PRIVATE SECTOR DEVELOPMENT DIVISION
DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS

ACHIEVEMENTS OF THE OECD INVESTMENT COMPACT FOR SOUTH EAST EUROPE

I. INTRODUCTION

Since 2000, South East Europe has made remarkable progress in terms of investment climate. Foreign direct investment inflows reached the record level of US$ 27.5 billion[1] in 2007 (up from US$ 4.4 billion in 2001), real GDP growth has averaged over 5% from 2000 to 2007, and inflation is regularly well below double-digit levels. Regional FDI inflows per capita increased three times faster than in CEE between 2000 and 2006. And the private sector share of GDP rose significantly over the same period, currently ranging from 55% to 75% across the region. While many factors have contributed to this improvement - a key factor being the developments linked to EU accession - the Investment Compact for South East Europe programme has played an instrumental role.[2]

Launched in 2000 as one of the initiatives of the Stability Pact for South Eastern Europe's Table II, on Economic Reconstruction, the Investment Compact has been managed since its inception by the OECD, following a mandate received from the Stability Pact. Since then, the Investment Compact has been working with South East European countries on improving the investment climate and encouraging private sector development in the region.

II. MAIN ACHIEVEMENTS

Through its work since 2000, the Investment Compact has:

- **Enhanced South East Europe's investment environment** by:
  - Increasing awareness of the impeding effects of policies across many areas on the development of investment flows and the private sector;
  - Accelerating reforms through the identification of policy priorities and guidance on how to implement them;
  - Moving countries closer to OECD standards through adherence as observers to OECD Committees;

[1] Estimated.

[2] Conclusion of the evaluation of the Investment Compact conducted by management consulting firm A.T. Kearny.

- Improving the region's image as an attractive destination for investment through promotional events and activities, and engagement with the OECD.

- **Promoted a culture of continuous improvement** through the systematic monitoring and evaluation of policy and reforms.

- **Built the capacity of policy makers** for effective policy design through the identification and dissemination of SEE and CEE good practices and the transfer of OECD methodologies, tools and instruments, taking into account the specific circumstances of the region.

- **Helped establish a sustainable process for reform** of the business climate at the regional level through a self-reinforcing mechanism of measurement, by institutionalising high level political support for the reform process and by boosting the private sector's advocacy role.

- **Encouraged regional ownership of the reform process** with the launch of the South East Europe Investment Committee (SEEIC) and regional thematic Working Groups intended to improve policy dialogue and implementation of investment reforms.

III. ACTIVITIES

The Investment Compact has been able to realise these achievements through activities under its four pillars of work:

1. Monitoring and evaluation of policy reforms;
2. Support in the implementation of reforms;
3. Institutionalisation of high-level political support for the reform process;
4. Development of private sector support.

1. MONITORING AND EVALUATION OF POLICY REFORMS

The Investment Reform Index

Monitoring and evaluation of policy reform has been a landmark of Investment Compact work, starting in 2001 with the first of five annual editions of the *Monitoring Instruments* report[3]. In 2006, the Monitoring Instruments evolved into the Investment Reform Index (IRI) and a first IRI report[4] was published in November 2006. A second IRI evaluation based on refined indicators will be launched in June 2008 and the second report will be published in April/May 2009.

The IRI is a practical tool developed by the Investment Compact to measure and communicate on progress made by South East European countries in implementing reforms to improve their investment climates.
The IRI has three main functions. It:

- Evaluates existing policies in each country through a set of comparative indicators;
- Defines both regional and country specific reform priorities; and
- Provides guidance on how to implement selected reforms.

[3] OECD (2001) (2002) (2003) (2004) (2005), Monitoring Instruments - Progress in Policy Reform in South East Europe

[4] OECD (2006), Investment Reform Index 2006 - Progress in Policy Reforms to Improve the Investment Climate in South Europe

The IRI is structured around the OECD *Policy Framework for Investment*, which incorporates good practices from OECD countries, and goes beyond the typical components of investment policy (e.g. national treatment of FDI, network of bilateral investment protection treaties, investment incentives) to evaluate government policy along the following 9 dimensions:

1. Investment policy
2. Investment promotion
3. Tax policy and administration
4. Trade policy
5. Anti-corruption
6. Human capital development
7. Infrastructure
8. SME policy
9. Better business regulations

Data for the policy evaluation are collected through a tripartite process that involves: (i) a self-evaluation by governments, (ii) focus groups and a survey with the private sector, and (iii) an independent OECD assessment with the support of local consultants in the region. Use is also made of existing diagnoses and implementation work conducted by other international organizations.

