policy research institutes to conduct research and inform policy discussions. Improving public sector governance is often a sub-component of other USAID

activities, including privatisation, trade facilitation, tax reform, and red tape reduction.

The UNCTAD Advisory Service on Investment and Training programme on Good Governance in Investment Promotion and Facilitation provides assistance to Ethiopia, Lesotho, Mali and Tanzania. In 2003, a review of the status of governance in investment promotion and facilitation was carried out in Lesotho and Tanzania. Advisory reports with recommendations were presented to the governments of these countries. Follow-up assistance to Ethiopia, Lesotho and Tanzania included training in customer services for employees of institutions dealing with foreign investors and the development of client charters for national investment promotion agencies (United Nations Conference on Trade and Development. 2004a).

3.2.2. Improving corporate governance

Because the mobilisation of private investment implies action by the private sector, growing attention has been given to improving corporate governance. Poor corporate governance contributes to anti-competitive and monopolistic behaviour, which in turn reduces the demand for reform from within the private sector. Thus, improving corporate governance contributes to strengthening and broadening the domestic demand for reform. Investment-oriented ODA is used to support these processes, which also require support for better-organised, more representative private sector organisations.

The Commonwealth Business Council endeavours to mobilise its global membership, comprising corporate members from both developed and developing countries, to promote the following objectives with respect to corporate governance:

- To achieve a common understanding of what corporate citizenship means in practice;
- To understand the perspective of companies in developed and, particularly, developing countries;
- To set out the views of members on how corporate citizenship can be made to work for them; and
- To produce research that examines the interaction between business, government and other sectors of society on support for sustainable development within an enabling business environment.

DFID also supports better corporate governance and social responsibility (DFID, 2003a and 2003c). DFID supports the Extractive Industries Transparency Initiative (EITI). This initiative works with African governments, donor agencies, NEPAD, trans-national corporations,

investors, civil society organisations, and international financial institutions to increase transparency and accountability in the extractives sector in Africa (as well as other developing countries). It was launched by the British Prime Minister at the World Summit on Sustainable Development in Johannesburg in September 2002.

Investment-oriented ODA in this development theme has been relatively recent and motivated by a better understanding as to why previous reform efforts have failed. Thus, it is wise to continue to work on improving public and corporate governance with an eye on the impact this can have on investment, economic growth and poverty reduction. Within the public sector the importance of state building has been recognised and looks particularly relevant for many countries in Africa. However, here again, donors should not look for short-term impacts.

Improving corporate governance is an important objective in a more integrated world economy in which multi-national corporations have increasing economic and political power. Donors can add-value to this field of work and ensure there is a connection between corporate governance and pro-poor growth, but there are other agents that appear better positioned for this work. Private sector organisations engaged in improving corporate governance in OECD countries, for example, should be encouraged to extend their reach to developing countries. South-south links between private sector organisations could also be encouraged for this purpose.

3.3. Improving infrastructure and utilities

Weak infrastructure has consistently been identified in investment climate surveys conducted in Africa as one of the most significant impediments to private investment. Infrastructure has traditionally been addressed by donor agencies through development loan programmes (e.g., provided by bilateral and multilateral development banks) or by the direct provision of grants to developing countries. However, in recent years, the private sector has become more engaged in infrastructure provision.

For some donor agencies, infrastructure and utilities have always featured strongly. Within the World Bank Group's lending operations, for example, "infrastructure for private sector development" is a major investment (World Bank Group, 2004b).[15]

The OECD (2004b) has noted previously that DAC members have supported infrastructure and utilities in many countries with specific interest in transportation, water supply and sanitation, energy generation and supply, and telecommunications. Denmark, for example, supports Ghana's National Road Sector Development Programme and has improved roads between Accra and neighbouring Cote d'Ivoire. France supports a programme to

supply drinking water in Mali, Senegal, Niger and Burkina Faso. While in Zambia, Germany has supported reforms to the regulation of water supply and sanitation. Sida supports energy sector policy and institutional reforms in Tanzania, Uganda and Zambia.

Donor agencies have been giving attention to the importance of information and communications technology in recent years. USAID for example supports the DOT-COM Alliance to promote the use of information and communications technology across all development sectors.[16] It also supports the regulation of telecommunications through the Southern Africa Telecommunications Policy and Regulatory Support Project which aims to harmonise a common framework of telecommunications policies, regulations and procedures in Southern Africa (United States Agency for International Development, 2004a). Sida supports the development of an information and communications technology policy in Tanzania, along with improvements to the way this sector is regulated.

MIGA in Africa

Mozambique Aluminium Smelter. MIGA issued a $40 million guarantee to the Industrial Development Corporation of South Africa for an aluminium smelter in Mozambique. The Mozal project, located near the capital city of Maputo, is covered against the risks of expropriation, and war and civil disturbance. It is one of the largest foreign investments in the country.

Mining in Mauritania. MIGA provided $68.3 million in guarantees to Tunisie Télécom of Tunisia for its equity investment in, and loan guaranties to, the Société Mauritano-Tunisienne des Télécommunications in Mauritania. The coverage is against the risks of transfer restriction, expropriation, and war and civil disturbance. The project involves the installation, operation, and maintenance of a new GSM telephone network, which will significantly improve Mauritania's teledensity levels, which are among the lowest in the world.

Source: MIGA (2003)

Connectivity Africa is one of three initiatives launched at the June 2002 G8 Summit in Kananaskis, Canada as part of its response to the G8 Africa Action Plan and the recommendations of the Digital Opportunity Task Force. Implemented by Canada's International Development Research Centre (IDRC) in partnership with the United Nations Economic Commission for Africa, Connectivity Africa is funded by the Canada Fund for Africa and aims to improve access to information and communication technologies in Africa. Among other programme activities Connectivity Africa facilitates linkages between national strategies and regional infrastructure priorities and supports the development of mechanisms for

enhancing intra-regional Internet connectivity (International Development Research Centre, 2003).

The Public Private Infrastructure Advisory Facility (PPIAF) provides technical assistance to developing-country governments to develop and implement appropriate policies, laws, regulations and institutions that will enable and encourage greater private investment in infrastructure. It includes some 15 multilateral and bilateral donor agencies and provides technical assistance to developing-country governments to improve the enabling environment for private sector involvement in infrastructure (i.e., water, sanitation, electricity, telecommunications, gas transmission and distribution, and transport).[17]

The facility funds a range of activities across developing and transition countries and, at the end of March 2004, the PPIAF portfolio covered 310 activities in more than 84 countries. National and regional activities in Sub-Saharan Africa have represented 32% of PPIAF's portfolio by value since PPIAF's inception (Public Private Infrastructure Advisory Facility, 2004).

In Senegal, Uganda and Lesotho PPIAF prepared a comprehensive study of the country's state of infrastructure, to identify opportunities and measures to improve the regulatory framework to improve private sector involvement in infrastructure. Roundtable discussions were then organised between government, private sector, potential investors, to build consensus between all stakeholders.

The Private Infrastructure Development Group (PIDG) is a group of donor agencies, presently comprising DFID, the Netherlands Minister for Development Co-operation, the Swiss State Secretariat for Economic Affairs of the Government of the Confederation of Switzerland, and the World Bank. PIDG members share a common interest in terms of designing approaches that promote private sector involvement in infrastructure development and this has led to the design of a number of donor-supported infrastructure programmes.

Finally, the Multilateral Investment Guarantee Agency (MIGA) is a member of the WBG, which promotes FDI into developing countries by offering political risk insurance (guarantees) to investors and lenders, and by providing technical assistance to help attract and retain foreign investment. MIGA's guarantee portfolio in Africa has grown from 7% in 1999, to 17% (or USD 793 million) by end of fiscal year 2002 (MIGA, 2003).

Investment-oriented ODA in this development theme is critical in Africa, but it is clear that new modes of ODA are required and are being elaborated. This annex has described a number of new facilities that have been established to deal with some of the specific concerns related to private

sector investment in infrastructure. Engaging the private sector has been an important step toward increasing the reach and therefore impact of this area of work. However, this should be balanced by support for a stronger role for government in regulating competition to ensure the social benefits of improved infrastructure.

3.4. Facilitating external trade and mobilising investment

In terms of number of projects, it appears that donor agencies are very active in efforts to promote reforms that increase external trade in African countries. Trade-related technical assistance and capacity building (TRTA/CB) has been the central theme of much of this work. These are efforts design to improve the capacity of governments to engage effectively in international trade. The following agencies appear particularly active in this development theme in Africa: European Commission, FIAS, France, Germany, Japan, Portugal, United Kingdom, United States, United Nations Conference on Trade and Development, and the World Bank.

The Integrated Framework (IF) is a multi-donor program that helps least developed countries to expand their participation in the global economy and enhance their economic growth and poverty reduction strategies. Launched by six multilateral institutions (IMF, ITC, UNCTAD, UNDP, World Bank and the WTO), the Integrated Framework has two objectives: (1) to "mainstream" (integrate) trade into the national development plans such as the Poverty Reduction Strategy Papers (PRSPs) of least-developed countries; and (2) to assist in the co-ordinated delivery of trade-related technical assistance in response to identified needs (IMF, ITC *et al.*, 2004). Thirteen Sub-Saharan African countries have benefited from the IF or are targeted for assistance under it: Benin, Chad, Guinea, Burundi, Lesotho, Senegal, Madagascar, Djibouti, Malawi, Eritrea, Mali, Ethiopia, and Mauritania.

The United States has contributed funds for the past three years to the Integrated Framework Trust Fund to finance diagnostic trade integration studies and, along with other IF partners, seeks to help partner countries follow up on TRCB priorities identified in IF diagnostic exercises. In 2003, US trade capacity building assistance to the 13 Sub-Saharan African countries participating in the IF exceeded USD28 million, more than three times the 2002 level for these countries. The United States has also provided bilateral assistance to Cape Verde in support of its efforts to accede to the WTO (Office of the United States Trade Representative 2004, pp. 26-36).

Much of the US Government's support for trade in Africa centres on the African Growth and Opportunity Act (AGOA). Signed into law on 18 May 2000, the Act offers incentives for African countries to continue their efforts

to open their economies and build free markets. The United States provided USD 133 million to trade capacity building activities in Sub-Saharan Africa in 2003, up 26% from 2002. These activities are implemented though about a dozen agencies including USAID, the Department of Commerce, the Department of Agriculture, and the US Trade and Development Agency (Office of the United States Trade Representative 2004, pp. 26-36).

The European Commission established the “Capacity building in support of the preparation of Economic Partnership Agreements (EPA)” programme in 2002 to provide technical assistance to assist the African Caribbean and Pacific members in their preparation for and conduct in EPA negotiations. Capacity-building operations include activities such as research, technical assistance or training in accession to WTO, preparation of and participation in WTO negotiations, and compliance to the multilateral trading system in general (European Commission, 2002).

The Sub-Saharan Africa Transport Policy Program (SSATP) is a partnership between the World Bank, the United Nations Economic Commission for Africa, and a large number of bilateral and multilateral donors. SSATP facilitates policy reforms in the transport sector in Sub-Saharan Africa and helps Sub-Saharan African countries to formulate and implement sound transport policies by: (1) sponsoring research, documentation, publications, and conferences; (2) disseminating information via publications distribution, the Internet, and at seminars and meetings throughout Africa; (3) co-ordinating initiatives and sponsoring links between institutions in Africa and elsewhere; and (4) serving directly as advisor or facilitators to transport policy reform in many African countries (World Bank Group, 2004c). GTZ has also supported a programme with the Southern African Development Community, which promotes better regional trade.

