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# Strengthening the Development Impact of UNCTAD's Investment Policy Reviews

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Research project on behalf of the Federal Ministry for Economic  
Cooperation and Development

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## Abbreviations

ASIT	Advisory Services on Investment and Training
BIT	Bilateral Investment Treaty
DITE	Division on Investment, Technology and Enterprise Development
DTIIS	Diagnostic Trade and Investment Integration Study
DTIS	Diagnostic Trade Integration Study
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
GAT	General Agreement on Trade in Service
HWWA	Hamburg Institute of International Economics
IC	Investment Compass
IIA	International Investment Agreement
IMF	International Monetary Fund
IPR	Investment Policy Review
IRCB	Investment-Related Capacity-Building
IRTA	Investment-Related Technical Assistance
ITC	International Trade Center
LDC	Least Developed Country
MAI	Multilateral Agreement on Investment
OECD	Organization for Economic Co-operation and Development
PRSP	Poverty Reduction Strategy Paper
QRW	Quick Response Window
SACU	Southern African Customs Union
SME	Small and Medium-sized Enterprises
TPC	Trade Policy Clinic
TPR	Trade Policy Review
TRCB	Trade-Related Capacity-Building
TRIM	Trade-Related Investment Measure
TRTA	Trade-Related Technical Assistance
UNCTAD	United Nations Conference for Trade and Development
UNDP	United Nations Development Program
WTO	World Trade Organization



## Preface

This study has been carried out for the German Ministry for Economic Cooperation and Development (BMZ) in cooperation with HWWA and UNCTAD.

The study focuses on two issues:

- the role of FDI in generating economic growth in developing countries;
- how should UNCTAD's Investment Policy Review process be organized to attract more and better FDI?

Compared to a number of simplistic positions, which tend to demonize either the role of FDI in developing countries or those who see them as a “deus ex machina” for the promotion of economic growth, the approach adopted by the authors is highly differentiated.

In line with a number of recent studies on FDI and development, the authors emphasize the need to analyse the specific circumstances and conditions of a given country to determine whether and how FDI can promote economic growth.

According to the authors, a central precondition for FDI to play a positive role in generating growth effects is the existence of a certain absorption capacity in host countries. They also point out that basic conditions of internal stability and transparency must be fulfilled to set the stage for FDI inflows. In this context it is also emphasized that, even in cases where in principle a sound FDI perspective exists in a country, FDI should be considered more as **one** factor of development alongside domestic investment in both real and human capital.

After this rather brief, but very general discussion of the role of FDI in developing countries, the main part of the study focuses on various issues relating to UNCTAD's Investment Policy Review (IPR) process. The issues discussed are based on long experience of UNCTAD's IPR programme in more than 15 countries. The authors conduct a detailed analysis of various content-related issues (e.g. should there be a sector-specific FDI policy?) as well as process- and implementation-related issues (e.g. how should stakeholders be more closely involved, or how could coordination with other institutions, such as the World Bank, OECD and UNDP, be intensified?). Another important issue discussed is the criteria for selecting the countries for which an IPR should be organized. Even though the report and recommendations are addressed mainly to those actors and decision-makers who are directly or indirectly involved in the practical IPR process, they also provide interesting insights for academic and non-academic experts in this field.

Bonn, July 2005

Tatjana Chahoud  
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## Summary

1. IPRs can be a very useful instrument for making FDI policy more effective for the development process.
2. IPRs should not focus exclusively on *foreign direct* investment but rather on investment in general and consider FDI as *one* of several elements in the development process.
3. UNCTAD should, in accord with donor countries, take a greater say in the selection of the countries reviewed. The starting point should be an analysis of the absorption capacity and the need for external assistance in the countries in question.
4. In view of widely differing domestic capacities and different needs for and institutional policy advice, UNCTAD should undertake more efforts to adapt the volume of issues covered to the advice actually needed. Activities could extend from Quick Response Window action on one or few specific problems to an “IPR light” or a full-fledged IPR.
5. Recommendations should be based more on investors’ and non-investors’ experiences and assessments than on a formal investment framework. Assessment of the impact and definition of investment opportunities should be more cautious, given the complexity of these issues.
6. Much weight should be given (1) to the coherence of the various policy actions and (2) to compatibility of national FDI policy and obligations resulting from international treaties.
7. Recommendations regarding policy measures should often be more precise.
8. Support should be given to UNCTAD policy with a view to making use of the knowledge and resources available in other programs. Co-ordination with other institutions (World Bank, OECD, UNDP, etc.) should be intensified. However, this should focus on exchange of facts – competition should continue as far as the provision of advices concerned.
9. Involvement of stakeholders from government, business, and civil society can contribute to better acceptance of an IPR. Top-level government support likewise serves to improve the chances that recommendations will in fact be implemented. UNCTAD’s policy in this respect should be continued as long as recommendations are not diluted and become featureless.
10. Implementation of recommendations should be promoted by integrating IPR activities more into “normal” development assistance. A certain share of the IPR budget should be reserved for implementation action, such as meetings, certain consulting activities, and development of domestic human resources. We consider a 30 % share appropriate.



