

INTER-AGENCY TASK FORCE
ON FINANCING FOR DEVELOPMENT

Issue Brief Series

The Investment Climate

International Finance Corporation (World Bank Group)

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The Investment Climate International Finance Corporation (World Bank Group)

1. Introduction

Public policy is needed to create the enabling environment at all levels necessary to encourage entrepreneurship and a vibrant domestic business sector. Monterrey tasked Member States with building transparent, stable and predictable investment climates, and many countries have made great strides in this area. In the Addis Agenda, countries resolved to continue this work, while aiming for private sector investment that is inclusive and sustainable.

In particular, in the Addis Agenda, Governments commit to: *“Create transparent, stable and predictable investment climates, with proper contract enforcement and respect for property rights, embedded in sound macroeconomic policies and institutions, transparent and stable rules, and free and fair competition. (36)”*

Private sector growth is essential for developing countries to create jobs and raise incomes. The rate and nature of private sector growth in a country is affected by many factors, including macroeconomic and political stability, traditions and culture, physical infrastructure, availability of capital, and human resources. Institutional, policy, and regulatory factors also play an important role. They are often grouped together under the rubric of “investment climate”.

Various indicators measure selected aspects of the investment climate. Research suggests, broadly speaking, that the regulatory framework does matter for economic outcomes, but it is inconclusive about which regulations matter most, and how much they matter compared with other determinants. Business laws and regulations are intended to generate benefits to society at large, but they also inevitably impose costs on the individual firm. Some regulations on firms may deliver an important public good—for example, the prohibition of child labor. Others—such as requiring multiple official stamps on a document—deliver little or no public benefit. They simply provide officials with opportunities for rent-seeking. The policy maker’s challenge is to find the level of regulation where the desired level of public good—say, tax revenues or worker safety—can be obtained with the minimum loss of efficiency to affected firms. Some countries may be overregulated; others may be under-regulated. The level of regulation in any country should reflect a country’s preferred trade-off between public goods and private (firm) benefits.

Substantial research literature has established an association between the characteristics of the business regulatory environment and the performance of firms, and thence to macroeconomic outcomes. But research overall is inconclusive about the direction of causation. While it is typically hypothesized that better regulations spur better economic results, causality may also run the opposite way, insofar as citizens in more advanced economies demand more efficient regulations. There may also be unidentified causal factors. For example, if cross-country analysis finds that higher labor productivity is associated with less onerous business start-up

procedures, it may be that a third factor (such as the quality of human capital) is driving indicators for economic performance and quality of public administration in the same direction.

2. Stocktaking (progress and implementation gaps)

Many dimensions influence the quality of a country's investment climate and overall competitiveness. While the appropriate set of policies are necessarily country specific, a number of global benchmarking initiatives have been developed that can be helpful in understanding the business investment climate in countries. Most of these initiatives are organized around five themes: (i) competitiveness and the investment climate; (ii) perceived constraints by businesses; (iii) business and investment barriers; (iv) risk and policy uncertainty; and (v) cost of operations.

In the area of competitiveness and the investment climate, the World Bank Group's Enterprise Surveys present data from surveys of formal sector firms on perceived constraints by businesses. The World Bank Group's Doing Business indicators measure regulatory challenges for businesses, based on a combination of statistical data, regulatory information and business surveys. The surveys and the indicators are complementary, but have different approaches to benchmarking the quality of the business environment across countries. Whereas the Enterprise Surveys are firm-level polls of a representative sample of the private sector in an economy, Doing Business primarily surveys legal professionals to measure the regulations applying to domestic companies throughout their life cycle.

