BIAC *In Response*

Paris, 28 June 2004

BIAC Discussion Paper

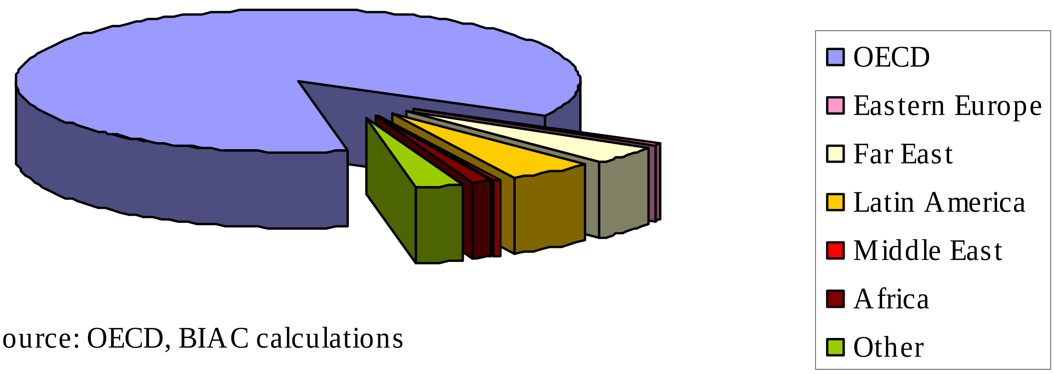
to the OECD-MENA Investment Steering Group Meeting,

- Amman, Jordan, 30 June – 1 July 2004 -

"Strengthen the Investment Environment in MENA-Recommended Action from Business"

The Business and Industry Advisory Committee (BIAC) represents the voice of the major industrial and employers' organisations from the 30 OECD member countries. With this statement we would like to express our support for the OECD activities focused on enhancing private investment in the Middle-East and North Africa region. BIAC welcomes the OECD-MENA Investment Steering Group follow-up meeting. The acceleration of trade and investment liberalisation, the improvement of transparency and good governance including a vigorous fight against corruption are basic conditions for making the MENA region more attractive to international investors.

Cross-border mergers and acquisitions: cummulative inflows by region (1995-2002)
% of total inflows



Source: OECD, BIAC calculations

I. Private sector investment depends on a conducive investment climate

Good governance is vital for investment

FDI has a positive impact on host countries' economies due to the additional financial, technological and managerial resources associated to it. The evidence from business is clear: good governance is a vital prerequisite for foreign direct investment (FDI), as well as for encouraging the development of the local private sector. Although macroeconomic policies, market size and risk environment are important determinants of private sector investment decisions, there is a growing consensus that the quality of business regulations and the institutions that enforce them are of at least equal importance. Government policies and practices regulating private investment and trade activities can emerge as a major barrier for mobilising both foreign and domestic investment as a force of growth especially in MENA countries. A transparent pro competitive regulatory environment has consistently proven decisive to the success of many emerging market economies. Deregulation and privatization of major state-owned enterprises promising a more dynamic market are crucial to promote private investment.

Indeed, a critical focus for a firm weighing a long-term decision to invest is the reliability and clarity of a host government's administration and the transparency of its decision-making process. Investors will often seek answers to the following questions before committing scarce resources to a venture:

- How layered and complex is the host government decision-making process?

- Is there sufficient coordination between the various ministries and agencies responsible for setting policy and overseeing regulation for relevant sectors of the economy?

