Asia-Pacific
Economic Cooperation

Measuring Progress in Implementing APEC's IFAP: Establishing a methodology and selecting key performance indicators

APEC Policy Support Unit

October 2009

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Centre for International Economics 2009

Produced for:
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APEC#209-SE-01.10

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ABOUT THIS REPORT

Foreign direct investment is an important contributor to economic growth in both developed and developing economies. Recognition of the economic benefits of foreign direct investment (FDI) has seen economies becoming increasingly competitive in their efforts to attract a larger share of the global FDI market.

The APEC Investment Facilitation Action Plan (IFAP) provides a working framework for a series of eight guiding principles that, if met, would constitute better practice in investment facilitation and improve the attractiveness of APEC member economies to FDI.

Implementing the eight principles identified in IFAP would facilitate achievement of a preferred investment environment. To this end, it is critical that economies can accurately measure their progress in implementing the principles over time. Measuring achievements also contributes to the goal of improving transparency. It also allows the benchmark APEC performers to be identified, which can in turn provide an avenue for other members to seek assistance from the leading members, and in so doing further enhance cooperation amongst APEC member economies.

The Centre for International Economics has been commissioned by the APEC Policy Support Unit to develop a methodology to measure APEC member economies' progress in terms of implementing IFAP, and to identify key performance indicators that can be used to provide a consistent basis for measurement of IFAP progress over the 2008–10 period.

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1 IFAP AND THE IMPORTANCE OF FDI

APEC is a forum for economies in the Asia-Pacific region to work collectively, devising and sharing ways in which economic growth can be achieved. Investment has long been recognised as one of the best avenues through which to achieve this growth, with a particular focus on foreign direct investment (FDI) and its associated additional benefits.

A. The Investment Facilitation Action Plan

In their May 2008 meeting at Arequipa (Peru), the APEC Ministers Responsible for Trade endorsed the Investment Facilitation Action Plan.

The main aims of IFAP are to:

- strengthen economic integration;
- strengthen the competitiveness and sustainability of economic growth of APEC's member economies;
- expand the prosperity and employment opportunities in the APEC region; and
- make further progress towards achievement of the Bogor Goals.

Importantly, IFAP is not meant to be a single and all encompassing framework for addressing all factors that influence the decision to invest. For example, IFAP does not seek to address the overall macroeconomic and political stability settings in APEC member economies. It does, however, set out a framework to guide the aims for, and the development of, investment related policies and actions to increase the potential for an economy to attract FDI.

IFAP outlines eight guiding principles, including:

- promote accessibility and transparency in the formulation and administration of investment related policies;
- enhance stability of investment environments, security of property and protection of investments;
- enhance predictability and consistency in investment related policies;
- improve the efficiency and effectiveness of investment procedures;
- build constructive stakeholder relationships;
- utilise new technology to improve investment environments;
- establish monitoring and review mechanisms for investment policies; and

- enhance international cooperation.

For each principle, IFAP identifies a range of actions that contribute to the meeting and implementation of the principles.

The IFAP principles therefore target investment related policies/actions to improve the ability of an economy to attract foreign investment and maximise the effectiveness and efficiency of investment administration through all stages of the investment cycle. In essence, the IFAP principles seek to improve:

- the availability of information important to the investment decision making process;
- the process of foreign investment policy formulation; and
- the attractiveness of APEC member economies to foreign investment through lowering the cost of making, and risk to, a foreign investment.

The purpose of implementing IFAP is to improve the attractiveness of investing in APEC economies and increase associated investment. Hence the ultimate objective of IFAP is to help maximise the share of global foreign investment captured by APEC member economies and the wider APEC region.

While IFAP is not — nor tries to be — a comprehensive tool to improving the investment climate, it does incorporate many actions that directly contribute to lowering the cost and risk associated with investing in a particular location. Numerous other multilateral organisations (World Bank Group, OECD, UNCTAD etc) have active FDI promotion/facilitation programs. IFAP has been developed with a view to building on the FDI programs of these other multilateral organisations. Given these other programs, IFAP is targeted in terms of the areas of foreign investment facilitation that it seeks to address.

B. The importance of foreign investment, and especially FDI

Many developed and developing economies around the world actively seek out foreign direct investment.[1] This can be via policy reforms to improve the wider investment environment, establishing investment promotion agencies (IPAs) and proactively seeking out foreign investors, through to offering generous investment incentives.[2]

The 'value' of inward FDI to an economy typically lies in either one of three areas (or some combination thereof), these being:

- to address a savings-investment imbalance;

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1 In official statistics, foreign direct investment is typically defined as that which leads to a greater than 10 per cent of the holding of a local company. Less than 10 per cent is defined as portfolio equity investment. Foreign ownership and control is usually defined in terms of majority foreign ownership (Australian Bureau of Statistics 2004, *Economic Activity of Foreign Owned Business in Australia: 2000-01*, ABS Cat No 5494.0 page 30).

2 Whether or not such investment incentives are needed/justified is an entirely different matter.

- as a source of direct productivity gains (productivity gains occur in firm where investment took place); and/or

- as a source of indirect productivity gains (productivity gains occur in other firms within the same sector, or in sectors upstream or downstream to where the investment took place).

Recognising the importance of FDI to economic growth, APEC has been active over the last 15 years in targeting investment liberalisation and facilitation; with IFAP concentrating on the facilitation facet.

The areas of value identified above are discussed over the next 5–6 pages.

i. Addressing a savings-investment imbalance

FDI is valuable if an economy has investment opportunities, but inadequate domestic savings to fund those investment opportunities (the so called 'savings–investment gap'). Under this scenario, FDI allows investment opportunities to be fulfilled at lower cost and in so doing augments the capital supply, which in turn accelerates economic growth and raises living standards.

Capital inflows to fund a savings–investment gap can take many forms — direct investment; portfolio equity investment; portfolio debt investment (investment in bills and bonds issued by an economy's institutions); or direct borrowing by households and business overseas. The various forms of capital inflow are close substitutes for each other. A company wishing to raise capital for an investment project can do so either by issuing equity or by borrowing. If it were constrained in some way from raising equity capital it could increase its borrowing to fund a given quantity of investment. If it were constrained in terms of borrowing it could raise more from the equity market. The same logic applies to international capital flows. Constraining equity inflows would simply lead to greater borrowing. The overall level of capital inflows (and outflows), would be little changed.

This also holds true for entities. Constraining foreign direct investment in a particular firm might mean that the firm borrows from a bank that in turn raises funds overseas. With a floating exchange rate and open capital markets, putting constraints at a particular point simply leads to greater flows somewhere else. In fact international capital markets are now so deep that any fall in direct investment would be quickly filled by increased flows in the debt market without any change in interest rates.[3]. Direct restrictions, and the taxation treatment of international income, influence the composition of inflows — what form they take — but have much less influence over the absolute level.

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[3] Global capital markets have become deeper and more diversified over the last ten years. Cross border capital flows have increased by more than a factor of three. The absolute size of the world capital market has also expanding rapidly. The total value of the World capital market (equities, debt securities on issue and lending by commercial banks) was $US194.5 trillion in 2006. Activity in the world derivatives market is about twice that, at around $US516 trillion at end 2007, roughly ten times the size of world GDP (with the size of the derivatives market measured by the value of outstanding contracts in the over the counter market at the end of December 2007); International Monetary Fund, 2008, *Global Financial Stability Report: Containing Systemic Risks and Restoring Financial Soundness,* Washington, April, page 141.

1. FDI inflows and outflows

Just as the benefits from trade are two sided, so are the benefits from more open capital flows. In the case of free trade, economies benefit from exports in terms of being able to exploit economies of scale and being able to sell to the highest bidder (and raising income), while with imports welfare rises due to having access to a greater range of available goods and services at a lower cost. Similarly with capital flows, economies benefit from the export of capital by achieving higher risk adjusted returns, and benefit on the import side from readier access to capital at a lower price (servicing cost) than would otherwise be available.
From the foreign investor's viewpoint, the decision to invest directly in a foreign economy is driven by a variety of factors.

1. Seeking access to unique workforce skill sets and cluster 'hot-spots' (such as Silicon Valley for computing, Singapore for logistics and so on) so as to facilitate innovation, and hence productivity, advances.

2. It can act as a means of expanding a service firm's client base/export market accessibility; that is, service exports delivered via commercial presence. This is particularly relevant for developed countries, where the service sectors account for 60 per cent of FDI stocks.[4]

3. It can occur to take advantage of economies of scale or scope on the part of the investing firm. A significant amount of merger and acquisition activity (which often leads to increased foreign ownership) occurs because of the existence of either economies of scale or scope. An example of economies of scale would be a firm wishing to exploit proprietorial knowledge or know how in producing or delivering a particular product (such as an international logistics company taking an interest in a local delivery company, resulting in a more efficient/lower cost local operation). An example of economies of scope would be a firm expanding its range of operations so that it defrays organisational, design and advertising costs across a range of goods and services (exploiting brand recognition or franchising).

4. It can occur for operational reasons for the purpose of establishing vertically integrated production chain, or a distribution network for the sale of a firm's product. For example, fashion producers moving into retailing where stores only sell their labels.

5. It can occur for financial diversification or hedging reasons. Just as it sometimes pays firms to diversify overseas so that their profits are not so dependent on the local conditions, so too it sometimes pays foreign firms to diversify into other economies. Similarly, sometimes an investment can be a natural hedge. For example a foreign steel maker or electricity supplier, whose profits depend on the price of iron ore or coal inputs, may wish to invest in mining companies as a hedge. In so doing the foreign firm will be prepared to pay a premium for a share of the mining asset, and in so doing lowering the cost of raising capital to the mine operator.

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4 Sauvant, K.P. (2005) *Reservoirs of the Future* in 'What's Next: Strategic Views on Foreign Direct Investment', ISA in cooperation with UNCTAD and WAIPA, page 93.

ii. FDI as a driver of productivity gains

While economies may be indifferent as to whether a savings–investment gap is funded via FDI, portfolio or direct borrowings overseas, economies may attach a high value to FDI due to technological advancements and know-how that it brings with it. Access to new technology and know-how can drive productivity gains, which in turn improve competitiveness and further contribute to economic growth and rising living standards. There are two types of productivity gains. Productivity gains can either be direct in nature (they occur in the firm where the investment took place) or indirect in nature (they occur in other firms within the same sector, or in sectors upstream or downstream to where the investment took place). While the evidence for some aspects of FDI related productivity gains may be ambiguous, some APEC members have a sufficiently high savings rate to fund investment, yet still have significant stocks of inward FDI. Productivity gains probably underlie the often observed situation where an economy pursues inward FDI despite not needing to address any savings–investment shortfall.

Typically, foreign multinational enterprises (MNEs) are thought to bring with them best practice technology and know how (including management/organisational structures); or if not best practice, then at least better practice than local firms.[5] If MNEs are to compete with local firms, with these firms having local market knowledge and established client relationships, then the MNE will need to have some other advantage in order to allow it to capture market share and compensate for the advantages enjoyed by the local incumbent firms.[6] If a foreign firm decides to invest in an economy, then logically, it could be expected that the foreign firm is either more efficient/productive or offers a higher quality product. Indeed, the evidence for a productivity differential between foreign and domestic firms appears to be convincing.[7] Foreign firms will try to capitalise on this productivity advantage by not lowering prices to fully match the efficiency advantage over local firms, but this will eventually occur through competition.

There is a vast literature on whether or not FDI confers spillover (or indirect) productivity gains to host economies.[8] If MNEs invest in another economy in order to exploit proprietorial knowledge and better technology, then those MNEs are unlikely to willingly

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5 Görg, H. and Greenaway, D. (2003), 'Much Ado About Nothing? Do Domestic Firms Really Benefit from Foreign Direct Investment?', *Institute for the Study of Labour*, Discussion Paper no. 944, November 2003, Germany, p. 18.

6 Girma, S. (2003), 'Absorptive capacity and productivity spillovers from FDI: a threshold regression analysis', *European Economy Group, Working Paper no. 25/2003*, p. 3.

7 For example, see Girma, S., Greenway, D., and Wakelin, K. (2001) 'Who benefits from foreign direct investment in the UK?', *Scottish Journal of Political Economy*, Vol. 48, pp. 19-33; who find that 'foreign ownership' accounts for foreign firms being over 5 per cent more productive than domestic UK firms in the same industry (and having accounted for differences in scale, capital intensity etc between foreign and domestic firms).

8 See Görg, H. and Greenaway, D. (2003), 'Much Ado About Nothing? Do Domestic Firms Really Benefit from Foreign Direct Investment?', *Institute for the Study of Labour*, Discussion Paper no. 944, November 2003, Germany, for a thorough literature review of the empirical evidence behind claims that FDI delivers productivity gains to host economies.

offer up their competitive advantage for free. Hence if productivity gains do arise in other firms, then they will be spillover in nature. The literature identifies five channels through which such spillover productivity gains could arise, namely:[9]

- imitation — methods such as reverse engineering of the MNE's product and adoption its management/organisational structure could see local firms becoming more efficient and productive;

- skills acquisition — MNEs typically engage in the training of their workforce and give them access to proprietorial knowledge/technology; movement of labour from the MNE to an existing or new firm may see this proprietorial knowledge/technology being transferred to local firms;

- competition — MNEs will produce in competition with local firms, and in so doing will provide an incentive for the local firms to either use existing technology more productively or to implement new technology/processes if they wish to remain competitive;

- exports — domestic firms can adopt the process (establishing distribution networks, creating export infrastructure, learning about consumer tastes etc) used by the MNC to improve their own export strategy, in other words, learning to export from MNEs; and

- supply chain linkages — through offering technical assistance, MNEs help suppliers to improve the cost/quality of their output (in order to meet the MNE's requirements), or raise standards which in turn encourages local suppliers to upgrade their technology/processes (forward productivity linkages have also been researched).

The spillover channels identified above may be 'horizontal' — in broadly the same industry — or 'vertical' through the production and marketing chain.

FDI, and the efficiency gains it brings with it, will therefore act to directly raise the productivity of the firm being invested in. If increased competition from the MNE sees local firms innovating/imitating and becoming more competitive themselves, or an exiting of firms unable to compete, then average sector productivity will rise further. FDI induced productivity gains, whether they are direct or indirect in nature, will promote economic growth.

Chart 1.1 depicts the various channels — investment stimulus, income diversification and productivity gains — through which FDI can promote economic growth.

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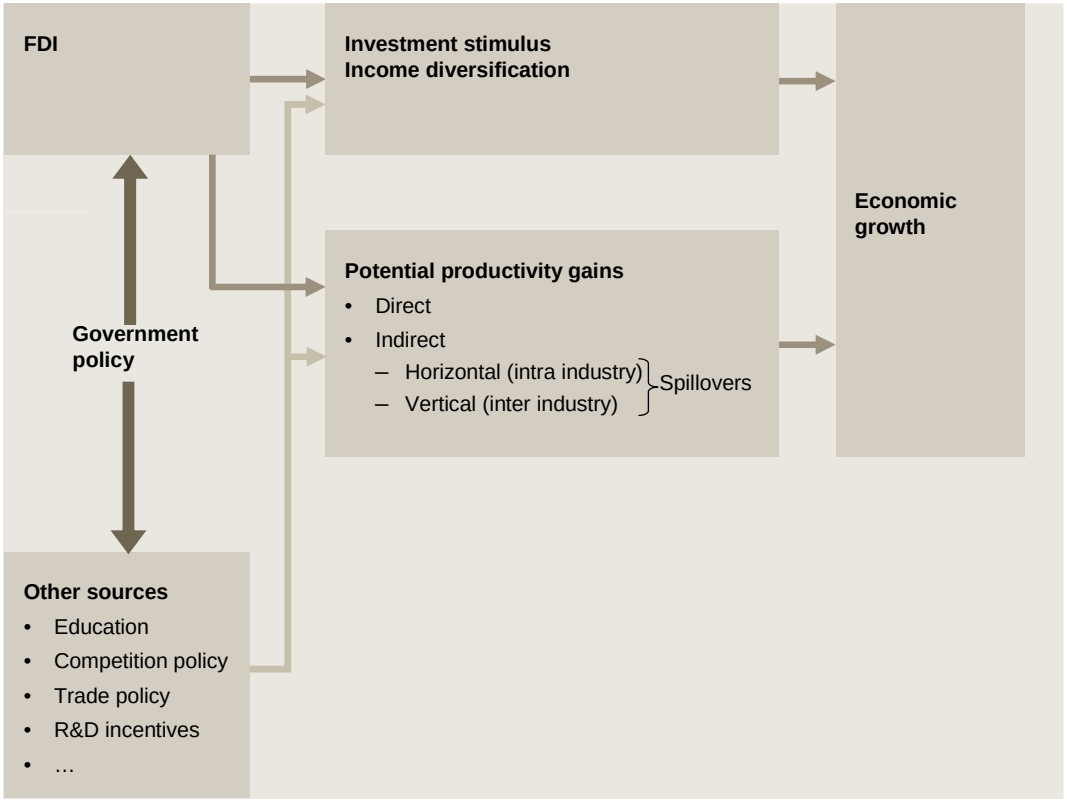
9 Ibid, and , Haskel, J., Pereira, S. and Slaughter, M. (2007), 'Does Inward Foreign Direct Investment Boost the Productivity of Domestic Firms', *The Review of Economics and Statistics*, Vol. 89, no. 3, pp. 482–96.

1.1 **FDI as a driver of economic growth**



Source: CIE.

2. What does the literature say about FDI and productivity gains?

Although theory can identify a number of channels through which spillover effects could be incurred, the empirical evidence is, at best, limited. This may reflect less than ideal approaches to the econometrics, a lack of required data sets, looking in the 'wrong place' for productivity gains (horizontal versus vertical), the requirement of certain local conditions before spillover benefits are observed, or the absence of any FDI productivity spillovers.

A thorough literature review of the topic, spanning some 40 econometric papers, identified only a handful (seven) of papers that are considered to have used the appropriate econometric methodology (firm level panel data) and which found a positive relationship between FDI and spillover productivity gains.[10] These papers spanned transitioning, developing and developed economies. Five other studies using the appropriate data and estimation techniques did not establish a statistically significant relationship, while 14 studies found an ambiguous relationship between FDI and productivity gains. However, more recent work has found a relationship between FDI and the presence of spillover productivity gains.[11]

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10 Görg, H. and Greenaway, D. (2003), 'Much Ado About Nothing? Do Domestic Firms Really Benefit from Foreign Direct Investment?', *Institute for the Study of Labour*, Discussion Paper no. 944, November 2003, Germany.

