Developing a Positive Climate for Business and Investment:

A Best Practice Guide

OSCE Organization for Security and Co-operation in Europe

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Organization for Security and
Co-operation in Europe

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Foreword

I am pleased to present the OSCE publication *Developing a Positive Climate for Business and Investment: A Best Practice Guide*.

The first version of the Guide was published in 2006 in response to requests made by the OSCE participating States. It facilitated broader and in-depth sharing of experiences and best practices in the areas of investment and the development of small- and medium-sized enterprises (SME).

Sixteen years after the publication of the first Guide, which was entitled *OSCE's Best Practice Guide for a Positive Business and Investment Climate*, the promotion of a positive business and investment climate remains a priority area for the OSCE. This has been demonstrated by several Ministerial Council Decisions and Declarations adopted by our 57 participating States, requesting OSCE – in particular, the Office of the Co-ordinator of Economic and Environmental Activities, as well as other Executive structures – to increasingly engage in this area. Starting with the 2008 global financial crisis and now within the unfolding impact of the COVID-19 pandemic, we have experienced profound negative effects on overall investment and the global economy. This negative impact has not spared any regions or economic sectors, and thus has amplified pre-existing structural weaknesses and growing inequalities.

Today's highly interconnected world requires inclusive and co-operative responses at the community, state, regional and global level. All stakeholders, including national governments, think tanks, civil society, international organizations, the private sector and academia need to contribute to the discussion. Multilateral organizations can provide platforms for dialogue, exploring collaborative solutions in dealing with the challenges of the current era. Ultimately, co-operation is the best defence against global crises. The OSCE, given its comprehensive approach to security, is well positioned to provide such a platform. Through dialogue and sharing lessons and best practices, the negative impact of economic global challenges can be tackled. Moreover, the OSCE's participating States can be supported to take advantage of opportunities, such as digitalization, to improve the investment and business climate.

It is within this context that this Guide was developed. This Guide presents key concepts, best practices and policies that support a competitive business climate, and offers policy and regulatory recommendations on how to attract foreign direct investment (FDI). It places special emphasis on effective tools and strategies that support the private sector, the main engine of job creation worldwide, and particularly small- and medium-sized enterprises (SMEs), which represent about 90% of businesses around the globe. In addition to being the main drivers of job creation, businesses contribute to economic integration and social cohesion. They also play an important role in innovation and the creation of more environmental friendly and human-centred business solutions. However, only through efficient and inclusive policy tools can SMEs successfully interact with external market conditions. And it is through this that economies can become more competitive and resilient. In this Guide, we present some of these tools, especially those that have already been shown to be successful throughout the OSCE area. The Guide also focuses on the impact of open data, digitalization and information and communications technology in accelerating socio--economic transformation by enabling new cross-border business models, and ensuring integrity and transparency in investment and trade.

It is my sincere hope that the Guide will be a useful tool for policymakers and practitioners seeking to develop new policies and strategies aimed at improving the investment and business climate in their respective countries. I also hope that it will inspire further dialogue and co-operation, not only among our participating States, but also between national authorities and other key stakeholders, on how to advance economic development by building and sustaining positive investment and business climates.

Ambassador Igli Hasani

Co-ordinator of Economic and Environmental Activities

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List of Abbreviations and Acronyms

ACAs	anti-corruption authorities
ACDI/VOCA	Agricultural Cooperative Development International/Volunteers in Overseas Cooperative Assistance (NGO)
AI	artificial intelligence
AID	asset and interest declaration
AIP	agro-industrial parks
ANAC	Anti-Corruption Authority (of Italy)
ANI	National Integrity Agency (of Romania)
B20	Business 20 (of the G20)
B2B	business-to-business
B2C	business-to-consumer
B2G	business-to-government
BITs	bilateral investment treaties
BO	beneficial ownership
BSOs	business support organizations
CAREN	Central Asian Research and Education Network
CAUSE	Confiscated Assets Used for Social Experimentations (of Albania)
CEDAW	(UN) Convention on the Elimination of All Forms of Discrimination against Women
CEE	Central and East Europe
CEFTA	Central European Free Trade Agreement
CETA	Canada–European Union Comprehensive Economic and Trade Agreement
CIS	Commonwealth of Independent States
CIT	corporate income tax
CPI	Corruption Perception Index (of Transparency International)
CSCE	Conference on Security and Co-operation in Europe
CSOs	civil society organizations
CSR	corporate social responsibility
D4D Hub	Digital for Development Hub
DESI	Digital Economy and Society Index
Digital CASA	Digital Central Asia South Asia (of Kyrgyzstan)
DISC	Digital Innovation and Scale-up initiative
DMA	Digital Markets Act
DNA	Anti-Corruption Directorate (of Romania)
DS	digital signature
DSA	Digital Services Act
DTRI	Digital Trade Restrictiveness Index
E4J	Education for Justice (of UNODC)
EAEU	Eurasian Economic Union
EaP	Eastern Partnership
EaSI	Employment and Social Innovation programme (of the EU)
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECA	Europe and Central Asia
ECIPE	European Centre for International Political Economy
EDA	Entrepreneurship Development Agency (of Georgia)
EDB	(World Bank's) Ease of Doing Business
EFSE	European Fund for Southeast Europe
EFTA	European Free Trade Association
EGDI	E-Government Development Index (of the UN)
EIB	European Investment Bank
EIF	European Investment Fund
EIP	eco-industrial parks
EIS	Eelnõude infosüsteem [legislative drafts information system] (of Estonia)
EPI	E-Participation Index (of the UN)

EPZ	export-processing zones
ESCs	Entrepreneurship Support Centres (of Kyrgyzstan)
ESG	environmental, social governance
EU	European Union
EU-27	27 European Member States
FAO	Food and Agriculture Organization
FASIE	Foundation for Assistance to Small Innovative Enterprises (of Russia)
FAST	finance against slavery and trafficking
FATF	Financial Action Task Force
FDI	foreign direct investment
fin-tech	financial technologies
FTZ	free trade zones
FOs	(OSCE) field operations
G20	Group of Twenty
G2G	government-to-government
GATS	General Agreement on Trade in Services (of the WTO)
GCC	Governance Coordination Centre (of Lithuania)
GDP	gross domestic product
GEFF	Green Economy Financing Facility
GGF	Green for Growth Fund Southeast Europe
GITA	Georgia's Innovation and Technology Agency
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GPA	(WTO) Government Procurement Agreement
GPP	green public procurement
GRETA	Green Economy: Sustainable Mountain Tourism and Organic Agriculture (of the Austrian Development Agency)
GRID	German–Russian Initiative for the Digitalization of the Economy

GSST	Green Scheme of Slovenian Tourism
GVH	(OECD) Hungarian Competition Authority
HTP	high-technology park
ICN	International Competition Network
ICR Stand-ard	Insolvency and Creditor Rights Standard
ICSID	International Centre for Settlement of Investment Disputes
ICT	information and communications technology
IFC	International Finance Corporation
IIAs	international investment agreements
ILO	International Labour Organization
IMF	International Monetary Fund
IO	international organization
IOT	internet of things
IP	intellectual property
IPAs	investment promotion agencies
IPRs	intellectual property rights
ISDS	investor–State dispute settlement
IT	information technology
ITC	International Trade Centre
ITU	International Telecommunication Union
KPIs	key performance indicators
KSSDA	Kyrgyz Software and Services Developers Association
LDCs	least developed countries
LIAA	Investment and Development Agency of Latvia
LMICs	low- and middle-income countries
LPA	Latvian Privatization Agency
MACN	Maritime Anti-Corruption Network
MAPS	Methodology for Assessing Procurement Systems
MDA	multi-donor account

MIGA	Multilateral Investment Guarantee Agency (of the World Bank)
MNC	multinational corporation
NGO	non-governmental organization
NRI	Network Readiness Index
OCDS	Open Contracting Data Standard
OECD	Organisation for Economic Co-operation and Development
ORF-EE	Open Regional Fund for South-East Europe – Energy Efficiency
OSCE	Organization for Security and Co-operation in Europe
P2P	peer-to-peer
PAIH	Polish Investment and Trade Agency
PFI	Policy Framework for Investment (of the OECD)
PPC	public–private consultation
PPP	public–private partnership
PRI	Principles for Responsible Investment
R&D	research and development
RBC	responsible business conduct
RFID	radio frequency identification
RIA	regulatory impact assessment
RTA	regional trade agreement
SBA	Small Business Act (of Georgia)
SCC	Stockholm Chamber of Commerce
SEF	Slovene Enterprise Fund
SEZ	special economic zones
SOE	State-owned enterprise
SME	small and medium sized enterprises
SRS	State Revenue Service (of Latvia)
SRSS	Structural Reform Support Service (of the European Commission)
SST	Special Investigations Service (of Lithuania)
STO	Slovenian Tourist Board
TFA	Trade Facilitation Agreements (of the WTO)
TI	Transparency International
TPJ	Technology Park Ljubljana
TRIPS Agreement	Agreement on Trade Related Aspects of Intellectual Property Rights
UBO	Ultimate Beneficial Owner
UNCAC	United Nations Convention against Corruption
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECE	United Nations Economic Commission for Europe
UNIC	Ukrainian Network of Integrity and Compliance
UNIDO	United Nations Industrial Development Organization
UNODC	United Nations Office on Drugs and Crime
USAID	United States Agency for International Development
VAT	value added tax
VGGT	Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security
WEF	World Economic Forum
We-Fi	Women Entrepreneurs Finance Initiative
WJP	World Justice Project
WP	working paper
WTO	World Trade Organization
YG	Youth Guarantee initiative (of the EU)

Introduction

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1.1. Background

In 2006, the OSCE published the *Best Practice Guide for a Positive Business and Investment Climate*. The Guide presented key concepts and best practices by showcasing examples from the OSCE region that had resulted in improvements to the business and investment climate. The publication served as a practical document, specifically tailored to the needs of developing and transition economies in the OSCE region.

The global economic outlook today is vastly different from that of 2006. Although global growth over the last decade has averaged around 3.4% a year, the OSCE region has experienced developments and crises that have had a powerful impact on the business and investment climate.

The 2008 financial crisis resulted in the most serious economic downturn since the Great Depression of the 1930s, leading, among other things, to a European debt crisis that put the survival of the Eurozone at risk. Emerging and transitioning economies in particular experienced a great deal of financial volatility.

Since the 2008 financial crisis, institutional frameworks governing the global economy have come under great pressure. Uncertainty has become widespread in global financial markets, resulting in unpredictability in trade policies. Global interest rates have fallen to historic lows, and there have been cases of negative yields of government bonds relative to inflation. Finally, the unfolding COVID-19 crisis is having a profound downward effect on global investment and economic activity.

Indeed, much has changed since 2006 when the OSCE published the first Guide. In recent years, several OSCE Ministerial Council decisions have been adopted that have broadened the mandate of the Organization and its Executive Structures in the areas of economy and business. A detailed overview of these MC decisions is found in the Annex of this new, revised Guide. At present, in contrast to 2006, it is primarily information and communications technology (ICT) applications that are accelerating socio-economic transformations, which in turn are facilitating new cross-border business models and trade and creating new digital platforms.

An updated OSCE guide on the business and investment climate has become even more critical considering ongoing efforts at economic recovery after nearly two years of restrictions due to the COVID-19 pandemic.

1.2. Methodology

The development of this Guide was managed by the Office of the Co-ordinator of OSCE Economic and Environmental Activities. It was collaboratively drafted during 2021, and includes input from other international organizations, government agencies of OSCE participating States, and various OSCE field operations. To ensure that the new version of the Guide responds to the needs of the participating States and the users of the Guide, including lessons learnt and recommendations by stakeholders on the ground, questionnaires were prepared and distributed to all OSCE field offices and their respective partners.

The updated Guide is based on the results of the above survey, as well as expert recommendations, a literature review and contributions from over 15 leading multilateral and donor organizations working in the fields of business climate reform, development of small- and medium-sized enterprises, and foreign direct investment. Contributors included the World Bank, OECD, UNCTAD, UNCITRAL, UNODC, WTO, UNECE, EBRD, ILO, and the EU. The key concepts and best practices that have proven successful since the first Guide was published are presented in this updated Guide in a form that aims to be both compelling and practical.

1.3. Purpose of the Guide

The purpose of this updated Guide is, on one hand, to reflect the changes that have occurred in the last decade in the global economy and, on the other, to analyse the impact these changes have had on creating competitive investment climates.

It aims to assist States, particularly those in the OSCE region, to improve their business and investment climates by developing new approaches. It provides samples of best practices and policy guidance from countries in the OSCE region that have made significant strides in recent years in improving their business climate.

It also compiles various resources and tools, as well as the perspectives of leading multilateral and donor organizations on how to improve the business and investment climate. It focuses on practical recommendations that should be valuable to experts, policymakers, government officials and decision makers, as well as to members of civil society organizations, chambers of commerce and business associations. In addition to an analysis and general recommendations, two other highly important areas are also reflected in different parts of the Guide: the persistent gender inequality in business, and the impact of the COVID-19 pandemic. Rather than replicating the work of leading experts and well-known agencies, or elaborating on the technical rational for measures favourable to the business climate, the intention here is to motivate readers and provide them with resources and mechanisms for conducting their own research on or analysis of the subject.

After the launch of this revised Guide, it is proposed that related regional and national workshops are organized. Such workshops will enable practitioners and decision makers to discuss specific parts of the Guide in more detail. The aim should be twofold: to increase the understanding of existing policy frameworks, best practices and key measures for enhancing respective business and investment climates, and to discuss how particular policies presented in the Guide might be adapted or developed to suit specific economic situations.

We hope that this Guide, together with the proposed workshops, will support dialogue and the development of national and regional practitioner networks. Its aim is to facilitate the exchange of information and best practices, and to enhance co-operation among the States of the OSCE region.

1.4. Summary

The Guide describes key concepts and offers an overview of best practices and policies that can have a positive impact on the overall business climate in order to support rising economic prosperity. A positive business and investment climate creates conditions that encourage business start--ups, employment opportunities and overall economic growth.

A precise definition of “business and investment climate” is difficult to find. The World Bank defines business and investment climate as opportunities and incentives for firms to invest productively, create jobs and expand. For the purposes of this Guide, the investment climate will be defined by three broad sets of variables:

- Macroeconomic policies and good practices, such as trade policies
- Governance institutions and regulatory systems
- Infrastructure

The range of aspects involved in creating a positive business and investment climate is incredibly vast. Without any doubt, the topics in this Guide are far from exhaustive. An effort has been made to select topics that the OSCE participating States find consensus on and that can lead to a favourable business and investment climate. This includes working with government authorities, policymakers, chambers of commerce and business associations.

▲ Flags of the OSCE participating States

The Guide takes a view based less on traditional economics, such as macroeconomic bank policies regarding inflation, tax rates, fiscal incentives, foreign exchange control, or the like. Instead, in line with the OSCE's concept of comprehensive security, it emphasizes across-the-board socio-political approaches. This includes the promotion of good governance, regulatory environments, political stability, rule of law, trade promotion, digitalization, etc., linking the OSCE's second socio-economic dimension to its first (politico-military) and third (human rights) dimensions.

In the 2006 Guide, developing small- and medium-sized enterprises (SME) and increasing foreign direct investments (FDI) were presented as two of the most significant catalysts for economic growth and job creation. The current Guide has added various other economic governance aspects that are integral to a healthy investment climate. These include legal and regulatory frameworks, integrity and transparency, the role of digital tools and their impact on a strong business and investment climate, new sustainable development models, the rising importance of climate change as an investment prospect, and the impact on economic development of promoting equal opportunities for women in the economic sphere. The last topic is gaining ever more significance, since gender inequality continues to persist in many economic areas,[1] including wages, unemployment rates, the number of female business leaders, accessibility of financing to start businesses, etc. The revised Guide also looks at the impact of economic and environmental challenges, such as the COVID-19 pandemic, and decisions of governments to effectively mitigate the level of macroeconomic uncertainty.

Finally, when reading the Guide, it should be borne in mind that there is no one-size-fits-all recommendation for improving the business and investment climate in any given country. Each country must adapt its own strategy based on its specific conditions and environment.

The Guide is intended to serve as a practical document that provides targeted recommendations specifically tailored to the needs of OSCE participating States. It aims to encourage the implementation of best practices and to promote the sharing of information and experience in the OSCE region.

ENDNOTES

1 The OECD Gender Data Portal: Data - OECD.

Political, legal and regulatory systems conducive to an attractive investment climate

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A favourable and predictable business climate is essential for the economic development in any country and for attracting foreign direct investment (FDI), which is a key to driving economic growth, including for post-COVID-19 economic recovery. This is especially the case in emerging economies, where FDI is often the largest source of external finance.

Strong legal and regulatory systems are fundamental ingredients for stability. They help governments find a balance between economic freedom and growth, while ensuring that economic activities benefit the public good with no negative consequences.

Long-term investors value stable governments, an independent and capable judiciary, and sound laws and regulations that are implemented fairly and impartially. Investors need reasonable assurances that their investments are being protected against arbitrary or uncompensated seizures, discriminatory sanctions, or government interventions stemming from political events.

2.1. Legislating, regulating and administrating business enterprises

Regulation is an essential instrument for governments to reach certain economic and social policy objectives. In many cases, regulation has become even more important than traditional macroeconomic tools such as monetary or fiscal policies. In addition to this, it is important that governments ensure the independence, training and adequate funding of the judiciary. Regulation together with a well-trained judiciary is essential not just to promote a system of checks and balances and instil good governance, but also for sustaining an efficient legal system regarding business and commerce. Efficient and effective legal systems protect businesses' commercial interests in land and property, provide guarantees against arbitrary or uncompensated expropriation, and effectively and efficiently enforce creditors' rights. If countries are to reach their full economic potential, all of these are essential. However, these and other aspects of legal systems require more than merely adopting good laws and regulations.

Legislating is perhaps the least difficult step of establishing legal or regulatory institutions and practices. The challenge lies with prompt and efficient enforcement of regulations, laws, and property and contractual rights. If these are not enforced, legislation can be rendered ineffective. As a result, economic development can suffer.

2.1.1. Effective regulatory frameworks

Any effective regulatory framework should include a legal framework for resolving disputes between businesses in a fair and transparent manner. Moreover, governments should make arbitration, as well as other forms of alternative dispute resolution, widely available for commercial disputes. Enforcing commercial rights and obligations through an efficient and independent judiciary, or through alternative dispute resolution methods such as arbitration, is crucial for sustaining and advancing a positive business and investment climate.

Ideally, regulatory frameworks are based on sound decision--making, as well as the existence of strong and independent regulatory agencies that can enforce regulations in a uniform way within their jurisdiction. In the case of federal States or large economies that have different regulations throughout the country, there must be means for co-ordinating regulatory frameworks.

▲ **First Preparatory Meeting of the 30th OSCE Economic and Environmental Forum.**

The OECD has set a global standard with a reference checklist for regulatory decision-making. It presents ten key questions that policymakers should ask when aiming to provide sound regulation. For example, policymakers should ask whether regulatory action is the best solution, if it has a correct legal basis and respects the rule of law, if the regulation is clear, consistent and can be comprehended by its intended users, and if there has been a public consultation process for stakeholders to present their views.

Effective regulation, however, also depends on regulators understanding the products or services being offered by businesses vis-à-vis a regulation's desired effect or its potential unintended side effects. The speed of innovation and digitalization can sometimes make such understanding challenging. If regulators must ascertain that a product meets safety standards or there are other legal requirements that must be met, it sometimes takes a long time for innovators to bring new products to the market.

In the evolving global economy, national boundaries are becoming less important for global markets, and products are sometimes a fusion of digital and physical goods. Businesses and innovators can thus easily fall outside the scope of existing regulatory frameworks. It is therefore important that regulators are well trained and that regulatory bodies can assure high competency levels.

For this, frequent meetings between regulators and relevant stakeholders from the various industries under regulation are essential. Since this can involve the perceived risk of policy capture, whereby regulators enact rules in favour of the regulated industry, it is recommendable that such processes are well designed, transparent and, ideally, involve third-party observers to safeguard independence and oversight.

For business to thrive, effective regulation ultimately needs to strike a balance between, on one hand, fair and sound regulation protecting the market's integrity and consumer safety, while on the other hand, providing a simple, transparent and fair legal framework for business to operate.

In the European Union, the *Acquis Communitaire* provides a well-known code of laws regulating the EU's internal market. Harmonizing legislation in line with EU regulation, without discriminating against non-EU OSCE States, could provide investors a sense of predictability and familiarity, and generate a pro-investment mood.

TEXTBOX 1.

The OECD Reference Checklist for Regulatory Decision-Making

1. **Is the problem correctly defined?**
   The problem to be solved should be precisely stated, giving evidence of its nature and magnitude, and explaining why it has arisen (identifying the incentives of affected entities).

2. **Is government action justified?**
   Government intervention should be based on explicit evidence that government action is justified, given the nature of the problem, the likely benefits, and costs of action (based on a realistic assessment of government effectiveness), and alternative mechanisms for addressing the problem.

3. **Is regulation the best form of government action?** Regulators should carry out, early in the regulatory process, an informed comparison of a variety of regulatory and non-regulatory policy instruments, considering relevant issues such as costs, benefits, distributional effects and administrative requirements.

4. **Is there a legal basis for regulation?**
   Regulatory processes should be structured so that all regulatory decisions rigorously respect the "rule of law"; that is, responsibility should be explicit for ensuring that all regulations are authorized by higher-level regulations and consistent with treaty obligations, and comply with relevant legal principles such as certainty, proportionality, and applicable procedural requirements.

5. **What is the appropriate level (or levels) of government for this action?** Regulators should choose the most appropriate level of government to take action, or if multiple levels are involved, should design effective systems of co-ordination between levels of government.

6. **Do the benefits of regulation justify the costs?**
   Regulators should estimate the total expected costs and benefits of each regulatory proposal and of feasible alternatives, and should make the estimates available in accessible format to decision makers. The costs of government action should be justified by its benefits before action is taken.

7. **Is the distribution of effects across society transparent?** To the extent that distributive and equity values are affected by government intervention, regulators should make transparent the distribution of regulatory costs and benefits across social groups.

8. **Is the regulation clear, consistent, comprehensible and accessible to users?**
   Regulators should assess whether rules will be understood by likely users, and to that end should take steps to ensure that the text and structure of rules are as clear as possible.

9. **Have all interested parties had the opportunity to present their views?**
   Regulations should be developed in an open and transparent fashion, with appropriate procedures for effective and timely input from interested parties such as affected businesses and trade unions, other interest groups, or other levels of government.

10. **How will compliance be achieved?**
    Regulators should assess the incentives and institutions through which the regulation will take effect, and should design responsive implementation strategies that make the best use of them.

Source: OECD

The previous edition of this Guide already highlighted that establishing an investment ombudsman can be quite helpful. Investors, particularly foreign investors, often face difficulties when working in unfamiliar cultures and regulatory frameworks. Their difficulties are compounded when they face bureaucracies or negotiations with State- or municipal-owned enterprises.

TEXTBOX 2.
Business ombudsman, Georgia

In 2015, Georgia transformed its tax ombudsman agency into a business ombudsman agency. The agency helps protect the rights and interests of entrepreneurs and investors doing business in Georgia. The business ombudsman is part of the Government of Georgia and has direct access to the Prime Minister's Cabinet. The main role of the business ombudsman is to oversee the protection of rights and legitimate interests of entrepreneurs and investors doing business in Georgia, and to support the restoration of violated rights.

2.1.1.1. REGULATORY REFORMS

Although regulation is a necessary and inevitable part of any business environment, when outdated or convoluted, regulation can significantly inhibit businesses from entering the market. As a result, companies often incur significant costs to ensure legal and regulatory compliance. One way for States to reform their regulatory frameworks is by means of the so-called "regulatory guillotine". The aim of a regulatory guillotine is to rapidly screen regulations and eliminate those considered no longer relevant, as well as to streamline and/or simplify regulations that overlap. This can assure better regulatory quality and prevent unnecessary re-regulation. A regulatory guillotine is particularly well designed to provide quick help in political and legislative contexts that are overburdened with various challenging reforms.[1] It is best used in conjunction with systemic reforms and reviews that extend across the entire public sector, and that complement the setting up of a new regulatory framework, for example via a regulatory impact analysis (RIA).

2.1.1.2. REGULATORY IMPACT ANALYSIS (RIA)

Most OSCE participating States have formal requirements for public notice and consultation on regulatory legislation. Given that the quality of legislation and regulation is largely dependent on the quality of the designing process, dialogue with involved stakeholders is vital. A model that is often deployed in this context is the so-called regulatory impact analysis (RIA), which is a document created before (ex ante) a new government regulation is introduced. It usually provides a detailed and systematic appraisal of the potential impact of the new regulation to assess whether it is likely to achieve the desired objectives. In the OSCE region, most participating States have embedded RIA in their legal systems.

TEXTBOX 3.
OSCE facilitated reforms in Kyrgyzstan and the regulatory e-guillotine

The OSCE Programme Office in Bishkek, in collaboration with international experts, assisted the Kyrgyz Government in improving the country's competitiveness by both simplifying and streamlining the legal framework regulating economic activity, as well as by aligning its regulatory policies and procedures with international best practices. It also set up an innovative software tool to help with this process, the e-guillotine. As a result, significant numbers of regulations were eliminated or simplified. The full implementation of the regulatory system will allow local businesses to reduce annual administrative costs by around €20 million, the equivalent of 10.8 million working hours.[2]

Other countries have also applied a regulatory guillotine for specific purposes. A sample can be seen in the following Table 1.

Table 1. Selected results of regulatory guillotines

	Target of reform	Before clean-up	% Eliminated	% Simplified
Korea (11 months)	Regulations	11,125	48.8%	21.7%
Mexico (18 months)	Formalities	2,038	54.1%	51.2%
Moldova (16 weeks)	Regulations	1,130	44.5%	12.5%
	Fee-based permits	400	68.0%	20.3%
Ukraine (12 weeks)	Regulations	14,000	36.0%	7.2%
Croatia (9 months)	Business Regulations	1,451	15.0%	10.0%
Kyrgyzstan (3 years)	Regulations	1,068	24.4%	19.5%

Source: OSCE

TEXTBOX 4.

Harmonizing investment laws in Bosnia and Herzegovina

The World Bank's Investment Climate Programme is helping the Government of Bosnia and Herzegovina to harmonize investment laws at a subnational level and to establish mechanisms to track and address investor grievances in a systematic and effective manner. This has included setting up a technology tool to track investor grievances. The mechanism has helped the Government receive new investments as well as re-investments by existing investors, which in turn have generated hundreds of new jobs.

2.1.2. Protection of contractual rights

Court intervention in the enforcement of contracts is often a last resort for enterprises, given that many agreements are self-enforcing. After all, businesses that successfully trade with each other for extended periods develop relationships of trust, a key part of their success. Reputation is also a strong motivation for parties to keep their agreements, since there are few who would like to do business with an enterprise known for breaking its promises. However, disputes do arise. In such cases, contracts should be enforced according to the terms these contracts contain. Although subject to exceptions, such as contracts affected by illegality, fraud, mutual mistakes or the like, the general principle of parties being bound by agreements is necessary for ensuring certainty and predictability in commercial relationships.

Formal rights enforcement mechanisms are therefore crucial to a healthy business and investment climate. The perception that legal enforcement is inefficient or too costly, to the extent that pursuing legal remedies is not considered worth the effort, is detrimental. Optimal performance of legal institutions, including the judiciary, also improves policy and regulatory predictability and strengthens the business and investment climate. Studies have also shown that efficient contract enforcement, including through the use of digital tools, is connected to an overall increase in trade. Greater confidence in courts increases the willingness of companies to invest. In addition, states with better court systems are often found to have larger and more efficient companies. Court efficiency has also been associated with improved access to credit (see below, Section 2.1.7. on insolvency legislation).[3]

The World Bank collects data regarding the time and costs for resolving commercial disputes. Table 2 presents contract enforcement statistics from OSCE participating States for which the World Bank has available data.

The data also charts the quality of the judicial processes index, which evaluates whether an economy has adopted a series of good practices promoting quality and efficiency in its court system. Such good practices can include, for example, a specialized court or division dedicated to hearing commercial cases, a "fast-track" procedure for small claims, the random assignment of court cases via an electronic system, or the like. Research has shown that solving commercial disputes is 92 days faster in economies with a specialized commercial jurisdiction.[4]

Table 2 demonstrates results in the OSCE region with regard to the speed, efficacy and costs associated with resolving disputes. To step up efforts to improve the business climate, several countries in the OSCE region have taken action to further enhance the adjudication of legal disputes.

Table 2. Contract enforcement statistics in selected OSCE participating States

Country	Time (days)	Cost (% of claim value)	Quality of judicial processes index (0–18)
Albania	525	42.7	7.5
Armenia	570	16.0	11.5
Azerbaijan	277	18.5	8.0
Belarus	275	23.4	7.5
Bosnia and Herzegovina	595	36.0	9.5
Bulgaria	564	18.6	10.5
Canada	910	22.3	11.0
Croatia	650	15.2	13.0
Czech Republic	678	33.8	9.5
Georgia	285	25.0	12.0
Hungary	605	15.0	12.5
Kazakhstan	370	22.0	16.0
Kyrgyz Republic	410	47.0	5.0
Latvia	469	23.1	13.5
Lithuania	370	23.6	15.0
Moldova	585	28.6	11.0
Mongolia	374	22.9	5.5
Montenegro	545	25.7	11.5
North Macedonia	634	28.6	13.0
Poland	685	19.4	11.0
Romania	512	25.8	14.0
Russian Federation	337	16.5	9.5
Serbia	622	39.6	13.5
Slovak Republic	775	20.5	13.5
Slovenia	1160	12.7	11.5
Tajikistan	430	25.5	6.5
Turkey	623	24.9	15.0
Ukraine	378	46.3	11.5
Uzbekistan	225	20.5	8.5

Source: https://www.doingbusiness.org/en/data/exploretopics/enforcing-contracts

TEXTBOX 5.

Enforcing contract reforms in the OSCE region: Azerbaijan, Kazakhstan and other countries[5]

In 2020, Azerbaijan made enforcing contracts easier by introducing an e-system that allows plaintiffs to file their initial complaint electronically, and by adopting a consolidated law on voluntary mediation. For commercial disputes, this means parties can now file summons online and receive financial incentive for mediation. Earlier, in 2018, Azerbaijan introduced a system allowing users to pay court fees electronically. In addition, in 2019, the country established a second commercial court in Baku, thereby increasing the number of specialized judges. In 2020, the country was ranked as the top-improver in the enforcing contracts indicator of the World Bank Group's *Doing Business* report.

In 2019, Kazakhstan made enforcing contracts easier by making judgments rendered at all levels in commercial cases publicly available, and publishing performance measurement reports on local commercial courts. Earlier, contract enforcement was improved by the introduction of additional time standards for key court events. In the majority of cases, these time standards have been met. The quality of the process has benefited from an electronic filing system, a new code of civil procedures, and a regulated maximum number of adjournments that can be granted by a judge in a given case. In 2016, Kazakhstan introduced a simplified fast-track procedure for small claims and streamlined the rules for enforcement proceedings.

Several other countries in the OSCE region have also drawn on some or more of these elements in their legal frameworks for dispute settlement. Canada, for example, recently introduced an e-system that allows plaintiffs to file the initial complaint and pay court fees electronically. Similar practices are (in part) also in place in Estonia, Denmark, Germany, Greece, Norway and Portugal. In Hungary, Ukraine and the United States, court fees can also be paid electronically; random case allocation through an electronic system is in use in Armenia and Georgia.

2.1.2.1. LEGAL AND ALTERNATIVE DISPUTE SETTLEMENTS

Options for businesses to settle their disputes in an efficient and fair manner is key for ensuring that a level playing field is maintained and the interests of investors and business are being protected. Nonetheless, businesses and/or their clients often have little appetite to enter into legal disputes, since legal proceedings are costly and time-consuming.

The availability of alternative dispute resolution possibilities is therefore a strong and important tool for settling disputes in an amicable way, and saving time and resources in the process.

Arbitration is a non-judicial means of settling disputes by referring them to one or more impartial persons for a final and binding decision. Arbitration is favoured as a method for resolving international disputes for a number of reasons:

1. It is a private and confidential proceeding;
2. It allows the parties to select persons with specialized knowledge to make decisions in their dispute;
3. The arbitration procedure is generally more flexible than court procedures, and can be tailored to meet the parties' specific needs;
4. Arbitral decisions are not subject to appeal on the merits, but are final and binding (except in extraordinary circumstances);

5. Arbitration can be faster and less expensive than court proceedings;
6. Arbitration is perceived as reducing inequities faced by parties from foreign countries;
7. In cases where the State is a party to the dispute, arbitration reduces the ability of the State party to exert improper influence over the determination of the dispute;
8. A number of arbitration treaties now make arbitral awards fully enforceable in signatory countries.

Work regarding arbitration, in particular international commercial arbitration, has undergone significant development over the past decades.

Among other documents, the United Nations Commission on International Trade Law (UNCITRAL) developed the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, better known as the New York Convention. This legislative text from 1958 deals with the recognition and enforcement of foreign arbitral awards and agreements to arbitrate, and requires member States to respect arbitral decisions rendered in other member States. Acting as the cornerstone of international arbitration, the New York Convention is also associated with several other benefits, such as increase in trade, inflow of foreign investment, and the ability for companies to enforce contracts in other jurisdictions.

The Convention can be said to have obtained near-universal application, with 165 Parties to date, as of October 2020. In 2012, 56 of 57 OSCE participating States adopted this important framework.

In addition to the Convention, UNCITRAL has also prepared other texts on international arbitration, including the widely used UNCITRAL Arbitration Rules (contractual rules for disputing parties) and the UNCITRAL Model Law on International Commercial Arbitration Legislation.
The Model Law has been adopted by

84 States

in

117 jurisdictions.

TEXTBOX 6.
Modernizing arbitration law in consultation with involved stakeholders in Luxembourg

Luxembourg is frequently chosen as a site for international arbitration and the enforcement of foreign arbitral awards. Parties to disputes value the country's open economy, neutrality and political stability. In September 2020, Luxemburg reformed its procedural framework applicable to arbitration. The new law was based on a proposal from the Think Tank for Arbitration, a group of local arbitration practitioners and university professors interested in arbitration who had been working on the reform since 2013.

The reform incorporates elements of French procedural rules, as well as the UNCITRAL Model Law on International Commercial Arbitration. Notable provisions include the establishment of the role of a supporting judge (*juge d'appui*) to resolve procedural difficulties, and the designation of the Court of Appeal as the only court that can hear requests regarding awards, thereby removing the requirement to first seek relief from a District Court. The reform aims to make arbitration in Luxembourg yet more attractive by setting up an efficient, arbitration-friendly ecosystem that adapts the country's existing legal framework to widely recognized international arbitration standards.

In addition to the above instruments, UNCITRAL has been working on an investor–State dispute settlement (ISDS) system. ISDS is a system through which foreign investors can raise claims against host States for breaching obligations, usually in bilateral investment treaties. If an investor from one country (the "home state") invests in another country (the "host state"), both of which have agreed to ISDS, and the host state violates the rights granted to the investor under that agreement or treaty, then that investor may bring the matter before an arbitral tribunal.

According to UNCTAD, the number of treaty-based ISDS cases reached over a thousand in 2019. Most of the publicly known ISDS cases initiated that year were brought under international investment agreements (IIAs) signed in the 1990s or earlier. ISDS tribunals rendered at least 71 substantive decisions. In decisions in which the State was held liable, the amounts awarded ranged from several million to eight billion US dollars.[6]

The work of UNCITRAL in this area has resulted in the UNCITRAL Rules on Transparency in Treaty-based Investor--State Arbitration,[7] and the United Nations Convention on Transparency in Treaty-based Investor–State Arbitration.[8] The Transparency Registry supports these two texts, functioning as the repository for the publication of information and documents in treaty-based investor–State arbitration. In combination, the Transparency Standards of UNCITRAL constitute a robust, innovative set of procedural rules that will make arbitrations involving a State and initiated under an investment treaty accessible to the public.

While the above Transparency Rules provide a level of needed transparency and accessibility to the public, the Mauritius Convention provides a mechanism to make the Transparency Rules applicable to past investment treaties. Recognizing that transparency is a key value of good governance and the rule of law, and that it also can promote the welfare of developing countries, work on transparency standards has focused on increasing democratic legitimacy, reducing bribery and corruption, and developing accountable institutions.

Over the past few decades, the advantages of arbitration have caused it to increase significantly. At the same time, mainly because of increasing complexity and the high value of disputes, the length and cost of arbitral proceedings have also increased. Indeed, cost is often seen as one of weakest features of international arbitration.[9] Other forms of dispute resolution, such as mediation, might provide a more cost-efficient way forward.

2.1.2.2. INTERNATIONAL MEDIATION

Other forms of dispute resolution include mediation and conciliation, terms that are sometimes used interchangeably. They both refer to a process in which the parties to a conflict seek to resolve their differences through discussion rather than litigation. Unlike arbitration, these procedures seek to resolve disputes without determining the merits of any party's claims, arguments or defence.

The United Nations Convention on International Settlement Agreement, also known as the Singapore Convention on Mediation, signed by 46 States in 2019 and entered into force a year later, provides for the enforcement of settlement agreements reached through mediation across jurisdictions. The 2002 UNCITRAL Model Law has been updated accordingly and now includes a section on mediation enforcement.

2.1.2.3. MEDIATION AND GENDER

UNCITRAL texts on mediation for dealing with commercial disputes often provide SMEs with dispute resolution tools that are more informal, flexible and efficient. Moreover, all UNCITRAL texts are formulated in gender-neutral language. Thus, the mechanisms are particularly useful for women entrepreneurs. Smaller businesses are often run by women and taking a disputed matter to court can be an expensive and time-intensive process. By engaging in mediation proceedings, women entrepreneurs can create their own processes and work on their own agreements to find convenient solutions to disputes, whether involving legal or non-legal issues, while preserving commercial relationships. Mediation can facilitate communication and negotiations, and can help disputing parties to find common interests, enabling them to reach a settlement. Another useful mechanism, particularly for women entrepreneurs, is expedited arbitration, since it provides simplified procedures carried out in a shortened timeframe and at reduced cost. Work on expedited arbitration provisions is currently ongoing.

2.1.3. Business registration and classification

Smooth and efficient procedures for business registration and classification are essential for a positive business and investment climate, facilitating the entry of new companies into the market, helping reduce informality and gender disparity, and overall support economic growth and innovation. Clear frameworks designating different types of business activities makes registration not only easier, but also helps third parties such as banks and risk professionals to better fulfil their regulatory roles and assign adequate risk profiles to clients. This helps all parties

to avoid unnecessary costs related to mismatches between classification and actual business activity. Clear criteria and rules on company classifications also help company founders to decide on the type of business activity to initiate, or on possible combinations of business activities. If publicly accessible, criteria and rules are also important for general transparency in countries' economies, since they enable better understanding of the types of activities being performed under different classifications, not only in general terms as lists of possible classifications, but also in relation to each registered company. Moreover, sound business registries are also helpful in combating corruption, since such registries often provide information that can help law enforcement agencies in investigations. They also support the work of investigative journalists and other practitioners providing oversight to map ownership structures.

The World Bank has prepared extensive guidance on how to best reform business registration procedures, focusing among other things on[10]:

- Establishing flat-fee schedules;
- Standardizing incorporation documents;
- Moving registration out of the courts;
- Making notary use optional;
- Reducing or eliminating minimum capital requirements;
- Making the registration process transparent and accountable;
- Integrating registration systems and unique identification denominations;
- Creating a one-stop shop;
- Instituting registration systems led by information and communications technology.

As has been noted by the World Bank, information and communications technology (ICT) can play an instrumental role in enabling smooth and easy business registration. In the OSCE region, several participating States use electronic registration systems.

TEXTBOX 7.
The one-stop shop for business registration in Serbia

In 2005, the World Bank helped establish the Serbian Business Register Agency, a one-stop shop for business registration, insolvency, collateral registry and financial accounts. The time needed to establish a business in Serbia was decreased from 51 to 7 days, and the minimum capital requirement of US$5,000 for limited liability companies was eliminated. More than 450,000 business records were made available online. The registry recorded a 70% increase of newly registered companies in the first year, and is now an up-to-date, transparent and accessible repository of data on businesses.

TEXTBOX 8.
The company registration portal of Estonia

The Central Commercial Register and the Company Registration Portal of Estonia are both hosted at the Registration Department of Tartu County Court.[11] The registration portal is a digital environment that allows entrepreneurs to submit electronic applications, documents, and annual reports to the Commercial Register. It is used to establish new businesses, non--profit organizations, state agencies and local government institutions, and accepts applications to amend, liquidate or delete registry data. The company registration portal includes an e-annual reporting environment that can be used for compiling, signing and submitting annual reports. The company registration portal also includes simple web-based accounting software, so-called e-billing, which can help start-ups and small business to organize their accounting.[12]

2.1.4. Protecting and using property

Property rights are key to a positive business and investment climate.[13] Secure property rights help stimulate economic development and foreign investment, thus creating jobs, and can boost private sector development. Property registers, including land registers, should have objective and clear legal rules that assist in protecting against theft, fraud or uncompensated seizure. In addition, properties should be transferable and be allowed to use as collateral for credit. Companies will often want to use land or other property titles to finance growth, such as expansion of operations.

2.1.4.1. INTELLECTUAL PROPERTY RIGHTS

Intellectual property rights (IPRs) – such as patents, trade-marks and/or copyrights that extend exclusive rights to entrepreneurs for the economic exploitation of their creations – are essential for economic growth and innovation. IPRs are also often a critical element in foreign investment decisions and a vital component in global value chains.

For example, research conducted by the World Trade Organization (WTO) has shown that 91% of the price of designer clothes can be linked to intangible assets, with IPRs an important component of this.[14] It is important that buyers can trust that they are buying authentic products. Likewise, for sellers it is important that they know their intellectual property will not be stolen.

Like other assets, IPRs have economic value that can be objectively measured. In fact, the value of many of today's largest companies is not based on their tangible assets, such as factories or machines, but is based on their intellectual creations. However, secured lending systems do not always provide clear ways for IPRs to act as collateral for financing. This creates uncertainty in lending transactions and potentially deprives knowledge-based enterprises of credit, or unnecessarily increases their costs. Accordingly, legislation should unambiguously provide possibilities for intellectual property owners to use that property as collateral.

IPR laws can be controversial, however. It is sometimes thought, for example, that rigorous enforcement of intellectual property deprives some countries from the benefits of important medical innovations due to disparities in purchasing power and world prices for pharmaceutical products. However, poor or no enforcement of IPRs also comes at a price. Countries with weak intellectual property laws lose revenues in the form of customs fees and taxes paid by registered owners of intellectual property. Moreover, investors are less likely to invest in research and development (R&D) in countries where intellectual property protection is weak.

Adequate intellectual property protection is also a prerequisite to joining the World Trade Organization (WTO), which requires its members to adhere to the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS agreement). This agreement is the most comprehensive multilateral instrument on intellectual property.

It establishes a minimum standards agreement between Members in the areas of patents, trademarks, copyrights, geographical designations, layouts of integrated circuits, trade secrets, anticompetitive practices in licensing and enforcement.

2.1.4.2. LAND RIGHTS

In 2012, the United Nations adopted the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security (known as the VGGT). The VGGT promotes secure tenure rights and equitable access to land, fisheries and forests as a means of eradicating hunger and poverty, supporting sustainable development, and enhancing the environment. Furthermore, nearly all countries have ratified the UN Convention on the Elimination of all forms of Discrimination Against Women (CEDAW),[15] and have laws in line with Article 16 of that convention ensuring, among other things, that woman are accorded the same rights with respect to property rights as their spouses.

Countries should endeavour to uphold and protect all types of property rights, including land rights, whilst ensuring non-discriminatory and equal access to such rights in law and practice for both women and men. Inequalities in land and property ownership and access are particularly unconducive to a positive business climate in emerging economies, since they can perpetuate various formal and informal constraints to innovation, investment and business enterprise.

In rural areas, where land fragmentation and abandonment are widespread and hamper agricultural and rural development, land consolidation projects are often a good tool for supporting more agricultural investment and increased productivity. In this context, equal access to land rights is vital for unlocking sustainable and inclusive economic development in such areas. Significant gains for societies can be made through women's right to owning or using land and other productive resources, defined as "the ability of women to own, use, access, control, transfer, inherit and otherwise take decisions about land and related resources."[16] The Food and Agriculture Organization (FAO) has calculated that were women to have access to the same production resources as men, they could increase yields on their farms by 20% to 30%. This would in turn raise total agricultural output in developing countries by 4% and reduce hunger in the world by 12% to 17%.[17]

2.1.4.3. MOVABLE ASSETS AND SECURED TRANSACTION REGIMES

Getting a loan to start a business, or to continue or expand operations, is essential for businesses of all sizes. Lenders, banks and financial institutions usually require collateral or security to be used to repay the loan in the case of default. For many businesses, movable assets are the main, and often only, type of asset they can offer as collateral.

UNCITRAL has also focused on working to support efficient secured transaction regimes to increase access to affordable and secured credit. This in turn can promote economic growth, sustainable development and financial inclusion. It can also assist in combating poverty. A key UNCITRAL text in this area is the UNCITRAL Model Law on Secured Transactions (2016), which contains a comprehensive set of provisions that States can adopt in their domestic legislation.[18] The Model Law addresses secured transactions involving all types of tangible and intangible movable property, such as goods, receivables, bank accounts, negotiable instruments, negotiable documents, non-intermediated securities and intellectual property. Its provisions could make it easier for businesses to get loans, and might also result in reduced interest rates and longer repayment periods. A number of OSCE participating States have already implemented secured transaction reforms based on the Model Law.[19]

UNCITRAL has also prepared a Practice Guide to the Model Law.[20] It is aimed at providing practical guidance to parties involved in secured transactions in States that enact the Model Law.

The Practice Guide explains the key features and benefits of the Model Law, illustrates the types of secured transactions that can be undertaken under the Model Law, and provides step-by-step explanations on how to engage in the most common and commercially important secured transactions.