## 1 General approach

*The overriding aim should be development, not streamlining FDI policy*

1. The IPR program has been operating for over 10 years now. A total of 15 countries have been covered so far, with another two (Kenya and Zambia) in the pipeline and more than 20 countries having applied for an IPR. The mere fact that (Foreign) Investment Policy Reviews have been asked for by an increasing number of countries is proof enough that the IPR program is encountering widespread demand and is in principle a meaningful one. Critical remarks in the following evaluation should, therefore, not be understood as criticism in principle. Such remarks are meant instead to point to some aspects that might be worth considering in country studies that are in preparation and whenever further applications come in.
2. Although the IPRs completed to date cover a wide range of countries that differ substantially in size and market potential (e.g. Brazil and Egypt vs. Mauritius and Nepal), income level (Botswana and Sri Lanka vs. Tanzania, Uganda and Ethiopia), endowments with natural resources, geographical position relative to the "First World," and in terms of political systems, there seem to be some common assumptions underlying the program. The first one is that there is an FDI potential for each country that has been covered already or is expected to apply for an IPR. Second, activation of this potential should be a priority field of national policy. Furthermore, judging from the IPRs available, it seems that UNCTAD presumes that one given concept fits all countries (one-size-fits-all approach).
3. In this evaluation, we start out from a more "neutral" point of view in discussing these issues. We see development as the overriding aim and focus of IPRs. To this end, we consider it necessary, before starting work on an IPR for a particular country, to discuss whether there really is a potential for substantial FDI in the country in question that would in fact benefit the country.
4. Our basic assumption is that economic growth in developing countries cannot generally be seen as depending on FDI and that FDI does not necessarily promote economic growth. It all depends on targeted policies and appropriate regulatory measures. Ample evidence supporting this view is provided by various studies (e.g. Carkovic / Levine 2002 and OECD 2002). These studies conclude that a certain domestic absorption capacity is needed for FDI to generate growth effects in host countries. By the same token, minimal conditions regarding internal stability and transparency are needed to set the stage for FDI inflows (OECD 2003). If absorption capacity is lacking or minimal standards are not met, FDI-focused policy would be a bet on the wrong horse. It could run the risk of encouraging the illusion that FDI-focused policy could be an easy way to bring forward domestic development and that promoting FDI could be a substitute for internal institutional and policy reforms. This is not to imply that countries with limited absorptive capacity do not need FDI or should not seek to attract FDI. To the contrary, with proper policies, FDI can help build domestic capability. The point is here simply to emphasize that in such cases assistance programs such as IPRs should give priority to the development of domestic resources and stability.
5. Even in cases where, in principle, a sound FDI perspective exists in the respective country, FDI should be considered more as **one** factor of development alongside domestic investment both in real and human capital. Foreign-owned firms more or less closely interact with domestic ones, as has been shown in detail in various UNCTAD World Investment Reports. In fact, the degree of integration of FDI into the local economy or, in political terms, of its "mainstreaming" into an overall development strategy is the key measure

of its contribution to sustainable development. Investment Policy Reviews should therefore generally look at FDI as part of the overall investment picture, or in a broader investment-growth framework, and analyze FDI policy in a wider industrial-policy context.

#### *Which countries?*

6. According to the mandate adopted in UNCTAD IX (Midrand) and reaffirmed at in UNCTAD X (Bangkok), the assistance that UNCTAD provides to developing countries through the IPR process should be demand-driven. In other words, IPRs should be carried out only in countries that have expressed interest by requesting UNCTAD to undertake such a review. The choice of countries receiving an IPR would thus result from a self-selection process. After finance is secured from one or several donor countries, UNCTAD organizes and undertakes the study if sufficient support from the respective government can be expected. This procedure is unsatisfactory since there is a danger that countries that receive support through IPRs may not always be those that could benefit most from it. In some developing countries, for instance those emerging from lengthy civil conflict or destructive war, a policy review that focuses on domestic investment, capacity-building, rehabilitation, and reconstruction is likely to be more directly relevant than one whose aim is to increase FDI inflows. This is not to say that FDI does not have a role to play in such countries but instead to emphasize the point that the priority need of countries may vary depending on the situation prevalent there, and that the selection of countries for review must reflect that. Thus, in order to maximize the impact of IPRs, UNCTAD must exercise a degree of flexibility in identifying, among countries that have expressed interest, those which could and should benefit from the IPR process.
7. We go even further here and suggest that UNCTAD, in accord with respective donor countries, should have a greater say in the decision as to which countries are “fit” for an IPR. One option in the IPR program should therefore be the recommendation **not** to bank on FDI but instead to start out by developing indigenous resources. UNCTAD (as well as donor countries) should be prepared to recommend that some demands for FDI-focused policy reviews be redirected as requests for general policy-focused advice and “normal” development assistance. The main decision criteria could include
  - general level of development,
  - political and administrative stability,
  - commitment of the government concerned to implement recommendations,
  - quality of infrastructure, and
  - availability of natural resources.
8. On this basis, it would be possible to avoid undertaking IPRs in situations with few prospects of attracting substantial FDI. Likewise, it would be possible to forego an IPR for countries that could do the job with their own resources (Brazil would be a case in point). If, however, self-selection is accepted, the preceding reasoning suggests that both volume and focus of the individual studies should be quite different.