The number of investment-oriented activities carried out by DFID in the trade field has grown dramatically in recent years: from around five trade-related projects in the period 1990-1993, to over ten projects in the period 1993-1995, to a very broad trade programme currently. The influence of the Government's 2000 White Paper on Globalisation has contributed significantly to the increase of DFID’s activities in this area. Over half the overall funding DFID provides in this theme is in Africa. Nearly two-thirds of trade policy and regulation programmes have been aimed at integrating trade into development plans or poverty reduction strategies and nearly three-quarters of trade development programmes assist small businesses gain access to trade finance (OECD, 2003). In Zambia, for example, DFID has helped to identify barriers to foreign and domestic investment, and the potential for supply chain linkages in commercial agriculture from big business to smallholders.

DFID claims it has moved the focus of its programmes in trade from technical assistance (TRTA) to trade facilitation and promoting awareness and knowledge amongst national institutions of the rules, procedures and institutions of the international trading system. A part of this shift in focus has been the move from a sectoral focus (i.e., working in sectors that showed the most promise for export promotion), to a broader systemic approach and the facilitation of trade. DFID programmes in this area go beyond the country level – the regional and global concerns of trade have become more prominent. The United Kingdom's International Trade Department focuses more on working with multilateral agencies (e.g., UNCTAD, ITC, WTO) than it has in the past (North-South Institute, 2004).

The programme of the Government of France, *Programme pour le renforcement des capacités commerciales*, which works predominantly in Sub-Saharan Africa focuses on increasing negotiating capacities and export capacities. In addition, the Government of Portugal provides assistance to Portuguese-speaking countries in Africa to build their negotiations capacity within the WTO and to promote a better integration in the multilateral trading system (OECD, 2003).

The OECD launched the Initiative on Investment for Development in 2003 in Johannesburg, South Africa. The Initiative supports the agreements of the Monterrey Consensus and includes three closely inter-related projects: (1) the development of a Policy Framework for Investment; (2) drawing lessons on the use of ODA in support of countries' efforts to mobilise investment for development; and (3) sharing the OECD's experience with investment policy peer reviews as capacity building mechanisms.

The Policy Framework for Investment is intended as a non-prescriptive checklist of issues for consideration by any interested governments engaged in domestic reform, regional co-operation or international policy dialogue aimed at creating an environment that is attractive to domestic and foreign investors and that enhances the benefits of investment to society. The Framework will serve as a reference point for investment promotion agencies and donor agencies as they assist developing and transition country partners in improving the investment climate, as well as businesses, trade unions and NGOs in their dialogue with governments. The Framework will be developed by a Task Force through a partnership process involving OECD Member and non-Member governments, in co-operation with civil society and other international organisations (OECD, 2004c).[18]

The Commonwealth Business Council (CBC) promotes the Commonwealth Investment Principles, which were endorsed by Commonwealth Heads of Government at their March 2002 meeting. This

Action Programme for Investment forms an important part of CBC's work to help mobilise investment into Commonwealth countries.

Finally, a number of OECD countries have employed home country measures (HCMs) to promote foreign direct investment to developing countries. This is done on the premise that FDI is good for development and that there are market and co-ordination failures that deter investment and cause the social benefits to FDI to be greater than the private benefits. A recent review of these programmes in the United Kingdom and the European Commission has found that one-stop-shops for outward investors could be useful to reduce potential confusion among investors (te Velde, 2003).

Investment-oriented ODA in this development theme appears to hold great potential. Indeed, many donor agencies are increasing their involvement here. The shift from focussing on exports toward better trade regimes and improving the capacity of African countries to negotiate trade agreements has been crucial. However, it should be recognised that while trade barriers around the world have been removed, many developed countries continue to apply subsidies to specific sectors such as agriculture. African governments are unable to afford such subsidies, leaving them at a distinct disadvantage, which could have a negative affect on investment. Thus, there are issues beyond the reform of policies and institutions in African countries that should be addressed to achieve results in this theme.

For donor agencies working in Africa to improve investment and growth, reforms that support increasing trade demonstrate the potential for positive impacts in the near future. Increased trade can quickly lead to greater investment. A particular challenge to address in this regard is the need to change investor sentiment or attitude towards Africa. As trade increases, so too will investor confidence, which will lead to significant long-term benefits.

3.5. Improving financial services

The inadequacy of financial services in Africa has been raised in several assessments as one of the most significant obstacles to greater investment and economic growth. Donor efforts in this theme have shifted significantly. While previously ODA mainly supported the development of financial schemes and loan programmes (and, indeed, some donors continue to provide this kind of support), there has been a shift toward supporting reforms that take a more comprehensive and systems approach to financial services. Here, the emphasis falls on broadening and deepening the access the poor have to financial services. As with other areas of investment-oriented ODA, improving financial services has moved from supporting

initiatives that directly affect the poor, to working upstream and helping governments, regulators and commercial banks to improve the ways in which financial services are provided.

DFID is currently undertaking studies of the impact of country credit ratings and taxation regimes on private investment in Africa. DFID also supports the FinMark Programme, which works across Southern Africa, in which the Banking Council of South Africa is helping to deepen financial markets. USAID has predominantly worked with institutions to broaden and deepen the availability of financial services. Its work on policy initiatives has been predominantly limited to the environment for microfinance institutions (Kleinberg, 2005). Sida supports a number of financial development programmes in Africa, including projects in Tanzania and Uganda. GTZ supports similar programmes in Ethiopia and Uganda.

The Financial Sector Reform and Strengthening (FIRST) initiative is a large technical assistance facility, located within the World Bank and funded by a number of multilateral and bilateral donor agencies. It supports capacity building and policy reforms to the financial sector in developing and transition countries.[19] The management unit is located in London, while the co-ordination unit is in Washington DC FIRST has up until now focussed on regulation, stability, and security. There is a need for facilities such as FIRST to be more closely linked to country offices so that country-level programming can draw more effectively from the resource that this facility offers.

Investment-oriented ODA in this development theme has, like other themes reviewed above, also taken on a more systemic approach. This has brought a field of work that has previously been closely tied to poverty initiatives out into the mainstream of the economy. Inadequate financial services have been cited in many assessments as a major obstacle to investment and growth. Reform in this theme can contribute to the mobilisation of domestic investments and the correction of market failures that have marginalised the poor from full participation in the economy.

Future donor interventions in this theme will lead to a better understanding of the policy and institutional characteristics that are required to ensure increasing investment and economic growth benefits the poor (i.e., toward pro-poor growth).

3.6. Developing human capital and entrepreneurship

Investment-oriented ODA includes support for the development of the human resource in African countries. Developing the human capital of African countries is critical to the long-term attraction of foreign investment and the mobilisation and growth of domestic investment; skilled, productive

workers are required to compete in an integrated global economy, just as local firms and entrepreneurs are required to innovate and respond to changes in African and international markets.

This is a broad theme of development work, containing a long history of donor intervention and a high volume of donor activity by bilateral and multilateral donors alike. It includes support for the improvements of education, vocational training, health services (including HIV/AIDS programmes) and social protection schemes.[20] Because of the magnitude and diversity of ODA provided to the development of human resources, this review will focus on a more narrow set of interventions: those promoting entrepreneurship and the development of domestic enterprises.

Strategies that support the development of domestic enterprises have strong synergies with the potential of a country to attract foreign investment. However, large foreign and minority firms in many African countries exhibit much higher levels of productivity than their smaller indigenous counterparts (Eifert, Gelb *et al*., 2005).

Box 7. Enterprise Africa

The Enterprise Africa programme was established in January 1998 as a regional initiative of the UNDP Africa Bureau designed to provide a regional framework for facilitating and coordinating private sector support activities in Africa and to increase indigenous African entrepreneurship. It provides a focal point for coordinating country-led initiatives in Africa, which seek to develop a new generation of dynamic and successful SMEs that can contribute significantly to enhancing productivity, competitiveness, job creation and sustainable livelihoods in Africa.

Enterprise Africa operates in 20 countries, both at the national level – by establishing new private sector programmes and strengthening existing ones – and at the regional level – by promoting cross-border linkages, trade and investment as well as technology transfer. The flagship programme model on which these interventions at the country level are based is the Empretec programme.

There are many donor agencies involved in enterprise development in Africa. They include: European Union, France, GTZ, ILO, Italy, UNDP, UNIDO, United Kingdom, United States, and the World Bank Group. There is a broad sweep of programmes contained within this theme, ranging from the provision of financial and business development services to small enterprises, to the facilitation of linkages with large and foreign firms, to the improvement of the representation of enterprises, to the reform of the business environment for enterprises.

Improving the representation of small enterprises is a focus of a number of donor agencies. These programmes build the capacity of small enterprise membership organisations and facilitate links with government policy-making structures. Some GTZ examples include the SME Promotion Project in Egypt and the promotion of sectoral associations in Algeria.

Many donor agencies have an emphasis on the promotion of small enterprises, including those in the informal economy.[21] This has largely been because of the extremely high numbers of micro and small enterprises found in African countries, as well as the high participation of the poor in small enterprises. In addition, smaller firms in Africa are more vulnerable to the high transaction costs associated with a poor business environment (Naudé & Krugell 2003, p. 66).[22]

Skills development is a feature of many donor interventions in this field. The ILO, for example, has provided the Start and Improve Your Business training programme, with financial support from Sida, for many years and in many countries in Africa. Despite the range of training programmes provided by donors, outside South Africa, Sub-Saharan Africa has not a single accredited business school (Eifert, Gelb *et al.,* 2005). UNDP has supported a number of enterprise development programmes in Africa through regional and national approaches. See Box 3.

The Africa Project Development Facility (APDF) was established by the International Finance Corporation (IFC) in 1986 as a multi-donor initiative helping African small and medium enterprises (SMEs) to develop bankable business plans and secure project financing. Headquartered in Johannesburg, with regional hubs in Abidjan, Accra, Johannesburg and Nairobi, and offices in Lagos and Cape Town, it facilitates access to a wide set of business development services for local SMEs and the organisations in Sub-Saharan Africa. APDF also works closely with its sister organisation the African Management Services Company, which provides management support, training, and corporate governance assistance. APDF's new five-year cycle includes Business Advisory Services to support the development of business plans (including due diligence and valuations); business diagnosis; and financial structuring and fund raising.

IFC is in the process of creating the Private Enterprise Partnership – Africa to take over the provision of technical assistance to SMEs in the region from the APDF. This will include support for consulting services, business associations, and local financial institutions.

UNIDO has supported the development of a number of industrial development policies and programmes in Africa, while agencies such as the ILO, GTZ and DFID have supported the development of small enterprise promotion policies and programmes. A number of agencies have provided

assistance to the support of youth entrepreneurship programmes (e.g., UNIDO in Uganda). Donors have also provided special programmes of support to help women entrepreneurs. This included ILO in Zambia, Malawi and Tanzania; UNIDO in Kenya and Morocco.

In addition, a growing number of donor agencies are supporting the promotion of local economic development initiatives in African countries: European Union in South Africa; GTZ in South Africa; ILO and the Italian Government in Mozambique, Angola and South Africa.