States that have a sound legal framework for secured transactions are generally ranked higher in the World Bank's Getting Credit – Doing Business scores, particularly regarding the strength of the legal rights index, which is closely aligned with the principles of the Model Law. One example of jurisdiction that has been inspired by the Model Law is in Azerbaijan and its Law on Encumbrances of Movables, enacted in 2017.

2.1.4.4. PROTECTION AGAINST UNCOMPENSATED EXPROPRIATION

One of the main guarantees found in international investment agreements (IIAs) is the protection of foreign investors from uncompensated expropriations.[21] While it is recognized as a fundamental right of sovereign States to take private property for public purposes, either directly or indirectly, governments should designate by law the limits that are in place and the purposes for which the government may expropriate property. Furthermore, expropriation should only take place in a non-discriminatory manner, under due legal process, and accompanied by the payment of compensation. The methods of calculating compensation are often an important provision in bilateral investment protection treaties (BITs). States that enter into agreements or trade pacts that include BITs should therefore ensure that care is taken when formulating such clauses.

2.1.4.5. PROTECTING MINORITY INVESTORS

Even if a country is secure and its government is stable, companies want to be certain that their rights are protected. Without minority investor protections, equity markets fail to develop properly, and there is higher risk that banks become the only source of financing. Yet, weak collateral or property registration systems block many businesses from obtaining even bank loans. As a result, business development is stalled due to a lack of access to capital and economic growth is held back.

The following are the most effective means for protecting minority shareholders[22]:

- Participation on the board;
- Access to financial information about the company;
- Right of first refusal (a shareholder who is subject to a right of first refusal must first offer shares to existing shareholders who hold a right of refusal);
- Company call for departed employees' shares;
- Right to participate in any subsequent offering of shares, options, warrants or other securities (pre-emptive rights);
- Right to participate in the sale of equities on the same terms and conditions as the selling shareholders (tag-along rights);
- Allocation of the share sale's proceeds in proportion to equity percentages (drag-along payment rights) and anti-dilution (ensuring that the investor's interest is not diluted through the issuance of new equity at a lower price);
- Supermajority voting/consent rights for major decisions;
- A "put right" clause (requiring either the company or other shareholders to buy out the minority investor in specific situations) or "shotgun" clause (giving minority investors the right to buy or sell shares to another shareholder or the company if specific issues cannot be resolved).

2.1.5. Competition law and policy

Competition (or anti-trust) law is an important policy instrument by which governments can promote economic efficiency by fostering competition. Such laws ensure that market forces are the key driver in economic activity. Among other means, competition can be legally preserved through prohibition firms from engaging in behaviour that undermines or eliminates competition, such as price agreements or market partitioning.

In today's increasingly globalized and digitalized world, while the transnational operations of companies across borders affect consumers in different countries in similar ways, competition decisions may vary according to national legal standards. There is an increasing need to streamline competition decisions. Co-operation and collaboration are also vital for maintaining and sustaining innovation, particularly in view of the digital economy, where concerns over so-called "vertical restraints" are increasingly leading to debate.

TEXTBOX 9.
Competition practices as recommended by the International Competition Network

The International Competition Network (ICN), a results-based and project-oriented organization that has grown from sixteen to over a hundred competition agencies across the globe, has established a list of recommended competition practices. These practices are the result of ICN working groups whose members deal exclusively with competition law and operate by consensus, whereby members and other experts conduct discussions and provide input. The ICN recommended practices include, among other things:

- Merger notification and review procedures;
- Merger analysis;
- Assessment of dominance/substantial market power;
- Investigative processes for competition authorities;
- Competition assessments;
- Application of unilateral conduct rules to State-created monopolies;
- Predatory pricing analysis pursuant to unilateral conduct laws.

Despite laudable efforts to introduce new institutions supporting competition as an economic paradigm, in emerging economies, there are often expectations of government intervention in economic matters. Strong competition authorities play an important role, however. For a more in-depth reflection on important considerations towards the institutional design of competition authorities, also consider the recent publication by the OECD on changes in institutional design of competition authorities. While recognizing that there is no blueprint for developing successful competition authorities, it outlines some key qualities for such authorities, such as their multi-functional nature or independence from governments. The publication also discusses how best to structure internal governance.[23]

TEXTBOX 10.

The OECD-GVH Regional Centre for Competition in Budapest

The OECD, in close collaboration with the Hungarian Competition Authority (GVH),[24] works with a range of competition professionals in the OSCE region. Through technical assistance, capacity development and policy advice, the OECD-GVH Regional Centre for Competition in Budapest fosters the development of competition policy, competition law and competition culture. Through its work, it has contributed significantly to discussions and relevant national competition policies on various topics, including competition neutrality between private and State-owned enterprises, fighting bid rigging in public procurement, competition enforcement in times of crisis, and regional and international co-operation.

Traditional market-based economies are generally founded on the premise that competition results in an efficient allocation of resources and benefits consumers by producing an optimal mix of quality, goods and services at the lowest possible prices. The detailed aims of competition policy – maximizing consumer welfare or social welfare, promotion of economic development, etc. – vary according to the political values of a given country or regional economic grouping. However, there is widespread consensus that competition law can ensure the effectiveness of market forces. Countries characterized by transitional economies need to define clear competition policies. However, since a culture of competition cannot be based entirely on laws and regulations, educational campaigns explaining new economic policies to the general public can be helpful. Competition policies should clearly prohibit so-called "hard-core cartel activity" among competitors. Such activities include price-fixing, establishing output restrictions or quotas, market segmentation, customer division, and bid-rigging (collusive tenders). In ordinary circumstances, there is little to no economic justification for such practices.

2.1.5.1. DIGITAL ECONOMY AND COMPETITION

The emergence of a digital economy has magnified challenges in the area of antitrust and competition for governments and policymakers. Currently, the competition authorities of several countries are concerned about digital economy markets being dominated by a small group of firms, and are grappling with questions of if and how competition policies should apply to online platforms, e-commerce, etc. In the EU context, two novel legal frameworks were presented in 2020: the Digital Services Act (DSA) and the Digital Markets Act (DMA). The aim of these two far-reaching legislative packages is to "introduce rules for platforms that act as 'gatekeepers' in the digital sector." Such platforms are described as having "a significant impact on the internal market, serve as an important gateway for business users to reach their customers, and which enjoy, or will foreseeably enjoy, an entrenched and durable position." As the Digital Markets Act describes further, such platforms would then have the power to act as private rule-makers and would function as bottlenecks between businesses and consumers. The Digital Markets Act aims to prevent gatekeepers from imposing unfair conditions on businesses and consumers and at ensuring the openness of important digital services.[25]

2.1.5.2. INCLUSIVITY AND COMPETITION POLICIES

Enactment of new competition laws, or the reform of existing ones, should ideally be drafted in consultation with the business community and consumer protection advocates who will be affected by the new or amended rules. National competition policymakers should strive to ensure that their policies do not become overly formal or mechanical, and that policies as well as laws are grounded in economic realities.

Competition policy alone is not enough; it must be implemented through appropriate laws and regulations that are effectively enforced.

Also gender can play an important part in competition policy, since men and women behave differently as consumers. A gender-sensitive competition policy might reveal gendered prices differences or anomalies in competition. Markets may also unintentionally espouse restrictions on female entrepreneurs. Gender parity in boards and senior management has been associated with stronger performance of the compliance of companies with competition rules, for example. To help governments eliminate barriers to competition and provide a method for identifying unnecessary restraints on market activities, and developing alternative and less restrictive measures, the OECD has developed a Competition Assessment Toolkit.[26]

In order to support competitive economies, many governments have enacted laws to prohibit abuse by monopolists, curb collusive practices between firms that should be competing, and prevent undue concentrations of market power as a result of mergers or acquisitions. Such laws reflect the reality that while self-interested behaviour on the part of competitors may ultimately produce results consistent with the public interest, it is also possible for markets to have participants whose desires do not lead to the best interests of consumers.

Modern competition laws normally contain the following components:

1. General regulations;
2. Prohibitions against collusion or collusive behaviour between erstwhile competitors, such as price-fixing, bid-rigging and the like;
3. A ban on abuses of monopoly power or of a dominant position in a relevant market;
4. Provisions dealing with enterprises with special or exclusive rights, or natural monopolies;
5. State aid;
6. Merger control;
7. Unfair competition;
8. Rules governing the conduct of government competition authorities;
9. Consequences (fines, penalties, imprisonment, and/or civil liability) in cases of violations of the competition law;
10. A detailed set of regulations concerning exemptions, procedures and other matters.

The EU system, widely considered the gold standard on competition policy, is mandatory for all EU Member States. OSCE countries that are EU Member States or candidates for EU accession have thus either harmonized their national policies on competition with those established by Brussels, or are in the process of doing so. The EU system aims at open markets, and punishes abuses of economic power through strong State action. Nonetheless, the State is generally assumed to be non-interventionist and non-discretionary. North American competition law systems are similar to those of the EU regime, albeit not identical to them.

The recommendations in this Guide are broadly consistent with EU and North American competition policies, policies that are also echoed and consolidated in the OECD framework.[27] However, the recommendations here can be applied regardless of whether a country aspires to EU accession.

▲ **Participants at the OSCE/OECD expert seminar in Vienna**

November 2018

2.1.6. Employment law and policies

Labour market flexibility is vital to ensuring the maximum utilization of human capital. This allows labour markets to shift to a competitive equilibrium.

2.1.6.1. KEY ELEMENTS OF A FLEXIBLE LABOUR MARKET

Freedom to decide on the workforce based on a business's needs is an important part of improving a country's business climate. Businesses are adversely affected by heavy restrictions on labour market flexibility. A firm that cannot adjust the size of its workforce in line with its business needs can lose its competitive edge. Nonetheless, such flexibility should also not endanger the job security of the firm's employees, since that can lead to serious declines in productivity. Successful firms always aim to find a balance between ensuring the job security of their employees and the maintaining the flexibility needed to adjust to the changing circumstances of the market.

Within this framework, protecting workers against all forms of exploitation and discrimination is critical. Governments should thus impose protective measures to reduce the likelihood of job-related injuries or deaths, as well as discrimination at the workplace. When designing regulations for safe workplaces, gender disparities should also be considered.[28]

A good starting point in this direction is to implement the 1998 Declaration on Fundamental Principles and Rights at Work[29] of the International Labour Organization (ILO), and the 2008 ILO Declaration on Social Justice for a Fair globalization.[30] These two documents promote the observance of core principles concerning labour and decent work, principles found in several ILO treaties. To enable emerging economies to take full advantage of a major competitive factor, attracting investment, a well-trained and educated workforce that is available at a reasonable cost is needed. Governments must be careful not to deter investors by placing severe restrictions on employee dismissals, limits on the use of flexible work contracts, lengthy termination notice requirements, or large mandatory severance payments.

2.1.6.2. FREEDOM TO HIRE CONTRACT-BASED, PART-TIME AND TEMPORARY WORKERS

Businesses often need workers on a seasonal or project--related basis. They should be able to hire workers to fulfil these specific needs. Requiring firms to hire full-time workers results either in less hiring, or in less profitable companies that either pay lower taxes or do not survive at all.

2.1.6.3. REASONABLE OBLIGATIONS REGARDING VOCATIONAL TRAINING

Employers may be required to provide a reasonable measure of vocational training to enable workers to perform their jobs well, and to improve their overall attractiveness in the national workforce. However, requirements of this kind should not be so onerous as to be detrimental to the overall productivity and profitability of a company.

2.1.7. Insolvency legislation

In any market economy, there will inevitably be businesses that do not succeed. If this happens, all involved parties are affected: shareholders, employees, creditors, property owners and governments all risk financial loss.

Good and efficient legislation on insolvency is therefore an important part of a positive business and investment climate, since it facilitates the restructuring of viable businesses to keep them in operation, while safeguarding the rights of all natural and legal persons involved.

Parts 1 and 2 of the UNCITRAL Legislative Guide on Insolvency Law provide legislators with key objectives, an overall structure and core provisions for effective and efficient insolvency laws. Also numerous recommendations for national insolvency systems are offered.[31] Part 3 provides guidance on the treatment of enterprise groups in insolvency,[32] an area that is becoming increasingly important, while Part 4 focuses on company (and enterprise group) directors' obligations when approaching insolvency.[33] The 1997 UNCITRAL Model Law on Cross-Border Insolvency establishes procedures for difficult cases, such as when an insolvent debtor has assets in more than one State, or some of a debtor's creditors are not from the State where the insolvency proceedings are taking place. The 2018 UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments complements the 1997 Law, improving on various legal aspects of recognizing and enforcing insolvency procedures across borders.[34]

Within the OSCE region, Greece (2010) and Slovenia (2007) have most recently adopted the UNCITRAL Model Law. OSCE participating States that are EU Members are also subject to the European Insolvency Regulation, which includes a cross-border insolvency regime for EU Member States. However, the European Insolvency Regulation does not extend into cross-border insolvency matters involving non-Member States.

Sound insolvency regimes are fundamental to robust and diverse modes of financial intermediation, adequate access to finances, and financial stability.

They are thus vital for a positive business and investment climate. This has been recognized by the World Bank and by UNCITRAL.

Both organizations have designed, in consultation with the International Monetary Fund (IMF), the so-called Insolvency and Creditor Rights Standard (ICR Standard).[35] In addition to setting out key principles for liquidation insolvency proceedings, including out-of-court restructuring practices, the ICR Standard identifies the principles underlying effective credit access and protection mechanisms (including security interests), commercial enforcement and credit risk management frameworks. In addition, the ICR Standard lists principles for effective handling of cross-border issues, drawing from the UNCITRAL Model Law on Cross Border Insolvency. The ICR Standard comprises the World Bank Principles for Effective Insolvency and Creditor Rights Systems (2011), and the Recommendations from the UNCITRAL Legislative Guide on Insolvency Law (2010).

2.1.8. Introduction of corporate social responsibility (CSR)

Corporate social responsibility (CSR) is a business model in which companies make an effort to operate in ways that improve societies through ethically oriented practices. In theory and practice, it has been recognized that good CSR policies positively influence the corporate image of companies. Such policies can also positively affect companies' competitive advantage and the willingness of investors to invest in them, while making a positive societal and environmental impact. A company with a good CSR policy has a far greater chance of achieving positive results in the market. According to a research poll conducted in 2017,[36] 63% of the interviewees were hopeful, in the absence of government regulation, that businesses will take the lead in driving social and environmental change. Moreover, 78% of the respondents preferred that companies address important social justice issues, 87% would purchase a product because a company advocated an issue they cared about, and 76% would refuse to purchase a company's products or services upon learning it supported an issue contrary to their beliefs. Examples of good CSR practices include[37]: investing money to address climate change and reduce waste, donating a percentage of net profits to charitable organizations, investing in various alternative energy sources, introducing socially responsible hiring processes to diversify the workforce, or introducing various healthcare initiatives.

2.1.9. Privatization, land markets and other reforms to liberalize the economy and sustain growth

In the recent past, the economies of a number of OSCE participating States were predominantly characterized by models of centralized state ownership and hierarchical public administration systems. A series of reforms aimed at liberalizing these economies and enhancing economic growth has since been initiated. Although the pace of reforms has differed from one country to another, general trends show a significant improvement in the attractiveness of these economies to foreign investment.

TEXTBOX 11.

Land market reforms in Kyrgyzstan

In the last two decades, Kyrgyzstan has been pursuing comprehensive reforms to develop commercial land and property markets to support private sector development. For more than a decade, the country has been investing in modern geospatial information systems and has prioritized the modernization of its cadastre and immovable property registration system. With the assistance of international partners, it has made enormous progress. For example, it has successfully established a digital land registry and cadastre system easing procedures for entrepreneurs to register and transfer property, reducing time limits for procedures (enabling buyers to mortgage their property or use it faster), or setting low fixed administrative fees. Kyrgyzstan is now ranked sixth in the world in efficiency of property registration,[38] placing it not only ahead of its regional peers, but also ahead of many advanced economies. These reforms have promoted an active and transparent land market for private property, and provided access for Kyrgyz small land-holders to more credit than that being provided by foreign direct investments. These reforms have also generated a strong demand for a broader use of open data in primary sectors of the economy.

2.1.10. The role of civil society in regulating business

A thriving economy can hardly exist in a society without civic engagement through civil society organizations (CSOs). Such organizations range from labour unions, research institutes, formal or informal social movements, professional associations, non-governmental organizations (NGOs), faith-based organizations or foundations, as well as others types of organizations and institutions. While the functions of CSOs vary greatly and include informing new approaches toward economic discourse, they also help in pioneering new standards and technology, or demanding their adoption. CSOs can also play a supporting role in strengthening regulatory frameworks and limiting corruption. They often act as watchdogs, helping ensure the proper conduct of governments and businesses by raising concerns and informing policymakers about the impact of certain policies or actions. The achievements of CSOs have been manifold. They have contributed to improved regulation of a range of socio-economic and health related issues, including environmental management, financial system oversight, public health, etc.

2.2. Conclusions and recommendations

Solid legal foundations regarding property rights, contracts, and access to justice are necessary for functioning and effective legal systems for governing markets. Strong contract enforcement, together with other means for settling disputes such as arbitration or mediation, can help avoid unpredictability in terms of the legal rights of companies and thus improve the business climate significantly. Strong legal systems, particularly efficient court systems, are also linked to improved access to financing. A sound legal business framework consists of various components that are interdependent, including regulation and enforcement of competition, labour law, property rights, insolvency legislation, and business classification and registration. Suboptimal conditions with regard to one component can significantly impair the overall business and investment climate. The strengths and weaknesses of one set of laws and regulations can thus also have a direct impact on the working of legislation in other areas. Despite the absence of replicable, one-size-fits-all approaches, several key evidence-based recommendations can be made.

REGULATORY POLICIES

- Regulatory decision-making should follow the rule of law. Countries should consider using regulatory impact analysis (RIA) to strengthen the regulatory decision-making process and safeguard the overall quality of regulation. Such an analysis should also take potential gender disparities into account.
- Regulatory reforms can benefit from using the "regulatory guillotine" process to get rid of overlapping, overly complex, or obsolete regulations. Technology and electronic tools can further enhance such efforts.
- Establishing institutions where entrepreneurs can raise concerns about their rights and interests with a business ombudsperson might be considered in order to provide businesses with easily accessible means to redress grievances.

LEGAL POLICIES

- Conform legislation to latest standards, such as the UNCITRAL Model Laws on arbitration, mediation, secured transactions and insolvency.
- Prevent gender-based discrimination and ensure non-discriminatory legal protection, including property rights, as well as equality under the law for all persons, including women and ethnic minorities.
- Bring national legislation into conformity with the WTO TRIPS standards.
- Establish mechanisms for investor protection and efficient adjudication of contract related disputes, including by providing for alternative dispute resolution mechanisms. Ensure that access to justice is inclusive.
- Adopt new tools and ICT technologies to improve access to justice and ease the registration of businesses.

EMPLOYMENT LAW AND POLICIES

- Whereas governments should protect the basic rights of workers, they should also reduce unnecessary obstacles to hiring employees or terminating employment contracts, when and as dictated by the necessities of a business.
- Governments should make efforts to ensure that requirements imposed on employers for paying social taxes or for worker training are reasonable and not unduly burdensome.

CORPORATE SOCIAL RESPONSIBILITY (CSR)

- Governments should motivate firms to enhance their CSR policies in order to improve their corporate image, competitive advantage and the willingness of investors to invest in them.
- In making business decisions, firms should consider their impact on societies and the environment, and engage in ethical practices.

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Open data, good governance and corruption: Their impact on the business climate

3

Open government initiatives are increasingly important means for advancing a positive business climate, since they enhance transparency, drive innovation and contribute significantly to combating corruption. To safeguard the civil, political and economic rights and freedoms of investors and businesses, good governance combined with adequate political, legal and regulatory systems are needed. Good governance and sound political, legal, and regulatory systems are also central to the creation and preservation of favourable market conditions.

The importance of good governance has been underscored in the OSCE mandate through several Ministerial Council decisions and declarations. OSCE participating States have identified since 1999 that rule of law and the development of transparent and stable legal systems in the economic sphere are essential for securing growth and stability.[1]

Businesses need a wide range of information to have confidence to invest. Most types of investment and business activity involve a certain degree of risk. The easier risks can be identified, assessed and minimized, the more investment and business enterprises will be encouraged.

Trust often lies at the basis of business relationships and entrepreneurship. But trust cannot be established if rampant corruption is commonplace, or there are no means to effectively redress abuses by public officials or misconduct in private transactions. An effective judiciary, managed impartially and with integrity based on the rule of law, is essential for such adjudication. It is the only way to enable a level playing field. Moreover, studies confirm that there is a positive relationship between government effectiveness,[2] regulatory quality,[3] foreign direct investments (FDI) and economic development.

3.1. The need for open government

Open government has been defined by the OECD as “a culture of governance based on innovative and sustainable public policies and practices inspired by the principles of transparency, accountability, and participation”.[4] In a 2020 Ministerial Council Decision, OSCE participating States emphasized that open government data helps prevent and combat corruption by increasing accountability, transparency and public oversight.[5] In addition to the main objective of open government in advancing government transparency and combating corruption, open government also holds great potential for catalysing inclusive economic growth.

According to Deloitte Analytics and its Open Data Institute, open data has fundamental implications for the future of business. Open government data and the gradual opening of commercial data propel innovation and support better overall business behaviour and decision-making. For example, open data leads to optimized supply chains. Moreover, adopting collective open data standards allows links and synergies between different data sets to be explored.[6] Such efforts can drive competition and inclusive growth, since open data applications typically draw on widely available resources.

3.1.1. Open data and geospatial information

Open geospatial registers and databases that include up-to-date and accurate data on rights, zoning, land use, availability, value, potential usage, and spatial planning constraints to properties can improve the business climate substantially by providing investors the information they need for making decisions. This is particularly relevant for land and site development, an area of concern for investors in emerging economies. Lack of geospatial information often leads to substantial delays in making investment decisions.

3

3.1.2. Open data and its economic impact

The open data market (in terms of economic value and number of jobs) is quite expansive. A vast and growing number of companies are involved in the disclosure and re-use of public sector information. The estimated economic impact of open data applications and use across the European Union, for example, involves hundreds of thousands of jobs. It has been estimated as generating up to €184 billion annually (data from 2019). It is expected that by 2025, this amount will have grown substantially, to around €334 billion.[7] Against the backdrop of digitalization and the use of technology in public policy, not least as a result of the COVID-19 pandemic, it can be expected that open data and open government are going to play an even more central role in the years to come.

Research conducted in Finland suggests that companies using open data are more likely to create successful innovations compared to those that do not.[8] Small firms appear to benefit more from newly opened public data with regard to their products and services. This is particularly true for business sectors considered "information--intensive", such as financial services, energy and ICT. Spatial or meteorological open data, for example, can help optimize agricultural production. Traffic data can play an important role for innovations in the logistics and transport sector, and can also bear commercial value for consumer markets.

In addition to supporting the development of new products and services, open data also leads to improved productivity due to lower operating costs and better labour data analysis.

Governments, including local administrations, can play an important role in enabling the leveraging of such economic benefits by encouraging and sustaining an environment that stimulates increased accessibility and creative re-use of open data.

TEXTBOX 12.

The City of Vienna's Data Excellence Strategy

In 2019, the City of Vienna published a Data Excellence Strategy as a part of its broader Digital Agenda. The Strategy promotes the concept of open data "by default" (the idea that information is publicly available even prior to a freedom of information request). The Strategy has a strong capacity building/training component. All staff members of the City of Vienna (approximately 3,000) must undertake training on data. This training ranges from basic courses to highly specialized ones. In addition to the provision of strong political and administrative support, regular disclosure of data, and collaboration with research and educational institutions, part of the strategy's success is the creation of open data with specific target audiences in mind. City of Vienna staff have identified, for example, different data needs for journalists, citizens and tourists, as well as the developers of applications for improving the delivery of public services. Some three hundred applications based on the city's open data have been developed so far. In many cases, these applications are creating commercial value and support innovation and entrepreneurship.

3.1.3. Corruption and its impact on the business climate

Corruption is an impediment to economic development and GDP growth. It affects almost every aspect of doing business. It seriously damages the integrity of markets and distorts competition. Moreover, corrupt practices add significant costs to doing business, and pose legal, regulatory and reputational risks. Furthermore, studies have shown that corruption presents a long-term impediment to investment, not only reducing investment but also having a negative impact its affect.[9]

In the OSCE region, there is strong consensus by the participating States that tackling corruption is essential for economic stability and growth. It has been acknowledged that corruption "represent[s] one of the major impediments to the prosperity and sustainable development of the participating States".[10] The 2012 Dublin Declaration sees achieving fair and transparent business environments as linked to combating corruption and strengthening good governance. It also recognizes that good governance, through a framework of economic policies, legislation and institutions, can help businesses and investments to grow. This consensus was strongly reaffirmed in 2016 and 2020. In 2016, the participating States adopted a Ministerial Council Decision acknowledging that good governance, rule of law and curbing corruption are critical components for promoting a positive business and investment climate in the OSCE region. In 2020, OSCE participating States recognized the important role of digitalization in the prevention of corruption, and also underscored that a public sector based on integrity, openness, transparency and the rule of law is crucial to preventing and combating corruption, achieving sustainable economic growth and improving the business and investment climate.[11] Building on this understanding, the OSCE Handbook on Combating Corruption outlines several concrete measures that help bring about economic growth and development.[12] Highlighted is the importance, among other things, of collective action in curbing corruption, as well as the role the private sector can play in achieving a corruption-free economy.

Most OSCE participating States are a Party to the United Nations Convention against Corruption (UNCAC), a universal legally binding anti-corruption instrument. The UNCAC has contributed significantly towards establishing common anti-corruption standards and activities, including for the business community. The UNCAC requires countries to criminalize a range of offences defined as corrupt acts, such as bribery, embezzlement of public funds, and money laundering.

It is important to understand, however, that the nexus between corruption and economic growth is not a simple mono-causal relationship.[13] Stakeholders would therefore be well advised to adopt a broad and systemic approach to diagnose and inform policymaking towards good governance and anti-corruption. Furthermore, given that corruption is difficult to define and sometimes used as a catch-all phrase, it is important to break down the various aspects of corruption in the business and investment environment, and to specify in detail how these aspects might hamper growth or deter investment.

This Guide therefore takes a targeted view, looking at practices that have proven successful in limiting the negative impact of corruption. It also looks at the topics of regulatory quality, rule of law and enforcement of the law, as well as management of public goods and assets, such as State-owned enterprises, privatization and public procurement.

Investors consider corruption a risk. They welcome well--defined legal aspects, such as property and contractual rights that are upheld fairly by legal institutions. Poor enforcement of applicable laws and regulations undermines the trust of businesses in the operating environment, deters investment, and feeds a downward spiral of instability, informality and corrupt deal making. Businesses generally perform better when there is strong enforcement and adjudication of the law. Rule of law and good governance are crucial pre-requisites for a well-functioning market that can easily attract investment.

3.1.3.1. CORRUPTION AND RULE OF LAW INDEXES USED BY INVESTORS

Investors use sovereign credit rating agencies and third-party risk-management companies to determine the level of corruption and strength of rule of law in a country in order to assess the costs and likelihood of these risks for their businesses or clients.

In terms of corruption, the starting point for such assessments are indexes aiming to shed light on the extent of corruption in a given jurisdiction. There are various indexes available, both public and private. Generally, many indexes draw from the Corruption Perception Index (CPI) of Transparency International (TI), the most widely used indicator of corruption globally. It is compiled from several surveys and corruption assessments collected by a variety of institutions. Another index often used to assess corruption levels is the Worldwide Governance Indicators, hosted by the World Bank. Here, a variable called Control of Corruption (-2.5 weak; 2.5 strong) describes the extent to which public power is perceived as exercised for private gain, including both petty and grand forms of corruption, as well as the "capture" of the State by elites and private interests.

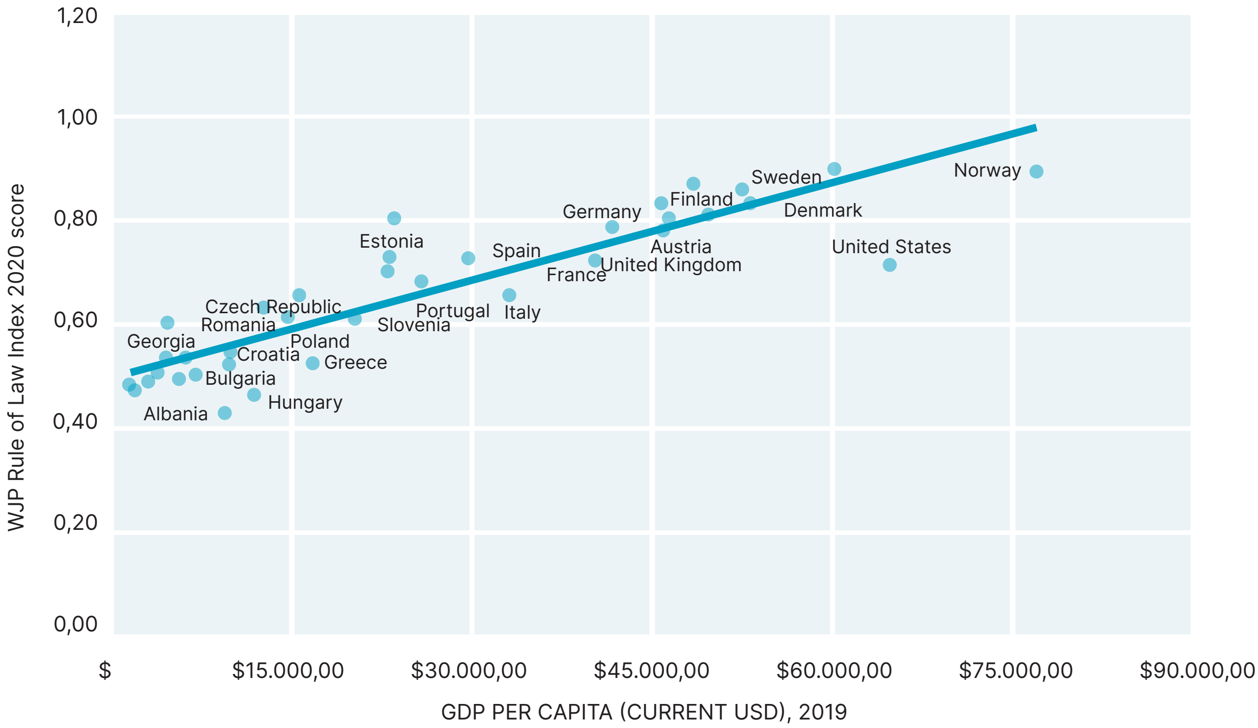
3

These data are construed from a broad range of other variables and also include TI's CPI. The average for 2019 based on 193 countries was -0.04 points.

In addition to corruption, rule of law indicators have been gaining increasing attention from economists and researchers. In the UN context, rule of law is defined as a "principle of governance in which all persons, institutions and entities, public and private, including the state itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards".[14] The UN also mentions that rule of law "requires measures to ensure adherence to the principles of supremacy of the law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness, and procedural and legal transparency".[15] Advanced indexes that gauge rule of law show a strong correlation between rule of law and GDP, as well as health outcomes such as life expectancy.

One of the most recognized rule of law indexes, used and referenced by the World Bank, OECD and the United Nations, is the index of the World Justice Project (WJP), which draws on thousands of legal practitioners and experts to measure how the rule of law is experienced and perceived worldwide. It is based on four key principles that define rule of law as a durable system of laws, institutions, norms and community commitment that deliver accountability, just laws, open government and accessible justice. The score is an aggregate from two surveys (household and expert surveys) and is broken down into eight dimensions of rule of law: constraints on government powers, absence of corruption, open government, fundamental rights, order and security, regulatory enforcement, civil justice, and criminal justice. Each comprise a number of subfactors.[16] Of the WJP scores, 16 feed the work of other users, including international investors, the compliance industry, multilateral organizations, development banks, and others. Also the CPI index and Control of Corruption index, mentioned above, use the WJP rule of law score in their rankings. Thus the weight of WJP index goes far beyond its own publication. Some organizations, for instance the US Chamber of Commerce, have used WJP data to develop a business rule of law index.

Table 3. Rule of law and economic development



Source: World Justice Project, UNCTAD

TEXTBOX 13.

Coalition for rule of law in global markets

In 2010, the US Chamber of Commerce established a coalition for the rule of law in global markets. The central objective has been "to promote and defend the rule of law in global markets as a critical factor in fostering a worldwide investment climate that supports equality, economic growth, and shared prosperity for the world's citizens". One of the tools that was established is the so-called Global Rule of Law and Business Dashboard, which informs policymakers about reforms and ranks countries on an overall dashboard score. In 2019, Slovakia showed a steep increase on the list, as did Kazakhstan. Both countries have recently introduced a wide range of reforms, such as increased transparency in beneficial ownership and government contracting (see Textbox 17 on Slovakia, and Textbox 5 on Kazakhstan).

3.1.4. Fighting public procurement corruption risks

Government procurement is high-risk area for corruption given its size in the global market, which amounts to an estimated

US$11 trillion.[17]

In some countries, public procurement totals up to 30% of the national GDP. Public procurement often provides opportunities for undesired rent-seeking behaviour by persons involved in the process of awarding lucrative government contracts, that is seeking to manipulate the procedures for their own benefit. Most court cases involving bribery of public officials are linked to public contracting.

Creating an efficient procurement system based on transparency, competition and integrity is a pre-requisite for all signatories to the UNCAC under Article 9 of the Convention. Markets where procurement is well regulated are often more competitive and innovative. They also provide better opportunities for small- and medium-sized enterprises (SMEs) to partake in and win competitive bids on government tenders. This improves overall public service delivery and creates a positive business climate for SMEs, which is key to ensuring local economic growth and job creation. This has also been recognized by the main international forum for global economic co-operation, the Group of Twenty (G20), which urges its members to ensure that procurement processes are open and fair, since this encourages a more equitable business landscape by allowing SMEs to compete more effectively.[18]

In terms of legal frameworks, there are three models implemented by States:

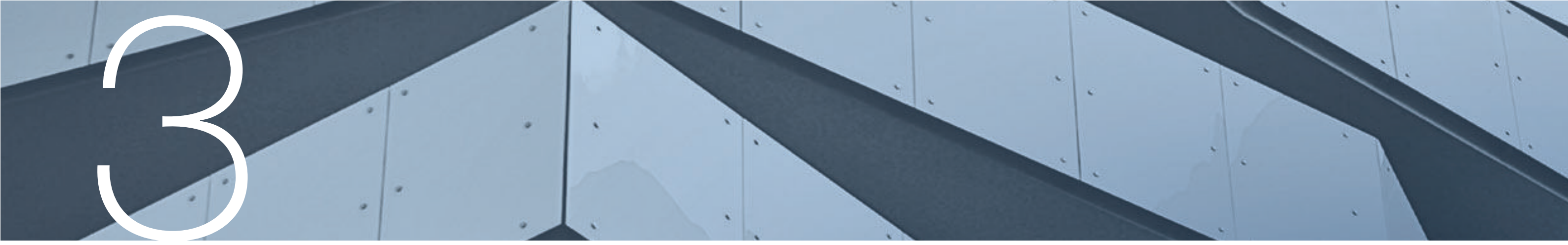
- the UNCITRAL Model Law on Public Procurement;
- the WTO Government Procurement Agreement (GPA);
- the EU Public Procurement Directive.

UNCITRAL MODEL LAW ON PUBLIC PROCUREMENT

In 2011, UNCITRAL adopted the Model Law on Public Procurement, replacing the 1994 UNCITRAL Model Law on Procurement of Goods, Construction and Services. To prevent abuses in procurement processes, the revised Model Law promotes transparency, objectivity, fairness, participation, competition and integrity. While allowing a procuring entity appropriate discretion in deciding what to purchase and how – essential for achieving sustainable procurement – the Model Law also ensures that decisions and actions taken in a procurement process can be reviewed by effective, impartial and independent review bodies.

With its all-encompassing scope, the Model Law provides a toolbox for handling procurement of different values and at different levels of complexity. By enabling the use of modern commercial techniques, such as e-procurement and framework agreements, it also allows procuring entities to maximize value for money in procurement.

The Model Law is accompanied by the Guide to Enactment, adopted by UNCITRAL in 2012, which operates as a reference tool for policymakers, legislators, regulators and those providing guidance to users of a procurement system based on the Model Law. The Guide explains the objectives of the Model Law and how its provisions can achieve these objectives.



The revised Model Law and accompanying Guide to Enactment have been used as models for procurement law reforms in more than 25 jurisdictions. The extent to which the resulting regulatory framework incorporates the provisions of the Model Law varies, since different frameworks also reflect legal traditions, domestic policy and other objectives.

In addition, various international organizations have used the Model Law and Guide as a benchmark for public procurement law reform in their member States, as well as when assisting States in an accession process.[19]

TEXTBOX 14.
Procurement law reforms based on UNCITRAL models: Modernizing procurement law frameworks in OSCE participating States

Armenia, Belarus, Kazakhstan, Kyrgyzstan, the Russian Federation and Ukraine are among jurisdictions that have used the 2011 UNCITRAL Model Law on Public Procurement and accompanying Guide to Enactment in reforming their public procurement law and systems. The major achievement of these reforms, in addition to modernization of procurement practices, has been to strengthen anti-corruption safeguards in public procurement. This was achieved in particular by enabling and promoting electronic government procurement, and making systems of procurement decision review more effective. As in the 2011 Model Law, in the new generation of procurement laws in those jurisdictions, lists of procurement decisions exempted from review have been deleted or shortened considerably. Such a list was included in the 1994 UNCITRAL Model Law on Procurement of Goods, Construction and Services, and incorporated into the legislation of States that used that Model Law as a template for their domestic procurement legislation. This was widely criticized by donors. When the 2011 Model Law was under preparation, deleting that list was considered a major step towards strengthening anti-corruption safeguards in public procurement, in compliance with the United Nations Convention against Corruption. Other major steps in that direction were the establishment of a specialized independent administrative review body capable of rapidly dealing with procurement disputes, and the introduction of a "standstill period". Both are provided for in the 2011 UNCITRAL Model Law.

Alexey Stukalo, Deputy Co-ordinator of OSCE Economic and Environmental Activities (l) and Michel Nussbaumer, Director of the EBRD Legal Transition Programme, during an opening session at the Regional Seminar on Enhancing Public Procurement Regulation

Vienna, 28 May 2015

As highlighted by the UNICTRAL Model Law, electronic procurement systems have played an important role in discussions on how to best address corruption vulnerabilities, and ways to implement and operate procurement systems that reduce such risks to a minimum. Although setting up an electronic procurement system involves a number of factors, including an appropriate legal foundation, technical expertise and resources, electronic procurement has proven to be a key mechanism in addressing corruption in procurement and providing better public service delivery.

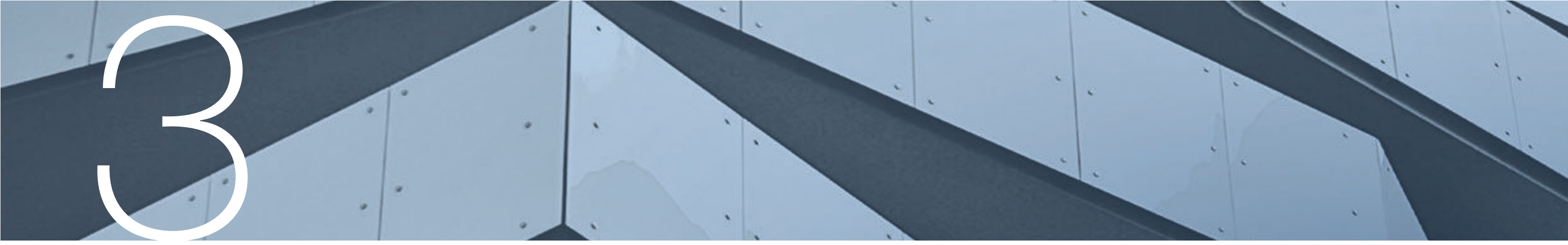
TEXTBOX 15.
Open Contracting Data Standard (OCDS) and the Ukrainian procurement system ProZorro

ProZorro is a hybrid electronic open-source government e-procurement system created in Ukraine as the result of a partnership between business, government and civil society. It puts transparency, open data and the principle that "everyone sees everything" at the heart of the procurement system. It has brought impressive results, mainly because of close collaboration between the government, business and civil society. Since the implementation of the e-procurement system in 2016, it has led to over one billion US dollars in savings by the government and has increased competition significantly, up to 45%, with thousands of new suppliers now working with the government. The supplier base of average procuring agencies grew by around 20%. Over 80% of government contracts are now awarded to small- and medium-sized enterprises (SMEs), and perceptions of corruption have been more than halved since 2015. Automated red flags and civic monitoring and feedback are also embedded in the system, with over 35% of flagged problems being fixed. Of the roughly 200 companies using ProZorro that were surveyed about its impact on their business, 80% said that the new system has had a positive impact on their business. Examples given were lowering of administrative costs (6%), saving time when participating in procurement (18%), increasing the quality of business decisions (19%), and making new connections (43%). The Ease of Doing Business Index of Ukraine steadily rose, from 71 in 2018, to 64 in 2020.

During the COVID-19 pandemic, ProZorro set up a special website for procurements related to COVID-19.[20] This platform proved to be a great resource in supporting Ukraine's management of the national COVID-19 response. It enabled the consolidation of the overall demand, informed the procurement strategy of medical supplies, and helped assess and minimize the risks related to emergency procurements.[21]

TEXTBOX 16.
Methodology for Assessing Procurement Systems (MAPS)

Another tool that countries can use to improve their public procurement system is the so-called Methodology for Assessing Procurement Systems (MAPS), which has been developed through the joint work of several international organizations, multilateral financial institutions, and donors.[22] It is a universal tool that can help catalyse and accelerate the implementation of modern, efficient, sustainable and more inclusive public procurement systems in any country. MAPS assessments highlight where reforms are most needed and indicate how reforms can best be implemented. In the OSCE region, the government of Kazakhstan has solicited a MAPS review of its general public procurement system, and a revised MAPS has been used to assess the procurement system of the Sovereign Wealth Fund Samruk-Kazyna. It was found that procurement practices had improved in efficiency thanks to the introduction of an e-procurement system. Numerous valuable recommendations were made, such as the advantage of using digital signatures and how overall transparency and citizen engagement in public procurement can increase value for money.[23]



3.1.5. Debarment procedures

In responding to fraud, corruption or other collusive behaviour (i.e., price fixing or bid rigging) by suppliers in public procurement, governments can impose suspensions (disqualifying bidders) or so-called debarments (the temporary exclusion of bidders) against particular companies. In many countries, this is implemented by means of a public list. Procurement agencies are required to check a contracting company against possible suspension or debarment lists before a government contract can be awarded. In addition to integrity violations, suppliers can be debarred for other reasons, such as failing to comply with regulatory standards, tax evasion or poor performance. Debarment systems are helpful in combating corruption, ensuring quality control, and more broadly in the enforcement of important market conditions. In addition to national debarment systems, a consortium of multilateral development banks resorts to a co-ordinated debarment framework, the so-called cross debarment, to safeguard their lending and financing from corruption and fraud.[24]

3.1.6. Beneficial ownership transparency

A transparency tool increasingly implemented by OSCE participating States to more effectively combat corruption and money laundering is that of beneficial ownership transparency or transparency regarding corporate information. Beneficial ownership information pertains to the real owner of a company or its assets, rather than a formal or nominee owner. Knowledge of the ultimate beneficiary helps in identifying unexplained wealth and detecting conflicts of interest.

Studies have shown that minority shareholder's rights are better protected in economies that promote transparency regarding corporate information.[25]

The Financial Action Task Force (FATF), a global watchdog that sets international standards on anti-money laundering and combating financing of terrorism, introduced rules on beneficial ownership into its recommendations in 2003 to prevent criminals from misusing corporate entities to disguise proceeds of crime and corruption. With the ever larger amounts of funds being laundered through global financial systems, in recent years laws on beneficial ownership have received more attention.

FATF Recommendations 24 and 25 require countries to put measures in place ensuring that legal persons and arrangements are not misused for money laundering or the financing of terrorism.

In the OSCE context as well, the importance of beneficial ownership transparency has been well acknowledged. In 2020, participating States unanimously adopted a Ministerial Council Decision encouraging the establishing or improving of mechanisms aimed at ensuring transparency of beneficial ownership information.[26] In addition, during the COVID-19 pandemic, many States have provided significant liquidity to support strategic enterprises, including both large publicly owned companies and SOEs. In some cases, States have even taken a direct stake in the ownership of companies aided by such rescue packages. Transparency of ownership structures in such companies is crucial to help verify that public resources are being well spent and benefit society at large.

Several OSCE participating States, notably, Albania, Armenia, Kazakhstan, Kyrgyzstan, Mongolia, Tajikistan and Ukraine, are already undertaking commitments towards beneficial ownership transparency within the framework of the Extractive Industries Transparency Initiative (EITI) to improve transparency of the ultimate owners of extractive sector companies, pursuant to the EITI standard.[27] In several other participating States, governments have passed legislation requiring various levels of transparency concerning the ultimate beneficial owner for companies that do business with the State. In January 2020, for example, an important regulation came into force for EU Member States via the Fifth Anti-Money Laundering Directive. Among other things, it requires EU countries to allow access to beneficial ownership information via a central register and to establish clear rules of public access.[28]

TEXTBOX 17.