Key questions addressed by the IRI process include:

- In which areas have SEE countries most made most progress in reform efforts aimed at increasing investment, trade, growth and employment?
- What are the reform priorities at the national and regional level?
- To what extent is there a consensus between countries, the private sector and international organisations on those priorities?
- In which policy areas can SEE countries receive the most valuable support?
- What practical guidelines can be developed in selected policy areas to support reform implementation in priority areas?

The IRI has 4 main benefits for countries. It:

- Provides an overview of each country's performance on investment policy reform;
- Allows countries to benchmark progress relative to their peers in the region;
- Supports countries in setting priorities to further improve the investment environment;
- Provides direction on how to make improvements within each policy dimension by adopting OECD good practices.

According to *The Economist* “the IRI methodology is solid and the results revealing”[5].

<u>The SME Policy Index</u>

Given the importance of small and medium-sized enterprises (SMEs) for economies in South east Europe, the Investment Compact has also focused on evaluating government policy to support SME development. *Enterprise Policy and Performance Assessments* (EPPA) were conducted in 2004 and 2005 and were followed by a first SME Policy Index evaluation in 2006-2007.

Prepared in collaboration with the European Commission (Directorate General Enterprise and Industry), the *SME Policy Index 2007*[6] report (published in June 2007) provides a comprehensive and

[5] *The Economist*, 09 November 2006

[6] OECD/EC (2007), SME Policy index 2007 - Report on the Implementation of the European Charter for Small Enterprises in the Western Balkans

comparative review of SME policy implementation in the Western Balkans. Since its publication, governments have used inputs from the reports to identify medium-term policy targets and mobilise technical assistance resources from the EC and other donors to address specific weaknesses in policy design and implementation.

The SME Policy Index is based on the European Charter for Small Enterprises, a pan-European instrument - developed under the framework of the Lisbon Agenda – and adopted in 2003 by all the Western Balkan countries[7] and UNMIK/Kosovo. Since its adoption, the Charter's policy guidelines have become a key reference for enterprise policy development in the region, with SME policy becoming a priority on the reform and EU pre-accession agenda of the Western Balkans.

The SME Policy Index is based on a set of 58 qualitative and quantitative indicators that capture the critical components of each of the Charter's 10 policy dimensions. The Charter's 10 dimensions are:

1. Education and training for entrepreneurship;
2. Cheaper and faster start-up;
3. Better legislation and regulation;
4. Availability of skills;
5. Improving online access;
6. Getting more out of the Single Market;
7. Taxation and financial matters;
8. Strengthening the technological capacity of small enterprises;
9. Making use of successful e-business models and developing top-class small business support;
10. Developing stronger, more effective representation of small enterprises' interests at Union and national level.

For each country, the assessment balances the results of a government-led self-assessment with an independent evaluation co-ordinated by the OECD Investment Compact and the EC DG Enterprise and Industry, in consultation with the European Bank for Reconstruction and Development and the European Training Foundation.

A second SME Policy Index evaluation will be launched shortly and will focus on innovation and the support provided to high growth and innovative SMEs. This evaluation will again be conducted in co-operation with the EC, the EBRD and the European Training Foundation, and the results will be presented in April 2009 through the publication of the *SME Policy Index 2009* report.

Country/Theme-Based Evaluations

The Investment Compact has also conducted in-depth evaluations on both a country and thematic basis. A thematic review of national treatment[8] conducted in 2003 led to Romania's adherence to the OECD National Treatment Declaration. Other regional evaluations of policy areas have included an evaluation of regulatory governance[9], a peer review on business registration[10], an assessment of competition law and policy[11], and a survey on taxation[12].

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[7] Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Serbia.

[8] OECD (2003), National Treatment of International Investment in South East European Countries: Measures Providing Exceptions

[9] OECD (2003), Regulatory Governance in South East European Countries: Progress and Challenges

[10] OECD (2005), The Business Registration Process in South East Europe: A Peer Review

[11] OECD (2003), Competition Law and Policy in South East Europe: A Programme of Action

[12] OECD (2003), Tax Policy Assessment and Design in Support of Direct Investment: A Study of Countries in South East Europe

Alongside the Enterprise Policy Performance Assessments (EPPAs), country specific evaluations have included an assessment of the role of foreign direct investment in Croatia[13], a review of the information and communications technology sector in Serbia[14], and an assessment of the informal economy in Albania[15] (prepared for the Ministry of Economy of Albania).