## 2 Specific issues

9. Bearing in mind these general remarks on the one hand and the experience made with the IPR program on the other, we find ourselves face to face with a number of specific issues which could be taken into account in further developing IPRs. Most of these issues were the subject of the terms of reference for this evaluation, and they were addressed during our talks in Geneva with UNCTAD and country representatives and experts. These issues are both content-related and process- and implementation-related. We are well aware that this classification is a bit arbitrary. It is especially content and process-related issues that have a bearings on implementation.

### 2.1 Content-related issues

#### *Focus and coverage*

10. Among content-related issues, one basic question concerns the overall orientation of Investment Policy Reviews, i.e. their focus and coverage. Essentially, IPRs are a two-pronged exercise aimed at both improving the strategies, rules, and procedures governing investment in a country under review and making these policies and institutions more transparent internally (i.e. for “stakeholders” within the respective country) and externally (i.e. with regard to other countries and stakeholders). The original mandate for IPRs given at the UNCTAD Conference in Midrand (South Africa) in 1996 provided for the reviews to “familiarize other Governments and the international private sector with an individual country’s investment environments and policies.”<sup>1</sup> This intention was explicitly (and exclusively) referred to in the preface to the first IPR report (on Egypt, 1999) prepared by the UNCTAD Secretariat. By contrast, in the preface to the most recent IPR report (on Brazil, 2005), apart from the call for transparency (and preceding it), the stated intention is “to help countries improve their investment policies”. The IPR process thus appears to have evolved beyond a mechanism designed to enhance transparency into an instrument of technical assistance and capacity-building conceived to enable client countries to design appropriate policies for investment from abroad and thus to attract FDI and benefit from it.
11. This bears resemblance to developments in the field of trade. Trade Policy Reviews under the aegis of the World Trade Organization have increasingly performed a technical assistance function for trade-related capacity-building beside their traditional role of providing a forum for achieving transparency in the trade policies and practices of WTO members. They are now more systematically used to detect any shortcomings in this policy field, to enhance interaction between the government agencies concerned, and to identify specific areas where technical assistance may be required (needs assessment). This is especially true for TPRs on behalf of Least-Developed Countries.
12. The yardstick for improving investment policies is their anticipated significance for development and growth that is sustainable and serves to reduce/alleviate poverty. Assessing such effects would first require identification of policy areas or measures that have a major bearing on FDI and then efforts to systematically gauge their development impact or the role they play in attracting “quality“ FDI. To this end, an analytical framework or

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1 See: Midrand Declaration and A Partnership for Growth and Development, UNCTAD Document TD/377, 24 May 1996, paragraph 89(c).

“taxonomy” would be needed that relates the activities of foreign-owned companies, and in particular their cross-border and domestic linkages, to the development of the overall economy and in this context also allows for international comparisons (“benchmarking”).

13. A “holistic” view of FDI along such lines calls for adoption in IPRs of a broad-based policy approach. Together with an analysis of foreign and general investment regimes and related reforms in the country under review, investment policy evaluations should also point to other necessary ingredients of a reform program. Complementary elements are likely to include measures to advance human capital development, upgrade infrastructure, or improve the institutional environment. In this respect, too, IPRs would come close to TPRs, with their wide coverage of “trade-related” policies (including investment regimes) and emphasis on the interaction of these policy areas with macroeconomic and structural policies guided by the notion of “mainstreaming” trade into national (economic and social) development plans and poverty reduction strategies.<sup>2</sup> In a similar way, IPRs would cover a broad range of “investment-related” policies (including trade regimes) aimed at “mainstreaming” FDI or matching the characteristics of foreign investors with the development needs of host countries.
14. The approach outlined above would basically apply to the countries under review, irrespective of their state of development or other characteristics and special circumstances (like civil war or unrest, ethnic conflict etc.) prevalent in certain countries or country categories. However, different weights would naturally have to be assigned to different parts of the analysis depending on the case at hand. In LDCs, for instance, FDI strategies would typically have to be discussed first and foremost in the context of poverty reduction strategies and efforts to strengthen the legal and institutional framework for coherent and sound policy-making. IPRs for such countries should also focus on identification of constraints to private-sector development in general, of both domestic and foreign firms. Constraints might e.g. include dysfunctional infrastructure, high costs and inefficient delivery of services (especially in the public utilities sector), or a shallow and ineffective financial system.<sup>3</sup>
15. In some cases, the prime question to be asked is of course whether there is a potential for economically advantageous FDI at all or, put differently, to what extent the country envisaged is politically and/or economically in a position to “absorb” beneficial foreign investment in the first place. The smaller (positive) effect on growth that FDI seems to have in LDCs as compared to more advanced developing countries may indeed be attributed to the presence of “threshold externalities” (OECD 2002, 10). Countries would accordingly need to have reached a certain level of development in education, health, physical infrastructure, technology, or financial intermediation before being able to take advantage of a foreign presence in their markets.<sup>4</sup> At the same time, engagement of foreign investors in these areas could help to attain this level and eliminate bottlenecks. In any event, however, increased investment and/or additional risk taking (by domestic or foreign firms) is

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2 As defined by the WTO, mainstreaming of trade “involves the process and methods of identifying and integrating trade priority areas of action into the overall framework of country development plans and poverty reduction strategies”. (WTO 2000, 1)

3 These were major constraints referred to in the recent Trade Policy Review for Sierra Leone, for example, which currently is rated the poorest country in the world (WTO 2005, 25–26).