11 For example, Haskel, J., Pereira, S. and Slaughter, M. (2007), 'Does Inward Foreign Direct Investment Boost the Productivity of Domestic Firms', *The Review of Economics and Statistics*, Vol. 89, no. 3, pp. 482–

It is becoming increasingly clear, however, that FDI related productivity gains are conditional on the destination economy having reached a certain level of development in education, technology and infrastructure (collectively termed 'absorptive capacity'). A paper by Borensztein *et al.* (1998) finds, for developing economies at least, that the effect of FDI on productivity and economic growth is dependent on the level of human capital (using education as a proxy for human capital).[12] The study finds that there is a strong positive relationship between economic growth and FDI, and the level of educational attainment. Essentially, the productivity gain from FDI increases in line with absorptive capacity (education levels) up until some threshold point beyond which the gain is less pronounced (as education levels increase the chance of a technological gap between source and destination falls). There is also a minimum absorptive capacity level — a workforce with around half to one year of secondary schooling on average — under which no spillover productivity gains occur.

A paper investigating the relationship between absorptive capacity and FDI related productivity gains in the UK manufacturing sector finds a similar result to that of Borensztein *et al.* (1998).[13] Girma *et al.* (2001) find that firms with a technology gap (the difference between the firm's productivity level and the industry frontier) of less than 10 per cent appear to increase productivity with increasing foreign presence, while firms with a larger gap seem to suffer reductions in productivity.[14] Other papers support the hypothesis that only firms with a certain level of absorptive capacity experience FDI productivity spillovers. Firms with (relatively) very backward technology and low skilled workers may be unable to learn from the more technologically advanced MNE.

Various papers have investigated the relationship between vertical productivity gains (versus horizontal gains). Some studies go further and identify whether any productivity gains in the vertical supply chain are backward or forward of the MNE. These studies typically find that while evidence of horizontal (intra) industry productivity gains is inconclusive/not strong, there is strong evidence of vertical (inter) industry productivity gains. Developing economy studies suggest that productivity gains are more prevalent backward/upstream of the MNE. For example, when investigating Indonesian manufacturing, Blalock and Gertler (2003) find that output of a firm increases by nearly 9 per cent as the share of foreign ownership downstream rises from zero to one (and with FDI shares of around 20 per cent common, the realised productivity gain is likely to be in the order of 2 per cent).[15] Interestingly, while the Blalock and Gertler study finds strong evidence that technology is acquired through the

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96, find that a 10 percentage point increase in foreign presence in a UK industry is associated with a 0.5 per cent increase in productivity of domestic plants in the same industry (horizontal spillover gains).

12 Borensztein, E., De Gregorio, J. and Lee, J-W. (1998), 'How does foreign direct investment affect economic growth?', *Journal of International Economics*, 45 (1998), pp. 115–35.

13 Girma, S., Greenaway, D. and Wakelin, K. (2001), 'Who benefits from Foreign Direct Investment in the UK?', *Scottish Journal of Political Economy*, Vol. 48, pp. 119–33.

14 A loss of productivity in the domestic firm could arise as the more competitive MNC captures market share from the local firm, with the reduction in its sales forcing the local firm up the average cost curve.

15 Blalock, G. and Gertler, P.J. (2003), Technology from Foreign Direct Investment and Welfare Gains through the Supply China, mimeo, Cornell University.

supply chain, the study finds little evidence of direct learning from foreign competitors (horizontal technology transfer).

While the above studies suggest a positive relationship between FDI and productivity spillovers, other researchers challenge these findings. For example, Hanson (2001), among others, has challenged the existence of convincing evidence of these spillovers.[16] Hanson draws on a variety of studies to conclude that productivity spillovers are questionable given that MNEs tend to invest in relatively high productivity sectors of the economy and may even have the effect of driving existing firms into lower productivity segments of the same industry. Gorg and Greenway (op. cit.) also conclude that the evidence on intra industry productivity spillovers is ambiguous.

While the empirical evidence on FDI induced productivity spillovers is limited, it does appear to be growing over time. The evidence to date suggests that FDI does bring with it technological/know how improvements, with some of the associated productivity gains spilling over to local firms. However, it appears as if the spillover productivity gains are stronger up the supply chain than horizontally across firms competing with the MNE. Furthermore, certain conditions — a skilled/educated workforce — need to exist in the host economy for productivity gains to be realised.

iii. The importance of FDI to growth and poverty alleviation

Developed, developing, transitioning and emerging economies increasingly see FDI as a source of economic growth and development. Realising the gains that FDI can bring, economies are moving to liberalise their FDI regimes and improve the wider investment environment so as to attract investment.

The empirical evidence on FDI induced benefits is growing over time. As indicated above, studies show that given the appropriate host economy policies and a basic level of development (absorptive capacity), FDI brings with it technology and productivity gains (reflecting technological advancements and human capital formation). FDI will also contribute to international integration, and ultimately, will help to create a more competitive, efficient and vibrant local economy. All of these contribute to higher economic growth, development and rising living standards.[17]

Like poverty, a low FDI stock (when measured as a share of GDP) is therefore probably more an indicator of a poor policy environment. If an economy has not yet achieved the basic fundamentals of an educated workforce and a business enabling environment that provides incentives for innovation and competition, then there is little in the way of a 'location offer' to attract FDI. A poor business and investment environment is a precursor to poverty.

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16 Hanson, G.H. (2001), Should countries promote foreign direct investment?, Research papers for the Intergovernmental Group of Twenty-Four on International Monetary Affairs, *G-24 Discussion Paper Series*, United Nations, February.

17 OECD 2002, *Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs*, OECD Policy Brief.

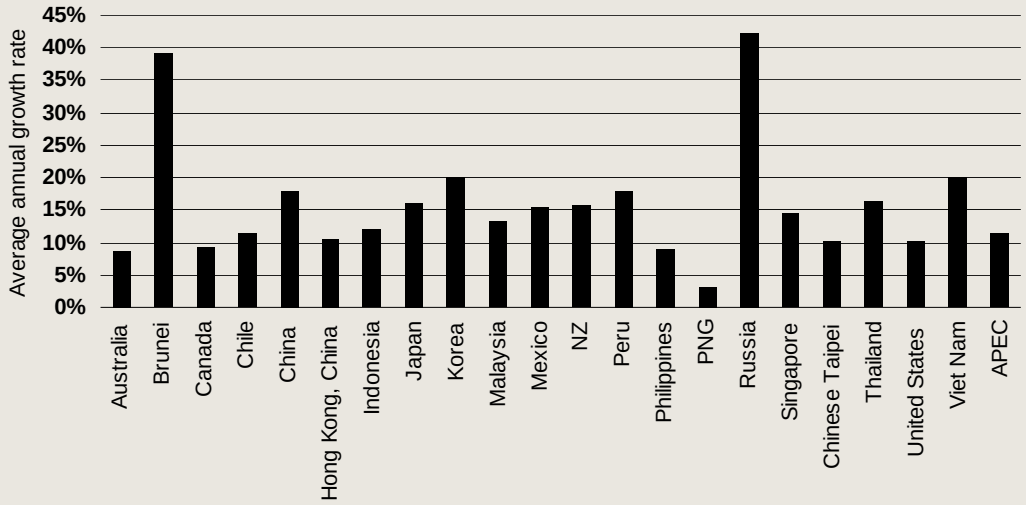
Econometric research supports the hypothesis that FDI is important for economic growth, with economic growth being central to poverty alleviation. In a comprehensive analysis of the topic, the World Bank concluded:

> Foreign direct investment is a key ingredient of successful economic growth and development…partly because the very essence of economic development is the rapid and efficient transfer and cross-border adoption of 'best practices'. Foreign direct investment is especially suited to this transfer and translating it into broad-based growth, not least by upgrading human capital. Growth is the single most important factor in poverty reduction, so foreign direct investment is also central to achieving that important World Bang goal... In short, foreign direct investment remains one of the most effective tools in the fight against poverty.[18]

iii. FDI in APEC member economies

Over the period 1989 to 2007, the stock of FDI in APEC economies grew by between an average of 3 per cent (Papua New Guinea) and 42 per cent (Russian Federation) per annum (see chart **Error! Reference source not found.**). Overall, the stock of FDI in the wider APEC region grew by an average of 11.4 per cent per year.[19]

1.2 **Annual average growth in FDI stocks** 1989 to 2007



Note: Russia's average annual growth in inward FDI stock relates to the period 1994 to 2007.
Data source: United Nations Conference on Trade and Development FDIstat (online database) and CIE calculations.

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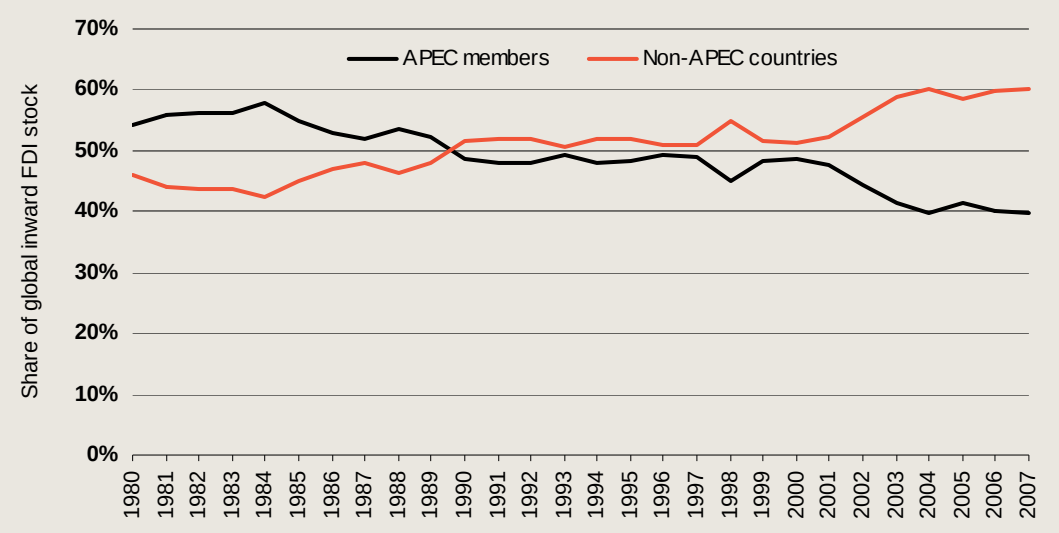
18 Klein, M., Aaron, C. and Hadjimichael, B. (2001), *Foreign Direct Investment and Poverty Reduction*, Policy Research Working Paper 2613, World Bank, June 2001.

19 The differing joining dates for APEC members creates difficulties when trying to calculate an average annual growth rate in inward FDI stocks since APEC's inception (in 1989) for the wider APEC region. When calculating this growth rate, the FDI stocks of all 21 members have been aggregated for each point in time and 'assigned' to the APEC region irrespective of whether a particular economy was a member of APEC at that point in time. The same approach was adopted when constructing chart 1.3.

While this is an impressive achievement, the stock of FDI in non-APEC members grew at the even higher average rate of 14.5 per cent per year. The compounding effect of the different growth rates over nearly two decades has seen the share of global FDI stocks accounted for by APEC members falling from 52 per cent in 1989 to 40 per cent in 2007 (see chart 1.3).

1.3 **APEC members' share of world FDI stocks**



Data source: United Nations Conference on Trade and Development FDIstat (online database) and CIE calculations.

The fall in share of global FDI stocks accounted for by APEC members reflects the rest of the world doing better in terms of attracting FDI, rather than a fall in the absolute quantum of FDI in APEC members. Indeed, as can be seen from chart **Error! Reference source not found.**, the opposite has occurred. The main region offering competition to APEC members for FDI is the European Union (EU). In 1989, the EU accounted for 35 per cent of the world's inward FDI stock; by 2007 the EU had increased its share of the world's inward FDI stock to over 45 per cent. Hence the 12 percentage point decline in the share of global FDI accounted for by APEC members is nearly matched by the 10 percentage point increase in the share of FDI accounted for by EU members.

It is also interesting to note from chart 1.3 that most of the 12 percentage point decline in share of world FDI stocks accounted for by APEC members occurred in the period since 2001. The impact of the Asian Financial Crisis (around 1997-98) can also be readily seen.

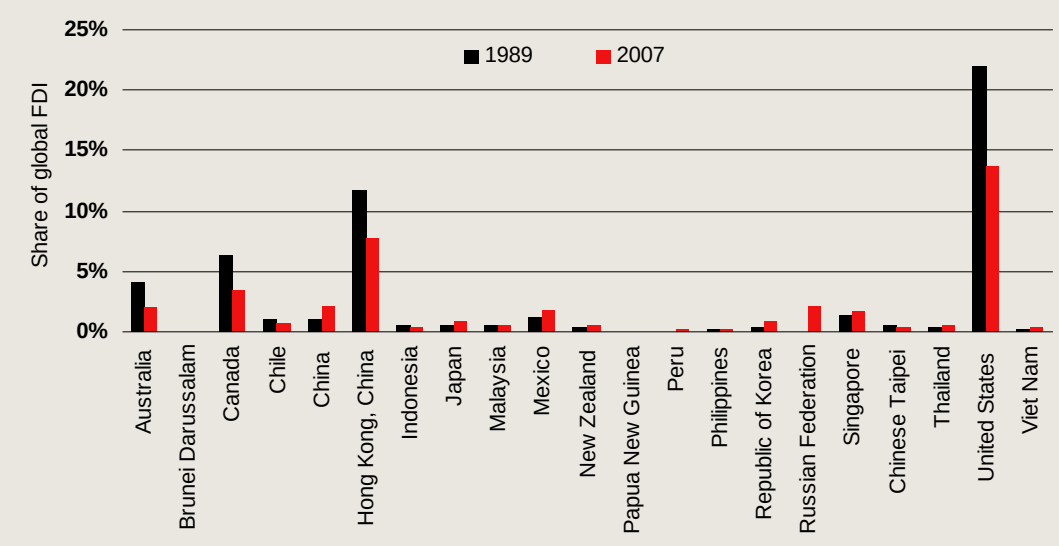
While APEC's share of global FDI stocks has contracted, is should be appreciated that this result is largely driven by 2 of the 21 APEC members. While the share of global FDI stocks accounted for by Australia; Canada; Chile; Hong Kong, China; Indonesia; Papua New Guinea; the Philippines; Chinese Taipei; and the United States all recorded contractions between 1989 and 2007, it is the falls in global FDI shares of the United States and Hong Kong, China that weigh heavily on the overall APEC result. For example, and as can be seen from chart 1.4, the decline in the United States' share of global FDI stocks (down from 22 per cent in 1989 to under 14 per cent in 2007) more than offsets the increases in global FDI shares of the other 12 APEC members.

The decline in share of global FDI stocks captured by APEC members reflects the increasingly competitive FDI market place, and the continual need for countries to lower

barriers to FDI and to improve the FDI location offer in order to maintain, or increase, market share.

Interestingly, not only is the APEC region's share of the global FDI market falling of late, but so too is the region's share of total foreign investment (comprising direct, portfolio, financial derivatives and other investment). In 2001 APEC members were the destination for 34 per cent of total global foreign investment. By 2007, this share had fallen to under 29

1.4 **APEC members' shares of global FDI stocks**



Data source: United Nations Conference on Trade and Development FDIstat (online database) and CIE calculations.

per cent. Of the foreign investment that does occur in the APEC region, there has been is a marginal shift away from FDI to portfolio investment. As can be seen from table 1.5, the share of total foreign investment in APEC members accounted for by FDI fell by 1.4 percentage points between 2001 and 2007, while the share of portfolio investment rose by 1.8 percentage points.

1.5 **Composition of foreign investment in APEC members**

Components of foreign investment	***2001***	***2002***	***2003***	***2004***	***2005***	***2006***	***2007***
	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
Foreign direct investment	21.3	20.5	19.9	20.5	19.5	19.6	19.9
Portfolio investment	44.5	43.5	48.9	48.7	47.7	48.5	46.3
Financial derivatives	0.2	0.4	0.4	0.4	5.2	4.6	7.7
Other investment	33.9	35.6	30.8	30.4	27.6	27.2	26.2

Source: International Monetary Fund Balance of Payments (online database) and CIE calculations.

Through seeking to improve the attractiveness of APEC member economies to FDI, IFAP provides another avenue through which APEC members can improve their competitive position in the FDI marketplace. The recent trends outlined above should act as an incentive for APEC members to implement the IFAP principles and supporting actions in a timely fashion even though they are non-binding.

2 ATTRACTING FOREIGN INVESTMENT – THE LOCATION OFFER

In recognising the importance of foreign direct investment to economies, it is necessary to be able to identify the key factors that attract investment to a particular location. The list of factors presented in table 2.1 has been drawn from the extensive international research, and compiled to reflect the economic development of APEC economies.

Each of the areas of influence can be thought of as affecting one or more of:

- expected revenue
- expected costs
- after tax profits
- risks.

As such, the factors identified in table 2.1 influence the risk-adjusted expected after tax return

2.1 **Factors influencing an investor's location decision**

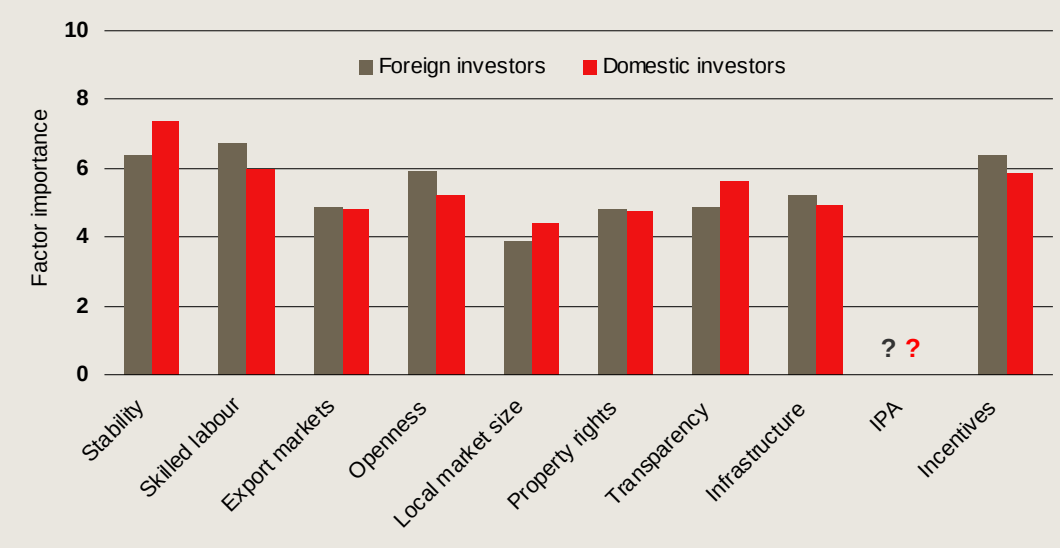
Political and macroeconomic stability
Quality of labour (education/skill levels)
Access to export markets
Openness to trade and investment
Size and purchasing power of the local market
Legal system and enforcement of contracts
Property rights
Transparency and absence of corruption
Quality of, and access to, infrastructure
Effective and efficient investment promotion agency
Investment incentives

Source: Multilateral Investment Guarantee Agency (MIGA) 2002, *Foreign Direct Investment Survey*, The World Bank and MIGA, p. 19, and FIAS 2005, *Review of Investment Incentives: Solomon Islands*, p. 5

to the investment. While there will be some variation between individual investors, our experience in undertaking reviews of investment policy, complete with extensive investor surveys and consultations, has indicated that it is typically only a handful of factors that really drive the attractiveness of a location to investment.[20] For example, the results of a survey of (domestic and foreign) investors in the Philippines as to the importance of the various location offer factors in influencing their decision to invest is reported in chart 2.2.

