



Business and Industry Advisory Committee to the **OECD**

Comité Consultatif Economique et Industriel Auprès de l' **OCDE**

## **MOVING FORWARD WITH BUSINESS: CHINA, INVESTMENT AND TECHNOLOGY**

**Discussion Paper for the Consultation with the OECD Liaison Committee**

**6 DECEMBER 2005**

*BIAC is pleased to submit this discussion paper to the 2005 Liaison Committee Meeting with Representatives of the Business and Industry Advisory Committee to the OECD.*

*BIAC appreciates this opportunity to engage in discussion with OECD Ambassadors on this paper's two areas of focus; the OECD's approach to China and the OECD Policy Framework for Investment.*

I.

## **OECD'S APPROACH TO CHINA: THE WAY FORWARD**

In view of the increasing importance of China for OECD economies, BIAC welcomes the emphasis the OECD places on its outreach work with China. For this reason, we are pleased to have the opportunity to discuss our priorities with OECD Ambassadors. The following paper sets out the reasons why China is important to the international business community and highlights BIAC's input to and priorities for the OECD's collaboration with China.

### **China's increasing importance for the world economy**

China has come a long way since it embarked on its program of economic and industrial reform in the late 1970s. Economic growth, meanwhile driven by private business, has averaged more than 9% over the past two decades. China has turned into a global player which accounted for 13 % of world output in 2004. It has transformed into an open economy with trade accounting for some 70% and FDI for about 36% of its GDP. China's share in global trade has risen to 6% and the OECD believes the country could surpass the US and Germany as the world's largest exporter within the next five years.

The impressive evolution of the Chinese economy presents both risks and opportunities for OECD economies. China has become the OECD countries' main external trading partner and an important production location for OECD-based firms. At the same time, China is a strong competitor in the area of labour-intensive goods and its increasing focus on R&D and high technology suggests that it may also gradually develop into a competitive provider of high-skilled manufactured products. Moreover, China's growing commodity consumption is placing upward pressure on prices and creates challenges for the global raw material supply.

### **What role for the OECD?**

China is already a key player in the world economy and its importance is likely to increase further. In order to remain an important agent shaping the global economy, the OECD must increasingly engage China in its own work. The OECD should continue to provide guidance to Chinese policy makers on how to develop their country in a sustainable way and help in facilitating China's further integration into the world economy. With its public policy expertise and its ability to draw upon the experience of thirty member states, the OECD is well placed to work with China on economic policy issues.

The emphasis of the economic interactions between China and OECD countries can be expected to change in the future. While the main issues of the past and present have concerned market access for foreign investors and liberalization under WTO rules, ensuring China's harmonization with international standards and business practices both at home and abroad will become a key issue in the future.

As a setter of global policy standards and a disseminator of best practices, the OECD is ideally positioned to help China with this next phase of global economic integration. Whereas China's economic emergence is becoming increasingly politicized, the OECD can play a key role in helping take politics out of the equation. Also as the emphasis moves away from immediate improvements in China's business environment, as demanded by WTO accession, and shifts toward the long-term need to carefully balance growth, reform and social stability, major cross-cutting issues will come into play. This is where the OECD's strengths lie.

China's willingness to play an ever-greater part in the global economy is highlighted by its invitation to the OECD to subject its policies to public peer review and scrutiny (e.g. Economic Survey, Governance Report). This represents a major opportunity for both the OECD countries and China, as peer scrutiny is an effective mechanism for encouraging countries to implement sound policies.

## **Business priorities for the OECD work on China**

BIAC welcomes that the OECD's co-operation with China has broadened and deepened over the past years. OECD work on China has been instrumental in fostering an open policy dialogue with Chinese authorities. It has also supported China's reform minded policy makers in building a market based economy that is more closely integrated into the global economic system. International business thus encourages the OECD to further intensify its outreach to China. The following section provides an overview of BIAC activities and priorities for the future.

**Intellectual property rights (IPR):** Forward-looking IPR protection provides the incentive for firms to invest in new technologies and products, ensures protection for consumer interests, and provides a more stable basis for economic development. Despite certain improvements of IPR laws and regulations since China's WTO accession, piracy and counterfeiting are still pervasive due to the lack of priority and resources dedicated to enforcement and closing existing loopholes in laws and regulations. Market access restrictions that prevent legitimate products from entering the Chinese market further exacerbate IPR infringements. Simply stated, business needs greater assurance that its IPRs in China will be enforced effectively and in a practical manner. Therefore, BIAC welcomes the launch of the OECD project on the economic impact of counterfeiting and piracy and is actively involved in this project.