USAID has a number of programs to support entrepreneurship in Africa. Its Development Credit Authority program often packages portfolio loan guarantee programmes with technical assistance to banks to increase credit available to particular sectors. Programs in Kenya increase the availability of credit in a number of sectors, including tourism, dairy, horticulture and agro-processing. In Mali, the facility increases the capacity of the private sector to benefit from other USAID programs in the agricultural sector.

Credit to small and micro entrepreneurs is a key element of many USAID programmes in Africa. Recently, credit activities have come to be more co-ordinated with the broader enterprise development portfolio, either in sectoral or geographic focus. USAID is also working to increase the access of small and micro firms to high-value niche markets, such as cacao and coffee. For example, coffee growers in nine African countries are gaining access to high value specialty coffee markets, through developing a greater understanding of cupping and grading standards (Kleinberg, 2005).

Box 8. Mediterranean 2000

This programme assists ten countries in the Mediterranean basin and Horn of Africa to promote SMEs that can grow, partner and compete in the global economy. The Government of Italy funds the programme so that SMEs in these ten countries will be able to participate in the future regional free trade area. Its gradual opening will hopefully provide sufficient time for the region's SMEs to modernise and be ready to successfully compete in fully liberalised markets. The process of economic liberalisation has to be accompanied by appropriate action and support measures to enable SMEs to survive and grow in the new environment. Besides having a multi-country approach, various international agencies such as the ILO, ISO, ITC, UNCTAD and UNIDO, are being encouraged to intervene in an integrated manner while executing their own SME development projects.

The Committee of Donor Agencies for Small Enterprise Development was established in October 1979 at a meeting in Berlin, convened at the invitation of the World Bank. Participants are representatives of bilateral

and multilateral donor organisations from around the world that are engaged in programmes of assistance in the development of small enterprises. The objectives of the Committee is to promote small enterprises in developing countries by exchanging information on the programmes of participating agencies in the field of small enterprise development; share experiences and lessons learned in the implementation of projects; and co-ordinate efforts and establish guidelines in these fields.

The second major conference of the Committee was held in Abidjan, Cote d'Ivoire in 1983. This conference had a regional focus on Africa and was followed by a conference ten years later at which the focus changed from a forum of (mainly Western) academics and donors to practitioners and policy makers from around Africa. The outcomes of this conference are documented in the publication *Agents of change; studies on the policy environment for small enterprise in Africa* (English & Hénault, 1995).

Over the years, the Committee has produced a number of reports and technical documents of use to donor agencies and other development partners engaged in small enterprise development. Among the most relevant of these are:

- Small and micro-enterprise finance: Guiding principles for selecting and supporting intermediaries (1995)
- Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention, 2001 Edition (Known as "The Blue Book")

In 2001, the Committee of Donor Agencies established the Working Group on Enabling Environment. A first initiative of the Working Group was to commission research into the role donor agencies play in promoting an enabling environment in five countries/regions.[23] This resulted in the publication of a report entitled, *Enabling small enterprise development through a better business environment.* In 2004, the Working Group commissioned a second research report. This report, entitled *Donor approaches to improving the business environment for small enterprises*, presents a more detailed examination of the concepts, tools and programmes donor agencies use to assess and reform the business environment.

In November 2005, the Committee plans to hold another major conference in Africa. This will be in Cairo and will focus on the roles donor agencies can play in supporting reforms that create business environments that are more enabling of small enterprise development.

Investment-oriented ODA in this development theme has been longstanding and should continue for some time. All commentators appear

to agree: Africa's potential to successfully engage with the world economy is subject to improvements in its human capital. In this context, all ODA directed toward human development in Africa can be seen as a contribution to increased investment and economic growth. However, there are a number of ODA activities within this theme that could be specifically called investment-oriented. This includes the support for entrepreneurship and the promotion of small enterprises.

There is great debate concerning the final impact of entrepreneurship and the promotion of small enterprises on investment and economic growth. One argument is that these programmes do little to contribute to growth and tend to further distort dysfunctional markets. Others suggest that getting the big picture right (i.e., improving the investment climate) is where the focus should lay. While others argue that working with the poor, building entrepreneurial skills and supporting the growth of small enterprises is an important contribution to the mobilisation of domestic resources, which are an essential ingredient for improving investment.

There are benefits to be gained in a continuation of donor efforts to unravel the lessons of new approaches in this theme. Donors are becoming more critical of their work and this has helped to improve practice.

3.7. Incentives for private investment, guarantees and risk mitigation

Donor agencies have also undertaken micro level interventions to improve investment in Africa through the provision of incentives for private investment, investment guarantees and risk mitigation. The design and implementation of investment policies and programmes have been one of the most common forms of donor intervention in this regard. For example, the German Investment and Development Corporation has supported the setting up and management of investment promotion programmes in Lesotho since 1985 through its 10% ownership of the Lesotho National Development Corporation. Similarly Japan has supported trade and investment promotion seminars in Africa and has conducted training and other capacity building measures in this field (OECD, 2004b).

The United Nations Conference on Trade and Development (UNCTAD) and the International Chamber of Commerce have established a programme that provides investment guides and capacity building support in Ethiopia, Madagascar, Mali, Mozambique and Uganda. UNCTAD has also established a programme entitled, "Needs Assessment to Attract Asian FDI into Africa" providing assistance to African countries in formulating policies favourable to attracting FDI from Asia, including by SMEs. The potential of Botswana, Ghana, Madagascar, Mozambique and Tanzania to

attract Asian FDI was reviewed in 2003. The UNCTAD Advisory Service on Investment and Training (ASIT) strengthens the capacity of developing countries to create and manage their FDI policy frameworks. In 2003, advice was provided to Angola on its newly enacted law on private investment. In addition, this programme provided assistance to a number of African countries (Botswana, Ethiopia, Lesotho and Tanzania) in follow-up to recommendations contained in the investment policy reviews prepared by UNCTAD (United Nations Conference on Trade and Development, 2004a).

Donors have also supported private investment in Africa through the provision of risk capital, investment guarantees and risk mitigation mechanisms. For example CIDA established the Canada Investment Fund for Africa to stimulate domestic and foreign investment through risk capital. The fund is a public-private partnership with the aim of channelling at least CAD 200 million in additional funds to Africa (OECD, 2004b).

UNCTAD provides advice, guidance and training for insurance supervisory authorities, in particular for the establishment of legal and supervisory frameworks geared towards sustaining the development of competitive insurance markets. A total of 32 African countries were involved in training and other events organised on selected insurance issues in 2003. In addition, some 30 African insurance companies received a credit rating under a scheme set up by UNCTAD and the African Insurance Organization (United Nations Conference on Trade and Development, 2004a).

The Emerging Africa Infrastructure Fund (EAIF) is a public-private financing partnership initiated by PIDG as a new financing approach for the long-term alleviation of poverty in sub-Saharan Africa through combining public and private funding partners and adopting commercial and developmental principles in support of sustainable development and economic growth. The UK Secretary of State for International Development launched EAIF on 30 January 2002. EAIF has the following objectives:

- To address the scarcity of long-term debt for significant private sector-based infrastructure development through the provision of long-term debt finance that can be tailored to suit the typically longer term nature of cash flow profiles arising in infrastructure.

- To be responsive to market needs by working with all participants (host governments, private sector sponsors and NGOs alike) to create appropriate financing solutions to meet the challenges of private sector financing in the region, including where possible and appropriate the facilitation of local capital market involvement.

- To ensure as far as is possible that all activity receiving support from the Fund conforms to internationally acceptable environmental and social impact standards.
- To operate on private sector commercial principles and so demonstrate the viability of long-term commercial lending into sub-Saharan Africa.
- To increase the size of the Fund and its effectiveness through using leverage of additional donor money to attract new private sector capital that would otherwise be unlikely to be made available to the region.

Many investment promotion and risk mitigation programmes endeavour to overcome the negative perceptions foreign investor have of Africa. For example, the Commonwealth Business Council established Investors in Africa, also known as Friends of Africa, which includes more than a dozen leading multinational companies with successful investments in Africa. The group aims to improve external perceptions of the African continent in the belief that more accurate perceptions will attract new interest from the investment community. The Friends of Africa are beginning with a study of the key issues facing new investment in Africa. In addition, the group is arranging introductions to key African government personnel, and organising information sessions between investors and African lenders to promote new cross-border investment. The Norwegian Investment Fund for Developing Countries is another example of an initiative that has been established to promote sustainable, viable private investment which perceptions of risk would otherwise prevent from taking place.

3.8. Summary

The above review illustrates a high volume of ODA in these themes. It is clear that donors are heavily engaged in these activities and are likely to remain involved. However, it is not always clear that donor agencies are involved in these activities for the same reasons or for the purposes of improving investment levels. Dag Larsson (2004) of NORAD notes that while “most donors have supported from some to all themes”, not all do so with “the objective of enhancing the investment climate or promoting private investment”. Some themes, such as human resource development and infrastructure, can be supported by donor agencies for other reasons and while this study is unable to determine the rationale behind donor interventions, the following sections attempt to examine those features of ODA practices that are investment-oriented.

4. Implementing and assessing investment-related ODA strategies in Africa

Having reviewed the range of development themes and sub-themes that investment-oriented can ODA focus on, this section turns to the issue of implementation. Here, the ways donor agencies assess African investment climates and business environments, then design and apply reform interventions are reviewed with the aim of determining those aspects of ODA that appear to contribute to increased investment and economic growth.

Also addressed in this section is the issue of effectiveness. The thorny issue of impact assessment in investment-oriented reforms is briefly reviewed, while attention is given to the claims donors make about the benefits of their support.

4.1. Instruments of investment-related ODA

The investment-related ODA described in the previous section applies a variety of instruments and models. For many bilateral and multilateral agencies, the process of intervention begins with assessment. A number of donor agencies have been undertaking assessments to identify the areas where meso level and micro level reforms are required. While these activities lead to the production of up-to-date and well-focussed data that can lead to the design of reform programmes, there are other benefits that result from these activities. In some cases, donor agencies work closely with African country partners in these activities in an effort to improve their capacity to undertake such assessments in the future. In other cases, the data produced is used to compare countries and to promote competition among countries through the use of scoring systems, thus, contributing to a growing demand for reform from within countries. Finally, assessments can be used to benchmark changes. Thus, regular assessments provide a measure for monitoring the impact of reforms over time.

The World Bank Group is by far the largest provider of analytical information to countries in Africa. The World Bank Group conduct Investment Climate Assessments (ICAs) and Investment Climate Surveys (ICSs). ICAs were begun in July 2002 and are used to identify and prioritise investment climate constraints, benchmark reform progress, provide cross-country comparisons of investment climate indicators, and help countries forge broad consensus on priority areas for reform. These assessments ultimately feed into World Bank operations and technical assistance.

Underpinning all ICAs is a standard core investment climate survey instrument, which allows the comparison of existing conditions and the

benchmarking of conditions to monitor changes over time. The survey is administered to managers of firms and consists of a core set of questions as well as several modules that can be used to explore in greater depth specific aspects of the country's investment climate and links to firm-level productivity.[24]

ICAs have been completed for 18 countries and ICA reports are available for the following countries in Africa: Algeria, Ethiopia, Eritrea, Kenya, Morocco, Mozambique, Tanzania, Nigeria, Uganda, and Zambia. South Africa is currently the only country in Africa being assessed at the moment.