4 Available empirical evidence suggests that human capital and the ability to effectively absorb foreign technology are particularly important for FDI as a means of promoting economic growth in developing countries. Accordingly, promotion of human capital, technological capabilities, and economic development would lead to more FDI inflows, which in turn would stimulate further economic growth and enhance competitiveness (Li / Liu 2004, 404).

unlikely to materialize and be sustained in an environment of major and persistent political instability.<sup>5</sup> In this case, FDI potentials are likely to be limited. Although UNCTAD's IPRs tend to focus more on FDI, efforts must be made to incorporate policies that are targeted primarily on domestic investment and the linkages between domestic enterprises and foreign affiliate firms in the country in question.

*Investment guide or policy guidance?*

16. In our talks with UNCTAD representatives and experts involved in the IPR program, it was clearly and unanimously stated that IPRs should **not** be an investment guide but rather guidance for national FDI policy. We understand that the difference between an investment guide and guidance for FDI policy is in the perspective taken. While FDI guides should follow and anticipate an international investor's perspective, the IPR program is more geared to reflect the views of the government and all other parties affected by FDI in the host country. For two reasons we have some difficulties in following the view that IPRs are and have to be fundamentally different from investment guides.

17. First, it seems to us that the set-up of the IPRs available does in fact have some marked elements of an investment guide. Although in detail the structure differs among the countries covered, the general set-up is similar: The reports start with an overview of the internal FDI pattern. This section includes – mostly rather brief – assessments of the impact on the host economy. The main sections of the reports (both in terms of quantity and importance) work out the legal framework for investment and discuss FDI strategies and opportunities against the background of

- locational strengths and weaknesses
- political priorities of the government and
- development needs defined by other national stakeholders.

These sections clearly have investment guide character.

18. Our second argument is: There is no need for IPRs to be different from investment guides in all respects since one core aim of the IPRs is, as noted, to familiarize the private sector with investment opportunities in the respective country. IPRs can only be successfully implemented within the legal and political system of the host country (i.e. with effect of attracting more FDI) if the policy recommendations and the outline of investment opportunities at least to some extent appeal to foreign investors. At the same time, it may be of interest for foreign investors to know the host governments' and other stakeholders' priorities regarding FDI.

19. On the whole, it therefore seems that the two products have a significant overlap and that this overlap should be considered not as a problem but a result of efforts to make IPRs more relevant for investment practice.

*Legal framework vs. investor experience and non-investor views*

20. The main parts of the IPR consist of a description and discussion of the legal and administrative framework and the experience of foreign investors in the country in question. The latter are integrated into various sections. While framework facts certainly are important

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5 On this, with reference to the Trade Policy Review of Burundi, see Milner (2004, 1376).



for (potential) investors, experience in many countries, in particular in developing countries, tells us that actual investment conditions depend to quite an extent on how the rules of the game are actually applied. This can best be taken into account by confronting formal rules with investors' assessments. UNCTAD makes use of this information. However, we consider it prudent to give even more weight to actual practice than to formal rules.

21. In this context, a related aspect was dealt with in greater detail: To look into the reasons why internationally operating firms have **not** invested in a respective country, or in cases where foreign investors have disinvested, to determine why they have done so and what it would take to get them to invest again in the same country. Surveys of international investors of the kind that have been conducted by UNCTAD and used in IPRs, for example in the one on Peru, could be a useful instrument in this context. By placing explicitly more weight on views of foreign non-investors, the government could gain some clues as to where reforms might be needed to attract new overseas investors. It would help to streamline and adjust the investment framework, both regulations and institutions, in a way that is conducive to FDI and not necessarily detrimental to the respective location.

#### *Impact of FDI on economy and society*

22. The IPRs available present examples of individual or groups of FDI projects and their impact on the host economy, primarily on development and human resource use as well as on technology and external position. This information can demonstrate to the government and the general public that (more) such FDI will bring with it more jobs, a better qualified workforce, technological catch-up processes, an improved external position, and, generally, income growth. This would make promotion measures justifiable. By the same token, reports on positive experience could motivate foreign firms to consider investment in the respective country.

23. However, it seems to us that the impact sections in the IPR are a bit too oversimplified to serve as a basis for policy conclusions. Especially in view of
- the comprehensive aim of IPRs to promote development and
  - the crucial role of the direct and indirect links between domestically and foreign- and owned firms,

the presentation of individual cases (largely restricted to positive ones, thereby leaving out critical aspects) and the limited room available for these presentations does not measure up to the complexity of the issue. Such presentations may give impressions of possible first-round effects of FDI. However, a sound analysis of the effects on the local economy would have to take into account, for example, any possible crowding out or crowding in of local SME as well as effects on labour outside the foreign affiliate. Economic impact always has to be assessed in the context of competition in factor and product markets and with a view to the prevailing policy and administration framework. An economy- and society-wide perspective should be taken.

24. It is obvious that with limited time and financial resources it is not possible to conduct a comprehensive impact analysis in an IPR. However, it would be helpful if UNCTAD made fuller use of the competence and resources available to it and developed a comprehensive database (a sort of benchmark) which could be used to draw on representative information about economic and social impacts of FDI under given investment regimes. UNCTAD's World Investment Report, an excellent source, could be used to this end.

