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Is a Good Investment Climate Relevant to the African Development Experience?

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Is a good investment climate relevant to the African development experience?[1] **(DISCUSSION DRAFT, NOT TO BE QUOTED)**

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The past several years have seen investment climate reform take center stage in the World Bank Group operations. While the drive to reform investment climate is not new—the Bank has been engaged in reform of the investment climate since the 1980s—the new approach places emphasis on tools for diagnostic, measurement and policy advice, rather than policy-based lending. Examples are the Doing Business Indicators, the Investment Climate Assessments, and the advisory activities of the Foreign Investment Advisory Services.

African countries have introduced a good number of reforms as a response to these new instruments, and in order to obtain higher positions in investment rankings. Nonetheless, experience with foreign direct investment in developing countries provides reasons for concern about these efforts, and whether they suit the development experience of Africa, including the Southern Africa region.

The paper will assess the reform agenda proposed by the World Bank's Doing Business Indicators, Investment Climate Analysis and other rankings and instruments and its implications for development prospects of Southern African countries.

The following section introduces the topic. Section I puts the World Bank's investmetn climate reform work into a broader context of similar efforts being undertaken in other fora. Section II explains and criticizes the assumptions underlying the World Bank approach to investment climate. Section III addresses the Doing Business Indicators project and the ways it exerts influence in policy-making. Section IV deals with the issues raised by the Doing Business Indicators project, including a indicator-by-indicator critical assessment. Section V dwells into the Investment Climate Assessments, their influence on policy and the issues they raise. Section VI addresses the Foreign Investment Advisory Services of the Bank and provides some examples of how its products influence policy design. Section VI, finally, presents some concluding remarks.

Introduction

In 2002 the World Bank adopted the Private Sector Development Strategy (PSD Strategy). This strategy comprised two main pillars: private sector participation in Infrastructure and reform of the investment climate.

The reform of the investment climate, however, dates farther back. The Bank already was engaged in reform of the investment climate in the 1980s, when the main instrument was policy-based lending. Three quarters of Bank's adjustment operations in 1989-1990 were aimed at "improving the business environment" (OED/IEG 2004: 11). "Dismantling barriers to market entry and exit were included in 60 percent of adjustment operations." In the late 1990s the Bank shifted from "first generation

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reforms" to "second generation" reforms, targeting the administrative, legal and regulatory function of the State.

However, the past several years have seen investment climate take center stage in the Bank operations. This has taken place, firstly, through an emphasis on tools for diagnostic and measurement. Two of these tools that have been launched are the Doing Business Indicators and the Investment Climate Assessments. They are both based under the Private Sector Development Vice-Presidency (a joint IDA-IBRD-IFC VP that was created as a focal point for PSD efforts and to ensure that WB would collaborate with IFC in the promotion of PSD). The Private Sector Vice-Presidency was created shortly after the endorsement of the PSD Strategy. In a bureaucratic organization like the Bank, the creation of such position does represent a political will to elevate the hierarchy of private sector development work. Even more importantly, the fact that this is a jointly shared Vice-Presidency for IDA-IBRD and IFC signals the attempt to strengthen cooperation via a unified command among these three World Bank Group components.

I. The PSD Strategy in a broader context

The move to raise the profile of Private Sector-led development in the World Bank activities is not an isolated one in the development financing and lending community. In fact, the number of similar initiatives has sprung up in the last few years.

- The G8-endorsed Investment Climate Facilities (NEPAD and OECD)

The G8 Summit in Sea Island (2004) devoted one entire declaration to spell out an Action Plan "Applying the Power of Entrepreneurship to the Eradication of Poverty." Improving the business climate for entrepreneurs and investors is among the objectives. G8 countries pledge, inter alia, to "support coordinated, country-specific MDB [Multilateral Development Banks] action plans to address key impediments to the business environment", "incorporate these action plans into their country strategies and budgets and report annually on the progress made in conducting investment climate assessments and action plans. They also pledge to work with developing countries in comprehensive reforms and programs to improve their investment climates, "working with the MDBs and other international bodies such as the OECD."

The G8 Declaration on Africa, on the following year (Gleneagles 2005), actually references two Investment Climate initiatives. One of them is the OECD/NEPAD[2] whereas the other one is the AU/NEPAD.[3]

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[2] Para. 19: African countries need to build a much stronger investment climate: we will continue to help them do so, including through the promotion of a stable, efficient and harmonised legal business framework (noting the work of the OHADA business legal unification process and the improvement of the investment climate through the OECD/NEPAD Investment Initiative) and increased access to finance including strong support for the development of micro-finance in Africa. Partnership between the public and private sectors is crucial.

[3] Para. 23: To boost growth, attract new investment and contribute to building Africa's capacity to trade we will: . . . b) Support investment, enterprise development and innovation, for example through support to the AU/NEPAD Investment Climate Facility

The distinction (one preceding NEPAD by "AU" and the other by "OECD") are not exempt of significance. Two points are worth noting about this distinction. While the first one says OECD/NEPAD, it is a OECD initiative, based around the PFI (see below). After a Roundtable meeting in November 2003 in Johannesburg with NEPAD and OECD it was agreed that they would undertake the initiative jointly. The OECD boasts of this, and other regional cooperation frameworks, being the vehicles by which investment principles in the PFI are influencing the policy debate in different forums. On the other hand, the AU/NEPAD Investment Climate Facility boasts of being a "unique private-public sector funded independent trust, in support of and supported by NEPAD and endorsed by African Heads of State.", also "only pan-African body, based in Africa, explicitly focused on improving the continent's investment climate." In spite of this, there seems to be a strong influence of DFID. Second, while only the AU/NEPAD is properly a "Facility", that does not mean that the OECD PFI does not have money attached, too, through the influence it may have on the policies of OECD donors.

The AU/NEPAD Facility is, interestingly, meant to have a limited lifespan of 7 years. Its aim is to raise – from public and private sources—550 million dollars and it would fund projects that "offer the highest rate of return in terms of improving the investment climate, particularly those that have the greatest impact on the environment for small business and poverty reduction (primarily through job creation)." Its announced focus will be reforms on:

- property rights and contract enforcement
- business registration and licensing
- taxation and customs
- financial markets
- infrastructure facilitation
- labour markets
- competition
- corruption and crime.

It is also curious that the ICF does not necessarily adhere to a specific investment framework, besides giving general guidelines on the projects it would support.