The World Bank Group also conducts Doing Business assessments. These cover 145 economies including 36 from Africa. The most recent results of this survey were published in the report *Doing Business in 2005*. It involves a review of existing laws and regulations in each economy; targeted interviews with regulators or private sector professionals in each topic; and co-operative arrangements with other departments of the World Bank, other donor agencies, private consulting firms, and business and law associations. The main topics covered include are: starting a business; firing workers; enforcing contracts; getting credit; and closing a business. The Doing Business Survey provides compelling data that is comparative across countries and over time.

FIAS also provide analysis into specific aspects of the investment climate. Where Investment Climate Surveys identify legal, regulatory and administrative barriers, FIAS aims to look more closely at specific problems, mainly associated with administrative barriers. In Kenya, for example, FIAS conducted an administrative barriers study and commercial legal framework review project has been developed in close collaboration with the World Bank and several bilateral agencies. The projects build upon the findings of the ICA and focus on the business regulatory areas indicated by the ICA as the most problematic, provide in-depth analysis and recommendations, and feed into the economic and sector work of the African Division of the World Bank (FIAS, 2004b).

USAID's investor's roadmap is a tool used by many USAID missions in Africa to develop their program frameworks and objectives, mainly by assessing the overall constraints to investments from administrative barriers. These assessments involve a three-phased process. First, they chart for government officials the needless red tape and administrative barriers to investment. Second, they examine how these barriers can be reduced. Third, they assist in the design of reform programmes. Investor's roadmaps can be repeated over time to compare changes (Kleinberg, 2005).

Also in the field of trade-related analysis, the United Nations Conference on Trade and Development (UNCTAD) undertakes Investment Policy Reviews (IPRs) to help countries improve policies and institutions that deal with FDI and increase their capacity to attract and benefit from it. IPRs have been undertaken in 14 countries, including the following countries in Africa: Botswana, Egypt, Ethiopia, Ghana, Lesotho, Mauritius, Tanzania, and Uganda. Ongoing IPRs are occurring in Benin, Kenya and Zambia (United Nations Conference on Trade and Development, 2004b).

The Commonwealth Business Council (CBC) has conducted three Business Environment Surveys: 1999, 2001 and 2003. The 2003 survey covered 31 Commonwealth countries, a wider range than in previous years. Business Environment Surveys have been supported by DFID with technical assistance from by Oxford Analytica. The survey provides information for the future development of national action plans. The survey also provides a valuable resource for dialogue with governments at the Commonwealth Business Forum and the CBC's series of national investment conferences. Through these activities the CBC will continue its work to help mobilise investment in Commonwealth countries and to strengthen the role of the private sector in that process.

The International Labour Organization has undertaken assessment of the business environment for small enterprise employment in a number of African countries, including Egypt, Guinea, South Africa, and Tanzania. These have mainly involved local consultants and agencies applying an assessment guide, with support from an international consultant. The ILO has also commenced a programme in Tanzania to help the Employer Organization assess the business environment for small businesses and come up with an advocacy programme that is linked to the implementation of the PRSP. Finally, the ILO has supported a regional programme in West Africa that has involved an assessment of the business environment for small enterprises, with the ultimate aim that this will lead to reform efforts in the region.

When moving from assessment of the investment climate and business environment to the design of reform programmes, donors have been found to apply a variety of instruments and models. Some of the most common reform activities supported by donor agencies in their support of reforms to the investment climate and business environment are as follows:

- **Advocacy**: activities that help certain actors (e.g., the private sector) create a demand for reform of the investment climate.
- **Budget support**: the provision of funds for investment climate reforms, which are integrated into government budgetary processes.

- **Capacity building:** activities that improve the ability of key organisations (e.g., government ministries, regulatory authorities) to carry out reforms or to manage the investment climate more effectively (e.g., training programmes).
- **Enterprise development:** activities that support the development of private enterprises.
- **Facilitation of dialogue:** activities that bring the public and private sectors together, or assist in negotiations between national governments and international agencies.
- **Financial support**: the provision of funds for investment climate reforms, but not through the national budget (as described above).
- **Management support**: activities that support change in key institutions.
- Policy development and implementation: activities that lead to the design and implementation of new policies.
- **Technical assistance**: the provision of technical information and advice (e.g., drafting policies and laws, advising on strategies and implementation arrangements).
- **Monitoring and evaluation**: activities that help reform partners monitor and evaluation the impact of their efforts on the investment climate and business environment.
- **Raising awareness and exchanging information:** activities that make government, the private sector, and other stakeholders more aware of the importance of the investment climate, as well as activities that facilitate the sharing of information on how to improve the investment climate.
- **Research:** activities that focus on better understanding the problems or constraints of the investment climate.

Presented in the above manner, none of these instruments appear to be very different from the kinds of instruments used in other development themes supported by donor agencies. Many of these instruments can be used in livelihood, housing, health or agricultural programmes. However, there appear to be a number of interesting differences in the use of these instruments for investment-related ODA.

Firstly, investment-related ODA has an increasing focus on facilitation and process. Donors are less inclined to provide direct solutions to perceived problems in this field. Rather than build a road to improve access to markets, donors are more likely to support processes that lever private sector investment into such projects. Rather than establish a loan guarantee fund,

investment-related ODA is more likely to work with local counterparts to improve financial systems. Rather than push governments to listen to them, investment-related ODA brings in other domestic partners who demand change and provides them with the information (e.g., assessments) and skills to do this. While there are exceptions to this, investment-related ODA appears to focus more on building sustainable processes for change.

Secondly, although bilateral and multilateral donors spend a significant share of their aid on investment-related activities – 26% of all foreign assistance according to the World Bank (World Bank, 2004a) – well designed interventions can produce significant economic and social benefits in the medium term, sometimes in return for comparatively modest outlays of ODA. Ultimately, however, spectacular success stories involving few funds are comparatively rare and project approaches are more effective and sustainable when activities are linked up to form part of a comprehensive strategy.

Thirdly, investment-related ODA can be very time consuming. Reform doesn't happen overnight and will often not happen within a typical three-year programme cycle. Thus, donor agencies need to apply these instruments in a consistent manner. Tsikata (2001) argues that "both donors and aid recipients need to work much harder at creating conditions that will ensure that reform policies are properly defined, articulated and implemented. The donor communities desire to control aid, in order to ensure full accountability to the home electorate must be balanced against the need to allow sufficient space for recipients to refine their bureaucratic systems and evolve their own procedures for aid management".

Fourthly, because reform interventions should be sequenced different instruments will be required at different stages in the reform cycle. While advocacy, research and other forms of diagnostics will be required in the early stages, later ODA will be required to support capacity building and programme management. Monitoring and evaluation will also become a consistent, but later-stage instrument. Devarajan, Dollar *et al.* (2001) argue that the design of donor-support reform interventions is important. When designing reforms technical assistance and policy dialogue are most supportive of reform. During periods of rapid reform, policy dialogue is important, as is finance. This is the phase in which conditional loans tend to be useful and effective. At a later stage of reform, conditionality is less useful, while finance remains important.

FIAS is presently embarking on a three-year strategy for fiscal years 2005-2007, which includes what it calls a new "programmatic approach" to its work. This new approach would be applied in many parts of the world, but specific reference has also been made to Africa. It builds a stronger link

between diagnostic studies and the reform interventions that follow them (FIAS, 2004a).

Finally, a word on conditionality: many writers claim that conditionality, as it has been used in the past, has often not worked as a universally applied instrument of donor support (Arcand, Guillaumont *et al*., 2001; Collier, 1997). In some cases conditionality may help ensure specific measures are taken that affect the performance of donor-intervention, but often it undermines efforts to build ownership of the reform agenda. Arcand, Guillaumont *et al* (2001) argue that conditionality has been more appropriate for authoritarian regimes than for democracies. However, there are new variations on conditionality that are more appropriate when promoting sustainable reforms that lead to economic growth. Indeed, the World Bank Group has recently found that conditionality can be used to strengthen the hand of reformers (World Bank Group, 2004b).

Thus, the new approaches to conditionality should focus on steps to be achieved within the reform process. They should involve both donors and their development partners in monitoring and responding to change so ODA is allocated according to performance, instead of being tied to specific policy measures.

4.2. Mechanisms for donor-supported reform

Donor agencies promoting reform of the investment climate and business environment in Africa use a variety of mechanisms to design, implement and monitor their programmes.

4.2.1. Direct programme interventions

This refers to a typical donor-supported activity in which a single donor agency provides direct support to one or more development partners. Because policy and institutional reform can take a long time, in many cases donor agencies work with development partners over quite a few years.

4.2.2. Collaborative projects

In some cases, donor agencies collaborate together on specific projects. Increasing evidence can be found of donors working together to improve investment growth in developing countries. Such collaborations enable donors to share risks and provide access to a larger pool of expertise. Some examples of the variations found in donor collaboration include:

- *Collaboration among bilateral donors.* The Business Environment Strengthening for Tanzania (BEST) Programme was cited earlier in this study. It is a good example of collaboration between a number of

donors, in this case four donors. Some effort was required on the part of each donor to sequence their programme cycles and the Government of Tanzania has signed contracts with each separate agency.

- *Collaboration between bilateral and multilateral donors.* Collaboration between bilateral and multilateral donors can benefit reform processes. White and Chacaltana (2002) found that many host governments were suspicious of bilateral donors becoming involved in high-level policy reform; host governments often questioned the motivations and interests of the bilateral agencies. By comparison, multilateral agencies were treated differently. Thus, collaboration between bilateral and multilateral agencies provides for the complementary application of each agency's capabilities and capacities.

- *Collaboration among multilateral donors.* FIAS (2004a) describe how most of its work in Africa is supported by and co-ordinated with IBRD/IDA, IFC, MIGA, the IMF, and a range of multilateral and bilateral agencies. For instance, IDA incorporated a large number of the FIAS recommendations on administrative barriers reform in Cape Verde into a new project of the World Bank's Private Sector Department that is now financing the implementation of these reforms.

There are a number of recent development frameworks that have been adopted by donor agencies and development organisations that encourage better coordination and collaboration. These include Poverty Reduction Strategy Papers (PRSPs), the Monterey Consensus, and the Millennium Development Goals (MDGs). "Multilateralism should not be seen as a competitor of individual donor efforts", says Mark Mallick Brown, the UNDP Administrator recently, rather it is an "instrument at the service of both donors and recipients to achieve a better and more effective distribution of international development efforts…. the MDGs constitute a significant, if not perfect, framework for international cooperation around which OECD/DAC donor countries could discuss a new division of labour, for example different donor countries championing different MDG targets. If the global partnership agreed upon in Goal 8 gained momentum, trade barriers hampering access to markets for developing countries were removed, market distortions like agricultural subsidies drastically cut, it would leave many developing economies with sufficient resources to advance their human development effectively.[25] If on top of that ODA increases to at least the doubling of ODA required to meet the MDGs, targeted on recipient country MDG priorities, the present geographic differences and preferences would have less relative weight. That means that major donors like bilateral agencies, the EDF and the Bretton Woods

institutions have to coordinate around nationally owned country strategies"(Brown, 2004).

