Deutsches Institut für Entwicklungspolitik

German Development Institute

d·i·e

Challenges of negotiating and implementing an international investment facilitation framework

DRAFT: 6.12.2019

Discussion note prepared for the expert workshop "Opportunities and challenges of establishing an international framework on investment facilitation for development in the WTO", 11 December 2019, Geneva.

Axel Berger, German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE)

Ali Dadkhah, Dadkhah Consulting

Introduction

Beyond economic fundamentals like market size, infrastructure and labour, the impediments to Foreign Direct Investment (FDI) in developing countries often relate to the predictability, transparency and ease of regulatory environments. This statement is substantiated by recent survey evidence. A survey by the World Bank of executives of companies with affiliates in developing countries underline that foreign investors value transparent and predictable domestic frameworks as well as the ease of business conduct (Kusek & Silva, 2018). Governance and regulatory factors rank also high in the A.T. Kearney Foreign Direct Investment Confidence Index that is based on annual survey of business executives (Laudicina, Peterson, & McCaffrey, 2019).

Discussions on investment facilitation for development driven by a number of low and middle-income countries in the World Trade Organization (WTO) have the potential to improve the transparency, predictability and efficiency of domestic investor-related systems enabling further attraction of FDI (as well as facilitating domestic investments). During the 11th Ministerial Conference in Buenos Aires in December 2017 a Joint Ministerial Statement on Investment Facilitation for Development was signed by 70 WTO members launching Structured Discussions on Investment Facilitation for Development that have unfolded since.[1] An updated Joint Ministerial Statement was adopted on 5 November 2019 during a trade ministers' conference in Shanghai and 29 additional countries,[2] most of which are developing and least-developed countries, have signed the statement. According to this statement, facilitating greater developing and least-developed Members' participation in global investment flows should constitute a core objective of the framework.

Several investment facilitation measures have been proposed by WTO members during the various work meetings of the Structured Discussions. The implementation of these measures is expected to improve the investment climate in several key policy areas, which will complement and strengthen existing FDI determining factors. However, the impact of an international investment facilitation framework (IFF) depend not only on its scope in terms of covered investment facilitation provisions but also their nature. Recent text proposals for an IFF indicate that several provisions are drafted as "best endeavours" and not as binding commitments, so the effectiveness of an international agreement will depend on the level of ambition and resources countries choose to devote to implementation. At the same time, it is important to acknowledge during the implementation that unfettered facilitation may not always be desirable and that some policy space may be required. Requirements that seem unduly burdensome in some respects, could be crucial for ensuring that projects are developed with input from interested and affected stakeholders and have the potential to contribute to sustainable development. Because of these implementation challenges, there are a number relevant areas in which international collaboration and assistance on the negotiation and

[1] WTO: WT/MIN(17)/59
[2] WTO: WT/L/1072

implementation of investment facilitation measures that should support sustainable development is clearly needed.

This paper analyses the level of implementation of investment facilitation measures and shows that the negotiation and subsequent implementation of investment facilitation measures is a bigger challenge for low and lower-middle income countries than it is for upper middle and high income countries. The introduction of an IFF, in some cases, would bring significant changes to member states' regulatory processes (with the potential to facilitate foreign and domestic investments). If an IFF is accepted as a multilateral agreement, this would imply the establishment of rules and institutions that reduce the administrative burden for foreign investors 'behind the borders', supporting the harmonization of procedures for the adoption and application of domestic regulations in all member states. Similar to the Trade Facilitation Agreement (TFA), some of the reasons countries might be reluctant to negotiate such behind the borders measures include lack of knowledge about the current state of implementation, identification of negotiation preferences and analysis of potential benefits of policy reforms. Furthermore, uncertainties concerning the resources needed to implement additional investment facilitation measures may also play a role, in particular for developing countries. These issues will be addressed in the remainder of this paper.

Challenges in Negotiating of Investment Facilitation Agreement

Some of the biggest challenges in negotiating an IFF, in particular for developing countries, are to gather information on the current state of implementation, identify their interests with regard to the design of an IFF and focus on measures where there is most convergence among countries. Therefore, against the background of the challenging nature of negotiating international disciplines on investment facilitation it is necessary to map which measures countries have already in place. In order to map out the current level of commitments and regulation on investment facilitation, the German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE) with collaboration with Dadkhah Consulting has developed the Investment Facilitation Index (IFI) that shows the current state of countries' investment facilitation regimes, identifies areas for action and enables the potential impact of reforms to be assessed and to quantify the changes as a results of the proposed IFF (Box 1).

