

IMPROVING THE INVESTMENT CLIMATE & THE ENVIRONMENT FOR DOING BUSINESS

*Prepared by
Aldo Fumagalli Romario and Yashuo Hayashi*

Improvement of the overall business climate in SEE depends on the minimization of political interference in the privatization process, and the transparent implementation of existing regulations, through judiciary and public administration reform, as well as the facilitation of public private partnerships. Both local SMEs, which constitute the backbone of the regional economy, and foreign investors will benefit from the upgrading and introduction of special zones, the consolidation of the banking sector and the elimination of current restrictions on corporate loans, the provision of tax incentives, the simplification of procedures for the participation of the private sector in EU funded projects, the improved operation of investment promotion agencies, the harmonization of the regional labor market, and the radical implementation of policies to clarify the land and ownership regime.

SOME GENERAL ISSUES

First of all, it is a fact that the flow of FDIs is higher in those countries and regions where **stability, transparency** as well as **good governance** are guaranteed, as these are factors of primary importance for any business activities worldwide. Second, existing investors need to be as “comfortable as possible” given that the successful Irish experience showed that **50% of the new business and new investment in a country normally comes from existing investors** (they draw their suppliers, customers, or friends). Third, strong and fruitful **synergies between the public and private sector** are an excellent tool to enlarge the presence of a market economy and open market regulations, in the best way and in the shortest time. The recommendations of the business community are to:

- **Speed up the privatisation process**, using professional managers and reducing the political influence to the largest possible extent;
- Establish **institutionalized dialogue channels between Government and private sector** bodies, to better evaluate the need and the impact of new laws and rules, and to **ensure follow-up and implementation**;
- Give priority to **judiciary system and public administration reforms**, so as to increase transparency in the business climate and trust

SPECIAL ZONES, AREAS & ARRANGEMENTS

Free-Trade-Zones can enhance investment attractiveness, by offering a haven of space and infrastructure for plants and logistics facilities, in an environment without risks and within stable and competitive conditions. Free trade and tax free zones need to be **extended and expanded to wider areas** – or even to whole countries, given the sizes of the region. In addition, the **special arrangements of SEE countries with CIS countries** work in their favour to attract investors, as long as they are not radically affected by the course of EU accession. The recommendations of the business community are to:

- **Promote the creation of industrial zones providing all necessary infrastructure to investors, including land and utilities at favourable cost and without risk;**
- **Maintain the advantageous elements of the existing trade and investment regime with the CIS to the largest possible extent during the process to the European Union family;**
- **Promote industrial districts and clusters, taking advantage of regional and local economic traditions, with a special focus on SME's development.**

BANKING, FINANCING & FINANCIAL SERVICES

The importance of prudent practices in the financial area is often pointed out as a key factor for investment facilitation. It is a fundamental of a market economy to have a healthy banking sector. **Improved access to and availability of finance for local small and medium size enterprises** is particularly important, because a) SMEs constitute the backbone of all national economies in SEE, and b) a healthy SME is the first step to an economically larger enterprise.

Recently, under the pressure of IMF, which is concerned by the increase of lending for private consumption, many Central Banks in SEE have established rules and measures to reduce lending from commercial banks (e.g. high increase of provision required for the same lending level, increase of minimum reserves at no interest, restrictions on foreign deposits). Since these restrictions are not differentiated, however, they restrict not only consumption lending but also, and much more, corporate lending for investments. This has severe consequences particularly for SMEs and local investors, but very often to foreign investors also.

The business community would like to recommend the following steps:

- **Accelerate banking sector consolidation and harmonization** of the local laws on the banking system, insurance, leasing and **free movement of capital with effective regulations on these areas in the EU members**
- **Increase transparency** of the banking systems in relation to securities for trading practices, takeovers, reporting and supervision requirements
- **Introduce a differentiated approach to monitoring of corporate loans**, which are currently as restricted as consumer loans, based on IMF directions to Central Banks
- **Facilitate law enforcement** to reduce bad credit and guarantee effectiveness of mortgages (court proceeding takes too long, and cadastres are either not existent or not updated)
- **Promote the introduction of notary public** within all Countries of the Region
- Institutionalize a balance between the **discretionary rights of national supervisory bodies** to issue licenses and permissions, and the **right of banking and financial institutions to be informed** about the criteria of such decisions
- **Strengthen the role of securities and exchange commissions**, making them more independent
- Improve flexibility of regulations concerning the creation of **financing tools** for banking and financing institutions to participate to **public private partnership schemes**

FDI FACILITATION

When deciding about an investment, investors need to a) **be aware of the advantages** that a location offers for new investment compared to others, b) be allowed to act in an **environment conducive to the realization of their investment** in the shortest possible time and c) have a constant, effective and fruitful relationship with an **efficient public administration structure**.