4.2.3. Participation in formal multi-donor facilities

There appear to be an increasing number of formal facilities being established to facilitate the involvement of different donors in the support investment-oriented reform programmes. A good example of the multi-donor facility model is PPIAF, referred to above. Another example is the Integrated Framework, a multi-donor structure supporting trade capacity building, as well as the Financial Sector Reform and Strengthening (FIRST) initiative which is a large technical assistance facility, located within the World Bank and funded by a number of multilateral and bilateral donor agencies.

The OECD/DAC is the principal body through which the OECD promotes donor collaboration and consensus on co-operation with developing countries. The DAC produced orientations for donor support for private sector development in 1995 and is now developing policy guidance for donors on growth and poverty reduction.

4.2.4. Establishment of specialised funding and programme facilities

Within certain fields, investment-oriented ODA can benefit from the use of dedicated facilities that can be used to focus and coordinate more effectively. In some cases a single donor will establish these facilities (e.g., the World Bank Group Project Development Facilities, DFID Challenge Funds); in other cases a group of donors will do this.

The World Bank Group's Small and Medium Enterprise Department has established the African Project Development Facility, along with other facilities located in other regions of the world. Project Development Facilities provide technical assistance needed to build commercially viable businesses, and take other broader initiatives to develop sustainable and dynamic SME sectors. Bilateral donors can contribute to the work of PDFs. These facilities help SMEs directly, while also create local capacity to give them technical and financial support. PDF teams also provide other essential services such as training and research, and work with the World Bank to frame and promote policy reforms aimed to improve the local business climate.

DFID has developed a specific mechanism for engaging the private sector more strongly in development co-operation. Challenge Funds were designed in the late 1990s to find creative ways for DFID to collaborate with

the private sector and overcome the unsuitability of conventional grant-making processes to private companies. In general, Challenge Funds aim to stimulate innovative approaches to development challenges; encourage the private sector to engage in commercially viable business activities that particularly benefit the poor, provide a simpler, less costly funding mechanism to build new partnerships between donors and private agencies undertaking such initiatives; and lever management and financial resources from the private sector.

Two Challenge Funds have been established, each with a specific purpose. These are:[26] (1) Financial Deepening Challenge Fund, a GBP 18.5 million fund designed to encourage banks and other commercial institutions such as insurance and leasing companies to develop innovative financial services that benefit the poor in 12 Sub-Saharan countries, as well as India, Pakistan and the United Kingdom; and (2) Business Linkages Challenge Fund, a GBP 18 million fund designed to stimulate business linkages between enterprises that generate employment and other benefits for the poor. In 2002, Challenge Funds guidelines were revised and business environment window was created in both funds specifically to encourage more applications from the private sector in this area (Deloitte Emerging Markets Group, 2004).

In Southern Africa, DFID has established the FinMark Trust to help develop the financial sector.[27] The FinMark Trust contributes to co-ordination of financial market development activities by working with a wide range of organisations active in promoting access to retail financial services – from government departments and regulators to banks, non-bank finance companies, NGOs and donors (FinMark Trust, 2004).

4.2.5. Supporting African institutions

Investment-oriented ODA is frequently designed to support African institutions in an effort to ensure donor efforts are strategic and well co-ordinated, as well as to build the capacity of agencies that are ultimately required to initiate and sustain reform efforts. The World Bank, for example, has undertaken to support NEPAD is all its thematic clusters, as well as regional economic communities such as ECOWAS, SADC and COMESA. The Bank's policy on NEPAD is to "avoid compromising African ownership of NEPAD and to work entirely according to its requests and with the institutions it designates" (World Bank Group, 2002). Among the areas of specific support that are relevant to this study are:

- Support for the implementation of a range of regional infrastructure projects (e.g., power generation, pooling and transmission, gas flaring, air and road transport, and the management of shared water resources)

under the leadership of the African Development Bank and in association with the European Union.

- Support for accelerated growth in productivity, improved food security, better management of natural resources, and heightened access to markets – guided by the NEPAD Secretariat in partnership with the Food and Agriculture Organization and the Forum for Agricultural Research in Africa.
- Work with Africa's regional economic communities, to ensure that their programs dovetail with NEPAD's priorities, including support to help strengthen the capacity of the ECOWAS secretariat to perform as a NEPAD focal point.
- Work with the UNECA on the development of appropriate codes and standards for the management of public resources.
- Facilitate NEPAD's dialogue with development partners, in particular the Strategic Partnership with Africa, which is chaired by the World Bank and is developing an action agenda aimed at supporting the new partnership framework emerging from the NEPAD and PRSP processes.

A number of other donor agencies have formed development partnerships with NEPAD on investment-oriented programmes (e.g., DFID, Commonwealth Business Council, Netherlands).

The Global Coalition for Africa (GCA) was established to bring together African policy makers and their partners to deepen dialogue and build consensus on Africa's priority development.[28] The World Bank and other "African development partners" fund the GCA, which aims to ensure that Africa remains high on the international agenda, to facilitate greater understanding of the development challenges faced by the continent, and to promote agreement on necessary actions to be taken by both African governments and their international partners. The GCA's agenda is focused on the broad themes of a) peace and security; b) governance and transition to democracy; and c) sustainable growth and integration into the global economy. In 2003, the GCA's main activities included a meeting on fair trade and market access held immediately prior to the WTO Ministerial Conference in Cancun; a review of regional integration and regional integration institutions conducted by groups of eminent persons; and the production of its Annual Report assessing political and economic trends in Africa (World Bank Group, 2004a).

4.2.6. Supporting private sector involvement in investment-oriented reforms

As described earlier in this annex, the involvement of the private sector in investment-oriented reforms is critical for success and sustainability. Thus, a number of donor agencies have developed programmes that build the capacity of private sector partners and facilitate their involvement in decision-making and consultative structures.

In Tanzania the World Bank provided credit to support the creation of a "government private dialogue mechanism". This led to the creation of the National Business Council in 2002. As a result of various meetings between government and the private sector, a matrix of actions has been drawn up by government (Small Business Project, 2003).

The Commonwealth Business Council (CBC) works closely with governments to ensure the views of the private sector on key trade and investment issues are presented and taken into account at the highest levels. Through presentations, proposals and public-private dialogues, CBC advances private sector views (particularly in relation to investment and trade matters) to: the biennial Commonwealth Heads of Governments Meetings; the Commonwealth Finance Ministers Meetings; ministers responsible for trade, commerce, infrastructure development and information technology; and national governments.

Views of the private sector are collected via worldwide opinion surveys and the views of the CBC corporate membership. Policy recommendations are developed through the CBC's working groups and disseminated through policy papers, research documents. Further inputs are provided by drawing on the expertise of advisors, consultants and experts in CBC core areas. Policy advice has been provided on investment, the liberalisation of financial services, international trade, electronic commerce, and business-government interaction.

Agencies such as CBC have promoted the role of governments and businesses in improving the business environment both separately and in collaboration. The most recent manifestation of this is the Abuja Manifesto on Business – Government Partnerships for Removing Practical Obstacles to Wealth and Job Creation (see Annex 2).

CBC also has supported the establishment the NEPAD Business Group in liaison with leading organisations including the African Business Round Table, the International Chamber of Commerce, the Canadian Council on Africa, the Corporate Council for Africa (USA), and the *Conseil Francais des Investisseurs en Afrique*.

In Kenya, CBC in association with the Eastern Africa Association hosted the Kenya Business Round Table. The Round Table will examine the opportunities available in the key sectors of the Kenyan economy – the largest and most sophisticated in the Eastern Africa region.

4.3. Effectiveness of investment-oriented ODA

Donors require evidence of effectiveness for achieving the MDGs if they are to focus more directly and explicitly on supporting reforms that lead to a better investment climate in African countries. In this section the evidence of effectiveness of investment-oriented ODA is considered.

Assessing the impact of reform programmes on the investment climate is difficult. White (2004) has found three major problems donor agencies experience in their efforts to measure the impact of reform programmes. This first is that it is extremely difficult to isolate the impact of specific reform measures from other changes and programmes that occur. This is especially so when donors embed their reform initiatives within programmes that contain other elements (e.g., a private sector development programme may contain a reform component along with other components dealing with promotion of the private sector). Thus, attributing change in national investment or growth to a single reform intervention creates difficulties when measuring impact. Would this change not occur without the intervention? Or did the intervention improve or lessen the amount of change?

Box 9. Highlights from DFID African case studies

The **Kenya** deregulation programme's support for removing import and export licensing requirements, dismantling price and exchange rate controls, and introducing a convertible Kenyan shilling led to the following estimated annual savings: £22m due to the Registration of Business Names Act; £38m due to the Trade Licensing Act (i.e., around one per cent of GDP at the time); and £4m due to the implementation of the Singe Business Permit. In the 32 local authorities that were using the single business permit, business transaction costs had reduced by up to 70 per cent.

The **Uganda** "Streamlined Business Registration Pilot" resulted in: 75 per cent lower compliance costs (reduction of registration time to 30 minutes); 43 per cent higher compliance levels (four times more businesses registered than in the previous year); 40 per cent higher revenue collection and a more steady revenue flow; 25 per cent savings in staff time; and a ten per cent saving in financial resources (DFID, 2004b) (also see Gamser, 2003; Scott & Darroll, 2003).

The FinMark Trust in **South Africa** has performed a significant role in establishing the Banking Charter, while FinScope has improved banking practices and the policies of the South African Reserve Bank.

Source: DFID, White, *et al.* (2004).

The second problem in measuring the impact of donor-support reforms is the time over which reforms occur. Investment-oriented ODA reforms take a long time. While individual interventions can create short-term outcomes, the impact of these outcomes takes a longer period of time to eventuate, making it difficult to measure.

The challenge for donors trying to measure the impact of their interventions is to find appropriate indicators to measure and draw causal links with their specific programmes. In many cases, donors and evaluators look for expedient means of dealing with this challenge. Many donors find is easier, and in some cases more relevant (in terms of their own accountability requirements) to measure the performance of ODA programmes (i.e., programme outputs and outcomes), rather than the final impact these may lead to in terms of increases in investment and economic growth. The World Bank has found, for example, that the outcomes of its investment climate reform programmes "are positively correlated with indicators of macroeconomic and financial sector performance – although there is no evidence to indicate causality from operations to economic performance" (World Bank Group, 2004b).

Most donor agencies undertake some type of monitoring and evaluation procedure. For example, most donor agencies record program inputs and activities; this kind of information is commonly used by donor agencies, but is of little use in the search for objective impact assessment (White & Chacaltana, 2002).

Some donor agencies record outputs based on donor interventions (e.g., drafting and adoption of a policy or law, removal of unnecessary regulations), while others undertake regular stakeholder perception surveys before and after donor intervention (e.g., GTZ). While anecdotal information is a poor substitute for "hard" monitoring and evaluation data, many donor agencies have indicated that good anecdotal information on the contribution of donor efforts to reform and the benefits these reforms have wrought upon the target group is very useful. In some cases, this kind of information meets the evaluation demands of taxpayers and other constituents very well (White, 2004).

Onyango and Tomecko (1995) relied on a description of the continuation of the programmes and projects supported by the small enterprise policy in Kenya as an indicator of the success of this policy, rather than improvements in the number, growth or productivity of small enterprises.

The corporate governance programme EITI, referred to earlier, is currently attempting to identify indicators for success in its work. EITI expect this will include technical indicators as well as indicators

demonstrating a political will for reform. In addition, these indicators would need to cover corporations that meet EITI requirements, as well as indicators of government acceptance of EITI standards.