Beneficial ownership transparency boosting investor confidence in Slovakia

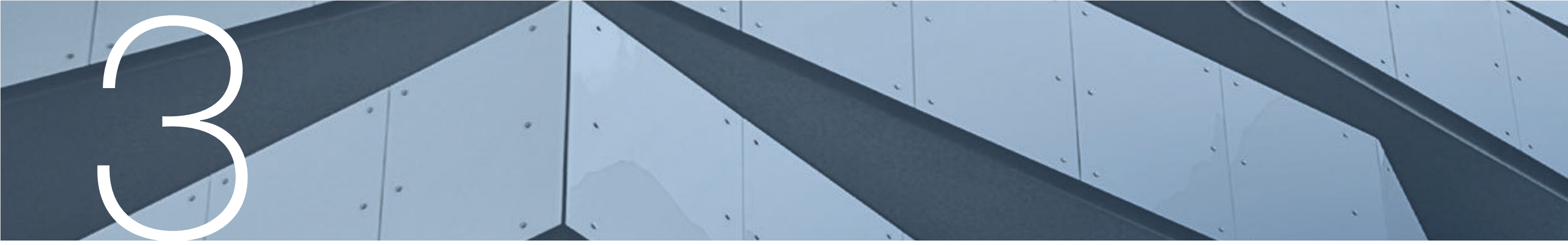
With the entry into force in 2017 of the Anti-Letterbox Companies Act of the Slovak Republic, companies operating in Slovakia and providing goods or services to the Government or otherwise obtaining public finance or public assets must register their Ultimate Beneficial Owner (UBO). Slovakia's pioneering approach is unique, since it adopts a comprehensive definition of beneficial ownership. Contrary to the definition in the EU Anti-Money Laundering Directive, Slovakia's definition includes joint control or co-ordinated action (e.g., via family members) within company structures. The registration process is also unique, since it requires businesses to register via so-called authorized persons, such as an attorney, bank, notary, etc., who are – together with the company at hand – jointly liable for possible incorrect information in the register. Anyone can file a complaint regarding the registry to a specialized court. In such cases, the burden of proof that the data is correct shifts to the company and its authorized person. Incorrect or incomplete information is subjected to a court-imposed fine amounting to the economic benefit gained or, if it is not possible to determine that benefit, a fine of up to one million euro for the involved companies, and up to a hundred thousand euro for the authorized persons or those in management positions. UBO information is freely accessible online and managed by a specialized court. The Slovak register has helped clean up public procurement and mitigated debt risks faced by SMEs when working for holding structures owned by shell companies. The register has also had an impact on corruption investigations abroad.[29]

3.1.7. Asset declarations

In pursuit of broader public sector integrity and the prevention of corruption, income and asset declaration systems have long played a central role. Such systems are recognized (for example in the UNCAC) as supporting the prevention of corruption as well as the enforcement of relevant legislation. There have been multiple challenges concerning the question of who should declare assets (political office holders, or also the managers of State-owned enterprises, etc.), how they should be declared, the types of assets to be declared, as well as how such declarations can be verified independently for accuracy and correctness while protecting private or sensitive data. Digital innovation and technology can play a significant role in supporting such instruments by providing (semi-)automated processes that can reduce costs and increase the capacity of authorities to manage and monitor large numbers of asset declarations.

Over the past years, an increasing number of OSCE participating States, including Armenia, France, Georgia and Ukraine, have adopted electronic systems for the asset and interest declarations of public officials. Other States use mixed systems, whereby part of the process is paper-based and some data is made available digitally.

In Croatia, for example, "although submission is in hard copy, support staff of the Commission for the Prevention of Conflicts of Interest enters selected data on officials' assets on its website, allowing public access to that information."[30]



TEXTBOX 18.

The Romanian PREVENT System

Romania's National Integrity Agency (ANI), which verifies asset declarations of around 300,000 public officials, including the president, members of Parliament, judges and other elected officials, has recently become more resolute in its work in this area. It introduced standardized asset and interest declaration (AID) forms "for a wide range of public officials, together with a verification mechanism focused on detecting and sanctioning unjustified variations of wealth, conflicts of interest and incompatibilities. Transparency has been critical to the system's effectiveness, as all disclosure forms are published on the website of the National Integrity Agency (ANI) and used by civil society and investigative journalists. ANI uses the system to sanction unjustified changes in wealth, as well as conflicts of interest and incompatibilities. ANI's work is also focused on prevention, most notably though the PREVENT system",[31] an ex ante control system that can issue early warnings signals to contracting authorities about potential conflicts of interest in procurement procedures.

PREVENT's so-called integrity warning is sent to both ANI and the authority involved in the procurement. From mid-2017 to early 2020, 47,571 procurement procedures were reviewed by the system and ANI issued over 120 warnings for potential conflicts of interest in procurement procedures, with an accumulative value of more than €274 million. In 96% of these cases, preventive measures were taken by the contracting authorities. For the remaining cases, ANI initiated formal legal procedures.[32] In order to manage the workflow and number of declarations received in hard-copy (normally around 400,000 per year, but approximately 1.4 million in an electoral year), ANI recently introduced e-forms that, among other things, include a bar-code for enhanced data management and verifiability. Over 90% of asset declarations are now filed electronically, but they must still be signed manually. For the future, legislation is underway that will allow for electronic signing of the forms, which will make the overall workflow easier and further improve verifiability.[33]

3.1.8. Asset recovery and social re-use

The proceeds of crime or corruption are often confiscated in legal procedures to deprive criminals of illegally obtained wealth and ensure that crime does not pay.

Although the primary goal of asset recovery is to make sure that ill-gotten gains are returned to their legitimate owner (usually the citizens of a particular country), asset recovery also helps support economic growth by combating corruption and (re)establishing trust in governance. In some OSCE participating States, there have been several successful initiatives ensuring that stolen and criminal assets are given to society for social re-use, including for entrepreneurial activities.

▲ **Participants of the OSCE training course on extended confiscation of proceeds of crime, Sarajevo, Bosnia and Herzegovin**

27 January 2022

TEXTBOX 19.

Social re-use of confiscated assets: OSCE project in South-Eastern Europe

In Albania, work in the social re-use of assets confiscated from organized criminal groups is being carried out by an initiative called Confiscated Assets Used for Social Experimentation (CAUSE). The initiative has been based on policies and experiences in Italy involving social re-use. Under this EU-funded CAUSE initiative, three confiscated assets have been transformed into social spaces/ businesses: a café/library in the city of Durres, a bakery employing and training victims of crime in the city of Fier, and a handicraft shop and studio in the city of Saranda.

Also an OSCE project on asset seizure, confiscation, management and re-use is supporting the social re-use of confiscated assets in South-Eastern Europe by replicating successful examples from Italy, Albania and Serbia. The project is raising awareness of the benefits of social re-use, enhancing the collaboration of civil society and asset management agencies in the region, and building capacities of civil society organizations in social re-use.

3.1.9. Anti-corruption authorities (ACAs)

In line with the UNCAC, many countries in the OSCE region have set up dedicated anti-corruption authorities (ACAs). In some cases, such agencies have received praise, but they have also been subject to criticism. The Romanian Anti-Corruption Directorate (DNA) and the Lithuanian Special Investigations Service (SST) have been frequently highlighted as successful examples of specialized agencies that have been instrumental in investigating corruption cases. Nonetheless, the overall impact of ACAs is generally considered limited due to challenges in their operating environments, such as political interference or weak judiciaries.

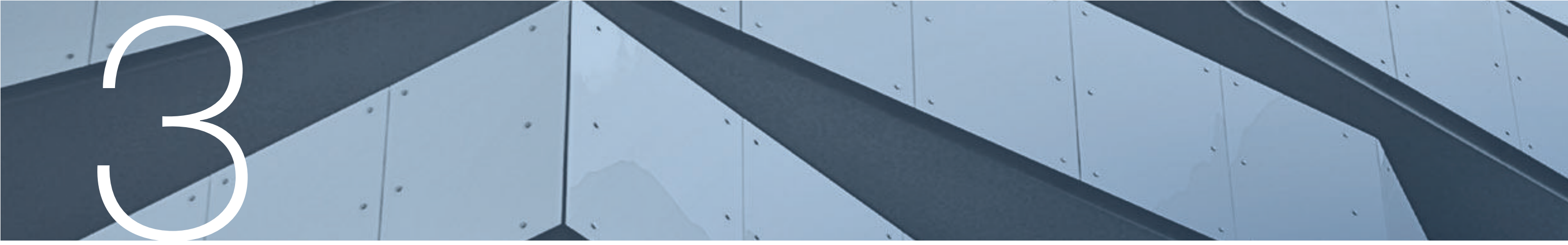
In going forward, ACAs can nevertheless play a key role in combating corruption by fostering a positive business and investment climate. In doing so, ideally they should follow the 2012 Jakarta principles. These 16 principles were developed by heads and former heads of anti-corruption agencies, as well as anti-corruption experts, under the auspices of the UNODC and the UNDP. They define ways to assure the independence of ACAs, with the aim of strengthening such bodies around the world.[34]

In addition to their general positive impact on the business and investment climate, many ACAs also have specific tasks and powers related to business entities. These can range from monitoring the anti-corruption policies of businesses[35] to assisting them in identifying their vulnerabilities to corruption.[36] Some ACAs have multiple tasks, such as issuing recommendations to business entities to prevent and deter corruption, controlling the implementation of compliance programmes, and applying sanctions for non--compliance with statutory requirements and the ACA's recommendations.[37]

3.1.10. Codes of conduct

A code of conduct can be best described as a set of voluntary principles that instil certain ethical standards for businesses and individuals.

Codes of conduct are typically developed with a certain industry or activity in mind, since contextual factors usually determine the types of challenges faced by businesses and their staff. Good professional conduct by both managers and representatives of private enterprises or when engaging in (international) business is crucial for a positive business and investment climate. It sustains trust and trade by



facilitating a positive workplace where staff can thrive, helps companies to better comply with local laws and regulations, and prevents conflicts of interest. Misconduct, negligence or other improper behaviour by companies or their staff members, such as discrimination or harassment, can lead to litigation and lawsuits, as well as significant financial costs to compensate material or immaterial damages. In addition, intangible assets can be severely affected by poor ethical conduct, including the loss of business goodwill or injury to a company's reputation, which can dampen future business activity. A quote that has been ascribed to legendary investor Warren Buffet describes this as follows: "It takes twenty years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently."

To set up a good code of conduct, organizations and businesses are best advised to outline their objectives (i.e., prevention of legal or regulatory violations, mainstreaming the corporate mission and company values, etc.).

In addition, they should explain how adherence to the code must be performed, what happens in the case of violations, how such violations can be reported, and to whom the code applies. Much attention is often given to "the tone from the top", meaning that securing buy-in and commitment from all layers of management is crucial for codes of conduct to be successful and taken seriously.

3.1.11. Collective action: Involving the private sector and civil society in the fight against corruption

Successfully tackling corruption requires multi-stakeholder engagement, ideally including the public and private sectors, civil society and academia. In anti-corruption efforts, this approach is often referred to as collective action, which is recognized by practitioners as an innovative and constructive way to lead away from corruption, especially the dilemma of bribery.

Collective action in anti-corruption initiatives can take many forms, ranging from so-called integrity pacts to business-led initiatives setting new standards, raising broader awareness about the topic, or endorsing a specific policy. Institutions with experience in this area further highlight that collective action can raise the standards of business integrity and level the playing field between competitors.

In the OSCE region, many actors recognize the added value of collective action and have underscored that tackling corruption requires broad support from society, including civil society. Getting the private sector on board and actively involved in conversations on anti-corruption policymaking is vital. For example, the United Kingdom, in its national anti-corruption strategy, has identified business-led collective action as a key tool to reducing corruption and has linked this work to improvements in the global business environment. In this context, the United Kingdom also endorses the collective action work of the "B20 initiatives" at the G20 anti-corruption working group.[38] The work of the so-called B20 (Business 20) started during the Russian presidency of the B20, when during the 2013 G20 Summit in Saint Petersburg, establishing a collective action hub was recommended as a resource for businesses, government and civil society to share and facilitate new anti-corruption approaches through collective action. The Basel Institute now maintains the B20 Collective Action Hub.[39] This vast online resource and knowledge hub offers over 300 different examples and tools for businesses on anti-corruption collective action.

TEXTBOX 20.
The Business Ombudsman Council of Ukraine

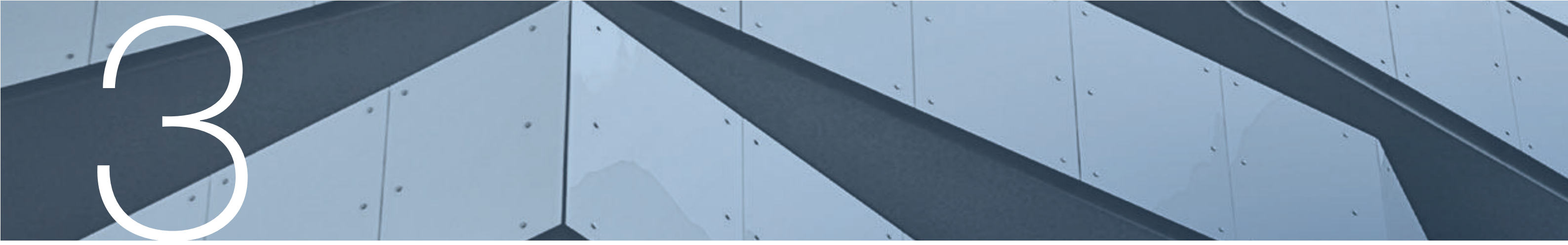
The main goal of Ukraine's Business Ombudsman Council,[40] a common form of collective action headed by the Business Ombudsman, is to improve the investment climate in the country. The institution, established in 2014, provides for greater transparency of business practices in Ukraine. It serves as the first point of contact for companies seeking redress against unfair treatment by State authorities. The Business Ombudsman Council is financed by the Ukraine Stabilisation and Sustainable Growth Multi-Donor Account (MDA), which is managed by the European Bank for Reconstruction and Development (EBRD). Current **contributors to** Ukraine's **MDA are the European Union, as the largest donor, and 13 individual countries. Following its guiding principles – independence, neutrality, accessibility, openness and transparency, accountability, integrity and confidentiality – another** important goal of the Business Ombudsman Council is to provide effective systemic communication between businesses and authorities, the Government and local self-government agencies, including State-owned enterprises (SOEs). Following recommendations of the Business Ombudsman Council, the Verkhovna Rada (the Parliament of Ukraine) adopted four new laws in 2020 that are important for business entities in the country, followed by six resolutions adopted by various ministries that also aim at improving conditions for the functioning of the business sector.[41] In 2020, the Business Ombudsman Council received 1,737 complaints from companies. Most of these involved taxes, law enforcement activities, activities of state regulators, customs, and actions of local government authorities. It successfully closed 1,159 cases, with a direct financial impact of €28 million and total financial effects exceeding €630 million.

3.1.12. Integrity pacts

Integrity pacts are perhaps the best-known example of collective action developed to prevent corruption in public contracting.

Promoted by organizations such as Transparency International, integrity "pacts" involve companies bidding for a particular tender or regularly bid in a specific market signing a no-bribery commitment in relation to that particular tender or market. They may further agree to the use of a (social) monitor to oversee adherence to this commitment, as well as actions in the case of non-compliance (i.e., enforceability of the pact in court, sanctions, etc.).

Other examples of collective action regarding anti-corruption are industry-led efforts to set new standards or norms on compliant business conduct that is free of corruption. Two unique examples of this type are the Maritime Anti-Corruption Network (MACN) and the Ukrainian Network of Integrity and Compliance (UNIC) (see Textboxes 21 and 22 below).



TEXTBOX 21.

The Maritime Anti-Corruption Network

The Maritime Anti-Corruption Network (MACN) was established in 2011 by a small group of maritime companies to curb corruption in the maritime industry, and to enable fair trade benefiting society at large. To date, membership has increased to over 140 companies that hold 50% of the world's tonnage. The network facilitates the sharing of good practices to prevent bribery, facilitation payments, or other forms of corruption. This involves multiple approaches. Guided by the question of how to practically discuss and resolve trade barriers imposed by corruption, the network has successfully mitigated the impact of corruption by means of specific actions in several locations. An essential component of their approach is mapping concrete business risks associated with corruption through industry dialogue, and using this analysis in outreach and advocacy. Such risks include increased costs due to delays, concerns about crew safety, demands occurring when a vessel is at berth, etc.

The MACN operates a unique reporting mechanism that maritime companies can use to report incidents of corrupt demands when a vessel is going through a port call procedure. Since its establishment, the MACN has collected over 40,000 corrupt demands globally. This data helps demonstrate the extent of corruption. It is possible, for example, to report the exact challenges vessels are experiencing at a specific port (i.e., demands for bribes or so-called facilitation payments), or to demonstrate how lengthy or complicated port procedures are. This type of data informs constructive dialogue with governments globally on systemic issues that are challenging good governance and ethics in port operations. In several cases, such engagement have led to government-facilitated grievance mechanisms that allow for real-time reporting of incidents to relevant authorities.

In Argentina, for example, through such a tool and increased awareness among companies and port staff, a 90% drop in corruption demands has been reported. In addition, MACN members can access the anonymized data to conduct risk assessments, making them better prepared to prevent corruption risks. The data has also helped expand the group's membership and boost the adoption of MACN practices in support of integrity at ports and in port procedures. Strong membership is a key to the group's success. Individual companies often do not act against corrupt demands for fear of retaliation. By assuring the MACN as an industrywide standard and speaking as one voice on behalf of the industry to governments and other stakeholders, retaliation risks are mitigated, a prime example of the added value of collective action.

TEXTBOX 22.
Industry-led benchmarking: The Ukrainian Network of Integrity and Compliance

In late 2017, the Ukrainian Network of Integrity and Compliance (UNIC) was established with the support of the European Bank for Reconstruction and Development (EBRD) and the Organisation for Economic Co-operation and Development (OECD). Guided by a vision to build a corruption-free business environment in Ukraine and to become a platform of knowledge in anti-corruption and compliance for its members, UNIC is a unique collective-action network of more than fifty companies. All members have signed a pledge of integrity, passed a self-assessment of compliance and business integrity, and have committed themselves to working on further strengthening their compliance culture. The aim is to promote ideas of responsible business conduct in accordance with international standards, and to foster the broad implementation of strong compliance systems among member companies.

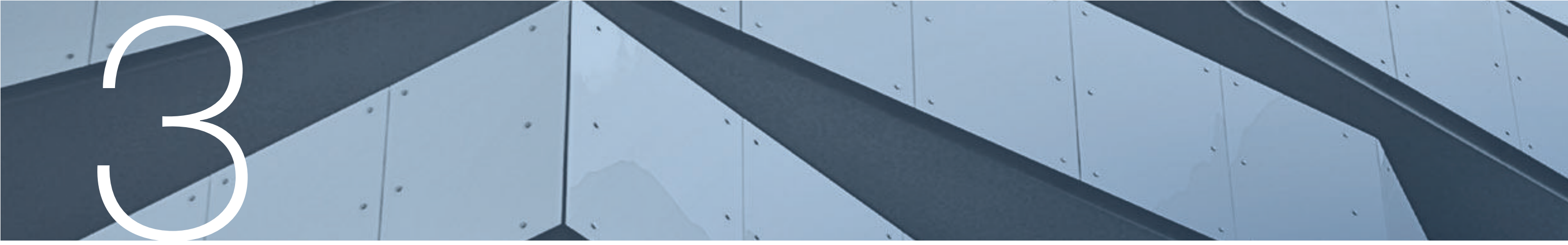
In addition, UNIC actively promotes knowledge, and shares best practices among member companies.

Members audit their own levels of compliance on a regular basis to improve their compliance and business integrity. Members with advanced compliance regimes can undergo formal certification by UNIC-recognized assessors. By instituting a strong compliance culture as the basis of its member company's operations, UNIC businesses are better able to counter corruption, lighten regulatory pressure, and ease access to credit and entry into foreign markets.

Business-driven integrity is important to help improve Ukraine's overall investment climate. Through leading by example, UNIC sets new compliance norms and influences the behaviour of corporate peers, thus also shaping a positive business climate in Ukraine. A significant positive shift in perception when conducting business with the government was revealed by surveys conducted among UNIC members: in 2018, 32.3% of Ukrainian executives indicated the need to bribe officials to secure a government contract,[42] compared to 97.9% in 2013.[43]

TEXTBOX 23.
The "Clear Wave" collective in Lithuania

Established in 2007 in Lithuania to encourage transparent and ethical business practices, the "Clear Wave" collective raises awareness among businesses, consumers and the Government about the benefits of business integrity. Through events, seminars and workshops, the collective unifies businesses that are operated and guided by the highest ethical standards. Members of the collective are easily recognized by the first social label of its kind in Lithuania: "Clear Wave". The label symbolizes business integrity, transparency, responsibility and sustainability. It is successfully working as easy communication tool to share company values and commitment for ethics with clients, partners and the society in general. The label is a registered trademark in Lithuania, Latvia and Estonia.[44, 45]



3.1.13. Independent judiciary, the role of technology

An independent judiciary is key to accountability and upholding anti-corruption reforms and legislation. It is also essential for a positive legal business environment, since an independent judiciary can ensure that applicable laws and regulations are enacted and enforced in an impartial way.

Independence of the judiciary involves the ability of courts and judges to perform their duties free of influence or control of other actors, whether governmental or private.[46]

The UN General Assembly has approved basic principles of judicial independence[47] for the following areas[48]: judicial decision-making, freedom of expression and association, qualification, selection and training, conditions of service and tenure, professional secrecy and immunity, discipline, suspension and removal.

For these principles to be upheld, governmental and other official institutions must respect and observe the independence of the judiciary, and require the judiciary to decide matters before them impartially, on the basis of facts and in accordance with the law, without restrictions, improper influences, inducements, pressures, threats or interferences, direct or indirect, from any quarter or for any reason.[49]

Creating an independent, well-paid and sufficiently trained judiciary is key to establishing rule of law.

In turn, rule of law is crucial for a positive business environment. Certain countries, due to the dominance of the executive branches in their governance structures, show tendencies to limit the independence of the judiciary for the sake of unrestricted powers of the executive branch.

At first glance, it may seem as if executive branch decisions that are not subject to independent judicial control are more effective and thus better for developing a positive business climate. However, in the long run such decisions are harmful. Due to their unpredictability and potential partiality, they have a negative impact on levels of investment, and thus on the business climate.

In an era in which digital technology is transforming societies, technology is also supporting and shaping essential state functions such as law enforcement and legal protection.

Court systems are often under pressure and strained, and backlogs in case management are not unusual. Leveraging digital solutions and emerging technologies can significantly increase efficiency, make access to important legal documents easier, and boost transparency, all at lower cost. In addition, technology can help to curb judicial corruption, such as through automated systems for court case management.

Several OSCE participating States have systems in place that provide for the random, computerized allocation of court cases, for instance, in Bulgaria, Estonia, Latvia, Montenegro, Romania and Slovenia. Random case assignment procedures are recognized by the UNODC as a procedure that can prevent “judge shopping” and increase system integrity. It therefore recommends introducing such procedures where judiciaries are affected by problems of corruption and low levels of public trust.[50]

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Vienna, 17 November 2021

TEXTBOX 24.

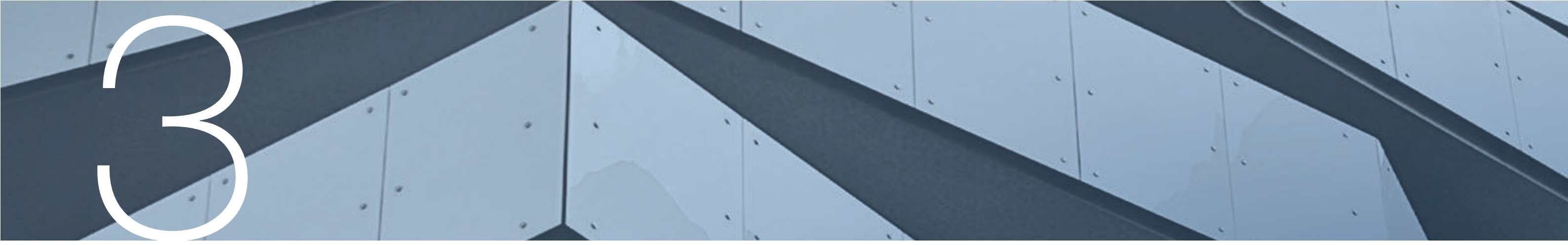
Estonia's efforts towards an independent judiciary and digital justice

While the independence of Estonia's judiciary is enshrined in the national constitution, the use of information and communication technology (ICT) is also part of the country's successful progress toward an independent and effective judiciary. In the EU, Estonia's justice system is recognized as being one of the most advanced with regard to ICT. Based on the EU Justice Scoreboard 2020, Estonia ranks in the top third of EU countries regarding ICT use. The system is highly efficient: the length of court proceedings in commercial and administrate cases is shorter than the EU average, and the number of pending cases has also been among the lowest in the EU.[51]

Estonia also uses ICT in its legislation and regulatory reform processes. An information system called "Eelnõude infosüsteem" (EIS) (legislative drafts information system) has been in place since 2011.[52] EIS is a digital platform for authorities involved in the legislative process, including the government and the parliament. It can also be consulted by the general public. Through EIS, it is possible to monitor legislative procedures, search documents, and participate in a public dialogue by submitting comments regarding particular documents.

Moreover, digital justice forms a substantial part of Estonia's law enforcement, which also allows fast and efficient handling of court proceedings. Key to the success of digital justice is the availability of legislation in an open, electronic format. Nearly all court decisions that enter into force are made publicly available.[53] Participants of court (and misdemeanour) procedures can access their cases through publicly available electronic files. These files also provide access to other documents and information about court hearings.[54] In addition, the system can be used to pay fees for court procedures, to submit additional documents to the court, and to notify the opposing party about such submissions. Legal professionals can form a user group on the platform, where they can enable user access to each other's work and collaborate as a team. An essential component of the system is digital security; it employs advanced secure authentication and digital signatures. Furthermore, information entered into the system is sent to courts via the so-called X-road,[55] a unique and open-source IT system developed by Estonia's Information System Authority (in collaboration with local researchers). X-road is now being used also by other governments, including Finland, Germany and Kyrgyzstan, to deliver certain public services.

In addition to its IT infrastructure, Estonia's success has been further augmented by an automated case allocation system, which supports courts in their case management. It also helps build trust in the justice system on the part of both individuals and businesses, thus contributing to a positive investment climate. Estonia is currently exploring whether other things can be made available through public e-files, such as the pre-trial criminal procedures of prosecution bodies.



3.1.14. Whistle-blower protection

Legal protection for whistle-blowers is another important aspect for the broader ecosystem of the rule of law. In 2016, OSCE participating States adopted a Ministerial Council Decision acknowledging that a sound regulatory framework towards a positive business environment should include adequate protection for whistle-blowers. There are many legal instruments aimed at implementing such protection. A landmark legislative act in this regard is the EU Whistleblower Protection Directive,[56] which entered into force in EU Member States in early 2020 and was transposed to individual legislation by December 2021.

The directive, among other things, prohibits all forms of retaliation against whistle-blowers and obliges legal entities that employ over fifty staff members to set up internal reporting channels. It also protects whistle-blowers from legal liability for the information they disclose. Digital infrastructure plays an instrumental role here as well, since it can facilitate, on one hand, the secure reporting channels required by the legislation, and on the other, more generally effective whistle-blowing.

TEXTBOX 25.

The "GlobaLeaks" whistle-blower system of Italy

In 2018, the Italian Anti-Corruption Authority (ANAC) adopted an acclaimed open-source software platform called "GlobaLeaks" to provide an online whistle-blowing platform for the entire country. The platform gives whistle-blowers a secure means for reporting illegal activity while protecting their identities. Many whistle-blowers first speak out anonymously, only disclosing their identities when they know their concerns are being addressed, or that they will be protected from possible retaliation. The customizable, low-cost platform is compliant with the EU directive and available in many OSCE languages. It is also used by the Barcelona City Hall and the anti-fraud authorities of Catalonia and Valencia.

3.2. Conclusions and recommendations

Corruption affects every aspect of doing business: it damages the integrity of markets, distorts competition, and impedes a positive business and investment climate. Indexes that measure corruption and the rule of law are the main type of instruments used by investors, both domestic and foreign, to assess the likelihood and cost of corruption risks for their businesses.

An effective, transparent and well-regulated system for public procurement can minimize corruption risks and offer important and sizeable economic opportunities for businesses of all sizes. It can particularly help boost SMEs.

In pursuit of broader public sector integrity, systems for income and asset declarations are an additional and complementary tool for preventing corruption. Together with open registers of beneficial ownership, declaration systems help establish trust in the public sector and allow companies to better manage risk.

Independent courts are key for public sector accountability and for enforcing relevant laws and regulations. In addition, the importance of collective action towards combating corruption, in particular private sector involvement and civil society support cannot be underestimated.

Collective action raises the integrity standards of business conduct and improves the levelness of the playing field between competitors.

RECOMMENDATIONS:

- Introducing a general governmental policy whereby data is transparent and publicly available, unless there are grounds and substantial reasons to protect certain data with some type or level of confidentiality;
- Adopting transparent and fair procurement procedures to encourage a more equitable business landscape, foster better competition, and improve overall public service delivery;
- Introducing and maintaining open registers of beneficial owners of all legal persons in the country;
- Developing ways to enhance co-operation between public bodies, such as anti-corruption agencies and business entities, to ensure partnerships between the public and private sector in fighting corruption;
- Ensuring the maximum level of judicial independence and judicial responsibility for assessing cases impartially, on the basis of facts and in accordance with the law;
- Adopting legislation enabling the use of modern information and communication technologies (ICT) in all areas, including judiciary and procurement, to ensure the effective functioning of crucial public bodies, disrupt corruption, and maximize value for money;
- Adopting Codes of Conduct in order to facilitate a positive workplace, prevent conflicts of interest, and avoid costly legal procedures; moreover, securing buy-in and commitment of senior management for the Code to be successful;
- Considering the introduction of new forms of collective action to fight corruption, as well as enhancing existing ones, to reduce the damaging effect of corruption on the business and investment climate and society in general;
- Establishing reporting mechanisms for both the public and private sector through which citizens and companies can report incidents of corruption or corrupt demands, thereby helping stakeholders to better map integrity challenges to the business climate and inform policy responses;
- Guaranteeing effective protection of whistle-blowers and related persons from retaliation, whether within their working environment or outside it.

3.3. Important elements for investors

3.3.1. Foreign direct investment (FDI)

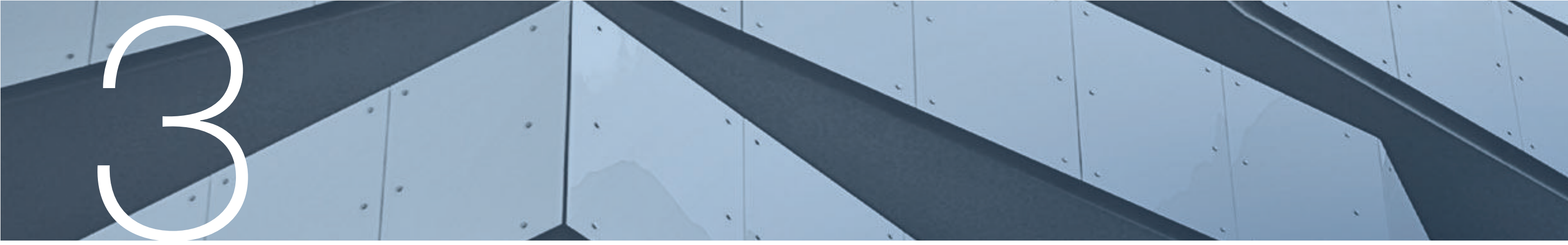
The past decades have been marked by rapid growth in international production, followed by periods of stagnation and (financial) crises. In addition to this, the increasing and continuous evolving impact of technology and digitalization has had profound effects on production, value-creation and labour.

While these developments present opportunities, they also pose significant challenges for economies seeking to promote economic growth and a positive business and investment climate. Foreign direct investment (FDI) will continue to be an important building block for growth and development. Especially in emerging economies, FDI is often the largest source of external finance, more important for example than remittances, development assistance, or (multilateral) bank loans.

Extensive literature exists on the determinants of FDI, with broad consensus on the overall factors driving FDI. Market size (as measured by per-capita GDP) is one of the strongest factors pushing FDI, but also external factors and political stability play an important role. It is also clear that there is no one-size-fits-all solution that countries can adopt to boost FDI and create an enabling investment environment. Strong economic policies, political stability, competitive tax rates, as well as sound legal and regulatory frameworks are all important aspects enabling an attractive FDI environment. Labour productivity and structural changes in the economy are also important.

Especially in times of economic decline, which is often coupled with an uncertain outlook, attracting FDI is even less likely to follow particular rules.

Currently, global interest rates have fallen to historic lows, and there have even been cases of government bonds with negative yields relative to inflation. The COVID-19 crisis is having a further profound downward effect on overall investment and economic activity, with some data suggesting global FDI plunged by 50% in the first half of



2020 compared to the second half of 2019.[57] However, FDI recovery is expected to commence by 2022.[58] Similarly, data on greenfield FDI projects (investments in new assets), often considered more relevant for economic growth than other FDI flows, indicate that the COVID-19 pandemic has affected emerging economies more than advanced economies, since emerging economies rely more on investments such as extractive industries, whilst being unable to provide the economic support measures being applied in advanced economies.[59]

Prior to the COVID-19 pandemic, attracting FDI was already an important policy objective for governments throughout the world. In 2019, for example, over 50 economies introduced at least 107 measures regarding foreign investment, with three-quarters of these in the direction of investment liberalization, promotion and facilitation.[60] While it is difficult to make predictions, FDI patterns are likely to change in the future. For example, re-shoring of manufacturing is set to accelerate as a response to the fragility in global supply chains recently experienced during the COVID-19 pandemic. As a result, emerging economies in the OSCE region may experience increased divestment and a "shrinking pool of efficiency-seeking FDI".[61] Yet also opportunities are possible, since it is likely that investors will aim at developing more resilient supply chains, which will require them to build a more diverse supplier base and shorter value chains. Moreover, countries that are competitively positioned for the technology, services and manufacturing of the future are likely to recover better and attract higher levels of FDI.

Until early 2020, many OSCE participating States continued to have relatively high inward FDI stocks as a percentage of their GDP. This was sometimes because these countries held unique roles, such as being the site of global financial centres or of corporate hubs for companies throughout the world. In other cases, it was because certain economies could attract stable FDI for extended periods of time. Table 4 shows the ten top OSCE countries regarding inward FDI stocks as a percentage of GDP in 2019. The OSCE countries with lower FDI stocks as a percentage of GDP were either countries with large economies or ones with less attractive business climates and relatively closed economies. The United States, although one of the world's largest recipients of FDI, has relatively low inward FDI stocks as a percentage of GDP because of the massive size of its economy and domestic market.

Table 4. Top ten OSCE participating States in 2019: Inward FDI stocks as a percentage of GDP (millions of US$).

	Economy
Cyprus	1817 %
Malta	1406 %
Ireland	290 %
Netherlands	193 %
Switzerland, Liechtenstein	190 %
Luxembourg	184 %
Mongolia	166 %
Georgia	110 %
Belgium	107 %
Montenegro	104 %

Source: UNCTAD

Smaller economies, even developing ones, can still be catalysed by FDI. Over the past ten years, several OSCE participating States, including Albania, Georgia, Lithuania, Montenegro, Serbia, Tajikistan, Turkmenistan and Uzbekistan have all seen significant increases regarding their inward FDI stock.

TEXTBOX 26.
FDI increases in Serbia

In 2018 Serbia attracted almost 12 times the amount of greenfield FDI than was expected based on the size of its economy, and topped the annual reading of the greenfield performance index of fDi intelligence (a Financial Times data division), This was followed by Montenegro.[62] In 2020, of OSCE participating States, Serbia occupied fifth place in the ranking, followed by Lithuania in the sixth and Georgia in the ninth.[63]

TEXTBOX 27.
FDI stability in the Czech Republic

After a significant drop in rankings in 2015, the Czech Republic managed to attract increasing levels of inward FDI stock in 2016 and retain these levels since then, while its regional peers witnessed a downward trend. According to the Eurostat Foreign Affiliates Statistics, "almost one-third of all jobs in the Czech Republic are provided by multinational corporations (MNCs), more than in any other Central and East European (CEE) country".[64] In addition, the Czech Republic is often praised for having a stable political and macroeconomic environment, and ranks strong in terms of competitiveness, being the most competitive country in the CEE region according to the 2019 Global Competitiveness Report.[65]

FDI statistics are hard to place against the broader backdrop of a changing global economy. These changes include more service-based economies, the emergence of an information economy, and the overall impact of digitalization on FDI flows.

While recognizing these complexities and in the absence of a simple formula that can help boost FDI, there are fortunately several internationally recognized guiding principles and elements of a good investment climate. In this context, the OECD Policy Framework for Investment highlights, for example, that "a fair, transparent and predictable regulatory framework for investment is a critical determinant of investment decisions".[66] Against a backdrop of "economic nationalism" and increased attention to national security considerations vis-à-vis FDI, several countries have also introduced more rigorous screening practices. UNCTAD noted that in 2019, at least 11 large cross-border merger and acquisition deals were withdrawn or blocked for regulatory or political reasons.[67] Notwithstanding the legitimate reasons for such scrutiny, it is important to assure that such policies do not disproportionately harm the overall investment climate.

3.3.2. Fiscal and political country risk assessments

A stable and predictable investment climate is of paramount importance, since investors need a sense of predictability and security. Fiscal predictability is often highlighted as a key element in making corporate investment decisions easier. Frequent changes in fiscal rules, as for example in VAT rates or corporate and personal income taxes, can create uncertainty for investors when they are reflecting on long-term costs or future returns.

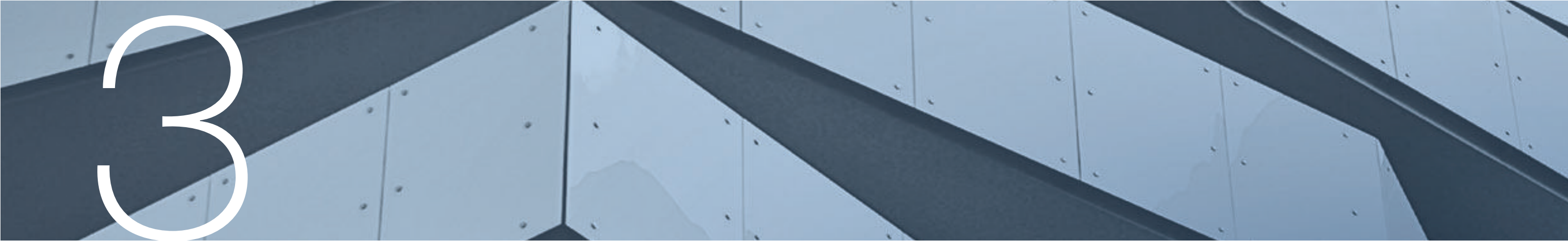
Frequent changes in fiscal rules may even trigger undesirable side effects, such as increasing informality, fraud and tax avoidance.

Political stability is also important. Political instability, often exacerbated by high levels of corruption or organized crime such as racketeering or extortion, strongly impedes legitimate economic activity, thus creating an unfavourable business and investment climate.

To assess the risks associated with doing business in a given location, investors and third parties, such as risk advisory firms, continuously monitor relevant developments with a view to establish a score for the financial and/or non-financial risks that businesses are exposed to in a given country or jurisdiction. Such country risk assessments and their scores matter greatly for FDI, since they are a numerical expression of the primary concerns foreign investors have with regard to a particular market. Unsurprisingly, high political risk has a demonstrated negative impact on inward FDI flows.[68]

Country risk assessments are multi-faceted. For example, assessments of financial risk usually include the stability and solvency of the banking system and unemployment figures, but they may also take into account debt-to-GDP ratios and risks related to foreign currency exposure.

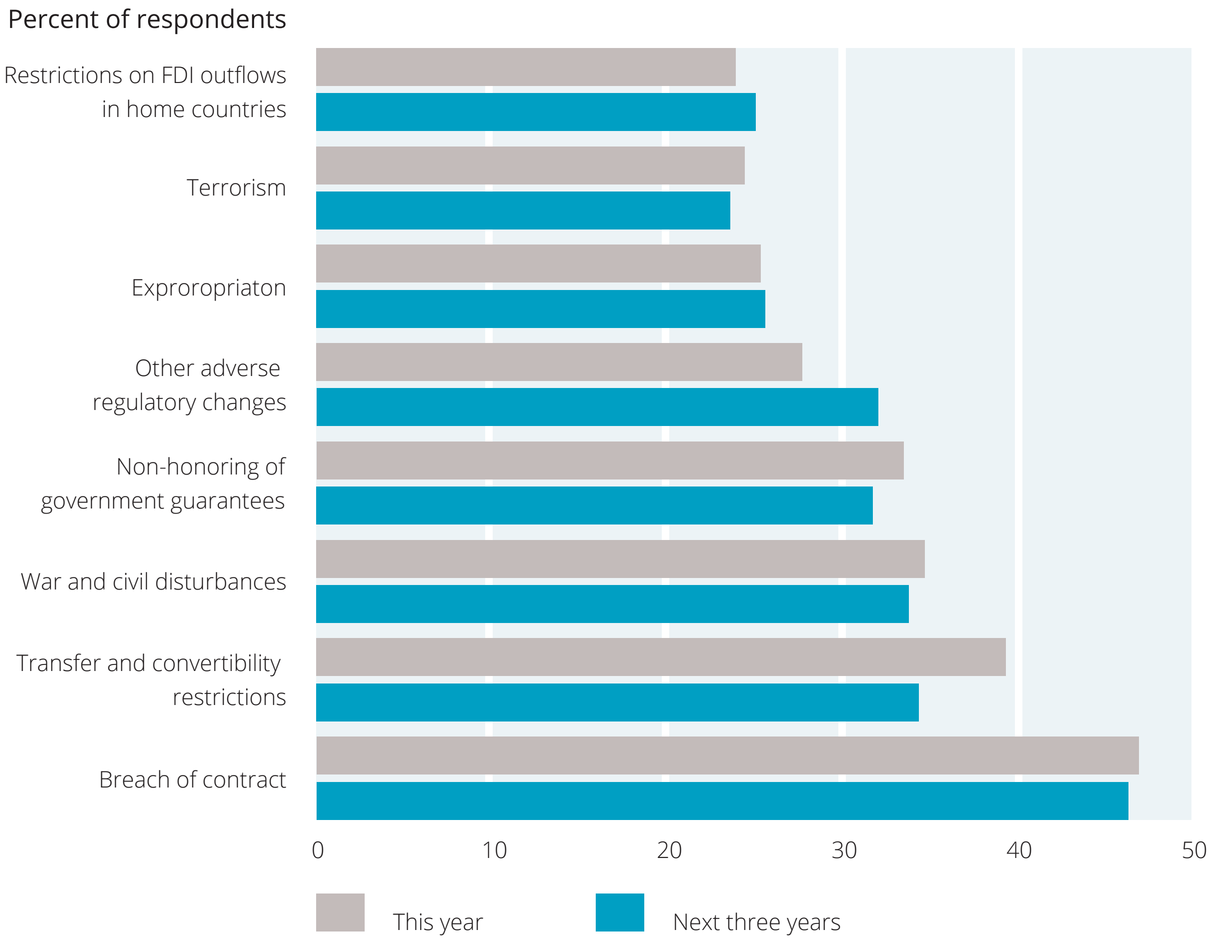
Non-financial risks, often referred to as political and security risks, are another important component in such assessments. These usually involve the anticipated effects that political events or decisions are projected to have on the profitability of businesses or investment decisions. The World Bank Group's Multilateral Investment Guarantee Agency (MIGA), whose direct objective is to promote FDI in developing economies, defines political risk as "actions which



deny or restrict the right of an investor/owner (i) to use or benefit from his/her assets; or (ii) which reduce the value of the firm. Political risks include war, revolutions, government seizure of property and actions to restrict the movement of profits or other revenues from within a country."[69]

MIGA, together with the Economist Intelligence Unit, conducted a survey outlining the types of political risk that are of most concern to investors (see Fig. 1).

Figure 1. Types of political risks of most concern to investors in emerging markets



In your opinion, which types of political risk are of most concern to your company when investing in emerging markets?

Source: MIGA-EIU Political Risk Survey 2009

Note: Percentages add up to more than 100 per cent due to the possibility of multiple selection.

3.3.3. Sovereign credit ratings and the business and investment climate

Sovereign credit ratings, which estimate the likelihood of a government defaulting on its outstanding debt, give investors an indication of how safe it is to invest in the national debt of a particular country. Such ratings often draw on non-financial risk assessments. There is a strong relationship between the scores of the three main credit rating agencies (Standard & Poor's, Moody's, and Fitch) and commonly used corruption indicators.[70] Sovereign credit ratings have important and direct links to financial markets, including bank lending channels that provide (in)direct financing for start-ups and small and medium-sized enterprises (SMEs). Thus, improving governance and combating corruption also matters in the view of capital markets. In addition, creditworthiness ratings can influence the broader financial stability of a country, especially in emerging economies. For example, a rating downgrade often leads to increasing outflows of capital, national currency depreciation, and higher interest rates for lending on capital markets.

Especially in times of economic crisis, when competition over FDI between countries increases, sovereign credit ratings and country risk assessments are perhaps the most important indicator for overall investor trust.

For many economies in the OSCE region, they have a strong impact on access to affordable capital. Regional questions also matter. Studies have shown that countries can attract more FDI when their geographic region has a higher average sovereign credit rating compared to other regions.[71]

In addition to credit rating agencies, financial service providers often establish country scores that assess exposure to risks such as money laundering and terrorist financing, and use these ratings when accepting clients. In determining country scores, financial service providers assess, among other factors, the regulatory framework and existing institutional safeguards that could help control or mitigate negative effects of such risk.

TEXTBOX 28.

Improved financing conditions for the construction of Elazig Hospital in Turkey

The European Bank for Reconstruction and Development (EBRD) and the World Bank's Multilateral Investment Guarantee Agency (MIGA) have developed an innovative risk mitigation instrument which enabled the issuance of Turkey's first-ever greenfield infrastructure project bond. The A1 bonds, issued by ELZ Finance, benefited from credit enhancement in the form of a political risk insurance policy from MIGA and an EBRD liquidity facility. Moody's subsequently viewed the involvement of MIGA as a political risk insurance provider, and EBRD as a subordinated revenue support facility provider as beneficial sources of external support given their preferred creditor status, potential influence on host government behaviour and ability to intermediate investment disputes. As a result, the project bonds were rated Baa2 by Moody's, two notches above Turkey's sovereign credit rating.[72] The proceeds of the bonds were used to build the Elazig Hospital under a long-term public–private partnership (PPP) between the Ministry of Health and ELZ Saglik Yatirim (a joint venture between the leading global infrastructure firm Meridiam, and one of Turkey's largest construction and infrastructure companies, Rönesans Holding).