[20] See FIAS website for list of publications reporting on investor perception surveys, http://www.fias.net/ifcext/fias.nsf/Content/Pubs_InvestmentPolicyandPromotion; and specifically

2.2 **Investment decision factors**



Note: The survey of investors in the Philippines did not ask respondents about the importance of an efficient and effective investment promotion agency in influencing the decision to invest.
Data source: CIE survey of investors in the Philippines.

As can be seen, political and economic stability and the presence of a skilled labour force are the most important factors. But transparency in decision and policy making (and a lack of corruption), plus having an effective legal system that protects property rights is also important to investors. Indeed, domestic investors in the Philippines view transparency as having a larger impact on their decision to invest than does access to quality infrastructure. These results illustrate that investment, whether it be by foreigners or the local private sector, is unlikely to proceed if a economy's 'economic fundamentals' are lacking.

While recognising the importance of these economic fundamentals for attracting investment, we should be cognisant of the broader relevance of these factors; their relevance extends beyond its impact on FDI flows, and to the economy more generally. As such, they are beyond the scope of any economy's investment specific policy and addressing these issues forms part of a broader economic reform agenda.

The implementation of broader economic reforms which complement investment policy can create a preferred investment environment —one in which distortions and undue government intervention in the economy are minimised, and which has:

- credible and consistent macroeconomic policies, with government expenditure redirected where possible away from recurrent government expenditure and towards infrastructure improvement and provision of public goods, including education and improved laws governing companies and investment;

Multilateral Investment Guarantee Agency (MIGA) 2002, *Foreign Direct Investment Survey*, The World Bank and MIGA, p. 19.

- a uniform corporate tax rate whose level is set as low as possible given budget responsibilities;
- broadly based indirect taxes on consumption with the tax net having minimal exemptions;
- uniform import tariffs or tariffs in few bands with few high rate tariff items and uniformly low rates imposed on inputs to production;
- access to imported productive inputs for exporters at or close to world prices; and
- minimum administrative barriers (and attendant costs) to establishing or expanding a business and non-discriminatory rule-based regulations.[21]

However, domestic reforms by themselves are not always enough to attract foreign investment; a precursor to the investment decision is to know about the investment opportunities in APEC member economies versus those elsewhere. It is possible that the investment decision making process could be subjected to three areas of market failure — (a lack of) information, externalities, and failures in third markets. An IPA has the potential to overcome the market failure associated with information, playing an important and legitimate role in disseminating information about investment opportunities in an economy. Further, and once the opportunities are known, investment facilitation eases the administrative and regulatory friction associated with implementing an investment decision. The way in which APEC's Investment Facilitation Action Plan facilitates achieving an improved environment for FDI is now discussed.

A. IFAP and attracting investment

The IFAP is not —nor tries to be —a comprehensive tool to improving the investment climate. It does incorporate many actions that directly contribute to lowering the cost and risk associated with investing in a particular location. The purpose of implementing IFAP is to improve the attractiveness of investing in APEC economies.

IFAP puts forward eight guiding principles for investment facilitation. Corresponding to each of these (non-exhaustive) principles is a menu of actions that an economy can choose to implement. The flexibility of implementation enables IFAP to be used in a different way for each economy, reflecting the innate differences between the APEC member economies. It also complements the consensus based nature under which APEC operates.

To demonstrate how implementation of IFAP principles could improve the investment environment, table 2.3 presents a matrix of IFAP principles and the key factors influencing the location investment decision. Note that table 2.3 identifies only five of the eight IFAP principles. The three principles omitted from the table — utilise new technology to improve investment environments, establish monitoring and review mechanisms for investment policies and enhance international cooperation — are considered to be more process orientated and important to the implementation of the other principles rather than stand-alone principles. APEC members' progress in implementing these three IFAP principles will be

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21 World Bank 2005, *World Development Report 2005: A Better Investment Climate for Everyone*, The World Bank and Oxford University Press, New York.

assessed via a survey of investors rather than through the use of key performance indicators (see chapter 6 and appendix B for the survey).[22]
Where the guiding principles are considered to contribute to a key location offer factor, the cell is marked. Determining this was guided by the actions associated with each of the principles, and their impact upon the key factor.

Given that IFAP is focused specifically on investment-related issues, several of the key location offer factors which relate to broader economic issues are outside the scope of IFAP. These cells have been shaded to illustrate that IFAP does not directly impact upon them. As illustrated in the table, these factors are addressed through other policy measures and tools. This is not a problem per se, but rather an illustration that IFAP is a complement to, rather than a replacement for, investment climate reform.

We now look at how IFAP contributes to the identified factors.

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22 An exception is made for the principle Utilise new technology to improve investment environments, which has one action related to intellectual property rights for which we have relevant data with which to construct a KPI.

2.3 IFAP and the factors influencing the investment location decision

	Promote accessibility and transparency in the formulation and administration of investment-related policies	***Enhance stability of investment environments, security of property and protection of investments***	***Enhance predictability and consistency in investment-related policies***	***Improve the efficiency and effectiveness of investment procedures***	***Build constructive stakeholder relationships***
Political and macroeconomic stability	Achieved through political system, fiscal and monetary policy, exchange rate policy, good governance, sound institutions etc				
Quality of labour (education/skill)	Achieved through primary, secondary, tertiary and vocational education policy				
Access to export markets	Meeting of Bogor goals, WTO membership and Doha round trade talks, bilateral trade and investment agreements etc				
Openness to trade and investment	Meeting of Bogor goals, WTO membership and Doha round trade talks, bilateral trade and investment agreements etc				
Size and purchasing power of local market	Achieved through policies encouraging private sector development, innovation and productivity growth				
Legal system and enforcement of contracts and property rights		X	X		
Transparency and absence of corruption	X		X		
Quality of, and access to, infrastructure	Approach to public-private sector interaction, regulation of infrastructure, competition policy etc				
Effective and efficient investment promotion agency	X			X	X
Investment incentives	Best practice incentives achieved through wider tax code				

Note: The remaining three 'principles' are considered to be more process orientated and feed into the operation of any IPA or institutional arrangements, and as such, don't map directly to the key factors influencing the location investment decision.

Source: CIE

i. Investment promotion agency

The establishment of an investment promotion agency (IPA) is explicitly included as an action (under the *Promote accessibility and transparency in the formulation and administration of investment related policies* principle). An IPA can adopt a range of operational strategies including:

- providing generic information and responding to enquiries (reactive);
- actively seeking out investors for investment in target areas (proactive);
- aligning the supply chain needs of investors with local businesses/researchers that can meet those needs (matchmaking);
- working with investors to establish the business case (attraction services);
- helping the investor to establish successfully in economy (facilitation);
- acting as a conduit of investor views to identify possible opportunities to reform/improve the location offer (policy advocacy); and
- viewing investors as 'clients' and maintaining an ongoing relationship (aftercare).

The level of market intervention and the effort required varies markedly between the various operational strategies. An important and cost effective responsibility of an investment promotion and facilitation agency is to provide information to potential investors. To make well-informed decisions firms require accurate, relevant and timely information. Yet information markets are imperfect, and hence information can be costly to collect. This can place direct investment at a disadvantage vis-à-vis portfolio investment, which may not offer the same social benefits to the host economy as direct investment (see chapter 1). There may also be asymmetries in the availability of information, which places foreign firms at a disadvantage to domestic investment. But while the incentive to sink costs into acquiring this information is there for domestic and foreign firms alike, the costs of acquisition are likely to be higher for the latter.

Furthermore, incumbent firms, both domestic and foreign, may have incentives to limit the flow of relevant information — particularly about market opportunities — in the interests of maximising returns to their own investments. This 'public goods problem' of information generation and dissemination is a widely recognised source of market failure. The incentive structure facing enterprises leads to under–provision of information and a resultant underinvestment in activities that depend on it.

A lot of emphasis has been placed upon undertaking this core function well, both in terms of the research and the emphasis placed upon it in the IFAP.[23]

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[23] The Investment Climate World Bank Group Advisory Services recently completed a study on Global Investment Promotion Benchmarking, which assessed the performance of 188 economies in undertaking this core responsibility.

IFAP, through the menu of actions, emphasises the importance of information dissemination. To achieve this end, IFAP encourages:

- electronic access to information, and encourages the adoption of new technologies for continual improvement in the ease of access to information;
- a central repositories of rules and regulations for potential investors to access;
- the dissemination of information on procedures, processes, and criteria; and
- the regular review and updating of information provided by the agency.

The approach to information provision under IFAP is largely reactive as the IPA is simply acting in response to the inquiries of potential foreign investors. Such an approach provides a starting point for those economies creating or nurturing a new body. As IPAs mature and economies develop, one could envisage investment promotion agencies increase the emphasis given to proactively seeking investors. This typically requires supply chain gap analysis, usually at sectoral levels, with the agency then approaching potential foreign investors. Box 2.4 presents the activities of Canada and Singapore, two globally leading IPAs, and their proactive strategy to attracting investment.

2.4 **Successful strategies in attracting investment**

Canada

As part of the Canadian strategy to foster greater productivity and growth, it has a program of product development, which involves policy advocacy to improve the domestic investment climate; proactively marketing to raise Canadian brand awareness; 'sales' activity via systematic prospecting in identified FDI source markets and sectors, and aftercare. It is based on identification and targeting of proactive sectors — where Canada has clear competitive advantages *and critically where proactive promotion will make a difference*. Canada has identified 16 such sectors.

Singapore

The Economic Development Board (EDB) has been central to FDI promotion. As well as filling the usual information and investment generation roles, it has been responsible for such strategic initiatives as devising the nation's Cluster Development Strategy. The cluster approach targeted electronics/semi-conductor, petro-chemicals and engineering initially but more recently has added life sciences, health care, education, logistics and 'MNC headquarters'. The strategy has been one of fostering *competition* across similar enterprises and *co-operation* up the value chain.

Source: Invest in Canada, website: investincanada.gc.ca; Singapore Economic Development Board (EDB) website: www.sedb.com accessed 6 Aug. 09;

In recognising that there are different characteristics of an IPA it is important to gauge whether these differences impact upon the success of an IPA. Success of an IPA will ultimately be judged by whether investment (beyond that which would have occurred anyway) is attracted to an economy. This is only answerable using detailed survey studies, of which there are now several. The general finding is that IPAs do indeed have explanatory

power over the inflow of FDI.[24] Investment promotion is positively associated with cross-country FDI flows but there is a minimum threshold expenditure on promotion for successful FDI attraction.[25] Interestingly, there is also a maximum, above which the extra expenditure does not attract further FDI.

One of the most rewarding activities that can be undertaken by an IPA, in terms of FDI inflows, is policy advocacy; Morisset (2003) found 'the estimated results reveal that policy advocacy appears to have the strongest impact on FDI inflows'.[26] The IFAP clearly acknowledges policy advocacy as an important responsibility of an IPA, listing as an action 'Promote the role of policy advocacy within IPAs as a means of addressing the specific investment problems raised by investors including those faced by SMEs' (under the principle to *Build constructive stakeholder relationships*).

Morisset (2003) went on to note that the return on this strategy is greater the better the business climate and level of development.[27] Conversely, for economies with a poor investment climate, policy advocacy may not provide the desired or expected returns. This reinforces the message that it is important to maintain focus on investment climate reform as the primary vehicle for attracting foreign investment.

Investment promotion activities are rewarded when they are targeted at particular sectors. A study spanning the 22 OECD economies and 19 industries found that targeting an industry for investment promotion increases the FDI into that industry by 41 per cent.[28] (However, it should be noted that their definition of 'promotion' extends beyond the usually accepted activities of image building, investment generation, investor servicing and policy advocacy to include *incentives* to specific industries.) Harding and Javorcikr (2007) extended this analysis to include developing economies, and using a more traditional definition of IPA promotion activity, it was found that the relationship still held; 'targeted sectors in developing countries appear to receive 155% higher FDI inflows [than non-targeted sectors, which is] statistically significant at the 1% level.'[29]

While the empirical evidence demonstrates that the higher order activities of policy advocacy and targeting sectors for promotion have the greatest impact in attracting FDI, the importance of information dissemination as the primary responsibility of IPAs should not be overshadowed. This is particularly relevant for developing economies, which don't

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24 Wells, L. and Wint, A. 2001, *Marketing a country: Promotion as a Tool for Attracting Foreign Investment (Revised)*, FIAS Occasional Paper, no. 13.

25 Morisset, J. 2003, *Does a Country Need a Promotion Agency to Attract Foreign Direct Investment? A small Analytical Model Applied to 58 Countries*, World Bank Policy Research Working Paper, 3028, April.

26 Morisset, op cit, p. 15

27 Morisset, op cit, p. 15

28 Charlton, A., Davis, N., 2007. 'Does Investment Promotion Work?', *The B.E. Journal of Economic Policy and Analysis*, Volume 7, issue 1.

29 Harding, T., Javorcikr, B.S., 2007. 'Developing Economies and International Investors: Do Investment Promotion Agencies Bring Them Together?', World Bank Policy Research Working Paper, 4339, August. p. 19

necessarily have the finances or human capital to be able to effectively perform these higher order activities. Harding and Javorcikr (2007) note:

> …little is known about the effectiveness of investment promotion in developing countries. One could argue that investment promotion could be more effective in the developing world due to the scarcity of detailed information on the prevailing business conditions, rules and regulations and due to the high costs of gathering such information. Alternatively, one can argue that in developing countries lacking a 'good product to market' (i.e. good business climate), investment promotion efforts may be a waste of resources…[30]

Despite whatever ambiguity may exist, developing economies are continuing to employ IPAs as a tool to attract more investment. Therefore, it is prudent that they structure IPAs and their role to match the product that they are able to market, operate cost effectively and focus on attracting investment that would not have otherwise arisen.

ii. Property rights

Property rights and the importance of them in facilitating economic growth is conceptually well understood and accepted. Empirical analyses of the relationship between FDI and property rights has focused on the direction of causality running from FDI to property rights and improved institutions. Although somewhat difficult to empirically test, Knack and Keefer (1995) have shown that

> …institutions that protect property rights are crucial to economic growth and to investment… moreover, the effect of institutions on growth persists even after controlling for investment. This suggests that the security of property rights affects not only the magnitude of investment, but also the efficiency with which inputs are allocated.[31]

To their knowledge Ali, Fiess and MacDonald (2009) are the first to test the specific relationship between FDI and property rights, finding a strong positive relationship exists between FDI inflows and property rights; 'the results show that FDI inflows have a positive and highly significant impact on property rights… [furthermore, these] results suggest that foreign investors do not only import high quality manufacturing and production to the host economy but also import high quality social and technology institutions.'[32] Ali *et al* go on to state that this could be a further justification for pursuing a more open policy for FDI, including investment facilitation, since it 'may lead to improved institutional quality'.[33]

Secure property rights are essential in facilitating investment, whether it be domestic or foreign (direct investment). From the perspective of a domestic investor, clear and enforceable property rights facilitate greater access to credit, and encourage investment (better utilisation) in the titled property. Where access to credit has been measured before and

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30 Harding and Javorcikr, op cit. pp. 10-11.

31 Knack, S. and Keefer, P. 1995, Institutions and economic performance: cross-country performance tests using alternative institutional measures, *Economics and Politics,* Vol 7, No. 3, pp. 207-227 (p. 223)

32 Ali, F., Fiess, N. and MacDonald, R. 2009, *Climbing to the top? Foreign Direct Investment and Property Rights*, Department of Economics, University of Glasgow, Working Papers No. 2009_01, p. 24.

33 Ali, F., Fiess, N. and MacDonald, R. 2009, op cit. p. 25.

after the rolling out of a titling program, the impacts of titling have been found to be significant. To summarise several of these studies:

- output was 14-25 per cent higher for Thai farmers with titled land;
- in Thailand, farmers with titled land were able to borrow between 0.5 and 5 times than those farmers with equal quality land, but not titled.
- the value of rural land increased between 43 and 81 per cent for titled land in Brazil, Indonesia, the Philippines and Thailand; titling increased the value of (urban) land in Manila by 14 per cent.[34]

While the benefits of developing titling and secure property rights is of most importance to domestic investors as they are typically limited in the choice of location for their investment, effective and secure property rights are crucial to attracting foreign investment. Quite simply, foreign direct investors will simply not enter a market where property rights are unclear or insecure. To communicate to potential foreign investors the presence of clear and secure property rights a registry of sorts is required. A property registry enables investors to verify ownership. Property registration is advocated by the IFAP, suggesting to APEC member economies that they should 'establish timely, secure and effective systems of ownership registration and/or property use rights for land and other forms of property' (under the principle *Enhance stability of investments, security of property and protection of investments*).

iii. Legal system and enforcement of contracts

The effectiveness of a legal system is consistently identified as being an influencing factor in an investors' location decision, and according to Perry-Kessaris (2003) it has become 'commonplace to argue that FDI flows are, to some extent, determined by a host economy's legal system — the institutions and officials involved in the creation and implementation of law, including courts, and judges, bureaucrats and politicians, in their capacity as makers and implementers of law'.[35] The rationale follows that laws and legal systems reduce transaction costs associated with search and information, and bargaining and enforcement. Inconsistency and unpredictability of enforcement of these laws and the legal system are a potential source of risk, with the converse mitigating risk. It follows then, that an economy with an effective legal system has lower associated costs and risks, and will attract more FDI than an economy with a less 'effective' legal system.