DFID is one donor agency that is very active in investment-oriented ODA that has taken a concerted approach to measuring the outcome and impact of reform. Along with a series programme monitoring instruments, DFID has produced several in-depth case studies (see Box 4). It also established the Enterprise Development Impact Assessment and Information Service (EDIAIS) several years ago.

As in other areas supported by donors, much more needs to be done to objectively assess the effectiveness of investment-oriented ODA. While the underlying problems referred to earlier limit the extent to which donors can claim success in single-handedly supporting reform that improved the levels of investment and growth in an African country, there are ways where the contribution a reform programme has made to this process can be determined.

The causal links between investment-oriented ODA outcomes and increasing levels of investment and growth need to be identified. There have been some interesting developments in this field of work, as reported in Section I. Following this, there is a need to better measure the nature and quality of these outcomes and the ways ODA can influence these outcomes.

A recent evaluation report on the World Bank Group's support for investment climate reforms found that success in the reforms supported by the WBG were affected by the following (World Bank Group, 2004b):

- The Bank has been successful in supporting reforms that grew out of crisis (macroeconomic, financial, political) or opportunity (the prospect of joining regional agreements, taking advantage of new technologies).
- The Bank's loan conditionality has played an important role in the political economy of reform in several case study countries by strengthening the position of reform-minded policymakers and other stakeholders against those opposed to reform.
- The Bank has been successful in working with a broad range of actors; while it is important to have the backing of key politicians to spur reform, other stakeholders such as professional civil servants, business groups, and the general public have also been critical to sustaining reforms.
- Changing incentives among senior civil servants has been the key to the Bank's success in reform efforts; senior civil servants need to understand, support and assume ownership of reforms.

- In some cases, the Bank's support was too modest, too piecemeal, and too inconsistent to get the job done; comprehensive reform programs that are meaningful, co-ordinated and sustained are more likely to be successful.

The International Monetary Fund (2004) argues that the positive impact of aid flows into Africa is limited by microeconomic and macroeconomic capacity constraints. "Understanding and monitoring these constraints will be important for ensuring that aid flows play an effective role in reaching the MDGs. These constraints can be partly addressed by increasing harmonisation and co-ordination in aid practices and delivery among donors and with the recipient countries, using vehicles such as the PRSP as a platform. Appropriate targeting and sequencing of aid to remove bottlenecks and build on previous reforms and investments can also increase absorption capacity and enable productive use of rising aid flows".

Box 10. World Bank support for investment climate reforms in Mozambique

The World Bank Group's strategy increasingly focused on institutional issues, including administrative and regulatory reforms, simplification of licensing procedures and labour regulations, and revisions to the commercial code. Enterprise surveys were prepared under the Regional Program for Enterprise Development. Investment climate reforms were supported through a series of Economic Recovery Credits as well as financial sector and enterprise development projects. IFC supported the establishment of a foreign bank and investment banking affiliate, and provided TAAS on financial sector issues and corporate governance. Despite progress in improving some aspects of the investment climate, the investment response has been less robust than expected. Investment has increased, but this was mainly due to several foreign "mega" projects (including an IFC investment in the MOZAL aluminium smelter). Institutional weaknesses and inadequate infrastructure continue to impede private sector activity.

Source: World Bank Group (2004b).

Andrei Mikhnev (2004) of the World Bank's SME Department in Washington claims that a major lesson from ODA in enterprise development is the need to focus on sustainability. A lot has been done, but reforms have not been sustained in the long term. For instance, in Ghana and Kenya the Bank had micro, small and medium-sized enterprise (MSME) development projects in the beginning of 1990s, but now under the new MSME projects the same problems addressed ten years ago still need to be addressed.

The process of reform involves dealing with moving targets. Achievement in one quarter can simply open up the need for more work elsewhere. Donors can't work in isolation from one another or from the key players in African countries. By understanding the processes of reform better, it will be more possible to measure the impact of programmes that aim to support reforms.

5. Lessons learnt and conclusions

This study has presented a broad range of donor activity in Africa, which could be considered investment-oriented. It has shown that investment-oriented ODA is more than simply the provision of support to certain development themes (i.e., *where* ODA is directed); it is also about the instruments and mechanisms used to promote sustainable investment-oriented reforms of policies and institutions (i.e., *how* ODA is provided). Finally, the study has examined the impact of investment-oriented ODA and found that the most decisive indicator of successful impact (the reduction of poverty) or even some other indicator close to this (increasing investment and a growing economy) are difficult to ascribe to a single donor intervention.

A critical examination of the practice of investment-oriented ODA is in place, in order to identify lessons for policy makers. The tentative list of lessons proposed below summarises the key features of donor assistance in this field and highlights those that are most strategically aligned to increasing investment and economic (pro-poor) growth. The lessons come from an observation of practice. They are not based on rigorous evaluations, although some of the lessons cited by other authors have indeed come from careful studies of donor effectiveness.

- **Investment-oriented ODA should build a demand for reform.** After years of frustration and programme failures, donors have learnt that they can't force African countries to reform. The motivation for reform must come from within. In most cases, it is governments that must come to see the need for change and to take measures themselves to improve their capacity to mobilise investment and stimulate economic growth . However, private sector organisations, civil society and even the local media also have a role to play in making demands on government for change. Collier and Dollar (1999) have found that the promise of donor finance is not enough incentive for host governments to undertake reforms. They need to see the longer-term value in undertaking these initiatives. Thus, donors are more aware of the need to stimulate debate around reform issues in an effort to build a stronger and broader demand for reform.

- **Investment-oriented ODA requires political commitment.** While this issue is related to the need for a broader demand for reform, there is another lesson here. Even with a broader and stronger demand for reform within African countries, it is important that donors don't impose plans for reform from outside. Donor driven reforms often do not last or are compromised by government-induced obstacles to investment and growth found in other fields. Sustainable reforms only work when they are driven, owned and managed by domestic agents. The principal agent in most cases is government. Governments should exhibit a commitment to reform from the highest level. Donors and African governments should form mutually agreed reform agendas.

- **Investment-oriented ODA should build the analytical capacity of host governments.** This issue is linked to the building of a demand for reform. Donor agencies are paying greater attention to the capacity of partner governments to undertake their own analysis and to monitor the progress of reforms. Tsikata (2001) argues that experience in Ghana and Tanzania shows that governments should be supported in their efforts to assess the investment climate.29 This implies the need for capacity building programmes for government as well as private sector organisations.

- **Investment-oriented ODA should be sequenced.** Moving from analysis to reform, finding appropriate starting points for reform, and establishing a mutually agreed upon sequence of reform interventions is a major challenge for investment-oriented ODA in Africa.30 Donor agencies are clear that reform is a multilayered interdisciplinary process that spans a substantial period of time. Beginning with achievable changes and building on success is critical. This view is supported by the findings of the World Bank Operations Evaluation Department's evaluation of investment climate reforms in which it was found that reform programmes that were "meaningful, co-ordinated, and sustained were more likely to be successful" (World Bank Group, 2004b).

- **Investment-oriented ODA should involve collaborative monitoring and adjustments.** Tsikata (2001) suggests that donors have come to see the value in building good relations between donors and government, especially through the use of a well-established and strategically focussed institutional frameworks for managing aid. She adds that strong institutional mechanisms for accountability build mutual trust between donor agencies and host governments. Such mechanisms allow both parties to monitor progress in reform efforts. Tsikata argues that this also "buys the recipient country some implementation space" and

discourages donors from micro-managing projects by introducing parallel management units with expatriate staff.

- **Investment-oriented ODA should be co-ordinated.** The need for donor co-ordination has been endorsed by donors from experience in a wide range of development themes, not only those related to investment. However, investment-oriented ODA has some specific needs for good co-ordination. Mikhnev of the World Bank's SME Department in Washington describes how many donors pump funds into projects in Africa that endeavour to address poverty leading to situations where there is donor crowding in specific areas. "This is one of the reasons why donor co-ordination is by far the top priority in the effective use of donor resources" (Mikhnev, 2004).

  Sound co-ordination increases credibility with the host country and improves efficiency and effectiveness of donor efforts. From a reform point of view, co-ordination contributes to consistency. Disch (1999) describes a number of ways for improving donor co-ordination, which recognise that donors often find it easier to agree on policies and priorities, but harder to agree on implementation. However, once a track record of success has been achieved, donors seem to become more willing to modify their own procedures in the name of successful co-ordination and collaboration. He also argues for less information meetings, and more formal contracts between donors and with host governments. Drawing from experience in Kenya, Mbugua, Ronge *et al*. (2004) suggest that a sector-wide approach to donor coordination should be encouraged.

- **Investment-oriented ODA should build strong domestic institutions.** It has been clear for sometime now that institutions have a strong role to play in the sustainability of reforms that lead to greater levels of investment in African countries. As a result, many donor agencies are paying more attention to how they can build stronger domestic institutions. However, it is also acknowledged that this is not an easy task. A recent evaluation report on the World Bank Group's support for investment climate reforms found that not enough is known about good practice in institutional design, or about the dynamics of changing institutions (World Bank Group, 2004b).

- **Investment-oriented ODA should focus on the local private sector.** There is a danger that strategies for greater investment and growth will be entirely based on a search for outside solutions. Similar to the "smoke stack chasing" of the 70s and 80s, national governments will try to entice outside investors with the lure of attractive government subsidies. Recent donor experiences in improving investment climates

have shown that the competitiveness of the domestic private sector is an important ingredient promoting economic growth and attracting FDI. Thus, creating a positive business environment for business operations in-country should take priority over special incentives for foreign investors (Investment Competition and Business Development Services Team & Bannock Consulting Ltd, 2004).

- **Investment-oriented ODA should focus at sub-national levels of reform.** While many donor efforts are directed to helping national government agencies manage reform processes, attention is also paid to the role of sub-national levels of government, in particular local government. While on the one hand this involves support for reforms that enhance the decentralisation of government services, it can also address the roles of local and provincial governments in improving sub-national investment climates. With the breaking down of national trade barriers, local and provincial economies are becoming more directly engaged in world markets. Indeed, it is at the local level that many private investors may have direct contact with government agencies. Thus, donor support for investment-oriented reforms should include support for reforms at the local level.
- **Investment-oriented ODA should recognise the importance of perceptions.** Reform is a political process, which is influenced by the choices people make. A number of studies have highlighted the negative perceptions investors have of Africa and the impact this has on poor investment levels (Vickers, 2003). Some donors, such as the Commonwealth Business Council, have developed interventions to address this. However, reviews of past reform experiences have shown that helping local actors deal with change, building on success, and helping local actors keep their eye on the big picture of reform is important.

Notes

1. The British Prime Minister cited these figures when launching the Commission for Africa in February 2004.

2. Total external debt in Sub-Saharan Africa (excluding Nigeria and South Africa) fell from an average of close to 90 per cent of GDP in 1997-2001 to 68 per cent in 2003 and a projected 59 per cent in 2004. This improvement reflects the declining reliance on debt-creating flows as well as debt forgiveness, in particular under the HIPC initiative (International Monetary Fund 2004, p. 2).

3. For examples of donor private sector development strategies see AusAID (2000), ADB (2000), Cida (2003), DFID (2004a), OECD (2004a; 1995), Sida (2001), UNDP (Commission on the Private Sector and Development 2004) and World Bank (2002b).