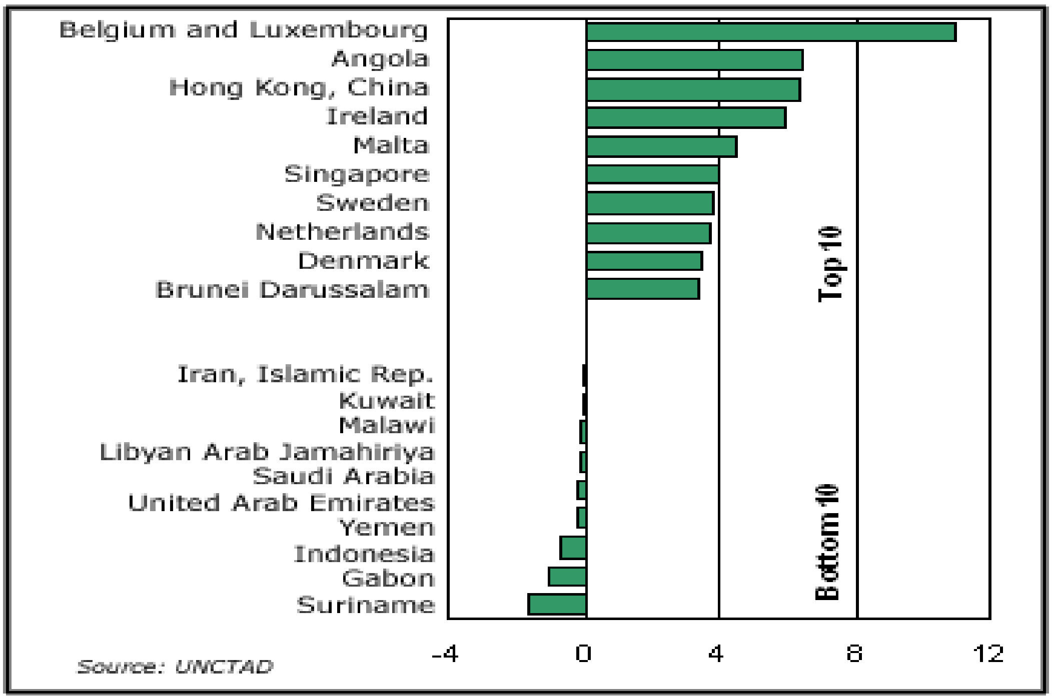
- Can decision-makers be readily identified and held accountable? Can they be trusted to make timely and binding decisions after adequately consulting stakeholders, including the business community?

- Are different levels of government (local, state, federal, or regional) supportive of one another or do they tend to work at cross purposes?

It is clear that foreign direct investment is vital especially for emerging countries that lack sufficient funding for investments to switch to a sustainable growth pattern. Although MENA countries require FDI for sustainable development, they are responsible for only 0.9% of global flows of FDI indicating the poorest performance compared to other regions. This figure underscores the urgency for rigorous structural reform programs to improve investment climate in MENA region.

While the MENA region has made some progress in this regard, our members also report that doing business in the region is unlike doing business anywhere else. An inescapable sub-text of this message is that there is still a great deal to be done to improve the climate for foreign investors. Improved governance practices hold the key.

The UNCTAD Inward FDI Performance Index, by host economy : the top 10 and the bottom 10, 1999-2001



Prerequisites of modern governance supportive of investment

For every country, no matter its size, location or level of development, attracting investment is a competitive exercise. Thus, all countries and local communities alike must be prepared to provide business with the right environment, including a transparent and predictable policy framework, if they are to be selected as the site for a new or expanded operations base. Important elements of a sound environment for foreign investors include:

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

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

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

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

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

Doing business requires high-quality regulation

BIAC continues to believe that the unique OECD work on regulatory reform can make a major contribution to foster investment in MENA countries. Regulatory reform is vital for the reduction of trade barriers encountered by services and investment. Regulatory reform that encourages open markets and competition must overcome entrenched interests and this requires a horizontal approach, including extensive multi-stakeholder consultation. OECD analysis and data are indispensable to this effort. One of the most important contributions of OECD work is to identify patterns of regulatory reform for which strong logic has been established in one or more member countries. A main focus should be to promote the adoption of these patterns in members and non-members alike.

Studies show that less developed countries tend to have a more highly regulated environment, often inhibiting the potential of business to foster development. In fact, it is the quality of business regulation and the institutions that enforce it, which are the major determinants for private sector investment.

For business, the core test for good regulation is the ability of governments to choose the most efficient policy tools that are least burdensome on commercial activity, whether regulatory or non-regulatory by nature.

OECD and non-OECD countries should be innovative in regulatory approaches working also to eliminate outdated regulations. From a business point of view, every new regulatory measure impacting the business environment should meet two general criteria:

- Have other possible alternatives to regulation (self-regulation, voluntary agreements) been adequately explored?

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

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

II. MENA initiative

BIAC welcomes the main conclusions of the Istanbul meeting ‘Mobilising investment for Development in the MENA Region’. The majority view during the meeting pointed out that the investment performance of the MENA region needs improvement. The participants agreed on the necessity of cooperating with the OECD to upgrade investment policy standards and capacities of this region.

It is common knowledge that investment is a horizontal issue compromising many policy areas that go into making a good investment environment. Drawing from long standing experience of the OECD, BIAC emphasizes that policy dialogue between OECD and MENA countries can help build consensus on the range of policy options that form the basis of a broadly-based investment initiative for development and support their effective implementation.

BIAC would like to underline that promoting regional cooperation to enlarge market size and to obtain stable economic endowment across the region is an important step for the OECD MENA program.