There are many elements that constitute part of the legal system, with the IFAP primarily focused upon the enforcement of contracts area:

- facilitating the flow of information about reputation; and

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34 The summary of studies is taken from the World Bank 2005, op cit, pp. 80-81.

35 Perry-Kessaris, A. 2003, 'Finding and facing facts about legal systems and foreign direct investment in South Asia', *Legal Studies*, Vol. 23, No. 4, pp. 649-689.

- arbitration and conflict resolution.

Facilitating contract enforcement plays a crucial role in the effectiveness of property rights, which as discussed has a strong empirical relationship with attracting FDI; 'delays or uncertainties in the enforcement of exchange erode the value of property rights and diminish the opportunities incentives to invest'.[36]

In forming a contract with another person/enterprise, knowledge of this potential partner's history plays an important role in determining whether or not the agreement will be made. That is, reputation is important to ensuring contract performance. Repositories of this information play a role in providing information on the reputation of the agents, enabling agents to make better decisions about with whom they do business.

Focusing on creditworthiness, credit bureaus facilitate information exchange leading to more efficient allocation of credit, overcoming the information asymmetries between lenders and borrowers. Credit bureaus, which facilitated greater information sharing, lead to larger total bank lending to the private sector and lower defaults (that is, the credit risk is lower).[37] This finding holds independent of whether or not the information sharing mechanism is private or publicly held.

IFAP is well aligned with the literature on the importance of facilitating exchange of information about reputation, including an action targeted specifically at this issue — to 'Foster the dissemination of accurate market reputation information including creditworthiness and reliability' (under the principle *Enhance stability of investment environments, security of property and protection of investments*).

In recognising the limitations of reputation-based mechanisms to ensure contract enforcement, it is important to have recourse to a well-functioning court system. However, lawsuits can be very expensive, making it highly desirable for business to have access to a low cost dispute resolution process. A dispute settlement framework provides a mechanism to foster private resolution through arbitration, mediation or conciliation. It provides a low-cost alternative to the formal court system, and can produce more accurate decisions.[38] The decentralisation of dispute settlement mechanisms allows for specialised dispute resolution bodies, the benefit being that they have subject matter expertise, which facilitates more appropriate outcomes.

APEC, in recognising the importance of cost-effect dispute settlement to business, has incorporated this into the IFAP. This is demonstrated through several of the actions.

- 'Encourage or establish effective formal mechanisms for resolving disputes between investors and host authorities and for enforcing solutions, such as judicial, arbitral or administrative tribunals or procedures'.

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36 World Bank 2005, op cit, p. 84.

37 Jappelli, T., Pagano, M., 1999. *Information Sharing, Lending and Defaults: Cross-Country Evidence*, Centro Studi in Economia e Finanza (Centre for Studies in Economics and Finance), Working Paper 22, Salerno, Italy.

38 World Bank 2005, op cit, p. 8.

- 'Encourage and facilitate the use of arbitration and other means of alternative dispute resolution for the settlement of international commercial disputes between private parties.'

- 'Facilitate commercial dispute resolution for foreign investors by providing reasonable cost complaint-handling facilities, such as complaint service centres, and effective problem-solving mechanisms'.

Consistency of these dispute settlements across economies and subject matter areas is necessary to ensure equity of treatment, which is reflected by the action encouraging the adoption of the international standards: 'Encourage the adoption of a dispute settlement framework that reflects the International Convention on the Settlement of Investment Disputes between States and Nationals of Other States'.

iv. Transparency and absence of corruption

Risk is implicit in any investment, but transparency, or more importantly, the lack thereof, increases the risk and uncertainty faced by economic agents. Although there are several origins of non-transparency in economic policy,[39] IFAP is primarily concerned with the unpredictable interpretation and enforcement of rules and regulations. This is of particular importance, as the greater the bureaucratic discretion and lack of transparency the greater the opportunity for corruption and bribery. Consequently, the IFAP actions focus on minimising discretion:

- 'Provide equal treatment for all investors in the operation and application of domestic laws and principles on investment'; and

- 'Reduce the scope for discriminatory bureaucratic discretion in interpreting investment-related regulations'.

Reinforced throughout the IFAP is the principle of transparency. This is done through the specific action 'Ensure transparency and clarity in investment-related laws', but also through the emphasis placed upon the accessibility of information. Transparency is not just related to making information available, but ensuring that it is relevant, easily accessible and provided in a timely manner. Empirical analysis assessing the importance of transparency to FDI flows shows that an improvement in transparency is associated with an increase in FDI inflow. Drabek and Payne (2001) show that 'on average a country could expect 40 per cent increase in FDI from a one point increase in their transparency ranking.'[40] However, this figure disguises a wide variation in the impact of increasing transparency, which may be due to 'the initial level of foreign participation in the economy…[and]… the country's ranking relative

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39 Corruption and bribery, property rights, bureaucratic inefficiency, poor enforcement of the rule of law, and policy reversal. For a full discussion see Drabek, Z. and Payne, W. 2001 (1999), *The Impact of Transparency on Foreign Direct Investment*, World Trade Organization Staff Working Paper ERAD-99-02, November.

40 Drabek, Z. and Payne, W. 2001(1999), op cit. p. 2. Transparency in this study is measured using the rankings of economies in terms of transparency, with the rankings taken from the International Country Risk Guide. Incorporated into this ranking of transparency is the level of corruption, law and order, bureaucratic quality, contract viability and the risk of government expropriation of private assets.

to the maximum possible value.'[41] This is reflected in the fact that it is unlikely that the benefit to FDI from an increase in a economy's transparency ranking is linear.

The importance of transparency can also be viewed through the prism of the avoided costs associated with corruption. The negative relationship between corruption in a host economy and FDI inflows has been consistently found to hold.[42] Furthermore, the difference in corruption levels between the foreign investor's home economy and the host economy also has a negative relationship to FDI inflows.[43] This infers that foreign investors are not willing to incur the planning and operational uncertainties associated with an economy that has a different level of corruption.

Now that the empirical groundwork for the IFAP has been established, we now move on to constructing key performance indicators against which APEC member economies' progress at implementing IFAP can be measured.

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41 Drabek, Z. and Payne, W. 2001(1999), op cit. p. 20

42 See Wei, S. 2000 'How Taxing is Corruption on International Investors', *The Review of Economics and* Statistics, Vol 82, No 1, pp. 1-12 and Habib, M. and Zurawicki, L. 2002, 'Corruption and Foreign Direct Investment', *Journal of International Business Studies*, Vol. 33, No. 2, pp. 291-307.

43 Habib, M. and Zurawicki, L. 2002, op cit. p. 303.

3 METHODOLOGY FOR MEASURING PROGRESS

APEC's Investment Facilitation Action Plan consists of a menu of recommended actions that are consistent with each of the eight IFAP principles. In this chapter we outline an approach for measuring progress in implementing these actions. The recommended approach focuses on measuring the outcomes of IFAP-related actions. The preferred measure of IFAP implementation is an indicator of the progress each APEC member economy has made towards achieving a world's best practice investment facilitation regime.

This reflects the fact that FDI is inherently mobile and will be attracted to the best location and facilitation offer. It is not to suggest that APEC members can immediately move to best practice, but indicates that competition for FDI is global and that for APEC to increase its regional share of FDI, members will need to move to and be close to best practice as an ultimate goal. It is also likely that global best practice will improve over time — this means that all economies have to commit to progress, no matter how close they are to current or past best practice.

A. General approach

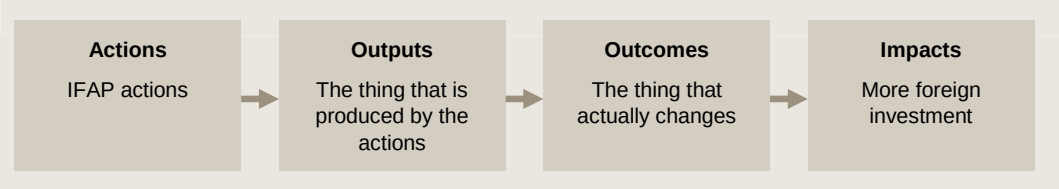
Measuring implementation progress should not be an onerous task. The approach taken is therefore to, where possible, identify existing key performance indicators (KPIs) that may be an appropriate measure of progress in implementing IFAP. We then identify any gaps and propose ways of filling those gaps by constructing indicators from published data, or by collecting primary data through stakeholder surveying. The selected KPIs are then aggregated to form an overall measure of IFAP implementation progress.

B. What are we measuring?

Before selecting key performance indicators, it is important to be clear about what is being measured. One way of measuring progress in implementing IFAP would be to treat the IFAP actions as a checklist and simply count the number of actions completed. However, that would not be a sufficient measure of progress, since it focuses on implementing IFAP actions, but does not measure the outcomes of those actions.

Ultimately, the aim of IFAP is to encourage APEC member economies to improve investment facilitation and therefore attract more foreign investment. It is therefore better to measure the outcomes of IFAP actions, rather than the actions themselves. The pathway from the specific actions that form IFAP to the impacts of attracting more investment is shown in chart 3.1. Actions produce outputs. For example, the output of a review of foreign investment screening procedures might be new, more efficient procedures. Outputs should lead to outcomes - what actually changes. In this case, the outcome might be the timelier processing of foreign investment applications or lower cost for applicants. This should then lead to impacts, such as more foreign investment, compared to what would otherwise have been the case.

3.1 **Pathway from IFAP actions to impacts**



Source: CIE.

Importantly, measuring the process by which outcomes are achieved (that is, measuring inputs) may give misleading IFAP implementation results, especially if economies use different processes to achieve outcomes. While it may be useful for APEC member economies to report the actions they have undertaken to demonstrate commitment to IFAP, the measure of implementation progress should focus on the outcomes of those actions. For example, 'conducting periodic reviews of investment procedures ensuring they are simple, transparent and lowest possible cost' (the action) will not ultimately lead to more foreign investment (the impact), unless the review leads to recommendations on how the procedures can be improved (outputs) and ultimately new procedures that are simpler, more transparent and lower cost (the outcomes). This is not to say that conducting periodic reviews of investment procedures is not important. It is. But it will only contribute to better investment facilitation if the review leads to more efficient procedures. The important thing about periodic reviews is that they constitute a systemic approach and process that is more likely to lead to ongoing improvements in procedures.

Focusing on outcomes rather than actions means that progress in improving investment facilitation is being measured, rather than progress in implementing IFAP *per se*. Progress in implementing the principles orientated towards better policy processes —'Utilise new technology to improve investment environments', 'Establish monitoring and review mechanisms for investment policies', and 'Enhance international cooperation' — will largely be measured through progress on related outcomes, rather than directly measured.

It is also possible that reforms unrelated to IFAP could also lead to improvements on some IFAP KPIs. This would be measured as progress in implementing IFAP, even though the reforms were independent of IFAP. However, this is not important so long as the selected KPIs are closely related to the outcomes IFAP is trying to achieve. While it could be possible to map each IFAP action undertaken by each APEC member economy through to its outcomes to directly measure the outcomes achieved through IFAP actions, this task is likely to be onerous. The important thing is that progress in improving investment facilitation is being made. How it is being made is less important. IFAP itself notes that it is not exhaustive. It would make little sense to report that an APEC member economy has made little progress in implementing IFAP, when they have made progress in improving investment facilitation through other means.

C. Measuring the quality of investment-related policy

Measuring progress in implementing IFAP is challenging because it is difficult to measure the quality of investment-related policy in an objective and tangible way. Over recent years the value of measuring aspects of the policy environment has been increasingly recognised as a tool for identifying weaknesses and stimulating reform. Consequently, attempts at measuring various aspects of the policy environment have proliferated. One of the first and

best known attempts is the World Bank's *Doing Business* indicators. *Doing Business* attempts to measure the ease of doing business across economies. It uses a variety of measures of ten different aspects of the investment climate, including paying taxes, getting credit, enforcing contracts and protection of investors. In many cases the indicators capture only one or a few aspects of a broader concept, but the aspects captured can be indicative of performance in that area more broadly. *Doing Business* indicators have been published annually since 2004 and the methodology has evolved over time.

Other attempts at measuring aspects of the policy environment include the World Bank Group's forthcoming *Investing Across Borders* indicators, the OECD's FDI Restrictiveness Index, the World Economic Forum's Global Competitiveness Report and Financial Development Index and the Property Rights Association's International Property Rights Index.

D. Absolute or relative performance?

The KPIs can be used to measure either relative or absolute performance. The World Bank's *Doing Business*, and other similar benchmarking exercises, typically measure relative performance at a point in time, by ranking the performance of each economy across each element and then looking at how the rankings change over time. This methodology means that an economy's performance in a particular measure could improve in absolute terms, such as by reducing the number of procedures involved with starting a business, but in relative terms, it could go backwards if other economies have improved by more.

While this method is appropriate for *Doing Business*, it is less appropriate for measuring progress in implementing IFAP. When measuring IFAP implementation progress, we are more interested in how absolute performance has changed over time — by how much has each APEC member economy improved its investment facilitation?

E. Aggregating the KPIs

The key performance indicators (KPIs) allow us to measure progress in implementing different elements of IFAP over time. But progress is likely to vary across different indicators, making it difficult to gain an understanding of overall progress. Moreover, some elements of IFAP are likely to be more important in terms of attracting foreign investment than others. This chapter discusses how the KPIs can be aggregated to form an overall measure of progress.

i. Standardising the KPIs

Measuring absolute, rather than relative performance creates some difficulties. Many of the indicators are in different units, making comparison and aggregation difficult. How does progress in removing three procedures from an administrative process compare to reducing processing time by two days (hence a number of procedures versus number of days comparison)? This is partly a weighting issue, which is discussed below. However, the measure of progress must also be standardised across indicators. For example, if world's best practice for processing an investment application is two days and the worst performer takes eight days, implementing IFAP actions that reduce processing time by two days would represent a significant improvement. However, if best practice was two days and implementing an IFAP action improved the processing time in a particular APEC member from 100 days to 98 days, this would represent only a modest improvement.

One way to standardise the KPIs is to divide the change over the IFAP period by the standard deviation of the entire sample.[44] The standard deviation is a measure of the variability of scores across economies. A low standard deviation means that the scores of most economies are closer to the average, while a high standard deviation means that scores across economies are more widely dispersed. Dividing the change by the standard deviation means that the progress in each measure would then be expressed in terms of standard deviation improvement. While this is less intuitive than the raw data, it is necessary to address/overcome the challenges of differing KPI units and scale issues.

ii. Weighting the KPIs

Once the KPIs have been standardised, they can then be aggregated to a single measure of IFAP implementation performance. In measuring overall progress in implementing IFAP, some outcomes are likely to have a bigger impact on attracting foreign investment than others. It is therefore important to assign appropriate weights to the indicators when they are aggregated to produce an overall measure of progress that reflects investor views on what is important. There are a number of ways a survey could be weighted. These include:

- statistical techniques such as principle component analysis;
- a survey of foreign investor perceptions; or
- simply assuming equal weights.

To measure overall progress in implementing IFAP, we propose that each indicator is weighted based on their importance in influencing investment location decisions, with the weights being derived from a survey of foreign investors. By regularly surveying foreign investors, say once every two years, derived weightings will remain representative of current investor views/opinions.

A sufficiently large sample should ensure that robust weights can be derived from the survey. However, if it is not possible to derive meaningful weights from the survey, an equal weighting approach could be a reasonable second best option.

Often, efforts to measure some aspect of the policy environment have a hierarchical structure. For example, Doing Business consists of ten topics, some of which have multiple KPIs. The KPIs under each topic are first aggregated together to produce a single ranking for each topic. Then the ten topics are aggregated to produce an overall ranking. In the case of Doing Business, each topic is given an equal weighting.

An analogous approach to measuring progress in implementing IFAP would be to first aggregate indicators of progress under each principle before weighting the importance of each principle to produce an overall measure of progress. However, this hierarchical approach is not appropriate for IFAP. The range of actions under some of the principles is much broader than others and spans a number of different themes. In addition, some actions overlap across principles.

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44 'Entire sample' should be interpreted as all economies for which KPI data is collected, and not just APEC member economies.

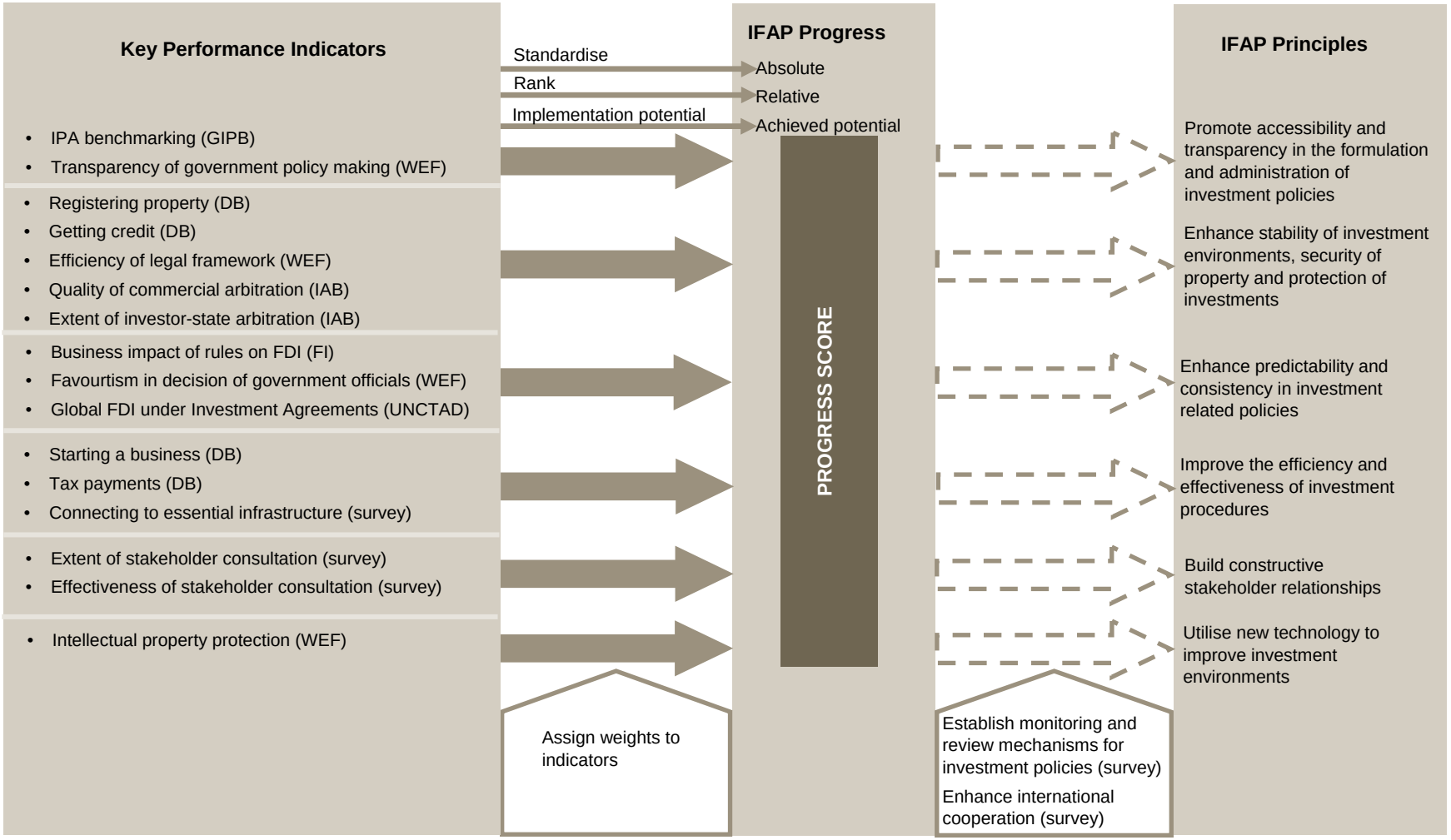
One way around this problem is to simply avoid this hierarchical approach. This would see selecting a set of indicators that measure progress in implementing IFAP and weighting these indicators directly using a survey to determine the importance of the actions.