The IFI covers 9 low income, 19 lower-middle income, 18 upper-middle income and 41 high income countries. The IFI makes clear that even before the discussion of an IFF, countries have been working on implementing investment facilitation measures, either unilaterally or through regional trade agreements (Polanco, 2018). The question, therefore, is how an IFF can be designed in a way to support domestic implementation efforts that often require the introduction of new regulations and the use of existing or establishment of new institutions supporting investment facilitation.

The current level of practice, state of implementation and the progress made by countries of different income groups can be assessed with the help of the IFI. The IFI makes clear that current

Box 1: Introducing the DIE Investment Facilitation Index (IFI)

The IFIs is composed of a set of variables measuring the actual extent to which countries have introduced and implemented investment facilitation measures in absolute terms, but also their performance relative to others. The indicators of the IFI are tools, not rules: they are not designed to assess country compliance with specific IFF provisions, but rather to help policy makers in developed and developing countries alike to assess the state of their investment facilitation efforts, pinpoint challenges, and identify opportunities for progress. The IFI covers 87 countries, most of which are signatories of the Joint Ministerial Statement on Investment Facilitation for Development. The current IFI is still a draft version (Beta Version II II, December 2019) and government representatives or experts are invited to verify the mapping of their country's investment facilitation regulations. After the initial test phase, the IFI data will be made publicly available.

The IFI is composed of 117 specific, precise and fact-based variables related to existing investment facilitation policies and regulations and their implementation in practice. These variables are organized under 6 policy areas:

1. Cooperation
2. Electronic Governance
3. Application Process
4. Focal Point and Review
5. Outward Investment
6. Regulatory Transparency and Predictability

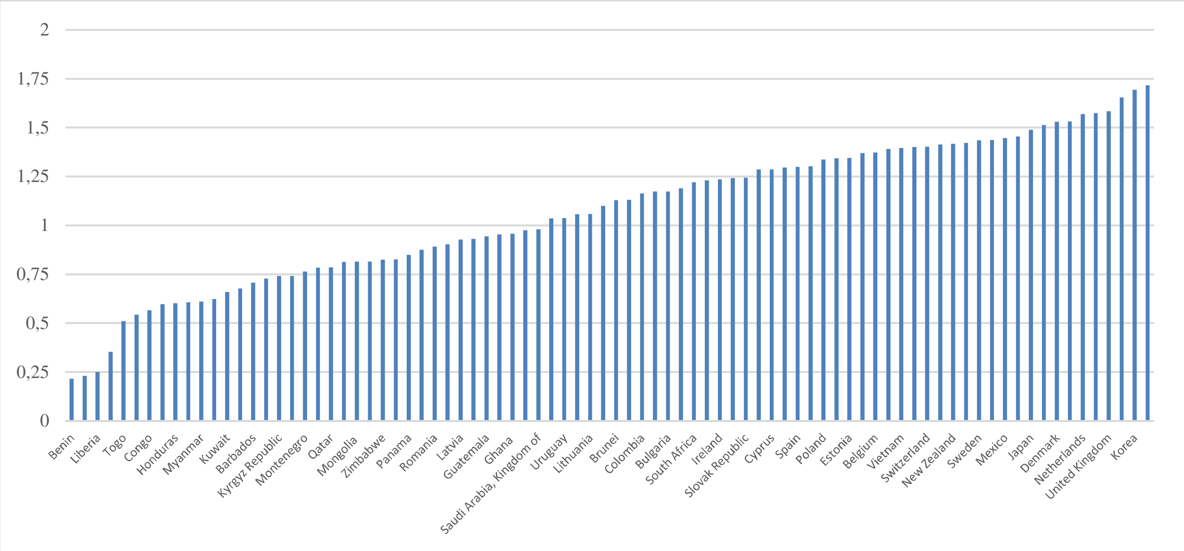
Given the degree of importance of the various measures for FDI attraction, different weight has been assigned to each indicator. A group of experts have been asked to allocate 100 points among the six indicators. These are translated into weights by assigning the points experts allocated to the indicator to each measure that falls under it and correct for differences in the number of measures under the indicator. Such differences are not arbitrary but reflect the relative importance of the indicator. To this day, over 125 experts have participated in the survey prepared by DIE.[1]

implementation levels differ widely with indices ranging between 0.215 and 1.716 with an average of 1.129. (Figure 1). An important observation is that the combined level of implementation of the 117 measures included in the IFI for all income groups of countries is 56%, however, with a wide variation. Based on this, high income countries implemented 65% of the measures included in the IFI while low income countries implemented 34% (Figure 2). Implementation therefore is highly correlated to a country's stage of economic development. Furthermore, these numbers indicate that there is substantial room even in the case of high income countries to improve their investment facilitation frameworks.