BIAC would like to highlight that the success of this programme relies on two main actions: the monitoring of progress achieved with the implementation of the national reform agendas and effective communication among political decision makers reaching out to business and civil society.

In line with the Istanbul exploratory meeting, five mutually reinforcing areas emerged for a co-operative investment-related programme with the OECD in partnership with key national, regional and multilateral actors:

- Transparent and open investment policies
- Encouraging Investment Promotion Agencies to act as driving forces for reform
- Providing a tax framework for investment
- Investment strategies in support of diversification
- Improving corporate governance practices

The following are BIAC views with respect to these five areas:

Transparent and open investment policies

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

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

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

- Existing rules and regulations are readily accessible to and understandable members of the public;

- Notice is provided to the public at an early stage of proposals that introduce new rules or change existing rules;

- Proposals to change existing rules or to introduce new rules provide sufficient time for the public to submit comments in a pre-determined manner;

- The public is provided with an explanation as to the reason(s) why the rules are being changed/introduced and the goals and objectives that are to be met;

- The public is invited to submit comments prior to decisions being taken and there is evidence that comments are seriously considered before regulations are finally issued;

- Points of enquiry are established to respond to the public for information (single window approach);

- The new rules or changes in existing rules are clear and understandable to insure predictability of success and to provide affected individuals with the necessary information to comply and

- A reasonable period of time is provided to allow affected persons to prepare for implementation.

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

Encouraging Investment Promotion Agencies

Setting the investment reform agenda in the MENA region should be flexible to suit different sets of individual countries requirements and this reform packet should be implemented in cooperation with business and civil society dialogue. This flexibility and cooperation with business can be obtained through local investment agencies which play a crucial role to build network systems among economic agents. Investment agencies also take initiatives to gather accurate statistics on investment vital for investors.

In addition, MENA investment agencies must have a clear mandate to undertake policy advocacy to build an investment friendly regulatory framework and to provide post investment services for effective investor targeting. As they are responsible for amendment in the policy and regulatory framework and the decision-making process relating to investment approvals, their advocacy role should be defined in terms of their ability to analyse and their knowledge capacity.

In some countries of the region, investment agencies can directly influence the investment policy agenda by drafting legislation, commenting on the regulatory policies and advising government and legislative bodies. **Accordingly, BIAC supports the OECD approach on encouraging investment promotion agencies to act as driving forces for reform.**

Providing a tax framework for investment

As economic and financial barriers disappear tax differentials have a greater impact on trade and investment flows, therefore tax policy a key element of a nations policy framework to attract and promote investment.

Numerous issues must be considered in the context of a nation's tax policy such as tax administration issues, the tax judiciary system, auditing, the tax procedural code, direct and indirect taxation. In this context, BIAC emphasizes the important work that OECD is doing with respect to outreach to non-members in the field of taxation, including with the input of business. This co-operation continues to be essential and is equally relevant in the context of the MENA initiative. The focus of this OECD work should continue to be on assisting countries to eliminate tax measures that distort trade and investment flows, prevent double taxation, counter tax evasion and avoidance and to improve the effectiveness of tax systems. The OECD Model Treaty and the OECD Transfer Pricing Guidelines are two key OECD instruments that serve as the basis for this ongoing dialogue.

Many MENA countries have deployed specific tax incentives, financial subsidies and regulatory exemptions aimed at attracting FDI projects. The cost-effectiveness of MENA incentives programmes should be assessed in the regional context, partly by using the OECD Checklist for FDI Incentive Policies and also through technical capacity building in tax incentive evaluation.

On the issues of tax incentives, BIAC recognizes that the establishment of a viable tax system and specific fiscal and non-fiscal incentives to attract investment can be an important tool for some MENA countries to attract investment. However, BIAC stresses that the majority of business would opt for a broader tax base and lower rates instead of incentives. In the case where tax incentives are applied, in order to be effective they must be generally available to investors, international or local, be non-discriminatory, transparent, non-trade distorting, casual or strongly linked, proportional, temporary, have long term orientation, and be otherwise fixed within the committed business model.

Key elements of a tax policy framework that supports investment and sustainable economic growth include:

- Transparent and predictable tax systems
- Broad tax base with the lowest possible rates
- No double taxation
- Transfer pricing law should be based on the arm's length principle as articulated in the transfer pricing guidelines – governments should follow the letter and the spirit of the Guidelines
- Consultation with the business community on tax matters

BIAC supports the proposed informal dialogue between the OECD and the MENA countries to promote a fiscal environment that attracts and supports investment in the region. This new group composed of tax officials, investment officials and investment agencies, should also include business input, which is an important element in developing coherent tax policy that supports economic growth. We encourage that this dialogue take place in close coordination with the OECD Centre on Tax Policy and Administration (CTPA).