One exception is where there are multiple indicators measuring what is essentially the same concept. For example, the 'Starting a business' indicator from Doing Business is measured in three ways: the number of procedures, the time taken and the cost. These three indicators are measuring different aspects of the same thing. In these cases, the indicators will be aggregated to a single 'Starting a business' indicator.

Chart 3.2 shows the approach to measuring progress in implementing IFAP. The chart also shows the indicators that are proposed to be used when assessing IFAP implementation. These indicators are discussed in chapter 4.

Note that while it is proposed to avoid a hierarchical type approach, it will be possible to aggregate the indicators in different ways to measure not only the progress in implementing IFAP, but also progress at the individual principle level, or wider location offer factor level. Furthermore, it will be possible to derive both absolute scores and relative performance.

3.2 Methodology for measuring IFAP progress



Where GIPB = Global Investment Promotion Benchmarking study, WEF = World Economic Forum, UNCTAD = Untied Nations Conference on Trade and Development FDI stat online database, DB = Doing Business, IAB = Investing Across Borders, FI = Fraser Institute, survey = stakeholder survey (to be undertaken), and PRA = Property Right Alliance.

Source: CIE.

F. Presentation of results

The IFAP implementation score calculated using the methodology outlined above will effectively be a weighted average improvement across indicators, expressed in standard deviation terms. This measure of progress lacks an intuitive meaning, except in the context of a comparison with the progress of other APEC member economies. Although it is useful to compare absolute progress across APEC member economies, those economies that are already at or close to world's best practice across most indicators in the base period have much less scope to improve their performance, compared with APEC member economies that have performed relatively poorly. Those economies that are close to world's best practice are therefore likely to have a low score in terms of absolute progress, even though they have a strong investment facilitation regime.

A more intuitive way of presenting the results is to compare the actual progress made by each APEC member economy over the period with the *potential* progress they could have made. Potential progress over a particular period can be calculated from the difference between each APEC member economy's actual score for each indicator in the base period and world's best practice at the end of the period (expressed in standard deviation terms). The lower the potential for improvement in a particular KPI, the closer that economy is to world's best practice in that KPI. Progress in implementing IFAP can be measured as actual progress expressed as a percentage of potential progress — the achieved implementation potential (AIP).

This method of presenting the results has a number of advantages. Most importantly, the AIP has an intuitive meaning. It can be interpreted as progress towards achieving a world's best practice investment facilitation regime over the period. After all, every APEC member economy should be striving to make progress towards best practice and ultimately getting close to it across every indicator. It also takes into account that every APEC member economy has a different starting point and therefore different implementation potential. The AIP method also recognises that world's best practice changes over time and even those economies at, or close, to world's best practice in the base period can benefit from undertaking IFAP actions.

4 KEY PERFORMANCE INDICATORS

In this chapter we identify appropriate key performance indicators (KPIs) of progress in implementing IFAP actions. As discussed previously, the KPIs should measure the outcomes of IFAP actions. The selected indicators should also measure the degree of improvement, not just that improvement has been made. It is also essential that the selected indicators cover all (or most) APEC economies and they are produced on a timely basis, so that performance at the beginning of the period (2007) can be compared to progress at the end of the period (2010) in order to measure progress.

A. Selecting key performance indicators

In this section, assessment is made of how appropriate some existing indicators are for measuring progress in implementing IFAP. Rather than matching each specific action to a KPI, we instead pick up the key themes of the actions under each principle and select KPIs on that basis.

While the ultimate aim of IFAP is to attract more foreign investment to APEC member economies, an impact-based measure of implementation progress such as cross-border investment flows in the APEC region (as suggested by the terms of reference) would not be an appropriate KPI. Cross-border investment flows are influenced by many factors including global macroeconomic conditions, as well as the investment locations factors discussed previously. Many factors influencing cross-border investment flows in the APEC region are beyond the scope of IFAP. Therefore, changes in cross-border investment flows unrelated to IFAP would imply progress (or regress) on implementing IFAP. For example, any reduction in cross-border investment flows associated with the global financial crisis would be recorded as negative progress towards implementing IFAP.

i. Promote accessibility and transparency in the formulation and administration of investment-related policies

The actions consistent with this principle essentially make relevant information more easily accessible to prospective investors. We propose two KPIs to measure progress in this area:

- the Global Investment Promotion Benchmarking (GIPB) study; and
- the World Economic Forum's 'Transparency of government policymaking' indicator.

The role of making relevant information easily accessible to prospective investors is normally the responsibility of Investment Promotion Agencies (IPAs). Rather than focussing on an input based KPI of progress in implementing this principle, such as the number of IPAs established in the region (as suggested by the terms of reference), an outcome based approach should focus on the performance of the IPA in providing information to prospective

investors. This is broadly consistent with the recent Global Investment Promotion Benchmarking (GIPB) study produced by the World Bank Group.[45]

The GIPB assessed IPAs ability to meet foreign investors' information needs in two ways:

- the extent to which IPA Web sites offer a business-support gateway for prospective foreign investors; and

- IPA capacity to deliver information directly requested by prospective foreign investors.

The GIPB only makes an assessment of the effectiveness of each economy's IPA on the most basic of IPA activities — the reactive provision of information. Many IPAs have a broader range of functions. Indeed research has shown that some of the more effective IPAs are pro-active in targeting companies to invest in their economy. However, the scope of the GIPB is broadly similar to the IFAP actions under this principle and is therefore conceptually an appropriate indicator for measuring progress.

The GIPB report covers 181 "economy-wide" IPAs and 32 "provincial" or "state" IPAs, including all APEC members. However, the report is not completed annually. It was first undertaken in 2006 and again in 2009. While this is not exactly the IFAP period, it will nevertheless be a useful indicator of progress.

While the focus of the GIPB study is specifically on IPAs, transparency across all government agencies is important. Furthermore, some APEC member economies may not have an "economy-wide" IPA. It is therefore important to include a broader measure of government transparency that is consistent with IFAP actions under this principle. An appropriate KPI is the 'Transparency of government policymaking' indicator published by the World Economic Forum as part of its Global Competitiveness Report. This is based on investor's perceptions of how well the government keeps relevant businesses informed on changes to policies and regulations.

ii. Enhance stability of investment environments, security of property and protection of investors

Actions that enhance stability of investment environments, security of property and protection of investors reduces the risk associated with investing in that location. One indicator of the risk of investing in an economy is the premium investors require to compensate them for accepting that risk. This is a broad measure of the risk associated with investing in that economy. However, this would include compensation for risk associated macroeconomic and political instability and other risk factors that research has shown to be important in influencing the investment location decision. While IFAP mentions providing an environment which is politically and economically stable as a government role under this principle, improving macroeconomic and political stability is well beyond the scope of any specific IFAP action. It is important that the KPIs reflect the outcomes of IFAP actions.

The actions that are consistent with this principle fall broadly into three categories:

- establishing effective property registers;

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45 World Bank Group, 2009, *Global Investment Promotion Benchmarking: Summary Report*, Washington DC.

- providing creditor information; and
- arrangements for effectively settling commercial disputes or disputes that a prospective investor might have with host authorities.

1. Property registers

Effective property registers increase the security of property rights over land. This reduces the risk associated with purchasing land and allows it to be used as collateral for a loan, which also improves access to credit to fund investment. The 'Registering Property' indicator from the World Bank's *Doing Business* benchmarking exercise records the full sequence of procedures necessary for a business (the buyer) to purchase a property from another business (the seller) and to transfer the property title to the buyer's name so that the buyer can use the property for expanding its business, use the property as collateral in taking new loans or, if necessary, sell the property to another business.[46] It measures the efficiency of the process across three dimensions: the number of procedures involved; time taken (in days); and the cost, recorded as a percentage of the property value. It is therefore conceptually consistent with IFAP actions in this area.

2. Creditor information

Creditor information can increase foreign investment by facilitating lending. Both domestic and foreign lenders are more willing to lend when they have information on borrowers' credit history and can therefore more easily assess the risk involved. The *Doing Business* 'Getting Credit' indicator includes: a depth of credit information index measuring how many of six desirable attributes are covered by a public registry or private credit bureau (or both); and indicators of the coverage of public credit registry and private credit bureaus as a percentage of the adult population.[47] These are important aspects of the dissemination of accurate market reputation information and are therefore appropriate measures of progress in implementing IFAP.

3. Dispute resolution

The ability to effectively resolve disputes reduces risk for investors. IFAP actions in this area focus on:

- commercial disputes; and
- disputes between investors and the government.

The most relevant *Doing Business* indicator is 'Enforcing Contracts'. This indicator effectively measures the efficiency of the judicial system in resolving commercial disputes. It measures the number of procedures, the time and the cost (as a percentage of the claim) involved in pursuing a specified commercial dispute between a business and a customer through the legal system. By contrast, IFAP actions relating to commercial disputes focus on encouraging the use of arbitration and other means of alternative

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46 The World Bank and the International Finance Corporation, 2008, *Doing Business 2009,* Washington.

47 The World Bank and the International Finance Corporation, 2008, *Doing Business 2009,* Washington.

dispute resolution to settle commercial disputes between private parties and providing a complaint handling facility for foreign investors. These alternative means of dispute resolution are often more efficient and less costly than the judicial system. The Enforcing Contracts indicator is therefore not considered appropriate to measure progress in implementing IFAP, because improving the efficiency of the judicial system is outside its scope.

The *Doing Business* 'Protecting Investors' indicator relates to the protection of minority shareholders against misuse of corporate assets for personal gain.[48] Improvements in this area encourage the development of equity markets, by reducing risk for minority shareholders. It is conceptually quite different from any of the IFAP actions and is therefore not useful for measuring progress in implementing IFAP.

While these *Doing Business* measures are not appropriate for measuring IFAP implementation progress, the forthcoming *Investing Across Borders* project will include indexes measuring the quality of commercial arbitration. This is consistent with the IFAP actions and is therefore an appropriate KPI of IFAP implementation progress.

The World Economic Forum's 'Efficiency of the legal framework' indicator is another useful KPI. This measures the efficiency of the legal framework for private businesses to settle disputes and challenge the legality of government actions and/or regulations on a seven point scale.[49] It is based on a survey of businesses. This is conceptually broader than the *Doing Business* measure as it measures commercial disputes between private parties and with the government. The indicator does include the efficiency of the judicial system, which is outside the scope of IFAP. However, increasing the use of arbitration or other dispute resolution systems in line with IFAP actions will be reflected in a more efficient legal framework and therefore an improvement on this measure. It is therefore an appropriate KPI for measuring progress in implementing IFAP.

IFAP also includes actions that reduce the risks for investors associated with disputes with host authorities. Actions include: establishing effective formal mechanisms for resolving disputes between investors and host authorities and for enforcing solutions. The *Investing Across Borders* project will include indicators of the extent of investor-state arbitration, which are consistent with the IFAP actions under this principle.

Another IFAP action involves adopting a dispute settlement framework that reflects The International Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID). Seventeen APEC members have signed the Convention, with 14 of those having ratified it. However, simply counting the signatories to this kind of international conventions (as suggested by the terms of reference) is an input-based measure. The better protection afforded to investors through the host economy ratifying these international conventions will be reflected in measures of the effectiveness of arbitration processes and the effectiveness of the legal system in resolving disputes.

iii. Enhance predictability and consistency in investment-related policies

Predictability and consistency in investment-related policies is a crucial factor for investors. Investors are more likely to invest in locations where policies and applied consistently and predictably, that is, sovereign risk is minimised. Transparency is the key to the predictable and consistent application of policies.

IFAP actions in this area relate to issues such as equal treatment of all investors and the clarity of relevant laws. Ambiguous laws that allow for bureaucratic discretion open the door for corruption. There are a range of published indicators that measure the level of corruption

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48 The World Bank and the International Finance Corporation, 2008, *Doing Business 2009,* Washington.

49 World Economic Forum, 2008, *Global Competitiveness Report 2008-09*, Geneva.

across economies. These include Transparency International's Corruption Perceptions Index and the World Bank's *World Governance Indicators*.

However, these corruption indicators are measuring a much broader concept of corruption than is covered by IFAP. A better indicator is the 'Favouritism in decisions of government officials' indicator that forms part of the World Economic Forum's *Global Competitiveness Report*. The indicator is based on investors' perceptions of whether governments favour well-connected firms and individuals when deciding upon policies and contracts. This indicator could cover the action relating to providing equal treatment for all investors as well as reducing the scope for discriminatory bureaucratic discretion in interpreting investment-related regulations. The World Bank's Enterprise Surveys also include an indicator of the percentage of firms that expect to make informal payment to public officials to get things done. However, only emerging market economies are covered by these surveys, so there are no indicators for around half of APEC member economies.

The *Doing Business* 'Dealing with licences' indicator is now called 'Dealing with construction permits' because it relates specifically to the number of procedures, time and cost involved in obtaining the relevant permits to build a warehouse. While this could be indicative of performance in other areas, such as foreign investment screening processes, progress in implementing IFAP is unlikely to be reflected in this indicator. It is therefore not an appropriate KPI for measuring IFAP implementation progress.

Indicators that measure the outcome of other actions under this IFAP principle are hard to find. For example, it is difficult to measure the simplicity and clarity of laws. Others such as the dissemination of clear definitions of criteria for the assessment of investment proposals are captured by the indicators relating to the IPA. However, another indicator relevant to this principle is the World Economic Forum's 'Business impact of rules on FDI' measure. This is based on investor's perceptions of whether the rules governing FDI discourage or encourage FDI. One interpretation is that this indicator is measuring whether foreign investors are treated fairly. It is therefore appropriate to include it as a KPI of progress in implementing IFAP.

International investment agreements (IIAs) — which include bilateral investment treaties (BITs), double taxation treaties (DTTs) and other international agreements with investment provisions, such as some free trade agreements (FTAs) — can also provide foreign investors protection against discrimination, unfair treatment, expropriation and transfer restrictions.[50] Coverage under an IIA could therefore be an important factor in an investment location decision, especially where the protection afforded by the law is inadequate.

Rather than simply counting the number of IIAs concluded, a better measure of IIA coverage for each APEC member economy would be the share of the world's total outward FDI (excluding that economy's outward FDI) covered by its IIAs. For example, according to UNCTAD, Thailand has IIAs with 32 economies. In total these economies account for 49 per

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50 UNCTAD, 2008, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge*, Geneva.

cent of the world's outward FDI (excluding Thailand). Thailand's outward FDI is excluded from the total because by definition, Thailand cannot attract foreign investment from itself.

However, we have to be careful when interpreting the results from this KPI because it could provide a misleading picture of the protection from discrimination afforded to foreign investors. Economies that unilaterally treat all investors fairly do not need to enter into IIAs to attract foreign investment. These economies could therefore rate poorly on this measure, even though they offer better protection to all foreign investors. Conversely, economies that do not unilaterally provide fair treat to foreign investors may need to enter into IIAs to attract foreign investment and therefore perform well on this KPI. Moreover, it may be difficult to interpret survey responses on how important IIAs are to the investment location decision, as it is likely to vary between economies. A foreign investor in an APEC economy that provides fair treatment to all foreign investors under the law may perceive that an IIA is not important, while a foreign investor in an APEC economy that does not necessarily provide fair treatment to all investors may perceive an IIA to be extremely important. While this indicator could encourage APEC member economies to enter into IIAs, rather than addressing the fundamental issue of fair treatment for all investors, we have nevertheless included it as a KPI to measure IFAP implementation progress since it could favour companies from IIA signatories by securing a minimum treatment level

iv. Improve the efficiency and effectiveness of investment procedures

Cumbersome, time consuming and costly investment procedures act as a deterrent to prospective foreign investors. They are more likely to invest their money in countries with less onerous investment processes (all else being the same). The actions under this principle largely relate to the efficiency of various procedures relevant to foreign investors, such as licensing and taxation procedures, foreign investment applications and processes for gaining access to essential services infrastructure.

There are a number of *Doing Business* indicators that are relevant to these actions. The 'Starting a Business' indicator measures the number of procedures, time, cost and paid-in minimum capital required to start a business. Similarly, the 'Paying Taxes' indicator measures the total number of taxes and contributions paid, the method of payment and the number of agencies involved during the second year of operation.

The *Investing Across Borders* project will include indicators on the number of procedures, time and number of agencies involved in starting a foreign business. This effectively measures the efficiency of foreign investment procedures for greenfield foreign investment projects. While this indicator is preferred over the Doing Business 'Starting a Business' indicator because it relate specifically to foreign businesses, it may not be available for the full IFAP period. We therefore recommend using the Doing Business indicator, unless the starting a foreign business indicator becomes available for the full IFAP period.

The World Bank's Enterprise Surveys include information on the number of days it takes to connect to electricity, water and telecommunications infrastructure. Conceptually, this information would be a suitable KPI for the IFAP action relating to simplifying the process for connecting to essential service infrastructure. However, as with all indicators based on the Enterprise surveys, only emerging market economies are covered. Also, the surveys appear to be undertaken infrequently, so the measure for some economies are a number of years old.