This high variation in terms of current investment facilitation frameworks is one of the key reasons to justify multilateral negotiations on a common set of investment facilitation commitments. At the same time this high variation implies challenges for the negotiation of an IFF (Berger & Gsell, 2019).

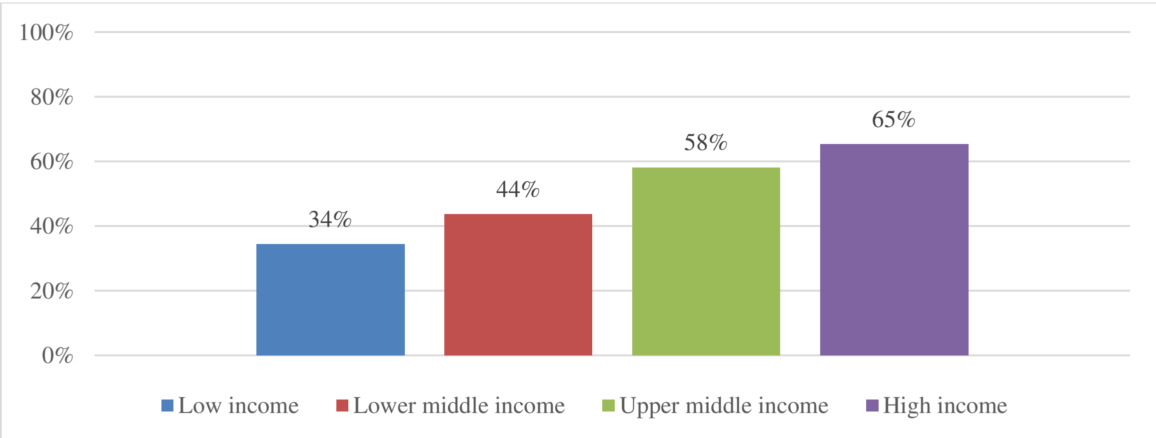
High income and upper-middle income countries already implement a large number of the potential provisions of an IFF. This implies on the one hand that they do face less pressure to reform their investment facilitation frameworks as a result of an IFF and on the other hand that the marginal effect of an IFF on the attraction of additional inward FDI could be small. High income and upper-middle income countries thus benefit mainly from the policy reforms undertaken in low income and lower-middle income countries which would potentially help to facilitate high income and upper-middle income countries outward FDI.

Figure 1: IFI total score per country, 2019



Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

Figure 2: Investment facilitation measures implemented as percentage of all measures included in the IFI, per country group.

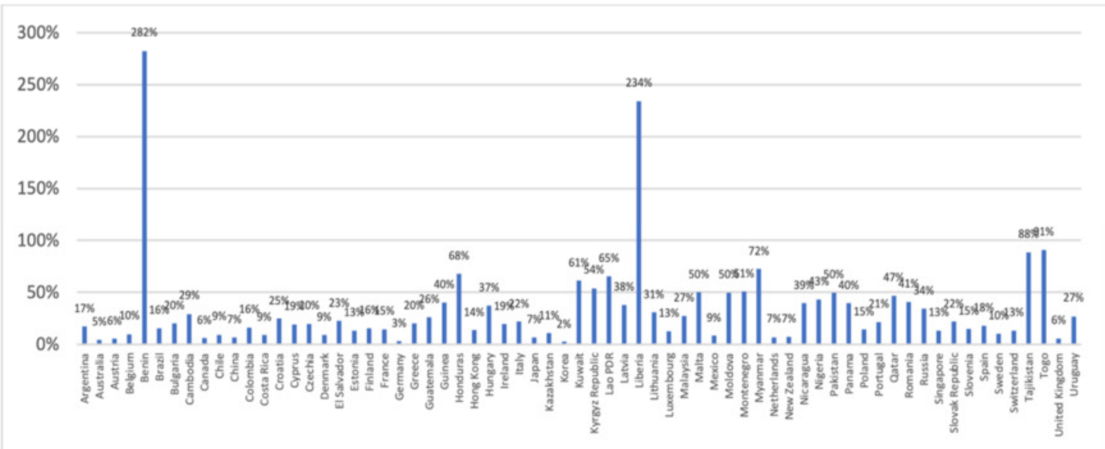


Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

In contrast, in light of low levels of implementation low income and lower-middle income countries face higher reform pressures as a result of a potential IFF. This may result in challenges to implement binding commitments on investment facilitation. At the same time, these policy reforms induced by an IFF could help to attract more inward FDI. To successfully implement the (binding) provisions of an IFF low income and lower-middle income countries thus need additional technical and financial assistance from upper-middle and high income countries. Such a technical and financial assistance framework can be modelled on the TFA that makes the implementation of certain trade facilitation measures by developing countries conditional on external support.