*Indication of sector-specific FDI opportunities?*

25. The IPRs available put some emphasis on identifying investment opportunities in a more or less detailed manner, often on a sector-specific basis. It is obvious that specification of profitable and sustainable investment opportunities could serve as valuable orientation for actual and in particular for potential foreign investors.
26. If, however, the opportunities indicated result largely from politically set priorities rather than from competitive and market conditions or from resources available, this can tend more to distort investment decisions than to help the development process and contribute to sound company growth. **There have been cases in which UNCTAD has been requested to develop an investment promotion strategy to attract investment into sectors and/or activities identified by a government as priority areas in a national development plan or PRSP. In this situation, UNCTAD should do its best, within its areas of competence, to provide policy advice on the feasibility of attracting investment into the selected sectors as well as on the measures required for investment targeting.** Otherwise, an IPR may run the risk of leading to inefficient structures in the long run.
27. In our view, identifying (and promoting) sector-specific investment opportunities is generally difficult because of information deficits. A more cautious approach in formulating 'opportunities' would be useful. It would be sufficient to briefly name government priorities as one point of orientation for potential investors. Another piece of useful information could result from an outline of the experience of countries competing for FDI, e.g. neighboring countries. On the whole, one more realistic and useful role for IPRs would be to improve the information on the side of potential investors by outlining a host country's pattern of structural change and development and by identifying supply-side constraints in the host economy. Would-be investors could then take their decision on that basis.

*Coordination of internal policy areas*

28. This issue mainly concerns policy coherence. It has two major dimensions:
  - Consistency between policies affecting FDI at the national level and institutional coordination among government bodies charged with formulating, implementing, and overseeing these policies.
  - Compatibility and compliance of national policies with international commitments and obligations.

In both cases the overriding objective is to attract "quality" FDI.

29. Foreign investors in many countries find that other measures, not necessarily directly related to foreign investment, often have a more critical impact on their business than FDI-specific instruments. Such policies include areas as diverse as international trade, foreign-exchange arrangements, competition, taxation, labor, sectoral regulations or property rights, and contract enforcement, which affect domestically and foreign-owned companies alike and have to do with a multiplicity of concerns apart from investment. In IPR reports these are each discussed separately in the regular chapter on the investment framework. However, little attention is paid to the linkages between these policy areas and to the interaction (or lack of it) between the agencies involved. It might therefore be a useful extension of the existing IPR format if a section was inserted to discuss in greater detail the institutional mechanics of investment-related policymaking as well as possible inconsistencies, contradictions, and trade-offs between the policies reviewed. Essentially, these are different elements of an industrial policy the workings and contents of which should be

come more transparent. On this basis it should be easier to develop reasonable proposals for a better coordination of policies and for “institutional streamlining“ (including more effective institutional arrangements in the area of investment promotion).

30. A case in point is the “special” investment-trade relationship. A common feature of both investment and trade policy is their international focus. Trade and investment are widely recognized as mutually reinforcing channels for cross-border activities that enhance a developing country’s integration into the world economy and may at the same time help to facilitate sustained economic growth and thus to promote sustainable development in a given country. Empirically, a positive cross-country correlation in fact exists between the intensity of international investment and trade links relative to overall economic activities (OECD 2002, 11). Moreover, among the various types of foreign investment, efficiency-seeking operations, and especially “network” or “global integrator” FDI involving higher imports as well as exports, appear to be on the rise. By and large, this kind of FDI also appears to have a relatively strong (positive) development impact (in terms of employment and training or transfer and dissemination of technology, for instance), which of course varies in terms of the individual country or country category under consideration. In consequence, trade policies of host countries, and of their trading partners, increasingly appear to determine a country’s ability to attract “quality” FDI.
31. IPR reports should treat this nexus in greater depth than they usually have until now. Besides export-processing zones, which are typically discussed at some length, other salient features of the trading regime that deserve closer scrutiny include the structure of import tariffs (especially their significance for access to intermediate and capital goods), customs procedures (as a core element of trade facilitation), trade-related performance requirements (like local-content, mandatory-export or trade-balancing provisions) or ease of market access and standard of treatment for service providers from abroad (in particular trade-facilitating business or “backbone” services like transport and logistics, finance, and telecommunications). Deeper analysis along these lines would help to design trade policies that are more conducive than current trade practices to FDI projects with a lasting positive impact on development. In this particular area, IPRs under UNCTAD should also work more in tandem with the WTO’s Trade Policy Review Mechanism.
32. IPRs may not only enhance internal coherence of investment-related rules and practices but also serve to make sure that these policies are consistent with obligations assumed by the reviewed country under bilateral or multilateral treaties.
33. Multilateral investment rules under the WTO are still fragmentary and dispersed over a number of different agreements (in particular on trade-related investment measures (TRIMs) and on services under the General Agreement on Trade in Services (GATS) and related sectoral arrangements in areas like finance and telecommunications). A unified set of such rules, in the framework of a multilateral agreement on investment (MAI) or the like, is unlikely to be established in the foreseeable future. The potential for conflict, and need for adjustment, at this level is nevertheless considerable, as a number of disputes on trade-related performance requirements clearly show.
34. In practice, however, bilateral investment treaties (BITs) are more relevant. The number of BITs has greatly increased in recent years. As a result, national regulations on investment and BIT stipulations often overlap to a high degree. Recurrent provisions in BITs include obligations to “publish promptly” relevant measures, to “notify” non-conforming measures, to respond swiftly to “requests” for information by contracting parties, or to establish “enquiry points” (OECD 2003, 10). A “new generation” of BITs is also emerging in which key concepts like “fair and equitable treatment,” “expropriation,” and “dispute