The project has drawn the attention of other international financial institutions that seek to improve finance conditions in countries with low investment grade sovereign ratings, as well as institutional investors who are looking for new ways of investing in infrastructure assets in emerging markets.

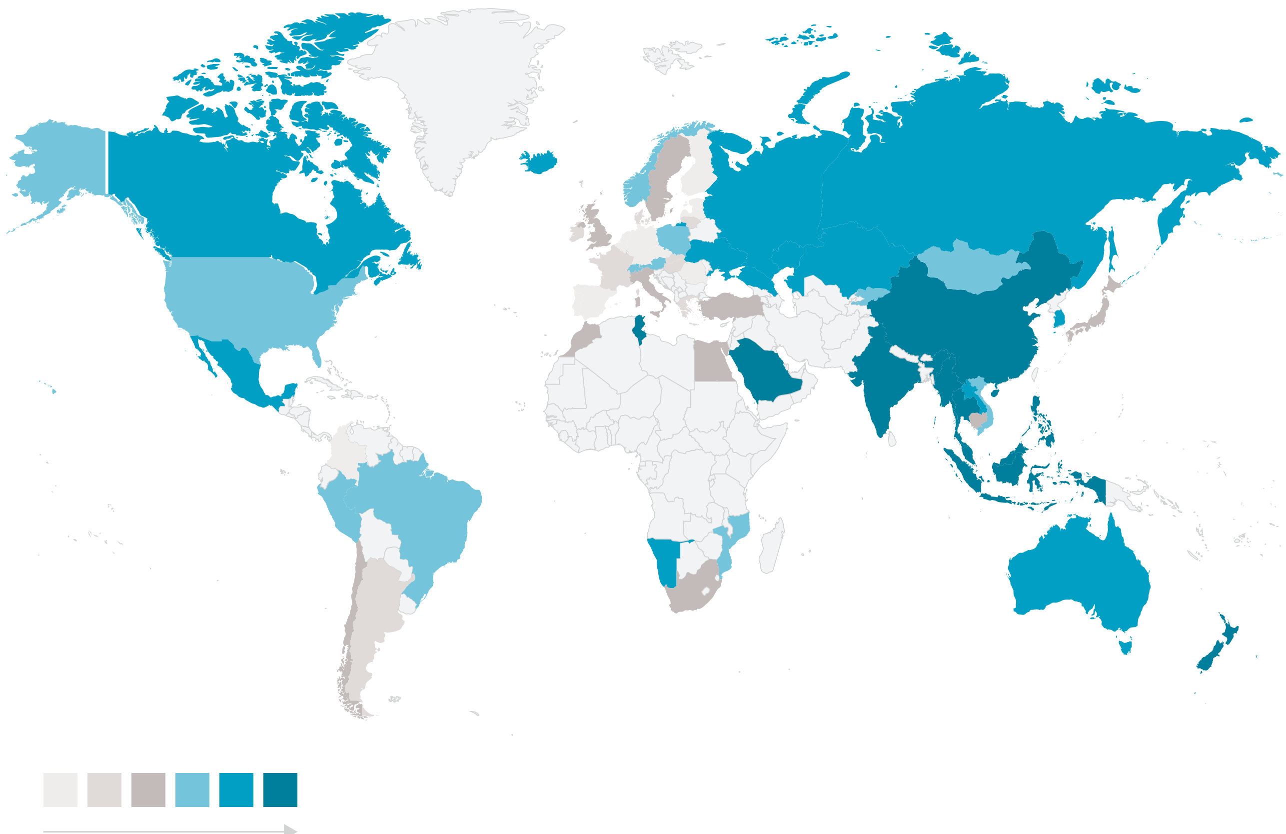
3.3.4. Other business and investment climate benchmarks used by investors

In addition to the assessments discussed above (in Sections 3.3.2. and 3.3.3.), there are various other indexes that investors and policymakers use to assess a positive business and investment climate. These indexes include, for example, regulatory burden, product regulation, FDI attractiveness, restrictions to FDI or to trade-in services, competitiveness, economic freedom, or so-called ease of doing business.

Indexes of factors such as these are excellent tools for diagnosing impediments to a positive business and investment climate. Nonetheless, caution is warranted. Such analyses should not lead to generalizations, or to economic policies merely being reduced to deregulation and tax cuts. Such indexes are increasingly catering to the corporate demand for insights and evaluation of market conditions in given locations.

There are in fact numerous commercial providers of bespoke business climate assessments. Companies and investors turn to these to gain a better understanding of the business climate in a location of their interest. In addition to commercial data and analysis, there are several indexes operated by multilateral organizations.

Figure 2. 2015 – OECD FDI Regulatory Restrictiveness Index



From least to most restrictive countries

Source: EU/OECD

The World Bank, in collaboration with several other institutions, including the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB) and the European Commission (EC), conducts so-called enterprise surveys in over 140 economies, including most of those of the OSCE region. These surveys provide a view of an economy's private sector from the viewpoint of companies, including a range of business environment topics such as access to finance, corruption, infrastructure, crime, competition and performance measures. The key objective for the survey is to help find the impediments and binding constraints to a company's growth and operations in a specific economy.

FDI attractiveness, measured by indexes such as the Kearney Foreign Direct Investment Confidence Index and the OECD's FDI Regulatory Restrictiveness Index are two well-reputed benchmarks that assess performance in countries' ability to attract FDI stock.

These indexes can also help inform economic reform processes and policy discussions.

Indeed, the OECD's FDI Regulatory Restrictiveness Index is frequently used by policymakers around the world to assess what areas could be improved to attract investment, as well as how to get the best out of incoming investment. The index looks at four dimensions:

(i) foreign equity restrictions;

(ii) discriminatory screening or approval mechanisms;

(iii) restrictions on key foreign personnel; and

(iv) operational restrictions.

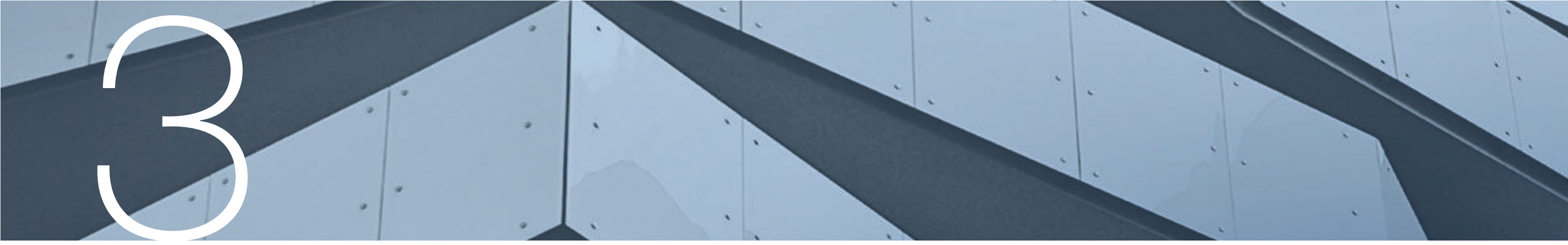
The index has empirically demonstrated that reforms towards liberalizing FDI restrictions by about 10%, as measured by the index, can increase bilateral FDI in stocks on average by 2.1%.[73] Effects are greater for FDI in the services sector, but even manufacturing sectors – which are typically open to FDI – are negatively affected by a country's overall restrictiveness. The EU, for example, has one of the world's most open investment regimes according to the index, with over 35% of total assets owned by foreign-owned companies.[74]

3.4. Conclusions and recommendations

A stable and predictable business and investment climate is of paramount importance for attracting investment. Political, legal and regulatory risks erode trust and deter investment. Sovereign credit ratings and country risk assessments help in estimating risks and are critical indicators that investors rely upon. Open government is an increasingly important area for the advancement of a positive business climate, since it contributes significantly to combating corruption and to driving innovation. Attracting FDI remains key for driving economic growth, including for post-COVID-19 economic recovery. Retaining competitiveness can be achieved, for example, by limiting the negative impacts of supply chain disruptions, or by making the best use of digital technology.

RECOMMENDATIONS:

- Considering a comprehensive attitude towards investment promotion, including through open dialogue with the private sector;
- Refraining from frequent changes in fiscal rules, since this creates uncertainty for investors;
- Supporting IT infrastructure and legal frameworks conducive to open government data, since this enables economic development, increases good governance, catalyses inclusive economic growth and motivates potential investors;
- Reducing vulnerabilities due to supply chain disruptions by diversifying the supplier base and shortening value chains, thereby also improving the environmental footprint of production.



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Government actions and policies that can improve the business climate

4

Government actions and policies can be conducive to a positive business climate. Many steps have been shown to be beneficial, including fostering competition among private actors, strengthening economic diversification, reducing the informal economy or reducing overall state management of the economy. Other means for improving a positive business and investment climate include simple, transparent and non-discriminatory taxation, since this enables entrepreneurs to better forecast their costs and potential profits.

Government investing in infrastructure – roads, transport networks, energy and other types of utilities – as well as the management and maintenance of that infrastructure, is critical for the business environment, since such infrastructure helps companies take full advantage of both local and global markets.

Moreover, the competitiveness of national economies is highly dependent on investment in human capital: government support of quality public education or effective training options, either through on-the-job training or by improving the skills of the unemployed or members of groups that face more difficulties in the financial market, such as women and youth. Furthermore, a regulatory framework that stimulates and encourages greater inclusion of women as entrepreneurs together with a greater role in the economy is also needed.

Isolationism or protectionism is one means of dealing with global markets. However, facilitating co-operation among trading partners through regional economic integration or free trade zones is more likely to produce economic benefits. Government policies also influence a country's openness to foreign investment. Ideally, investment policies should be based on non-discriminatory principles ensuring that investors' rights are adequately protected and that their economic activities are well regulated. In addition, States can show a firm commitment to fair competition and a level playing field. This can be done by ensuring that the privatization of State-owned enterprises (SOEs) follows rigorous processes driven by clear strategic objectives, a view of the benefits of privatization for the State, as well as sound valuations of SOEs that are privatized. Finally, by enhancing climate risk management and green investments States can ensure sustainability of economic growth.

4.1. Creating a strong and supportive macroeconomic environment: Special challenges in times of crisis

The last two decades have been characterized by rapid technological developments and liberalization. This has been driven partly by the emergence of global production chains. In this context, trade policies remained a key tool for government action and policies aimed at reducing trade-related costs and removing remaining trade barriers. However, this may begin to change, with a turn back toward more protectionist trade policies due to health, environmental, economic, social and fiscal challenges. Such challenges have been compounded by the COVID-19 crisis. As many analyses have shown,[1] the COVID-19 pandemic has triggered the most serious economic crisis in the world since World War II.

All economic sectors have been affected by disrupted global supply chains, weaker demand for imported goods and services, drops in international tourism, declining business travel and many combinations of these.

Measures to contain the spread of the virus have hit SMEs and entrepreneurs particularly hard. Unemployment levels and the number of aid seekers have increased in many countries, sometimes dramatically. Many countries "exited" virus containment measures to mitigate the impact of the economic crisis. But recovery has been jeopardized by the rising waves of cases in the fall of 2020 and of 2021.

As mentioned in Chapter 2 of this Guide, strong political, legal and regulatory systems are a key component in establishing the necessary conditions for effective government actions and policies. But also other government actions and policies affect business decisions, such as where to set up new corporate operations, how to expand current operations through new investment, or whether to hire or fire employees. For example, many countries have sought to revise their tax policy frameworks to introduce more comprehensive approaches and taxation that is fairer, more predictable and less bureaucratic. In order to develop competitive, skilled and flexible human resources, as well as reliable and sustainable public infrastructures, tax incentives to support investment are frequently explored.

Effective and government action across various policy areas that is well co-ordinated can significantly reduce the costs of running businesses and provide overall support for investment. Clear government goals and strategies regarding economic policy not only help maintain a predictable and transparent environment for businesses, they can attract investors.

Stable market prices and predictable future taxation help businesses to better price their goods and services, predict return on their investments, and reliably forecast the benefits of innovations in their products or technologies. Heightened exposure to currency volatility makes cross-border activities uncertain. A strong macroeconomic environment is thus essential for a positive business climate. Although national governments are limited in their ability to create favourable macroeconomic conditions, a number of tools are at their disposal to maintain low and predictable inflation, sustain acceptable levels of public debt, and manage public finances and monetary policy in a predictable way (including balanced budget, appropriate interest and real exchange rates, and a viable balance of payments).[5] In addition, strong policy support for international trade in the form of an active trade policy is an important policy tool, both for promoting the internationalization of domestic SMEs, as well as for attracting FDI. Active, international market-oriented trade policy uses various instruments – such as trade agreements, or bilateral investment treaties – or employs the lowest most-favoured-nation tariffs in line with international norms and rules provided by the World Trade Organization (WTO). This section provides a quick overview of the most common trade policy tools.

TEXTBOX 29.
Reforms in Uzbekistan aimed at improving the business and investment climate

Over the past few years, Uzbekistan has embarked on a series of reforms with a particular focus on improving the business and investment climate. The adoption of digital tools and procedures has played an instrumental role in advancing these reforms. Aiming to better integrate the country into the global economy, Uzbekistan has made, for example, the process of establishing new companies significantly easier by rolling out a one-stop shop for business registration and by reducing associated capital requirements. Business registration can now be completed online.[2] Paying taxes has also become easier through the introduction of an electronic system for filing and paying VAT, land tax, corporate income tax, etc. Cross-border trading has also become easier through the introduction of an electronic application and payment system for several required export certificates. This has also reduced the time needed for export documentary compliance.[3] Moreover, Uzbekistan has established a modern, unified collateral registry that operates via the internet, which encourages more lending and reduces risks for creditors.[4] It has also reformed its banking laws, enhanced protection for minority investors, and amended legislation on secured transactions, registration of property and contract enforcement. In addition, the Uzbek Government has prioritized anti-corruption actions in State policy and has implemented substantial judicial reforms with a view to improve the overall well-being of its citizens.

Notably, economies can still suffer from external shocks, like the crisis that has been caused by the COVID-19 pandemic. During times of crisis, it is vital for governments to be agile in their reaction to their shocks and to take actions that are appropriately designed to minimize the negative effects. According to a number of international organizations,[6] in response to the COVID-19 crisis, most governments are acting in the following three areas:

- on the health front, by adopting differentiated territorial approaches, for example, policies regarding masks or lockdowns;
- on the socio-economic front, by providing massive fiscal support to protect firms, households and vulnerable populations. Many countries have reallocated public funding to crisis priorities, such as support of health care, SMEs, and vulnerable populations and regions particularly hit by the crisis. In addition, many countries have introduced measures to support subnational finance – on the spending and revenue side – and have relaxed fiscal rules;
- applying large investment recovery packages and focusing on public investment; these investment recovery packages prioritize three areas: strengthening health systems, enhancing digitalization, and accelerating the transition to a carbon neutral economy.

As the recent COVID-19 crisis has demonstrated, governments can effectively mitigate the level of macroeconomic uncertainty by launching large-scale recovery packages to help businesses maintain their operations. In line with the swiftly published recommendations of various international organizations,[7] most OSCE participating States were quick to revise their annual budget plans and to introduce economic stimulus packages. However, all these actions also have a direct negative effect on budget balances, and lead to higher levels of public deficits. The trade-off between rules on balanced budgets and quick and flexible economic stimulus are complicated. Nonetheless, increased transparency of procedural changes and legislative budget oversight are widely seen as effective tools that can help in the search for the right balance.[8]

TEXTBOX 30.

Legislative budget oversight for safeguarding balanced budgets in times of crisis

Legislative budget oversight aims to provide an inclusive, participative and realistic debate on budgetary choices by allowing parliaments and their committees to be involved in the budgetary process at all phases of the budget cycle. The challenges of the COVID-19 crisis have shown how such oversight is useful in times of crisis. A number of legislatures of OSCE participating States have reacted in innovative ways to these challenges, and have succeeded in keeping legislative oversight effective, even with temporarily limited workforces or the physical absence of legislators. One solution was to temporarily ease standard budgetary processes. For example, Sweden not only changed its standard budgetary procedures, but its Government submitted eleven so-called supplementary budget bills in addition to the normal budget legislation to speed up the decision process. In Finland, the requirement for new economic and revenue forecasts for supplementary budgets was suspended. Other countries (including Austria, the Czech Republic, France, Latvia and Lithuania) created new “fast track” procedures to be able to reallocate spending across budget lines and programmes more quickly, or made immediate access to so-called contingency reserves (such as in Canada, Latvia and the United Kingdom). There were also examples of maintaining legislative oversight. Many legislatures developed remote participation procedures and invested quickly in virtual sittings and electronic voting (Estonia, Spain). In the United Kingdom, so-called proxy voting allows a member of parliament who cannot vote in person to nominate another parliamentarian to vote in his or her name. It is important to note that the genuine function of legislative oversight in the budgetary processes is ensuring fiscal stability. This can be ensured if relaxations are introduced only temporarily and are communicated clearly and in a timely manner to the business sector and the broader public. Only so can governments fulfil the expectations of the business and the general public that balanced budget rules will be respected in the long term.[9]

A number of international organizations are carefully monitoring the quality of post-COVID-19 recovery,[10] that is, whether the recovery of countries is strong, inclusive, green and resilient. They are also highlighting problems of gender inequality in all mentioned areas.

Under the criteria of "strong", the following features are usually being monitored: economic activity, household incomes, excess deaths, hours worked, business dynamics (new companies, bankrupt companies).

Under the criteria of "inclusive", the following features are usually being monitored: income inequality, financial insecurity, labour underutilization, young people not being employed, education and training, and people with low satisfaction with life.

Under the criteria of "green", the following features are usually being monitored: greenhouse gas emissions, renewable energy, material consumption, outdoor air pollution, and natural land.

Under the criteria of "resilient", the following features are usually being monitored: COVID-19 vaccination rates, investments, broadband coverage, trust in government, and debt.

4.2. Trade agreements, World Trade Organization membership

In addition to budget plans and sound oversight of national spending, reducing trade barriers and seeking deeper integration of their economies in global markets can bring enormous benefits in terms of international trade opportunities. Lowering international trade barriers is traditionally associated with economic growth and increased welfare due to improved access to not only better quality but also a wider variety of goods and services. Multilateral or bilateral agreements between countries offer opportunities for companies to more easily access tradeable sectors and new markets. Moreover, since market integration engenders greater competition, it can lead to companies expanding their operations or becoming more innovative. Empirical evidence has demonstrated that trade agreements can generate economic gains in terms of increase of exports (by 80% on average) and company growth rates. Export gains are higher when less developed economies have trade agreements with more progressed countries.[11]

Removing trade barriers via trade agreements is therefore a common and frequent practice in the global economy. As of 2020, over thirty multilateral trade agreements are in place in the world, and many involve OSCE participating States. For instance, the Central European Free Trade Agreement (CEFTA) was launched in 1992 by the four Visegrád countries (the Czech Republic, Hungary, Poland and Slovakia), and later expanded to South-East Europe. Following the EU accession of the founding countries, the geographic scope of the free trade zone shifted to the Western Balkan as well as Moldova, and recently it is guiding trade relationships in this region. In 2015, the Eurasian Economic Union (EAEU) was established by Belarus, Kazakhstan and Russia with the aim of providing a better regulated and harmonized trade policy framework for free movement of goods, services, capital and labour. Armenia and Kyrgyzstan joined the union later in 2015.

The main function of trade agreements (most under the umbrella of the World Trade Organization, WTO) is to reduce trade tariffs and to make trade relationships more predictable, transparent and accountable. By acceding to the WTO and agreeing to comply with its multilateral rules that do not allow the arbitrary use of protective and discriminatory trade distorting measures, countries also signal their commitment to move away from protectionism.

Within the OSCE context, there is consensus that integration of national economies into international economic and financial systems is advantageous for global development.[12] Participating States are thus recommended to accede to the WTO and, in particular, to enjoy benefits of the 2014 WTO Trade Facilitation Agreement, which helps in expediting the movement, release and clearance of goods, including goods in transit.[13] Several OSCE participating States have successfully completed the WTO accession process in the last decade (e.g., Ukraine in 2008, the Russian Federation in 2012, Tajikistan in 2013). The relatively recent (2015) Kazakh experiences and lessons learned (see Textbox 31, below) may be the most up-to-date for orientation for countries still negotiating with the WTO (e.g., Azerbaijan, Belarus, Bosnia and Herzegovina, Serbia, Uzbekistan).

TEXTBOX 31.

Kazakhstan's WTO accession: Experiences and lessons learned

Kazakhstan undertook a series of important trade policy reforms during the 1990s and applied for accession to the WTO in 1996. After a long negotiation process, the country became a WTO member in 2015. The WTO accession package, whose high quality was praised by the involved WTO Working Party members,[14] focused on three main policy areas: reduction of tariffs, improving market access and opening the services sector, and enhancing sector-specific FDI. While recent growth data suggest that positive effects of these steps can be seen in the short run, country assessments point to the need of continued efforts. Still needed are reductions in trade-related costs and barriers, stepping up of diversification efforts by easing access to key export destinations, and more FDI in sectors outside the extractive industries.[15] Overall, the WTO accession process addressed several trade-related challenges in Kazakhstan: it improved the predictability of the country's trade policy framework, shaped the trade regime in line with the common WTO rules, made the international enforcement mechanism more effective, and freed the way to more FDI inflow in the services sector.

4.3. Bilateral investment treaties (BITs)

Bilateral investment treaties (BITs) have been in place for over fifty years to ensure more predictable investment environments for foreign investors.

Globally, there are currently over three thousand bilateral treaties, and approximately four hundred treaties with investment provisions.[16]

There are several rationales for bilateral or regional investment treaties. Among the main purposes of BITs is providing foreign investor protection, reducing risks for transnational investors, and creating economic incentives for investors. Generally, investment treaties are country and context specific. They reflect a country's position in the regional or global economy, the perception of foreign investors, and the country's self-perception. Treaties can be revised more flexibly to reflect changes in trade relationships, and can be an effective tool to respond to investor needs and claims.[17] The unique feature of such treaties is that they allow for an alternative dispute resolution mechanism. If the rights of investors under a BIT have been violated, they can turn to international arbitration (for example, arbitration operating under the auspices of the International Centre for Settlement of Investment Disputes [ICSID]), instead of bringing their legal complaints to the courts of the host country. Under three thousand existing treaties, investors have filed more than a thousand dispute settlement claims over the last decades.

Renegotiations due to controversial interpretations of certain treaty clauses (especially treaties signed decades ago, or those related to recent climate change policies of host countries) is costly, time-consuming and involves political risks. So does the termination of existing trade agreements. For these reasons, a number of governments and international organizations (EU, OECD, UNCITRAL) have proposed reforms of the dispute settlement system.[18] The UN Commission on International Trade Law (UNCITRAL) is in discussion with the OECD on reforming the investor–-State dispute settlement mechanism, whose value and fairness has been subject to increasing criticism both by governments and private investors. Recent proposals point to the alternative, low-cost option whereby a government approves plurilateral "interpretative" joint statements that clarify and define the positions of parties to existing trade or investment treaties on contentious clauses.[19] For more on the importance of dispute settlements, see above, Section 2.1.2.1. on the UNCITRAL Rules on Transparency in treaty--based investor–State arbitration.

Several types of treaties are currently being used internationally. Among many others, some examples are the US Model BIT, the Canadian Model, the Belgium--Luxembourg Model, the Germany-China BIT and the Japan/Korea BIT. The Canadian and US model treaties incorporate transparency and performance requirements.[20] Investment treaties have been recognized as tools for supporting changes in business responsibilities, such as responsible business conduct (RBC) or human rights requirements.[21] More recently, they have begun to be seen as serving as a background for sustainable development or green investments. For more on these policy avenues, see Section 4.10.2.

In recent years, sustainable and development-oriented reform of the international investment framework (including stocktaking, replacing old investment treaties and formulating new ones) has entered the mainstream of international investment policymaking. For general guidance on such reform steps, governments might refer to the UNCTAD's Investment Policy Framework for Sustainable Development,[24] and study treaties that already reflect sustainable development goals in their provisions, like those of the Netherlands or Italy.[25]

TEXTBOX 32.

Low carbon economy though international law?

Climate change litigation is on the rise globally, and this means there is also an increase in commercial and investment disputes involving green technology. Initiated in 2017, the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) established the Stockholm Treaty Lab crowdsourcing challenge. The initiative called for legal teams from all over the world to design policy tools that can effectively encourage investment to meet the climate objectives of the Paris Agreement. In total, 22 teams representing more than 25 countries and composed of lawyers, environmental scientists, policy advisers, entrepreneurs and climate diplomats registered to compete in the initiative, and submitted proposed texts for a model treaty aimed at generating and protecting green investments.[22] One of the winning teams presented a text entitled Model Treaty on Sustainable Investment for Climate Change Mitigation and Adaptation. In the opinion of the contest's jury, the text of this model treaty offers innovative and out-of-box ideas as well as clear-cut language to promote and encourage green investments, while at the same time addressing the risks posed by non-green investments. It also supports the need for just transitions.[23] While time has been too short to test applications of this new model treaty, it provides a good benchmark or reference for OSCE participating States that are revising their stock of investment treaties and agreements and formulating new ones.

4.4. Tax policy tools to support a positive business and investment climate

Taxation is the most common tool for governments to raise revenues in order to provide goods and services demanded by the public. Setting up an efficient and fair tax system is, however, far from simple. Efficient taxation involves applying tax rates and procedures that maximize expected revenues and minimize potential distortive effects at the level of businesses.

Tax burdens on companies should be proportional to their size and productivity.

Nonetheless, taxes cannot be seen as a stand-alone issue. While corporate taxation does have a significant effect, for example, on FDI location choices or on investment decisions of domestic companies, business environment reforms are increasingly based on the understanding that tax cuts on their own do little good, and tax evasion and excessive tax competition are undesirable phenomena.[26] After all, taxes are essential for sustaining a well-resourced public sector that is able to invest in the public goods and services that drive a business-friendly environment, such as education, public infrastructure (e.g., public transport networks) or safe and secure e-government services. As such, there is no one-size-fits-all approach, and the relationship between taxation, business and (foreign) investment remains complex. This guide therefore does not endorse certain taxation policies or practices. Instead, it aims to help decision makers and other stakeholders to navigate the challenges regarding taxation by sharing examples and recommendations that can be used to make tax systems efficient, fair and conducive to investment.

▲ **Representatives of Government of Tajikistan and international organizations at the official launch of Tajikistan's Trade Portal**

Dushanbe, 26 April 2019

4.4.1. A strong tax policy framework

In terms of attracting investment, the OECD's Policy Framework for Investment (PFI) has set out a number of key questions that decision makers should ask themselves when assessing whether their tax regime is fit for its purpose. It identifies the six most important questions relevant for judging the effectiveness of a country's tax policies and practices, and offers guidance in formulating taxation strategies that support investment.

Many countries have been successful in designing tax policies that are attractive to investors by adopting a whole-of-government approach to ensure consistency between tax policy and other government policies (e.g., sectoral regulations, competition policy, labour policy or education).[27]

Practically, this also means that governmental agencies (for example, investment promotion agencies) that often seek to offer tax incentives or other fiscal measures to help attract investment are involved in broader government decision--making processes.

TEXTBOX 33.

The PFI's six guiding questions

The PFI's six guiding questions for developing a strong tax policy framework to attract investment are the following[28]:

1. How does the government's tax policy support its development objectives and its investment attraction strategy?
2. Given the socio-economic and political conditions of the country, is it reasonable to assume that policy, including tax incentives, can favourably affect investment decisions?
3. If tax incentives target special groups/locations, can a non-uniform treatment of investors be justified?
4. Does appraisal of the costs and benefits of tax incentives regularly take place to support government decision-making?
5. Are tax incentives consolidated in the tax law? Are they offered on an automatic or discretionary basis? Is the process for granting and administering tax incentives clear and transparent?
6. Have unintended domestic and cross-border tax-planning opportunities been evaluated? Have measures been taken to improve international tax co-operation to counter abusive tax planning strategies?

Source: OECD (2015)

4

4.4.2. International trends and examples regarding tax policy tools

As international comparisons show, tax burdens vary significantly between developed and transition economies. As a gross figure, taxation in developed economies appears to be nearly twice that of emerging economies (approximately 40% versus 18% of the GDP).[29] Nonetheless, there have been substantial changes around the globe over the past decades that policymakers and other stakeholders could reflect upon when designing business-friendly tax reforms. These include, but are not limited to, the following[30]:

1. **Simplification of tax regimes.** The growth of cross--border economic activities due to regional integration and globalization in general has pushed countries to simplify their tax systems. Simplifying business-related taxes, especially corporate income taxes, has primarily been guided by the need to create a more business-friendly market environment. It also minimizes the negative effects of national/regional or local jurisdictions either competing with each other to offer more favourable tax rates for companies (tax competition), or adopting very similar tax measures (tax mimicking) to attract more businesses to their territories.[31] A justification for flat taxes or simplified tax schemes is the need to reduce the relatively large tax administration costs of SMEs. A further positive effect of simplified tax schemes is the formalizing of SMEs.[32]
2. **Harmonization of fiscal regulations.** Globalization and enhanced international trade also necessitate harmonization across national jurisdictions. Good examples of harmonization are the European efforts that resulted in the Code of Conduct for Business Taxation in 1997,[33] as well as more recent EU efforts of harmonizing VAT regulations and procedures. Also the Eurasian Economic Union, established in 2015, aims among other things at harmonizing certain elements of fiscal policies (see Section 4.2.)
3. **New tax instruments, carbon pricing.** A policy shift can be seen from taxation of both corporate and personal incomes towards levying more consumption taxes and broadening the tax base by introducing new types of taxes. Studies have shown that a number of countries have extensively reduced overall labour taxation by cutting the tax wedge[34] and tax burden for the most vulnerable groups (primarily low-income earners) in a targeted way. Public and political concerns about the environment (pollution, greenhouse gas emissions) and the broader negative effects of climate change have also pushed policymakers towards introducing so-called green or carbon taxes. In 1990, Finland was the first OSCE participating State to introduce a carbon tax; Denmark, Norway and Sweden soon followed. Since then, several other OSCE participating States have introduced carbon taxes (including Estonia, Kazakhstan, Poland and Ukraine).[35] Impact studies conducted in the Scandinavian countries show that there has been a positive and significant reduction of carbon emissions.[36]
4. **Increasing importance of local taxes.** Complementary to regional and global harmonization efforts, delegating fiscal competences to lower government levels can be increasingly seen. For example, local governments are now often given the option to raise local property taxes. According to OECD data, revenues from property tax account for approximately 30% of sub-national revenues; this proportion has been on the rise for the last decade. In some countries, local governments have started redesigning property taxes to foster green investment. In the United States, for example, local governments use various property tax incentives for boosting energy efficiency and the use of renewable energy. Other countries (the Czech Republic, Italy, Norway and Spain) offer tax relief for adopting renewable energy solutions. While the environmental effectiveness of this policy tool must be assessed in the future, these examples show possibilities for local governments to use taxation as policy tool in shaping the local business environment.[37]
5. **Enhanced enforcement of fiscal laws.** Strengthening tax governance has gained in importance in the last decade. Related recommendations stress the need to improve tax compliance through administrative simplification, e-taxation development, and bolstering the enforcement and consultative capacities of national tax authorities. Such measures are often linked to broader changes in government services, including the use of new information and communication technology (ICT) and digital tools. ICT and digital tools are not only useful for enhancing tax collection, they can also help combat the informal economy.

TEXTBOX 34.
Enhancing tax collection in Latvia and France with IT solutions and machine learning

Latvia and France increasingly use technology and artificial intelligence to optimize tax collection and combat fraudulent tax reporting by businesses. In 2015, the Latvian Ministry of Finance and State Revenue Service (SRS) started efforts to reduce the tax gap, minimize the occurrence of tax fraud, and enhance public revenues. In partnership with the European Commission and the World Bank, a multi-annual plan was designed that focused on improving the administrative capacities of the Latvian SRS and adopting a structured, risk--based, IT-driven approach to detect tax evasion. Through training and IT development, staff were prepared to better recognize different forms of fraud. Since this project is still ongoing, figures on the final results are not yet available. According to an ex-ante impact assessment, tax revenues are expected to increase by 4% if the reform project is fully completed.[38] Moreover, in 2018 the SRS began to develop a taxpayer rating system based on various company-level data available to the SRS (such as company financial indicators, salaries paid, declaration discipline, tax debt and registration risks). The rating system produces target ratings that indicate the quality of a given company's social and economic role, and whether the company is a reliable counterparty in tax transactions as well as its business and employment relations. Companies can view their target rating in the SRS electronic declaration system, and have the option to decide whether these ratings may be published.[39]

Similarly, in France a special government task force called Etalab has run a pilot project in collaboration with the Ministry of Economy and Finance and the Bourgogne-Franche-Comte regional administration to develop machine learning algorithms to identify companies at risk of going bankrupt and to detect potential tax fraud. The so-called "Weak Signal" (Signaux Faibles) project has produced software that analyses company-level data (such as social contributions, employment and financial data) and produces a graphic interface that lists companies and their calculated risk of failure. The software is being used as part of a broader regional programme striving to provide appropriate support to companies before they fail. As records show, during the pilot period, regional authorities conducted on-site visits of 24 companies and offered active government support to 19 enterprises.[40]

TEXTBOX 35.
Estonian tax policies for promoting liquidity at the company level

In 2000, Estonia became a frontrunner by introducing zero tax on retained and reinvested profit.[41] On one hand, this provides an incentive for reinvestment in companies to support growth, innovation or other business needs. On the other, it moves the moment of taxation to when profits are paid out to the owners of the capital (i.e., when dividends are distributed, shares are sold, etc.). Although overall corporate tax revenues dropped initially, a few years later they had increased nearly fourfold and have remained stable since.[42] Estonia has generally favourable tax rates for both corporate and property taxation. It also offers the possibility to pay taxes fully online.

These policies explain why Estonia has ranked among the top countries in the International Tax Competitiveness Index for the past seven years. Inspired by the Estonian experience, similar corporate tax policies were implemented by Romania and Latvia in 2014 and 2018, respectively.[43] More recently, Hungary and Poland have announced that they will introduce zero corporate tax on reinvested profits to mitigate the effects of the COVID-19 crisis and to support economic recovery.[44]

While the popularity of tax policy instruments among OSCE participating States is generally high, it is likely that their effectiveness will depend on the time period and the characteristics of the related economic sectors or companies. For example, international assessments suggest that tax credits can be particularly effective in supporting start-ups or knowledge-intensive companies (which often need time to generate positive taxable income). However, in other cases tax credits can be distortive.[45]

For this reason, recommendations for tax policy reforms focus

increasingly on reducing the general tax burden and the complexity of taxation systems, rather than selectively introducing tax incentives.[46]

This approach can be seen in the example of Croatia.

TEXTBOX 36.
Comprehensive tax policy reforms and ICT in Croatia

Rates of taxation in Croatia are quite high, in fact they have been well above the EU average for the last decade. In response to this, and in line with international recommendations for tax administration simplification, the Croatian Ministry of Economy launched a comprehensive tax policy reform package in 2017. The main goals were: i) simplification of the tax system, ii) streamlining of tax reporting and administrative obligations, and iii) modernizing the tax administration agency via re-organization and improvements in taxpayer services by means of digitalization and expansion of e-taxation services. In the first year, reductions in corporate and personal income taxes and in social security contributions were introduced. Moreover, real estate transfer taxes were streamlined, and tax registration procedures were simplified.

In 2019, the Croatian Government stepped up its efforts, with further amendments to the General Tax Act and a Tax Administration Information System Development Strategy. The amendments introduced further cuts to the tax burdens of SMEs, as well as to taxation of labour and acquiring property. Reporting requirements for companies were cut radically, to once a year from the previous four times a year. The Act also enables complaints or appeals to be submitted electronically to the tax authority, as well as the possibility of converting accounting documents from paper to electronic format, and vice versa.[47]

While it is still too early to assess the full impact of Croatia's reform process, a mid-term evaluation undertaken by the World Bank on measures related to the revenue administration's modernization has noted that the new website of the Croatian Tax Authority provides more user-friendly information on tax legislation and amendments to tax laws. Moreover, the rate of electronic filing of value-added tax and corporate income tax returns has become close to 100%. Nonetheless, the evaluation recommends that continued efforts be made to reduce the complexity of tax forms and the number of administrative steps taxpayers must take to meet their taxation obligations.[48]

4.4.3. Tax reforms and economic cycles

While tax reforms are important and can help enhance a positive business and investment climate, it should be noted that taxation is also heavily dependent on economic cycles. Indeed, economic cycles can be volatile and are often unpredictable. In times when countries need to reduce their national debt and pursue so-called fiscal consolidation, governments are prone to increase the overall tax burden, including both direct taxation (e.g., income tax, or specific sectoral) and indirect taxation (consumption tax). During periods of economic growth, reducing the overall tax burden (including administrative costs of compliance) is often more easily achieved. Notably, the COVID-19 crisis has posed severe challenges to businesses to maintain operations. In response, governments have introduced measures allowing businesses to defer tax and social security payments, or even to partly cancel tax obligations for a certain period of time. In the OSCE region, measures of this kind have been quite common. While such measures have given some leeway to companies to adjust during the current crisis, they are not sustainable in the long term and will likely need revision.[49]

4.5. The importance of investment promotion and facilitation

Improving the national investment climate is a top priority for many countries, including in the OSCE region. After all, foreign direct investment (FDI) offers many benefits for receiving countries. Not only does FDI help finance socio-economic development, it also contributes domestically to technological advancement and knowledge transfer. In addition, FDI is often a pathway toward better integration in international trade markets via global supply chains.[50]

As discussed in Section 3.3.1., key determinants of FDI are market size, growth perspectives, openness to international trade, and relevant policy structures.[51] Government actions that seek to promote and facilitate foreign investment therefore frequently focus on these elements by adjusting relevant laws and regulations, adopting tax-policy incentives, or initiating efforts aimed at reducing administrative barriers. Another popular avenue for promoting and facilitating foreign investment has been to set up special economic zones and industrial parks, or establishing investment promotion agencies (IPAs).

4.5.1. Investment promotion agencies

Investment promotion agencies (IPAs) were introduced in the 1980s. They grew rapidly in the 1990s due to the opening of markets in Eastern Europe and the former Soviet Union, as well as the liberalization of FDI regimes.[52] Traditionally, IPAs have performed several key functions: supporting investors, cultivating and projecting a favourable image of the country as an investment destination, and advocating investment-friendly macroeconomic policies.

Today the role of IPAs is gradually changing, with one of their functions now investment retention and facilitation. Another focus has shifted to supporting domestic companies in efforts to expand their markets and business networks internationally.[53]

Crucial to the success of IPA activities are clear trade policy mandates and strategies, close collaboration with other governmental investment institutions, and sufficient financial and human resources.

In addition, IPAs are thought to perform best when their functioning and set-up resembles the private sector. This can be supported, for example, by persons from the business community being appointed to IPA boards.[54] Better performance and accountability can also be ensured through monitoring and assessment, as well as gender parity and inclusivity. All of these factors are essential to the design of future IPA strategies.[55]

In accordance with new investment policy frameworks promoted by the UNCTAD and the OECD, many OSCE participating States are currently reviewing their investment policies. A number of new IPA mandates have emerged that include the various functions listed above to better embed strategic goals in broader development policy contexts. The emphasis is on inclusiveness and sustainability.[56] Several examples of recent positive IPA practices in the OSCE region are discussed in Textbox 37, below.

TEXTBOX 37.

IPA strategies and a selection of inspiring practices: Czech Republic, Latvia, Poland and Turkey

Since its establishment in the early 1990s, the Czech investment promotion agency CzechInvest has managed to increase investments and jobs substantially, despite facing a number of economic and organizational challenges. By 2014, the agency had successfully attracted and facilitated a record high of 147 FDI projects, which have generated investments of €3.32 billion and more than 16,800 jobs. This was done by means of a balanced mix of investment promotion tools, above all, tax incentives and the establishment of special economic zones. In 2018, FDI inflow accounted for €12,713 per capita in the Czech Republic, which is outstanding compared to its peers in the region. Czech-Invest has distinguished itself also globally through a strong focus on R&D intensive sectors, as well as sectors with high value and innovation potential, such as the health and pharmaceutical industries, ICT, and advanced manufacturing. A key element of the CzechInvest operations is its well-organized network of regional offices. More recently, Czech-Invest has put considerable effort into supporting domestic companies (primarily start-ups) in acquiring necessary know-how for succeeding in foreign markets. Within the framework of the so-called CzechAccelerator, CzechMatch and CzechDemo programmes, the agency is currently offering mentors and tailor-made company advice to more than two hundred start-ups. The agency has also developed a monitoring and evaluation toolkit that applies a complex set of key performance indicators (KPIs) to assess the agency's progress in its main tasks.[57]

The Polish Investment and Trade Agency (PAIH) actively advocates various sectors in Poland that use artificial intelligence (AI). The PAIH has been deeply involved in developing the Poland's Artificial Intelligence Strategy, facilitating public–private dialogue between relevant stakeholders, and co-ordinating public–private consultations. The agency regularly publishes databased reports on the AI status of leading Polish sectors. For example, it is active in the promotion of the Map of Polish AI (an investor-oriented analysis of barriers and opportunities for AI in Poland), and uses such input in its policy advocacy.[58]

The Investment and Development Agency of Latvia (LIAA) is part of a dynamic environment of more than four hundred innovative start-ups in the country. The LIAA targets start-ups with a wide variety of support tools (mentoring, business travel, acceleration funds, innovation vouchers, and science commercialization). The agency is currently operating fifteen business incubators. It also has three specialized funds: its "Build it" fund targets object start-ups, the "Commercialization Reactor" fund reaches out to deep-tech start-ups, and the "Overkill Ventures" fund provides financial assistance to software start-ups. The LIAA is also active in policy advocacy at the international level. It operates offices in several EU Member States (including Denmark, France, Finland, the Netherlands and the United Kingdom) as well as in the United States to help connect Latvian companies efficiently with international government and business stakeholders.[59]

The investment promotion agency in Turkey is its Investment Office, which is directly subordinate to the Presidency. The investment marketing services provided by the Office are based above all on the recognition that country- and sector-specific information plays a crucial role in the early stages of investment decision-making processes. The Office's most important role is thus to provide information about investment and business opportunities in Turkey. The Office publishes several guides (on legal questions, taxes, investment incentives, and acquiring property and citizenship in Turkey). These guides are easy to access on the Office's website and are written in an easy-to-read style.[60] Recently, the Office collaborated with Turkish Airlines and set up an "Invest in Turkey" splash page on the Turkish Airlines website. Travelers who connect to the Turkish Airlines Wi-Fi network at the national airport business lounge are automatically directed to the splash page. In addition to well-structured marketing information on investment opportunities in Turkey, the page also offers an application to download with detailed sector-specific data and testimonials.[61]

▲ **Local and international entrepreneurs demonstrate their products at the trade fair *„South Expo 2019"***

Osh, Kyrgyzstan, 2019

IPAs operate in a highly competitive environment and are often active in policy advocacy. They provide international investors with detailed information about the national public policy context, as well as about available national support funds. They frequently monitor foreign investors' perceptions of the host country and give formal and informal feedback to governments. According to a survey conducted by the OECD and the IDB in 2017, in the OSCE region, Canada, the Czech Republic and Turkey are the countries dedicating the most resources (in terms of both staff and budget) to policy advocacy.[62]

TEXTBOX 38.

Digital tools for IPAs and post-pandemic economic recovery: The example of Estonia

The Estonian Investment Agency has taken a proactive part in the Estonian government's COVID-19 response by supporting stakeholders and investors with digital tools during the pandemic. The Agency launched a chatbot and other e-consulting services, initiated virtual business visits for investors during lockdown periods, and leveraged the country's information technology capacity and experience in e-government. In December 2020, Estonia received an UNCTAD award for excellence in its COVID-19 response.[63] IPAs in other countries have also endorsed the use of technology, such as introducing automation to handle incoming enquiries. This can improve the ability of IPAs to support economic recovery substantially, given that digital channels are increasingly important for maintaining commercial relationships, including with foreign investors.

4.5.2. The importance of industrial parks and their new forms

Industrial parks are planned and developed with the aim of giving space to industrial activities that need specific types of infrastructure and commercial services. As an important element of the business climate, industrial parks have the potential to create jobs and boost innovation. By creating skill-based, high-quality job options within national borders, in many economies industrial parks play a significant role in reversing the so-called brain drain phenomenon – the outward migration of highly skilled workforce (especially youth). There is a wide variety of types of industrial parks in the OSCE region: special economic zones (SEZ), early reform zones, export-processing zones (EPZ), free trade zones (FTZ), bonded zones, high-technology parks (HTP), agro-industrial parks (AIP) and eco-industrial parks (EIP).[64]

Eco-industrial parks offer significant business advantages and have emerged as an effective approach to sustainable growth, since they often use resources efficiently and are geared to improving productivity. They also help achieve corporate social responsibility by reducing risks associated with climate change.[65]

According to the definition of the United Nations Conference on Trade and Development (UNCTAD), special economic zones (SEZs) are "geographically delimited areas within which governments facilitate industrial activity through fiscal and regulatory incentives and infrastructure support". In the last decades, SEZs have grown in popularity: there are currently over 5,400 special economic zones in 147 countries, compared to only 845 SEZs in 93 countries in 1997.[66] SEZs in different types of economies have various objectives. While in high-income economies, SEZs have the objective of logistic and technical efficiency, in low- and middle-income economies their main goal is usually to advance the business climate and bring employment and technological improvements.[67]

While over the last decades the more traditional types of industrial parks (such as SEZ, EPZ and FTZ) have dominated policy practices around the globe, there is a growing interest of policymakers and private actors alike to establish and collaborate in more specialized forms of technology parks.[68] For example, to boost innovation, sectors oriented towards science and technology are pushing governments to join forces with private actors to establish high-tech parks near universities or scientific research institutions. France, Ireland, Italy, Spain, Sweden and the United States are among the countries that first introduced such initiatives. The Technology Park Ljubljana is a good reference case for OSCE participating States with lower income levels (see Textbox 39, below).

TEXTBOX 39.