What are the potential benefits of a IFF for the different country groups? While impact assessments of the economic benefits and costs are note available yet, the implied reduction of investment barriers as a result of an IFF may serve as a first indication (assuming that investment facilitation measures help to attract FDI). Full implementation of a potential middle-range scenario IFF[3] can reduce the barriers relating to the investment facilitation measures from the IFI by an average of 33% for all country included in the IFI. However, the gap between the current level of implementation and the commitments included in a potential IFF vary significantly (Figure 3). The lowest percentage change is Korea with a 2.5% reduction and the highest is Benin with 282.5% reduction. While countries with a lower score change have already implementing most of the commitments of an IFF the countries with a higher score change face a high burden to implement additional measures.

Figure 3: Gap between the current level of implementation and the commitments of a middle-range scenario IFF.



Source: Authors, based on Investment Facilitation Index (Beta Version, December 2019).

Challenges in the Implementation of Investment Facilitation Measures

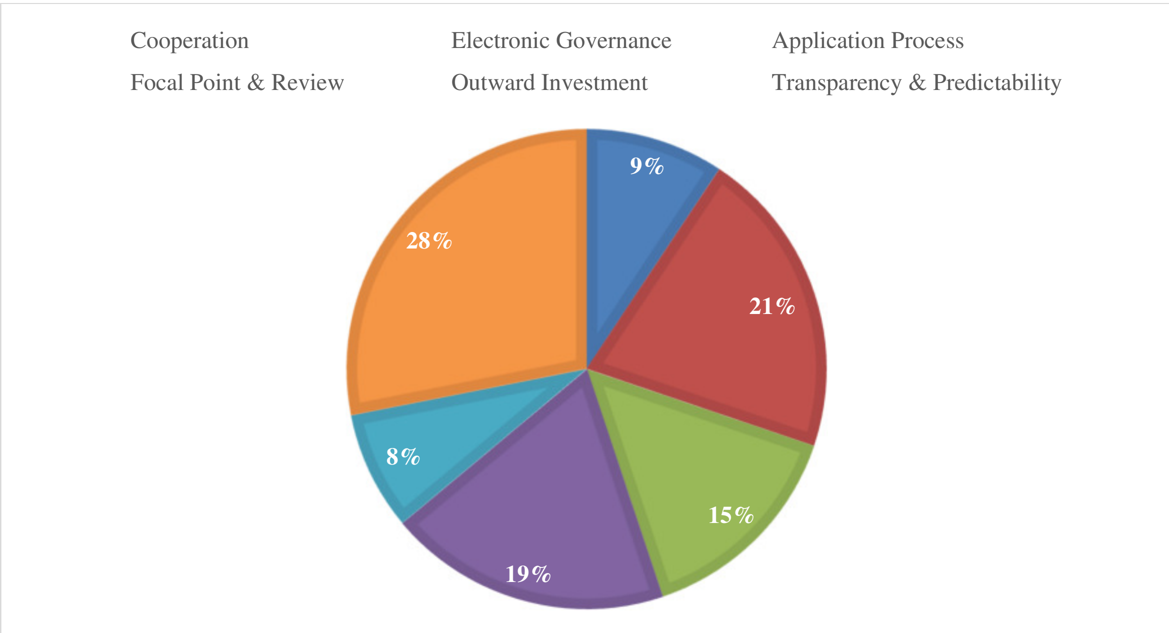
In the previous section we have shown that different countries have achieved varying levels of implementation of investment facilitation measures, and as such they have different motives for

[3] In this middle-range scenario, we will assume that the implemented IFF is similar to the text proposal submitted by Brazil dated February 1, 2018. See (Berger, Dadkhah, & Olekseyuk, 2019).

negotiating and designing an IFF. However, during the structured discussions some issues have been designated as top priorities such as transparency and predictability as well as the use of ICT. Incidentally, these are among the policy areas with the highest gap in implementing investment facilitation commitments. Respectively only 45% and 47% of the measures concerning Transparency and predictability and ICT are being implemented. This suggests countries are looking to apply provisions that promise the biggest improvements in investment costs and benefits, regardless of implementation complexity.

This finding is in line with the results of the survey that DIE conducted in October 2018 asking representatives from the private sector, international organizations, academia and government to allocate a total of 100 points across the six policy areas of the IFIs in a manner that reflects each area's relative importance in investment facilitation, in particular with regard to the attraction of FDI flows (Figure 4). According to this survey, measures related to transparency and predictability and electronic governance contribute to almost half of the weight of the IFI measures (49%) which reflects the fundamental role of these two policy areas in investment facilitation. This suggests that the structured discussions already focus on the issues that are valued the most by stakeholders as important mechanisms to facilitate investment.