Another source of information is the World Economic Forum's "Global Competitiveness Index", which combines executive opinion survey results and quantitative data in an attempt to measure the competitiveness of an economy, based on institutions, policies and other factors as delineated in box 1. ¹ The United Nations Industrial Development Organization's (UNIDO) Competitive Industrial Performance (CIP) benchmarks more than 100 countries in terms of their industrial competitiveness, and specifically their production and export capacity. The Organization for Economic Cooperation and Development's (OECD) Policy Framework for Investment looks at a range of policy areas affecting investment. The framework has been used in 25 countries and two regional economic communities — the Southern Africa Development Community and the Association of Southeast Asian Nations — to assess their investment policies and enhance their regional investment policy frameworks. Lastly, the World Bank's Regulatory Quality Index captures perceptions of the ability of the government to formulate and implement sound policies and regulations.

With a smaller geographic coverage, the European Bank for Reconstruction and Development is implementing the Business Environment and Enterprise Performance Survey (BEEPS) in partnership with the World Bank Group. BEEPS is a firm-level survey based on face-to-face interviews with managers that examines the quality of the business environment.

Measurements of business and investment barriers focus on foreign and domestic firms' ability to enter markets, set up operations, access finance and exit business operations. Relevant

comparative indicators across countries produced by the World Bank Group include the “Cost of registering a business”, “New firm registration rate”, “Cost of registering property” and “Time to obtain a construction permit”. There are also numerous measures of investment attraction and retention produced by the World Bank (including “Investment Promotion Best Practice Indices” and “Time to start a foreign business”) as well as measures of dispute and debt resolution (including “Contract enforcement time”).

Relevant surveys to monitor risk and policy uncertainty include the World Bank Group’s World-wide Governance Indicators (which measure the perceived quality of institutions and traditions that governments use) and the Control of Corruption Index (which captures perceptions of public power being used for private gain, including capture of the state by private interests).

With regard to the cost of operations, data is collected on the cost and reliability of electricity connections, the cost of trade (quality of trade and transport-related infrastructure, border and documentary costs associated with importing and exporting goods, etc.), and the effect of tax rates and administration processes on business.

The following are some of the key global datasets from which information on the above five dimensions of the investment climate can be obtained. The data only track some elements of the investment climate, and need to be viewed within the broader country context. Furthermore, these should not be considered in isolation from other concerns and goals, such as social and environmental sustainability. In addition, there are many other regional and country-specific sources of information:

Doing Business: The Doing Business project of the World Bank uses surveys and questionnaires, primarily of legal professionals, to measure business regulations and their enforcement across 189 economies. The Doing Business topics include: starting a business; dealing with construction permits; getting electricity; registering property; getting credit; protecting minority investors; paying taxes; trading across borders; enforcing contracts; and resolving insolvency. The data generally reflect a limited geographic coverage within countries (usually the largest or several of the largest cities).

Global Competitiveness Index: This World Economic Forum dataset combines executive opinion survey results and quantitative data to compare the competitiveness of an economy. Global Competitiveness pillars are the pillars under which the components of the Global Competitive Index are grouped to assess institutions, policies and other factors, including: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication and innovation.

Enterprise Surveys: The World Bank Group’s Enterprise Surveys provide company-level data in emerging markets and developing economies, including 130,000 firms in 135 countries. For most countries, an Enterprise Survey is conducted every 3-4 years. The surveys cover a broad range of business environment topics including access to finance, tax rates, corruption, labor regulations, informal sector practices, business licensing and permits, courts, infrastructure, crime, competition and performance measures.

Worldwide Governance Indicators: The World Bank Group’s Worldwide Governance Indicators (WGI) assess 215 economies over the period 1996–2014, in six categories of governance, including: voice and accountability; political stability and absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption. These indicators are based on over 30 individual data sources produced by a variety of survey institutes, think tanks, non-governmental organizations, international organizations and private sector firms. The WGI present country rankings based largely on perceptions of governance, meaning they may not reflect real changes in governance over time.

However, as shown in Annex 1, the leading global cross-country indicators of various dimensions of investment climate are not sufficient in providing a comprehensive picture of the binding constraints and investment competitiveness challenges. Challenges include unavailable data for many countries (especially low-income and fragile), difficulty in drawing policy implications from the data, lack of dis-aggregation to a level that allows for meaning analysis, or lack of comparability across countries.