The Technology Park Ljubljana, Slovenia

The Technology Park Ljubljana (TPJ) was launched in 1994 as a pilot project by private companies. It is an exemplary start-up ecosystem with more than 300 member companies that until today have created around 9,000 jobs at the innovation hub. The park offers business support services that are subsidized by public funds. The facilities are co-owned by the municipality of Ljubljana, which joined the initiative in 2004. The Slovene Ministry of Economic Development and Technology and the Slovene Enterprise Fund (SEF) are the public members of the network, along with more than two dozen other private partners (including venture funds, business angels and accelerators). Co-leading the initiative is Venture Factory (a private venture capital organization). The TPJ offers start-up support services and also provides a platform for selecting aspiring start-ups. The TPJ has also initiated a special workgroup at the Slovene Ministry of Economic Development and Technology, which has prepared reports mapping and analysing the obstacles to start-up ecosystems developing more dynamically. The park management is also intensively engaged in building regional partnerships with science parks and centres, as well as other start-up networks in the Central European and Balkan region. The TPL is currently the leading or a participating partner in several interregional projects, with partners from Austria, Croatia, Hungary and other EU countries. The park management is keen to share its experiences and lessons learned about its public–private partnership-based governance model with peer organizations in the Western Balkan countries.[69]

TEXTBOX 40.

The Graphisoft Park, Hungary

The Graphisoft Park was established by a Hungarian 3D-design software company in the late 1990s with the key objective of attracting talent and reversing the brain-drain of highly skilled Hungarian graduates to more developed countries. It currently has more than 5,000 employees and hosts over 1,000 students. With 75,000 square metres of office, lab and educational space (with a 98% occupancy rate),[70] the park hosts several large companies from the high-tech sector (including Microsoft and Canon) and the pharmaceutical industry (Thales Nanotechnology). It also offers lab space for R&D centres (SAP, Servier), and has a Start Up House that provides offices and mentoring to high-tech start-ups. Since 2014, the park has housed the Budapest campus of the International Business School as well as two smaller educational institutions with curricula in IT and environmental studies. Based on its innovative IT-focused collaborations with actors from the business sector and higher education, the park has been characterized as the "Silicon Valley" of the Central and Eastern European region.

TEXTBOX 41.

The High-Tech Park of Kyrgyzstan

Over the past few years, the Kyrgyz IT sector has developed rapidly. The country now hosts a growing number of IT companies and tech start-ups. In 2008, the Kyrgyz Software and Services Developers Association (KSSDA) first floated the idea to create a high-technology park. Supported by the government, the Law on the High-Tech Park (HTP) of the Kyrgyz Republic was adopted in 2011 as the HTP's legal basis. The law establishes a special legal zone for the HTP, including a tax regime for its tenants and fiscal and insurance premium benefits. The HTP supports domestic high-technology industries, computer science and education, and also fosters a more export-oriented economy. The so-called "park residents" do work in various fields, such as producing and testing software for private and State-owned companies, creating call-centres and internet projects, and conducting business process outsourcing. HTP developers have also been involved in the creating an e-government system for Kazakhstan, and in the automation of banking payment systems in Kazakhstan and Russia. The park's annual revenues increased from US$2 million in 2015 to nearly US$13 million in 2019.[71] Most of the products developed at the park are exported (80%), with destination countries including Canada, Japan, Kazakhstan, Russia, Ukraine, the United States and various European countries. India and several African countries are also among its customers.

4.5.3. Eco-industrial parks

Eco-industrial parks are defined as dedicated areas for industrial use where sustainability is ensured by integrating environmental quality aspects into planning, management and operations.[72] Eco-industrial parks are gaining momentum as more countries make efforts to curb environmental damage and assist transitions to green policies. Eco-industrial parks develop or adopt eco-conscious practices, such as pollution control mechanisms, sustainable waste disposal infrastructures, or utilization of locally available raw materials and energy sources. In 2018, the number of eco-industrial parks globally had reached 250.[73]

TEXTBOX 42.
The NÖ-Süd Industrial Zone in Austria

The NÖ-Süd Industrial Zone in Austria is a fully developed eco-industrial park comprising altogether 370 companies and employing around 11,000 people. It houses both Austrian SMEs and international companies. The park offers various business support services, such as a one-stop service with direct links to the public authorities of the province of Lower Austria, business networking opportunities and conferences, and co-ordination of joint company media efforts. The park also helps recruit highly skilled workforce for its companies by collaborating with local vocational schools in neighbouring municipalities. The park gained an eco-friendly qualification by setting up a central wastewater treatment plant in 2017. It also maintains 100,000 square metres of green space, which provide recreational areas and a positive landscape image for the park's member companies.[74]

In 2019, International Guidelines for Industrial Parks were issued by UNIDO. These guidelines stress the need for developing not only competitive but also inclusive and sustainable parks, in line with the UN's 2030 Agenda for Sustainable Development. A series of environmental safeguards for industrial parks are presented in the guidelines, these based on a holistic approach beginning with the planning phase of a park and continuing through all dimensions of its operation and management. It is recommended that along with normal economic performance indicators, systematic evaluations should be undertaken of the social and environmental performance of such parks.[75]

UNIDO has also developed an International Assessment Framework for Eco-industrial Parks, in which UNIDO and its international partners have elaborated a list of criteria and performance indicators for eco-industrial park assessments. UNIDO has also organized field visits, interviews and workshop sessions with local stakeholders at selected parks. Rates of compliance with the criteria list add up to a total eco-industrial park (EIP) scoring; these scores show the proportion of prerequisites and performance indicators that are being met. The EIP scoring framework is a useful resource for self-assessment by park owners and managers in the OSCE region, since it offers a practical roadmap on how to undertake shifts to greener industry and technology.[76] In 2020, the first international assessment covered fifty industrial parks in eight countries. It has shown that EIPs comply on average with 57% of the UNIDO's criteria.

TEXTBOX 43.
Assessment of four industrial parks in Ukraine

Ukraine was the only OSCE participating State included in the UNIDO's 2020 international EIP assessment. The four selected industrial parks performed with an average EIP scoring of 41%. Interestingly, public–private partnerships appeared to be an important mechanism for success: the industrial parks in the sample that are managed by private actors or public–private partnerships showed better performance (i.e., higher scores) than parks under State ownership. The assessment project was used in Ukraine to set new target EIP scores for the four parks. The projected goal is an average of 27% in improved scores.[77]

4.6. State-owned enterprises

While governments regularly take part in commercial transactions, some governments prefer to do so via special companies that are either fully or partly owned and controlled by a State or local governing body. A commonly used definition of State-owned enterprises (SOEs) is the one formulated by the OECD, namely, "enterprises that are under the control of the state, either by the state being the ultimate beneficiary owner of the majority of voting shares or otherwise exercising an equivalent degree of control."[78]

4.6.1. Presence and economic importance of SOEs globally and in the OSCE region

SOEs are important business actors since they create economic value by offering high-quality public services in sectors that cannot be (fully) open to competition. For example, sectors characterized by a network infrastructure are often dominated by natural monopolies owned by the State (e.g., energy, transport, telecommunications). In other cases, governments may argue that certain commercial activities are of strategic importance for the country (e.g., financial services, telecommunications, air transport), or require activities that generate losses (e.g., microfinancing, or providing broad band internet connections in remote rural areas, where clients' ability to pay may be limited). These cases may justify more active ownership by governments, ownership that goes beyond the usual market regulatory role.

SOEs make up a significant proportion of many national economies, albeit with regional variation, and over time, many have expanded their operations from domestic markets to cater to global clients as well.

The number of SOEs among the Fortune 500 largest companies worldwide increased from 9.8% in 2005 to 22.8% in 2014 (mostly driven by a steep increase in the number of Chinese SOEs).[79] In many countries, a significant share of employment and assets are held by SOEs. In 2015, the OECD estimated that the total value of SOEs is over US$2.4 trillion and the number of their employees is over 9.2 million people.[80]

Numerous governments in the OSCE region own a substantial number of companies.[81] France, Kazakhstan, Lithuania, Poland and Russia are the "leaders" among the countries in the OSCE region with a large number of sectors (above twenty) with at least one State-controlled company. In these countries, State presence is most dominant in mining, finance, energy, public utilities and transport. According to OECD data, direct State control in the form of owning majority shares or the government having special voting rights (e.g., golden shares) is the highest in Russia, followed by Turkey and Kazakhstan.[82] In contrast, in Denmark, State ownership is concentrated in the transport sector, together with the State lottery company.[83] The number, scope of sectors and economic role of SOEs also vary greatly across the OSCE region, although the governance and political challenges faced by SOEs in these countries may seem similar. While governments have different approaches for tackling these challenges, there are a number of good practices that can be identified and promoted.

4.6.2. Strengthening SOE performance through privatization or restructuring

The performance of SOEs has sometimes been considered less optimal than that of private companies.[84] Recent developments, however, have shown that exposing SOEs to some degree of market pressure (through partial or full liberalization of the sector) whilst protecting them from political influence or corruption can result in SOEs performing as well as private companies.[85]

Extensive or poorly managed State ownership can have a number of negative consequences, including low productivity, low innovation levels, poor quality or high prices for essential public goods, or lower returns on equity.

Poorly managed SOEs may also require fiscal resources (subsidies or government bailouts) that could have been spent on improving other public services, such as public education or healthcare. And finally, since SOE management can be influenced by political rather than economic considerations, this can also lead to the misuse of public (investment) funds. In such cases, SOEs can even hold back the development of the private sector, or deter both foreign and domestic investments. Such circumstances pose significant challenges to a positive business and investment climate.

Over the past decades, progress in technology and public regulation has paved the way for the gradual opening of certain sectors, particularly manufacturing, finance, telecommunication and transport, and allowing for their privatization. As such, privatization of SOEs can be an important tool in countries where State ownership is extensive. Ideally, however, privatization should not be a goal in itself. It is best as part of broader government reforms. This can ensure that privatization meets broader goals, and does not fall prey to the misappropriation of SOEs by narrow-interest groups.

▲ **Speakers at the Conference „Business integrity, international standards, regional challenges and the way forward", held in Tashkent**

Uzbekistan, 16 December 2019

Privatization can bring significant benefits, but it should be designed carefully.

Political commitment and transparency of the process is crucial if privatization is to contribute successfully to development in the private sector. Moreover, the gains in operational efficiency and productivity that are expected from publicly listing company shares or selling whole companies should be part of wider market and sectoral reforms. They should also be accompanied by improvements in the legal and regulatory environment.

The experiences of large-scale privatization in the 1990s, especially experiences in Central and Eastern European countries such as Hungary and the Czech Republic, have shown that when undertaking privatization, sectoral regulations often need revising, the capacities of sectoral regulatory bodies and competition authorities need to be built up, and judiciaries need strengthening.

At the same time, it is also important to launch mitigating measures to tackle negative social and environmental implications of privatization. Examples are the re-training of ex-employees of SOEs, offering other active labour policy support to improve their chances of finding new jobs, or requiring and enforcing green investments from the new private owners.[86]

TEXTBOX 44.
Privatization in Kazakhstan

In 2016, SOEs still produced close to 50% of Kazakhstan's GDP. The government committed itself to an ambitious privatization programme, the first step in 2013 and the second in 2016. The second step aimed at bringing the number of SOEs closer to the OECD average (15%).[87] Two new government agencies have been set up to support the structural market reforms: the Agency for Strategic Planning and Reforms, which oversees the management and monitoring of the reform agenda, and the Agency for Protection and Development of Competition, which focuses on restructuring and regulating major SOEs. Originally, the list of companies marked for privatization included 874 (fully or partially) State-controlled entities. By early 2020, close to 500 of the original listed companies had been sold to private owners. To sell small State- or municipality-owned enterprises, the Kazakh government set up an electronic auction system.[88] It was planned to undertake the privatization of key State assets – such as the national oil and gas company and the national railways – through public offerings at the London Stock Exchange and the Astana International Financial Centre. This has been postponed due to the COVID-19 pandemic and the resulting negative prospects for international capital inflow. But the sale of smaller companies continues and the ambitious goal to reduce the economic share of SOEs in Kazakhstan is still upright.

4.6.3. Improving the corporate governance framework of SOEs

Improving the corporate governance framework of SOEs is an additional policy avenue for enhancing the performance of such companies. Ideally, this step can also lead to more inclusive, green and sustainable economic development in SOEs. In literature on SOEs, a positive governance frame work is often referred to as "active state ownership". This concept guides discussions on how SOEs, which often play a dominant role in the market, can also be used to showcase and diffuse good practices in business integrity and transparency, as well as in environmentally and socially conscious business conduct.

SOEs have strong standard-setting abilities and thus can have an important positive influence on business partners and stakeholders. In national contexts where corruption is a problem, SOEs can exemplify good anti-corruption practices for the business sector as well as for the broader society.

Governments can also drive ethical and socially responsible business practices through the activities of SOEs. Enhanced transparency and accountability of SOEs can improve the business climate and attract investment, since both factors strengthen predictability and thus contribute positively to investor confidence. There are three main aspects that are effective for generating positive change in SOE performance. **First**, to enhance their operational efficiency, SOEs should be exposed to market pressure. **Second**, they should be insulated from political interference. **Third**, it is very important that SOEs maintain the highest possible level of integrity. A broad array of recommendations for improving SOE performance and integrity have been formulated in recent years by academia, trade unions, business representatives, CSOs and various international organizations.

Landmark frameworks in this context are the OECD Guidelines on Corporate Governance of State-Owned Enterprises,[89] and the OECD Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises.[90] These guidelines are the gold standard when it comes to governance and integrity of SOEs, and are a unique internationally agreed-upon benchmark on how governments should exercise their SOE ownership rights, and how governments and SOEs can enhance and maintain integrity.

TEXTBOX 45.

The OECD Guidelines on Corporate Governance of State-Owned Enterprises

First drawn up in 2005, the OECD Guidelines on Corporate Governance of State-Owned Enterprises were updated in 2015 to include developments since their adoption, and to reflect the experiences of the growing number of countries that have taken steps to implement them. The guidelines give concrete advice to governments on how to align management and regulation of their SOEs with standards used in the private sector. The guidelines are complementary to the OECD Principles of Corporate Governance and based on the vision that ultimately, the public is the owner of SOEs. That means that SOEs should be accountable to the general public to the same degree, for example, that listed companies are to their shareholders.

The key OECD recommendations focus on several thematic areas. First of all, they separate SOE ownership from the government's role as a business regulator. SOEs should be governed independently.

4

4.6.3.1. STRONGER AND ACCOUNTABLE OWNERSHIP POLICIES

Since SOEs are established on an institutional basis, the corresponding public policy objectives and purposes should be clearly defined. Purposes may include social goals, provision of public goods, or the existence of a natural monopoly. In most countries, governments express their public ownership rationale in specific legislation (Estonia, Germany, Latvia, Poland) or via government decisions or resolutions (Finland, Norway, Switzerland). Such legislation designates specific bodies to exercise public control. There is also an emphasis on the need for a transformed role of the State that shifts from "steering" (i.e., management activities) to "rowing" (i.e., ownership functions). Through contractual agreements, responsibilities may be shared between SOEs and the State. This can lead to enhanced autonomy of SOE management and further corporatization through the establishment of a separate executive board. For instance, legislation in Estonia enables the government as an owner to influence operational decision-making and implementation of policy objectives only through shareholder meetings. This clearly differentiates between managerial and ownership functions. It not only reinforces the autonomy of SOEs, but also minimizes political interference effectively.[91]

4.6.3.2. INDEPENDENT, NON-POLITICAL BOARDS

The next step towards a more efficient and transparent SOE regime is to have board members with professional expertise who have been selected in a transparent, competitive and merit-based way. It is preferable if SOE board candidates have private sector or business expertise and have been screened and assessed based on publicly communicated professional requirements. Merit-based selection better guarantees that board members will be able to improve operational efficiency and service quality. For example, in Canada a formal and public process requires SOE boards to set up a board profile identifying potential directors for appointment. Board candidates in Portugal are screened and vetted by the Committee on Recruitment and Selection for Public Administration, with choices based on publicly communicated criteria. And in Lithuania, the annual aggregate report on SOEs includes information about all board members for each SOE in the country, and identifies those who are considered independent (i.e., are not civil servants, nor have been politically appointed).[92]

It is considered good practice to promote gender diversity on boards and in SOE management, for example, by using voluntary targets or boardroom quotas. Such steps are taken in Belgium, Canada, France, German, Italy, Norway and Sweden. Requirements regarding gender parity are a progressive tool that promotes equal chances for female professionals.[93]

While competitive selection of SOE board members is legally possible in many countries, politically based board appointments are still the norm. Such appointments potentially prevent SOEs from functioning like corporations in their economic activities.

4.6.3.3. STRENGTHENING OVERSIGHT

Oversight makes it easier to respond to risks of SOE economic or market failure. It also enables better monitoring of overall performance. Annual as well as quarterly financial reports and other oversight measures also support pre-set policies and financial objectives to be met, and allow for more accurate annual performance plans. Annual plans of SOEs may include clearly defined objectives and targets based on earlier fiscal, financial or macro performance of the SOE portfolio.

The monitoring and evaluation of such plans are important for minimizing the risk of failing to meet desired targets.[94]

Most countries with evaluation measures use aggregate reporting tools to monitor the financial performance and value of SOEs. These tend to focus on the implementation of policy objectives, composition of boards (including information about gender diversity), and annual funding and costs. However, recent reports on SOE governance practices suggest that few countries use aggregate reporting to monitor the overall performance of SOEs, although such monitoring could significantly curb corruption.[95]

Sweden provides a good example: its Division for State-Owned Enterprises, the country's central SOE co-ordinating agency, publishes an annual aggregate report. Also the Netherlands publishes reports on individual SOEs. These aggregate reports usually cover progress in implementing State ownership policies, the financial performance of SOEs, data about total employment, and information about the composition of SOE boards. Kazakhstan provides another good solution in linking reports on the financial performance of individual SOEs to an online SOE inventory called The Register of State Enterprises and Agencies.

In sum, enhancing the performance of SOEs requires clear government foresight regarding the goals of State ownership, separation of government ownership and regulatory functions, and systematic and consistent financial oversight or audits. Lithuania provides an interesting example of how such a complex reform process can be undertaken (see Textbox 46, below).

TEXTBOX 46.
Enhancing the performance of Lithuanian SOEs

Historically, in the OSCE context Lithuania had (and still has) a relatively large number of SOEs. They operate in a similarly large number of sectors (160 SOEs in 22 sectors in 2015). Following a comprehensive overview of its SOE portfolio and recommendations from the EU and OECD, Lithuania launched an SOE reform package in 2010. Its aim was to improve the performance results of Lithuania's SOEs. To begin, the Lithuanian Government issued a set of guidelines on transparency and ownership. The guidelines set various accountability standards, including criteria for nominating and appointing chief executive officers and for assessing SOE management.

They also define minimum criteria for board members, including competency and independence. Second, a specific government agency, the Governance Coordination Centre (GCC), was set up to strengthen ownership co-ordination. The GCC monitors SOE performance and implements State ownership policy, in line with the Ownership Guidelines as well as standards issued by the Ministry of Economy. Third, the Government made efforts to remove politicians and place more independent directors on SOE boards.[96]

As the result of these reforms, the average financial performance of SOEs in Lithuania has improved in the last decade. Moreover, more substantial information on Lithuanian SOEs has been made publicly available. The GCC publishes an annual aggregate SOE sector report. This report provides an overview of the main laws and regulations concerning SOEs and a summary of the progress of State ownership policy goals. It also includes an assessment of individual SOEs with regard to transparency, board independence and competency, and their quality of strategic planning. A unique component in this annual report, uncommon in the OSCE context, is a section dedicated to the estimated costs of SOEs implementing "special obligations" and the amount of compensatory funding provided by the State.

More recent reform measures in Lithuania are aiming to strengthen corporate governance practices still further by regulating all SOEs with commercial activities through company law (instead of their being subject to statutory legislation). Moreover, any more favourable treatment of SOEs that still exists is being phased out in order to level the playing field in sectors where private actors also operate.[97]

4.6.4. Integrity-driven SOE governance and its importance for a positive business climate

Public ownership comes with enhanced responsibilities. Such responsibilities are even greater if a State is acting as the ultimate beneficial owner and thus is playing a role as an economic actor. In this case, the State is expected to lead by example, such as regarding human rights, labour conventions, etc.[98] A key concept in this regard is that of "active ownership". This means that the rights and position of State ownership are used to influence the activities or behaviour of SOEs to ensure they serve the public good. SOEs have been established to integrate public interests into their operations and to create public value. The involvement of the government in SOEs can enable them to adopt and diffuse business standards that have a positive influence on business partners, stakeholders and clients. Such standards can include integrity-driven corporate governance, or enhanced business awareness of climate change and social responsibility.

TEXTBOX 47.

The OECD Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises

The OECD Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises were adopted in 2019 to serve as a complement to the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The new guidelines contain important chapters on State integrity as the owner of SOEs, how State ownership can enhance integrity, how SOEs themselves should engage in efforts to ensure meaningful anti-corruption efforts and support integrity, and on the accountability of the State and SOEs in all of these areas.

4.6.4.1. TOOLS FOR INCREASING TRANSPARENCY: GOOD PRACTICES IN PUBLIC REPORTING AND AUDITS

There are several tools that SOEs can consider using to increase transparency, reduce corruption risks, and improve operations. SOE reforms as well as digital technologies can play an instrumental role in this process.

As discussed above in Section 3.1.4., Ukraine has made significant strides forward in combating corruption by adopting the ProZorro platform. Ukraine has also embedded this platform in broader regulation. For example, SOEs are now required to use this centralized system for procurement and to submit public financial statements. Also other countries have instated programmes towards similar ends.

TEXTBOX 48.

SOEs in Estonia

Estonia provides a good example in government SOE transparency. The website of Estonia's Ministry of Finance publishes information about all companies in which the government is a (co-)owner, including the State's share in these companies and the companies' financial status. According to this list, as of 2021 the Estonian Government was the full or a majority owner of 29 companies. Most of these companies provide basic infrastructure services or transport.[99] Estonian SOEs have been quite profitable, as can be seen in the dividends received by the general Government. Between 2005 and 2014, on average these dividends have improved Estonia's budgetary position by 0.9% of GDP. Thus these companies are a small but stable source of income for the budget.[100]

TEXTBOX 49.
The Budget and Fiscal Risk Statement of Georgia

In Georgia, the Government has implemented a number of programmes aimed at strengthening the country's fiscal sustainability. In this context, it has undertaken and published a number of risk assessments. Some of these assessments regard Government risks related to SOEs. Georgia's Budget and Fiscal Risk Statement discloses information about transfers between the Government and SOEs. The Statement includes information about direct transfers to SOEs, such as subsidies, equity provisions or loans, as well as exposure to non-debt guarantees, such as letters of comfort. The Statement also includes aggregated data on income and balance sheets for about three--quarters of the SOE sector (65 SOEs). Furthermore, the State budget now has an annex that analyses macroeconomic risks. The Ministry of Finance also performs enhanced assessments of fiscal risks emanating from SOE activity, including assessments based on selected financial ratios. It then classifies SOEs into different categories based on the degree of risk they pose.[101]

TEXTBOX 50.
Improving corporate governance in State-owned financial institutions: Citadele Bank, Latvia

Several reforms have been initiated in the last years by the Latvian government to enhance good corporate governance of SOEs. Many of these involve the centralization of SOE governance and more effective implementation of corporate governance principles. The Latvian SOE Citadele Bank is a financial group that provides banking and management portfolios for individuals as well as companies. It currently has €22.8 billion total assets. Among the Baltic States, Citadele Bank has been recognized as a leader in good corporate governance. The Bank now answers to the Latvian Ministry of Economics, the Ministry of Finance and the Latvian Privatization Agency (LPA). The restructuring of the Bank involved the introduction of several good practices[102]:

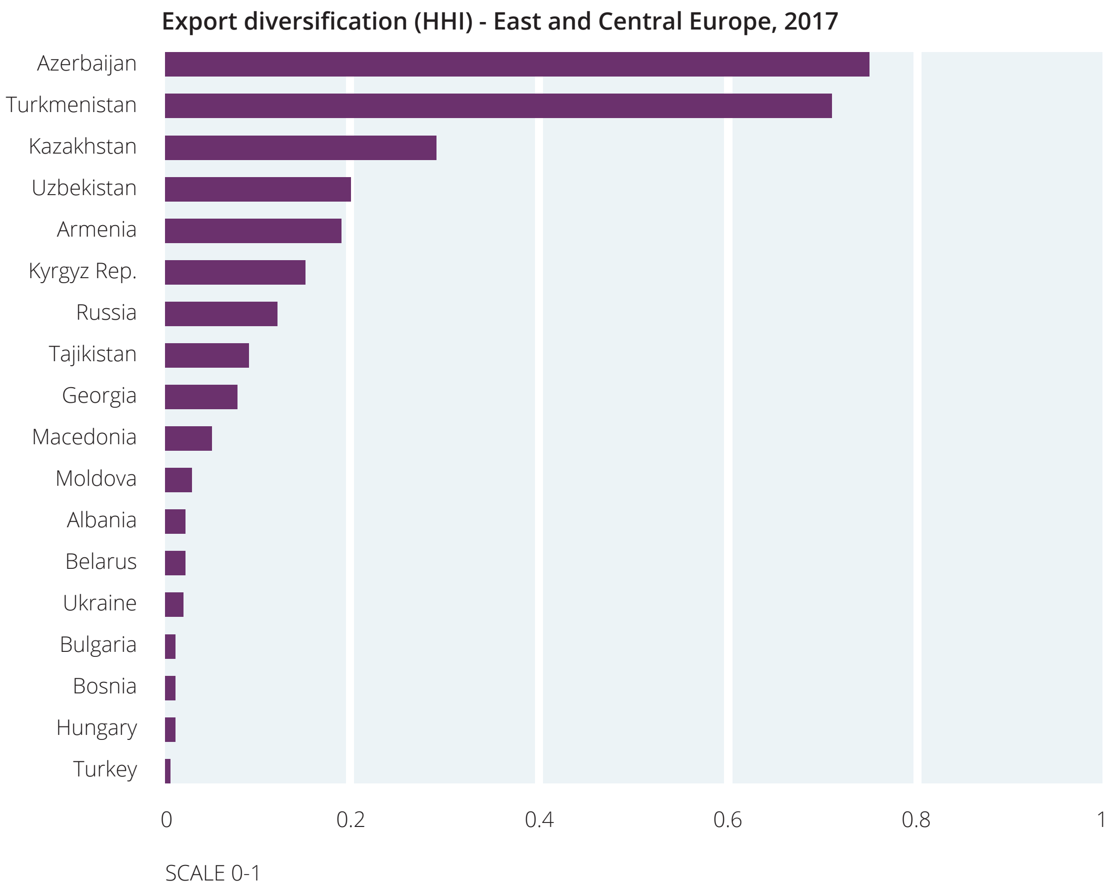
- A committed leadership focused on good governance reforms of the SOE;
- Limited extension of State oversight measures from an independent State owner, namely the Latvian Privatization Agency;
- The establishment of a committed, independent board, enabling the successful delivery of necessary reforms;
- Board members with relevant international and local professional experience, including bank management, risk management and restructuring;
- The company fully operational in competitive markets, further boosting its performance.

The commitment of Citadele Bank to good corporate governance is also illustrated by its strict internal control system. The Bank operates with a management board and a supervisory board, in addition to its shareholders, with whom regular meetings are scheduled. Citadele also has an audit committee reporting to the supervisory board which issues annual audit reports based on the audit plan. Risk assessment is carried out by a risk and governance committee, which regularly monitors risks, ensures the sufficient inclusion of risk pricing, issues regular risk management reports, and provides professional recommendations.[103]

4.7. Economic diversification

Economic diversification is a key element in economic development. Diversification involves a country moving away from a single income source and seeking to attain more diverse production and trade structures. It is the process of shifting an economy away from a dominant activity towards a range of activities. Countries with a strong single sector, such as energy or extraction industries, often base their development on the growth of a limited group of companies. Frequently these companies are State-owned. Extreme cases of non-diversified economies may lead to the so-called "Dutch disease", in which an increase in the economic development of a specific sector, such as natural oil resources, leads to a decline in other sectors, for example, the manufacturing sector or agriculture.[104] A lack of economic diversification is associated with increased vulnerability to external shocks, and can undermine prospects for long-term economic growth. Reliance on a single product or service can even lead to significant drops in growth figures, and may have a lasting negative impact. The COVID-19 crisis has shown that this problem is not only limited to extractive industries. It can also be seen in over-reliance on the tourism sector. Countries where tourism is a large component of the GDP have suffered greater setbacks than those with more diversified economies.[105]

Table 5. **Diversification levels in East and Central Europe (using Herfindhal-Hirschman indices [HHI] of market concentration.**[106]



Economies overly reliant on extractives are also likely to experience negative effects of the COVID-19 crisis, since the crisis has led to a decline in energy consumption at the global level. Countries that are leading exporters of oil and gas whose economies are focused on energy resources will suffer more reduction in export revenues than those with multiple exporting sectors.

Over half of low- and lower middle-income countries depend on oil and gas for their exports. These revenues have been classified by the OECD as "fragile".[107]

Diversification encourages structural transformation aimed at positive economic growth and development. This is particularly the case for SMEs that are not part of a dominant industry supply chain. Benefits are twofold: on one hand, economic resilience is increased; on the other, through sustainable economic growth, poverty is reduced. Such benefits can be achieved when diversification is integrated into sustainable development plans. To expand institutional capacities, diversification measures, including methodologies and tools, must be developed and disseminated. If similar economies exchange experiences and opportunities, this can support such efforts.

TEXTBOX 51.

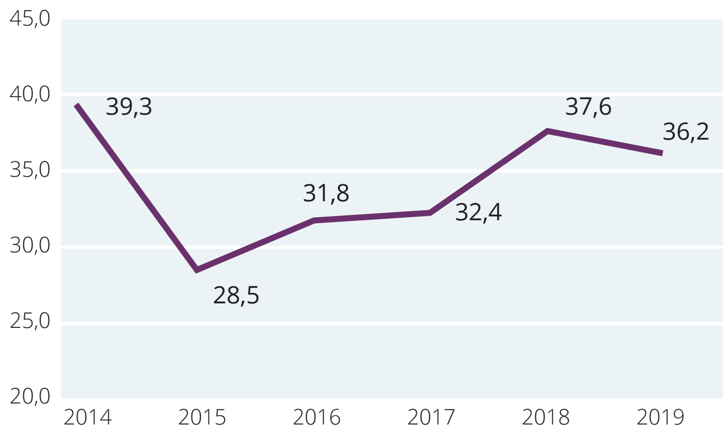
Kazakhstan – Successful practices to kick-start a process of economic diversification

After achieving independence in 1991, Kazakhstan successfully restructured its economy and propelled itself in to becoming one of the economic leaders in Central Asia. In 2006, it entered the upper-middle-income group of countries, driven by its strong economic growth drawn from its extensive use of natural resources, particularly the exploitation of oil and natural gas. The oil-and-gas sector contributes about a third of the country's public revenues, which in turn support Kazakhstan's fast-paced development and growth, and enable it to invest in more infrastructure, and at the same time to uplift the social conditions of its people through reducing poverty, improving access to primary education, and promoting gender equality and women's empowerment. Kazakhstan significantly reduced poverty from 46.7% in 2001 to 2.6% in 2016.

Under a new state programme, by 2021 agricultural production is targeted to increase by 30%, productivity by 38%, and the annual agri-food trade balance by $1.42 billion, relative to 2015. Goals also include stimulating domestic trade and improving water use efficiency. As discussed in Chapter 2, Kazakhstan's accession to the World Trade Organization (WTO) in 2015 has further increased its access to external markets and enhanced competition and vertical integration, and should lead to higher productivity in the sector.

Chart 2. Kazakh exports as percentage of GDP by year

Source: World Bank macroeconomic indicators



Another government programme aims to stimulate competitiveness in the manufacturing sector, oriented to labour productivity growth and an expansion of exports of manufactured products. The targets in the same period include: 19% real growth in manufacturing exports, and 22% real growth in labour productivity in manufacturing, also promoting export-orientation and reducing State ownership.

Source: Asian Development Bank. 2019: Kazakhstan – Accelerating Economic Diversification.

4.7.1. Implementing economic diversification strategies

Strategies for economic diversification range from enabling basic access to utilities and importing know-how, to manufacturing new products and services designed for export. The focus should be on sectors identified as capable of improving export sophistication, since these are the sectors that can be transformed into high-value-added areas. Clear policy frameworks can support efforts to take advantage of opportunities and address product-specific constraints.

To increase diversification, governments can take the following steps:

a. Formulate, co-ordinate, implement and monitor sector development programmes and strategies. Starting with a poverty reduction strategy, develop a national development strategy or economic diversification strategy that reviews and streamlines existing national agendas. Set up a high-level co-ordination working group to institutionalize the process and create benchmarks for the strategy.

b. Establish a dialogue with the private sector and address investment constraints. The government should work in close collaboration with the private sector to identify and address problems in the business environment, with a focus on those sectors facing constraints in inward investment. Together with the private sector, develop strategies on how to expand the country's exports and increase sophistication levels in order to accelerate growth and create jobs.

c. Develop new sectors or support sectors that are lagging economically. This cannot be achieved without human capital development and innovation. Lack of skill sets and technical know-how hinders sector development. Thus, such development can be supported by improving the quality of primary and secondary education and encouraging on-the-job training and apprenticeships. Moreover, taking a gender-balanced approach and engaging women on an equal footing adds value to economies and entrepreneurships (see below, Section 4.9.), and can thus also support sector development. Moreover, for product competitiveness, innovation, digitalization and process re-engineering, investments in research and development are needed. Such investments can come from development agencies, as well as public and private resources.

d. Removal of infrastructure bottlenecks. Transportation, logistics and utility access must work towards increasing trade and diversification, especially in making exports more competitive. Long-term structural investments in these systems may thus be needed. This might also involve investments from the public sector, which is best done through public–private partnerships or monitoring mechanisms that involve civil society organizations such as entrepreneur associations. Green investment benefiting the environment may be part of these steps (see below, Section 4.10.1.).

4.7.2. Projects and tools that support economic diversification

There are several methods for enhancing economic diversity at the State level. While many strategic and development initiatives require top-down management, there are also several successful examples of bottom-up approaches. These often include a significant regulatory advocacy component.

While economic diversification, as described above, requires high-level engagement, the case studies presented below also elaborate on how sector approaches taken at the business level can move towards the same objective.

An example of strengthening sector work from Georgia demonstrates how an entire value chain can get a boost with minimal strategic input and using a bottom-up approach (Textbox 52).

TEXTBOX 52.
Developing value chains: Initiatives in Georgia

Established in 2017 with the support of the German development agency GIZ (Deutsche Gesellschaft für Internationale Zusammenarbeit) within the European Union's "EU4Business Initiative" framework, the Georgian Film Cluster has united forty leading companies and professionals in Georgia's audio-visual industry. The Cluster aims to promote the Georgian film industry abroad, establish links between Georgian and international film producers, identify new opportunities for training and apprenticeships abroad, and serve as a united voice to lobby industry interests and programmes with the Georgian Government and the Cluster's international partners. Since the start of the project in 2017, turnover in the Georgian film industry almost quadrupled (see Table 6, below).

A diverse membership base enables the Cluster to offer its clients a full range of services. These include customized, integrated production and post-production services, as well as standalone services at any stage of the production process. The main activities of the Cluster have been identified as private–public dialogue, skill development and internationalization. However, initiatives in the area of taxation, co-production contracts, copyrights and intellectual property have also been undertaken. As one first such step, the Cluster proposed needed changes to Georgia's Tax Code.

Table 6. Growth of the Georgian film industry

The above Table 6 presents the growth of the Georgian film industry through the activities of the newly formed Cluster[108] vs. the baseline 2016 prior to the launch of the Cluster's operations.

TEXTBOX 53.

OSCE support for economic diversification in the Syunik region of Armenia

The OSCE has long recognized that the province of Syunik in Armenia is heavily reliant on the mining industry. Indeed, mining has dominated the local economy for decades. Pilot research showed that the area has significant potential for tourism and expansion of agricultural production. The local skills to move this agenda forward, however, have proven insufficient. With the support of the OSCE Office in Yerevan,[109] a project was initiated to promote job creation and income generation in these non-mining industry sectors. Following a series of meetings with the local stakeholders, an Economic Diversification Plan was completed. With OSCE support, an Investment Forum was organized by the local administrative bodies in November 2013. The Plan was adopted at this forum and later approved by the Armenian Government in February 2014.[110]

The Plan has aimed at diversifying local industries and putting together a variety of investment projects in the form of business proposals. These proposals have been carefully formulated and are detailed enough to be ready for fundraising or private sector investment. They range from revitalizing the local airport and building a plastic waste processing plant, to developing food processing capacity and leasing agricultural machinery and tools to local farmers. At the macro level, the Plan has also aimed at increasing taxes payable to the national budget in order to contribute to the socio-economic development and stability of the country. Central to the Plan is ownership by local stakeholders and the provincial government, with support from the central administrative level. A number of the proposed investments have attracted private funding or donor grants. This has resulted in a new tile factory being set up, revitalization of the airport, and a range of new machinery being made available to local farmers. These developments all stemmed from projects originally proposed in the Plan.

4.8. Reducing the informal economy

Informal economic activity presents different, but often severe challenges to the business and investment climate. In most countries, the expression “informal economy” refers to the “shadow” or “grey” economy. This is not because the enterprises and the workers employed by them produce illicit goods, but is because they fail to comply with registration, tax or other bureaucratic requirements to formally engage in economic activity. Their activities are therefore different from criminal or illegal activities (such as arms or drug production, which is subject to criminal laws). There are also grey areas where an economic activity is part of both the formal and informal economy, as for instance when formal workers are given undeclared remuneration, or when groups of labourers in formal enterprises work without being properly registered. Another variation involves legal enterprises not declaring all of their economic activity, with some of their operations therefore falling in the grey area.

In short, informality is an institutional problem. Moreover, it involves a degree of mistrust between the authorities and citizens.

Lack of confidence in governmental institutions leads people to evade paying taxes or social contributions, chiefly because they believe the returns on that investment are not worth it.

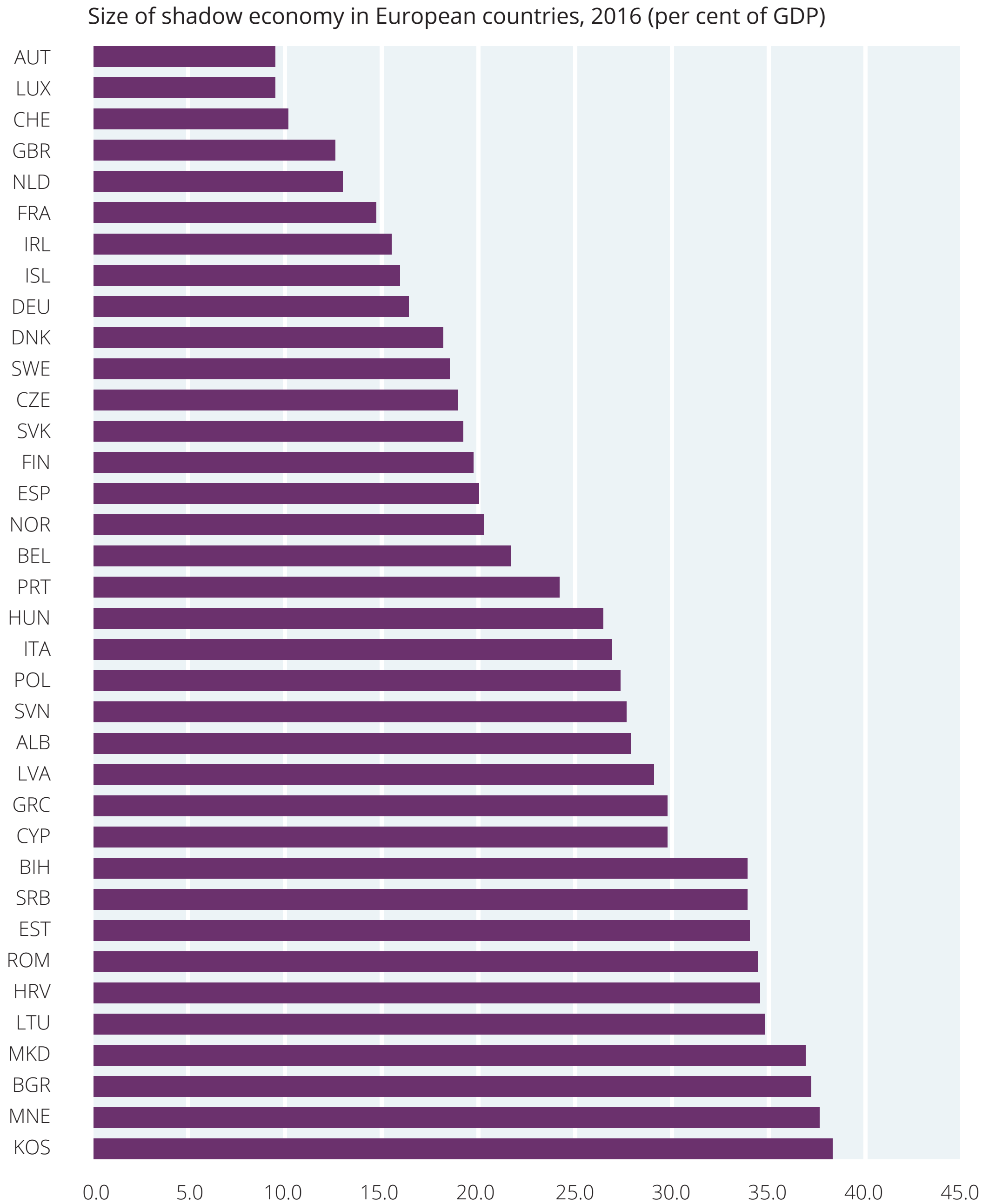
International studies suggest that lower entry costs and improved information sharing on financing opportunities are associated with larger numbers of formal businesses. In turn, high exit costs are linked to a larger informal economy.

To reduce informality it is therefore key to provide financial support in the form of welfare bridges and well-tailored (market and business) information for small entrepreneurs who are willing to step out of the shadows. The issue of policy coherence with social policies and social security systems deserves special attention in view of promoting economic empowerment, especially on the part of groups that are often marginalized or vulnerable (such as women or ethnic minorities).

In advanced economies the shadow economy is estimated, on average, at around 15% to 20% of the GDP; in emerging economies it is around 30% to 35% of the GDP.[111] The ILO estimates that six of ten workers worldwide fall under some form of informality. Moreover, it estimates that eight of ten enterprises are informal, with these enterprises providing 52% of the world's employment.[112]

While estimates cannot yet be made with any accuracy, the COVID-19 crisis has increased the level of informality around the globe. Governments have focused on preserving jobs rather than formalizing the informal economy.[113]

Table 7. **IMF estimates of the size of shadow economies in Europe, 2016**

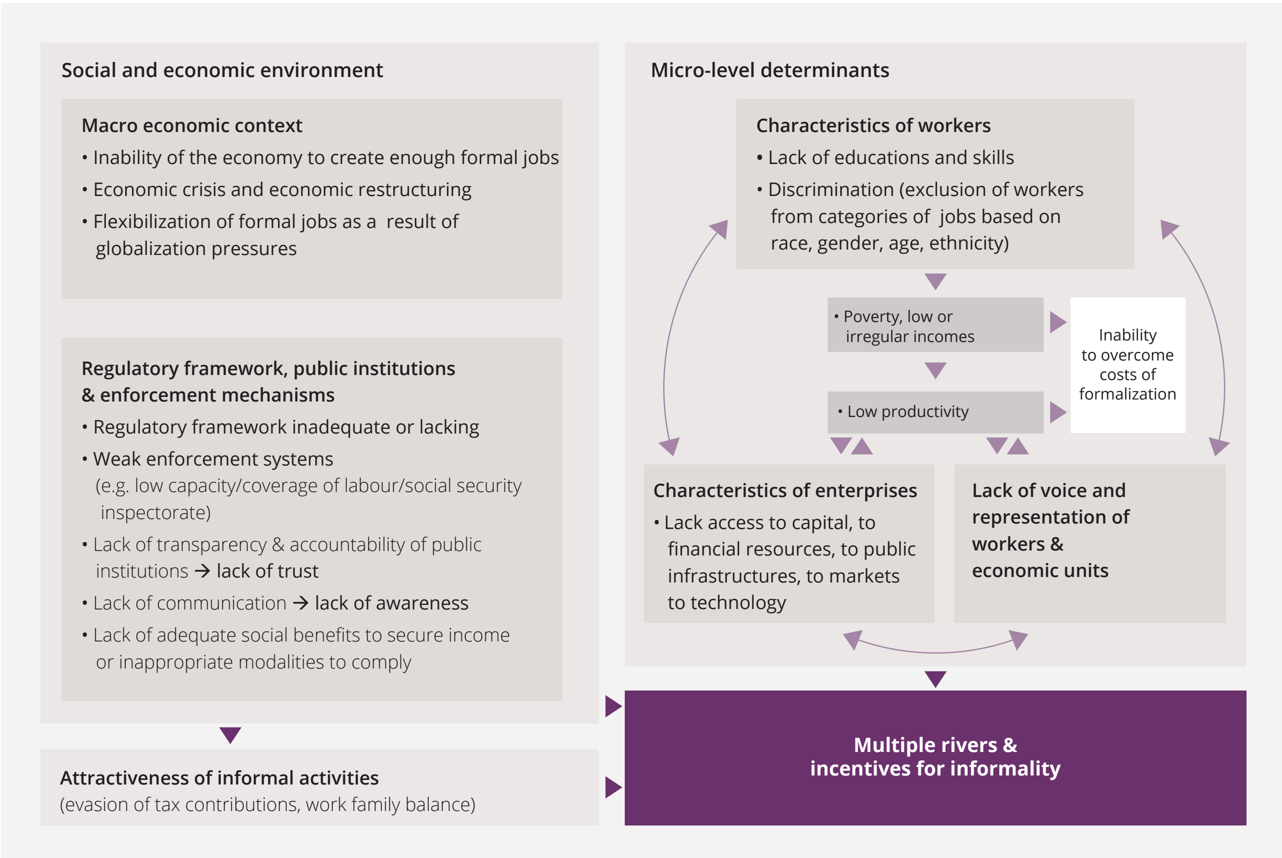


Source: IMF staff calculations

4.8.1. Drivers of informal economic activity

A better understanding of the drivers of informal economic activity is vital for addressing the possible negative impacts such activity has on the business and investment climate. Typically, most people enter the informal economy not by choice, but due to reasons motivated by (business) survival. Some enterprises operate informally because inappropriate regulations and excessively high tax policies result in prohibitive costs of formalization, posing barriers to market entry. Moreover, poor quality of public services and lack of market information, insurance, technology and education exclude entrepreneurs from the benefits of formalization. Corrupt or inefficient environments also stimulate operating outside the legal zone, since high transaction and compliance costs might additionally involve dealing with corrupt or inefficient bureaucrats. Especially in circumstances of high unemployment and poverty, the informal economy has significant potential for job and income generation because of the relative ease of entry. The informal economy serves as a social buffer and helps meet the needs of poor consumers by providing accessible and low-priced goods and services. It also enables enterprises that are otherwise burdened by various fiscal and parafiscal duties to keep their head above water and remain in business. In many cases, they would be unable remain in business if they complied completely with all requirements, or are operating in an investment climate without a level playing field. Therefore, in some instances, the informal economy saves jobs, jobs that are simply not entirely regulated. Nonetheless, although informal economic activity may fulfil essential economic functions, long-term sustainable economic development is bettered by increasing the formalization of economic activity. The figure below summarizes how context affects decision-making at the company level, including employees, decisions about remaining informal, or what efforts must be undertaken to formalize a business.