Therefore, strong political will and commitment in the reform and modernization process of public administration is required, making radical re-organization necessary in those countries where Ministries exercise inflexible and often pointless authorities and practices. The business community would like to recommend the following:

- Increasing **support for Investment Promotion Agencies (IPAs) in terms of funds and human capacities**
- Improving the **management and marketing activities of IPAs, through professional managers**, able to travel and communicate with investors abroad
- **Training IPAs officers** according to the best European and international practices, and through regular exchange with similar institutions abroad
- **Adding emphasis to green-field investments** (which should grow) in contrast to privatisations, by distinctly differentiating the two amounts in FDI statistics
- **Promoting equal treatment for foreign investors and national ones** in practice and not only on papers
- **Implementing “one-stop-shop” and “silent is consent” rule**, to reduce the timing and complexity of receiving permission for location and building
- **Reducing registration time and procedures for companies**, and transfer of registration procedures from the court system to a Registration Agency
- Facilitating the **transition of business** in an intelligent and reasonable way, creating the proper **legal and time** framework for harmonization to the EU acquis
- **Introducing and implementing transparent anti-monopoly regulations**, so as not to obstruct the inflow of foreign investments or the positive concentration of local investors

INCENTIVES & TAXATION

Some developing countries do not have a good reputation regarding taxation: sudden changes in tax laws have a huge impact on corporate results and could make it hard to continue doing business. Therefore, it is very important that **simple and stable tax systems** are implemented and guaranteed. In addition, very ambiguous and unclear practices also hamper the activities of the private investors. Tax evasion and grey market drain state revenues and wealth, create unfair competition, and enhance corruption. Therefore, **tax systems must be enforceable**. In this sense, a very simple tax system as in Latvia and other Baltic countries could be a good model for SEEs.

As for **tax incentives**, probably businesses in the manufacturing and service sectors are less favored than those in the financial sector. When doing business in the quite risky environment of SEE countries, some public support for finance is also welcome, even for multinationals. Focusing only on the creation of a healthy banking environment is not enough to nurture the promising SMEs in SEE countries: true incentives are necessary.

Many investors claim that EU funds and financing vehicles of IFIs are often un- or under-utilized, due to the complexity of the process, the difficulty of access, or the small benefits received compared to the costs of entering such a procedure.

Taking all that into consideration, the business community would like to recommend the following:

- **Adoption of simple tax systems**, and guarantee their stability and enforceability;
- **Combating tax evasion;**
- **Providing tax incentives for new investments;**

- **Creating the preconditions for the participation and/or access of the private sector to European funds, instruments and programs (ISPA, SAPARD, CARDS) for investment and development**
- **Provision of opportunities to SME's to access international funding through special vehicles for micro and small lending at low interest, and with incentives to reduce risks**
- **Reduction of the time for VAT reimbursement**

LAND & OWNERSHIP

Unfortunately, the land and ownership regime is too restrictive for foreign and local investors in almost all the SEE Countries, and the procedures for land acquisition are very complex. Given that worldwide competition is very tough (in a Chinese province, for example, land acquisition is usually handled very effectively and efficiently), a rapid and effective relaxation of such restrictions is necessary. The business community would like to propose the following:

- **Speeding-up the implementation and/or the up-dating of National Cadastre and Real Estate Register;**
- **Implementing urban development plans;**
- **Making available to investors land free of ownership claims risk for new investment and facilities**

LABOR & EMPLOYMENT

Harmonization of regulations is important in order to make it easy to do business across the region. We emphasize this point, as almost **all the investors in SEEs are aiming at regional and Pan-European operations**. In this sense, it is extremely difficult to place human resources adequately, if there is not a simplified and harmonized framework governing employment in the region (labour laws and practices, redundancy practices in the case of necessity, regulatory framework of the government, etc). **Social security cost structure** is also important to private companies, as it can work as a hindrance to employment and the Pan-European staffing strategy.

Generally speaking, the labour laws and practices in Europe work at restricting employment. **SEE's labour systems are now more flexible than those in the EU**: it is important that this advantage is maintained as a critical element of competitiveness.

Companies require more and more skilled workers. Therefore, efforts should be putted towards workers and managers formation and training, as well as towards the **promotion of professional schools**.

Bearing all that in mind, the business community would like to propose

- **The harmonization of working regulations, laws and practices within the region**
- **The promotion of professional schools, continuous education and vocational training**
- **Maintaining and if possible increasing the labour flexibility of the existing working systems**
- **The promotion of VISA facilitation for youth and workers, so that they may be trained abroad**