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Barriers and Impediments to Foreign Direct Investment (FDI): Checklist and Recommended Policy Response

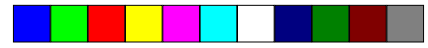
The World Bank and others, including private sector groups, have provided advice on the optimal investment environment. The following guiding principles seem to be used by many multinational corporations to evaluate direct investment opportunities. These are divided into two main groups: (1) The basic requirements, meaning those that a potential investor will want to see met before going any further; and (2) Specific requirements, those that inhibit the willingness of an investor to seriously consider an investment or inhibit the ability of the investor to operate efficiently and effectively in a market. The over-arching message is that governments must take steps towards greater financial sector openness in conjunction with broader structural reform policies in order for both entities, the investor and the host economy, to fully realize the benefits of FDI.

1. Basic Requirements

- **Stable and sensible economic policies** . Business needs confidence that the host economy will be managed in a competent and predictable way and that the rules of the game will not change mid-way through.
- **Low political risk** . Capital tends to flow toward environments with low political risk. An investor's ability to rely upon the integrity of the host government, and its ability to maintain local law and order, are both essential to any long-term investment.
- **A well educated labor force and availability of necessary inputs to an operation, including access to technology** . While the investor brings capital, often new technologies and management to the table, the quality of the local work force and the availability of in-country materials are also important for success. As financial services become increasingly IT-enabled, access to communications infrastructure and the Internet become critical.
- **The size, value and potential for growth of the host economy's domestic market** , especially the purchasing power of its consumers. Companies will not invest in areas where there is little potential to make

a profit. Note: some markets are small but attractive because they are high value.

- **Reliable infrastructure**. The ability to complete transactions, get products and services to market, resolve disputes, and enter into contracts depends upon the presence of reliable telecommunications services, transportation services, power generation, office support services, a competent financial system, legal and judicial services, and other basics. Investments cannot yield reliable returns without them.
 - **A stable currency, especially protection from currency devaluation or manipulation** . Investments are often made in a foreign currency, usually dollars or yen, but the local products are sold in the local currency. While businesses recognize they need to adopt good mechanisms and management regimes to hedge against currency fluctuations, businesses are wary of economies with a history of currency devaluations and artificial currency manipulations. For example, they will be unwilling to make an investment in dollars if they suspect that local assets (valued in the local currency) will be devalued, and they will lose part (or possibly all) of the original dollar-based investment.
 - **Stable and well-functioning market system**. Private property and the freedom to make contracts are essential components as are financial disclosures based on sensible accounting practices. Investors and creditors are rewarded for their good decisions and not shielded by government from the consequences of bad decisions.
 - **Ongoing program of regulatory reform and efficiency**. Increased regulatory uniformity among economies should lower regulatory costs for market participants and the governments.
- #### 2. Specific Requirements
- **Market access and non-discrimination** . Investors will gauge the degree to which foreign governments will interfere with the

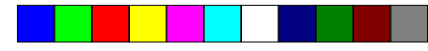


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company's ability to enter the market and compete fairly with domestic or other foreign providers. In some cases joint ventures are a condition of market entry. These can increase the risk to the investor if the regulatory framework is not transparent, is discriminatory and the local partner is not well established. The freer the market, the more attractive it becomes as an investment opportunity.

- **Sensible capital requirements and the ability to manage assets** . Investors will look favorably on economies that adhere to international best practices for paid up capital and capital reserve requirements, and where foreign and local investors are treated in the same way. They also look favorably on markets where they have the ability to manage assets on a global basis (for example, in the ability to invest funds where the return is likely to be greatest, rather than being forced to invest all funds domestically).
- **Policies that encourage the development of strong and stable capital markets** . Investors need to be able to borrow and invest locally as they wish with competitive sources of capital.
- **Provision for the remittance of dividends, interest, and royalties** . Investors are reluctant to place significant investments in economies that do not allow the repatriation of profits.
- **Property rights and the protection against the unfair seizure of or nationalization of assets**. Investors will not put their resources into economies that confiscate them. The importance of government protection of property and asset rights cannot be overstated. Property, includes real assets as well as intangible assets like patents and copyrights.
- **A good corporate governance ethic, supported by the host economy** to ensure that the owners of a company and all its stakeholders get their fair share.
- **Potential for the provision of services beyond the geographic area of establishment**. A business will not necessarily locate in a particular economy or geographic region of a particular economy solely to operate there. Companies value the ability to source from an operating unit in one market to serve nearby external markets, or geographic regions in an economy.
- **A transparent and open legal and regulatory regime and good regulatory supervision**. Companies seek markets with fair and consistently enforced business laws, sensible and well-designed regulatory regimes, which do not impose undue burdens and impede the ability of the company to grow and create more opportunities. At the same time, they want to be sure that their investment is subject to sensible and predictable regulatory supervision consistent with international best practices.
- **Favorable taxation and tax incentives** . While tax incentives geared to attract initial investments are important, governments have to think long-term. The final investment decision is usually based on how an economy's taxation will affect the normal operating environment.
- **Temporary entry of natural persons** . Companies want to have the ability to move in professionals from other areas or regions on a temporary basis as needed.