- The Policy Framework for Investment

The Policy Framework for Investment (PFI) was endorsed at OECD Ministerial level in May 2006. The OECD claims PFI goes to great lengths to stress the "non-prescriptive" and mere "checklist" nature of the PFI, as well as the "inclusive process" (involving CSOs, business, trade unions, besides government representatives from OECD and non-OECD member countries) that was followed in its design and wide "flexibility" it allows governments to adapt the framework to their needs. However, it is impossible not to find parallels between the PFI and the MAI initiative of late 1990s, and some analysts have suggested it is intended to creep, eventually, into a binding framework. (Interview with Myriam Vander Stichele 2006)

Moreover, it is worrisome that the adoption of the PFI was encouraged, and welcomed, by the Business and Industry Advisory Committee to the OECD, a body that represents the business community of the 30 OECD member states. (BIAC 2004)

The PFI is intended to serve as basis for peer-review exercises about investment climate, and the OECD has already started several initiatives to build regional platforms that could use the PFI principles ("OECD/NEPAD" mentioned above is one of them). PFI is also meant to serve as a reference for donors on ODA oriented to support investment climate reforms. In fact, the OECD has released a Guide for Using ODA to Promote Private Investment for Development" that goes in that direction.

II. The assumptions underpinning WB work on investment climate reform

The general premise that grounds the World Bank's work on investment climate reform is, as in other World Bank policies, crafted in positive terms and hard to disagree with. For who can be against a "good investment climate", one that achieves growth and poverty reduction? "The critical role the investment climate plays in poverty reduction can be se in two ways. First, at the aggregate level, economic growth is closely associated with reduction in poverty. . . . a good investment climate enhances the lives of people directly, in their many capacities." (World Bank 2005a: 3) "Private firms, from farmers and microentrepreneurs to local manufacturing companies and multinational enterprises – are at the heart of the development process." (World Bank 2005a: 1)

There is no shortage of literature – provided by the World Bank itself—justifying these findings. In fact, the heavy utilization of World Bank literature is visible in the evaluation of the World Bank work on investment climate published by the Operations Evaluation Department of the Bank (since then renamed Independent Evaluation Group) in 2004. The evaluation totally bypassed the question of whether the theoretical framework on which reforms promoted by the Bank were based could be empirically justified. According to the terms of reference of the evaluation, it would rely on a "review of literature" to determine "the relationship between economic growth and poverty reduction", "the relationship between the quality of the investment climate and investment flows, both domestic and foreign", "aspects of the investment climate that make the most difference to investors, both domestic and foreign", "the importance of the investment climate as a determinant of investment, relative to other factors", etc. (OED/ IEG 2004:58)

The evaluation, after this, became an exercise in comparing the promotion of the reforms with the implementation, without significantly questioning the assumptions underlying the chosen reforms.

This could seem uncontroversial in the light of the claim for the Bank to be a "knowledge bank", that is, a provider of high-quality, unbiased and objective research. Unfortunately, there are reasons to think that the political structure and governance of the Bank, as well as its internal incentives system, prevent it from fulfilling such a role. The quality and objectivity of the research produced by the Bank has been recently brought into question by what was the first effort in the history of the Bank to externally review its research activities. An External Panel of researchers found that Bank research on areas such as globalization, aid effectiveness or growth and poverty had been "used to proselityze on behalf of Bank policy, often without taking a balanced view of the evidence, and without expressing appropriate scepticism." (Rogoff et al 2006:6) On globalization and growth, "much of this line of research appears to have such deep flaws that, at present, the results cannot be regarded as remotely reliable, much as one might want to believe the results. . . " (Ib.: 53)

In fact, if we unpack what the Bank means by a "good investment climate", several issues emerge.

- General methodological controversies surrounding impact of foreign and domestic investment on growth

- The assumptions that the more FDI, the better and that FDI is always good for development

- The assumptions about what attracts FDI

- Political impact of investment climate activities on ongoing trade and investment negotiations

<u>1. General methodological controversies surrounding impact of foreign and domestic investment</u>

The proposition that FDI leads inexorably to economic growth is not conclusively proven. Prof. Milberg, after a review of literature, suggests that the evidence points, in fact, to a reversed direction of causality " that is, economic growth is what leads to increased FDI." (Milberg 1999) Dani Rodrik concludes that developing countries that experience a significant and sustained increase in investment are most likely to see a rise in economic growth. However, whether this investment is foreign or domestic does not seem to make a real difference. (Ib.)

<u>2. The assumption underpinning the World Bank's work is that more FDI is better</u>

One consequence of the assumptions about FDI –growth causation is the belief that more FDI is always better, which also underpins the World Bank's work. This is a very questionable premise, especially when it ignores the potential negative pressure that FDI may build on the balance of payments through profit repatriation and royalties. "In the longer run, as the investment begins to pay off, profit repatriation will only increase." (Milberg 1999:100-101) On the same subject, Woodward concludes that "Clearly, it is possible or a country to attract enough new direct investment to receive an inward net transfer of resources. In principle, it is even possible to maintain inward net resource transfers for a prolonged period. . . However, there may be a high cost attached to attracting inward net transfers: in general, any individual inward investment will ultimately require an outward net transfer much larger than the initial capital inflow." (Woodward 2001:145)

But an uncritical emphasis on the quantities of FDI may be the especially dangerous when it is interpreted as a need to downsize government at all costs in order to facilitate increased foreign capital inflows, ignoring the high complexity of the processes that have unleashed virtuous circles of growth and development in developing countries.

For instance, discussing the experience of the East Asian developing countries Akyuz argues that the success of industrialization depended on the role of government intervention in accelerating capital accumulation and growth through the animation of an “investment-profits nexus.” (Akyuz et al 1996)

According to UNCTAD, policy-makers have to ask hard questions such as whether FDI raises production costs and lowers profitability for domestic firms, the likely extent of positive spillovers and linkages, and whether domestic firms are able to benefit from them, the likelihood of increased import dependence and profit repatriation, etc. and avoiding such questions “in favour of easy recipes of rapid liberalization in the hope of attracting FDI will neither achieve economic development goals nor maximize potential gains from hosting it.” (UNCTAD 2005: 68)

A critique of the World Bank’s assumption is also found in a well-researched study by Sanjaya Lall, where he argues that a healthy investment climate is not the first priority in increasing Africa competitiveness and, in fact, liberalization of investment may have counterproductive effects. “The dominant mainstream solution to growth problems – a universal prescription to create a healthy investment climate and leave the rest to the market – is inadequate and misplaced. It neglects the capacity of African industry to respond to the challenges of competition, technical change, growing skill needs and shrinking economic distance. . . . The first step in revitalizing African industry is to include detailed supply-side measures.” (Lall 2005)

3. The assumptions about what attracts FDI

But the emphasis on investment climate reforms is misplaced even if measured in the Bank’s own terms. Even if we were to make the assumption that more FDI is better, there is substantial evidence to assert that the role of the investment climate in bringing more FDI is not significant.