Figure 4: Expert survey on the importance of investment facilitation areas for FDI attraction.



Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

In the following we will compare the level of implementation of investment facilitation measures between different country groups for the six policy areas included in the IFI: regulatory transparency and predictability, cooperation, focal point and review, outward investment, application process and electronic governance. Table 1 shows the spread and average score of each of these policy areas. What becomes clear is that the policy areas transparency and predictability as well as electronic governance achieve the highest overall average score in the IFI meaning that countries already implement many of the measures included in these policy areas. At the same time, the spread between the highest and lowest score are particularly high for those two policy areas. While the policy area cooperation has the second-lowest average score the spread between the lowest and highest score is the largest which indicates that negotiating parties need to invest a lot of energy to reach compromise on binding commitments in this area.

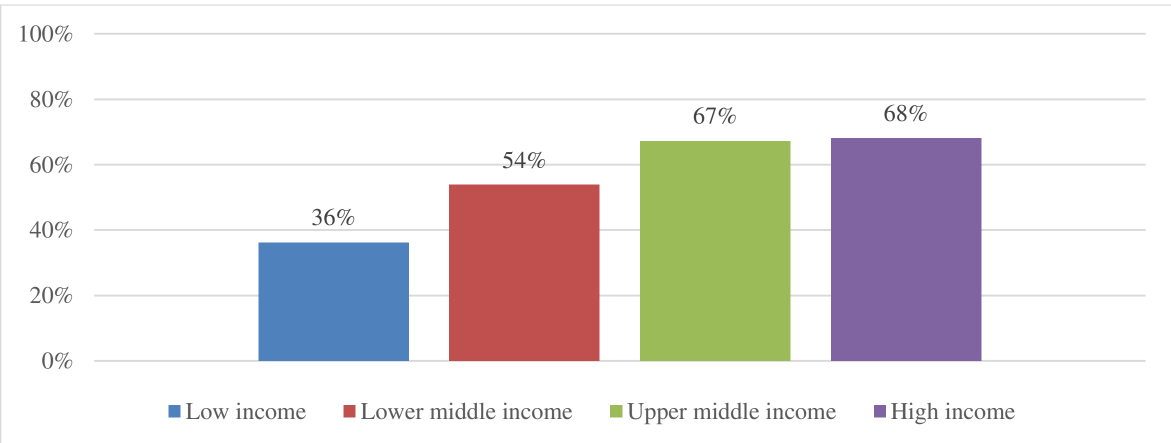
Table 1: IFI scores and spreads per policy area.

	Cooperation	Electronic Gov.	Application Process	Focal Point	Outward Investment	Transparency Predictability
Min value	0,000	0,038	0,051	0,008	0,020	0,010
25th percentile	0,062	0,199	0,121	0,084	0,040	0,270
50th percentile	0,109	0,275	0,159	0,130	0,040	0,333
75th percentile	0,155	0,332	0,198	0,221	0,100	0,395
Max value	0,179	0,398	0,249	0,358	0,160	0,697
Average	0,105	0,262	0,157	0,152	0,064	0,334

Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

Under the policy area **transparency and predictability**, only 36% of low income and 54% of lower-middle income countries have implemented such measures, according to IFIs data (Figure 5). The level of implementation of investment facilitation measures relating to regulatory transparency and predictability is 67% and 68% respectively for upper-middle and high income countries.

Figure 5: Level of implementation of regulatory transparency and predictability measures as percentage of all measures included in the IFI, per country group.