settlement” are clarified. During our conversations in Geneva, though, the impression was conveyed that in many cases neither domestic investment legislation nor BITs yet live up to modern, state-of-the-art standards of investment regulations as referenced, for instance, at UNCTAD. Moreover, as they exist, national rules and BIT provisions appear not always to be congruent, or indeed may even be openly contradictory one another, such as in the field of dispute settlement.

35. In their section dealing with the regulatory framework for investment, IPR reports typically also discuss issues relating to international investment agreements (IIAs) and especially BITs. This analysis could be enhanced by making more transparent existing inconsistencies between relevant rules and practices at the national and international/bilateral level and proposing reasonable adjustments. UNCTAD could also assist countries in the negotiation of BITs.

#### *Regional IPRs?*

36. Whereas investment issues or policy linkages between investment and trade have for the time being effectively been removed from the multilateral trade agenda, ongoing deliberations in the WTO Working Group on Trade and Investment notwithstanding, they loom larger in regional and bilateral trade agreements. Investment regimes are a common feature of “modern” integration schemes (“deep integration”) in the context of the “new regionalism.” To what extent investment-related policies should be reconciled or harmonized among host countries in a regional or bilateral context, is a question that would seem worth considering in IPR reports for individual countries. There might also be a rationale for “bundling” IPRs for neighboring countries or regional partners. With Trade Policy Reviews in the WTO, this has already occurred (witness the WTO Secretariat’s TPR report on SACU, the Southern African Customs Union, in 2003). In our interviews at UNCTAD we were told that a regionally based IPR approach (“basket cases”) was uncharted territory that might confuse clients and grow into an oversized and protracted exercise, although it might nonetheless be envisaged as an experiment, since as FDI policy was “not (meant) to beggar but to prosper thy neighbor”.
37. Policy areas in need of international coordination include the removal of restrictions against FDI (“negative” approach) and, even more importantly, “pro-active” measures to attract foreign capital (“positive” approach). An issue of considerable controversy in this context concerns the granting of subsidies or use of investment incentives. Avoiding any waste of resources and preventing competitive distortions caused by incentive escalation is a major economic argument in favor of common investment rules.<sup>6</sup> In essence, this also holds for investment promotion strategies more generally. Against this background, technical assistance projects like the development of a regional investment promotion strategy for the Andean region (launched via the “Quick Response Window” (QRW) facility within UNCTAD’s ASIT (Advisory Services on Investment and Training) program) appear to lead in the right direction. As regards individual country cases, IPRs occasionally criticize incentive policies, as practiced e.g. in Mauritius, for their “expensive piece-meal tax give-aways, which have poor strategic rationale,” and recommend “replacing them with a more coherent, attractive regime based on strategic goals.” This may help to devise more rational investment promotion schemes.

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6 On balance, theory and empirical evidence largely favor the elimination of investment incentives (and performance requirements), from both the global and the national perspective (Young / Tavares 2004).

*Quick Response Window as an “IPR light”!*

38. As mentioned above, the original concept of IPR seemed to follow the slogan “one size fits all.” This concept runs the risk of inefficiency when the “amount” of development- and FDI-related issues to be solved by external advice differs from country to country. Country-specific particularities can exist only when specific questions arise in the context of FDI, for example when adjustment to a more open trade policy is pending, when the institutional set-up of FDI promotion is to be changed, or when FDI and development policy have to be re-designed or even start from ‘ground zero’ after political, economic, or military crises. Countries also differ in terms of their endowments with organizational or financial resources. With the introduction of a “Quick Response Window” (QRW) important progress was made in “customizing” IPRs to the real needs of the applicant countries. The possibilities opened by QRW should be developed further.
39. The QRW option was introduced in order to assist countries with swift suggestions on solving specific problems. In view of its limited scope but close relation to IPRs, we have labeled the QRW option as well as everything between QRW and the full IPR program as “IPR light.” This option should be used as a means of achieving more flexibility in the coverage of advice in general.
40. In using this instrument, UNCTAD could learn from (and exchange experience with) the WTO’s “Trade Policy Clinic.” This program is designed to help respond quickly and flexibly to trade-policy issues/crises or urgent technical assistance needs identified by WTO members (i.e. TPC is demand-driven). It provides diagnoses and practical recommendations on how such needs might best be addressed. In this way, TPC makes it possible to identify gaps in planned technical assistance and answer the type of questions that are not covered by WTO’s present activities.
41. IPR light should not only be an option when countries ask for solutions to specific questions. Rather, UNCTAD should be given, and take, the right of initiative to suggest an IPR light instead of the full program. It could cover, for example, one of the following topics:
- How to reorganize FDI promotion agencies
  - How to avoid adverse distribution effects of FDI
  - How to optimize the tax system in order to ensure equal treatment of domestic and international investors
  - How to adjust to the fuller opening up of an economy to foreign competition
  - How to profit from natural resource-oriented FDI

There is an obvious link to bilateral and multilateral technical assistance programs, which could arrange for specialized experts to help the country in question.