While it is true that investment climate plays some role, this role is not critical. Mkandawire and Soludo exemplify with Nigeria which, between 1970-1980 and 1991-94, were among the top 10 developing countries receiving the largest amounts of FDI (and the largest in all Africa). (Mkandawire and Soludo 1999:83). During 1991-96 both Nigeria and Angola were the most and second most attractive countries for flows of FDI in Africa. It would be simplistic to assume that Nigeria and Angola are the countries with the least risk for investors. (Ib.) Research especifically focused on Southern Africa reaches similar conclusions. “A positive correlation between FDI and ‘good economic behaviour’ doesn’t appear to exist, at least concerning this study’s variables. FDI seems to be primarily driven by more important factors than ‘economic fundamentals’, at least resource-driven investments in Southern Africa.” (Dahl 2002:19)

Contesting the view that Africa’s low level of FDI is due to “governance failures”, UNCTAD says that such low levels coincide with a period of vigorous and repeated application of adjustment policies that included reducing the role of the state and covered all aspects of monetary and exchange rate policies, financial market reform . . . , privatisation, deregulation, and trade and FDI liberalization. "The fact that these efforts have still not attracted the expected inflows of FDI raises questions about the role of governance reforms, at least as this has been conventionally defined and implemented in Africa." (UNCTAD 2005:22)

On the other hand, such perspective may downplay the importance of market-related determinants of FDI, such as market size, GDP, GDP per capita and GDP growth, that are backed by a strong review of empirical literature. Nunnenkamp (2002) takes on contesting the view that traditional determinants of FDI are losing relevance compared with non-traditional determinants. The "ease of doing business" is, alongside "cost differences between locations", "the quality of infrastructure" and "the availability of skills", among these alleged non-traditional determinants that are gaining in relevance.[4] Nunnenkamp finds that "Traditional market-related determinants are still dominant factors shaping the distribution of FDI. If at all, the bias of foreign direct investors in favor of large host countries has become stronger, rather than weaker." (2002: 35) UNCTAD mentions "market size and growth, resource endowments and infrastructure development" as consistently the most significant determinants of FDI flows to Africa. (UNCTAD 2005:35) A survey of investors in Southern Africa, carried out by UNIDO, throws as a result that

A number of studies, while reaching different conclusions on what are the factors that attract FDI, agree on the dismissal of investment climate as one of them. Ferrarini states: "The results from empirical studies on the determinants of FDI . . . show that it is mainly economic fundamentals – such as national income – that underlies investors' preferences to invest in certain countries rather than in others. This is further sustained by clear anecdotal evidence on huge amounts of FDI flowing to notoriously non-transparent and corruption-ridden countries, such as China and Malaysia. . . . there is no reliable empirical evidence that suggests that transparency is as important as economic fundamentals, such as national income." (2000: 21)

Kamaly states "Besides the fact that no study took the burden of pinpointing and weighing the relevant fundamentals affecting FDI, the recent trend in FDI casts much doubt on [the argument that FDI follows more closely countries' fundamentals rather than cyclical variables such as international interest rate]. . . . First if this is argument is correct then such upbeat trend in FDI should be the result of a continuous improvement in developing countries' fundamentals. However casual observations does not support this claim especially during the second half of the 1990s. Second, top recipients of FDI are not the top macroeconomic performers among developing countries, and vice versa." (Kamaly 2003: 8) Indeed, Kamaly's study finds FDI sensitive to the interest rate with higher levels of interest rate in developed countries corresponding to less FDI to developing countries. (2003: 23)

[4] Relying on a review of comprehensive survey data compiled by the European Round Table of Industrialists, complemented by more conventional sources, on investment conditions in 28 developing countries since the late 1980s.

4. Political impact of investment climate activities on ongoing trade and investment negotiations

The investment climate work falls among the World Bank activities that dovetail with ongoing negotiations on multilateral, regional and bilateral trade and investment agreements. Achieving the adoption of a multilateral agreement with minimum standards for the protection of investment that can facilitate foreign investors' access to developing countries (in the fashion of the controversial Multilateral Agreement on Investment) is a long-term goal of industrial countries, and their business sectors. The successful drive by developing countries to force the "Singapore issues" issue out of the agenda at the World Trade Organization (WTO) Ministerial in Cancun in 2003 is certainly not the end of such efforts. The agenda on investment liberalization continues to be promoted by other vehicles, regional and bilateral.

The investment climate work of the Bank is one aspect of the drive to promote basically the same concepts embedded in an investment agreement, though on a unilateral basis, and with the same end goal. The European Roundtable of Industrialists was already stating, in 2002, its hope that in the face of a continuing process of "autonomous " investment liberalization, Southern governments' opposition to a multilateral agreement would be overcome gradually paving the ground, when time is ripe, to the emergence of WTO rules to effectively lock in deregulation process and "protect against backsliding from the levels reached by individual countries." (Hoedeman 2002)

III. The Doing Business Indicators project

The Doing Business Indicators project compiles indicators about specific regulations, for all countries, year by year. In the Bank's own description, the analysis is based on assessments of laws and regulations, with input from and verification by local experts." (World Bank 2004:viii) It covered 145 countries in 2005, 155 in 2006 and in its last edition is already covering 175.

The Doing Business indicators have power to influence policy in several ways. The first one is providing an incentive for countries to introduce specific reforms taken into account by the indicators. The Bank says the indicators are intended to "motivating reforms through country benchmarking." (WB 2004:ix) So, they act in a very similar fashion to the Country Policy and Institutional Assessments (CPIA). In fact, CPIAs are ratings of the policies of a country used with the purpose of ranking countries as "good" or "bad" performers. The classification is used in a variety of purposes, from determination of funding allocations to measurement of the amount of debt a country can undertake without risking "debt distress." In order to give countries a ranking, the World Bank uses a set of pre-determined, "one size fits all criteria": the Doing Business indicators are one-size-fits-all indicators that aim at the harmonization of certain regulations part of the business environments in the concerned countries.

