SigmaBleyzer

Where Opportunities Emerge.

IPCTF Economic Policy Framework

June 20, 2002

The Objective of the IPCTF Economic Policy Framework is to provide the basis to transform a developing country into a country with:

- an improved quality of life,
- better per-capita income,
- less income inequality, and
- fair protection of the disadvantaged poor.

- Countries with these better conditions are less susceptible to terrorism and political instability.
- The IPCTF Economic Policy Framework has two components:
  - Macroeconomic Stabilization Policies
  - Policies for Sustainable Investments.

(I) Macroeconomic Stabilization Policies

Macroeconomic Stabilization policies are those policies and actions that would generate stable prices with low inflation (internal stability), and a stable foreign exchange rate (external stability).

- Internal and external instability increases the risk of doing business: Investors will require significantly higher rates of returns to compensate for the risks of instability.
- As a result of this high risk premium, few projects would qualify for investments, reducing the overall level of investments and economic growth.
- In order to achieve internal and external stability, two sets of policies are key: Fiscal policies and Monetary policies.

1. **Fiscal Policies** are those that would lead to a Government's fiscal budget in which the fiscal deficit that can be financed by borrowings on a sustainable basis (normally no more than 3% of GDP). This includes actions to:
   - improve the fiscal revenues (tax structure, increase in the tax base, improve tax administration, eliminate tax exemptions, improve cost recovery of public services)
   - Improve Management of Public Expenditures (reduce Current Expenditures of Government, Improve Treasury Operations, reform the Pension System and eliminate Subsidies.
2. **Monetary Policies** are those under which the creation of money (money supply) will not exceed the demand for money (which is affected by the level of income, inflation and interest rates).

(II) Policies for Sustainable Investment

Policies for Sustainable Investment are those policies and actions that would generate a high rate of GDP growth that can be maintained over a long period of time.

- Macroeconomic stabilization policies by themselves are necessary but not sufficient to achieve long-term stability and sustainable growth.
- This is because stabilization policies fail to remove deep-rooted structural economic and social distortions.
- To bring sustainable economic stability and growth, stabilization policies must be complemented by policies for sustainable investment activity.

- Sustainable investment activity will depend on the adequacy of nine investment drivers:
    1. Liberalization and Deregulation of Business Activities
    2. Stability and Predictability of the Legal Environment
    3. Corporate and Public Governance
    4. Liberalization of Foreign Trade and International Capital Movements
    5. Financial Sector Development
    6. Corruption Level
    7. Political Risk
    8. Country Promotion and Image
    9. Targeted Investment Incentive

Driver 1: Liberalization and Deregulation of Business Activities

This driver includes government policies and actions that reduce government interventions, enabling private businesses to operate freely and make profits in a competitive environment. An on-going system must be created to remove barriers to entry, operations and exit. Following are examples of what must be one in this area:

- Facilitate the formation of new businesses
- Reduce licensing and registration requirements
- Remove price controls and domestic trade restrictions
- Reduce the number of government inspections, interventions and interferences in business activities
- Simplify reporting requirements
- Reduce the cost of doing business, including taxation levels
- Simplify closure of failing enterprises
- Liberalize labor markets, improving labor mobility and reducing excessive labor costs imposed by Government (such as excessive minimum wages, payroll taxes, high un-employment compensation).

Driver 2: Stability and Predictability of the Legal Environment

Set of policies and actions to enact and implement stable and predictable laws and regulations that would support and encourage private sector businesses in a free market. They require, among others, the following actions by the Executive, Legislative and Judiciary branches of Government:

- Enact appropriate legislation that would define the "rules of the game" for all business, without discrimination or preferential treatments, including modern civil, labor, tax and commercial codes and legislation to protect intellectual property rights, patents, technology transfer policies, and direct foreign investments.
- Improve the processes for drafting, presenting, and carrying out public review of proposed business-related legislation.
- Create an independent Judiciary, with its independent budget.
- Make the Courts more efficient and capable of settling commercial disputes.
- Empower the Executive to enforce judgments made by the Courts, including those on commercial contracts.
- Review existing legislation from the point of view of inconsistencies among different legal documents.

Driver 3: Corporate and Public Governance

Set of policies and actions aimed at improving the governance of private companies and public administration to support private sector activities in a free market economy. They include policies in Corporate Governance, Public Administration and Privatization of state properties.

- **On Corporate Governance,** the objective is to establish appropriate rules that would guide the activities of businesses in the best interest of their shareholders, protecting ownership rights. Key policies and actions include:
  - Enact appropriate corporate governance legislation.
  - Require all companies listed in stock exchanges to switch over to international accounting standards and to submit annual reports.
  - Encourage the creation of non-government organizations to support corporate governance and issue corporate governance codes and model charters and by-laws.
  - Implement a comprehensive corporate governance training program for board members, shareholders, managers, etc.