42. Another advantage of combining the QRW and the IPR concept would be more flexibility in adjusting the “level” of assistance to the financial and human resources available in an applicant country. For example, in our view a country like Brazil does not really need to be assisted through a fully-fledged IPR. A focus on the most pressing issues where domestic capacity is lacking would be more efficient in terms of both time needed and donor country/UNCTAD resources spent.

## 2.2 Process-related issues

### *Involving stakeholders*

43. The basic aim of IPRs is "...to help countries improve their investment policies...". To this end co-operation with and commitment of top-level government officials is considered to be of overriding importance for the success of an IPR since they are the ones who will ultimately implement the IPR policy recommendations. Backing by highest government officials is indispensable for developing a coherent FDI policy at all levels of government and administration. However, it is explicit UNCTAD policy not only to cooperate with the government but to involve, as far as possible, all parties that could be affected by FDI and FDI-related policy. Besides government and parliament, such "stakeholders" include above all both local and international businesses and their associations and non-governmental organizations.
44. This policy is based on the assumption that broad agreement can be achieved, i.e. that diverging interests and policy concepts can be reconciled. In principle, this is a convincing concept that has several advantages: First, it is intended to result in a sort of "national ownership" of the final IPR outcome. Recommendations assumed in consensus will, it is assumed, be better anchored in the host country society. They will thus be more broadly accepted and easier to implement. Second, broad ownership of an IPR also increases the chances of a coherent and appropriate policy over time, even in case of changes in government policy. Third, involvement of local business should ensure that competition is not distorted by privileges for foreign-owned firms over national ones ("reverse" national treatment). At the very least, there will be better transparency as regards the treatment accorded to foreign investors.
45. However, the extensive involvement of national stakeholders may entail costs. It is obvious that finding a common denominator can result in either meaningless propositions or in policy recommendations that will not be successful in attracting FDI. The IPRs available so far seem to have solved this trade-off between the need to find consensus and to come up with quality recommendations in a way which has not substantially impaired policy recommendations.
46. In total, we therefore consider the involvement of many stakeholders as a positive factor in the IPR process. However, it seems to us that further improvements in the formulation of recommendations could be achieved by taking into consideration the views and concerns of investors who have left the country and investors who have not yet invested but could given the opportunity to do so. Gathering information from such investors may prove to be expensive and even difficult, but if achieved, it would provide the host government with clues as to where reforms could be introduced in order to attract new overseas investors.

### *Internal coordination at UNCTAD*

47. The wealth of data and other information gathered in IPRs for individual countries could to some extent be made available in standardized form and thus be used to build databases, or be fed into existing ones, which would permit comparisons among countries.
48. Benchmarking the country under review with regard to other countries or locations competing for FDI, especially in a regional integration context, is a major building block of IPRs and an element that should be reinforced. To this purpose, a complementary instrument particularly useful for IPRs is the Investment Compass (IC), an Internet-based inter-

active tool developed by UNCTAD's IPR section proper. It aims to analyze the main economic and policy determinants that affect the investment environment. IPR reports can both draw on and elaborate ICs in dealing, for instance, with the investment framework. IC, again, is comparable to the World Bank's Doing-business database, which focuses on the scope and manner of regulations that enhance business activity and/or constrain it.

### *External Coordination*

49. As far as the relationship of IPRs to projects or initiatives by other international organizations is concerned, a certain measure of competition among different reporting systems could in principle help to enhance the quality of their results. This might, for instance, apply to IPRs and FIAS, the Foreign Investment Advisory Service of the World Bank Group, which has a similar mandate, namely to help client countries reach their potential for attracting FDI. However, exercises like IPRs, FIAS, and others are essentially about creating public goods. This limits the scope for rivalry, while it opens ample space for coordination, cooperation, division of labor, and networking with a view to the various review products. Combining the activities of various institutions in the field of investment-related policies would indeed be sensible and could be especially meaningful when the programs are conducted in tandem. Combinations could come about, as was suggested in our talks in Geneva, for instance by means of cross-referencing, in summary form, in the respective reports. Evidence of inter-agency cooperation in this area includes the OECD's participation in transition-country surveys such as the IPR on Uzbekistan as well as repeated exchange of information on UNCTAD's Investment Policy Reviews and the WTO's Trade Policy Reviews. In the case of Egypt, for instance, the final IPR report, as presented at two workshops (in Cairo and Alexandria in early 1999), was available for, and cited in, the WTO TPR on Egypt (held in Geneva in June 1999).<sup>7</sup> In a similar way, the IPR report on Lesotho (published in January 2004) provided inputs to the parallel WTO examination of Lesotho's trade in the context of the Trade Policy Review for SACU, the Southern African Customs Union.
50. From a development perspective, efforts to link up IPRs with the PRSPs (Poverty Reduction Strategy Papers) process and the Integrated Framework (IF) for Least-Developed Countries (LDCs) appear to be particularly important. Since the overhaul of the IF in July 2001, which led to a new approach – the IF Pilot Scheme – agreed to by the six core agencies (WTO, UNCTAD, ITC (International Trade Center), UNDP (United Nations Development Program), World Bank, and IMF), the “mainstreaming” of trade into overall development and poverty reduction strategies has become its centerpiece. The analytical tool used to implement “mainstreaming” is what is known as the Diagnostic Trade Integration Studies (DTISs), which are then discussed at Trade Integration Strategy Workshops with the aim of mobilizing Trade-Related Technical Assistance (TRTA) for Trade-Related Capacity-Building (TRCB). It would be worth considering the possibility of transforming DTISs into DTIISs, i.e. Diagnostic Trade and **Investment** Integration Studies, and of complementing TRTA/TRCB with **Investment-Related** Technical Assistance for **Investment-Related** Capacity-Building (IRTA/IRCB). IRTA/IRCB would focus on assisting developing countries to develop stronger competences to overcome supply-side constraints; to formulate and implement broad-based policies on FDI; and to negotiate and implement international treaties and agreements related to foreign investment (OECD 2002, 32). This is of course the principal mandate of IPRs. It could usefully feed into the IF, making it a more comprehensive mechanism for promoting sustainable development.