Figure 3. Main drivers of informality



Source: OECD/ILO (2019), Tackling Vulnerability in the Informal Economy, Development Centre Studies, OECD

4.8.2. Limiting the negative impact of informal economy activity on the business and investment climate

Unregistered and unregulated enterprises often do not pay taxes or social benefits and other entitlements to workers, thus posing unfair competition to enterprises that are in compliance. In turn, however, most informal labour has little or no social protection, whether from employers or governments. While workers and enterprises in the informal sector may not contribute to the tax system, this is possibly because only so can they survive financially. And yet, such situations deprive a government of public revenue, thereby limiting the government's ability to extend social services.

4.8.3. Reducing the administrative burden

Regulatory and administrative simplifications aimed at diminishing both market entry and exit costs in terms of expenses and time spent on administrative obligations provide important avenues for shifts toward formal entrepreneurial activities. Various aspects of this are covered in the above chapters of this publication, particularly the use of technology, business friendly regulation (see Chapters 2.1)

While reducing regulatory and administrative barriers to entry is necessary, this is insufficient for systemic change. There is consensus that systemic government efforts need comprehensive policy packages involving co-ordinated and simultaneous measures across various policy areas. Such measures include simplifying taxation schemes, easing conditions for tax compliance (such as reducing tax burdens for micro- and small firms), relaxing rules for hiring and firing employees, partnering with business associations or civil organizations to offer information or in-person counselling, fighting corruption, improving the availability and quality of public services, and, last but not least, strengthening enforcement with effective penalties.[114]

Tackling the informal economy therefore requires re-aligning an economy's formal and informal institutions. Not only does this mean changing norms and values or educating citizens, but also changing formal institutions to improve trust in government.

Similar to the steps for economic diversification described above (Section 4.7.), reducing the size of the informal economy requires educating employers and workers about the benefits of formalization vs. the threats of remaining informal. It also needs close collaboration between the private sector and the public one. Part of this is making the voice of the informal economy heard. Surveying entrepreneurs operating in the shadow parts of an economy can shed light on their rationales against becoming formal.

Governments are thus well-advised to encourage and support conducive macro-economic, social, legal and political frameworks for creating sustainable jobs and business opportunities. Ideally, this can be achieved through a dynamic approach toward promoting well--functioning labour markets and related institutions (labour market information systems and credit institutions). With regard to tax avoidance and tax evasion, policies should aim at expanding the tax base and ensuring fair taxation. Such reforms should also be accompanied by reducing tax bureaucracy and reporting requirements, coupled with effective prevention and correction mechanisms. Finally, education of entrepreneurs and taxpayers and an effective communication strategy is vital for strengthening compliance. The costs and complexities for registering enterprises and the workforce need to be reduced, and a systemic strategy for aligning policies, regulations and institutions needs to be put in place. All of these steps will generate incentives for formalization, since it will become easier, less costly, more feasible and more attractive.

4.8.4. Projects and tools for formalizing the informal economy

It is critical to determine the driver of informality at the outset of any related reforms. Similar to the issue of economic diversification, this ideally requires an overarching formalization strategy on the part of the government. Recent examples of formalization strategies include experiences from Greece, Moldova, Mongolia, Tajikistan, Turkey and Ukraine.[115] Moreover, mechanisms for monitoring and measuring progress need to be set up.

A mechanism for tripartite negotiations between the government, employers and the workforce has been a key to success in the following examples.

Such negotiations can address the priorities of the State, the desire of employers to remain competitive through fewer payments (both fiscal and parafiscal), and the need of workers to operate legally and under full social protection. These interests diverge; the challenge is to bring them to a common denominator. For this reason, policies shift from measures aimed at suppression (or reduction) of the informal economy to measures aimed at increasing formalization. Ultimately, the cost-benefit calculation of staying informal or moving to formality will determine the impact of such reforms. As an economy modernizes and grows, in addition to greater general productivity and profitability, informal companies can be increasingly incentivized to formalize.

TEXTBOX 54.

Efforts in Moldova to formalize the informal economy

Moldova has been working systemically for over a decade to move the grey economy into regular channels. Currently, the returns for taxes paid are perceived by many in the population as insufficient and the phenomenon of undeclared wages is widespread. A study undertaken in 2011 by the Moldova Ministry of Labour, Social Protection and Family estimated that 57% of the employed population had not fully reported their salaries in 2010. The existing regulatory framework, relatively high costs for loans, and constraints on technological absorption and innovation, combined with low chances of being identified or penalized, low fine levels and low levels of conviction in the justice system are the key factors driving the informal economy in the country. According to the national Bureau of Statistics of Moldova, in 2018 the “non-observed” economy in the country was estimated at 25.1% of GDP.[116] Informality is concentrated in a few sectors: agriculture, construction and trade in the informal production sector, and hotels and restaurants as hidden production within the formal sector.

Of the total employed population in 2013 in the Republic of Moldova, 30.9% had an informal job. Of these jobs, 68.7% were in the agricultural sector. Since 2013, the number of informal jobs has decreased in almost all sectors except construction. While informal employment in formal sector enterprises affected more than 60,000 people in 2013, it had decreased significantly since 2003.[117]

As possible solutions, the following measures could be identified: reducing the cost of formal economic activities or creating incentives for their formalization, and promoting skills and providing opportunities for members of the population more likely to be trapped in the informal economy. These measures could be supported by: easing administrative burdens on firms; easing access to financing for companies working formally; transparent, well--communicated and well-understood fiscal policies; providing tax incentives for SMEs working formally; providing incentives for start-ups and for investment in technologies and know-how; and increasing enrolment of young people with low education or skills in training programmes.

TEXTBOX 55.

Reducing the undeclared workforce in Greece

Research undertaken in Greece has shown that undeclared work is concentrated in a limited number of sectors and occupations, most notably in agriculture, construction, distributive trades, hotels and restaurants, and among domestic workers. The size of the undeclared economy is usually estimated as equivalent to some 25% of Greece's GDP.[118] After reaching a tripartite agreement in 2015 (between the International Labour Office [ILO], the Government of Greece and various social partners in Greece, and the European Commission's Structural Reform Support Service [SRSS]) on the main characteristics and drivers of informality, a road map for addressing undeclared work in Greece was designed. The road map contains a balanced regulatory and policy framework for preventive and corrective measures to facilitate transitions to the formal economy and tackle undeclared work.

In addition to more intensive surveillance, stricter penalization and higher fines for undeclared workforce, Greece took steps to modernize its migration policy. Policy reforms in this area included three regularization amnesty steps, simplification of permit procedures, and easing of residence permit renewal procedures. The country also improved interagency collaboration and administration, conducted targeted country--wide campaigns in selected sectors (including awareness campaigns), and made use of an integrated information system. Greece has thus followed a well-organized, multidimensional plan with activities in several policy fields. One of the aims was to overcome all obstacles, including regulatory, administrative and technical.[119] The objective in Greece of transforming undeclared work into declared work is slowly becoming reality.

4.9. Economic empowerment of women and gender-sensitive policymaking

Women are one of the key drivers in economies, whether as consumers, part of the workforce, suppliers, administrative stakeholders, or as business leaders. Nonetheless, overall they are underrepresented in the business world as entrepreneurs or as chief company executives. Several studies have shown that the global economy would benefit significantly from the greater inclusion of women in entrepreneurship and if women had a greater role in economies that brought them closer to parity with men.[120] At the company level, for example, research has shown that companies with more women in senior executive positions are often more profitable.[121] Such companies also often exhibit better corporate social responsibility.[122]

This has led to increasing global efforts to mainstream gender in business, both from the regulatory (macro) side, and through guidance to companies at the company (micro) level.

There is a growing body of research which finds that gender-sensitive business environment reforms have the potential of positively impacting the economic empowerment of women. Such reforms support the creation of jobs. Globally, the increase in incomes could add up to

US$12 trillion

by

by 2025.[123]

However, gender equality is not only important in business enterprises. It can also enable growth and development. The Food and Agriculture Organization (FAO) has calculated that if women had the same access to productive resources as men, they could increase yields on their farms by 20% to 30%. This could raise total agricultural output in developing countries by 2.5% to 4% (see also Section 2.1.4.2.).

Unfortunately, the COVID-19 pandemic has shown to be negatively affecting such potential positive trends of greater inclusion of women. As the World Bank's 2020 Enterprise survey follow-up on the COVID-19 pandemic demonstrates, in a number of the countries examined, there has been a decline in the number of women among permanent, full-time workers. For example, in Albania in only 2020, the number of women in the manufacturing sector shrank by 42.5%, the largest percentage point drop. In Poland the drop has been 15.0%, while in Bulgaria it has been 2.3%. In Georgia, however, the COVID-19 crisis did not cause any gender disbalance, with the number of women in the manufacturing workforce actually increasing by 3.5%.[124]

In the OSCE context, the importance of economic empowerment of woman has been highlighted by Decision No. 10/11 on promoting equal opportunity for women in the economic sphere, adopted at the 18th OSCE Ministerial Council in Vilnius in December 2011. It calls on the OSCE's participating States to create policies and take concrete action to stimulate equal opportunities and greater engagement of women in entrepreneurship.

A number of tools have been developed to help businesses develop more equal opportunities.[125] Many of these tools are geared to support the greater inclusion of women in the economic sphere. Some provide finance support to businesses led by women or that have a significant proportion of women employees.

TEXTBOX 56.

EBRD efforts to support women-led SMEs

One programme to support women's participation in business is run by the European Bank for Reconstruction and Development (EBRD). The EBRD's Women in Business programme works with SMEs led by women. From accessing financial support to business advice, the EBRD helps increase the skills, knowledge and resources of women so their businesses can thrive. It provides access to financing through credit lines dedicated to women-led SMEs at local banks, and offers business advice to help women-led businesses become more competitive. This support is part of a service package that can also include training, mentoring and other resources to help women entrepreneurs share experiences and learn from each other as peers. Finally, the EBRD works closely with national partner financial institutions in the countries where the programme is operating to help these banks offer financial products that better meet the needs of women-led businesses.[126]

4.9.1. Gender-sensitive business environment reforms

In order to encourage women to enter business, it is critical to create favourable business environments. Women are often disproportionately affected by market barriers, such as limited access to capital, discriminatory property rights, etc. To help women overcome such barriers, additional efforts are needed.

Financial barriers include limited access to bank accounts, credit, land or property ownership, as well as other barriers; non-financial barriers include direct and indirect legislation and regulations disadvantaging women vis-à-vis men, administrative hurdles, family obligations, and other obstacles to full participation in the economy.

Self-employment or entrepreneurship provides many women with a viable option for combining family life and work. If women are supported with adequate financial and advisory services, entrepreneurship can facilitate the financial independence and empowerment of women.

Moreover, it has been shown that income earned by women has a multiplying effect: it contributes to other positive development factors, such as children's health and education.[127] Across the Europe and Central Asia (ECA) region, 32.5% of companies are partially or fully owned by women; women are top managers in 19% of the region's companies. According to figures of the World Bank, women represent exactly half of the ECA's full-time workforce.[128] While such figures are encouraging – indeed, the ECA region has greater gender parity than most other parts of the world – there is still a long way to go in promoting women's entrepreneurship to balance their share in ownership and top management.

Women's entrepreneurship contributes to economic growth through:

a. **Job creation.** Women-led businesses, like the rest of the SME sector, are an important source of job creation. An estimated 48 million female entrepreneurs and 64 million female business owners worldwide currently employ one or more persons in their businesses.

b. **Improved women's labour force participation, through self-employment.** GDP gains associated with closing gender gaps in the labour market by 2025 have been estimated in double digits for OECD countries (10% for the United States, 11% for Germany); this effect is even larger in emerging economies.[129]

c. **Improved productivity.** Adequate support for women-led businesses, through access to financial resources and quality advisory services, can help improve women's productivity by shifting women's employment from low-quality, low productivity jobs to higher-value added sectors.[130]

Governments can play an important role in women overcoming obstacles to entrepreneurship, provided governments are responsive to group-specific needs and find a comprehensive mix of policy tools.

Policies and programmes tailored to needs of specific target groups are often more effective than generic, one-size-fits--all approaches. Such policies are therefore desirable.[131] An interesting example of such a group-targeted policy approach is the French Women's Entrepreneurship Plan.

TEXTBOX 57.
The Women's Entrepreneurship Plan, France

As in many other countries, women are under--represented among French entrepreneurs. In 2012, only 30% of the companies in France had been founded by women. The Women's Entrepreneurship Plan (*Plan entrepreneuriat des femmes*), launched in August 2013, aimed to change this status quo. In the first year alone, the initiative reached 2,600 young women interested in setting up a business, and connected 130 women entrepreneurs in regional networks. By 2015 it had conducted 600 promotional events and its guarantee fund had supported 2,281 women to start a business.

The Plan, which was in operation until 2016, followed a three-step approach. First, it strived to strengthen government efforts to promote entrepreneurship with better public communication, more promotional events, and by setting up a government website to share information about gender-specific support programmes (such as training and mentoring). Second, it created and facilitated 14 regional support networks that provided mentoring to women entrepreneurs. Third, in partnership with financial institutions and a national financial network, it sought to close the information gap between female entrepreneurs and financial institutions by organizing business breakfasts and networking events. The Plan also offered loans to women entrepreneurs through the above-mentioned loan guarantee fund.[132]

There are also several EU-level and national information platforms that provide tailored information for specific groups about starting and operating a business. For example, the WEGATE website[133] established by the EU is a one-stop shop for women entrepreneurs. It is an information and network hub for women who plan to establish a business, as well as for those who are already operating one.

4.9.2. Projects and tools that support gender mainstreaming in business

The following measures can be taken to improve gender balance and ensure the broader benefits of gender parity, not only in the business sector but also for consumers.

4.9.3. Gender mainstreaming at the company level

For many companies, implementing an employee diversity performance management system is a first step toward supporting a more productive and inclusive workplace.

Such systems focus on gender disaggregated indicators. They also include guidance on how to analyse diversity performance data. Through regular monitoring and analysis of such data, senior management can make informed decisions toward developing a more gender balanced and equitable workforce.[134]

TEXTBOX 58.

International Finance Corporation support for women-led businesses

The International Finance Corporation (IFC) has recognized that aspiring businesswomen are often prevented from realizing their economic potential. It therefore has taken steps to create business opportunities for women. Some of these steps have involved efforts to mainstream gender issues to help better leverage the untapped potential of both women and men in emerging markets. The IFC provides financial products and advisory services to:

- Increase access to finance for women entrepreneurs;
- Reduce gender-based barriers in the business environment;
- Improve the sustainability of IFC investment projects.

Thus far, the IFC has worked with over 16 banks around the world, many in the ECA region, to enhance their ability to provide more targeted products and services to women entrepreneurs. Through this intervention, the IFC has invested over US$118 million, of which over US$86 million have been lent to women entrepreneurs. Moreover, over 2,200 women entrepreneurs have been given opportunities to improve their business and financial management skills (for example, through the IFC's Women's Entrepreneurship and Leadership Training Program[135]).

Providing finance and business training is based on the concept that credit is more likely to be extended to persons who have a stronger knowledge of business practices and are financially literate. Having these skills is often a predictor of how productively a credit will be used.

▲ **OSCE Training for women entrepreneurs**

Batken, 2021

TEXTBOX 59.

The impact of the Women Entrepreneurs Finance Initiative in Central Asia

The Women Entrepreneurs Finance Initiative (We-Fi), run by the EBRD, offers support for women entrepreneurs in Central Asia through its "Women of the Steppe" programme. We-Fi provides capital and know-how to women entrepreneurs to increase the competitiveness of their businesses and put them on a sound path to grow. It also supports women by offering entrepreneurial skills training and giving women matching grants to strengthen their businesses. To date, the programme's ambitious agenda of reforms and support has reached 7,000 women entrepreneurs and catalysed US$114 million in financing to women-led SMEs.[136]

The programme has brought about shifts in the financial sector by demonstrating the commercial viability and bankability of women-led SMEs, as well as by assisting financial intermediaries to better serve the needs of women as clients. In particular, We-Fi encourages investors to fund early-stage businesses led by women, for example through seed funding, which helps start-ups to expand. Businesses are also encouraged to employ a new female labour force. For example, during the COVID-19 pandemic, women working from home has been shown to be viable option.

Moreover, the We-Fi programme collaborates with governments and the private sector to improve the laws and policies that hinder women's businesses from thriving.137 This involves removing structural barriers by identifying and addressing gender biases in regulatory environments. The programme also contributes to the Women, Business and the Law ranking of the World Bank, which measures gender inequality in laws.

By actively demonstrating how women can drive productivity, profitability and performance, the We-Fi programme encourages gender equality in the workplace. This encouragement to deepen commitment to workplace gender equality has won some partners EDGE certifications,[138] the leading global business certification standard for gender equality. Finally, We-Fi builds research partnerships to expand knowledge about how to effectively support women-led SMEs, and how to increase their access to corporate supply chains.

TEXTBOX 60.
The Boyner Group's Good for Business programme in Turkey

In May 2015, the Boyner Group, in a joint initiative with the International Finance Corporation (IFC), launched its Good for Business programme, working with female managers and owners of companies that are suppliers to the Boyner Group. The programme is part of Boyner Group's broader goal of promoting equal opportunity for men and women and establishing gender equality within the company and its supply chain. The aim of the Good for Business programme was to position women-owned businesses in Boyner Group's supply chain so they and their companies could become more competitive. The suppliers were coached to become top performers and to comply with the group's social and environmental standards.

To achieve its goals, Boyner Group has aimed at:

- Raising women business owners' productivity and performance;
- Enhancing their business with Boyner and other companies;
- Expanding their knowledge of the markets in which they operate;
- Improving their business and management skills;
- Increasing their access to market and finance opportunities.

The Good for Business programme selected 23 female participants representing 20 companies in the Boyner Group's supply chain. The women of the first cohort attended 12 weekly sessions. Organized into three thematic units, these workshops combined classroom instruction and coaching linics with certified business and management trainers. Trainees also heard talks by guest speakers from other organizations in the Good for Business programme. Most important were networking events, such as a vendor fair, to introduce the entrepreneurs to potential buyers.

In the first thematic unit, women-owned suppliers learned to better position themselves in the group's supply chain by closing gaps in interpersonal and leadership skills, business and financial knowledge, access to financing, and network integration. Directed toward strengthening women's soft skills, certified trainers conducted workshops on various topics, including leadership, human resource management, communication and motivation. In these sessions, a group of successful Turkish women entrepreneurs were invited to speak.

The second unit was designed to build the women's market knowledge and relevant skills, focusing on product and customer-focused marketing, segmentation and positioning, and business-to-business marketing. A certified trainer conducted the sessions. In addition, experts with in-depth local and sector expertise, such as the Boston Consulting Group, provided their insights into the retail industry and shared market patterns and trends. This helped increase the women's business contacts and gave them valuable information for strategic planning.

The third unit focused on finance and covered topics such as financial analysis and reading and writing balance sheets. In this training block, three Turkish banks (Garanti Bank, Sekerbank, and TEB) presented their programmes for women entrepreneurs. This introduced the participants to banks offering financing products and services specifically for women entrepreneurs.

4.9.4. Regulatory reforms leading to better gender equity

When addressing the legal and regulatory barriers preventing women from full participation in the economy, it is paramount to understand both formal and informal rules and regulations, as well as local definitions and traditions. Project managers, policymakers and other stakeholders need to address both direct and indirect barriers.

Access to and control over property is a basic requirement for running a business.

It determines whether an enterprise has the necessary input, as well as the degree to which returns to the enterprise can be retained.

Given the significance of property rights in providing the ability and incentive to grow a business, addressing gender gaps in such rights removes an important constraint to women's entrepreneurship.

While not all individuals are even aware of their formal rights (or lack thereof) and not all laws are enforced, as countries develop, the role of the law grows in importance. Moreover, the principles espoused by the law shape individuals' expectations, choices and thus their outcomes. Ensuring women's property rights is therefore a central part of the broader commitment to gender equity and women's empowerment.

In addition to questions of property, women entrepreneurs can be assisted through easier business entry or registration. Given the often-conflicting gender expectations in many societies, business registration can in some cases be more cumbersome for women than for men. Addressing constraints in business registration can benefit women who have less information or time, and who are largely involved in informal businesses.

Furthermore women entrepreneurs can be assisted through increased access to borrowing and the costs involved being reduced. Women would benefit if financial infrastructure such as credit bureaus and collateral registries were expanded. Integrated credit bureaus that access microfinance credit histories and offer small loans can improve access to finance. Bureaus should not only include negative histories, such as when loans were not paid back in full, but also positive histories of successful repayment.[139]

Building credit histories may be particularly beneficial for women seeking to increase their credit but who are more likely to lack traditional collateral. Also useful would be to gather gender disaggregated data on SME financing in a co-ordinated manner and to track the success of such reforms over time.

4.9.5. Strengthen SME access to small claims courts and alternative dispute resolution mechanisms

The strong link between well-functioning court systems and access to finance for small firms has been amply demonstrated. For SMEs, the most relevant starting point is through small claims courts,[140] or improved access to court-referred mediation or alternative dispute resolution mechanisms.

Building more inclusive public–private dialogue processes by empowering women's networks and associations leads to an active participation in policy discussions (see, for example, textbox 59 above on the We-Fi programme).

Strengthening women's voices includes involving women in reform processes, and ensuring that issues relevant to women are included on the agenda.

Women's participation can reveal gender-differentiated constraints that are often overlooked in gender-neutral policies and male-dominated policymaking processes. Participation could be facilitated by including women's networks and associations in policy dialogue. A positive goal would also be increasing women's access to mainstream networks such as chambers of commerce or business and industry associations, which often have low female representation.

4.10. The environmental footprint and investment

Climate change poses environmental, social and economic risks. It is expected to have a great impact in the long term. In the OSCE context, several participating States have faced significant environmental problems connected not only to heavy industry, but also to many years of intensive exploitation of natural resources. The result has been severe damage to the stability of ecosystems, as well as worsening of the health of the population and lower life expectancies.[141] To address this and to avoid consequences that are even more damaging, change is needed now. Investors no longer assume that economic growth will continue if societies are heavily reliant on energy sectors powered predominantly by fossil fuels. This presents asset owners and investment managers with both risks and opportunities.

Climate change will inevitably have an impact on production cycles and investment returns, so investors need to view it as a new return variable.

The renewable energy sector is meanwhile expected to be the biggest winner. Depending on the climate scenario that develops, average annual returns in the coal sector could fall by 26% to 138% over the next ten years. Conversely, average annual returns in the renewables sector could increase by between 4% and 97% over the next ten years.[142] Key risks are either problems related to structural changes during the transition to a low-carbon economy due to investors being unprepared for these changes, or high physical damage to the environment.

4.10.1. Investor actions supporting transition to a low-carbon economy

Investors have two key levers in their portfolio decisions: investment/divestment and engagement. From an investment perspective, resilience begins with the understanding that climate change risks can have a significant impact at the level of asset classes, industry sectors, and sub-sectors.

Climate-sensitive industry sectors should be the primary focus, since they will be significant players in certain scenarios (such as commitments to emission reductions by 2050). Investors have various engagement options. They can engage with investment managers and the companies in their portfolio to ensure appropriate climate risk management and associated reporting. They can also engage with policymakers to help shape regulations.

Institutions such as insurers and pension funds are also becoming aware of the opportunities arising from the transition to a low carbon economy, and are working to improve the data and expertise they can call on. Nonetheless, few financial institutions would claim that they have mastered climate-related issues, nor that they fully understand the systemic risks they pose to the stability of the financial system. Players throughout the investment value chain are struggling to get to grips with this uniquely complex issue – one made even more challenging by the unpredictability of future political and regulatory responses, as well as the lack of reliable data.[143]

TEXTBOX 61.
Six Principles for Responsible Investment (PRI)

The Six Principles for Responsible Investment (PRI) are a voluntary menu of possible actions for incorporating environmental, social and corporate governance (ESG) issues into investment practices. These principles have been developed for investors by investors. The initiative was started by the United Nations in 2005. Since then the collective assets under management represented by PRI signatories has increased by 20%, from US$86.3 trillion to US$103.4 trillion as of 31 March 2020. The most recent figures represent the PRI's 3,038 signatories. Among other things, the PRI is one of the founders of Climate Action 100+, the world's largest investor-led engagement initiative[144] aimed at ensuring that the world's largest corporate greenhouse gas emitters take necessary action on climate change.[145] ESG issues have a material impact on corporate performance. They may give rise to financial stability risks via exposure of banks and insurers to large losses from climate change. The integration of ESG factors into the business models of companies – prompted by regulators, businesses' own interests, or by investors – may help mitigate these risks. While investor interest in ESG factors has continued to rise in recent years, policymakers should continue to develop standards, foster disclosure and transparency, and promote integration of sustainability considerations into investments and business decisions.[146]

The PRI is also part of the Finance Against Slavery and Trafficking (FAST) initiative. The related Blueprint provides a collective action framework for the entire financial sector and professional service providers to accelerate action to end modern slavery and human trafficking. The OSCE supported efforts to produce the FAST Toolkit, which spells out the initiative's envisaged steps and objectives.[147]

The policy engagement of PRI signatories aims at supporting sustainable recovery in the post-COVID-19 period. While this will require concerted investor action, it is also an opportunity for accelerating climate policy commitments and ensuring that they are inclusive. The PRI thus recommends the working out of detailed relevant policy steps.[148]

4.10.2. Projects and tools that can support green investment

Eco-investment or green investment involves socially responsible investment in companies that support or provide environmentally friendly products and practices. Such companies encourage new technologies that support the transition from carbon dependence to more sustainable alternatives. Green finance is "any structured financial activity that has been created to ensure a better environmental outcome."[149]

▲ **Participants of a green technology workshop for women entrepreneurs discussing key principles of solar panel**

Kostanai, 18 May 2017

TEXTBOX 62.
Georgian efforts towards a green economy: GRETA

The Green Economy: Sustainable Mountain Tourism and Organic Agriculture (GRETA) project supports the development in selected mountain areas of Georgia of new opportunities in two growth sectors: mountain tourism and organic agriculture. It aims at increasing the income of beneficiaries as well as improving the business environment in these sectors.

The beneficiaries in the first two years (2018–2020) of the project have been 400 small-scale business enterprises and producers in mountain tourism, 300 accommodation service providers, 300 other tourism service suppliers, 230 farmers in organic agriculture, 2 certification bodies, as well as 76 local villagers and inspectors.

The following results achieved in these two sectors, mountain tourism and organic agriculture, are worth mentioning. A newly established legal and policy framework[150] has enabled sustainable and inclusive development. Employment and incomes have increased due to new and better products and services, as well as through better market connections locally, nationally and internationally. Access to capacity development measures for individuals and institutions active in both sectors has improved. And finally, a system of knowledge management is in place that has enabled joint learning between public, private and civil society actors.

Direct green financing of environmentally friendly products and practices is a clear means for supporting needed changes. Various projects aimed at cleaner, cheaper and more reliable energy utilizing such financing are being conducted in Eastern and Southeast European countries. The European Bank for Reconstruction and Development (EBRD) provides guarantees on loans through the EU. These guarantees are passed on to lenders, such as local commercial banks in these countries. This allows them to provide financing for projects alongside the EBRD's own loans. This has enabled the development of several private renewable energy projects that will reduce CO2 emissions significantly. They will also introduce a number of new private investors to the sector to support the transition of these countries to low-carbon economies.

Financing of renewable energy investments contributes to climate action and environmental protection and management, thus producing climate co-benefits. It is estimated that the projects described below will increase renewable energy capacity in the countries in question by 340 MW, producing an extra 970 GWh per year of electricity from renewable sources. This will cut annual greenhouse gas emissions by equivalent to 530 kilo tons of CO2. This will help unlock these countries' substantial potential for renewable energy, promote the development of renewable energy more widely, and demonstrate how the private sector can help meet growing demands for energy.

The benefits of such projects include:

- creating jobs and raising people's incomes;
- improving people's health
- helping businesses operate more efficiently;
- making it easier to deliver healthcare and education services;
- cutting carbon emissions;
- creating additional capacity from renewable energy sources;
- increasing power production from renewable energy sources.

Specific examples of renewable energy projects include:

- The EBRD project "Green Economy Financing Facility (GEFF) for the Western Balkans" (2017–2020). This initiative provides financing for green economy investments in the residential sector, as well as to businesses who supply energy efficiency and renewable energy products and services to households in the region.[151]
- The EIB (European Investment Bank) and KfW Development Bank project "Green for Growth Fund Southeast Europe (GGF)" (2009–2025). The GGF is a specialized fund for advancing energy efficiency and renewable energies. Activities include capacity building and training for GGF partners, validation and monitoring of energy saving and CO2 emission reduction, and increasing awareness of energy efficiency and renewable energy solutions.[152]
- The GIZ project "Open Regional Fund for South-East Europe – Energy Efficiency" (ORF-EE) (2006–2020). The Fund's goal "is to support energy and climate relevant political and civil society actors, through networks in South-East Europe, in implementing required EU regulations. Regional networks supported by the ORF-EE share their experiences on implementation of energy efficiency and climate protection measures independently, and are empowered to address issues of common interest. [...] Efforts, among others, include support in developing Sustainable Urban Mobility Plans, Roadmaps, implementation of urban transportation Smart-Models (e.g. bike and car sharing)."[153]

4.11. Other government actions that support a positive business climate

In addition to creating a strong macro-economic environment, setting up business-friendly tax systems, actively promoting investment in the country, enhancing women's participation business processes, actively engaging in the protection of and responsibly manage SOEs, strengthening economic diversification, and reducing the informal economy, there are a number of other actions governments may wish to undertake to help bring about a positive business and investment climate. These include:

- Prepare an annual report on the state of the investment climate. The U.S. Department of State, for example, analyses the business climates of more than 170 economies around the world. Topics include openness to investment, legal and regulatory systems, dispute resolution, intellectual property rights, transparency, performance requirements, state-owned enterprises, responsible business conduct, and corruption.[154]
- Invest in the digitalization of public administration authorities and improve e-government services in general to further accelerate simplifications of administrative procedures for businesses. Chapters 2 and 3 of this Guide highlight good practices in this area.
- Mainstream the use of public–private partnerships (PPPs) when possible when initiating government actions designed to improve the business climate. Traditionally, PPPs were a mechanism used to realize large-scale public infrastructure projects.[155] The concept of PPP is flexible, however, and can easily be adopted in other policy areas and at all government levels. This can positively contribute to a better business climate. As discussed in Section 4.5., collaboration between public and private actors is often a key element in the success of industrial and technology parks (see Textbox 39: Ljubljana Technology Park and Textbox 41: High-Tech Park in Kyrgyzstan).
- To prevent counterfeiting of products and support increasing market valuation of locally developed agricultural products, governments can consider setting up systems that register so-called appellations of origin. Such initiatives are often the outcome of public–private consultations and represent good examples of how public–private partnerships can be further extended to new policy areas to bring mutual benefits.

TEXTBOX 63.

Kyrgyzstan Entrepreneurship Support Centres (ESCs) supporting start ups: An example of PPP

PPP-based collaborations can be useful in nurturing local business start-ups, as has been demonstrated for example by Kyrgyzstan's Entrepreneurship Support Centres (ESCs). As part of a broader international project, also supported by the OSCE, five local support centres were established in regional centres in South and North Kyrgyzstan with the aim of supporting local entrepreneurs and contributing to the economic diversification efforts of the country. City governments offered the sites for these centres, and business support services have been provided by local business organizations. The public and private parties co-operate in making access to local public services easier. The centres have developed into entry points for simplified business procedures. The first ESC established in Osh in 2017 has also started to collaborate with youth and civil organizations to improve outreach to youth and women, as well as expand training and business advice services to these groups.[156] Within 2021, the ESCs delivered more than 6,000 consultations to local entrepreneurs on different topics, including financial management, business planning and marketing, taxation, business registration, and other legal matters directly related to the entrepreneurial activities. Additionally, with the support of the OSCE Programme Office in Bishkek, the ESCs have conducted offline and online mini-MBA courses, workshops and meetings between the entrepreneurs and local state agencies to promote public–private dialogue.

4.12. Conclusions and recommendations

As discussed in Chapter 2, political, legal and regulatory contexts in a given country can greatly influence company decisions about whether to set up new business operations in the country or expand existing ones. But there are many government actions and policies that can affect business decisions.

TEXTBOX 64.

Moldova's office supporting national wine producers

Following consultations with stakeholders in the wine industry, the Moldovan Government has amended its Vine and Wine Law and established a national office to promote a new brand called "Wine of Moldova". Since 2013, the National Office for Vine and Wine is leading work aimed at streamlining licensing procedures, setting up standards across the wine industry, and creating a register that meets the EU's "place of origin" requirements. The National Vine and Wine Fund, a fund financed by both public and private sources, provides marketing support to national wine producers. The new national brand is instrumental in controlling the quality of wine products in Moldova and in boosting the market value of these products abroad.[157]

The creation of a strong and supportive macroeconomic environment with low risks of currency volatility, high inflation and excessive budget deficits helps businesses to better price their goods and services. This in turn stabilizes market prices. Simple, fair and predictable taxation that does not levy unnecessary administrative burden on companies is also an important policy tool. It stimulates private investment and supports private actors in calculating returns on these investments. The opportunity of cross-border trade is valuable for businesses if trade rules are transparent and predictable, and if the costs of trading across borders are not too high. The international standards and procedures elaborated under the WTO framework can help governments build trade relationships, thereby contributing to costs and risks related to entering foreign markets being reduced for businesses. The international system of trade and investment treaties along with international dispute settlement systems provide a framework for a more nuanced set of mutually agreed-upon rules between countries interested in open economies.

Investment promotion agencies (IPAs) play a key role in attracting foreign investors to their countries. This is done by highlighting profitable investment opportunities, identifying local business and public partners, and helping to build a positive image of national economic policies. In the last decade, a growing number of IPAs have expanded their clientele, especially innovative and export-oriented groups of entrepreneurs keen to expand their markets and business relations to countries abroad. Finally, privatization or reform of corporate governance practices of State-owned enterprises can be considered an integral part of government efforts to support the private economy.

Strengthening diversification encourages structural transformation aimed at positive economic growth and development, particularly of SMEs that are not in a country's dominant industry supply chain. The lack of economic diversification is often associated with increased vulnerability to external shocks, which undermines prospects for long-term economic growth. Reliance on a single product or service can lead to significant drops in growth figures, drops that can have a lasting impact.

The COVID-19 crisis has increased informality challenges around the globe. The focus during the crisis has often been on preserving jobs, rather than steps to formalize the informal economy. Most informal labour has little or no social protection, whether from employers or the government. Moreover, unregistered and unregulated enterprises often do not pay taxes, or social benefits and other entitlements to workers. This poses unfair competition to other enterprises that are compliant with taxation regimes.

The following goals and steps are thus recommended for governments to consider.

A STRONG AND SUPPORTIVE MACROECONOMIC ENVIRONMENT, AS WELL AS INTERNATIONAL TRADE TREATIES AND AGREEMENTS

- Strengthen institutional and legal mechanisms that make the government's commitment to fiscal consolidation credible (legislative oversight, independent budget councils);
- Prioritize balanced budgets, low inflation and predictable monetary policy;
- Those countries that are not already members of the WTO should consider accession after careful assessment of the expected benefits of expanding cross-border trade opportunities and the reduction of both tariff- and non-tariff-based costs;
- Consider harmonizing trade and investment policies at the regional level by means of trade agreements (both bi- and multilateral) and the adoption of the international rules and procedures enforced by the WTO;
- Leverage policy efforts with regional trade partners based on common economic interests to prevent harmful trade competition.

SIMPLE, FAIR AND LESS BURDENSOME TAXATION

- Set up a strong tax policy framework and make the tax system more efficient and conducive to investment;
- Adopt a whole of government approach and actively involve government agencies involved in promoting investment in the broader government decision-making process;
- Where possible and appropriate, reduce the general tax burden for businesses (including effective tax rates as well as tax compliance costs);
- Assess tax compliance costs, and when doing so, also pay particular attention to the variance of these costs by company size;
- Tailor simplification measures in tax administration in accordance with the needs of different company types (consider the disproportionally larger relative compliance costs of SMEs), and make use of e-taxation solutions;
- Enhance the institutional capacities of the national tax authority both in combating tax evasion and in becoming more transparent and responsive to business needs.

PROMOTE INVESTMENTS IN THE COUNTRY AND FACILITATE DOMESTIC FIRMS IN EXPANDING THEIR MARKETS

- Assess the fitness of the national investment policy framework based on international guidelines;
- Establish an investment promotion agency and define a balanced mix of strategic goals for it;
- Monitor and assess whether fiscal incentives are cost-effective;
- Encourage the "green shift" of business infrastructures managed by public owners (promote good models of high-tech and eco-industrial parks);
- Keep the public policymaking process regarding investment open, and invite various types of stakeholders (from business as well as government bodies, such as the education or health sectors, or municipalities) to engage in policy design and actions;
- Make better use of PPP-based collaboration to improve outreach to specific private sector groups (in particular, young/female/innovation entrepreneurs).

4

BUILD THE AUTONOMY AND MORE TRANSPARENT AND DILIGENT PERFORMANCE OF STATE-OWNED ENTERPRISES

- Improve SOE governance in line with business integrity-driven practices and international standards;
- Strengthen ownership policy and financial oversight for SOEs;
- Enhance SOE autonomy by setting up independent, diverse and professional boards, and improve SOE reporting standards via public disclosure.

STRENGTHEN DIVERSIFICATION TO ENCOURAGE STRUCTURAL TRANSFORMATION AIMED AT POSITIVE ECONOMIC GROWTH AND DEVELOPMENT, PARTICULARLY OF SMES NOT IN THE DOMINANT INDUSTRY SUPPLY CHAIN

- Holistic activities to create a sound business environment should take priority over reliance on donor or State subsidies. Sector development programmes and strategies need to be formulated, co-ordinated, implemented and monitored. Establishing dialogue with the private sector can improve the effectiveness of sector selection and in addressing investment constraints. Increased human capital development and innovation in lagging economic areas can lead to new economic sectors being developed.
- Strengthening sector diversity using a bottom-up approach boosts entire value chains with minimal strategic input. By linking SMEs, synergies are created. Such steps also lead to structured dialogue between the public and private sectors, which can also improve the overall business climate.

RECOGNIZE THAT INFORMALITY IS AN INSTITUTIONAL PROBLEM, IN SOME CASES BASED ON MISTRUST BETWEEN AUTHORITIES AND CITIZENS OR BUSINESSES

- Regulatory and administrative simplifications should aim at diminishing market entry and exit costs, as well as the time needed for administrative obligations.
- Complementing the above, various policy measures can be taken, including: simplification of taxation schemes, creating conditions for better tax compliance, relaxing rules for hiring and firing of employees, partnering with business associations or civil organizations, fighting corruption, improving the availability and quality of public services, and strengthening enforcement with effective penalties.
- Education of employers and workers on the benefits of formalization vs. threats of remaining informal; to support these efforts, close collaboration between the private and public sectors is necessary.
- Introduction of incentives to formalize, combined with strengthening of labour inspections.

GREATER INCLUSION OF WOMEN AS ENTREPRENEURS TOGETHER WITH A GREATER ROLE IN THE ECONOMY

- Gender equity can promote economic growth and improve the social performance of companies. To ensure the financial independence and empowerment of women, a regulatory framework that stimulates and encourages the inclusive participation of women is needed, as well as adequate financial resources and advisory services.
- Barriers to the financial independence of women need to be satisfactorily addressed. Financial barriers include lack of access to credit or bank accounts, or to land and property ownership. Non-financial barriers include direct and indirect legislation, regulations disadvantaging women vis-à-vis men, administrative hurdles, family obligations, etc.
- Targeted training in finance and business management for (potential) women entrepreneurs makes it more likely that credit will be extended.
- At the company level, implementing employee diversity performance management systems is a first step toward supporting a more inclusive workplace.

ENHANCING CLIMATE RISK MANAGEMENT AND GREEN INVESTMENTS ENSURES THE SUSTAINABILITY OF ECONOMIC GROWTH

- It is no longer assumed that economic growth can continue if there is heavy reliance on energy sectors powered by fossil fuels. This presents both risks and opportunities. Climate-sensitive industry sectors should be a primary focus. Investors can engage with investment managers to ensure appropriate climate risk management and associated reporting, and with policymakers to help shape regulations.
- Eco-investment or green investment encourages new technologies that support the transition from carbon dependence to more sustainable alternatives. Providing financing or funds will support such transitions. Development support is often available for this purpose.

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131 EU/OECD (2019), The Missing Entrepreneurs 2019: Policies for Inclusive Entrepreneurship. OECD Publishing, Paris.

132 See the website of the Government of France. Available at: www.gouvernement.fr/action/l-entrepreneuriat; for a brief assessment of this policy example, see: OECD/EU 2016. Policy Brief on Women's Entrepreneurship. Paris: OECD Publishing.

133 Webgate [website]. Available at: www.wegate.eu [accessed 31 Dec. 2021].

134 USAID: Gender Equality Mainstreaming for Business Growth and Impact – A Step-by-Step Manual for Investors and Capacity Builders.

135 IFC, Women Entrepreneurs Are Essential for Private Sector Development in Emerging Markets. Available at: https://www.ifc.org/wps/wcm/connect/d7623440-8bb4-4827-9ce5-470dcb6f86b1/Entrepreneurship+Offering+Brochure+July2017.pdf?MOD=AJPERES&CVID=lQps6KM [accessed 15 Dec. 2021].

136 Women Entrepreneurs Finance Initiative (We-Fi), 2019 Available at https://we-fi.org/wp-content/uploads/2019/06/European-Bank-for-Reconstruction-and-Development-We-Fi-Proposal-copy.pdf [accessed 31 Dec. 2021]

137 Women Entrepreneurs Finance Initiative (We-Fi) Annual Report, 2020. Available at: https://we-fi.org/wp-content/uploads/2021/03/WeFi-Annual-Report-2020.pdf [accessed 31 Dec. 2021]

138 See the EDGE website, available at: https://edge-cert.org/ [accessed 31 Dec. 2021].

139 One such strong example is in Austria, where KSV, the largest credit bureau in the Austrian market, collects both positive and negative information, which is then exchanged between banks, insurance and leasing companies operating across Austria. KVS is a private association owned by members. Members pay a small membership fee. The cost per report varies according to whether it is provided on- or off-line. See: Matuszyk, A. and L. Thomas (2010), "The Evolution of Credit Bureaus in European countries". *Journal of Financial Transformation* 23. Available at: https://www.researchgate.net/publication/215991962 [accessed 31 Dec. 2021].

140 An example of functioning small claim courts can be found in the United Kingdom. See: https://www.gov.uk/make-court-claim-for-money [accessed 31 Dec. 2021].

141 Stoklasa, J. (1994). Environmental Problems in Central and Eastern Europe: The Possible Role of International and Market Oriented Instruments. In Nagel, S. and Rukavishnikov, V. (eds), *Eastern European Development and Public Policy*. London: St. Martin Press.

142 Mercer, IFC, 2015, Available at: https://www.mercer.com/content/dam/mercer/attachments/global/investments/mercer-climate-change-report-2015.pdf [accessed 31 Dec. 2021].

143 EY, 2016, The upside of disruption. Available at: https://cdn.ey.com/echannel/gl/en/issues/business-environment/2016megatrends/001-056_EY_Megatrends_report.pdf [accessed 31 Dec. 2021].

144 With more than 450 investor signatories representing more than US$40 trillion in assets.

145 PRI (2020), Annual Report 2020. Available at: https://www.unpri.org/about-the-pri/annual-report-2020/6811.article [accessed 31 Dec. 2021].

146 IMF, 2019, Sustainable Finance, available at: file:///D:/OSCE/UserData/egjergji/Downloads/ch6.pdf [accessed 31 Dec. 2021].

147 Lichtenstein Initiative, Finance Against Slavery and Trafficking (FAST). Available at: https://www.fastinitiative.org/wp-content/uploads/Blueprint-DIGITAL-3.pdf. [accessed 31 Dec. 2021].

148 PRI (2020), Sustainable and inclusive: Covid-19 recovery and reform [website]. Available at: https://www.unpri.org/covid-19-resources/sustainable-and-inclusive-covid-19-recovery-and-reform/6016.article [accessed 31 Dec. 2021].

149 World Economic Forum (2020), What is green finance and why is it important? [website]. Available at: https://www.weforum.org/agenda/2020/11/what-is-green-finance/ [accessed 31 Dec. 2021].

150 Documents that have been adopted in the first two years of the project include: Mountain Tourism Development Strategy, Destination Management and Planning Strategy, and related regulations and standards.