Furthermore, diagnostic scorecards that leverage cross-country indicators often leverage a variety of methodologies summarized in the box below.

Box 1: Diversity of indicator scorecard approaches

SCORECARD PARAMETERS	
Methodology: A scorecard can be based on diagnostic assessments through legal/economic analyses and stakeholder surveys, or on pre-agreed commitments made by the countries themselves	
<p>Diagnostic</p> <ul style="list-style-type: none"> addresses issues of relevance results are objective and comparable reforms that matter may take a long time political buy-in of reforms is not automatic 	<p>Process</p> <ul style="list-style-type: none"> political buy-in is ensured opportunities for quick “wins” results may be not directly comparable, commitments may not cover main constraints dependency on political continuity
Approach: On the one hand, the list of issues can be identified through surveys of the private sector. At further stages, the private sector opinions can be fed into the scorecard results. On the other hand, the assessment can be carried out with no input from the private sector	
<p>Bottom-up</p> <ul style="list-style-type: none"> addresses issues of priority to the private sector creates a push for reforms from the private sector identified constraints may not be easy to tackle due to intertwined multi-dimensional legal and regulatory frameworks 	<p>Top-down</p> <ul style="list-style-type: none"> direct link to the benchmark may not have direct connection to the private sector needs and national level reform agendas
Check: Assessments can be performed through a legal check of one or few specific commitments, or evaluation of on-the-ground situation	
<p>De jure</p> <ul style="list-style-type: none"> comprehensive and legally thorough captures constraints in the context of solid legal regimes may not be appropriate for regimes with large implementation gaps non-conformity is sometimes difficult to measure and compare 	<p>De facto</p> <ul style="list-style-type: none"> reflects issues persistent on the ground reveals constraints not captured by the legal check barriers often can not be addressed individually, as they are imbedded in broader sets of rules
Benchmark: Countries can be assessed against international best practices, or against certain regional integration principles	
<p>International</p> <ul style="list-style-type: none"> allows comparisons across the world and against a “blue print” policies and regulations may not be useful in weaker countries that need a lower benchmark for assessment 	<p>Regional</p> <ul style="list-style-type: none"> allows comparisons across similarly positioned countries shows regional integration trends regional principles may not be based on international best practices

Source: World Bank Group internal analysis of various scorecards on investment climate data

3. Policy options and recommendations for corrective action

Institutions matter a great deal for development, and a country's regulatory institutions are vital for the pace and quality of economic growth. Improvements in the climate for businesses can potentially generate jobs and incomes. Indicators of regulations and administrative efficiency are built on the premise that these firms are more likely to flourish if they have to abide by fewer, cheaper, and simpler regulations.

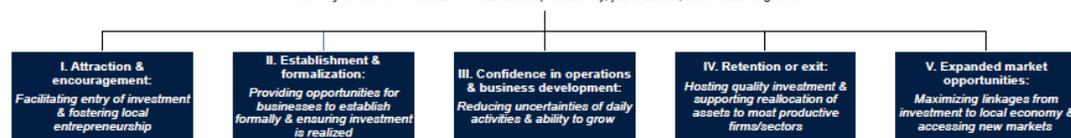
By ranking countries, various indicator reports have attracted considerable attention of policymakers and researchers alike. The WBG Doing Business (DB) project, for example, offers a consistent yardstick for comparing countries on regulation as seen from the firm's private point of view. But a complete appreciation of the quality of the business climate must also measure the quality of infrastructure, labor skills, competition policies, and other determinants and outcomes of investment and profitability. DB has often sparked constructive debate among country authorities and business interests about ways of making regulation simpler and lighter on firms.

In coming years, regulatory actions will become increasingly important as countries address challenges such as migration, health, and climate change. It will be crucial to emphasize both the need for efficiency in the implementation of a regulation and the benefits that a good regulation can bring.