The Bank reported in 2004 that 20 developing countries and 12 IDA countries Doing Business report 2004 had influenced the introduction of reforms and some 30 countries worldwide had instituted reforms motivated by the indicators. (IMF/WB 2004: para. 19) In fact, not a small impact of the report comes through the establishment of “name and shame” rankings and the impact they are perceived to have on the perception of prospective investors.

According to Doing Business report 2007, the project has inspired so far 48 reforms around the world. The big news in this year was that, while Africa was behind all the other regions in previous two years, this year it ranked third, behind ECA and OECD. “Two thirds of African countries made at least one reform, and Tanzania and Ghana rank among the top 10 reformers.” (WB 2007: 2) Mauritius set itself the goal of reaching the top 10 by 2009. This is taken as a sign that “Benchmarking—via the Bank’s Doing Business and Investment Climate assessments—has proven useful in focusing high level attention on the business environment.” (World Bank 2007a:13)

But in the same Doing Bussines report it is said that 213 reforms, in 112 economies, were introduced between January 2005 and April 2006. (WB 2007: 1) In spite of the differentiating language used by the report, it is unclear whether there are any differences between reforms “inspired” and those “introduced.“ Worldwide, a growing number of countries are introducing changes to their investment climates, and an overwhelming majority of the changes are in the direction of liberalizing and facilitating, rather than setting constraints on, foreign investors. (Woodward 2006) In other words, could the latter have not been also “inspired” by Doing Business Indicators?

The second way the ranking can influence policy is by influencing the conditions and criteria used by the Bank, but also by other donors, in loans and grants. It is hoped that the indicators help donors increasingly driven to make “performance-based” eligibility and allocations. For example, the Bank cites the Millennium Challenge Account (MCA). (WB 2004: x)

The WB reports that indicators from the Doing Business project (and from investment climate surveys) found their way into monitoring and evaluation efforts of the World Bank. In Brazil, for example, they are being used to assess progress in an adjustment loan that includes components for improving business climate regulations and reducing logistical costs. (IMF/WB: para. 23)

This years’ Doing Business report explains that in 2003 IDA set targets related to Doing Business Indicators (for reducing the time and cost to start a business) as conditions for obtaining additional grant money. As a result, 16 countries reformed business entry. According to the same report, the MCA introduced, in 2004, eligibility conditions based on specific indicators from Doing Business Indicators. (WB 2007: 5). The report laments that in 2004 the conditions were replaced with soft targets, leading to a “missed opportunity” (WB 2007: 7)

The International Monetary Fund frequently includes reference, in its country-based policy and surveillance reports, to “strengthening the private sector” or the “business environment”, both code words for reforms that cross-reference whatever the Doing Business Indicators or other World Bank analytical work have highlighted as desirable reforms in this area.

A third way the Doing Business project influences policy is by shaping a body of policy research that fosters the adoption of reforms along the lines of what the indicators consider “good”. The indicators” facilitate tests of existing theories and contributes to the empirical foundations for new theoretical work on the relation between regulation and development.” (WB 2004:x) In a report on implementation the World Bank and IMF mention a new training course on investment climate reform currently developed at IFC/ WB, for staff who help governments support investment climate reform processes. (IMF/WB 2004: para 18)

Since the year the first Doing Business project came out, the Doing Business project has grown in number of indicators, covering a growing number of areas. The first year it covered 1) starting a business 2) hiring and firing workers, 3) enforcing contracts, 4) getting credit, 5) closing a business. The following year it added 6) registering property, 7) dealing with government licenses and 8) protecting investors. In 2006 it added 9) paying taxes and 10) trading across borders. It is announced that next year it intends to add transparency of government procurement and the quality of business infrastructure. (World Bank 2007: Overview)

IV. The issues raised by the DB project

1. Process issues

Before entering into a critical assessment of the specific content of the Doing Business indicators, a process issue needs to be raised and is that the indicators, in the same fashion as the Country Policy and Institutional Assessments. CPIAs criteria, as well as the ratings based on them, are developed by World Bank staff in a process that allows for no intervention of the government of the country concerned, let alone its population.

The process run in secrecy and does not allow those affected to have a say in the matter, making for a degree of unaccountability that has fuelled intense criticisms. In fact, criticisms came not only from outsiders, but led to critiques inside the Board of the World Bank (For a more detailed critique of the CPIAs see Caliari, 2005)

The issues –some say tantamount to a lack of “due process”—raised regarding the CPIAs, are certainly applicable to the Doing Business indicators under analysis. Just like in the CPIA process, Doing Business Indicators are developed on the basis of criteria that the rated countries did not play any role in shaping. Nor do the populations of the countries concerned, many of them unquestionably democratic, seem to have a say in the criteria according to which the policy of their government towards investment climate is evaluated.

This applies to both, the design of the indicators themselves and the priorities, and to the measurement and ranking. The involvement of “experts” chosen by the Bank is of no help in allaying such concerns.

2. Content issues

Some general problems with the surveys that give rise to the indicators are recognized by the Doing Business Report itself and, hence, worth mentioning here. Survey questions do not always elicit meaningful responses, due to a series of reasons such as design bias in the survey, scales of the responses, uninformed answers, lack of reference points and sample selection. (WB 2004: 12-13) Perceptions measures may not provide useful indicators of specific features of the business environment. (WB 2004:13)

Under a heading “Other indicators in a crowded field” (WB 2004: 7) the Bank calls attention to the existence of plenty of indicators of business climate. The best attempt to provide an answer is given in the same report (xiii) “More than a dozen organizations . . . produce and periodically update indicators on country risk, economic freedom and international competitiveness. . . . But few indicators focus on the poorest countries, and most of them are designed to inform foreign investors. Yet, it is local firms, which are responsible for most economic activity in developing countries, that could benefit the most from reforms.” (Ib.)

