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WG A – Political commitment for institutional development and reform

Session A3: Improving the business climate by building local capacity and promoting co-operation

The importance of the business climate for private sector growth

The private sector contributes the lion's share to a country's total economic output. A flourishing private sector creates employment opportunities and income, productivity growth and income growth, and contributes to poverty reduction. Promoting private sector development is of central importance to governments in developing and transition countries. Consequently, multilateral and bilateral aid agencies devote considerable attention to assist governments in their efforts to design and implement private sector development strategies.

Private sector development strategies and supporting external assistance focus frequently on promoting the development of small and medium enterprises (SMEs). SMEs are often called the “backbone” of an economy: they create the vast majority of jobs and serve an important function in the process of economic innovation and production. Compared to the situation in Western industrial countries, developing and transition countries typically have a deficit of productive SMEs. For SMEs to operate productively and attract domestic and foreign investment, the environment in which they operate needs to be simple, supportive, predictable, and transparent. In many developing and transition countries SMEs still face a disproportionate burden of legal, financial and regulatory barriers.

It is policies and institutions that determine enabling conditions for private sector development. The major actors in determining the investment climate are governments and their authorities on the one hand, and business organisations and related organisations of the civil society on the other hand. Their commitment, power and strength to develop and sustain a good investment climate are decisive for private sector development, and necessary preconditions for any effective and efficient external assistance.

The Swiss commitment to support economic reforms and institutional development

Switzerland is committed to support countries in improving the framework conditions for investment by creating incentives and opportunities for entrepreneurship. It advocates for a progressive, stable, coherent and transparent legislative framework conducive to private sector development. To achieve this, Switzerland supports local authorities by the simplification of the legislative regulation with the goal of removing administrative barriers that impede establishment and growth of SMEs. In this context, Switzerland actively promotes measures in the following key domains:

- investment regime (foreign and domestic),
- financial sector regulation (property rights of creditors and debtors, credit information systems, banking and securities laws),
- commercial law regime (company law and registry regulation, entry regulation, corporate governance regulation, accounting and auditing standards, contract law, collateral registries and law, bankruptcy law, land titling and registration, property rights),
- microeconomic policy,
- leasing regulation, and
- mortgage market regulation.

Further, Switzerland builds capacities of business associations and Investment Promotion Agencies (IPAs) to create sustainable entities which can serve the needs of SMEs through information sharing, creation of networking opportunities, advocacy work with the government, and serve as a portal for essential training and consulting services.

Two examples of Swiss support

Given the fact that improving the investment climate is a political and institutional reform process, multilateral agencies play a key role. With their financial, organisational, and analytical capacity they are usually better prepared and legitimised to organise and lead a policy dialogue than any single bilateral donor. In the context of its investment promotion activities, Switzerland financially participates in a number of multilateral initiatives aimed at improving the framework conditions for investment in developing and transition countries.

- **The OECD Investment Compact**

The Investment Compact is an initiative of the Working Table II of the Stability Pact for South Eastern Europe aimed at improving the region's economic and business environment. It sets out the commitments of countries in the region - Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Former Republic of Macedonia, Moldova, Romania, Serbia and Montenegro - to lay the structural policy foundations for sustainable growth and reform so as to create a robust market economy and encourage private investment. The Investment Compact process involves the support and active participation of Country Economic Teams from the region, donor country Stability Pact partners, international organisations and financial institutions, non-governmental organisations and the private sector. The Investment Compact aims to promote private investment, improve the investment climate and help generate structural policy and institutional reform in South East Europe. The program currently focuses on policy reform in three areas:

- Foreign Direct Investment
- SME support
- Governance, competition and regulatory regimes

To monitor progress along these areas, the Investment Compact project team employs various tools such as the Monitoring Instruments which highlight progress along the policy priorities for each country.

Internet: www.investmentcompact.org

- **Foreign Investment Advisory Service (FIAS)**

The Foreign Investment Advisory Services (FIAS) of the World Bank and IFC helps identify the essential attributes of a sound investment environment and advises developing and transition countries to reach their potential for attracting foreign direct investment (FDI). FIAS works only at the request of governments, on topics identified by the government and agreed to by both parties. This ensures the relevance of the assistance and lays the basis for active partnership. FIAS offers much more than one-way advice and written reports: through interactive workshops and roundtable meetings that often include business executives and other stakeholders, it helps governments chart technically and politically practical paths to change. In Eastern Europe, Caucasus and Central Asia, the following examples illustrate the activities of FIAS.

Moldova: FIAS reviewed the draft Investment Law and discussed the findings and recommendations with the Government. FIAS also participated in a round table discussion of the draft law involving the Government, representatives of the private sector, the IMF, the World Bank, and the OECD**.** The draft law is currently being revised prior to its submission to Parliament.

Azerbaijan: FIAS reviewed a new Draft Law on Investment Activity and provided a set of guidelines for drafting an investment law in line with international best practices.

Albania: FIAS assisted the Government in conducting a regulatory and administrative cost survey among existing firms, investigated the issues concerning the business community most (including customs, tax administration, land, and licensing), and provided policy and technical advice on needed improvements. Also provided additional assistance to turn the recommendations into an implementation action plan.

Macedonia: FIAS conducted a study of administrative barriers to investment, including a business survey of administrative and regulatory costs and templates filled by government officials regarding procedures necessary to start and operate a business.

Kyrgyz Republic: FIAS conducted a review of the environment for FDI, with emphasis on administrative and legal barriers, and the way to structure a promotion agency.

Internet: www.fias.net