The OECD and UNCTAD's FDI Restrictiveness Index also includes information on the screening procedures for FDI. The allocation of scores for the screening and approval component is shown in table 4.1. Since this is a measure of how restrictive each economy's FDI screening and approval processes are, it seems reasonable to include as a measure of progress in measuring IFAP. However, it is not clear if the OECD/UNCTAD data will be updated. It cannot therefore be used as a KPI to measure IFAP implementation.

4.1 **Screening and approval scoring**

Screening and approval	*Score*
Investor must show economic benefits	0.20
Approval unless contrary to the national interest	0.10
Notification	0.05

Source: OECD, 2006, *OECD's FDI Regulatory Restrictiveness Index: Revision and Extension to More Economies*, Working Papers on International Investment, Number 2006/4.

v. Build constructive stakeholder relationships

Constructive relationships with key stakeholders, such as the business community, consumers and international organisations are an important element of good policy-making. Consultation with stakeholders can help to ensure that new policies do not impose unnecessary burdens on sections of the community and identify policies that are not meeting their objectives. Consultation can also play an educative role and help to overcome opposition to controversial reforms that are nevertheless in the public interest. Stakeholders are more likely to accept reform if they understand the benefits to the community, even if some stand to lose.

There do not appear to be measures of the quantum, or effectiveness, of IPA and wider government consultations with stakeholders.

Constructive relationships with stakeholders do not directly attract foreign investment in any tangible way. Rather, they are likely to lead to better government policy and performance. It is therefore better to measure the outcomes of good stakeholder relationships — better policies — rather than the relationships themselves. When considered from this viewpoint, building constructive stakeholder relationships is therefore a process by which the other principles can be met.

Other IFAP principles, namely 'Establishing monitoring and review mechanisms for investment policy', and 'Enhance international cooperation' can be viewed the same way. That is, these later areas are largely processes that enable/facilitate meeting the other 'policy orientated' principles.

vi. Utilise new technology to improve investment environments

New technology can make investment processes simpler and faster. However, it is the ease and speed of processes associated with the new technology, rather than the technology itself, that facilitates investments. Maintaining the focus on outcomes, it is better to measure the number of procedures, the time taken and the cost of submitting applications, rather than the technology used. The introduction and use of new technologies is therefore likely to be reflected in other KPIs, such as the time taken to start a business.

This principle also includes actions related to the protection of intellectual property rights. According to the Property Rights Alliance, intellectual property rights are exclusive rights over creations of the mind: inventions, literary and artistic works, and symbols, names, images and designs used in commerce.[51] Intellectual property rights encompass trademarks, patents, copyrights and related rights. Protection of intellectual property rights encourages investment in new ideas. Developing new inventions or artistic works can often be costly. Without the exclusive rights to profit from this intellectual property, there would be little incentive to make that investment.

The Property Rights Alliance publishes an annual report measuring the strength of intellectual property rights across 115 economies, including 19 APEC member economies.[52] The World Economic Forum also measures the strength of intellectual property rights through a survey of business perceptions. Both these measures are suitable KPIs of the strength of intellectual property rights. However, the Property Rights Alliance measure is broader and in fact contains the World Economic Forum measure within it. The Property Rights Alliance measure is therefore preferred.

vii. Establish monitoring and review mechanisms for investment policies

Ongoing monitoring and review of policies and procedures are cornerstones of good policy making (as is stakeholder consultation). They can contribute to continuous improvements in policies and procedures and ensure that policies remain appropriate and procedures use international best practices, which are constantly evolving.

Despite the obvious benefits of monitoring and review mechanisms for investment policies, they do not necessarily contribute directly to attracting foreign investment. If recommendations on how investment policies can be improved are not implemented, the review will not contribute to attracting more foreign investment. Prospective investors are unlikely to check whether monitoring and review mechanisms are in place for investment policies when comparing locations. Rather, they will investigate the quality of policy currently in place, which is itself influenced by the presence of a monitoring and review mechanism. While the perception of investors on the effectiveness of monitoring and review mechanisms may be important, these perceptions will be shaped by the outcomes from previous reviews. It is difficult to see how an investor could perceive monitoring and review mechanisms to be effective if investment procedures continue to be complex, opaque and costly. The best measure of the effectiveness of monitoring and review mechanisms is therefore the efficiency of the relevant procedures. This is consistent with the focus on outcomes, rather than actions.

viii. Enhance international co-operation

In itself, international co-operation does not directly lead to more foreign investment. Rather, international co-operation through: observing multilateral or regional conventions; making use of international or regional initiatives; complying with the commitments of international investment agreements; and reviewing existing international agreements and treaties could contribute to better policies. It is therefore better to focus on the policy outcomes, as measured by the other KPIs suggested above.

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51 Property Rights Alliance, 2009, *International Property Rights Index: 2009 Report*, Washington DC.

52 Brunei-Darussalem and Papua New Guinea are not included.

B. Summary of key performance indicators

The existing indicators that we consider appropriate for measuring progress in implementing each IFAP principle is summarised in table 4.2. The table also highlights some key gaps that will need to be filled through primary data sources. Conceptually, existing indicators cover most elements of IFAP, with there being only a few indicator gaps.

4.2 **Summary of suggested KPIs**

Principle	*Suitable existing indicators*	*Gaps*
Promote accessibility and transparency in the formulation and administration of investment-related policies	▪ Both the website and inquiry handling indicators from the *Global Investment Promotion Benchmarking* study. ▪ The World Economic Forum's 'Transparency of government policymaking' indicator from the Global Competitiveness Report.	
Enhance stability of investment environments, security of property and protection of investments	▪ The 'Registering Property' indicator from *Doing Business* (procedures, time and cost). ▪ The 'Getting Credit' indicator from *Doing Business* (depth and coverage). ▪ The WEF's 'Efficiency of the legal framework' indicator. ▪ Quality of international commercial arbitration index from the *Investing Across Borders* project. ▪ Extent of investor-state arbitrations index from the *Investing Across Borders* project.	
Enhance predictability and consistency investment-related policies	▪ The 'Favouritism in decisions of government officials' indicator from the WEF's Global Competitiveness Report. ▪ The 'Business impact of rules on FDI' indicator from the WEF's Global Competitiveness Report. ▪ Share of global outward FDI covered by IIAs.	
Improve the efficiency and effectiveness of investment procedures	▪ The 'Starting a Business' indicator from *Doing Business* (procedures, time, cost and start-up capital). We recommend this indicator over the *Investing Across Borders* indicator because it is available over the full IFAP period. ▪ Starting a Foreign Business Index from the *Investing Across Borders* project (procedures,	▪ A measure of the efficiency of the processes associated with connecting to essential services infrastructure for all APEC member economies.

	time, agencies). This indicator is preferred to Doing Business measure if available over the full IFAP period. ▪ The 'Tax Payments' indicator from *Doing Business* (the number of payments and time).	

(Continued on next page)

4.2 **Summary of suggested KPIs** (continued)

Principle	***Suitable existing indicators***	***Gaps***
	▪ Time taken to connect to electricity, water and telecommunications infrastructure from the World Bank's enterprise surveys (where available).	
Build constructive stakeholder relationships	▪ Progress in the other areas is likely to be reflected in improved policies and procedures. It is better to measure the policies and procedures themselves.	▪ Measures of the extent and effectiveness of IPA and wider government consultation with stakeholder.
Utilise new technology to improve investment environments	▪ The intellectual property rights measure from the Property Rights Alliance's *International Property Rights Index*.	
	▪ Progress in the other areas is likely to be reflected in improved policies and procedures. It is better to measure the policies and procedures themselves.	
Establish monitoring and review mechanisms for investment policies	▪ Progress in this area is likely to be reflected in improved policies and procedures. It is better to measure the policies and procedures themselves.	
Enhance international cooperation	▪ Progress in this area is likely to be reflected in improved policies and procedures. It is better to measure the policies and procedures themselves.	

Source: CIE.

C. Filling the gaps

There are two key areas where there are gaps that need to be filled. These are:

- a measure of the efficiency of the processes for connecting to essential services infrastructure, such as electricity and telecommunications for those APEC member economies not covered by the World Bank's enterprise surveys; and

- a measure of the extent to which IPAs and government agencies more broadly engage with stakeholders, and the effectiveness of such engagement.

In addition to these indicator short falls, there is the issue of what weight to assign the various KPIs when aggregating to an overall measure of IFAP's implementation.
Some suggestions for filling the gaps in these areas are discussed below.

i. Connecting to essential services infrastructure

The same method used to estimate the time taken to connect to electricity, water and telecommunications infrastructure simply needs to be extended to those APEC member economies that are not covered by those surveys.

ii. Stakeholder consultation

A survey, targeting IPAs and other relevant government agencies as well as investors, is the preferred way through which an estimate of the level and effectiveness of stakeholder consultation and engagement would be obtained. By surveying IPAs and other relevant government agencies as well as investors, it will be possible to obtain insight into the views of both parties, and whether views are in accordance with one another.

iii. Weights to assign to the various KPIs

Table 4.2 identifies 16 indicators for measuring IFAP implementation performance. These indicators need to be aggregated to provide an overall measure of IFAP performance. However, it can be expected that some outcomes have a bigger impact on attracting FDI than others. Given this, it will be important to assign weights to the various indicators, where the weights represent how important a particular area is to attracting FDI.

As it is the investors who are making the decision whether or not to invest in a particular APEC member, the weights will need to reflect investor views about what is important. Given this, a survey of investors will need to be used to obtain weights.

5 APPLYING THE METHODOLOGY

In chapter 3 the methodology for measuring progress in implementing IFAP was outlined, while in chapter 4 the KPIs to use in assessing IFAP implementation were identified. This chapter works through an illustrative example using actual data for a subset of KPIs relevant to IFAP over the period from 2005 to 2009. The example is also used to clarify how the results should be interpreted. The intention of this example is to demonstrate the methodology. Despite the use of actual data, it is not intended to highlight the progress that APEC member economies have made across these KPIs.

A. Illustrative example

As the IFAP period is 2008 to 2010, not all of the data required to measure progress in implementing IFAP are yet available. The example presented in this chapter therefore uses actual data across a subset of the KPIs required to measure progress in IFAP implementation over the period from 2005 to 2009. The same methodology can easily be extended to cover all the KPIs relevant to IFAP, once the data become available.

At the twentieth APEC Ministerial Meeting in Lima, Peru in November 2008, Minister's identified three priority areas:

- e-transparency;
- simplifying business regulation; and
- reducing investor risk.

For this example, available KPIs have been selected that are relevant to two of these priority areas— simplifying business regulation and reducing investor risk. The (currently available) KPIs are listed below:

- the 'Starting a Business' indicators (including number of procedures, time and cost), from *Doing Business*;
- the 'Registering Property' indicators (including number of procedures, time and cost) from *Doing Business*;
- the 'Getting Credit' indicators (including the depth of credit information index and the credit history coverage of the adult population by either public registries or private bureaus) from *Doing Business*;
- the 'Paying Taxes' indicators (including number of payments and time spent completing tax requirements) from *Doing Business*; and

Other KPIs identified in chapter 3 that are relevant to simplifying business regulation and reducing investor risk are not available for the relevant time period.

The weights used to aggregate the KPIs into an overall measure of progress in implementing IFAP will be obtained via a survey of investors. As this information is not yet available, the weights used in this example are loosely based on previous CIE work (see chart 2.2) and are shown in table 5.1.

5.1 **Weights used for the example exercise**

KPIs	*Weight*
	%
Starting a business	20.0
Registering property	25.0
Getting credit	30.0
Paying taxes	25.0

Source: CIE.

B. Measuring progress

This section provides a step-by-step guide to measuring progress in simplifying business regulation and reducing investor risk across APEC member economies, over the period from 2005 to 2009.

Step 1: Collect KPIs over relevant period

The first step is to collect the relevant KPI data. The KPI data used for this example is shown in appendix A. In this example, all of the KPIs are readily available. However, measuring IFAP implementation will require some data from primary sources in addition to readily available KPIs.

Step 2: Calculate potential improvement for each economy over the relevant period

For each APEC member economy, the potential improvement on each indicator over the period is calculated as the difference between the score in the base period and world's best practice at the end of the implementation period. World's best practice across each of the KPIs is shown in table 5.2. As APEC member economies are competing against all other economies for FDI, it is important that best practice is determined based on all economies for which data are available, not just APEC member economies. The difference between each APEC member economy and best practice is expressed in absolute terms since for some indicators a higher score represents an improvement, while for others a lower score is an improvement. The absolute difference between each APEC member economy and best practice can be interpreted as the potential improvement each APEC member economy could have made over the period.

5.2 **Key performance indicators and world best practice**

	World best practice (2009)	*Standard deviation (2005)*
Starting a business (number of procedures)	1.0	3.4
Starting a business (time in days)	1.0	37.2
Starting a business (cost)	0.1	153.8
Registering property (number of procedures)	1.0	2.6

Registering property (time in days)	2.0	129.8
Registering property (cost)	0.1	6.1
Getting credit (credit information index)	6.0	1.6
Getting credit (coverage as percentage of adult population)	100.0	32.3
Paying taxes (number of payments)	1.0	21.1
Paying taxes (time spent)	12.0	316.9

Source: Doing Business and CIE calculations.

The potential improvement across each KPI can be expressed in the relevant units. For example, the potential improvement for Viet Nam on the 'number of procedures required to start a business' KPI is 10 procedures. This is the difference between the number of procedures in Viet Nam in 2005 (11 procedures) and world's best practice in 2009 (1 procedure required in Canada and New Zealand). This means that Viet Nam needs to reduce the number of procedures required to start a business by 10 over the period to achieve world's best practice.

However, when aggregating KPIs to obtain an overall measure of potential improvement over the period, the potential improvement across KPIs must be standardised to account for the different units each KPI is measured in, as well as to standardise the scale of potential improvements. Standardisation can be achieved by dividing the potential improvement by the standard deviation of the entire sample of economies (in the base period). Returning to the number of procedures required to start a business in Viet Nam example, dividing the potential improvement (10 procedures) by the standard deviation of the sample (3.4 procedures) gives a potential improvement for Viet Nam of 2.92 standard deviations. This means that Viet Nam needs to improve by 2.92 standard deviations to achieve world's best practice in this KPI.

Once the potential improvements across each KPI has been standardised, they can be aggregated using the weights shown in table 5.1 to obtain an overall measure of potential improvement. However, since there are multiple KPIs that are effectively measuring different aspects of the same thing, these are first aggregated using a simple average. For example, there are three different KPIs of the ease of starting a business (number of procedures, time and cost). The potential improvement for each of these three KPIs (in standard deviation terms) is averaged to obtain a single indicator of the potential improvement in the ease of starting a business. The weighting of 20 per cent is then applied to this average measure of the potential improvement in the ease of starting a business. Table 5.3 provides a summary of the potential for improvement in the various indicators (and in standardised units) for the various APEC members.

5.3 **Potential improvement over the period from 2005 to 2009**

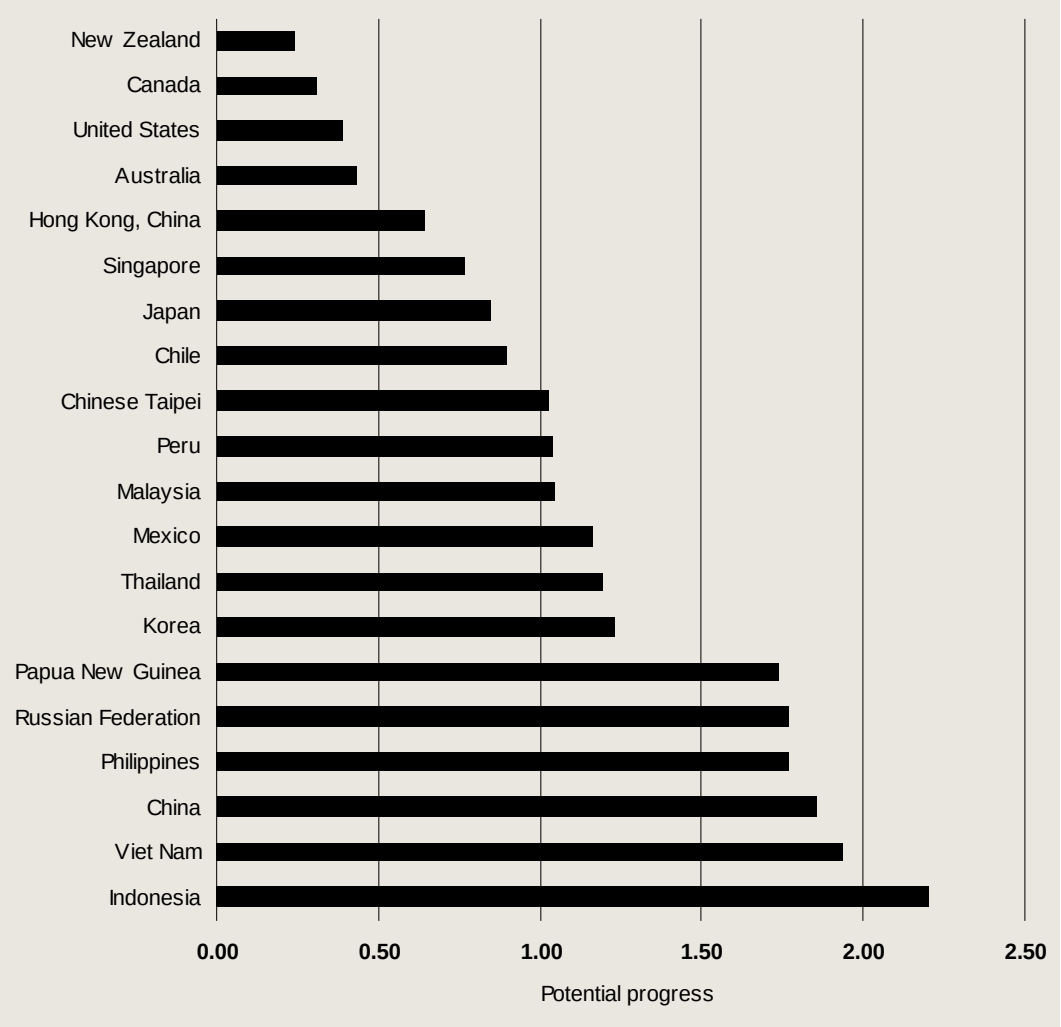
Economy	*Starting a business*	*Registering property*	*Getting credit*	*Paying taxes*	*Overall measure*
	Std dev	Std dev	Std dev	Std dev	Std dev
Australia	0.11	0.77	0.38	0.43	0.44
Canada	0.12	0.78	0.00	0.36	0.31
Chile	1.03	0.79	1.06	0.69	0.90
China	1.62	0.64	2.77	2.16	1.86
Hong Kong, China	0.49	0.91	0.90	0.18	0.64
Indonesia	2.70	1.29	2.77	2.05	2.20
Japan	1.27	0.91	0.60	0.76	0.85
Korea	1.05	1.12	1.85	0.75	1.23

Malaysia	1.09	0.99	1.02	1.09	1.04
Mexico	1.33	0.98	0.96	1.47	1.16
New Zealand	0.20	0.13	0.34	0.26	0.24
Papua New Guinea	1.24	0.84	3.38	1.06	1.74
Peru	1.82	0.76	0.91	0.84	1.04
Philippines	1.95	1.23	2.41	1.40	1.77
Russia	1.22	0.75	3.38	1.28	1.77
Singapore	0.65	0.42	1.64	0.15	0.76
Chinese Taipei	1.12	0.60	1.34	1.01	1.03
Thailand	0.98	0.47	1.93	1.20	1.19
United States	0.53	0.43	0.00	0.71	0.39
Viet Nam	1.53	0.84	2.76	2.37	1.94

Note: Brunei-Darussalam was not included in *Doing Business* until 2008 and has therefore not been included for the purpose of this exercise.
Source: Doing Business and CIE calculations.