At first sight, this claim seems to disarm arguments that Doing Business Indicators are another tool at promoting changes that are to the benefit of foreign investors. In spite of the rhetorical device, this is hardly the case for, at least, four reasons:

First, all the changes in the business environment that are preached through the Doing Business Indicators are equally applicable to foreign and local companies, not one of them making discriminations on the basis of origin. Against the backdrop of externally-driven reforms that have pushed for lowering barriers to foreign investment in borrowing countries—and that continue to do so through a concurrent tools that are also assessed in this paper, such as investment climate assessments and advisory services--, one is forgiven for understanding the deregulation as beneficial to foreign investors. This becomes clearer one factors in the continued process of adoption of rules that facilitate entry and operation of foreign companies in bilateral and regional instruments.

Second, the harmonization of standards for investment that Doing Business Indicators, by definition, promote, has special benefits for companies operating on a global scale, more so than for local small and medium enterprises. It is hard to see how these latter would benefit from practices of unclear relevance given that they have been determined through a survey aggregation process, instead of locally-designed regulations that can better capture the unique features of the environment in which they operate.

Third, under the cloak of reducing costs and simplifying procedures, it is clear that not a single one of the prescriptions of the Doing Business Indicators is favourable to discriminating in the treatment of foreign and domestic investors.

Finally, the way Doing Business Indicators interact with both ICAs and Foreign Investment Advisory Services (instruments more clearly focused on the removal of barriers to foreign investment, as analyzed below) leaves less scope for doubts.

Another issue raised by the growing plethora of rankings and indicators is that they abound in inconsistencies of measurement. If a “good investment climate” is composed of such a clear set of policies as the Bank argues, then large differences among indexes should not be warranted. However, large differences exist. For instance, a review sheds large differences on a World Economic Forum Competitiveness Index and rankings emerging from Doing Business Indicators 2006 with differences that, in some cases, exceed any reasonable boundary. For 26 countries, the difference exceeded 40 places, with the extreme case of Egypt – rated 63 in the WEF and rated 165 in the Doing Business Indicators. For over 45 countries the difference exceeded 20 places. Overall, the review registered 92 cases of differing rankings (see Table 1). It is true that the two indexes use different criteria.[5] This certainly does justify their yielding different results. But this is no comfort for confused country governments who may believe in the logic of the rankings and implement the necessary reforms to climb in them, or know how well they are doing. Should they trust the World Bank criteria, based on surveys of academic experts, or should they believe the WEF, result of the vision of private sector leaders about the desirable reforms ? More importantly, we would hold that the different in rankings throws the whole idea of rankings out of the window. In fact, it demonstrates the fallacy and lack of conclusiveness of measurements of what is a good investment climate. It is not hard to imagine examples of how attempts to climb in one ranking may mean going down in the other. For instance, an extreme simplification of licensing, if applied to the educational and health services sectors, may mean higher scores with the Doing Business Indicators, but bring lower rates of education, hence bringing lower scores in the WEF index.

A general problem that affects the content of the indicators is their standardized nature, which clearly flies in the face of the art. 8 of the Sao Paulo Consensus, the first North-South document consecrating the concept of "policy space":

'The increasing interdependence of national economies in a globalizing world and the emergence of rule-based regimes for international economic relations have meant that the space for national economic policy, i.e. the scope for domestic policies, especially in the areas of trade, investment and industrial development, is now often framed by international disciplines, commitments and global market considerations. It is for each government to evaluate the trade-off between the benefits of accepting international rules and commitments and the constraints posed by the loss of policy space. It is particularly important for developing countries, bearing in mind development goals and objectives, that all countries take into account the need for appropriate balance between national policy space and international disciplines and commitments.' (Sao Paulo Consensus 2004)

A number of mainstream economists have moved to recognize the importance of country-specific reforms in kick-starting processes of growth. "All successful cases of development in the last fifty years have been based on creative and often heterodox policy approaches. . . . If we want to assist developing countries in their quest for development, the way to move forward is not through more onerous conditionality, further international harmonization, better dissemination of 'best practices' or greater international discipline. It is through greater policy space." (Rodrik et al 2005: 9) It seems the Doing Business project, with its attempt to determine more and more aspects of the microeconomy goes exactly in the opposite direction of this advice.

A connected weak point, noted by the Independent Evaluation Group's evaluation on investment climate, is that "as countries and firms differ in optimal firm size and

[5] The factors taken into account for the GCI Index are Institutions, Infrastructure, Macroeconomy, Health and primary education, Higher education and training, Market efficiency, Technological readiness, Business sophistication and Innovation.

structure, estimating the time required to set up a straw firm provides comparability but at the expense of some bais against countries with heavier reliance on the informal sector." (OED/IEG 2004: 24)

Finally, if the empirical test is whether countries doing better in the Doing Business Indicators do, actually, grow faster, some striking anomalies emerge. For example, in 2004, countries with very poor rankings were growing very fast: Venezuela (164) at 17.9 %; Angola (156) at 11.1 %; Afghanistan (162) at 8 %; Chad (172) at an astonishing 29.5 %. And this does not even bring up China—which many would say is a special case—growing at 10.1 % while positioned in place 93 at the table.

But a critique should also be levelled one-by-one at the content of the indicators that form the body utilized in the Doing Business project.

<u>Paying taxes:</u> This indicator measures the number of tax payments, time it takes to prepare and file taxes and total tax payable. In all cases, to a lower number corresponds a higher ranking.

While the first two figures may not be controversial, the third one certainly is. This indicator clearly sends signal that the lower the tax rates on businesses, the better. If there is one truth common to businesses all over the world, is that they do not like paying taxes. Unfortunately, relying on this sight would entirely miss the other side of the coin which is the need to finance a state able to provide to the collective needs of its citizens (including, ironically, businesses owners and employees).

An additional problem with this indicator is that the impact of tax rates on foreign investment decisions is very debatable. A study by McKinzey Global Institute actually found that direct incentives to FDI did not have a major impact on FDI flows. The incentives, on the contrary, came "with significant costs, including a negative impact on productivity and 'race-to-the-bottom" dynamics. (McKinsey 2003:25)

Tax rates are, indeed, an important mechanism for governments to raise revenue, especially when they affect foreign investors operating in the country. Tax holidays and incentives, which would contribute to raise a country's ranking, have been shown to carry important costs as they erode the tax base. (Morisset et al, 94)

In a study on Indonesia, tax holidays and incentives were shown not to influence the decisions of foreign investors. (Morisset et al, 41) Still, the same study cautions that tax holidays influence the decisions of "some investors some of the time." (Ib., 41) Then, the issue is to determine in which sectors investments are likely to come even in the absence of incentives, rather than the total quantity of taxes charged. In assessing the costs of lower taxes one has to consider whether the investors would have come anyways, absent the tax holiday or incentive, a calculation for which this standard indicator is not suitable.