2. SUPPORT IN THE IMPLEMENTATION OF REFORM

As a logical follow-up to the monitoring and evaluation of reforms, the Investment Compact's second area of work and achievement is the provision of support in the implementation of reforms.

Guidelines

One way the Investment Compact has supported implementation has been through the development of guidelines. It has, for example, drafted guidelines on designing competitive strategies for attracting FDI[16] as well as guidelines on designing competition policy[17]. Through the expert Working Groups established under the South East European Investment Committee (see section 3), guidelines are now currently being developed to support the design and implementation of reform in anti-corruption, business regulation, human capital development, and in linkage programmes between foreign and local investors. These working groups are regionally-owned and focus on policy priorities identified through the Investment Reform Index evaluations. They are composed of experts from SEE and OECD countries and from the OECD Secretariat.

Projects

The Investment Compact has also conducted country/issue specific projects. The three most recent are:

- The ongoing Investment Compact/World Bank project 'Strengthening Sector Specific Sources of Competitiveness in the Western Balkans', which seeks to identify and remove specific barriers to investment and trade in four sectors (i.e. automotive components, textile and garment, business process outsourcing, and information and communications technology).
- The Investment Compact/EC 'SEEStat' project, which coached South East European countries in improving the quality of their investment statistics;
- The Investment Compact/Swiss Confederation 'Moldova FDI Strategy' project, which supported Moldova in designing an FDI strategy.

3. INSTITUTIONALISATION OF HIGH-LEVEL POLITICAL SUPPORT FOR THE REFORM PROCESS

The Investment Compact fosters political support for its activities in order to:

- Promote high-level political co-operation at the regional level;
- Encourage consensus on the reform process;
- Guarantee the applicability of recommendations and reforms advocated;
- Garner political commitment for the implementation of reforms;
- Ensure the relevance and sustainability of the reform process.

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13 OECD (2007), The Role of Foreign Direct Investment in the Croatian Economy
14 OECD (2003), An Overview of the Information and Communications Technology Sector in Serbia and Profiles of Selected Companies
15 OECD (2004), The Informal Economy in Albania: Analysis and Policy Recommendations
16 OECD (2002), Strategic Investment Promotion - Successful Practice in Building Competitive Strategies
17 OECD (2003), Competition Law and Policy in South East Europe

Ministerial Conferences

The Investment Compact has notably generated political backing through five annual ministerial conferences during which ministers from the region took stock of achievements and agreed on a roadmap for reforms. At the 2006 Ministerial Conference (Vienna, 26-27 June 2006), ministers adopted a 'Regional Framework for Investment in South East Europe' which outlined a range of targeted policy reforms consistent with the OECD *Policy Framework for Investment* and adapted to the specific context of the region.

The South East Europe Investment Committee

Anticipating the evolution of the Stability Pact towards the more regionally owned Regional Co-operation Council (RCC), SEE countries and the Investment Compact launched the South East Europe Investment Committee in April 2007. Headed by SEE ministers, and with SEE-country chairmanship of the working groups, the Committee provides added political backing and impetus for reform. It has already led to increased co-operation between countries of the region.

As the 'Investment arm' of the new RCC, the SEE IC is responsible for evaluating and supporting the implementation of investment-related policies in SEE. In addition, the SEE IC will also provide technical expertise to the Secretariat of the Central European Free Trade Agreement[18]. Concretely, the Investment Compact will: (1) monitor the impact of CEFTA on promoting foreign direct investment flows to the region and (2) assist in monitoring the three investment-related clauses of the treaty: co-ordination of investment policy, intellectual property rights, and public procurement. Decisions on the formal relationship between the SEE IC and CEFTA will be taken shortly.

In an open-editorial published by the *Balkan Investigative Reporting Network* in October 2007, Dr. Erhard Busek, Special Co-ordinator of the Stability Pact for South Eastern Europe, stressed the key role the Committee plays: "Co-ordination, peer-review mechanisms and exchange of best practices between the countries of the region have a major role in improving the investment climate in each of them, and in identifying and implementing key reforms. This is the aim of the recently launched SEE Investment Committee, a modern tool assisting SEE countries in developing policy guidelines and implementing reforms in the field of investments, mirroring in SEE mechanisms already adopted by the most advanced economies of the world".