4. For further information on the role of markets in pro-poor development see DFID (2000), OECD (2004a), Sida (2003) and World Bank (2002a).

5. Overall, FDI flows to developing countries have declined by 26 per cent since 1999 and Sub-Saharan Africa continues to receive a very low and decreasing share of global FDI (FIAS 2004a).

6. The Government of the Netherlands has proposed that the categories “core” and “non-core” be replaced with “narrow” and “broad” to avoid the implication that one category of activities is more important than the other (Vlaar 2005)

7. For example, Tanzania hosts 1,000 donor meetings every year and prepares 2,500 donor reports every quarter (Birdsall 2004, cited in Eifert, Gelb *et al*. 2005, p. 34). While, a recent study of donor-supported interventions geared toward developing the micro and small enterprise sector found 130 projects in operation. Seventy of these provided financial services to MSEs, 29 were education and training projects, 15 dealt with infrastructure and institutional development, nine with information and technology and seven with policy (Mbugua, Ronge *et al*. 2004).

8. Collier and Gunning cite evidence that suggests growth in Africa in 1960-73 was more rapid than that in the previous half century (p. 3).

9. The remaining proportion was allocated as 'Other and unallocated/unspecified'. Of all ODA provided to Africa in 2001-2002, 36 per cent was allocated to Social Infrastructure and Services, 14 per cent to Economic Infrastructure and Services, and nine per cent to Production. These figures are from 2001-2002.

10. In 1988, Ghana became the first country in Sub-Saharan Africa to introduce foreign exchange bureaus, where foreign exchange was traded with 'no questions asked' (Tsikata 2001).

11. The range of product areas includes diagnostics (in the Seychelles), administrative barriers studies (in Kenya, Cape Verde, and Eritrea), administrative and regulatory costs surveys (in Cape Verde, Ghana, Guinea-Bissau, Burkina Faso, Uganda, and Zambia), reviews of investment laws (Kenya and Sierra Leone), and taxation and incentives policy and implementation (Guinea-Bissau, Senegal, Sao Tome and Principe – not yet an IFC Shareholder). FIAS also pursued work at the regional level with programmes addressing constraints and the reform agenda of the West African Economic and Monetary Union and the East Africa Community (FIAS 2004a).

12. UNIDO's diagnostic study of regulatory and administrative constraints is used to inform remedial actions by national and local partners. Specific reference is made to women entrepreneurs for whom "the constraints are often exacerbated by laws and regulations that explicitly discriminate against them. Further more, the gender-sensitivity of many officials in rural areas tend to be more heavily influenced by local tradition than in urban areas".

13. For more information see http://www.grolink.se/epopa/

14. As Wade (2001, p. 26) argues "stronger markets need stronger states, and stronger states need both stronger markets and stronger civil societies".

15. "Infrastructure for private sector development" is the dominant theme in "non-core investment climate themes" (i.e., above tax policy and administration, export development and competitiveness, trade facilitation and market access, and other financial and private sector development) (World Bank Group 2004b).

16. See http://www.dot-com-alliance.org/

17. PPIAF is governed by a Program Council of contributing donors, which meets once a year and is chaired by the World Bank's vice president for infrastructure. PPIAF also has a Technical Advisory Panel, a Program Management Unit (located in the World Bank in Washington D.C.) and three Regional Coordination Offices (located in Kenya, Singapore, and South Africa).

18. The first plenary meeting of the Task Force took place at the OECD in Paris on 17 June 2004 and identified a preliminary list of policy building blocks for the Framework: investment policy; investment promotion and facilitation; trade policy; competition policy; tax policy; corporate governance and responsibility, and market integrity; human resource development; infrastructure development; and public governance. In addition to host-country policy action, the contribution of international co-operation, including through regional integration, and home-country policy action will also be addressed.

19. FIRST provides technical assistance grants for short and medium-term projects in the areas of financial sector regulation, supervision and development. FIRST supports activities and interventions mainly in the public sector, principally by providing technical assistance grants to policy makers and regulatory bodies. It also supports private sector activities when organised through recognised institutions. Source: http://www.firstinitiative.org

20. Data provided by OECD/DAC indicates that 54% of DAC funds (USD 6,626 million) were allocated to Social Infrastructure and Services (comprising Education, Health and Population, Water, Government and Civil Society, Employment/Housing/Other) in 2001-2002. This was 36% of all aid to Africa in 2001-2002.

21. The term "small enterprises" is used to describe a wide range of enterprises that are often disaggregated into micro enterprises as well as small- and medium-sized enterprises (SMEs), with the specific definition depending on the purpose or country context.

22. This view is supported by Goedhoys and Sleuwaegen (2000) in their study of small firms in Côte d'Ivoire, and Mollentz (2002) in South Africa.

23. The five countries/regions examined were the Balkans (encompassing Albania, Bosnia-Herzegovina and FYR Macedonia), the Caribbean (specifically Dominica, Grenada, Guyana, and Jamaica), Peru, Tanzania, and Viet Nam.

24. The ICS uses large samples of firms (i.e. 1,500 firms), while the ICAs supplement this with information from key informants.

25. Millennium Development Goal 8: Develop a global partnership for development; Target 12: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system, including a commitment to good governance, development, and poverty reduction – both nationally and internationally; Target 13: Address the special needs of the least developed countries (LDCs), including tariff and quota free access for LDC exports; enhanced programme of debt relief

for HIPC and cancellation of official bilateral debt; and more generous ODA for countries committed to poverty reduction.

26. More details on the Challenge Funds can be found at: www.challengefunds.com

27. FinMark Trust: http://www.finmarktrust.org.za

28. The GCA Co-Chairpersons are President Festus Mogae of Botswana; Prime Minister Meles Zenawi of Ethiopia; Chairperson of the Commission of the African Union, Alpha Oumar Konaré; Frene Ginwala, former Speaker of the South African National Assembly; Minister Hilde Johnson of Norway; and President of JICA, Sadako Ogata. Former President Sir Ketumile Masire of Botswana, former Minister Jan Pronk of the Netherlands, and former World Bank President Robert McNamara are Co-Chairpersons Emeritus. Mr. Hage Geingob, former Prime Minister of Namibia, is the GCA Executive Secretary.

29. In a comparative study of the factors that have lead to the ownership of economic reforms in Ghana and Tanzania, Tsikata (2001, pp. 15-16) cites six interrelated lessons from improving reform in Africa.

30. The World Bank recently hosted an Internet discussion on ‘Moving from Analysis to Action on Investment Climate Reform’ (4-24 January 2005): http://rru.worldbank.org/Discussions/topics/topic58.aspx

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Annex 1

Economic characteristics of African economies

Country	Region	Income Category	GNI per Capita	Informal Economy (% GNI, 2003)	Population (millions)
	East Asia & Pacific		5,464	24.3	139.5
	Europe & Central Asia		3,047	37.7	17.8
	Latin America & Caribbean		2,976	41.5	24.9
	Middle East & North Africa		6,096	27.4	20.8
	OECD: High income		25,773	16.8	41.5
	South Asia		538	35.7	232.5
	Sub-Saharan Africa		562	42.3	19.5
Algeria	Middle East & North Africa	Lower middle income	1,890	33.4	31.8
Angola	Sub-Saharan Africa	Low income (LDC)	740	..	13.5
Benin	Sub-Saharan Africa	Low income (LDC)	440	45.2	6.7
Botswana	Sub-Saharan Africa	Upper middle income	3,430	33.4	1.7
Burkina Faso	Sub-Saharan Africa	Low income (LDC)	300	38.4	12.1
Burundi	Sub-Saharan Africa	Low income (LDC)	100	..	7.2
Cameroon	Sub-Saharan Africa	Low income	640	32.8	16.1
Central African Republic	Sub-Saharan Africa	Low income (LDC)	260	..	3.9
Chad	Sub-Saharan Africa	Low income (LDC)	250	..	8.6
Congo, Dem. Rep.	Sub-Saharan Africa	Low income (LDC)	100	..	53.2
Congo, Rep.	Sub-Saharan Africa	Low income (LDC)	640	..	3.8
Cote d'Ivoire	Sub-Saharan Africa	Low income	660	39.9	16.8
Egypt, Arab Rep.	Middle East & North Africa	Lower middle income	1,390	35.1	67.6
Ethiopia	Sub-Saharan Africa	Low income	90	40.3	68.6
Ghana	Sub-Saharan Africa	Low income	320	38.4	20.4
Guinea	Sub-Saharan Africa	Low income (LDC)	430	..	7.9
Kenya	Sub-Saharan Africa	Low income	390	34.3	31.9
Madagascar	Sub-Saharan Africa	Low income	290	39.6	16.9
Malawi	Sub-Saharan Africa	Low income	170	40.3	11
Mali	Sub-Saharan Africa	Low income	290	41	11.7
Mauritania	Sub-Saharan Africa	Low income	430	..	2.7
Morocco	Middle East & North Africa	Lower middle income	1,320	36.4	30.1
Mozambique	Sub-Saharan Africa	Low income	210	40.3	18.8
Namibia	Sub-Saharan Africa	Lower middle income	1,870	..	2
Niger	Sub-Saharan Africa	Low income (LDC)	200	41.9	11.8
Nigeria	Sub-Saharan Africa	Low income	320	57.9	135.7

Country	Region	Income Category	GNI per Capita	Informal Economy (% GNI, 2003)	Population (millions)
Rwanda	Sub-Saharan Africa	Low income (LDC)	220	..	8.3
Senegal	Sub-Saharan Africa	Low income (LDC)	550	43.2	10.1
Sierra Leone	Sub-Saharan Africa	Low income (LDC)	150	..	5.3
South Africa	Sub-Saharan Africa	Lower middle income	2,780	28.4	45.3
Tanzania	Sub-Saharan Africa	Low income	290	58.3	34.9
Togo	Sub-Saharan Africa	Low income (LDC)	310	..	4.9
Tunisia	Middle East & North Africa	Lower middle income	2,240	38.4	9.9
Uganda	Sub-Saharan Africa	Low income	240	43.1	25.3
Venezuela	Latin America & Caribbean	Upper middle income	3,490	33.6	25.6
Yemen, Rep.	Middle East & North Africa	Low income (LDC)	520	27.4	19.2
Zambia	Sub-Saharan Africa	Low income (LDC)	380	48.9	10.4
Zimbabwe	Sub-Saharan Africa	Low income	480	59.4	13.1

Source: World Bank and IFC: http://rru.worldbank.org/DoingBusiness/ExploreEconomies/EconomyCharacteristics.aspx
List of LDC (Least Developed Countries): www.un.org/special-rep/ohrlls/ldc/list.htm

Annex 2
Abuja Manifesto

Governments will:

- Set clear targets and realistic plans for investment in and provision of essential services such as infrastructure, education, health and water
- Ensure a legal framework with timely enforceability of all contracts
- Create a good business climate focused on predictability and simplicity of regulations rather than offering elaborate incentives to investors
- Offer transparency of public fiscal affairs
- Implement a continual program to lighten the regulatory burden on business, for example by making it faster and more affordable to start a company, employ staff, register assets or clear customs
- Address constraints on competitiveness in national economies in order that domestic business can compete internationally and benefit from trade liberalisation measures
- Improve public access to government services and the efficiency of these services by embracing an e-government strategy
- Set mechanisms for regular consultation between the public and private sector at the highest levels

Business will:

- Implement best practices for Corporate Governance and citizenship to meet high standards for each company and ensure widespread adherence
- Integrate into the business model a work plan for investment in the workforce, local communities, and the supply chain
- Ensure that business activities are sustainable and avoid undue external costs on stakeholders or on society as a whole
- Pay taxes and other revenues to the public treasury in accordance with the provisions of the law
- Invest in ICTs to improve productivity and make increased use of e-commerce
- Organise itself for constructive and cohesive dialogue with government in business policy formulation and assessing priorities

Together governments and businesses should:

- Explore best practice on private sector participation in the provision of infrastructure and other public services
- Implement common standards on Codes of Ethics and systems to eliminate corrupt practices in public and private organisations

Source: Commonwealth Business Council (2003).