**Environment:** Environmental issues have come to the forefront in China. The country is the second largest consumer of primary energy and oil, as well as being the world's largest coal producer. According to the IEA, China will account for one-fourth of all new global CO<sub>2</sub> emissions until 2030, exceeding the increase in emissions from all OECD countries combined. Given the potential negative impact of Chinese economic growth on the environment, we urge the OECD to strengthen its outreach work with China in areas related to environmental policy, climate change, and innovation and technology for sustainable development in order to achieve real global improvements.

**Innovation/technology:** BIAC appreciates that the OECD and China have decided to extend their cooperation to the area of innovation and have launched a study of the Chinese innovation system. We hope that this study will lead to improved understanding of the Chinese innovation system while at the same time strengthening the policy dialogue between China and OECD countries on innovation-related issues. We believe that the OECD should also identify barriers that foreign investors are facing (e.g., compulsory technology transfer to obtain investment approval or contracts for public procurement) and assess their negative consequences on foreign investment.

**Investment:** Foreign investment still faces numerous obstacles in China, as highlighted by the recent OECD project on cross-border mergers and acquisitions. BIAC has provided substantial input to this project, and the business community has a strong interest in further OECD analysis on investment issues combined with policy recommendations that provide for the creation of a more open and reliable investment environment in China. As Chinese businesses are also increasingly investing abroad, BIAC supports the OECD's goal to encourage Chinese investors to enhance their corporate responsibility profile by taking into account the OECD Guidelines for Multinational Enterprises.

**Regulatory Review:** BIAC applauds the OECD for its recent landmark report on governance in China to which the business community provided input. It was with great interest that business learned of the Chinese request for a regulatory reform review as follow-up work. China's public services system is facing major challenges, and business has a strong interest in the efficient provision of high-quality public services as well as in a market-oriented regulation for public services. By assisting China to reform its regulatory system, the OECD can help create a market for public services that is transparent and accessible to business. Through this, the OECD could facilitate investment, economic growth and public service quality in China and provide increased business opportunities for OECD-

based service providers. BIAC encourages OECD governments to undertake this important regulatory review and looks forward to participating in the process.

Further areas of particular interest with regard to the OECD's outreach to China include: anti-corruption, competition, corporate governance, taxation, and trade.

In addition, BIAC would welcome if the OECD could shed some light on further issues of interest to international business, such as:

- the impact of sharply increasing imports by China of certain raw materials on OECD countries and on world prices;
- the effects of specific barriers for foreign investors, such as overly cumbersome qualification requirements for some service providers (e.g. construction) or compulsory technology transfer to obtain investment approval or contracts for public procurement.

BIAC stands ready to provide business input to the OECD-China co-operation. We urge OECD countries to actively support the China-related work of the OECD Secretariat.

### **Questions for discussion**

*Would Ambassadors agree with BIAC about the need for a broad and deep co-operation between the OECD and China?*

*Would Ambassadors agree with business' priorities for such co-operation?*

*What strategies would Ambassadors prefer in order to get China as engaged as possible in the OECD's work?*

## **II. THE OECD POLICY FRAMEWORK FOR INVESTMENT: CREATING INVESTMENT FOR DEVELOPMENT**

### **PFI – Why this project is critical**

The Policy Framework for Investment (PFI) is intended to assist governments in their efforts to create a good investment environment. The OECD together with over 20 non-OECD countries (including Argentina, Brazil, Chile, China, India, Russia and South Africa) have been trying to promote shared views on what constitutes best practises in policy areas impacting on investment. The PFI will take the form of questions addressed to policy makers and consist of ten chapters, one for each of the policy areas covered.<sup>1</sup> Its policy recommendations will mainly be addressed to non-OECD countries. After investment was taken off the Doha Development Agenda at the WTO, the PFI is currently the only significant multilateral initiative aimed at improving the international investment environment. Thus, the OECD is in a unique position today to take the lead on a project which will stimulate global investment for development.

### **PFI – What it should become**

For the PFI to provide added value for international business, participating countries must make investment promotion the central goal of the PFI. Investment is best promoted when

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<sup>1</sup> The ten policy areas are investment policy, investment promotion and facilitation, trade policy, competition policy, tax policy, corporate governance, corporate responsibility and market integrity, human resource development, infrastructure and financial services, and public governance.

countries provide a well functioning legal, political, social and economic environment in which companies can operate successfully. An attractive investment environment includes in particular government accountability and transparency, rigorous enforcement of the rule of law, a strong commitment to fighting bribe solicitation and corruption, open trade and investment regimes, a level playing field between domestic and foreign investors, reduction of investor risk (excepting inherent entrepreneurial risks), labour market flexibility, human resource and infrastructure development.