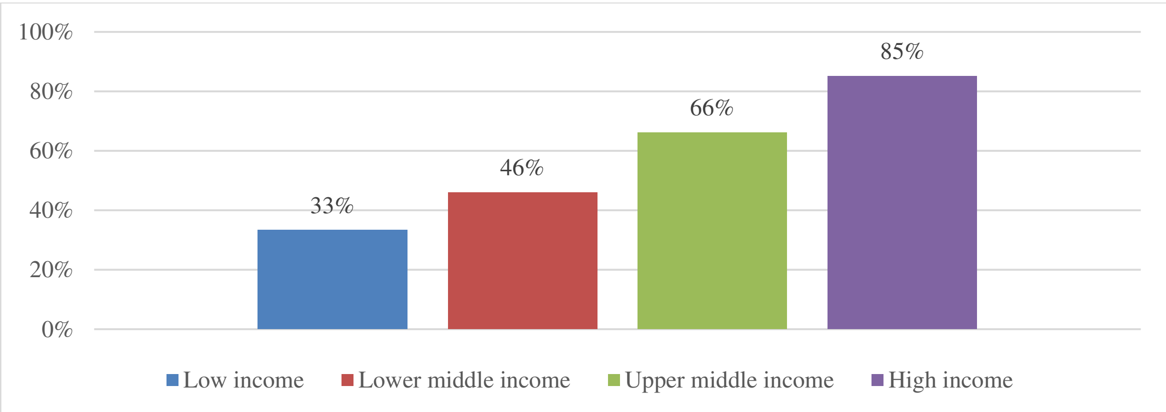


Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

Measures that involve making the investment process for a foreign investor more transparent and predictable depend heavily on systems for information and analysis. Processing significant levels of information may require adaptations by regulatory agencies. Given the advanced electronic capabilities required, high income countries are farther along in the process than lower income countries; their rate of implementation is 68%, compared with 36% for low income countries. Within this policy area, countries have made the most progress in the requirement to publish information on investment regulations and the least in publication of judicial decision on investment matters.

In terms of **cooperation**, which includes both cooperation among different stakeholders within a country and cooperation between different countries, there is a big gap in the current level of implementation between country groups. As Figure 6 shows, the low income countries have implemented 33% of the measures compared to 85% in high income countries. In this policy area, sharing of best practice and information on the facilitation of FDIs is the least and public consultation between investors and other interested parties is the most implemented measures among the countries in the IFI.

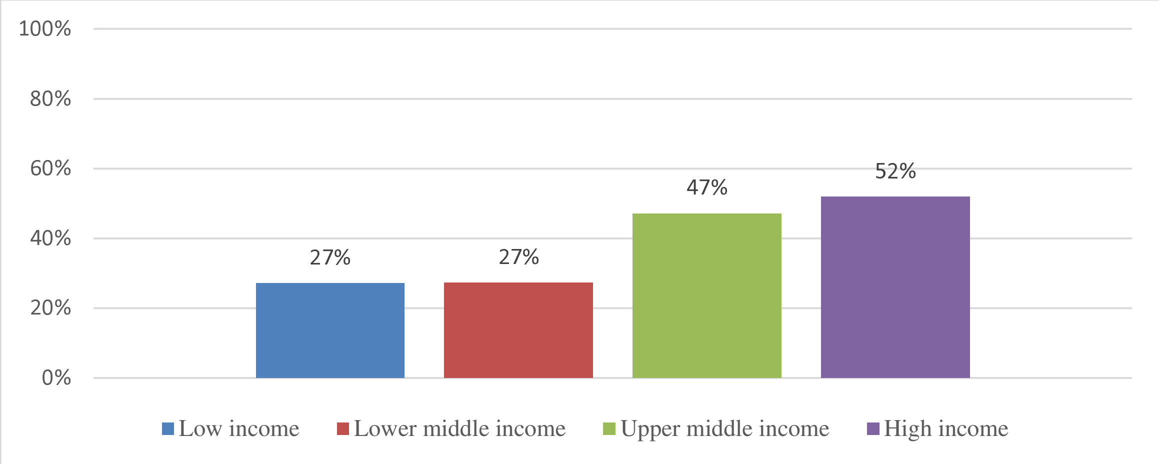
Figure 6: Level of implementation of investment cooperation measures as percentage of all measures included in the IFI, per country group.



Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

In the **focal point and review** policy area, there is a lesser gap and more commonality between the country groups compared to the other policy areas (Figure 7). Low income and lower-middle income countries have each implemented 27% of the measures compared to 47% in upper-middle income countries and 52% in high income countries. At the same time this comparatively low level of implementation across country groups implies challenges to comprehensively include including such measures in an IFF.