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<sup>7</sup> See: IPR Evaluation Report 1999, 4.

*Discussion and communication of the final report*

51. Discussion and communication of the final IPR report is a crucial action that has its influence on the implementation process. In this respect, the most important aspect seems to be the national level: UNCTAD's policy of holding meetings and seminars with as many stakeholders as possible deserves full support.

At the international level, the Geneva meeting of the Investment Commission serves several functions to which we attribute different levels of importance:

- Transparency for donor countries, which can be an important element in learning from former IPRs.
- Transparency for businesses representing (potential) investors
- Forum for inter-governmental discussion with countries that could represent competing locations.

52. The last-mentioned of these discussions should be confined to less time in order to cut back on meaningless political declarations. Instead, it seems to us worthwhile to think about participation of a representative from the scientific community who could try to provide a "neutral" assessment of the efficiency of the recommendations.

*More concrete recommendations!*

53. The task of deriving persuasive and realizable recommendations is the core of the IPR exercise. Often, this is done in a very convincing way when constructive advice is given. This holds, for example, for the institutional recommendations for reorganizing investment promotion in Sri Lanka.

54. However, there are numerous examples of recommendations framed in rather vague and redundant terms (such as "pro-active investment policies") and often referring to non-specified "best practices", "transparency", "good governance", "core competencies". Also, vague wording like "consolidating and extending the role of the new Board of Investment" (as in the case of Mauritius) or "elaborate proactive strategies of investment promotion at national and sectoral level" (as in the case of Benin), "modernizing the regulatory and institutional framework for investment and guaranteeing the correct application of existing rules" (as in the case of Algeria) leave much space for interpretation. In the same vein, the investment strategy recommended to Lesotho is "to retain existing investors and diversify investment", which is self-evident.

55. Such formulations should not be avoided in principle. They can be provided in order to leave room for the development of appropriate decisions and to underscore that national policy has retained its autonomy. However, in most cases it seems that vague formulations are chosen with no concrete solution in mind. That cannot be much help for the government addressed.

## 2.3 Implementation-related issues

56. Implementation of recommendations is of course what the IPR is about. UNCTAD is placing increasing weight on it, mostly by holding follow-up meetings with the respective governments and offering assistance when needed. This action should be reinforced, using "sticks and carrots", with a focus on the carrots.



*Mandatory follow-up meetings*

57. The mildest way to nudge governments toward cooperation in the implementation of the recommendations would be to agree upon follow-up meetings already at the start as part of the entire IPR action. At these meetings, the government would be committed to giving account of what has been realized and providing reasons for non-action. The “stick” to this end could be to make support by UNCTAD or the donor country dependent on such statements of account. The “carrot” could be the amount of assistance granted. This leads to an implementation-related issue which, in our view, was given too little weight in previous IPRs: integration of the IPR program into bilateral and multilateral development assistance.

*Integration with bilateral and multilateral assistance*

58. There seems to be broad scope for integration of IPRs into development assistance. Capacity-building can be promoted by sending specialists from donor countries to governments and administrative institutions where particularly debilitating bottlenecks exist. Likewise, real investments in infrastructure could be financed in order to increase a country’s attractiveness for foreign investors. Generally, adjusting development aid to the needs identified in IPRs (infrastructure, institution-building, qualification of public officials and private-sector employees) would not only be helpful for foreign investors, it would at the same time improve investment conditions for domestic firms. Integrating IPR and development aid would not exclusively mean promotion of and special benefits for FDI. It would also include assistance in designing policy measures, such as a competition policy that aims at protecting domestic firms and consumers against the superior market power of multinationals.

59. Most of the development assistance elements adjusted to the needs identified by IPR will involve costs for development of domestic human resources and some investment for institution-building and consultants. Therefore, it seems reasonable to allocate a certain percentage of the entire IPR budget to implementation measures and to communicate this to the country in question. This would give a signal to the recipient country that financial means are available for action that has been identified in the IPR or the need for which becomes apparent in the course of implementation. 30 % of the budget would seem to be a reasonable share.

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