Annex 3

Glossary of Abbreviations

AGOA	African Growth and Opportunity Act (USA)
APDF	African Project Development Facility (IFC)
AusAID	Australian Agency for International Development
BEST	Business Environment Strengthening for Tanzania
CBC	Commonwealth Business Council
COMESA	Common Market for Eastern and Southern African States
DANIDA	Danish Ministry of Foreign Affairs
DFID	UK Department for International Development
EAIF	Emerging Africa Infrastructure Fund
ECOWAS	Economic Community for West African States
EITI	Extractive Industries Transparency Initiative (UK)
EPOPA	Export Promotion of Organic Products from Africa
FIRST	Financial Sector Reform and Strengthening
GFA	Global Coalition for Africa
GFC	Global Forum on Competition
GTZ	*Gesellschaft für Technische Zusammenarbeit* (Germany)
IBRD/IDA	International Bank for Reconstruction and Development International Development Association
IFC	International Finance Corporation
ILO	International Labour Organization
ISO	International Standards Organization
ITC	International Trade Centre
FIAS	Foreign Investment Advisory Service
FDI	Foreign direct investment
GDP	Gross Domestic Product
HIPC	Highly Indebted Poor Country
ICA	Investment Climate Assessment (World Bank)
ICS	Investment Climate Survey (World Bank)
IF	Integrated Framework
IMF	International Monetary Fund

IPR	Investment Policy Review (UNCTAD)
JICA	Japan International Cooperation Agency
LDC	Least developed country
MDGs	Millennium Development Goals
MIGA	Multilateral Investment Guarantee Agency
NEPAD	New Partnership for Africa's Development
NGO	Non-government organization
NORAD	Norwegian Agency for Development Cooperation
MSME	Micro, small and medium enterprise
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
OECD/DAC	OECD Donor Assistance Committee
PDF	Project Development Facility (IFC)
PIDG	Private Infrastructure Development Group
PPIAF	Public Private Infrastructure Advisory Facility
PRSP	Poverty Reduction Strategy Papers
SADC	Southern Africa Development Community
Sida	Swedish International Development Cooperation Agency
SME	Small- and medium-sized enterprise
SSATP	Sub-Saharan Africa Transport Policy Program
TRTA/CB	Trade-related technical assistance and capacity building
UNCTAD	United Nations Conference on Trade and Development
UNDP	United National Development Programme
UNECA	United Nations Economic Commission for Africa
UNIDO	United National Industrial Development Organization
USAID	United States Agency for International Development
WBG	World Bank Group
WB	World Bank
WTO	World Trade Organization

Statistical Appendix

Table 1. OECD Foreign Direct Investment Flows

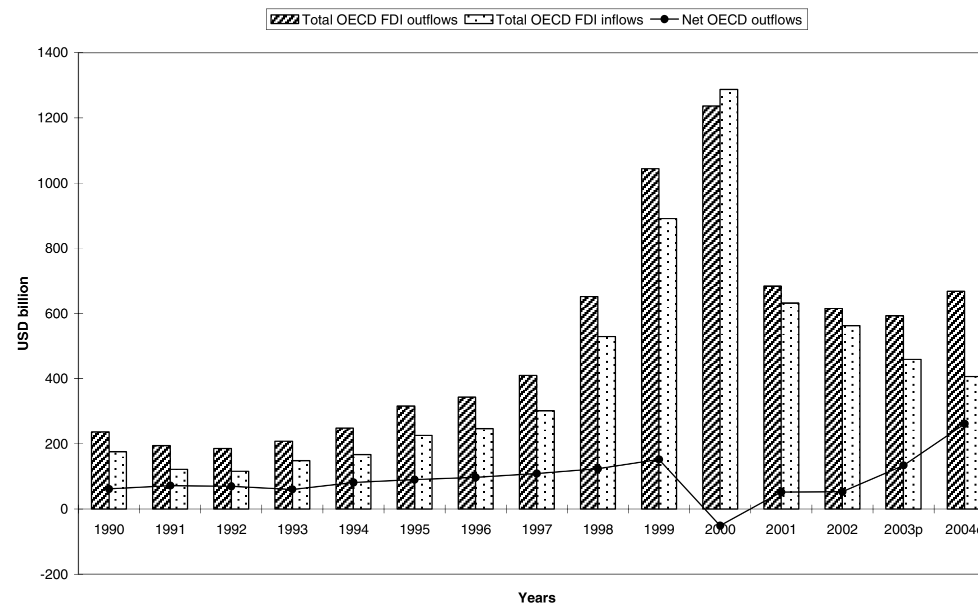
	OECD outflows to:			OECD inflows from:			
	1990	1995	2003	1990	1995	2003	
Major non-OECD countries							
Singapore	2457.8	3004.7	13476.8	328.1	819.5	1144.4	Singapore
China	408.8	6898.5	8005.6	26.2	143.8	680.2	Venezuela
Russian Federation	0.0	436.6	6008.0	12.5	17.4	567.4	Israel*
Hong Kong	1948.6	3654.8	2875.9	67.9	241.1	464.8	South Africa
Brazil *	2118.4	9271.6	2044.6	178.0	294.5	454.8	Hong Kong
Morocco	45.8	33.7	1938.5	47.4	122.8	371.2	China
South Africa	122.1	1519.6	1234.1	0.9	84.9	152.1	Cyprus
India	120.2	770.0	1234.0	0.0	-0.1	122.0	Latvia*
Croatia	0.0	108.9	1115.5	14.9	6.0	35.1	Morocco
Romania *	3.0	203.9	1078.6	0.0	0.6	31.6	Malta
Egypt	-253.9	201.5	1024.9	0.0	-0.2	30.0	Slovenia*
Chinese Taipei	816.3	1439.7	977.0	10.2	-4.8	27.8	Egypt
Chile *	646.0	2115.1	919.0	-2.5	4.2	18.7	Bulgaria
Malaysia	1271.1	1673.6	915.6	1.1	7.9	13.3	Romania*
Venezuela	12.1	969.7	859.7	-1.3	0.4	5.9	Uruguay
Thailand	1644.6	2793.9	737.8	4.7	16.4	3.0	Colombia

	OECD outflows to:				OECD inflows from:			
	1990	1995	2003		1990	1995	2003	
Malta	2.8	0.2	628.0					
Bulgaria	-1.3	13.1	618.6					
Israel *	-73.4	499.0	582.7					
Colombia	13.9	671.9	540.5					
Memo items: Total OECD Investments to and from								
Non-OECD countries	*46 666*	*72 094*	*121 743*		*20 196*	*17 334*	*33 700*	*Non-OECD countries*
OECD countries	*188 984*	*263 077*	*406 364*		*150 360*	*196 558*	*284 716*	*OECD countries*
Total	*235 650*	*335 208*	*504 363*		*171 419*	*213 954*	*318 415*	*Total*

* Non-OECD countries adhering to the OECD Declaration on International Investment.

Source: OECD International direct investment database.

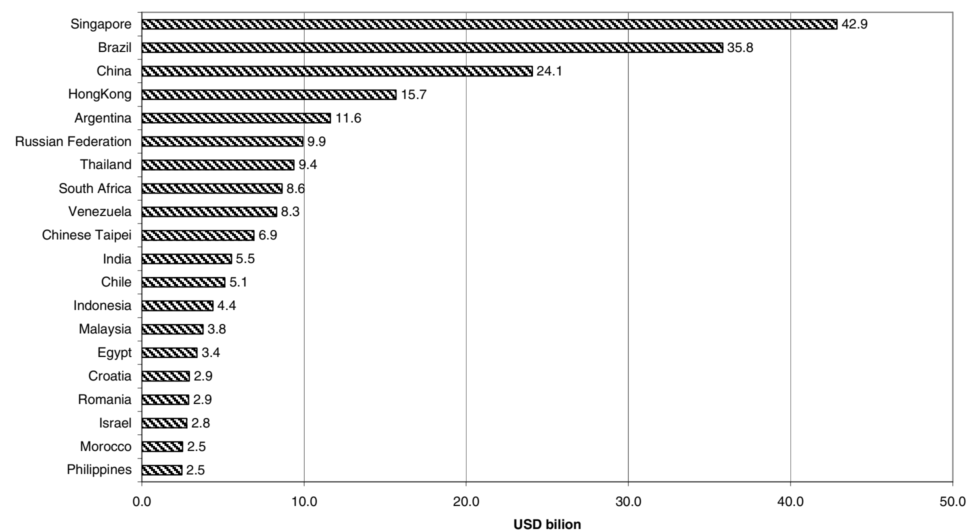
Figure 1. FDI Flows to and from OECD



Notes: Data are converted to US dollars using average exchange rates; e: estimate; p: provisional.

Source: OECD International direct investment database.

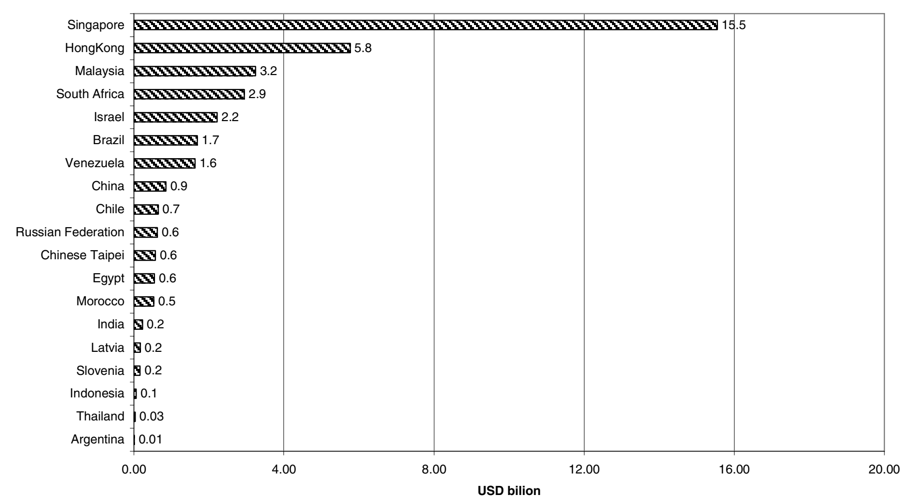
Figure 2. FDI Outflows from OECD to major non-OECD host countries
1990-2003 (cumulative)



Notes: Data are converted to US dollars using average exchange rates.

Source: OECD International direct investment database.

Figure 3. FDI inflows to OECD from selected non-OECD investors
2002-2003



Notes: Data are converted to US dollars using average exchange rates.

Source: OECD International direct investment database.

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