Investment strategies in support of diversification

Most countries in the region are heavily dependent on primary production and resource-based sectors, with narrow export bases. The non-oil sectors have been neglected and should be promoted. Countries are considering strategies of intra-industry trade[1] based on inter-sectoral linkages in petrochemical and other industries, the development of agricultural resources, and the growth of the services sector. FDI can play a crucial role in the process of product differentiation. In terms of sectoral distribution, some other countries such as Bahrain, Egypt, Morocco, Tunisia and Lebanon have witnessed FDI inflows into various sectors such as tourism, banking, telecommunications, manufacturing, and construction. Some of these non-hydrocarbon sectors, especially privatised firms offered excellent floor FDI flows were ushered in by cross-border M&A.

BIAC suggests that investment strategies for this region must be designed to promote greater product diversification.

Improving corporate governance practices

The essence of corporate governance is to increase growth and performance of companies and the guarantee of shareholder rights. The discussion about corporate governance is not the right place for achieving other policy objectives (e.g. so-called "Stakeholder-debate", or the broader debate on “corporate social responsibility”).

BIAC urges the OECD to enhance corporate governance practices in the MENA region by bringing together key players and stakeholders in the region with their counterparts from OECD countries and from other emerging economies and international institutions, for roundtable meetings to exchange experience and engage in policy dialogue to develop common recommendations and pursue implementation of corporate governance reforms, taking into account the revised OECD Principles of Corporate Governance.

BIAC regarded the revision of the OECD’s Corporate Governance Principles as a useful exercise and an important step for improving the trust of market participant in an open free market system with the private corporation at its centre. At the centre of these debates was

[1] The need for an extension of trade theories in order to deal with differentiated products was recognized many years ago. According to many authors interested in intra-industry trade (especially Helpman (1984)), the major innovation of the new theory lies in its accommodation of two assumptions: a) that there exist sectors with product differentiation and there exists in every country a demand for a wide spectrum of varieties, b) That each variety of differentiated products is produced with internal economies of scale. The second assumption has lead to the adoption of a monopolistic market structure in the differentiated products industries, in other word finite number of varieties is produced, with every producing a different variety. Since in an equilibrium there exist differentiated products which are produced in more than one country, then –since each variety is produced in only one country- the first assumption assures intra-industry trade.

the search for the right balance in order to create a spirit of transparency and accountability rather than compliance with form alone.

The principles recognize that the notion of "one size fits all" do not apply to corporate governance. The adoption and implementation of the Principles should be left to national systems. Every national regulatory system has the flexibility to find its own balance between regulation by governments and self-regulation. The current structure of competing systems of national corporate governance regulations should be maintained. Often the disparities are founded in different legal traditions, as well as in different industrial, different ownership structures. Some level of diversity is deemed necessary for the maintenance of an internationally competitive environment.

From a business point of view, the Revised Corporate Governance Principles recognise that:

- Investors should have both the right to nominate company directors and a more forceful role in electing them.

- Shareholders should be able to express their views about compensation policy for board members and executives and submit questions to auditors.

- Institutional investors should disclose their policies with regard to the invitees' affairs, but it should also be made clear that an institutional investor may legitimately decide that its policy will be not to intervene or not to play an active role.

- Effective protection of creditor rights and an efficient system for dealing with corporate insolvency should be recognized.

- Rating agencies, brokers and other providers of information that could influence investor decisions to disclose conflicts of interest should be recognized for transparency.

- The board of a publicly owned corporation should have a substantial degree of independence from management. BIAC supported giving whistle blowers a confidential means of voicing their concerns.

III. The way ahead

BIAC would like to be a part of Steering Group constituted in Amman to steer and monitor the action programme. BIAC believes that the Steering Group would be in charge of shaping the future development of the programme and its management. It would be comprised of senior investment officials from MENA and representatives of donor country partners, international organisations and financial institutions, non-governmental organisations and the private sector.

BIAC Task Force on MENA

Following a new focus of the OECD's investment and regulatory reform outreach work, BIAC Non-member Economies Committee decided to set up a new Task Force on the Middle-East and Northern Africa to be chaired by Dr. Peter Kreutzberger, Regional Director for Africa and the Middle East, BDI (Germany). The new initiative of the OECD on "Mobilising Investment in the MENA Region" will offer a good opportunity for our members to impact on the investment conditions in these countries while meeting investment promotion and other government officials from the countries of the region.

The involvement of business in the MENA region in this programme is crucial for obtaining further support to the implementation of the key actions of the programme.