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Checklist of Barriers and Impediments to FDI in the Financial Services Sector and Recommended Policy Response

Barrier/Impediment	Issues/Concerns	Recommended Policy Response
<p>Restrictive conditions of market entry and operation :</p> <ul style="list-style-type: none"> - inhibits the willingness or ability of investors to bring in full range of capital, skills and technology and the efficiencies of management and new product lines - increases risk to potential investor - benefits of new capital, skills, technology and products only available to a portion of the market where establishment or trade is restricted to certain geographic regions - SMEs in restricted regions unable to profit from competitive benefit of new services - Incentive reduced for host government to upgrade prudential standards to internationally accepted requirements (foreign investors generally subject to high standards of prudential supervision in their home economy) 	<ul style="list-style-type: none"> - foreign equity caps - joint venture requirements including ownership and control issues - limits on range of products - limits on ability to operate in an integrated national market - onerous capital requirements 	<ul style="list-style-type: none"> - phase out foreign equity caps - phase out joint venture requirements as condition of market access - remove limits on range of products offered (subject to appropriate supervisory mechanisms) - permit comprehensive market access in all regions of an economy - permit foreign majority ownership - establish a strong regulatory system (thereby making establishment and operating restrictions unnecessary) <p><i>Strengthen Local Industry</i></p> <ul style="list-style-type: none"> - support and encourage capacity building in regulatory supervision - encourage local providers to participate in Basel 2 capacity building workshops (capital adequacy, risk assessment and management, operational risk and financial disclosure); and other financial sector capacity building programs such as those promoted by the IAIS, World Bank, ADB, IMF, PECC and APEC.

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<p>Lack of National Treatment and MFN</p> <ul style="list-style-type: none"> - reduces competitiveness and discourages growth and efficiency of local providers - local providers less resilient to shocks - increase risk by over-reliance on a few foreign service providers 	<ul style="list-style-type: none"> - discrimination between local and foreign providers, including differing capital requirements - differential requirements on 3rd country providers - discriminatory tax 	<ul style="list-style-type: none"> - equal treatment for foreign and local providers - improve operational risk through capacity building (e.g. Basel 2) - remove discrimination between foreign service providers in terms of market access and operations
<p>Restrictions on Asset Management</p> <ul style="list-style-type: none"> - inability to get best return on investment - increases risk - inability to match liabilities with assets 	<ul style="list-style-type: none"> - restrictions on financial service providers; banks, insurers, asset managers - restrictions on assets for investment - restrictions on personnel 	<ul style="list-style-type: none"> - allow cross border investment - allow fund management from overseas - provide for commercial presence of overseas service suppliers
<p>Lack of transparency, predictability and openness in legal and regulatory regimes</p> <ul style="list-style-type: none"> - increases risk to investor and consumer - encourages discriminatory business practices - increases risk of corruption - promotes market inefficiencies 	<ul style="list-style-type: none"> - procedures for right of redress and/or appeal - license application and award procedures - inconsistent and discriminatory treatment of business entities 	<ul style="list-style-type: none"> - clear, published processes for legal and regulatory decisions and right of appeal - clear published process for regulatory policy formulation and stakeholder consultation
<p>Weak regulatory and legal infrastructure</p> <ul style="list-style-type: none"> - inhibits smooth functioning of the market - encourages monopolistic and cartel practices - inhibits ability to enter into contracts - increases risk and costs to investor and host economy 	<ul style="list-style-type: none"> - poor prudential supervision - enforcement of binding contracts - lack of expertise - inadequate solvency and creditor rights - weak property protection rights and enforcement 	<ul style="list-style-type: none"> - capacity building in internationally recognized best practices for financial sector regulation - strengthened economic and legal infrastructure, including bankruptcy laws and regulations



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Capital controls <ul style="list-style-type: none"> - potential to increase cost of capital to investor and consumer - inhibits ability of investor to source and place capital appropriately and efficiently - difficulty in hedging risk - inhibits willingness of investor to participate in the market - future exchange rate vulnerabilities without clear exit strategy 	<ul style="list-style-type: none"> - repatriation of profits, dividends, remittances - inability to source capital and place investments on a global basis 	<ul style="list-style-type: none"> - phase out capital controls - strengthen capital markets infrastructure - regulatory reform - phase in flexible exchange rate arrangements
Weak governance <ul style="list-style-type: none"> - increases threat of corruption - reduces market efficiency - promotes monopolistic practices - threat of market failures 	<ul style="list-style-type: none"> - corruption - lack of accountability - unpredictable market situation - lack of competition 	<ul style="list-style-type: none"> - strong corporate and public sector governance ethics - capacity building measures to promote understanding and awareness of good governance - competition policy and laws
Poor property rights protection <ul style="list-style-type: none"> - inhibits ability of investor to offer innovative product lines - inhibits willingness to fully participate in the markets 	<ul style="list-style-type: none"> - asset seizure, including nationalization - patent, copy right and trademark protection 	<ul style="list-style-type: none"> - adequate laws and rights of redress - eliminate ability to nationalize assets - enforcement of property laws
Restrictions on the Movement of Natural Persons <ul style="list-style-type: none"> - reduced ability to share expertise, technology and skills - increases operational inefficiencies - inhibits ability to offer and service innovative product lines on time 	<ul style="list-style-type: none"> - delays in processing temporary visa applications - limited adjudication ability - lack of clear criteria and procedures 	<ul style="list-style-type: none"> - facilitate business travel and intra-company transfers - expedite visa processing for professionals