151 The project is being implemented under the umbrella of the REEP Plus programme, in partnership with the Energy Community Secretariat. See: Energy Community (2020), Green Economy Financing Facility (GEFF) for the Western Balkans. Available at: https://www.energy-community.org/regionalinitiatives/infrastructure/donors/Regional/GEFF.html [accessed 9 Sept. 2020].

152 Ibid.

153 GIZ (2020), Open Regional Fund for South-East Europe – Energy Efficiency. Available at: https://www.giz.de/en/worldwide/31746.html [accessed 9 Sept. 2020].

154 U.S. Department of State (2021), Investment Climate Statements. Available at: https://www.state.gov/investment-climate-statements/ [accessed 31 Dec. 2021].

155 Examples of such large-scale projects are the recent Kyrgyz plans to construct a cargo terminal at Manas airport in Bishkek, or the Kazakh project to build a 66 km ring road around Almaty. The latter project has been implemented by a Turkish–Korean consortium and is being co-financed by the Kazakh Government, foreign banks, and various international organizations, such as the EBRD and the Eurasian Development Bank, among others.

156 See: OSCE (2018), OSCE-supported Osh Entrepreneurship Support Centre celebrates its anniversary [website]. Available at: https://www.osce.org/programme-office-in-bishkek/405320 [accessed 31 Dec. 2021].; OSCE (2019), OSCE helps open Entrepreneurship Support Centres across Southern Kyrgyzstan [website]. https://www.osce.org/programme-office-in-bishkek/420173 [accessed 31 Dec. 2021]. [accessed 17 Jan. 2021]; OSEC (2019), OSCE-supported Entrepreneurship Support Centre in Kyrgyzstan opens in Issyk-Kul province [website]. Available at: https://www.osce.org/programme-office-in-bishkek/438995 [accessed 31 Dec. 2021].

157 For more on this initiative, see: Chemonics (2016), Strengthening the Moldovan Wine Sector from Grape to Glass [website]. Available at: https://chemonics.com/impact-story/strengthening-moldovan-wine-sector-grape-glass/ [accessed 31 Dec. 2021].

5

Small- and medium-sized enterprises: Entrepreneurship development and promotion

The private sector is the main engine for job creation. Indeed, it is responsible for 90% of all jobs worldwide. Within the private sector, small- and medium-sized enterprises (SMEs) provide the majority of jobs in emerging markets. SMEs also represent a significant proportion of jobs in the informal economy. But SMEs are not only drivers of job creation; they also contribute to economic integration, social cohesion, community building and reducing poverty. They can play an important role in innovation and the adoption of business solutions that are environmentally friendly and human-centred.

This chapter discusses the economic role and impact of SMEs vis-à-vis economic and social development, offering insight into the ways that SMEs promote entrepreneurship and create a positive business and investment climate.

5.1. The importance and economic impact of SME development

SMEs are key to developing productive, diversified and resilient economies. Their share in service provision and production in job creation, along with their contribution to value-added at factor cost is critical. SMEs contribute roughly around one third to gross national income globally.[1] In both developed and transition economies, the percentage of SMEs is far above 95%. And yet, while they represent more than 58% share in total employment, their contribution to value added at factor costs is often, with some exceptions, lower compared to large companies.

Table 8. Structural indicators for SMEs in selected OSCE participating States

Country	Share of SMEs in company population (%)	Share of SMEs in labour productivity (%)	Share of SMEs in value added at factor costs	%Simplified
Croatia (2018)	99.6	45.5	61.4	68.5
Czech Republic (2018)	99.7	43.2	50.9	58.7
Germany (2018)	99.4	41.1	67.7	58.8
	99.3	N/A	59.0	62.1
Italy (2018)	99.8	36.3	62.2	76.3
Poland (2018)	99.7	36.9	45.9	66.9
United Kingdom (2017)	99.7	43.6	N/A	N/A

Note: own calculation based on data from the OECD's Structural and Demographic Business Statistics (ISIC Rev.4), https://stats.oecd.org/Index.aspx?DataSetCode=SSIS_BSC_ISIC4#

High-income economies usually also have the highest business density rates, meaning that in these economies there are more SMEs per thousand people. More developed economies also often show higher levels of business dynamism, the process whereby companies (often SMEs) grow and shrink, as well as enter and exit markets. Empirical data suggest that business dynamism in the developed world has been falling over the last three decades. In contrast, emerging economies – despite the global dampening effects of the 2008 economic crisis – currently display higher levels of business dynamism.[2]

Such turnover in business is often related to growth. This adds to the significance of the central role of SMEs in economic development and job creation. However, the positive economic impact of SMEs depends also on other factors, such as time, sectoral composition, and differentials in competitiveness, as well as various national characteristics, including the quality and effectiveness of institutional and regulatory frameworks.

In sum, the growth and job creation potential of SMEs depends on the structural and institutional characteristics of a given economy. As discussed in other chapters of this Guide, current challenges to SME growth and competitiveness are increasingly related to the ability and openness of SME operations to digitalize and internationalize.

Across the OSCE region, similar patterns of sectoral distribution and company size can be seen with regard to SMEs. This composition also appears to be stable over time. For the most part, manufacturing is represented by large businesses; the trade and services sectors are primarily represented by micro-enterprises. SME employment is concentrated in a few specific sectors, above all wholesale, retail trade and construction. In manufacturing, the percentage of SME employees is lower, a trend expected to continue in the future due to developments in manufacturing automation.[3]

Studies have pointed out productivity gaps between large companies and SMEs, but such differences are subtler when looking at particular subsectors. As such, it is important to look beyond productivity and recognize the importance of innovation and development in knowledge-intensive industries. For example, in knowledge-intensive service sectors, medium-sized companies usually outperform large enterprises in terms of productivity. In addition, factors like the size of the economy, market conditions and resource endowments may further explain country-specific variances in both productivity and average company size across sectors.[4]

It is important to identify and assess the reasons why some SMEs prefer to operate in the informal sector.

There can be manifold causes for this, such as burdensome regulations, excessive entry costs, strict labour laws, high (marginal) taxes, or complicated licensing/operating procedures. In addition, low quality of government institutions and services – resulting in general low trust in the government – may contribute to choices of running businesses informally. For more insight into this phenomenon, as well as recommendations for government responses, see Section 4.8. of this Guide.

SMEs are quite heterogeneous and therefore will always display variance, not just across sectors, but also across countries and regions in terms of productivity, wages, innovation and international competitiveness. To design adequate and effective interventions by governments or international organizations, it is important to understand the subtle, country-specific factors of the national context in question, as well as the diversity of entrepreneurs within the SME sector.

5.2. Creating a supportive policy framework for SMEs

Entrepreneurship is a multi-faceted undertaking. It involves forming a business to seize existing market opportunities, developing the knowledge needed to generate income, and producing surplus value. According to traditional economists, entrepreneurs are people willing to attempt innovative new products, services, technologies or business models. By making investments, companies transform human and material resources into the production of new goods and services. Consequently, entrepreneurship can be an important element for boosting autonomy and enhancing personal development and well-being, all factors that can have a broader social impact.

Starting and running a business, however, may not be an obvious option. On one hand, people with business ideas may face information, financial, or administrative challenges. Setting up and operating a business may also not be the solution for everybody wishing to be productive or creative.

In academic literature on this subject, an important discourse concerns the difference between "necessity-driven" and "opportunity-driven" entrepreneurship; scholars stress that entrepreneurship may not be a viable option for everyone.[5]

Necessity-driven entrepreneurs are defined as those who have limited employment (or other) opportunities for generating income. They generally establish small businesses to sustain their livelihood out of necessity rather than by choice or business initiative. Experts have distinguished various "push factors" leading people to choose entrepreneurship as a second-best option, despite desiring or preferring active employment. For example, lack of permanent employment options or only precarious employment being available tends to push people towards necessity-driven entrepreneurship.

By contrast, opportunity-driven entrepreneurs envision business opportunities and choose to start a business to generate income for themselves, despite potential options of being employed. Setting up a business as the first-best option has different "pull factors", such as the prospect of good earnings, a strong preference for autonomy, or a desire for self-expression.[6]

These two types of entrepreneurship differ in their potential for job creation or innovation; the sustainability of their business operations may also vary significantly. While all such businesses, whether small or large, can be socially beneficial, when government policies are developed, the underlying rationales for these two types of entrepreneurship should be reflected upon.

Classical justifications for SME-focused government policies are usually based on arguments of market failures and distortions.

But there are other reasons SMEs are not established. People may be unaware of the benefits of starting a business, lack a template on how to run a business properly, or need a role model. As empirical data suggest, this is particularly the case for vulnerable and/or disadvantaged groups, especially youth, women and the unemployed.

Little or no access to market information may leave potential entrepreneurs unaware of the benefits of external advice from experts or peers, the availability of external financial resources, or possible ICT solutions fitting their specific business plans. It may be challenging to provide certain groups, such as youth, women, and people with disadvantages (including ethnic minorities or immigrants), with market information or peer and expert support. And yet, among the biggest impediments for these groups to start businesses is limited access to financial and technological resources. This is often exacerbated by risk-adversity of financial institutions, lack of collateral, or poor or limited own capital or social capital. Moreover, these problems are sometimes coupled with discrimination.[7]

As discussed in Chapter 4 of this Guide, governments can play an important role in supporting potential entrepreneurs in overcoming such challenges, if they are responsive to group-specific needs and employ a wide range of policy tools. Policies and programmes tailored to needs of specific target groups are desirable and often more effective than generic one-size-fits-all approaches.[8]

5.2.1. Designing and implementing evidence-based and tailor-made SME strategies

To maximize policy impact, it is necessary to have a clear understanding of the national SME sector, including its structural characteristics, composition and specific business needs.

International databases on structural characteristics and business dynamics of SMEs are readily available for a large number of OSCE participating States. However, policy designers using such databases often encounter challenges if they need analyses that are more sophisticated. The SME sector is highly diverse and thus to examine it accurately, it must be properly broken down into segments. Such segmentation can be based on types of entrepreneurs (differentiated by age, gender, geographic location, or ethnic origin) and/or types of businesses (differentiated by sector, size or business life cycle). International databases are useful for gaining a general overview of the economic role and importance of the SME sector. But for more robust policy evaluations, national policymakers should also conduct national business surveys and reviews or examine past datasets based on well-selected representative samples.

Based on such additional data, decision-makers can be better informed about the characteristics of the business demographic in their country. They can gain essential insight into the needs and barriers faced by various SME groups, broken down by size, owner gender, or company type (such as start-ups, high-growth gazelle companies,[9] or small businesses focused on local markets).

TEXTBOX 65.

Development of business statistics to help evidence-based SME policy: A data collection project in Armenia

Together with the national statistics office, in 2017, Armenia's Ministry of Economy launched a data mapping and collection project with the aim of improving the reliability and international comparability of the country's business statistics. As part of the EU4Business initiative, this multi--stakeholder project involved government agencies, national business organizations and SME experts from the OECD. Along with a focus on harmonization of the national statistical practices with the OECD-Eurostat business statistics standards, the project also mapped gaps in existing business statistics and provided guidance to collect more sophisticated, internationally comparable company-level data. Part of the project was to develop key structural and business demography data broken down by size segments. As the result of the project, the Statistical Committee of the Republic of Armenia now publishes the Statistical Bulletin on Small and Medium Entrepreneurship on an annual basis. The Bulletin contributes to better-informed strategy making at the ministry level.[10]

In addition to high-quality data, policy strategies are most effective if they are well designed and implemented consistently. Moreover, for a good policy strategy, clear definitions are needed. The optimal scenario involves priorities that are clear-cut, limited in number and include measurable targets. To work toward strategic goals, it is also important to mobilize not only government agencies, but also non-government stakeholders in the country. Ensuring support from private stakeholders and stimulating their engagement in policy processes is a key to transforming policy ideas and measures into real and consistent action on the ground. Public–private consultations (PPCs) can greatly benefit public policy design and implementation processes, since such consultations introduce the perspectives, expertise and ideas of those who run businesses into the public decision-making process. The case of Kyrgyzstan in Textbox 66 below demonstrates this well.[11]

TEXTBOX 66.
Public–private consultations and the role of business councils, Kyrgyzstan

The business community in Kyrgyzstan is highly engaged in policymaking and in improving public services via frequent dialogue with the government. The various business associations and organizations in the country (the major ones being the National Alliance of Business Associations, the International Business Council, the Chamber of Commerce and Industry, and the American Chamber of Commerce) participate regularly in consultations on new regulations. These associations also actively contributed to the planning of the National Strategy for Sustainable Development 2018–2040, which aims to meet the most current development challenges in the country. This new national strategy has well-defined objectives. For example, in the plans for developing the business environment, a particular focus is on increasing the share of SMEs in the GDP to at least 50% by 2022. It is also planned to make all government services electronic (this process is already underway with the introduction of e-licensing in 2018). One of the most important platforms for cross-sectoral dialogue in Kyrgyzstan is the Council for Development of Business and Investment, which operates under the Prime Minister. It is considered one of the most effective business councils in the Central Asian region.[12] According to estimates by the Kyrgyz International Business Council, their advocacy and policy consultation efforts brought about savings in Kyrgyz companies of up to US$12 million.[13]

For other examples of policy initiatives based on public–private collaboration and partnership in Kyrgyzstan, see Textbox 41 on the country's high-technology park and Textbox 63 on Kyrgyz entrepreneurship support centres.

Consulting and including SME representatives in policy decisions may sometimes prove challenging, given the large numbers of SMEs, as well as their geographic and sectoral variety. Nonetheless, it is important to ensure that SME needs are properly addressed and that the business regulatory process is open and responsive to the needs of specific entrepreneurial groups. A Montenegrin initiative called Business Caravan offers an example of good practices on improving outreach to local SMEs.

TEXTBOX 67.
The Business Caravan initiative: Strengthening SME participation in public–private consultation processes, Montenegro

Montenegro launched a Public Administration Reform Strategy in 2016 with the aim of improving performance and increasing public trust in the Government. The first two steps of were to make obligatory consultations with the business sector for all business-related legislation. The e-government portal became the main platform for the conduct of these consultations. While the Government's commitment to engage Montenegrin companies in this systematic dialogue was strong, it faced challenges in gaining the active participation of smaller companies. To help in this respect, Montenegro's Ministry of Economy, in co-operation with the United Nations Development Programme (UNDP), launched the "Business Caravan" initiative in 2017 as part of its preparations for a new SME development strategy. The initiative involved Government representatives meeting local entrepreneurs in 14 municipalities across the country over the span of 15 months. The meetings focused on mapping the strengths and weaknesses of the national SME policies and collecting concrete policy proposals. The Business Caravan proved a good mechanism for mobilizing local SMEs, whose feedback was collected and systematically analysed. Two factors played an important role in the success of the initiative. First, it was officers at the municipality level who actively approached and invited local entrepreneurs. Second, the Minister of Economy also participated in the meetings, giving political urgency and credibility to the entire consultation process.[14]

5.2.2. Multi-stakeholder approaches in action, "SME envoys" and other support measures

In general, a multi-stakeholder, partnership-based approach is also advocated by the SME Strategy of the European Union and the OECD.[15] In more than half of the EU Member States, national governments have appointed a so-called "SME envoy" to facilitate partnership-based approaches. The main role of the SME envoys is to play a pro-active role in representing and lobbying for the interests of SMEs. Most SME envoys come from the ministry in charge of the national SME strategy (usually ministries of the economy) and others from government agencies engaged in the implementation of the national SME strategy.[16]

Assessments published by the EU and OECD emphasize that implementing SME policies can be supported by: 1) developing and applying outreach methods policy support tools tailored to the profiles of specific strategic target groups; and 2) building the capacities of organizations providing SME support tools. For example, collaborating with youth organizations helps to better understand the specific motivations and needs of young people and potential young entrepreneurs. Such organizations can help tailor messages specifically for young generations. This approach has been employed and achieved positive results in a few countries (including Denmark, Estonia and Sweden) as part of the EU's Youth Guarantee framework, an initiative aimed at promoting self-employment and business start-ups among youth.[17] Outreach is crucial for boosting the acceptance of SME support tools among groups that are commonly difficult to reach since they are less likely to follow mainstream communication channels of relevant government agencies (such as migrants or the unemployed).[18]

Public, business and civic organizations involved in implementing national SME support strategies should recruit staff who have experience in working with specific target groups. Moreover, staff should be trained to understand the challenges faced by their clients when setting up or running a business. If those in charge of implementation do not understand and address the unique needs of the final beneficiaries, funds dedicated to entrepreneurship promotion and support may not be allocated effectively.

International experience shows that in the case of female entrepreneurs, involving NGOs with local presence, close links to women, and the capacity to provide complex support (for example, financial assistance as well as skill development) can be key in providing effective help to this group.[19]

TEXTBOX 68.
A multi-stakeholder and needs-oriented approach: The Central Asia Impact Fund

A recent initiative called the Central Asia Impact Fund, run by the international NGO ACDI/VOCA (Agricultural Cooperative Development International/Volunteers in Overseas Cooperative Assistance), offers a relevant example for a multi--stakeholder and needs-oriented approach. The fund (US$2.15 million) was launched in March 2020 to invest in rural businesses in Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. In line with the economic diversification strategies of these countries (for more on this, see Section 4.7.1.) the planned SME support concentrates on the sectors of food, agriculture, technology, tourism and consumer goods. The Fund offers micro-credits and other in-person support schemes aimed at improving the financial literacy of the target groups. While it is too early to assess progress or results of the Fund's activities, the following three design elements are worth noting. First, ACDI/VOCA builds on local agencies and a network of regionally engaged microfinancing institutions, institutions that have been active in these countries since 1992, when an initial inflow of microfinancing funds came from USAID and the U.S. Department of Agriculture. Second, building on the decade-long experience of these earlier programmes in providing technical assistance and mentorship to women at the local level, the initiative has involved the clientele of those programmes, of whom 60% are women already engaged in local businesses. Third, the Fund's volume is relatively small, which can reduce time and performance pressure on the fund managers.

▲ **Experts discuss obstacles faced by foreign investors in South-Eastern Europe at a seminar session in Vienna**

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As shown by evaluations of several SME support programmes, pressure to reach timely implementation and absorption can easily diverge from approaches oriented on true need. This can lead to selection and market biases, such as supporting local entrepreneurs who might have obtained small bank loans without microfinancing schemes because it is easier and faster.[20]

Finally, SME strategies often risk remaining in the planning phase, or fail to properly measure progress against the original objectives or targets.

Systematic monitoring and evaluation are a necessary component of policy development cycles.

These activities should also be based on proper data collection and data linking practices. The SME Performance Review framework, co-ordinated by the EU, may help national policymakers to monitor and access their countries' progress in promoting SMEs. For emerging economies outside the European Union, the SME Policy Indexes produced by the OECD can serve the same function.[21]

TEXTBOX 69.
The National SME Development Strategy of Georgia

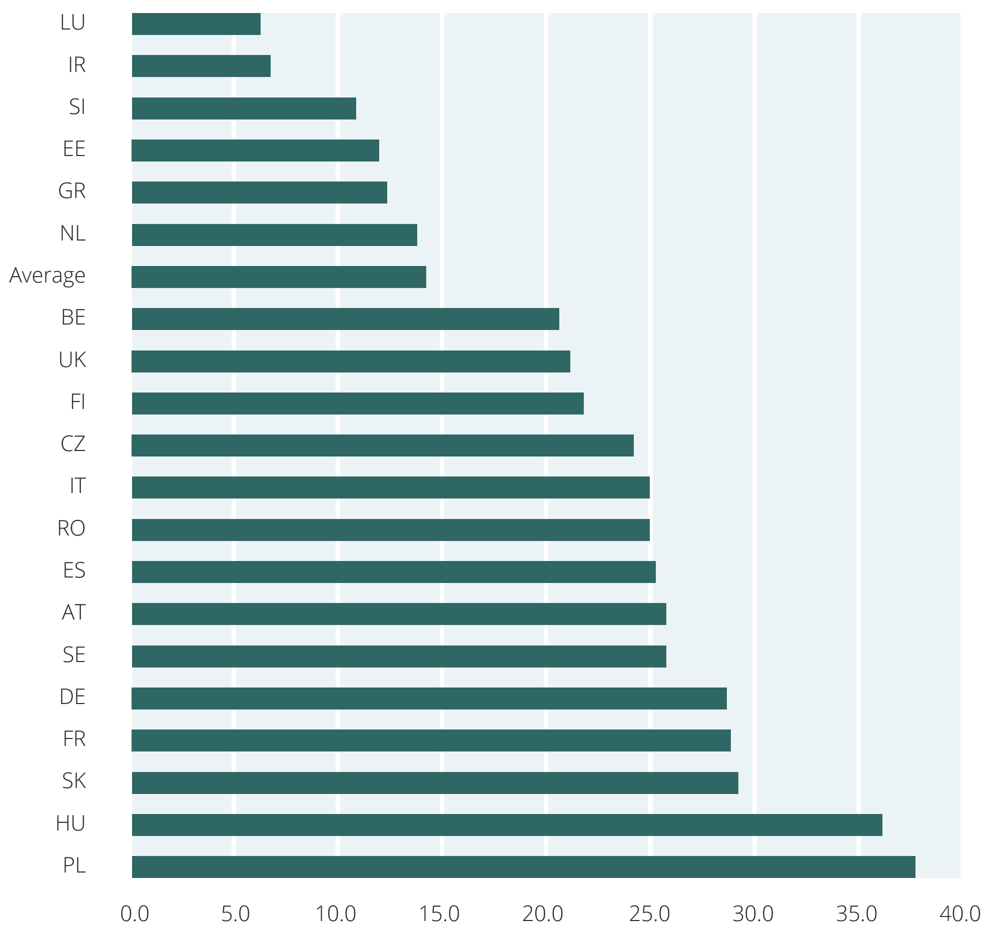
In 2015, Georgia adopted a national SME Development Strategy along with an action plan. The Strategy, which ran from 2016 to 2020, resulted in positive progress in several policy areas, making Georgia the best performer for SME policies among the EU's Eastern Partnership countries. According to a country assessment based on the OECD SME Policy Index, Georgia excels particularly in simplifying steps for business registration, developing e-government services, and promoting female entrepreneurship. The successful Strategy was based on the principles of the Small Business Act (SBA),[22] as promoted by the European Union, and on a comprehensive approach toward streamlining the relevant institutional, regulatory and financial frameworks aimed at developing SMEs in Georgia. Two government agencies were established to ensure timely and consistent implementation: the Entrepreneurship Development Agency (EDA) and Georgia's Innovation and Technology Agency (GITA). EDA provided both financial and non-financial instruments, aligned also with skill development and entrepreneurial learning, and helped Georgian SMEs in export promotion. GITA co-ordinated and managed measures aimed at building a knowledge-based and innovation-driven economy. In addition, the Development Advisory Council was created to systematically engage business representatives in the Strategy's monitoring and revision.[23]

5.3. Building a supportive business regulatory framework for SMEs, and reducing SME-specific administrative burdens and obstacles

Compliance with government regulations and administrative procedures takes considerable time and raises entry and operating costs for businesses. Potential entrepreneurs may face major barriers when attempting to register a company due to no or limited experience with regulatory procedures and institutions. In addition, frequent or unpredictable changes in business regulations result in extra time and additional expenses when operating businesses. While compliance with administrative and regulatory provisions required by governments is necessary, it can be quite a burden on business resources in terms of managerial and staff time, as well as direct costs.

Studies on tax compliance costs have estimated, for example, that related costs per annual turnover for the average company in twenty EU countries are close to 1.5%. However, in some countries they are around or even above 3% (such as in France, Germany, Hungary, Poland and Slovakia).[24]

Figure 4. Tax compliance costs per annual turnover related to corporate income tax (CIT) and value added tax (VAT) in 21 EU Member States.



Source: Authors' own calculation based on publicly available data.

The above tax compliance costs percentages have been estimated based on two company-level surveys that mapped all statutory tax administrative obligations related to corporate income tax (CIT) and VAT in the corresponding countries. A standard-cost model was then used to quantify the time spent for compliance. The data for Hungary is from 2019; for all the other EU countries, a company-level survey was conducted by the author in 2014. The data point “Average” indicates the mean costs calculated across 19 EU Member States covered by KMPG 2018 (all countries listed above except Hungary).[25]

Tax compliance costs vary significantly with company size. Obviously, the larger the firm, the more it spends on tax administration and compliance, as shown in Table 9 below for five OSCE participating States (the so-called Visegrád 4 + Austria). Nonetheless, the relative costs measured in terms of costs per annual turnover for the larger companies are smaller. For instance, the figures for Hungary show that the relative tax compliance costs for micro- and small enterprises are almost three times higher (5%) than for large companies (2.1%).[26]

Table 9. Total tax compliance costs related to CIT and VAT broken down by company size segment (2014, in euros)

	Austria	Czech Republic	Hungary	Poland	Slovakia
Micro-sized enterprises	8,562	4,252	5,267	4,240	4,980
Small-sized enterprises	24,927	12,390	9,919	11,823	11,008
Medium-sized enterprises	22,732	15,736	28,686	20,853	19,092
Large-sized enterprises	100,019	20,845	31,449	93,326	37,605

Sources: KPMG 2018, BI-EY 2020.3

In addition, a lack of stability of business regulatory frameworks makes business planning difficult, especially for SMEs, which usually lack capacities to monitor changes in government regulations or in taxation. SMEs thus have other losses due to regulatory and administrative compliance, such as productive investments not realized or business innovations not developed. Moreover, when the costs and time needed for registering a business or becoming self-employed are high, this can turn into an effective barrier to entrepreneurship. On one hand, it may discourage some from starting a business altogether, on the other, it might encourage others to shift some of their operations to the informal sector.

Notably, simplification of business start-up requirements and procedures has become an integral part of policy agendas not only in all EU Member States, but also in the countries of South-East Europe and beyond (for example, in the EU Eastern Partnership countries). Over the last decade, governments in many countries have made commitments and set up plans to simplify business start-up and closure requirements and procedures. Based on a policy mapping exercise conducted by the EC and the OECD within the framework of Small Business Act initiative of the EU,[27] the following policy measures are being commonly pursued:

- Simplifying business registration process by developing e-government services and setting up a “one-stop shop” for SMEs (20 EU Member States, plus countries in the Eastern Partnership and the Western Balkan). For good practices regarding a one-stop shop, see the case of the EasyGov portal from Switzerland presented in Textbox 70 below.

- Developing e-government services for operating businesses with a special eye on e-taxation. While this has been taken up by almost all countries in the OSCE region, the scope and quality of these e-government services vary significantly. Estonia, however, is often considered a frontrunner. As suggested by the EU SME Performance Review, entrepreneurs in Estonia complain significantly less about burdensome legislation or complex administrative procedures, and have the benefit of the fastest tax payment procedures in Europe. As of 2018, 98% of tax declarations in Estonia were submitted online. Moreover, the central government website not only allows entrepreneurs to register a new business, they can also initiate changes in the business register, file yearly reports, and make inquiries about other companies without the involvement of a third party. As government monitoring data show, since 2011, 98% of new companies in Estonia have used this website.[28] See also the example in Section 2.1.3./Textbox 8: The company registration portal of Estonia.
- Minimizing information obligations requested from entrepreneurs. The EU, for example, promotes a so-called "once only" principle, which involves government agencies requesting company-level data only upon a company's first encounter with those agencies. It also promotes the linking of government databases. It seems this move is currently too challenging to implement for the majority of countries in the OSCE region (such a programme has been initiated by only ten EU Member States, and by none of the EU's Eastern Partnership countries). However, Slovenia recently developed a plan to apply this principle by linking the databases of the Social Work Center and the Financial Administration of Slovenia, so that Slovenian companies only need to submit information about the salaries of their workers once.[29]

TEXTBOX 70.
The EasyGov portal, Switzerland

The EasyGov portal is a one-stop shop SME portal managed by Switzerland's Ministry of Economy. The portal centralizes, facilitates and optimizes mandatory administrative procedures for Swiss companies by providing the following e-government services: business registration, social security registration, accident insurance, registration with the commercial register, specific operations related to VAT registration, applying for and receiving extensions, and official declarations. While it is currently available mainly at the federal level, the government plans to roll out these services in many cantonal authorities and at municipal level. By 2018, the number of companies registered on the portal had reached 36,928. These companies now carry out their administrative tasks there on a regular basis.[30]

It should be noted that in the last decade, almost all countries in the OSCE region have decreased the minimal capital requirements for new businesses. This follows the cutting red tape agenda of the OECD and country-specific recommendations made by the European Commission.[31] Nonetheless, countries remain less responsive in launching measures that aim at the following:

- Speeding up and simplifying insolvency procedures by deregulation and easing financial costs of re--organization or exiting the market (notably, only 10 of the 27 EU Member States make it possible to complete insolvency procedures within a year) (see also Section 2.1.7.).
- Revising and reducing the business information requested from new businesses for statistical purposes.

5.4. The importance of regulatory and administrative simplifications for SMEs

Both the EU and the OECD actively promote comprehensive regulatory simplification reforms that go beyond the business start-up phase. Governments are encouraged to launch a systematic review of existing and new regulations, to use digital tools (such as websites or platforms) for managing and co-ordinating public–private consultations in a transparent and efficient way, and to assess the impact of new regulations on SMEs.

To ensure that SMEs can operate smoothly, processes of introducing changes to the business regulatory environment need to be transparent and predictable, and they should include the relevant stakeholder groups.

The disproportionate burdens of business administration levied on SMEs for regulatory compliance can only be reduced if regulatory reforms are well designed and consistently implemented. The Slovenian Stop the Bureaucracy initiative described in Textbox 71 below offers interesting insights and lessons learned in this regard.

TEXTBOX 71.
The Stop the Bureaucracy initiative, Slovenia

In 2005, the Ministry of Public Administration in Slovenia initiated a government project to map and collect stakeholder ideas on how to reduce administrative obligations. They consulted with a broad group of government, business and civil actors and delivered evaluations of the measures needing highest priority. This pilot initiative was followed in 2007 by the establishment of an interministerial working group and the approval of a government programme aimed at eliminating administrative barriers. The so-called Minus 25% programme included 35 measures. Its defined goal was to reduce the administrative burden levied on Slovenian companies by 25% in the subsequent three years.

In 2013, a new government portal called Stop the Bureaucracy (www.stopbirokraciji.gov.si) was developed (along with a Facebook site). The portal integrates the communication, monitoring and public consultation functions of the previous relevant websites.

In line with corresponding international recommendations, the Slovenian Government has also adopted a “single framework”, which encompasses a comprehensive, whole-of--government approach in regulatory policymaking. In addition, an SME test (as promoted by the EU) was introduced. It requires a systematic assessment of the effects of new regulations on the SME sector. So far, the Slovenian Government has implemented 568 measures. Most of these focus on finance, business statistics, justice and agriculture. The implementation of 170 measures has been evaluated; the results show that these measures have realized savings of €420 million in regulatory compliance costs.32

Over the past decade, the Slovenian Government’s approach has been clearly guided by SME policy principles promoted by the EU (including “Think Small First”,33 the SME test, and “once only”).

As demonstrated by the Slovenian case, it is useful to begin regulatory reforms as a pilot project (with few priority areas and a small number of planned actions). Also essential is investing in training of civil servants engaged in and managing the regulatory reform process. Framing reform steps as part of a policy learning process supports strong co-operation and co-ordination, both within various government bodies and across the public and private sectors.[34]

5.5. Improving consistency between labour, social and tax policies

Labour, social and tax policy measures can provide both incentives and disincentives for entrepreneurship. Effective active labour policy measures (such as training, wage subsidies, job sharing, or rotation schemes) may offer viable alternatives for the registered unemployed or for those who are employed but at risk of involuntary job loss. If such assistance and support services are well designed, they can help reduce the risk of continued or long-term unemployment. This will also reduce the probability of such people being pushed towards self-employment or necessity--driven entrepreneurship as a way out of their unemployed status or poverty.

Access to social security schemes (such as health insurance, sickness benefits or pension schemes) often differs between employees and people who are self-employed. If there are gaps in social security coverage between the self-employed and persons who are employed, this may emerge as a barrier to establishing new businesses.

The potential loss of a social security safety net if a person turns to self-employment or starts a business can be a financial disincentive. Improving access to social security schemes for the self-employed may expand options for individual entrepreneurship. If a potential entrepreneur has fewer purely financial considerations and worries, there is more room for creativity and entrepreneurial spirit. This can be particularly relevant for people with higher health risks (seniors), or for those with children or other family care responsibilities (often women).

Temporary reductions of required social security contributions is another policy option for making business creation more attractive. Such reductions, usually offered during initial business years, are seen as a good practice among OECD participating States. Phasing out the reductions over an extended period is preferable to ending them in a single step. In April 2018, Belgium launched a reform measure reducing social security contributions for self-employed entrepreneurs. The measure applies for the first four quarters of tax liability when self-employed. Self-employed people are targeted, since they often have low incomes at the beginning of their entrepreneurial activity.

Another financial incentive for starting businesses is offering a “welfare bridge” to new entrepreneurs. This bridging scheme involves a small subsistence allowance or unemployment benefits typically for a fixed period of time after a business is established. The amounts are calibrated to cover at least social security contributions as well as some living expenses. These allowances help beneficiaries to survive the early business phase, when expenses easily surpass revenues. Such schemes are often complemented with one-time start-up loans or grants, and accompanied by additional business support services (see Section 5.6.).

TEXTBOX 72.
Start-up grants as a welfare bridge, Finland

The first welfare bridge scheme involving start-up grants was launched in Finland in 1984. Such start-up grants support business creation by the unemployed as well as those who are employed, studying or in an inactive status but desire self--employment. Initially, the scheme was primarily financed from the national budget. Later in the 2010s, it was co-financed in part by the European Social Fund. The budget in the period 2010–2012 was a total of €40 million. The basic sum provided to applicants has been €33 a day for at least 6 months and for a maximum of 18 months. Beneficiaries also have access to capital loans and to free entrepreneurship training through the Employment and Economic Development Office.[35]

5.6. Easing access to finance, diversification of business funding opportunities, alternative financing, and linking finance with SME support in entrepreneurship skills and competences

While SMEs are usually financially constrained and more dependent on external financing than large enterprises, financial institutions and banks are increasingly cautious about SMEs in sectors associated with high risk (such as agriculture), or certain groups of people, such as women returning from maternity leave or the long-term unemployed.

The financial gap faced by SMEs globally as well as in the OSCE region is considerable. It is even larger in emerging economies.[36]

In both emerging and developed economies, it is common for the majority (60%–70%) of micro-enterprises and SMEs not to have external financing from financial institutions. Moreover, an additional considerable percentage (15%) are underfinanced by the financial market.[37]

Various institutional constraints impede access to financial resources for micro-businesses and SMEs. These include lack of reliable credit information, lack of suitable collateral, and weak legal enforcement (for example, in the case of delayed payments).

Nonetheless, while the average SME faces challenges in accessing finance, such companies are quite heterogeneous. And there are some types of firms, mainly companies with high-growth potential or in high-growth sectors, for which financial constraints are less significant.

The governments of OSCE participating States recognize the shortcomings listed above and thus provide various types of financial support for SMEs.

The most typical financial instrument used by governments for SMEs has been grants that directly transfer money to companies.

Grants do not need to be repaid and are based on eligibility criteria. While grants have been popular in the past, there are clear drawbacks in using only grants for supporting SMEs. Since they are not paid back, they do not generate re-funding for government agencies. Grants can also adversely change market conditions if selection biases are involved in their allocation. As empirical evidence suggests, SME grant programmes have a tendency to select companies that are performing better than average, even before grant programme goes into effect ("cream skimming"). Another problem is subsidized companies pushing out peer companies from the (local) market (the so-called displacement effect). It is thus recommended to offer grants only if such distortions can be minimized.[38]

Start-up grants, however, can be justified if these are aimed at groups that usually lack capital (such as the unemployed, youth or migrants). Recent policy recommendations related to start-up grants stress the need for linking financial assistance with development of entrepreneurial skills. In several EU countries, SME support schemes combine start-up grants with training, mentoring and coaching. This idea is also pushed in several EU Member States under the Youth Guarantee initiative, as explained in Textbox 73 below.

TEXTBOX 73.
Promoting entrepreneurship in Hungary and Slovenia under the EU's Youth Guarantee initiative

In 2012, in response to alarming increases in youth unemployment rates following the 2008 economic crisis, the EU launched the Youth Guarantee (YG) initiative. Its aim has been to commit EU Member States to ensuring that all young people under the age of 25 years receive a good quality job offer, are supported in starting a business, or can continue their education within four months of becoming unemployed or leaving formal education. The launch of the YG initiative has led a growing number of EU countries to start youth entrepreneurship support programmes. More than half of the EU Member States identified self-employment and entrepreneurship as a strategic priority in their national YG implementation plans (especially those Member States where young people are more vulnerable economically).

A common feature of these YG measures is that they combine financial support with various types of skill-oriented assistance (entrepreneurship training, mentoring, and/or coaching). For example, as part of the Slovenia YG programme, young unemployed persons aged up to 28 years who undertaken entrepreneurship training (100 hours) have access to a start-up subsidy. If they complete the training successfully, prepare a business plan, and are willing to start their own business they can receive subsidies up to €5,000. Optional individual mentoring is also offered. The first such training events in Slovenia started in March 2018; by the end of that year, 439 young people had completed the training and 330 of them had received start-up subsidies.

In Hungary, a similar Youth Entrepreneurship Programme started in 2014. It targets young people under 25 years of age and jobseekers up to 30 years of age. The first training-mentoring component runs the same way as in Slovenia. In a second component in the Hungarian programme, participants can apply for a grant of up to €10,000, but are asked to co-finance at least 10% of the needed start-up costs. Access to this financial support is based on completion of entrepreneurship training and approval of submitted business plans. By the end of 2018, the programme had registered 1,359 participants and 616 successful project applications.[39]

Financial institutions sometimes consider it too risky to finance certain types of SMEs, in particular, micro-enterprises in rural or disadvantaged areas. Thus, some micro- or small businesses may be charged higher interest rates on loans than their "true" risk profile warrants. In compensation for such market problems, governments sometimes provide loan guarantees to help aspiring entrepreneurs who lack collateral, or provide microcredits (i.e., small loans usually less than €25,000) to people with little savings or no credit history, or who are not served by banks.

Micro-financing schemes do not only offer microcredits, but also other support services (mentoring, networking). This is the case of the Central Asia Impact Fund discussed in Textbox 68 above.

The EU promotes the use of low interest rates and small loans. Within the framework of the European Progress Microfinance Facility launched in 2010, the EU guarantees Member States funding of ca. €200 million. The European Investment Fund (EIF), the EU-level managing agency, collaborated with a set of financial intermediaries across the EU in providing microloans mostly to individual entrepreneurs at the national level. With the new EU budget cycle starting in 2014, the Progress Microfinance Facility was replaced by three community-level financial instruments implemented successively as part of the EU's Employment and Social Innovation (EaSI) programme.

In line with the recommendations of a mid-term evaluation report on the original Progress Microfinance Facility, the focus of the new microfinance instrument has been broadened in both its geographical scope and its target groups.[40]

The new EaSI Guarantee Instrument covers more EU regions and aims to give access to finance not only to micro-enterprises and self-employed people from vulnerable groups, but also to social entrepreneurs.

So far,

30,473 SMEs

have received financial support through these schemes and a total amount of

€350 million

million has been distributed in 21 countries.[41]

A gender-focused study analysing the monitoring data from the first period (for the years 2012–2013) suggests that approximately 40% of microloans allocated by the Progress Microfinance Facility in 2012–2013 went to women, and about one-third of micro-finance institutions focused specifically on women.[42]

The advantage of loan guarantees is that they inherently share the risk of business default between the financial institutions and the government agencies backing the SMEs participating in these programmes. Microfinance has been criticized as being costly due to the relatively high fixed costs of setting up and operating small loans (e.g., transfer costs, costs of case assessments, screening and monitoring). Moreover, supplementary business support services (such as counselling and training) may enhance the effectiveness of such loans, but they also increase the fixed costs and make these programmes less cost-efficient. However, it is important to note that cost-efficiency indicators in these cases should not be compared with standard credit schemes, but rather with the alternative options for these groups (costs of unemployment benefits or of public work programmes).

Thus, these instruments are an important part of the toolbox for supporting entrepreneurship and a positive business and investment climate.

In the last decade, other alternative financing mechanisms and initiatives have emerged. These include self-financing groups, crowdfunding initiatives, and peer-to-peer (P2P) lending.

For more information about these alternative financing mechanisms and good practices, see Chapter 5 below.

In sum, improving access to financial resources for SMEs can involve a wide and diversified set of financial instruments. Because SMEs are a heterogeneous group, their financial needs and barriers to accessing financial resources differ considerably. Diversification of financial support schemes available to SMEs according to the real financial needs of the potential target groups are key in designing effective SME policies.

An increasing number of OSCE participating States recognize the need for such a diversified approach. For example, the Russian Foundation for Assistance to Small Innovative Enterprises (FASIE) has two decades of experience in providing financial support and business assistance. It offers various financial tools based on the changing financial needs of innovative companies going through different stages of their business life cycle. With its UMNIK programme, it offers pre-seed financing up to €6,400; companies at the stage of internationalization can apply for project co-financing up to €200,000. Such diversification of available financing options in line with actual business needs is important for all types of entrepreneurial groups, whether they are defined by the company's added value and innovativeness, or by the age of the key entrepreneur behind a given company (see Textbox 74 below, about young entrepreneurs in Portugal).

TEXTBOX 74.
SME financing support schemes for youth, Portugal

The Portuguese government provides a wide range of financial support schemes for young entrepreneurs in accordance with the key strategic goals defined by Portugal's Industrial Development Strategy for Growth and Jobs 2014–20 programme. Here we present four programmes that have been tailored to the needs of four specific target groups.

The Ignition Programme (*Programme de Ignicao*) focuses on young companies with high growth potential. The programme was launched in 2015; in the last 5 years, it has managed 2,000 applicants and selected 1,000 beneficiaries. The selected projects received capital investments (between €100,000 and €750,000, up to a maximum of 85% of the project's budget) and benefited from mentoring. The programme focuses on market-oriented, science- and technology-driven projects in specific sectors (including ICT, life sciences, endogenous resources, and travel and leisure technologies).

The Finicia Jovem programme is dedicated to supporting business ideas developed by young people.[43] Programme participants can request specialized in-person counselling to support idea development. If the business ideas are approved by the programme management, microcredits of up to €25,000 are available.

The Youth Invest (Investe Jovem) programme supports young unemployed people between 18 and 29 years old who have a viable business idea. It provides financial support for business creation in the form of an interest-free loan (up to €2,500), and offers individualized support to help young people develop their entrepreneurial skills.

The goal of the programme Support to the Establishment of Young Farmers (*Apoio a instalacao de Jovens Agricultores*) is to reach out to young people between the ages of 18 and 40 who wish to manage a farm for the first time. The main objectives are to enhance the renovation and development of agricultural companies, and to promote the establishment and development of farms. Young people can apply for a lump sum grant of €15,000, with an option for further financial support (up to an additional €11,250). They must also take part in training to get a professional qualification.[44]

5.6.1. Alternative finance

Financing for businesses has long been limited to traditional sources, typically local bank loans. Over the past years, alternative finance has grown from a little-known source of funding to a mainstream alternative, giving business owners more options for financing the growth and expansion of their businesses. Alternative finance has made raising financial resources easier, faster and less time-consuming. The majority of such funding is generated through investments, loans and donations, but the demand for this sector is based on mutual benefit.

Investors have more choices, enabling them to donate towards a cause or generate income based on their risk appetite (since risk is inevitable with any investment). Borrowers benefit from finance that is easy to apply for and quick to obtain.

Alternative finance refers to financial channels, processes and instruments that have emerged outside traditional finance systems such as regulated banks and capital markets. Examples of alternative financing activities through "online marketplaces" are reward-based crowdfunding, equity crowdfunding, revenue-based financing, online lenders, peer-to-peer consumer and business lending, and invoice trading third party payment platforms.

Alternative finance differs from traditional banking or capital market finance by it technology-enabled "disintermediation", which means utilising third party capital by connecting fundraisers directly with funders. In turn, this reduces transactional costs and improves market efficiency. Alternative finance instruments include inter alia cryptocurrencies, community shares, private placement and other "shadow banking" mechanisms.

According to various reports, alternative finance has grown into a considerable global industry in the years since the financial crisis of 2008. It has particularly involved SMEs. In 2018, the global alternative finance industry facilitated US$304.5 billion in transaction volume. This volume represents funds raised via online alternative finance platforms for consumers, business and other fundraisers.[45] This is also an emerging area in business in Europe and Central Asia. The demand and absorption capacity for alternative finance mechanisms in the region, on the side of both supply and demand, is not large but lately it has begun to increase in a number of countries.

Singling out effective instruments is difficult, given the constraints in the region for systemically monitoring the performance of instruments recently introduced. The following section will thus present some recently designed and tested alternatives with the available success indicators.

5.6.2. Innovative technologies, cryptocurrencies, blockchain technologies

Some of the benefits of cryptocurrencies are that they are difficult to falsify, can be stored on a hard drive instead of a bank, and because of decentralized control, are not subject to inflation curves should a national bank decide to print more money. Decentralized control ensures that each cryptocurrency works through distributed ledger technology, typically a blockchain, which serves as a public financial transaction database. A blockchain is typically managed by a peer-to-peer network using cryptography and a special protocol validating new blocks.

TEXTBOX 75.
Blockchain popularity in Georgia

Blockchain technologies are widespread in Georgia, thanks to a highly supportive environment for technological innovation and the mining of cryptocurrencies. Georgia's high use of cryptocurrencies is driven largely by tax exemptions and low electricity prices. Georgia is the world's third largest miner of cryptocurrencies and home to one of the largest cryptocurrency mining companies in the world. Surveys indicate that up to 5% of households in the country are engaged in cryptocurrency mining or investments. Since cryptocurrency is not a legal tender in Georgia, most interest lies in cryptocurrency mining.

Mining of cryptocurrencies has had a major impact on electricity consumption in Georgia, turning the country from a net exporter to a net importer of electricity. Estimates of the share of Georgia's electricity use devoted to cryptocurrency mining range from 10% to 15%. Per capita electricity consumption in Georgia in 2016 was almost three times higher than in countries with similar levels of per capita income.