Country Economic Teams and Co-Chairing

The creation of the SEE IC can to a certain extent be viewed as the culmination of the Investment Compact's strategy of increasing regional ownership of the reform process in order to strengthen political support for it. Investment Compact success in producing sustainable results has been closely correlated to this close collaboration with SEE governments and the progressive transfer of ownership of the reform process. In this area, the Investment Compact itself has led the way: first by setting up a network of Country Economic Team Leaders[19] and a network of regional Investment Compact offices (Serbia, Romania, Bulgaria, Croatia), and then by introducing in 2003 a system of regional co-chairmanship of the programme, with Romania (2002/3), Bulgaria (2004/5) and now Serbia holding the position.

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[18] Adopted in December 2006

[19] Country Economic Teams were set up by the Investment Compact to ease liaison and co-ordination with SEE governments. They are headed by a senior level official (Minister or Deputy Minister) who represents his country on the SEE Investment Committee.

Involvement of Parliamentarians in the Reform Process

From 2005 to 2008 the Investment Compact - in co-operation with GTZ - conducted five country studies on the improvement of economic reform legislation and the role of Parliaments (Albania, Bosnia and Herzegovina, Montenegro, FYR Macedonia and Serbia). Workshops with senior government representatives and leading Parliamentarians were held in each of the participating countries. A regional parliamentary conference is envisaged for end September 2008. This will draw conclusions from the country studies and prepare a list of indicators for the measurement of legislative progress relevant to economic reform.

4. DEVELOPMENT OF PRIVATE SECTOR SUPPORT

The Investment Compact views the involvement of the private sector in the reform process as critical and therefore works on generating private sector involvement in its activities. By doing this, it specifically aims to:

- Foster public-private sector dialogue;
- Receive business' views and advice on policy reform issues;
- Benefit form best practices identified by business;
- Guarantee the relevance of the reforms advocated;
- Ensure support for advocated reforms;
- Guarantee support for the reform process itself.

One way the private sector is involved in the work of the programme is through direct participation in some of its activities. Currently, this participation involves an advisory role in SEE Investment Committee Working Groups, and the provision of inputs in the Investment Reform Index and SME Policy Index monitoring processes.

Foreign Investors Councils

The Investment Compact has also fostered private sector involvement in its work through the critical role it played it the establishment of SEE's Regional Network of Foreign Investors Councils (FICs). The Investment Compact proposed the Network's creation and played a crucial role in developing it with country FICs. The creation of a regional network of FICs has strengthened the efforts of individual FICs across the region and provides a forum for region-wide sharing of information and experience. It also constitutes a platform for promoting better awareness and communication of key policy issues affecting business and investment and building interaction and partnership with all private sector groups committed to improving the investment climate in SEE. The Investment Compact's partnership with FICs provides for a 'reality check' – from a business perspective - of reform implementation and priorities. The partnership also affords opportunity for constructive dialogue and increased co-operation with SEE countries and partners in shaping and improving the investment and business development environment.

The Investment Compact has also been strongly involved in the establishment of some of the region's country FICs (Serbia, Moldova) and has played an important role in some of the FICs' activities: it set up the SEE Investment Forum, a partnership of national organisations active in the field of investment promotion; it contributed to the publication of various FIC *White Books*, which identify obstacles to investment and business development and formulate practical legal and technical proposals to overcome them; and it supported the Bulgaria Economic Forum in developing 'www.seeurope.net', the first business portal for SEE.

Investors of the Year Awards

The Investors of the Year Awards have been organised annually since 2003 by the Investment Compact to promote awareness and appreciation of major investment projects in the SEE region. The

Investors of the Year awards have been a unique opportunity to present successful examples of international and domestic investments in the SEE region and to highlight the region as an attractive destination for investment. The candidate nominations are made by the investment promotion agencies of the region and the jury is composed of senior-level officials from these agencies.

As a group, the winning companies form a representative sample of the kind of success stories that confirm the recent emergence of South East Europe as a destination of growing importance for international business. The winning companies also highlight two key aspects of international investment in the South East European Region: (i) the diversity of sectors in which FDI is being attracted to the region; and (ii) the diversity of geographical sources of FDI. Importantly, this diversity strengthens the prospects for stability and growth in FDI flows to the region.

These Awards have been organised as part of the programme's ministerial conferences and have provided a valuable and highly appreciated complement to the business events (which include 'reality checks' bringing together public and private sector representatives), which are also organised as part of the conferences.