The misleading nature of the indicator could be seen by taking it to the extreme. Too low tax rates, when they lead to the depletion of treasury resources, may affect the macroeconomic situation, widely accepted to be a more important factor than any other microeconomic factor in attracting foreign investment ! Curiously enough, the Doing Business Report 2006 recognizes that "business care about what they get for their taxes." To this effect the report compares the few complaints about tax burden in Finland, with a relative high tax burden, and the many complaints about tax burden in Mexico, with a relatively lower tax burden. Unfortunately, even this insight coming from the business community itself is lost in the World Bank's mechanical assessment.

This indicator should also be criticized on the basis that it favours the application of regressive tax systems. A OECD study states that the behaviour of corporations which try to avoid taxes by moving parts of their businesses to countries with favourable tax regimes "may hamper the application of progressive tax rates and the achievement of redistributive goals." (OECD 1998) The cut in business taxes might have to be made up with indirect taxes, which are more regressive. Among "successful" reformers the Bank mentions countries such as Serbia and Montenegro and Afghanistan for having introduced the VAT or cut corporate taxes from 25 to 20 percent. (WB 2006: 47) In the specific case of Ghana, the Bank praises the government for cutting corporate tax rates while raising VAT in 2.5 percentage points to offset the losses. (WB 2006: 48)

Hiring and firing workers

This indicator measures the difficulty in hiring new workers, rigidity of hours, difficulty in firing, hiring cost and firing costs (both as a percentage of the worker's salary). The rigidity of employment index is also included and is an average of the first three variables. The highest scores are for countries that have the lowest number in all of these variables.

The indicators provide incentives for governments to roll back entire systems of worker protection that were the hard won accomplishment of struggle by the labour movement. A good investment climate is here equated with the removal of principles such as minimum daily rest, maximum number of hours in a normal workweek, premium for overtime work, restrictions on weekly holiday, mandatory payments for nonworking days, minimum wage legislation, grounds for dismissal, notice period, severance payments. Constitutional principles on the protection against dismissal and minimum conditions of employment are targeted by this indicator. (WB 2004: 108)

Understandably, the indicator has come under fire from workers all over the world. As can be seen, the measures that would be recommended by this item try to standardize sensitive elements of social contracts and delicate balances in enterprise-labor relations that are specific to each society.

This does not seem to scare the World Bank, which in the latest Doing Business Indicators report recommends specific reforms such as raising the retirement age in countries with an aging population and making the retirement ages for men and women equal. (WB 2007: 24) Very confidently, in its 2004 edition it states "the fact that employment regulation arose in response to market failures does not mean that today's regulations are optimal." (WB 2004: 35) Ignoring that, in fact, employment regulations were obtained usually by hard social struggles, not because of an abstract recognition that there were failures in the market that required solving. "What was appropriate in, say, 1933, when Portugal adopted its constitutional protections of workers, may not be appropriate today" (Ib: 35)

Trading across borders.

This indicator measures number of documents, time and cost of the procedures required for exporting and importing goods. The lowest numbers in all these categories are assumed to mean better investment climate conditions.

This indicator makes the rather simplistic assumption that less time and cost of the procedures for importing goods are a problem. But, in a situation where countries are increasingly required to lower tariff barriers, the utilization of other barriers, some of them of an administrative nature, is not always negative and might offer the only mechanism for protection of local producers and industries. Ha-Joon Chang (2002) explains how today developed countries, in order to develop, relied, at a time when communications and transport were not as advanced as today, in natural barriers. And, without going to the past, the utilization of technical barriers to trade, imposing significant costs on Third World producers, continues to be an important element of protection for industries in industrialized countries.

Dealing with government licenses

This indicator measures number of days, procedures and the cost of obtaining a license. The assumption is that the lowest these numbers are, the highest the ranking for the country.

Again, Doing Business Indicators seeks to provide a standardized and simplified solution to a very delicate question that requires careful country-by-country and society-by-society balance. Licenses are an aspect of regulation that has to be followed almost in any industry in any country. Usually they allow for a government control of standards that are implemented to ensure the protection of socially-desirable goals such as avoiding consumer abuse, safety, public health, environment, equity, etc. Against this background, equating shorter and less costly procedures to a good investment climate seems rather short-sighted. In fact, the total elimination of licenses might place a country in a very high ranking, but the indicator does not incorporate the concerns about the other side of the equation (consumers, users, citizens, etc) that the licensing procedures are meant to address in the first place.

The removal of licensing requirements would also be consistent with the trends in the General Agreement on Trade in Services (GATS) and other agreements on trade in services at the regional or bilateral levels, and prejudge matters that are under the discussion in the World Trade Organization negotiations, with regards to domestic rules. In fact, one sticking point in WTO negotiations is the further definition of Art. VI.4 (on domestic regulation) of GATS, which provides for disciplines to be developed to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services. The disciplines "shall aim to ensure that such requirements are based on objective and transparent criteria, not more burdensome than necessary to ensure the quality of the service and (in the case of licensing procedures) not in themselves a restriction on the supply of the service." While industrial countries have been pressing for an approach that requires a “necessity” test do not go beyond what is "necessary" to achieve the member's policy objective—developing countries have repeatedly opposed the utilization of this test arguing for members' rights to regulate the provision of services to accomplish national policy objectives.

The Doing Business Indicators indicator is clearly biased towards this approach, one of many possible approaches to evaluate regulation. It has been said that submission to the principles in GATS entails the risk of stifling government regulatory activity, by placing the onus on the government of showing that the method used to regulate an activity is the least burdensome.

Among the controversial practices advocated by the 2006 Doing Business report are cost-benefit analysis of any licensing legislation (it praises Poland in this regard), automatic expiration of licensing requirements not renewed after a certain period of time, and a so-called "guillotine" approach to licensing, that is, the massive cancellation of licensing requirements. (WB 2006:16)

Another factor to keep in mind, in line with Prof. Robert Wade's reflection on the experience of Taiwan, is how the licensing power of the government can be used as a positive leverage on foreign companies in order to have them transfer specific technologies, skills or other know-how to the host country.