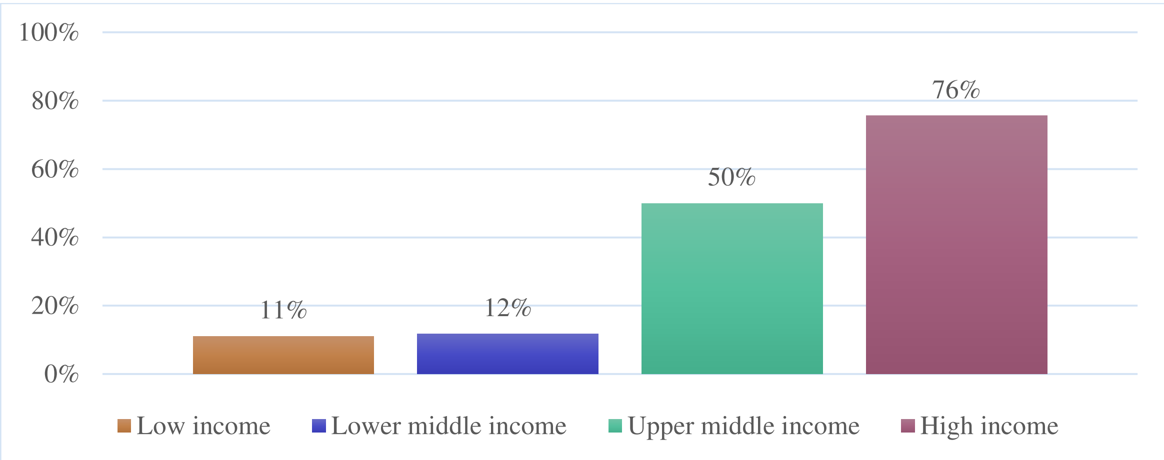
Figure 7: Level of implementation of focal point and review measures as percentage of all measures included in the IFI, per country group.



Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

Within the policy area of focal point and review, the establishment of a mechanism for coordination and handling of foreign investment complaints (e.g. Ombudsperson) is one of the key measures currently under negotiation. Figure 8 shows the big divergence in different country groups in their level of implementation.

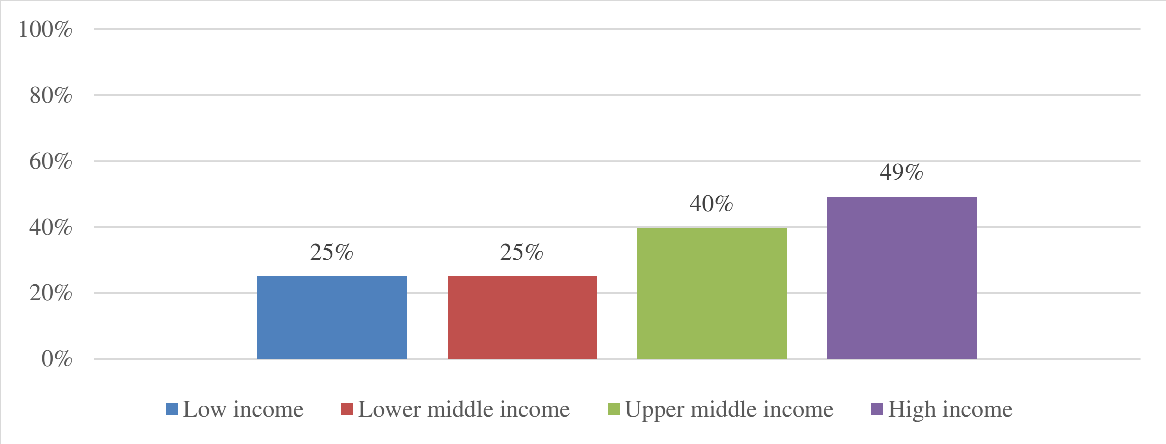
Figure 8: Level of implementation of ombudsperson mechanisms as percentage of all measures included in the IFI, per country group.



Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

The measures related to **outward investment** have been implemented the least among the countries included in the IFI (Figure 9). Even high income countries have only implemented 49% of the measures of this policy area and upper-middle income countries 40%. Given the importance of high income and upper-middle income countries as home countries for foreign investors, a stronger emphasis on these measures in an IFF could help to facilitate FDI not the least in low income and lower-middle income countries.

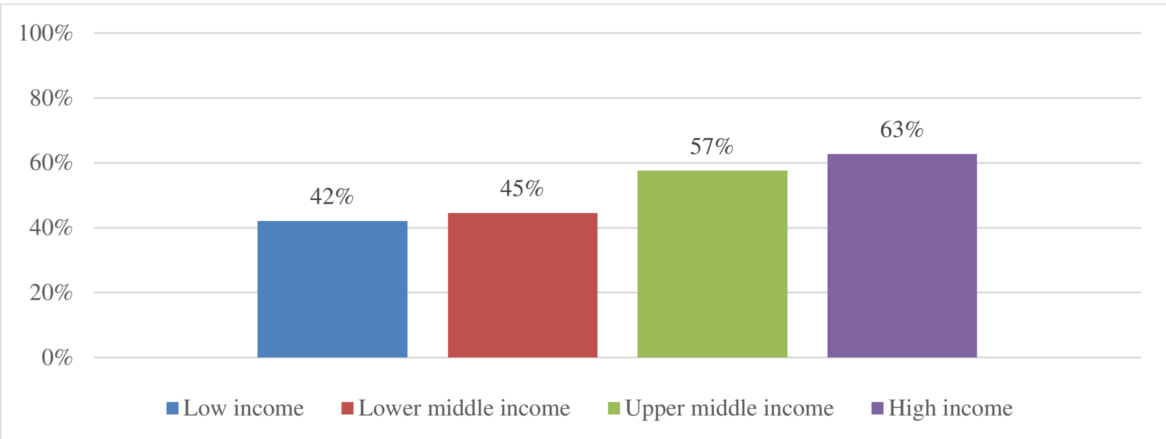
Figure 9: Level of implementation of outward investment mechanisms as percentage of all measures included in the IFI, per country group.



Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

As Figure 10 shows, the gap in implementation in the policy area **application process**, between the low income and high income countries is the lowest indicating that consensus among countries to include such measures in an IFF is high. However, given the low level of implementation, even in upper-middle and high income countries, negotiating countries may need to be more ambitious in terms of an IFF.

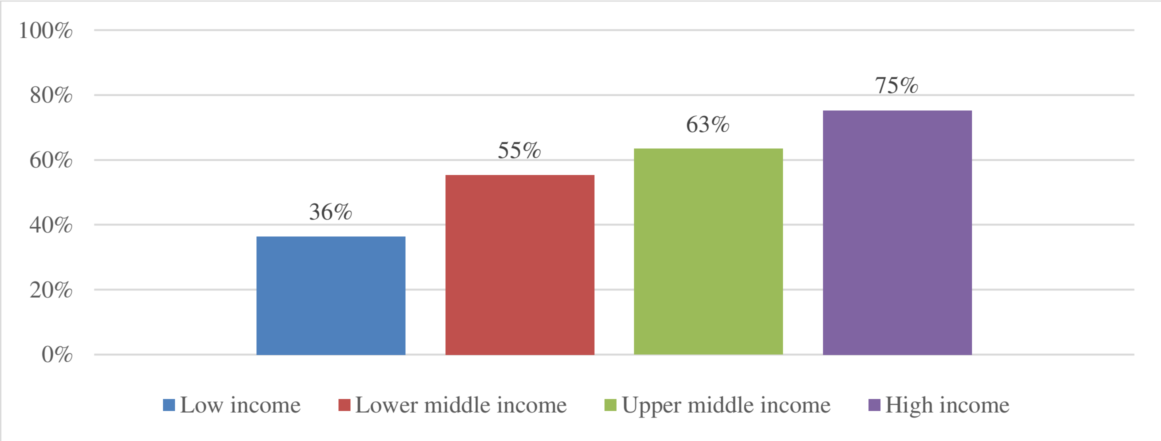
Figure 10: Level of implementation of application process mechanisms as percentage of all measures included in the IFI, per country group.



Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

Electronic governance policy area in the IFI deals with IT related measures. To illustrate this, the IFI shows that only 36% of low income countries have implemented the electronic governance measures in contrast to 75% of the high income countries (Figure 11).

Figure 11: Level of implementation of electronic governance mechanisms as percentage of all measures included in the IFI, per country group.



Source: Authors, based on Investment Facilitation Index (Beta Version II, December 2019).

Measures on ICT have a low rate of execution, for example, single windows have been set up in 80% of upper-middle and high income countries and only 54% of low and lower-middle income countries. The significant difference in those percentages reflects the ability to address complexity, time commitment, technology requirements and cost associated with implementation.

References

Berger, A., Dadkhah, A., & Olekseyuk, Z. (2019). *Potential Investment Facilitation Agreement: Possible Scenarios and Their Impact on Countries' Regulations*. Paper presented at the 22nd Annual Conference on Global Economic Analysis "Challenges to Global, Social, and Economic Growth" Warsaw.

Berger, A., & Gsell, S. (2019). *How Can an International Framework for Investment Facilitation Contribute to Sustainable Development? (Briefing Paper 15/2019)*. Bonn: German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE).

Kusek, P., & Silva, A. (2018). *What Investors Want. Perceptions and Experiences of Multinational Corporations in Developing countries (Policy Research Working Paper 8386)*. Washington: World Bank.

Laudicina, P. A., Peterson, E., & McCaffrey, C. R. (2019). *Facing a Growing Paradox. The 2019 A.T. Kearney Foreign Direct Investment Confidence Index*: A.T.Kearney.

Polanco, R. (2018). *Facilitation 2.0: Investment and Trade in the Digital Age (RTA Exchange Think Piece, September 2018)*: International Centre for Trade and Sustainable Development (ICTSD) and Inter-American Development Bank (IDB).