The overall measure of potential improvement effectively measures how far each APEC member economy was (in the base period) from world's best practice (at the end of the period). The lower a member economy's score, the closer that economy was to world best practice. This means that the potential improvement scores can be used to rank the investment facilitation regime (or at least the aspects of the investment facilitation regime relevant to this example) across APEC members in the base period (see chart 5.4). Across the measures used in this example, New Zealand had the least scope for improvement, which implies it had the best investment facilitation regime among APEC member economies. By contrast, Indonesia had the most scope for improvement, followed by Viet Nam; China; the Philippines and Russia.

5.4 **Potential progress over the period 2005 to 2009**



Data source: Doing Business and CIE calculations.

Step 3: Calculate actual improvement for each economy over relevant period

Each APEC member economy's actual improvement on each KPI is measured as the difference between performance at the end of the period and performance in the base period. The difference is measured such that an improvement is represented as a positive change. Therefore, for those indicators where a lower score is an improvement (the 'Starting a business', 'Registering property' and 'Paying taxes' KPIs), the difference is measured as the score in the base period minus the score at the end of the period. Conversely, for those indicators where a higher score represents an improvement (the 'Getting credit' KPI), the difference is measured as the score at the end of the period minus the score in the base period. To obtain an overall measure of progress for each APEC member economy over the period, the actual change in each KPI must be standardised by dividing by the standard deviation of the sample in the same way as for the potential improvement. Overall progress can then be measured as the weighted average of progress over all of the KPIs (see table 5.5).

5.5 **Actual improvement over the period from 2005 to 2009**

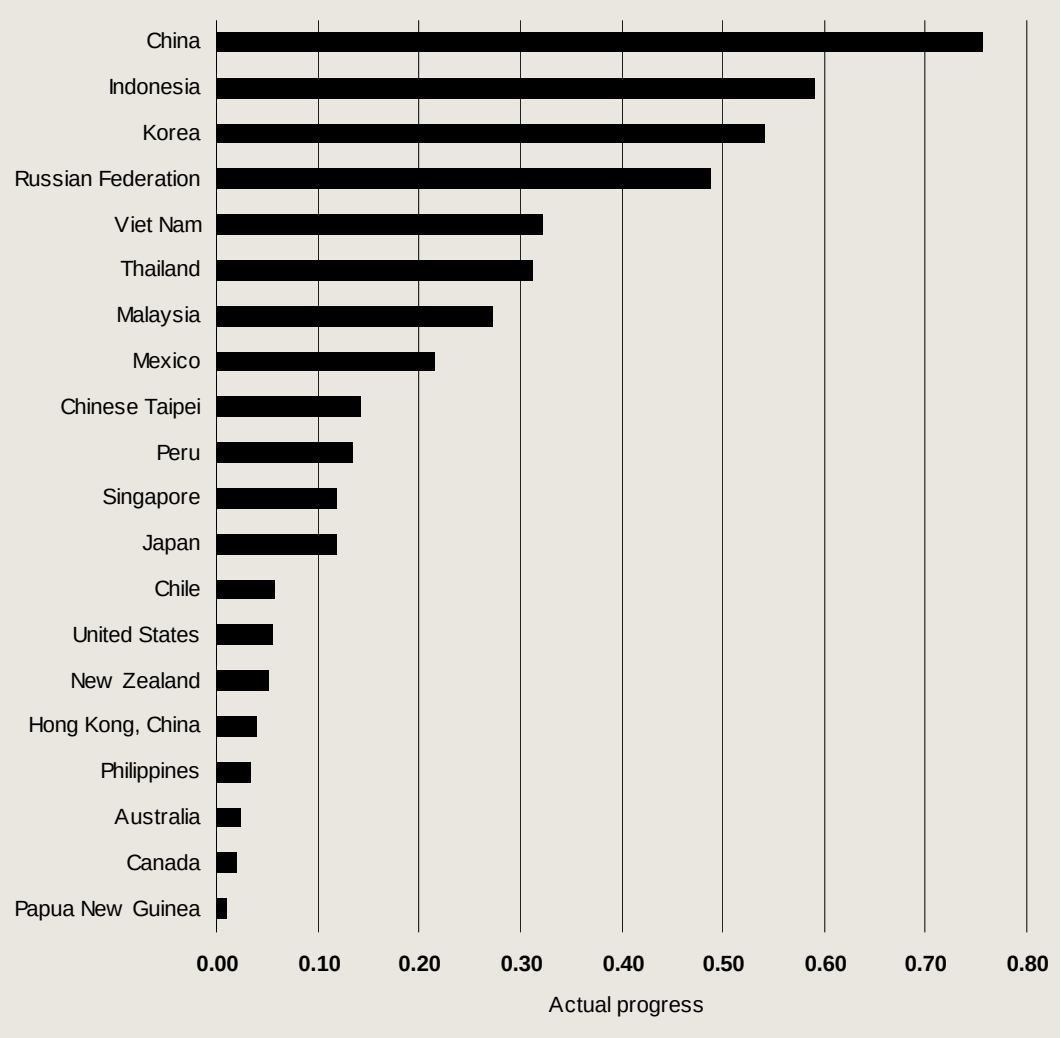
	Starting a business	***Registering property***	***Getting credit***	***Paying taxes***	***Overall measure***
	Std dev	Std dev	Std dev	Std dev	Std dev
Australia	0.00	-0.02	0.07	0.02	0.02
Canada	0.08	0.01	0.00	0.00	0.02
Chile	0.01	0.01	0.18	0.00	0.06
China	-0.01	0.02	1.52	1.20	0.76
Hong Kong, China	0.00	0.00	0.13	0.00	0.04
Indonesia	0.88	-0.02	1.01	0.46	0.59
Japan	0.37	-0.03	0.23	-0.06	0.12
Korea	0.00	0.05	1.71	0.06	0.54
Malaysia	0.17	-0.02	0.29	0.61	0.27
Mexico	0.28	0.03	0.50	0.00	0.22
New Zealand	0.20	0.01	0.03	0.00	0.05
Papua New Guinea	0.02	0.01	0.00	0.02	0.01
Peru	0.32	-0.01	0.24	0.00	0.13
Philippines	0.06	0.03	0.03	0.02	0.03
Russia	0.28	-0.02	1.38	0.09	0.49
Singapore	0.33	-0.01	0.23	-0.06	0.12
Chinese Taipei	0.06	0.00	0.45	-0.02	0.14
Thailand	0.00	0.29	0.57	0.28	0.31
United States	0.00	0.00	0.00	0.22	0.05
Viet Nam	0.08	0.25	0.81	0.00	0.32

Note: Brunei-Darussalam was not included in Doing Business until 2008 and has therefore not been included for the purpose of this exercise.
Source: Doing Business and CIE calculations.

In absolute terms, China has made the most progress in simplifying business regulations and reducing risk for investors over the period from 2005 to 2009, followed by Indonesia; Korea and Russia. By contrast, Papua New Guinea; Australia and Canada made relatively little progress. The actual progress in implementing IFAP over 2005 to 2009 across various APEC members is shown in chart 5.6.

China's strong result was driven by simplifications to the tax system and a large expansion in the availability of credit information through its public registry. Despite this progress, there remains significant scope for China to improve even further across all of the KPIs examined for this example (referring back to chart 5.4, China had room to improve IFAP implementation by around 1.9 standard deviations).

5.6 **Actual progress from 2005 to 2009**

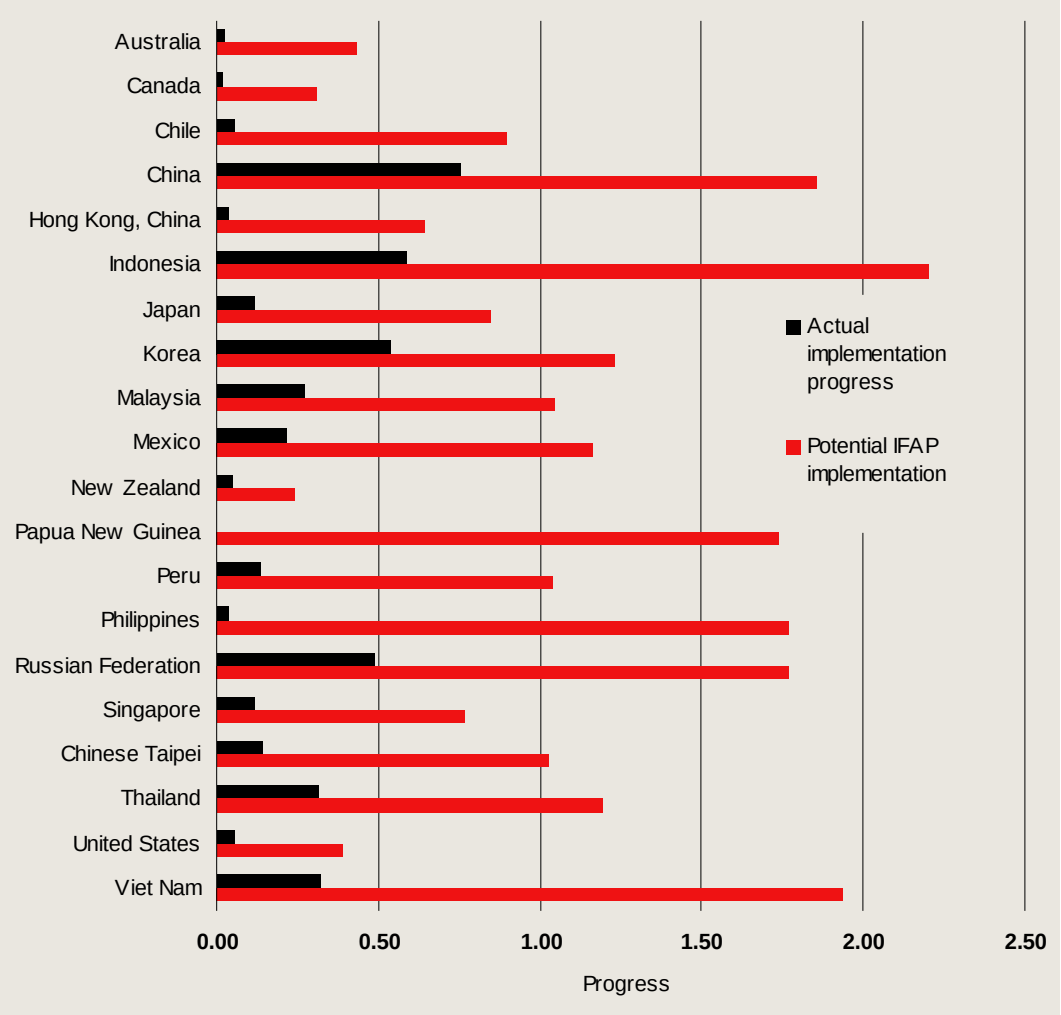


Data source: Doing Business and CIE calculations.

Step 4: Calculate realised implementation potential

The final step is to compare actual progress with potential progress (see chart 5.7). This gives some context to the progress achieved by economies such as China; Russia and Indonesia. While they made more absolute progress than other APEC member economies, they also had greater potential to make progress. Similarly, New Zealand and Canada made little absolute progress, but were already much closer to world's best practice.

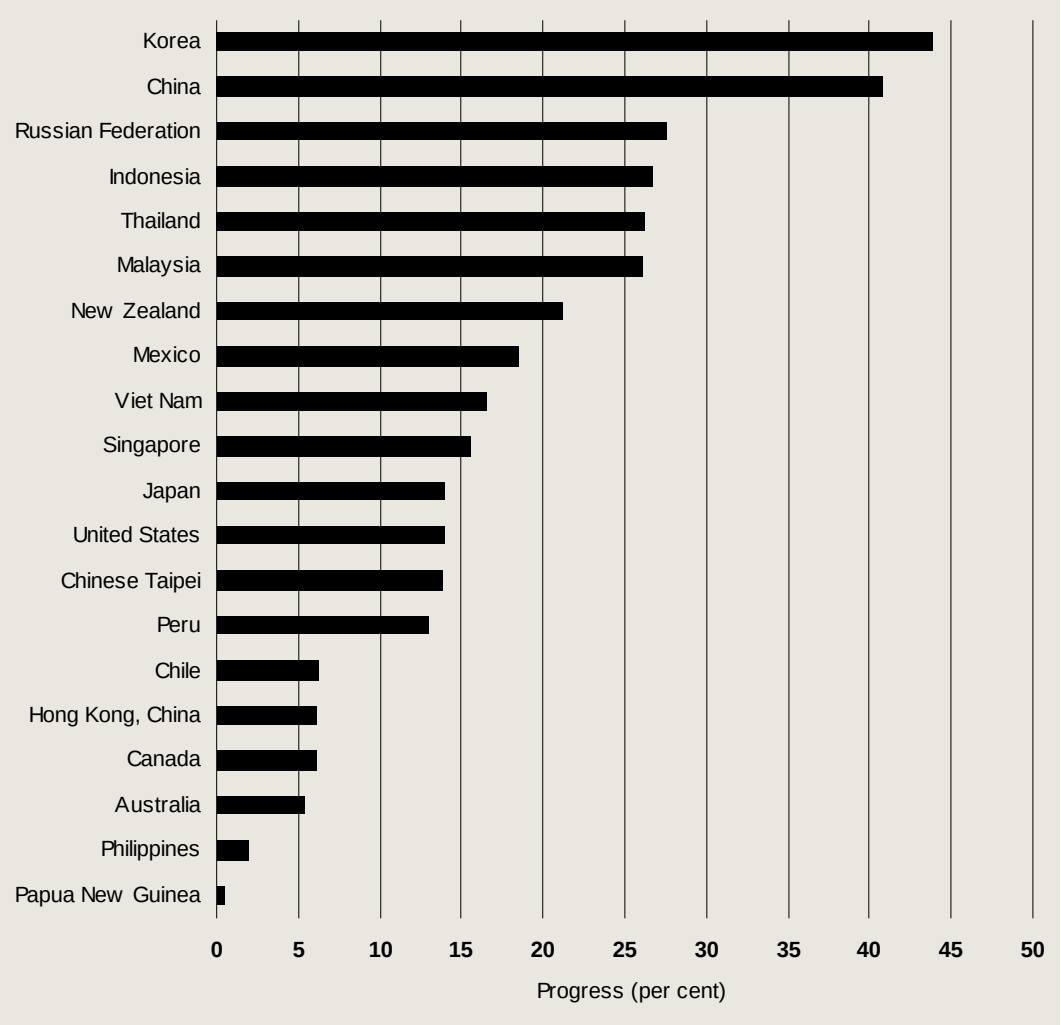
5.7 **Actual and potential progress**



Data source: Doing Business and CIE calculations.

Expressing actual implementation progress as a percentage of potential progress gives the Achieved Implementation Potential (see chart 5.8). The AIP represents the progress each economy made towards world's best practice across the KPIs being measured. On this measure, Korea made the most progress in simplifying business regulation and reducing investor risk. Korea achieved a score of nearly 44 per cent of the progress it needed to make towards achieving world best practice across all of the KPIs. China also performed relatively well on this measure, making more than 40 per cent of the progress required to achieve world's best practice.

5.8 **Achieved Implementation Potential**



Data source: Doing Business and CIE calculations.

6 OVERCOMING KPI GAPS THROUGH A STAKEHOLDER SURVEY

The KPI data gaps will be addressed via a survey of foreign investors. Importantly, when developing the survey it will be necessary to ask respondents not only how well do APEC members rate in particular areas, but also how important are those areas in influencing the decision to invest. By asking how important are particular items in influencing the decision to invest, weights will be able to be derived to attach to the various KPIs.

A. Survey design

In order to maximise response rates and the quality of survey results, it is important that the administered survey meets best practice; hence there are a number of factors that will need to be met when designing the survey.

- Simplicity — a simple unambiguous survey design is more likely to increase response rates.
- Questions — survey questions should not impart a bias or lead respondents.
- Length — to maximise response rates, the time taken to complete the survey should not exceed 20 minutes.
- Ease of providing answers — the survey should not impart a burden on respondents in terms of assembling responses.
- Quantitative — since the survey results will be used to develop KPIs and weightings, there must be a quantitative element to it.

The survey to be administered has been developed with the above requirements in mind.

The developed survey comprises 4 sections, namely:

- background information — firm name, year established, type of business etc (will allow, if needed, stratification of sample and to re-survey same firms over time);
- KPI data — empirical questions to garner stakeholder views on the:
  - extent of stakeholder engagement;
  - effectiveness of that engagement;
  - measure of the efficiency of the processes associated with connecting to essential infrastructure;
- the decision to invest — how important are the various IFAP actions in influencing the decision to invest (will provide weights for the various indicators allowing their aggregation to a single measure of IFAP implementation); and

- the impact of IFAP's implementation — how has implementation of IFAP impacted on investors/businesses, and do business perceptions on IFAP's impact reflect KPI data collected from other sources?

The developed stakeholder survey to capture currently absent KPI data and indicator weights is presented in appendix B.