- **On Public Administration**, the objective is to redefine the role of the Government to support the private sector and secure the provision of sound and efficient Government services without corruption . The implementation and sustainability of economic policy reforms over time also require strong -- though smaller -- Government with strong management and administrative capacity. A Public Administration reform program should include:
  - Establish a clear strategy and vision for the role of the Government as complementary to and supportive of the private sector.
  - Introduce adequate regulations to avoid monopolistic behaviors.
  - Consolidating ministries and agencies to avoid responsibility over-lapping.
  - Undertaking “Functional” and “Operational” reviews for individual ministries and agencies.
  - Reforming and modernizing the Civil Service by providing adequate incentives for performance and “market” controls.
  - Reforming Government Procurement Practices.
  - Reforming central-local government fiscal relationships.
  - Reduce shadow economy activities by drastically lowering cost of compliance with legislation in effect.

- **On Privatization,** the objective is to improve the efficiency of resource use through private ownership, minimize the possibilities of undue market power by the Government, and concentrate Government resources on public goods. Key measures include:
  - Pass appropriate legislation to permit the privatization of land and state enterprises.
  - Develop appropriate mechanisms to register ownership rights, including land titling and land registration.
  - Create and encourage the independence of an agency to carry out the privatization of state properties.
  - Approve fair and transparent procedures for the privatization of state properties
  - Complete rapidly the privatization of all state enterprises under clear and transparent procedures.
  - Take early actions to prepare state companies for privatization, including actions to protect minority shareholder rights, and transfer social assets to local authorities.

Driver 4: Liberalization of Foreign Trade and International Capital Movements

Set of policies and actions to facilitate the exports and imports of goods and transfer capital internationally. This will require the following actions:

- Remove restrictions to exports, including export quotas, duties, indicative prices, advance deposits, and foreign exchange surrender requirements.
- Remove restrictions to imports, including high import duties, critical import list, and indicative prices.
- Simplify and expedite custom services, including procedures for custom clearances.
- Develop more modern and consistent procedures for certification requirements and standards of products
- Liberalize foreign exchange transactions and eliminate restrictions on foreign direct investments.
- Cancel all restrictions on purchase of securities in foreign currency.

Driver 5: Financial Sector Development

Set of policies and actions to develop a healthy financial sector capable of meeting the financing needs of growing businesses. Key measures are the following:

- Liberalize interest rates on bank deposits and lending.
- Eliminate preferential credit programs imposed by the Government on banks
- Increase the independence and autonomy of the Central Bank to operate by efficiency not political considerations, with its main goal being the maintenance of internal and external stability.
- Ensure that health of the banking sector by improving bank supervision and enforcing prudential regulations.
- Develop appropriate mechanisms to deal expeditiously with troubled banks.
- Strengthen the Securities and Stock Market Commission.
- Introduce International Accounting Standards and external auditing requirements for all banks.
- Encourage competition and efficiency in the financial sector by facilitating the expansion of foreign banks and non-bank financial institutions.

Driver 6: Corruption Level

Set of policies and actions to minimize corruption and protect businesses from abuse of power by government officials. Key measures include:

- Undertake measures to “prevent” corruption, reducing the opportunities for corruption and making corruption more difficult to undertake.
- Develop the legal framework to ensure better enforcement of anticorruption measures and impose visible, harsh, swift and certain penalties for official corruption.
- Get public support for anti-corruption programs by making people aware of their rights and the rules of the game.

Driver 7: Political Risks

Set of policies and actions to minimize the effects of political uncertainties on business activities. Key measures include:

- Pass appropriate legislation to reassure investors that arbitrary expropriation of private property, including "creeping expropriation", will not be permitted in the country.
- Introduce strong measures to eliminate power abuses by the Government authorities, bring tax collectors and local officials under the control the central administration.
- Give the Government the total authority to do their jobs unimpeded by vested interests.
- Provide Governmental stability, including the longevity of key Officials.
- Ensure law and order.
- Minimize the risks of civil and external disturbances that may affect businesses.

Driver 8: Country Promotion and Image

Set of policies and actions to promote the country and improve its image as perceived by foreign and domestic investors. Key measures include:

- Announce and disseminate widely the Government's policy and commitment to implement strong market oriented policies and show implementation progress.
- Vocally support foreign investment by changing the attitude of officialdom at central and local levels.
- Require all embassies abroad to have their commercial section strengthened, and to go on a sales drives to better disseminate business opportunities.
- Assist in the establishment of a private investment promotion agency.

Driver 9: Targeted Investment Incentives

Set of policies and actions to bring investment incentives to levels similar to those of its trading partners, while avoiding targeted incentives that may lead to distortions and inefficient allocation of resources. Key measures include:

- Set taxes at levels comparable to those of the country's neighbors or competitors.
- Eliminate special investment incentives targeted to specific sectors, enterprises or regions.

(Note: since this driver had a negative correlation, we may need to talk more about it. I do not want to imply that we favor targeted incentives by listing them)