Registering property,

This indicator measures the number of procedures, time and cost involved in transferring property title from the seller to the buyer, where lowest numbers are assumed to mean better investment conditions.

The 2006 Doing Business report, under the heading "Why reform? " claims that these reforms strengthen property rights. It follows property rights are considered important in the investment climate. The conception that stronger property rights bring economic development and enhance wealth creation, says Ha-Joon Chang, is widely believed in orthodox economic discourse today. However, the role of property rights is much more complex. He quotes examples in history where preservation of property rights has been harmful to economic development and, conversely, the violation of certain existing property rights beneficial to it. (Chang 2002:83). Hence, he concludes, what matters is which property rights are protected under which conditions. "If there are groups who are able to utilize certain existing properties better than their current owners, it may be better for the society not to protect existing property rights, but to create new ones that transfer the properties concerned to the former groups." (Chang 2002: 83) Obviously, this sort of judgment is lost on the breadth of the indicator as it is measured.

Closing a business.

This indicator captures the time and cost of a bankruptcy process, as well as the recovery rate of foreclosure or bankruptcy procedures. Lower times and cost, and higher recovery rates, are associated to higher rankings.

Bankruptcy law seems hardly an element of generalized importance in the process of jumpstarting growth and development. Chang brings to attention the examples of developed countries that did not develop a bankruptcy law until late in their development, and did not seem to see their development process affected by that. (Chang 2002)

Another factor to be kept in mind is that, like the elements addressed by other indicators, bankruptcy laws are very specific to the social contracts in each country. The balance of rights between creditor and debtor is a very sensitive one. Nowhere is this better illustrated than in the words of economist and Economics Nobel Prize-winner, Stiglitz, when he says:
“. . . there is no single, “right” approach to bankruptcy. Indeed, the design of bankruptcy law has been among the most contentious topics within the American political scene. To think htat one can rely on some international technocrats for the solution to what is a quintessentially political issue is not just nonsense but dangerous, for those seeming technocrats may well reflect particular interest groups. But bankruptcy law reflects more than just the balance between creditor and debtor interests; it says something about a society’s views of social justice.” (Stiglitz 2006:232)

In fact, on top of the sin of trying to find a uniform prescription for all countries, there are elements to say that the prescriptions leans too much to the side of the creditors. Doing Business report 2006 praises examples of countries that reformed their systems to strengthen and enlarge creditors’ powers. (WB 2006:67; 68) Equating a good bankruptcy system with high recovery rates, as one of the indicators does, seems biased in that same direction.

V. The Investment Climate Assessments (ICAs)

Investment Climate Assessments are designed to systematically analyze the conditions for private investment in a country. They are broader and more detailed than the Doing Business Indicators and are underpinned by a survey (the Investment Climate Survey). The surveys are administered to firms, unlike those used for the Doing Business Indicators (which are administered to experts).

Like other analytic documents produced by the Bank, such as the just-analyzed Doing Business reports, the nature of ICAs as primarily analytical documents does not detract from their strong influence on policy-making in developing countries..

According to a 2004 report, the ICAs had shaped 15 new lending operations in 13 IDA countries, among them Mozambique, Nigeria and Uganda. Another report points to Poverty Reduction and Support Credits as the program documents where to look for evidence of the incorporation of the ICA results (IDA 2004b:5) in countries such as Ethiopia, Mozambique, Senegal and Tanzania. However, a review by this author found that in most of the PRSC cited the issues have more to do with sectoral infrastructure bottlenecks –transport, financial, electricity- than with across-the-board investment climate reforms of the type of those encountered in the Doing Business Indicators.

The rest of this section addresses some of the concerns raised by the ICAs.

1. Unclear value added

In some countries the nature of investment climate constraints and the actions required are already known. Often, similar surveys have been conducted by the government, local universities or think tanks, the Bank or other donors. In fact, given the concerns noted above regarding the politicised and non-neutral characteristics of World Bank research, it would be highly desirable to ensure that ICAs are carried out by local or regional research institutions, if possible in relation with the governments concerned, rather than with the Bank (otherwise results could still be bent). This issue has been recognized by an IEG evaluation of 2004 (OED/IEG 2004). The number of surveys also brings survey fatigue among firms asked to participate. This is a particularly acute problem in smaller countries with relatively small private sector.

2. Inadequate coverage

An ICA is unfit to capture variations in investment climate conditions by geographic area and by industry. In their ambition to provide a generalization for a whole country of the investment climate, there is a risk that the value of the study of specific activities and their investment climate might be lost. Of course, from the general approach underpinning the Bank's exercise, market-friendly and rather dismissive of government's role in addressing market failures, this seems not very important. However, for an analysis that has to pinpoint the needs where government intervention through selective and strategic interventions is needed, ICAs are wanting. Moreover, in some countries the main constraints to private sector development may lay outside the scope of ICAs.

3. Lack of priority

Surveys and assessments had tended to produce long lists of problems and proposed solutions. ICAs use firms' rankings or impacts on productivity to set priorities. Feedback from clients suggests that more effort is needed to identify priorities and sequencing. (OED/IEG 2004)

5. Lack of follow up

One concern that emerges in assessing a number of ICAs[6] in Africa is that why they may offer good descriptions, they do not offer much as a way of insight on a course of intervention or action. According to the IEG evaluation of 2004, investment climate indicators tell analysts, from the perspective of firms, what hurts but not what to do about it. They tend to be descriptive rather than prescriptive. Examples of constraints typically include high taxes, high interest rates or the high cost of regulatory compliance. (OED/IEG 2004)

Access to credit, infrastructure costs in terms of transport, power, telecommunications, ports, etc. are oftentimes cited as constraints on the private sector. There is no question that they affect SMEs more than they affect large companies which are better equipped to cope with the costs. However, the ICAs either do not propose a solution or, when they propose it, it is in terms of privatising the services in question – or deepening the privatisation when it has occurred.

[6] Zambia, Mozambique, Tanzania, Nigeria.

Intervention to correct market failures is never a valid option. In the case of Zambia, the ICA criticizes that privatisation has thrown the previously state-owned companies into a regulatory vacuum. This has proved to be a common weakness in privatisations in low and middle-income countries. Yet, that does not say how the lack of regulatory capacity in already overstretched developing country governments can be addressed. The possibility of discriminatory treatment on foreign investors in order to allow cross-subsidized financing of access to services by the SMEs, for instance, does never appear as a legitimate option.