To gain support for the project and the ongoing monitoring of IFAP implementation progress, it is important that businesses (to be surveyed) are informed of IFAP and the need for measuring implementation, and why business assistance is needed. Ideally, this would be conveyed by a letter to businesses, through using IPA, (foreign) Chambers of Commerce, ABAC contact points and business club contact lists. Harnessing the assistance of chambers etc in identifying and then contacting businesses to be surveyed will greatly reduce the time and effort required in administering the survey.

The letter to be sent out to potential respondents should described the context and objectives of the study and invites company representatives to participate in the survey (and in future surveys). In order to gain support for the study the letter should be on a member economy letter head (or the relevant IPA's letterhead), and co-signed by various chambers of commerce.

i. Target population and sample frame

Strictly speaking, the developed survey targets two populations of foreign investors — those that have been invested since (at least) 2007, and those who are considering investing in an APEC member economy. The former is needed to gauge how have the various indicators changed since IFAP's implementation. Both populations — those who have invested and those who considered investing — are needed to assess how important are the various activities under IFAP to the investment location decision making process.

However, determining which companies have considered, but not followed through, on making an investment in an APEC member economy is a difficult task. This is especially the case for foreign companies as there is no indication that their investment choice set includes a specific APEC member economy. Consequently, a second best option must be used that can proxy the preferences of those companies that have, or are likely, to seriously consider investing in an APEC member economy.

The second best option is to target companies that have invested in an APEC member economy, and assume that the weights assigned to the various factors that influenced these investors to invest in a particular economy are the same for investors who considered, but did not follow through, on making an investment in an APEC member. A list of existing foreign investors is best obtained from the IPA and through discussions with chambers, ABAC contact points, business clubs etc.

ii. Sample units

The survey is aimed to derive data/preferences from those that make investment decisions, such as CEOs and CFOs. Although it could not be guaranteed that the same person who makes the investment decision is the same person who completes the survey, the preliminary letter sent to businesses should make it clear that this is the most preferred outcome.

iii. Type of sampling

The objective of the sampling is to extract a sample of companies that are representative of the types of companies that have invested in (each of) the 21 APEC member economies. The sample should be as representative as possible of the broad spectrum of foreign investors, spanning investment in different sectors, company sizes, market focus, origin of investment etc.

Importantly, the aim is to maximise the efficiency of the sampling procedure such that information derived from the sample is optimised with respect to cost and time constraints.

It is highly likely that the vast majority, but not all, of foreign investors will have registered with the IPA or appropriate government department/agency (or they will be aware of them).

Sampling those companies that have registered with the IPA may bias the sample towards these types of companies. If their view of what is important in influencing the decision to invest is different to those companies that may consider investing, then any policy/reform derived from the survey results may not be targeted appropriately. However, any such bias between current and future investors is considered to be small, so this issue is overlooked. Drawing respondents from chambers of commerce, ABAC contact points and business clubs should also help to remove survey bias.

When analysing the results of the survey, the sample populations could be stratified by areas such as source of investment, company size (using employment as a proxy for size), sector of the economy, and market focus etc. Taking a strata of the sample allows account to be taken of differences between stratum in investment decisions. The aim of stratifying the sample is to ensure the units within each stratum are as homogenous as possible with respect to the stratifying variables. Stratifying the sample in this way ensures that all company 'types' are sampled and their experiences in the 3 KPIs and what is important in influencing the investment location decision making process are included in the analysis.

iv. Sample method

The choice of survey mode is crucial to the survey success. In theory, once the effects of sampling variability have been taken into consideration a survey should elicit the same preferences irrespective of the way it was implemented.

Given that businesses spanning a number (21) of economies need to be surveyed, it is considered that the Internet provides the best approach to delivering the survey (that is, the survey should be conducted online).

One of the primary benefits of using Internet questionnaires is that it is a relatively inexpensive method of collecting responses. Although the response rates may not be as high as interviewer administered questionnaires, the marginal cost of an additional survey is relatively small. This is especially useful if a wide geographical coverage is required as Internet charges are not a function of distance. Other advantages of Internet questionnaires include:

- the respondent has time on their hands to think about the questions in the context of their situation, to consult additional information on the topic at hand, and to review their responses. This means there is less incentive to hurry through the survey;

- it is easier to answer sensitive questions such as those that present a moral dilemma, or those that require personal information;

- there is no scope to introduce interviewer bias such as social desirability effects or group conformity within the survey; and

- the survey can be designed in a way to greatly facilitate respondents' assigning of preferences (weights) to the various IFAP factors influencing the investment location decision making process.

However, three major concerns with using the Internet can be identified. The first is that not everyone may have access to the Internet, and so the sample may not represent the population, thereby introducing a non response bias. In order to address this problem, respondents who are not comfortable with filling the survey out on the Internet can be instructed to print out the survey, fill it in manually, and then get a representative of the company who is comfortable with using the Internet to fill out the survey over the Internet (or alternatively, completed surveys could be faxed).

The second concern is that even though the survey may explicitly state who is to fill out the questionnaire there is little control over who actually answers the questions, and no opportunity to validate whether the intended respondent was the person who answered the questions.

A third concern is that respondents will not be able to clarify questions within the survey or probe into the context of the survey or questionnaire. This increases the possibility that respondents do not understand the questionnaire, the context with which it is set, or the impacts their choices may have. In order to address this problem, pop-up windows should be prepared explaining what each KPI is measuring, and elaborating on each of the (IFAP) factors influencing the investment location decision making process. In addition to the pop-up windows, respondents could be provided with a 'hotline' which they could dial and ask questions. Ideally, the hotline would be administered by the survey company commissioned to conduct the survey. More 'substantive' enquiries could be directed to the APEC official, or consultant, in overall charge of the survey and result analysis.

Despite the concerns of Internet surveys eliciting different preferences over equivalent types of surveys (such as post and telephone), it has been demonstrated that Internet surveys can result in equivalent preferences.[53]

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53 Berrens, R.P., A.K. Bohara, H.C. Jenkins-Smith, C.L. Silva, and L. Weimer, 2004, Telephone versus Internet samples for a national advisory referendum: are the underlying stated preferences the same?, *Applied Economics Letters*, Vol. 11, pp. 173-76.

B. Survey implementation

Implementing the stakeholder survey should be a relatively straightforward process. The implementation of the survey should be conducted by a consulting firm with experience in this area.

After the target population has been identified (foreign firms registered with the IPA, business clubs, chambers of commerce etc), and these firms have been advised of the survey via a preliminary letter, then the survey will need to be piloted (in say 2–3 APEC members). The purpose of the pilot is to check whether respondents understand the survey instructions and task at hand, and whether the survey meets the 5 requirements for a best practice survey (simplicity, questions, length, ease of providing answers and quantitative).

If needed, the stakeholder survey should be refined to reflect feedback from firms participating in the survey pilot.
Once the finalised survey has been uploaded to the Internet, firms in the target population should be provided with a window — say 6–8 weeks — over which to complete the survey. As the survey will be collecting 'new' data, there will not be any external data sources that can be used to provide an estimate of the expected standard deviation around survey results; hence it will be impossible, a priori, to determine the required number of completed surveys for statistical rigour. Given this, it is suggested that the overriding objective should be to obtain as many completed surveys as possible. This may extend to cold calling firms within the target population if response rates are low.

As surveys are completed, the results can be analysed to assess the magnitude of the standard deviation around results, with the option of terminating the survey early if the standard deviation narrows sufficiently.

Over time, the survey can be amended if it becomes apparent that existing indicators are deficient in certain areas, and additional KPI data is needed (bearing in mind the need to keep the time taken to complete the survey to less than 20 minutes).

The KPIs identified in chapter 4 have been chosen for their ability to measure the implementation of the IFAP actions/work plan over the period 2008 to 2010. If the survey is first conducted during 2010, then the assessment could obtain/use KPI data from 2009 (when available around the third quarter of 2010). This mid term assessment could then be supported by a full term assessment conducted late in 2011 when all data (for years 2008–2010) is available. This approach would see the survey being conducted late in 2010 (mid-term assessment) and again in late 2011 (full term assessment).

It is important to note that there may be a solid rationale for continuing to measure performance against the KPIs identified in chapter 4 beyond 2010 for the purpose of encouraging and facilitating further IFAP implementation, especially when considering that APEC member economies will have the potential to continue improving their performance on investment facilitation. Under this scenario it makes sense to administer the survey every year so that APEC economies can have regular/timely feedback on their progress in implementing IFAP.

APPENDICES

A KPIs used in the illustrative example

Detailed results for the various KPIs used in the illustrative example provided in chapter 5 are reported below. KPI data is provided for each of:

- Starting a business (procedures, time and cost) — table A.1
- Registering property (procedures, time and cost) — table A.2
- Getting credit (depth, public coverage and private coverage) — table A.3
- Paying taxes (number payments and time) — table A.4

Note that KPI data was not always available for Brunei Darussalam or Papua New Guinea. Reported indicator data is from the World Bank's Doing Business survey.

A.1 **Starting a business KPIs**

APEC member	*2005*			*2009*		
	Procedures	***Time***	***Cost***	***Procedures***	***Time***	***Cost***
	No.	Days	%	No.	Days	%
Australia	2	2	2.1	2	2	0.8
Canada	2	3	1.0	1	5	0.5
Chile	9	27	10.0	9	27	7.5
China	13	48	15.9	14	40	8.4
Hong Kong, China	5	11	3.4	5	11	2.0
Indonesia	12	151	130.7	11	76	77.9
Japan	11	31	10.6	8	23	7.5
Korea	10	17	15.7	10	17	16.9
Malaysia	9	30	25.1	9	13	14.7
Mexico	9	58	16.7	9	28	12.5
New Zealand	2	12	0.2	1	1	0.4
Papua New Guinea	8	56	30.7	8	56	23.6
Peru	10	98	36.4	10	65	25.7
Philippines	15	60	25.4	15	52	29.8
Russia	10	37	9.6	8	29	2.6
Singapore	7	8	1.0	4	4	0.7
Chinese Taipei	8	48	6.3	8	42	4.1
Thailand	8	33	6.7	8	33	4.9
United States	6	6	0.7	6	6	0.7
Viet Nam	11	56	30.6	11	50	16.8

A.2 Registering property KPIs

APEC member	*2005*			*2009*		
	Procedures	***Time***	***Cost***	***Procedures***	***Time***	***Cost***
	No.	Days	%	No.	Days	%
Australia	5	7	4.5	5	5	4.9
Canada	6	17	2.0	6	17	1.8
Chile	6	31	1.4	6	31	1.3
China	4	29	3.6	4	29	3.2
Hong Kong, China	5	54	5.0	5	54	5.0
Indonesia	6	39	10.3	6	39	10.7
Japan	6	14	4.4	6	14	5.0
Korea	7	11	6.1	7	11	5.1
Malaysia	5	144	2.2	5	144	2.5
Mexico	5	74	5.3	5	74	4.8
New Zealand	2	2	0.2	2	2	0.1
Papua New Guinea	4	72	5.2	4	72	5.1
Peru	5	33	3.2	5	33	3.3
Philippines	8	33	4.8	8	33	4.3
Russia	6	37	0.5	6	52	0.2
Singapore	3	9	2.7	3	9	2.8
Chinese Taipei	3	5	6.2	3	5	6.2
Thailand	2	2	6.3	2	2	1.1
United States	4	12	0.5	4	12	0.5
Viet Nam	4	67	5.3	4	57	1.2

A.3 Getting credit KPIs

APEC member	*2005*			*2009*		
	Depth	***Public coverage***	***Private coverage***	***Depth***	***Public coverage***	***Private coverage***
	Index	Days	%	No.	Days	%
Australia	5	0.0	95.4	5	0.0	100.0
Canada	6	0.0	100.0	6	0.0	100.0
Chile	5	29.0	22.0	5	28.1	34.5
China	2	0.4	0.0	4	58.8	0.0
Hong Kong, China	5	0.0	61.5	5	0.0	69.9
Indonesia	2	0.4	0.0	4	26.1	0.0
Japan	6	0.0	61.5	6	0.0	76.2
Korea	5	0.0	0.0	6	0.0	90.4
Malaysia	6	33.9	0.0	6	52.9	0.0
Mexico	6	0.0	38.2	6	0.0	70.8
New Zealand	5	0.0	97.8	5	0.0	100.0
Peru	6	14.3	27.1	6	23.7	33.2
Philippines	3	0.0	3.4	3	0.0	5.4
Russia	0	0.0	0.0	4	0.0	10.0
Singapore	4	0.0	33.5	4	0.0	48.3
Chinese Taipei	5	0.0	33.4	5	0.0	62.7
Thailand	4	0.0	15.0	5	0.0	31.8
United States	6	0.0	100.0	6	0.0	100.0
Viet Nam	2	0.8	0.0	4	13.4	0.0

A.4 **Paying taxes KPIs**

APEC member	***2006***		***2009***	
	Payments	***Time***	***Payments***	***Time***
	No.	Days	No.	Days
Australia	13	107	12	107
Canada	9	119	9	119
Chile	10	316	10	316
China	35	872	9	504
Hong Kong, China	4	80	4	80
Indonesia	51	560	51	266
Japan	13	315	13	355
Korea	14	290	14	250
Malaysia	35	190	12	145
Mexico	27	552	27	549
New Zealand	8	70	8	70
Papua New Guinea	33	206	33	194
Peru	9	424	9	424
Philippines	48	195	47	195
Russia	26	448	22	448
Singapore	5	49	5	84
Chinese Taipei	22	340	23	340
Thailand	35	264	23	264
United States	10	325	10	187
Viet Nam	32	1050	32	1050

B Stakeholder survey

Background information

1. **Company name:** _____
   _____
2. **Company address/location:** _____
   _____
   _____
3. **Company contact details:**

   Contact person: _____
   Position: _____
   Telephone no.: _____
   Fax no.: _____
   Email address: _____
4. Is your company considered to be a 'foreign' investment?

   Yes ☐ No ☐
5. If YES, from what economy was the investment 'sourced'? _____
6. In what year was your company registered/established (in current legal form)? _____
7. What is your company's main product or business activity? _____
   _____
8. In the last financial year, what share of your revenue came from sales to:
   - the local domestic market? _____%
   - export markets? _____%
9. How many people do you currently employ:
   - Local citizens? _____
   - Foreigners? _____

Key performance indicators

We would now like your views on the performance of <APEC MEMBER ECONOMY> in the following indicators. These indicators, along with several others, are being used to assess IFAP's achievements in the areas of improving the efficiency and effectiveness of investment procedures and in building constructive stakeholder relationships.

10. Measuring the efficiency of the processes for connecting to essential infrastructure (electricity, communications etc). Could you please provide an estimate of:

	Electricity	***Gas***	***Water***	***Phone***	***Internet***
The number of procedures associated with getting connected to infrastructure (procedures)					
The number of days between first applying for connection and being connected (days)					
The financial cost associated with getting connected to infrastructure (local currency)					

11. Measuring the extent of investment promotion agency (IPA) and/or government agency engagement with stakeholders. On a scale of 1 (no consultation whatsoever) to 10 (extensive consultation on all issues), could you please give an indication on the level of IPA/agency engagement with your firm?

	No engagement									***Extensive engagement***
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***
Engagement	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

12. Measuring the effectiveness of IPA/agency engagement with stakeholders. If there was some level of IPA/agency engagement with your firm, how effective was that engagement? On a scale of 1 (my needs/concerns were not addressed) to 10 (my needs/concerns were completely addressed), please rate the effectiveness of the engagement with your firm.

	Needs not addressed									***Completely addressed***
	1	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***	***10***
Effectiveness of engagement	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

13. To the best of your knowledge, please provide an estimate of how the achievement under each indicator has changed since 2007 (if at all).

Indicator	***Better***	***Worse***	***No change***	***Amount of change (if applicable)***
Infrastructure connection				
Procedures	☐	☐	☐	Number of procedures_____

Days	☐	☐	☐	Number of days_____
Cost	☐	☐	☐	Per cent (%)_____
Extent of engagement	☐	☐	☐	
Effectiveness of engagement	☐	☐	☐	

The decision to invest

We would like you to consider the relative importance of certain factors that may have influenced your decision to locate your investment project in <APEC MEMBER ECONOMY>.

14. From the list (below) of factors that have been recognised as influencing the decision to locate an investment in a particular APEC member economy, please choose what you think was the most important factor and the least important factor influencing your decision to invest, then exclude those two factors from the list and repeat the labelling process for the remaining factors (continue until there are no factors remaining). Please consider all factors before choosing the most and least important.

Factor influencing the decision to invest	
Provision of information/data about economy and investment opportunities	☐
Transparency in government policy making	☐
The ability to register property (as a form of collateral)	☐
The ability to get credit from domestic lenders (banks etc)	☐
The efficiency of the legal framework for dispute resolution	☐
The presence and quality of commercial arbitration services	☐
The approach to investor-state arbitration	☐
Presence and quality of foreign investment code/laws	☐
Equal treatment of investors and absence of ambiguous laws	☐
Presence of an International Investment Agreement	☐
The time and cost associated with starting a new business	☐
Number of taxes required to be paid and total tax liability	☐
Difficulty of connecting to essential infrastructure	☐
Extent of IPA/agency engagement with investors	☐
Effectiveness of IPA/agency engagement	☐
Protection of intellectual property	☐

The impact of IFAP implementation

Finally, we would like you to consider the impact that <APEC MEMBER ECONOMY's> implementation of IFAP has had on your business. We are asking you about the impact of IFAP on your business as a means of checking whether data collected from other sources accurately reflect investor/business views and perceptions.

15. On a scale of 1 (substantially worse) to 5 (marginally worse), no change, and 6 (marginally better) to 10 (substantially better), please rate the impact of IFAP's implementation (since 2008) as it relates to you in the following areas.

Area	*Substantially worse*				*Marginally worse*	*No change*	*Marginally better*				*Substantially better*
	1	*2*	*3*	*4*	*5*		*6*	*7*	*8*	*9*	*10*
Availability of domestic laws, regulations, judicial and administrative rulings, including online access	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Difficulty and cost of administrative procedures to start a new business	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Availability of information regarding investment promotion and protection schemes, including online access	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Availability of updated information on investment regime, including mechanisms to provide investors with advance notice of proposed changes to laws, regulations and administrative changes	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Presence of effective mechanisms/tools for obtaining public comments on proposed changes to laws, regulations and administrative procedures	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Presence of effective mechanisms to resolve disputes between investors and domestic authorities	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Presence of a secure and effective system of ownership registration and property rights for land	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Presence of an adequate system to provide effective compensation in cases of expropriation	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Degree of transparency, fairness and objectivity of the investment process and assessment of investment proposals	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Extent of consistency between local and international investment promotion and facilitation protocols	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