Diagnostic tools and indicators should therefore evolve over time in the light of operational experience, evolving priorities, and advances in the academic literature. New initiatives are needed to develop new, and refine existing diagnostic tools, and to review how indicators and other benchmarking tools are utilized by international organizations and other stakeholders to inform investment climate reforms, with a view to expand the utilization of indicators as an engagement tool.

Annex 1: Gaps in investment climate indicators

Pathway to the Twin Goals: Private sector productivity, job creation, and inclusive growth



Country Coverage	Kenya OECD Total country count	Raw or firm-level data			Actionable/regulatory indicators							Perception surveys & Non-Actionable indicators			Internal tools		Standardized policy notes			
		WDI	ES	Other	DB	OECD PMR	IAB/FDI Reg	GIPB	WBL	WGI	Other	WEF	WPR	Other	Internal instruments	Ad hoc project surveys	DB Memo	IRM		
		Spotty	Good	N/A	Good	None	OK	Good	Good	Good	Good	N/A	Good	By region only	N/A	N/A	N/A	N/A	Good	Scarce
		Good	Good	N/A	Good	Good	Good	Good	Good	Good	Good	N/A	Good	None	N/A	N/A	N/A	N/A	None	None
		Varies	135	N/A	189	34	87	200	143	215	N/A	144	N/A	N/A	N/A	N/A	N/A	About 80	Fewer than 10	
		Annual	Sporadic	N/A	Annual	4 total	2 total	Triennial	3 total	Annual	N/A	Annual	5 total	N/A	N/A	N/A	N/A	Spotty	Scarce	
I.A.	Effective FDI attraction	1	0	FDI Markets	0	0	0	0	0	1	0	1	1	UNCTAD FDI Potential and Performance; EY Investor Attractiveness Survey	0	1	0	1		
I.A.1.	Improved promotion approaches & institutions	0	0	0	0	0	0	1	0	0	0	0	0	0	1	1	0	1		
I.A.2.	Increased effectiveness of investment incentives	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1	0	1		
I.B.	Optimal level of investment entry	1	1	FDI Markets, UNCTAD FDI statistics, WEO Macroeconomic forecasts	0	0	0	0	0	0	0	1	0	0	0	0	1	1		
I.B.1.	Reduced substantive barriers to foreign investment	0	0	0	0	1	1	0	0	0	0	0	0	0	1	1	0	1		
I.B.2.	Transparent access to industrial land	0	1	0	1	1	1	0	1	0	0	1	0	0	1	1	1	1		
I.B.3.	Effective anti-monopoly regulation	0	0	0	0	1	0	0	0	0	0	0	0	0	1	0	1	0		
I.C.	High levels of entrepreneurship	0	0	Global Entrepreneurship Database	1	0	0	0	0	0	0	1	0	0	0	0	1	0		
I.C.1.	Effective entrepreneurship	0	0	0	1	0	0	0	1	0	0	0	0	0	0	0	1	0		
II.A.	Efficient business start-up	0	1	KILM, MSME-CL, Schneider	1	1	1	0	0	1	0	1	0	0	0	1	1	1		
II.A.1.	Simplified business & tax registration process	0	1	0	1	0	1	0	0	0	0	1	0	0	0	1	1	1		
II.A.2.	Efficient licensing systems	0	1	0	1	1	1	0	0	0	0	0	0	0	1	1	1	1		
II.A.3.	Easier hiring of employees	0	0	EUI	1	1	1	0	1	0	0	1	0	0	0	1	1	1		
II.B.	Increased access to infrastructure & skills	1	1	0	0	0	0	0	0	0	0	1	0	0	0	1	1	1		
II.B.1.	Simplified procedures to register & transfer property	0	0	0	1	0	0	0	1	0	0	0	0	0	0	1	1	0		
II.B.2.	Efficient processes to obtain permits	0	1	0	1	1	0	0	0	0	0	0	0	0	1	1	1	0		
II.B.3.	Improved infrastructure access & reliability	1	1	0	1	0	0	0	0	0	0	1	0	0	0	1	1	1		