6. Where are the trade-offs?

The evaluation hits the right target when it says: "This does not necessarily suggest that taxes, interest rates or regulations should be reduced. Economic and social objectives – fiscal stability, monetary management, environmental protection, labor protection—are the 'benefit' side of the cost-benefit analysis that needs to be done." Survey-based instruments are not designed to provide an understanding of both sides of the analysis. Neither are they designed to provide an understanding of the root cause of the problem. (OED/IEG 2004)

VI. FIAS (Foreign Investment Advisory Services)

According to the World Bank description, FIAS is a joint program of IFC and World Bank that "has advised 130 member country governments on how to improve their investment climate for both foreign and domestic investors." (IFC/WB 2005: Cover) The Doing Business report and ICAs often provide the analytic starting point for FIAS advisory services to a country (IFC/ WB 2005:8) At the same time FIAS collaborates with IDA "providing its advisory work as inputs to ICAs, CASs and PRSPs and through direct collaborations.", with FIAS analytic work "being routinely incorporated in ICAs." (IDA 2004: 17) FIAS also collaborates with MIGA in providing "comprehensive package of investment promotion assistance to governments and investment promotion agencies." (IDA 2004a: 3)

As for the nature or the underpinnings of the advice provided by FIAS, it is hard to know it given that FIAS projects are not disclosed (unlike, for example, project concept documents given by other parts of the Bank).

Even in the absence of disclosure of concrete projects, however, the following statements give us a good glimpse of its inclination. Indeed, FIAS seems clearly more blunt in its goals of removing barriers beneficial to foreign investors. For instance, "FDI is no panacea for the problems of development, but if combined with a neutral trade regime, favoring neither export-oriented nor domestically focused industries, it can be an effective catalyst for economic growth." "A liberal regime of trade and investment that allows for competition from domestic and foreign sources promotes innovation and formulation of skills through experience." (IFC/WB 2005:7)

A large track-record vouches for the influence FIAS may have on policy reforms:

The Bank reports that 70 percent of FIAS policy recommendations were fully or partially implemented within three years of being made. (IMF/WB 2004:para. 19)

In 2004 FIAS completed 42 projects in IDA countries related to investment climate policy reforms and capacity building. (IDA 2004: 16) The projects include “reviews of investment laws and policy frameworks, diagnostic studies of administrative barriers to investment, specialized work on competition policy. . . “

Following completion of a FIAS Administrative Barriers Study in 2004, the WB incorporated FIAS analysis and recommendations in its economic and sector work and further in its private sector development policy dialogue with the government. Subsequently the Bank/IDA and IFC jointly designed the Kenya SME project, which “”includes reforms in such areas as speeding up the legal and instutional changes to ease business entry and licensing, SME tax simplification. . . “ (IDA 2004a: 4)

In Lesotho FIAS did an administrative barriers study in 1997. In 20003, the new reformist government informed the Bank that it was willing to move on reform. . . . the Administrative barriers study findings were adopted as part of the reform mix. . . “ (IDA 2004a: 13) In Zambia FIAS carried out an administrative barriers study in 2003. A joint ARCS/ Investment Climate survey was designed by FIAS and the Africa WB private sector department. The recommendations of the administrative barriers study were incorporated by government into private sector development reform plans, whose implementation is being supported by the Bank initially through a component of an existing Bank project, and then a new enterprise development project. (IDA 2004a:13) Also in Zambia, with advice from FIAS, the government has changed tax law to eliminate discretion and to make the playing field more level. For example, some sectors, like tourism and manufacturing, granted exemptions to parts of subsectors and not to other parts. (IFC/ WB 2005:10)

In Sierra Leone, FIAS provided advice to the government on how to change the investment code to meet international best practices. Specifically, the new code eliminates discretion in granting incentives . . . states that all incentives are offered universally to any firm . . . also formally prohibits discrimination of treatment of investors based on nationality or color. (IFC/ WB 2005:10) In Kenya, a ”Guillotine reform” in licensing was undertaken at the behest of FIAS.

The support of “Private –Public business fora” is, apparently, another way for the IFIs to promote reforms of the investment framework. As described by the Bank, investor councils are composed of business leaders and key ministers under the chairmanship of the country president, who prioritise and take action on issues to remove obstacles to investment. Examples of countries where pilot investor councils have taken place are Ghana, Senegal and Tanzania (2001), Mali and Uganda (2004).

FIAS also reports to have several of its advised reforms implemented in Bangladesh because they were taken for follow up by a Business-Government council. While business-government coordination is important and was at the root of, for example, the Korean take-off, it should be noted Korean government coordination was of domestic entrepreneurs, whereas it is not clear who are the business leaders involved in the IFI-promoted councils, nor what their agendas are. Neither is it clear whether the government is in the driving seat of the coordination (as in the Korean case) or it functions as a way for business pressure groups to get a fast-track approval of its demands in a way that bypasses public scrutiny.

VII. Conclusion

In the past few years the World Bank has increased its emphasis on investment climate reforms as a way to grow, reduce poverty and achieve development. This paper has sought to present the World Bank's efforts in the context of other ongoing efforts to reform investment climate and unpack what the World Bank means by a "good" investment climate.

Any attempt to capture the features of a "good" investment climate can be qualified as overly ambitious, given that different approaches and measures, tailored to specific social, political and economic contexts are more likely to be necessary. But the World Bank efforts are plagued by additional problems that make even more doubtful that it can succeed at it. The analytical and diagnostic work rely on assumptions that are far from sound, such as an always positive relationship between foreign investment and growth, benefits from FDI per se as opposed to FDI with certain characteristics and under certain level of state control, and the nature and features of the policy measures that are likely to attract FDI.

The World Bank's influence on the agenda and policy-making on investment climate reform in Africa may prove damaging to development and growth in the region. But this may not actually be the most damaging aspect. By creating the perception that these reforms should be prioritised, scarce human and technical resources in African countries may be put at the service of this agenda, rather than at the service of designing country-tailored measures that may better take advantage of opportunities to harness private capital for development purposes. Through its bias towards a hands-off approach by the state, and its distrusting attitude towards any form of state intervention, the Bank's investment climate reform agenda may undermine the very capabilities that states in Africa need to nurture in order to embed, as they craft their optimal investment climate, responses to the specific market failures they face.

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