### **PFI – What it should not become**

For business, it is critical that the PFI not start new debates about the relationship of commercial issues on the one hand, and social and environmental issues on the other. When the chapter on “Corporate responsibility (CR) and business integrity” – which has not yet been drafted – is produced, it is important that it clearly distinguish between legal obligations and voluntary corporate initiatives. Furthermore, BIAC would like to underline that the corporate responsibility part of PFI should not go beyond the scope of existing OECD integrity instruments nor should it suggest policies that would unnecessarily restrict commercial activity and investment.

The PFI should not just become “just another paper” which disappears in the drawers of policy makers’ desktops. This would clearly be another missed opportunity to promote investment on a multilateral level. In order to prevent the PFI from this fate, the OECD and non-OECD countries must formulate sound policy recommendations which can have a real and positive impact on investment. The standards and scope of the policies suggested in the PFI must not fall behind the expectations of international private investors. Otherwise the PFI will not achieve its potential.

Provided that the PFI is constructed properly, the OECD Secretariat and OECD countries also have to market it correctly. Identifying good policies does not help if countries cannot be convinced to apply them. The OECD should encourage countries to take the PFI questions and explanatory background notes seriously, and the OECD should use a properly constructed PFI as an additional benchmark for its investment reviews. In order to effectively promote good policies impacting on investment, the OECD countries should consider giving the final PFI high political status.

### **Where do we stand?**

Thus far, the OECD has drafted the background papers on all chapters with the exception of the chapter “Corporate responsibility and market integrity”. In addition, a first draft of a consolidated PFI has been produced which includes the questions addressed to policy makers plus an annex with annotations to each question. BIAC has been an active member of the PFI Task Force. We have provided written comments on the investment policy, trade policy, and tax policy background papers. Currently, BIAC is also preparing comments on the background papers related to corporate governance, infrastructure and financial services, and human resources.

BIAC support is critical to the success of the PFI. Both potential investors and non-OECD countries will be interested in how the business advisory body to the OECD views this project. The OECD business community welcomes the comprehensive approach of the PFI. Countries that want to attract and retain investment must develop coherent policy approaches across all the policy areas that impact on investment. BIAC commends the OECD for the overall good quality of many of the draft background documents. Most of them need further improvement, though, if they are to become real benchmarks for policy makers who are committed to improving the investment environment. We consider some of the existing draft background papers -- namely those concerning public governance and competition policy -- to have been well done. We also agree with the statements expressed

in the tax policy background paper which could be further enhanced in some parts. The draft background on the infrastructure and financial services chapter is also a good first attempt which should be further improved.

The core chapter of the PFI concerns investment policy. The revised background on this chapter<sup>2</sup> has been improved compared to the first draft. However, although the paper addresses many key issues, it still falls short of setting good benchmarks with regard to all aspects of investment policy that are important. BIAC would welcome significant improvements. In our view, the OECD should provide existing strong empirical evidence about the advantages of good investment policies in order to convince policy makers to create better investment environments. In addition, it is important to discuss initiatives that have already been undertaken, by aid-agencies for example, to overcome the major obstacles to transparency-enhancing reforms. The OECD should also better define in the chapter what exactly it means by “investment”, as countries and investors need to be clear about the extent and scope of coverage that is being addressed in the PFI. The section on IPR protection should also be improved. Finally, the investment chapter should highlight the ways in which non-member countries provide for fairer compensation of investors in cases of expropriation, it should more clearly advocate the free transfer of capital and it should underline the positive relationship between foreign and domestic investment.

With regard to the overall structure of the PFI, BIAC believes that the final PFI must include the background texts and not only the questions addressed to policy makers accompanied by brief annotations. The more extensive background texts are the backbone of the PFI. They provide explanations and guidance. Without them, the PFI will not provide the substance, guidance and persuasiveness needed to positively impact the global investment environment.

### **BIAC suggestions to Ambassadors**

BIAC would like to ask the Ambassadors to the OECD to:

- ensure active country participation in the important work on the PFI;
- help ensure that the OECD encourages countries to apply policies that can actually make a real positive difference for domestic and foreign investment;
- provide high-level support for the PFI and its promotion.

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<sup>2</sup> DAF/INV/TF(2005)8/REV1