Although citizens are not allowed to use cryptocurrency to pay for goods or exchange cryptocurrency for flat currency (government--backed currency), transactions are not subject to value-added tax (VAT), a rule that also applies to companies and private individuals trading bitcoin. This is in line with rules that several other European countries also follow.

While many countries in Europe and Central Asia are experimenting with blockchain technologies, Georgia is at the forefront. Going forward, it will be important for governments to ensure financial oversight, protection of consumers, and tax administration. In addition to Georgia, several countries are investigating blockchain technology as a means to streamline public services and digitize them, with the aim of making these services more transparent, secure and safer. For example, Estonia, Georgia and Ukraine have experimented with blockchain to set up land and real estate registries. While more specialized and efficient designs are needed, these initial experiments have given a boost to efforts to digitize government services.

5.6.3. Equity funding

Equity financing involves selling a portion of a company's equity in return for capital. This extra capital can be used to grow a business with no additional financial burden, since it carries no repayment obligation. However, companies that choose equity financing must share profits with new partners, and consult them any time decisions are made that affect the business.

In contrast, borrowing or debt financing involves obligations of repayment. However, it does not require giving up a portion of ownership.

5.6.4. Remittances directly supporting private sector development

Remittances are money transfers by foreign workers to persons in their home countries, usually families. Workers' remittances form a significant percentage of international capital flows, especially for labour-exporting countries, and in recent years, this has increased. Remittance flows to low- and middle-income countries (LMICs) reached US$551 billion in 2019, an increase of 4.7% compared to 2018. Moreover, since the mid-1990s remittances have exceeded official development aid by a factor of three. A challenge is how to channel these abundant funds to support not only home family subsistence, but also growth of the private sector. To achieve this, several investment promotion and facilitation activities are needed, with addressees on both sides: the workers sending money home and the recipients of that money. Structured awareness--raising sessions on investment possibilities, adjusted to local circumstances, would help these two sides make qualified decisions that would ensure economic sustainability, especially needed in the increasingly demanding circumstances of global warming and the current COVID-19 pandemic. Several countries with a vast diaspora have set up specific vehicles for this purpose (for example, India and Turkey). The following textbox 76 provides an example of such a vehicle in Armenia.

TEXTBOX 76.

Diaspora equity financing in Armenia

The EU and the EBRD provided €16 million in September 2019 to launch the Amber Capital EU-Armenia Private Equity Fund. The Fund aims to attract a total of €75 million for investing in Armenian SMEs. The Armenian diaspora is encouraged to invest in their homeland through this secured vehicle providing private equity investments. The purpose of the Fund is to improve the competitiveness of SMEs in Armenia by fostering their internationalization. The initiative also plans to expand consulting for local businesses within the framework of the EBRD's Small Business Advice programme. This programme is designed to encourage willingness to invest, and to promote the competitiveness of SMEs by introducing new technology and know-how, much needed in the local markets. Individual equity investments are planned between €3 and €5 million per year, over a period of up to five years. The maximum amount per company is €7.5 million. The only form of investment provided by the Fund is equity. This will greatly change the investment landscape in Armenia, since most companies in the country are accustomed to borrowing, rather than seeking capital investors or partners.

The Fund is managed by Amber Capital International Investment Company, which has a representative office in Armenia. A team of specialists is creating a diversified investment portfolio in the areas of renewable energy, agriculture, processing, tourism, information technology and logistics. Such synergies of knowledge are unavailable locally. The competitive products and services that emerge as a result of these investments will expand the market for exports to the EU. It will also make Armenian companies more attractive for future partnerships and investment from destination markets. While operations have slowed down during the COVID-19 pandemic, several companies assessed positively by the Fund are in the process of receiving equity financing.

5.6.5. Peer-to-peer financing

Peer-to-peer (P2P) financing is similar to bank loans in that borrowers receive funding and are required to make regular monthly repayments with interest. However, the funds are raised from investors rather than a bank. A recent form of P2P financing is crowdfunding. There are various types of crowdfunding. For example, business owners who raise funds through equity crowdfunding provide investors with company shares in return for their investment. Reward-based crowdfunding is an option for owners who want to attract investors without giving up shares in their companies. They instead offer rewards or incentives for investing. Donation-based crowdfunding is popular with charities, since it relies on the strength of the cause and the goodwill of others. P2P financing is relatively new in transition economies, and most often involves limited crowdfunding of the latter two types.

A nascent form of financing from peers has emerged recently in a few countries where exporters have insufficient funds to complete their operations or enter new markets. These companies have attracted the attention of other members along their value chains, and with it funding from these other players. This type of financing is still in an early stage and may not represent a fully-fledged P2P mechanism. Nonetheless, the case study from Ukraine in Textbox 77 below presents some valuable lessons learned from such inner sector links.

TEXTBOX 77.

Value chain links in Ukraine's berry production sector

Berry production is a relatively new sector in Ukraine. It has been in operation for only thirty years. The Association of Berry Producers is a new project in Ukraine that is helping berry producing SMEs gain access to new markets, with a focus on the EU, by helping these SMEs identify and comply with quality and standards to meet international requirements, linking them with buyers along the value chain, and providing cluster support. Other types of support include targeted capacity-building, advisory services and market access activities. Assistance to local business support organizations (BSOs) is also provided. The primary focus is on value chain development for three product groups: fresh, processed and organic berries.

The project has brought together thirty members accounting for 15% of all berry exports from Ukraine. New links have resulted in peer-to-peer financing within the value chain and among the newly networked businesses.

Directly benefitting the participants are information and knowledge sharing platforms that facilitate technical and commercial links to professional institutions and organizations in the target markets. Support to the participating SMEs to attend European fairs is provided on a cost-shared basis.

Moreover, the International Trade Centre (ITC) – a joint collaboration of the WTO and the UN providing support to SMEs – provides market intelligence services otherwise unavailable to smaller firms. This has prompted a number of participating firms to change their business approach and start investing in marketing. Some have established partnerships that have led to both long-term contracts and pre-contracting for future crops. Others have joined forces in a co-operative. All members have benefited from reduced prices for various services. They have also gained access to financing from new domestic sources, as well as from financial institutions and businesses in the target markets.

Evidence suggests that these activities have resulted in the acquisition of many new markets for Ukrainian berry producers, who are now annually exporting approximately 30,000 tons of berries valued at €25–€27 million. Of these exports, 80% are produced by SMEs, often individual households.

The Association of Berry Producers works with Ukraine's Export Promotion Office, which was established under the Ministry of Economic Development to help shape and support the country's export agenda. This is very important for the young berry production sector, since to export competitively in the EU and other markets, it needs business friendly regulations (such as certification, export procedures, leasing, etc.).

5.6.6. Crowdfunding in times of COVID-19

Several crowdfunding initiatives across the EU have supported the business community during the hardships of the COVID-19 pandemic, a time when SMEs have been struggling to cope with lockdowns and maintain financial liquidity. Some of these alternative finance models include:

- Several equity-based German crowdfunding platforms have held joint fundraising rounds for COVID-19 start-ups, combining their investor base and thus increasing the overall financing volume. Prior to this, the platforms synchronized their term sheets and investment contracts.
- A number of UK equity crowdfunding sites have delivered government match funding via their sites as part of the "UK Future Fund", which made it possible for start-ups with earlier equity-based crowdfunding to obtain convertible loans at reduced interest rates.
- A Spanish financial technology (fin-tech) company provides digital pension services to retail customers. As part of COVID-19 relief measures, the fin-tech clients were given credits to their pension accounts when shopping at local shops.
- An Austrian technology company has supported the government by creating loan models to speed up relief measures, support the vetting process and help curb fraud.

5.6.7. Bond investments for businesses

Bonds are a type of investment whereby an investor lends money to a bond issuer in exchange for interest payments. For the borrower, a bond is simply a loan. Instead of going to a bank, a company gets money from the investors who buy its bonds. In exchange for this capital, the company pays an interest coupon, which is the annual interest rate paid on a bond expressed as a percentage of its face value. The company pays the interest at predetermined intervals (usually annually or semi-annually) and returns the principal on the maturity date, ending the loan.

Examples from Ukraine and Moldova (Textbox 78) demonstrate the availability and attractiveness of this instrument in developing economies. They also underline the importance of lending and borrowing in local currencies. This creates a more predictable climate for local SMEs.

TEXTBOX 78.

Bond issuing in Moldova and Ukraine

The European Fund for Southeast Europe (EFSE) is the implementing partner for a bond issuing project that aims to foster economic development and prosperity in South-East Europe and the European Eastern Partnership countries by providing additional sustainable development financing. In Moldova and Ukraine, there is a growing need among private households and micro- , small- and medium-sized enterprises for financial products in the local currencies. This project aims to address this need by providing, in addition to the EFSE's existing A, B and C Shares, an additional new share class (L Shares).

These L Shares act as a dedicated share class to support local currency lending by providing an internal hedging mechanism to offset resulting currency risks. The main goal of L Shares is to protect both partner institutions and end-borrowers from currency risks arising from lending in hard currencies.

By providing lending in local currencies to SMEs in Moldova and Ukraine, the project generates significant economic and social benefits. By increasing access to financing, the project is contributing to job creation, facilitating self-employment, generating income and reducing poverty in the region. It is likely to have a catalytic effect by leveraging public and private capital, as well as encouraging other market players to participate in financing the SME sector. Moreover, the project is contributing to the strengthening of local financial markets based on sustainable, market-based principles.

In Ukraine, the EFSE has provided financing to a local bank in Ukrainian hryvnia (UAH) equivalent to €10 million. This includes a UAH 250 million (€8.2 million) investment in local bonds issued by the bank, making it the largest non-government bond investment in Ukraine in 2018. The dedicated funding provided by the EFSE has enabled the bank to offer longer-term financing to SMEs in the local currency. It has also supported the bank by increasing its nationwide outreach.

5.7. Developing entrepreneurship skills, introducing entrepreneurship education and promoting entrepreneurial culture

To promote entrepreneurship and ensure the long-term survival of SMEs, the attractiveness of entrepreneurial careers as well as the entrepreneurial attitudes and skills of citizens are highly important. However, many people may be wary of risk or fear failure. Moreover, many people may not have acquired entrepreneurial skills in their education or through social networks.

As suggested by data from surveys conducted in 2018 by Global Entrepreneurship Monitoring, there are differences between women and men in entrepreneurial skills and attitudes.

In general, women are more risk-averse than men, a lower proportion report having needed entrepreneurship skills (30% on EU-27 average, as opposed to men, which are close to 50%), and they have smaller and less effective entrepreneurial networks.

Combined with the gender gap in access to financing, these characteristics may explain why women tend to run smaller and less dynamic businesses than men.[46]

In addition, negative public perceptions of the social and economic role of entrepreneurs can be can be a barrier to business creation.

Unfavourable socio-cultural attitudes toward entrepreneurship and the public perception of corrupt business practices can mitigate the expected benefits and effectiveness of SME-oriented government support programmes. While making public attitudes more business friendly takes time and can be quite costly, governments can take some initial steps towards shifting individual and social perceptions of entrepreneurship:

- Awareness campaigns to share successful business stories, introduce role models, and demonstrate various forms of entrepreneurship (e.g., social entrepreneurs, socially conscious and responsible entrepreneurs, innovative start-ups, export-oriented gazelles, national champions);
- Facilitating and organizing business events or conferences for reaching out to civil and business organizations, as well as to educational institutions (e.g., the Entrepreneurship Week organized across all the EU Member States);
- Creating business networks and appointing (young/female) ambassadors to represent them;
- Presenting business awards in different categories (e.g., young business talents, female entrepreneur of the year award, etc.).

As presented above (Textbox 57), the French Women's Entrepreneurship Plan combined exactly these measures to make entrepreneurship more attractive for women and to boost the number of female start-ups. In 2018 Belgium started the "Yet Awards" contest for 12- to 18-year-olds who initiate an entrepreneurial project at their schools.[47]

5

TEXTBOX 79.
Positive change and attitudes toward entrepreneurship through CSO and business sector engagement in Slovakia

The Pontis Foundation in Slovakia has long been engaged in linking the private sector to social causes and broader engagement within Slovak society. It actively works towards benchmarking positive companies in several ways. For example, since 1998, it has awarded the annual Via Bona awards. Televised live on national television, it recognizes outstanding projects and companies that have brought about positive change within Slovakia based on sustainable approaches. It is the only award in the country that make examples of corporate social responsibility visible. It has inspired dozens of companies. Thus far, 465 companies have applied, sending in over 1,000 nominations for the award. The Pontis Foundation has conferred altogether 137 awards and 41 certificates of merit.[48]

On behalf of a select group of companies, the Foundation also operates the Transparent Slovakia Fund, which pools financial resources from the involved companies to support local NGOs in their work on combating corruption and improving transparency in the country. Finally, the Foundation operates a forum of business heads from companies committed to being leaders in promoting the principles of corporate social responsibility (CSR) in Slovakia. Through discussions and the participation of external guests, the forum shares examples of best practices in specific CSR topics, assesses implemented activities and plans future activities.

Another policy avenue is introducing the topic of entrepreneurship into formal education, either in the form of extracurricular activities or as part of regular school curricula.

Governments may opt for opening classrooms at the primary and secondary level of public education and inviting successful entrepreneurs to share their business stories.

Some OSCE participating States (e.g., the Scandinavian countries, Belgium, Estonia, Germany) have developed specific entrepreneurship education strategies, expanding entrepreneurship education also into higher education and the vocational training systems. Most countries, however, incorporate entrepreneurship education into broader government strategies (such as national lifelong learning strategies, or growth and competitiveness strategies).[49]

TEXTBOX 80.
Entrepreneurship education, Poland

In Polish primary schools, learning about entrepreneurship is a core subject like history or math. Upper-secondary students are required to take a class called “Introduction to Entrepreneurship”. This subject is also embedded in the National Qualification Framework for Higher Education.

Entrepreneurship education in public schools can also take the form of pilot or experimental projects, or one-off partnering projects between schools and business or civil organizations. The international NGO Junior Achievement organizes entrepreneurship after-school programmes in all OSCE participating States. Their programme in Sweden, which has been running for several decades, offers good practices that have had a positive impact (see Textbox 81).

TEXTBOX 81.

Business education: The Junior Achievement Company Program, Sweden

Junior Achievement is an international NGO that educates young students about workforce readiness, entrepreneurship and financial literacy through a hands-on approach. An impact assessment study found that programme participants were more likely to start a business even 12 years after participation and their earnings from business ventures were also higher than of those in a control group (i.e., interested students who had not participated). The Junior Achievement programme achieves this by helping prepare young people for the real world by giving them the opportunity to work on real business ideas and develop their own entrepreneurial project under experienced guidance.

The Junior Achievement Company Program in Sweden is a business education programme that was launched for upper-secondary students in 1980. The aim is to stimulate creativity, raise awareness about entrepreneurship, and support the future creation of businesses by young people. The programme organizes a platform for students to gain experience about the entire life cycle of a business, from starting up entrepreneurial activities through running them and then winding down. It is a nation-wide programme: in the 2014–2015 school year, a total of 24,415 students took part. The programme builds on the strong co-operation between secondary schools, private companies and municipalities.[50]

Assessing the impact of entrepreneurial education programmes is challenging. For example, it is not obvious how to measure entrepreneurial mind-sets or attitudes. Moreover, it is difficult to monitor the effects of factors not directly related to a particular programme (such as differences in the economic or cultural context). Assessing these two things would require the use of more complex methods of analysis. Nonetheless, the conclusions of the few available studies and evaluations[51] agree that such programmes can be very effective, if:

- there is strong co-operation between the various stakeholders, including the general public and the private and civil sectors. Good practices in entrepreneurship education point to the need of collaboration between educational institutions (e.g., schools, vocational training centres, universities) and business and civil society organizations, preferably those with strong links to active entrepreneurs;
- teachers are trained by persons with entrepreneurial experience, and are provided hands-on teaching materials containing practical examples that engage pupils in interactive ways.

A useful resource for those developing entrepreneurial material for national education curricula, including broader themes such as rule of law and anti-corruption, is the Education for Justice (E4J) initiative of the UNODC. The E4J initiative supports crime prevention by introducing the concept of rule of law into education worldwide. The E4J has developed a series of integrity and ethics modules to enhance the awareness of higher education students. One module focuses on business integrity and ethics, explaining why integrity and ethics are important for both companies and individuals. It provides a comprehensive teaching package, with guidelines, background readings, exercises with business case studies, and a student assessment tool.[52]

The Entrepreneurship Competence (EntreComp) Framework initiated by the European Union is another excellent source for practical tools and best practices in entrepreneurship education for both public policymakers and business/civil stakeholders (see Textbox 82 below).

TEXTBOX 82.
The EU Entrepreneurship Competence Framework (EntreComp)

The Entrepreneurship Competence Framework (EntreComp) is a knowledge-sharing initiative that has been established to foster entrepreneurial learning across the European Union and its partner countries in the South-East Europe region. It is essentially a community of practitioners interested in and committed to embedding entrepreneurship competency into public education and beyond. In 2018, the EntreComp framework published a guide introducing basic ideas and concepts on entrepreneurship competency. The guide also provides a diverse set of practical examples and case studies on how the EntreComp approach can be applied in the various countries and used for developing entrepreneurship skills in formal education and training, as well as in non-formal learning.[53] In Montenegro, for example, the Montenegrin National Partnership for Entrepreneurial Learning has been active in organizing a series of national conferences and workshops to promote the EntreComp framework, and has been behind efforts to embed the educational methods and best practices recommended by EntreComp into the national education and training curricula.[54]

TEXTBOX 83.
Peer-learning and role models for women entrepreneurs, Germany

The "Push up" project is a women-focused local initiative in Berlin that supports women with business ideas. The project offers in-person consultations and advice from peers. It is managed by a women's co-operative that is also a drop-in self-employment service centre for women. Since "Push Up" is a small-scale project, women seeking advice and mentoring are selected by a jury that evaluates their business ideas.

"Frauenunternehmen" (Women's Business) is a larger-scale initiative in Germany that aims to create a network of role-model women entrepreneurs. It provides a platform for exchanging experiences among the network members, as well as for bringing such entrepreneurial experience to educational institutions (universities, schools and vocational training centres). Female entrepreneurs are invited to apply to participate in the project. Members can benefit through workshops and peer exchange. The network is facilitated by the government agency Gründerinnenagentur.[55]

In addition to teaching entrepreneurship skills as part of the national school curriculum, most policy recommendations have increasingly given attention to the benefits of promoting peer learning and mentorship programmes. As country-level practices show, government agencies can be pro-active partners in such programmes, for example, by identifying young or female business leaders, organizing them into networks or platforms, and facilitating peer learning. This type of involvement can help both business and government actors to better understand the specific skills, needs and experiences of young and women entrepreneurs in a mutually beneficial way.

In sum, developing or teaching business skills as part of a national school curriculum is most successful if it builds strongly on practical business knowledge and experience.

Such practical experience must be communicated to teachers and trainers in advance. Involvement of business stakeholders is useful for closing the gap between educational institutions and private companies and for better motivating pupils and students.

5.8. The role of SMEs in greening the economy

As mentioned in Section 4.10. of this Guide, climate change is posing environmental, social and economic hazards to all countries in the world.

Reducing the environmental footprint of SMEs across various sectors is a key factor in greening the economy. Although the environmental impact of an individual company may be small, the aggregated impact of SMEs on the environment is significant.

The environmental footprint of SMEs can be minimized by increasing the efficiency that resources are used, as well as by adopting circular economy solutions and green business practices.[56] The transition to a more sustainable green economy can also bring business opportunities for SMEs, as suppliers of eco-friendly products or services. It is expected that SMEs going green, whether through innovation or adopting new practices, will generate a significant number of new jobs and boost company-level productivity and competitiveness.

According to the 2017 Flash Eurobarometer survey of SMEs in 37 OSCE participating States, SMEs are less likely to invest in green activities. Indeed, the majority of SMEs in these countries have projects to minimize waste (65%) and have adopted energy-saving (63%) and material-saving (57%) solutions. However, resource efficiency actions (such as saving water, or internal recycling through the re-use of material or waste) are less popular, and the overall investment in resource efficiency is still relatively low. The overwhelming majority of SMEs (74%) do not offer green products or services. Only the Scandinavian countries, Austria and the Netherlands see more than 30% of SMEs already active in green markets as suppliers.[57]

Other studies have shown that large companies are more likely to adopt proactive environmental strategies. In contrast, SMEs are often reactive, focusing on compliance with obligatory environmental requirements rather than strategically thinking about green transition.[58] Several factors may explain this difference in the environmental performance of large versus smaller companies.

First, SMEs may not be aware of the benefits of green actions and innovations, or of the negative environmental impact of their current business practices.

Second, even if they do recognize these things, they may lack the information, capacity or time to map available green options, whether of a financial, organizational or technological nature.

Third, insufficient financial resources may pose barriers. SMEs, especially small or micro-enterprises, are more cost-sensitive and focus on short-term profitability rather than the rate of return of long-term investments.

The most recent Eurobarometer survey (2018) examined the reasons behind the environmental performance of SMEs. Approximately 33% of the surveyed SMEs claimed that administrative or legal procedures were too complex, and 24% said that the cost of environmental actions was a barrier. In addition, 20% indicated that they were hampered by a lack of specific environmental knowledge and expertise, or experienced problems in choosing the right actions for their company.[59]

There is a range of policy tools that policymakers can use to address these issues.

Regulatory incentives can help shift SME performance towards better compliance with environmental regulations. In turn, this can result in SMEs better understanding the negative environmental impact of their operations.

In the Netherlands, for example, companies whose operations have a lower environmental risk are allowed simplified permit procedures. In Norway and France, companies with environmental management certification have lower environmental inspection compliance costs, since they are inspected less frequently.[60]

In addition to regulation, tools such as financial support or incentives can be utilized to reduce the costs of green investments and promote the adoption of green technologies. These include preferential tax treatment, direct financial assistance for resource-efficient investments, or low-interest loans. Another possibility is the co-financing of company-level expenses linked to establishing environmental management systems, acquiring eco-labels, running resource-efficiency audits, or engaging environmental consultancy services.

TEXTBOX 84.

The Green Scheme of Slovenian Tourism: An environmental development tool and certification programme

The Green Scheme of Slovenian Tourism (GSST) is a comprehensive model for promoting sustainable business models in the Slovenian tourism sector. The concept of eco-friendly tourism and reducing tourism's environmental footprint is picking up speed. Consumers increasingly seek and appreciate sustainable accommodation. The GSST is playing into these dynamics. It promotes energy-efficient solutions and the use of renewable energy sources among service providers and destinations. It also offers guidelines and tools for providers to evaluate and improve the eco-friendliness of their business. Businesses that meet the GSST criteria receive a green certification (Slovenia Green). The programme was launched by the Slovenian Tourist Board (STO) and is supported by the Ministry of Economic Development and Technology. Since 2015, the STO has certified 55 destinations, 57 accommodation providers, 4 natural parks, 5 travel agencies, 2 attractions, 3 restaurants and 1 beach. All comply fully with the national green strategic guidelines and operate under the Slovenia Green label.[61]

Possible government interventions include providing information about available SME greening options, raising awareness about the benefits of adopting green solutions, using green labels for consumer marketing, and recognizing and showcasing those companies that are front-runners in the green transition. In some OSCE participating States, as part of government business information and advisory portals targeted especially at SMEs, a number of governments have begun to provide environmental guidance or information services.[62] A unique EU-wide example of such an information- and knowledge-sharing website is the GreenEcoNet platform (see Textbox 85).

TEXTBOX 85.

GreenEcoNet: An EU-wide website for SME greening

GreenEcoNet is a website aimed at helping European SMEs find green business solutions and potential financial resources. It provides access to a rich inventory of businesses that have adopted green solutions, and provides a library of tools that can be used by companies or policymakers (such as templates for and examples of carbon footprint analysis, or for green investment cost–benefit analysis). GreenEcoNet also strives to facilitate communication between European SMEs engaged in green transition, as well as among national and regional SME networks. Policymakers, researchers and business community members can also interact on the online forum.

The website was established in 2014 by the European Commission as part of a wider programme co-ordinated by the GreenEcoNet consortium, which is made up of several academic and business institutions across the EU.[63]

▲ **Participants of the OSCE Economic and Environmental Forum's second preparatory meeting "Greening the economy for sustainable development, security and stability", held in Astana**

15 June 2017

Governments can also create new demand for green products and services, or boost markets where private consumer demand is insufficient by increasing efforts in green public procurement (GPP) and promoting GPP across the entire public sector. GPP practices favour suppliers who comply with environmental requirements, or have green certifications or qualified eco-labels. Typically, GPP is applied by public authorities in areas such as ICT equipment purchases, environmentally designed buildings, recycled paper, electric cars, etc. Several OSCE participating States have specific measures involving GPP, either within the framework of a green national action plan or as part of the national public procurement strategy. Austria, Ireland and the Netherlands were the first three countries among the EU Member States to instate a GPP agenda. Since 2010 these countries have been pushing for a still more progressive agenda that also covers areas such as food and catering services, cleaning products and services, and uniforms and textiles.[64]

5.9. Conclusions and recommendations

SMEs play a crucial role in economic growth, job creation, and economic and social innovation. Simplifying and easing the road for business start-ups has a great potential for contributing to government efforts to reduce poverty and integrate disadvantaged regions and groups.

There is a range of instruments and tools that policymakers can use to promote entrepreneurship in general, as well as to support SMEs, with their highly heterogeneous nature. The above overview of recent policy trends and good practices in the area of entrepreneurship policies has led to the following policy recommendations:

CREATE A COMPREHENSIVE SME POLICY FRAMEWORK THAT:

- Builds on co-operation between the various public and private (both business and civil) stakeholders;
- Harmonizes various reform initiatives and improves the consistency of policy areas relevant for SMEs (social and employment policy, education, monetary and fiscal policy, sectoral policies).

DESIGN AND IMPLEMENT AN EVIDENCE-BASED SME STRATEGY THAT:

- Builds on an in-depth analysis and breakdown of SMEs that is based on reliable and high-quality company-level databases, accurate data collection and clear definitions;
- Defines specific entrepreneurial target groups based on an in-depth analysis of the SME sector;
- Identifies the needs of these target groups clearly, with an eye on differences and specific needs;
- Considers the benefit of appointing a special SME envoy to harness SME-sensitive policymaking and assure that the interests of SME groups are represented in relevant circles of government;
- Can draw on continuous lessons learned and is able to adjust course if needed, based on a sound monitoring and evaluation framework that is embedded in the implementation of SME strategies.

BUILD A SUPPORTIVE BUSINESS REGULATORY FRAMEWORK THAT:

- Pays special attention to the disproportional nature of regulatory compliance and the relatively larger burden of SMEs for tax compliance as well as broader regulatory obligations;
- Simplifies business registration processes, as well as informational and administrative obligations levied on businesses through regulatory simplifications, improved e-government services, and lowering of capital requirements;
- Builds on international best practices, and assesses the impact of regulatory simplification reforms.

IMPROVE ACCESS TO FINANCE BY:

- Diversifying the financial instruments offered to SMEs and tailoring them to the needs of specific entrepreneurial or SME groups (in particular underrepresented groups such as youth, women, immigrants or seniors);
- Improving identification of targets of loan guarantees and microfinancing;
- Coupling access to financial support with skill development by combining financial assistance with other types business support (with a special eye on the training, mentoring and coaching of youth and women);
- Improving communication about available SME support schemes by means of digital and social media tools, and by involving business and civil society organizations linked to specific target groups.

CONSIDER ALTERNATIVE FINANCING, SUCH AS:

- Financing that has grown from a little-known funding source to a mainstream alternative;
- Financing that differs from traditional banking or capital market finance, made possible through the use of third-party capital by connecting fundraisers directly with funders, thus reducing transactional costs and improving market efficiency.

The following forms of alternative financing have been presented in this chapter:

- Innovative technologies, cryptocurrencies, blockchain technologies ;
- Equity funding, whereby donor funds provide financing;
- Remittances that directly support private sector development through donor supported schemes and funds;
- Peer2peer finance, whereby funding for companies is provided by other businesses, facilitated by means of intra-business channels, including crowdfunding;
- Bond investments for businesses, whereby investors lend money to a bond issuer in exchange for interest payments.

PROMOTE AND STIMULATE ENTREPRENEURSHIP BY:

- Providing role models and business awards or competitions (particularly effective for youth and women);
- Embedding entrepreneurship teaching in public education (especially at the secondary level);
- Promoting entrepreneurship training and development of entrepreneurship skills outside of formal education (in accordance with life-long learning strategies and actions);
- Facilitating entrepreneurship networks, based on partnerships with business organizations.

PROMOTE AND STIMULATE GREEN SMES BY:

- Putting appropriate regulatory incentives in place (simplification of environmental regulations, lowering costs of green compliance);
- Designing and promoting financial incentives that reduce the costs of green investments and share the risks of green innovation processes;
- Shifting business preferences towards resource-efficient investment and adoption of environmental management systems;
- Providing information about available SME greening options and raising awareness of the benefits of green transition.

5

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Digital transformation conducive to a strong business and investment climate

6

The rapid spread of digital technologies over the past few decades has led to a vast transformation in global economic activities.

Digital technologies present a broad array of new opportunities for economies.

They allow economies to increase productivity, enhance the distribution of goods and services, and even adopt new methods of production and value creation. This digital transformation, sometimes called the fourth industrial revolution ("Industry 4.0") also involves the emergence of an entire new industry, the so-called digital economy. It is estimated that by 2022, over 60% of global GDP will be digitized.[1] Furthermore, roughly 70% of value created in the world economy over the next decade is expected to be based on digitally enabled platforms.

With an estimated 4.38 billion internet users worldwide, roughly a billion people using social media, and over 360 million people already taking part in cross-border e-commerce,[2] digitally enabled commerce is becoming incredibly important for any business and investment climate, given that these numbers are only set to grow in the years to come. Policies and initiatives that stimulate the digitalization of businesses will be key to attracting and retaining investment.

In addition, the often-observed trend towards outsourcing and offshoring production is increasingly being reversed through digitalization. This development has been further accelerated by the COVID-19 pandemic, which, among other things, has ignited a process of growing economic regionalization.

The phenomenon of bringing back production from abroad to a company's initial country of production or manufacturing is often referred to as reshoring. In addition to digitalization, there can be many other drivers of reshoring, including regulations, cost changes, proximity of innovation, and threats to intellectual property.[3]

6.1. The importance of digital transformation in the OSCE context

Digitalization and digital transformation have taken centre stage in the OSCE context, particularly since 2018, when digital transformation was named a core component of the Italian Chairpersonship. That year, the OSCE participating States adopted the Ministerial Council Decision Human Capital Development in the Digital Era and the Declaration of the Digital Economy as a Driver for Promoting Co-operation, Security and Growth. The Decision calls upon participating States to build capacities regarding digital literacy, among other things, and underscores the importance for countries to implement measures that help develop the human capital skills required for participation in the digital economy.[4]

The Declaration acknowledges the role of the digital economy as a driver of innovation, competitiveness, growth and connectivity within the OSCE region.

Moreover, it recognizes the potential of digital transformation towards the implementation of the United Nations 2030 Agenda for Sustainable Development, whereby it highlights the role of e-government and good governance in modernizing and increasing the efficiency of public administration, as well as the contribution that the digital economy can make to better policymaking.[5]

To reap the benefits of the digital economy, the OSCE participating States stress the importance of expanding digital infrastructure and digital trade among countries of the organization, as well as enhancing the connectivity and business interaction among the participating States by means of digitization.[6] The participating States also recognize that steps must be taken to ensure that women benefit from new forms of employment, including shared economy and web-based female entrepreneurship.[7]

6.2. The influence of digital transformation on the business and investment climate

The development of digital technologies is increasingly leading to digitalization of all stages of economic value creation.

From design and production processes, to sales, logistics and after-sales service, digitalization transforms value chains and opens new channels for value creation and structural transformation.

In virtually every value chain, the ability to collect, store, analyse and transform data provides extra opportunities and competitive advantages. Digital technologies can thus play an essential enabling role in promoting a positive business and investment climate, and provide new opportunities for businesses and investors to create value. As technology offers new ways of consulting with stakeholders, it can also improve the ease of doing business (i.e., registering a company, paying taxes). Technology is also expected to become crucial for regulating new business ventures or in adjudicating corporate disputes. The impact of technology on trade and competitiveness is thus significant.

The digital revolution is changing the customary ways of doing business and offering countries tremendous opportunities.

However, it is also presenting policymakers with numerous challenges. Such challenges include security and economic governance, as well as lack of inclusivity and inequality due to digital divides. To fully harness the benefits of digitalization and manage its challenges, proper regulatory and institutional frameworks are essential (see also Section 2.1.), as are ICT infrastructure and sound government policies.

6.3. The acceleration of digitalization during the COVID-19 pandemic

The COVID-19 pandemic, with its associated lockdowns, has demonstrated that digitalization can boost resilience in societies, protecting them from external shocks and allowing them to resume vital social and economic functions following a crisis. According to the Digital Economy and Society Index of the European Commission:

"The coronavirus crisis shows how important it is to ensure the continuation of public services when social distancing measures are in place. A successful exit strategy to the current pandemic will require robust digital public services throughout EU Member States, including in the field of e-health, such as telemedicine, electronic prescriptions and medical data exchange, and the use of advanced technologies to enhance public services, for example though big data or AI technologies."[8]

The COVID-19 pandemic has made it even more clear that accelerating digitalization in both commercial and non-commercial settings is vital for positive social-economic development. Numerous efforts have emerged to support countries in expanding ICT solutions, such as government-facilitated online identification technology, or further automation of logistics and customs operations. The latter has facilitated the management of life-saving shipments by enabling the prioritization of humanitarian and medical cargo. Needless to say, the use of video calls has risen sharply during the lockdowns, as have digital public services, such as telemedicine services, online education, online steps for delivering justice, and in some cases even online (local) elections.

In addition to amplifying all aspects of the digital transformation process, especially increasing connectivity and internet use, the COVID-19 pandemic has also forced countries to strengthen their strategic approach to policies regarding digitization. It has also shown clearly that while big data can create new opportunities for businesses and consumers, it also presents new challenges for security and privacy.[9]

6.4. Digital data and the new infrastructure

Traditionally, the notion of infrastructure has mainly been related to structures on land.

The focus is now gradually and inevitably shifting to a new type of digital infrastructure based on data as an important driver for growth and development.

In comparison to traditional infrastructure, the new digital infrastructure has the additional layer of information and communication, which provides support for the digital economy. Today, the expression "new infrastructure" usually refers to 5G communication networks, artificial intelligence technologies, big data, data centres and cloud computing. New infrastructure also includes smart ultra-high voltage power networks, industrial internet, charging stations for electric cars and high-speed intercity railway networks.

6.5. The digital economy and its impact on the business climate

6.5.1. Emergence of the digital economy

The digital economy is growing quickly, often more quickly than we can comprehend. And yet it is not always clear what the term digital economy encompasses. Given that related technologies are being developed every day, no comprehensive definition is possible.

In essence, however, the digital economy is the economic output related to the use of digital technologies for the creation and sale of goods or services within an economy, including e-commerce.

Such activities often involve specific digital technologies, such as 3D printing, artificial intelligence (AI), creating and analysing big data via AI or algorithms, blockchain technologies, and the "internet of things" (IoT). All of these digital technologies, which are briefly explained in this section, are having – and will continue to have – an enormous impact on the economy due to their ability to reduce costs, create employment and mitigate the negative effects of climate change.

According to the OECD,[10] governments started to wake up to the opportunities and challenges brought by the wave of digital transformation around 2015. On one side, information technology services continue to grow, spurring a positive outlook. Quickly developing communication infrastructure and services are upgrading to be able to handle new surges of data. The use of information and communication technology (ICT) continues to grow.

Digital innovation and new business models are driving transformation in many areas, including business opportunities, jobs and trade. On the other side, however, these changes are unequally distributed across countries and among companies and individuals.

The effective use of ICT in daily life and for work requires both specialist and generic skills. In some cases, concerns about digital security and data privacy are restraining the adoption of certain ICT tools. The potential found in AI is accompanied by important policy and ethical questions. And the future of blockchain technology hinges on technical hurdles and policy challenges.

According to the World Trade Organization (WTO), digital technologies could reduce trade costs by 11% by 2030, and could boost trade volumes and growth by up to 34%.[11] Transaction costs, for example, can be reduced, since technology enables easy and cost-efficient matching of buyers and sellers via digital platforms, and reduces traditional barriers to accessing essential market information. Communication costs are decreasing due to the increasing availability of new digital channels. Digital technologies can also facilitate and ease customs procedures and cross-border payments. Certain digital technologies will allow more products to be manufactured locally, reducing transportation costs. This, in turn, can lower greenhouse gas emissions and the overall environmental footprint of economic production.

According to the World Economic Forum (WEF), digital technologies will help to create 150 million new jobs in the next five years. In some countries, as for example the United States, the number of experts working in the digital economy, such as data scientists and data engineers, is already growing annually by 35%. The most in-demand jobs in the digital economy require specific digital skills, including software development, data analytics, digital marketing and graphic design.[12]

6.5.2. Digital technologies

The digital technologies described below are essential components of digital transformation and the digital economy, since they drive economic development and innovation. They are also becoming important investment objectives.

- 3D printing is manufacturing that uses various techniques to build products by adding material in layers, often using computer-aided design software.[13] This type of printing is one of the most important digital technologies. Worldwide spending on 3D printing reached US$13.8 billion in 2019,[14] and is expected to reach US$32.78 billion by 2023.[15]

  It is expected that 3D printing will have a major impact on international trade and value chains, since it allows products to be manufactured closer to consumers and reduces the need to import goods. Automobile parts, electronic components, furniture, prosthetics and pieces of technical equipment, for example, can all be printed on 3D printers, making it no longer necessary to import them. By 2040 this could mean a reduction in global trade volumes of up to 40%, with a proportional decrease in overall production costs.[16] At the same time, the development of 3D printing could lead to an increase in cross-border trade of raw materials. Denmark, Switzerland and Singapore have invested significantly in the development of 3D printing technologies and are currently the main exporters of these technologies.[17]

  Tremendous economic potential can be unlocked by 3D printing, and it can bring millions of jobs. In the United States alone, it is expected to create three to five million skilled jobs in manufacturing in the next decade and yield US$900 billion in total economic value.[18]

- Artificial intelligence (AI) involves "self-learning systems that can learn from experience with humanlike breadth and surpass human performance on all tasks".[19] Worldwide spending on AI systems grew to nearly US$35.8 billion in 2019.[20] AI is expected to have a significant impact on international trade through its impact on competition, as well as on knowledge creation and diffusion.[21] It will also impact the development and management of global value chains by improving economic predictions (e.g., consumer demand), allowing more efficient inventory management and increasing the accuracy of time-sensitive manufacturing and delivery. This can change specifications along value chains and make them shorter.

- Big data are "information assets characterized by such a high volume, velocity, and variety to require specific technology and analytical methods for its transformation into value".[22] Worldwide revenues from big data and business analytics solutions reached US$189.1 billion in 2019, and are expected to grow to US$274.3 billion by 2022.[23] The majority (US$100 billion) of this revenue was generated in the United States. In digital trade, big data are used to optimize logistics, forecast product demand and find related solutions, facilitate data validation and error checking, detect anomalies in supply chains, conduct mobile reporting, improve global logistics visibility for real-time route optimization, improve inventory management and improve responses to government audits.

  One example of big data is blockchain technology. Blockchains are managed by peer-to-peer networks that collectively adhere to a protocol for inter-node communication and validation of new blocks. This technology can be used in multiple areas. As it has been described by specialists, "blockchain has a nearly endless number of applications across almost every industry. The ledger technology can be applied to track fraud in finance, securely share patient medical records between healthcare professionals, and even acts as a better way to track intellectual property in business and music rights for artists."[24]

  Blockchain technology has many potential applications in digital trade, including trade finance, business--to-government (B2G) and national interagency co-ordination, certification and licensing release, customs clearance of goods, temporary admission of goods, revenue collection, accuracy of trade data, post-clearance audits, compliance and identity management, cross-border government-to-government (G2G) processes, logistics and transportation, cross-border payments, insurance, retail distribution and e-commerce, intellectual property (IP), piracy and counterfeiting, government procurement processes and data monitoring. Blockchain technology can be used in trade financing to improve procedures. Traditional trade financing involves a great deal of paperwork and intermediaries. With the use of blockchain, importers and exporters can record their transactions after having agreed on the terms of their contract (goods, price, payment term, settlement conditions) on a blockchain platform. In B2G, blockchain can make such processes more efficient. It can also enhance interagency co-operation at the national level and help administer single windows – facilities that allow trading parties to lodge standardized information and documents with a single entry point to fulfil all import, export, and transit related regulatory requirements. It allows information to be exchanged and processed with all those authorized in real time and in a highly secure manner. It also enables processes to be automated using smart contracts, thereby minimizing co-ordination costs and delays.

- The internet of things (IoT) is defined as “the growing array of Internet-connected devices such as sensors, meters, radio frequency identification (RFID) chips and other gadgets that are embedded in various everyday objects enabling them to send and receive various kinds of data”.[25] The global spending on the IoT is staggering and is projected to grow from US$726 billion in 2019 to more than US$1 trillion by 2023.[26]

  In digital trade, the IoT can be beneficial in four areas: marketing, real-time management, logistics and storage. In marketing, such technology can provide all the necessary data for analysing markets and consumer behaviour. In real-time management, IoT devices help to control conditions in warehouses such as temperature, noise and humidity. IoT devices also help to authorize item processing. In logistics and supply chain management, IoT tracks shipped items through sensors, thus being able to predict transportation conditions and time of arrival of products. This in turn can help to manage shipment routes, speed up transportation and reduce the risk of lost shipments. Real-time routing leads to significant improvements in operational efficiency; it has been predicted that it will result in between US$253 and US$460 billion in benefits by 2025.[27] In storage, IoT in technologies such as smart containers can be used to share information about cargo with multiple stakeholders, such as shipping lines, cargo owners, terminals, ports and other cross-border agencies. IoT can also be used in agriculture, where smart farming enables farmers to reduce waste, enhance productivity and improve quality. It also provides for better tracking and tracing of agricultural goods along supply chains.

The deployment of digital technologies requires certain conditions to be fulfilled, such as proper regulatory and institutional frameworks, and suitable conditions for financing digital infrastructure.

Digitalization is needed, as well as policy drivers and mechanisms for monitoring progress towards digitalization policy targets. Inadequate regulatory frameworks can result, on one hand, in security threats and loss of privacy, and on the other, in inequalities between social groups and countries. The following sections describe how such challenges can be addressed, and how conditions can be created to deploy digital technologies.

6.6. Strategies to support the digital economy

Governments should consider adopting a comprehensive digital transformation strategy. A strategy of this type is important because it shows political will and gives direction. It can also settle digitalization targets at various levels of government, and provide short-, medium- and long-term priorities. A comprehensive strategy also allows the efforts of multiple stakeholders to be harmonized. Without a strategy, deployment of innovation or technology is unlikely to go beyond individual projects, which in turn can inhibit needed socio-economic transitions or transformations of technological systems.

Digital transformation strategies can play important and successful roles in individual countries, as well as in international groups of States. From the side of policy, the typical elements of a successful digital transformation strategy are forward-looking ideas, clear priorities and objectives, measurable targets and sufficient budgetary means, coupled with progress monitoring and policy evaluation. Effective management of digital transformation can support effective co-ordination across policy areas and among the involved stakeholders. In turn, it can bring sustainable growth and inclusive prosperity.

6.6.1. European Union digital strategies

The European Union's digital strategy is a best practice example for a sound policy that enables a strong digital economy. The aim of the EU's Digital Single Market strategy is to move from 27 national digital markets to a single digital market. The strategy was adopted in 2015 as one of the European Commission's ten political priorities. Making the EU's single market fit for the digital age means new opportunities for Member States, since it removes the key differences between the online and offline worlds, and breaks down barriers to cross-border online activity. The EU-wide digital single market will provide better access to online goods and services for consumers and businesses across Europe.

The Eastern Partnership (EaP) is a joint policy initiative that aims to deepen and strengthen relations between the Member States of the European Union (EU) and the EU's six Eastern neighbours, Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine.

The project Eastern Partnership Connect (EaP Connect) aims to bring together research and education communities from the EU and the Eastern partner countries and to reduce the digital divide.

EaP Connect is a part of EU4Digital, whose aim is to develop the potential of the digital economy and society in the Eastern partner countries. In the first phase of EaP Connect (2015–2020), investments of €13 million were made to extend network infrastructures in order to scale up scientific exchange across borders, offer new services to enhance co-operation in international research and education, strengthen national research and education networks, and build knowledge, skills and collaborative work. The current phase of the project, building on the achievements of the initial programme, aims at establishing and operating a high-capacity broadband internet network for research and education activities. This will facilitate national research and education, and will also stimulate collaboration among scientists and researchers.

TEXTBOX 86.

The impact of EaP Connect

- Reduction of cell phone roaming costs through the establishment of a single roaming space;
- More than tenfold increase in internet connectivity in Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine;
- Increased connectivity between institutions in Georgia (17%), Armenia (26%) and Azerbaijan (58%);
- Provision of internet access to around 800,000 students and scientists;
- Within the framework of EU4Digital, establishment of partnerships in Ukraine and Poland to introduce electronic, paperless formats for government services;
- Also within the framework of EU4Digital, in Belarus and Lithuania, launch of an e customs project to enable data exchange on freight transportation.

▲ **Participants of an OSCE workshop on e-commerce held in Chisinau**

4 October 2018

TEXTBOX 87.

The Digital Innovation and Scale-up Initiative (DISC)

The Digital Innovation and Scale-up Initiative (DISC) was launched in 2019 by the EU to channel initial investment to digital start-ups in Central, Eastern, and South-Eastern Europe. DISC also offers a technical assistance programme to strengthen the institutional capacities of public agencies to design, develop and implement digital innovation programmes.

The European Commission aims to measure the need and possibilities for the implementation of a similar initiative in the Eastern partner countries. In order to achieve this, the EU4Digital Facility has launched the new activity "Market assessment for the Digital Innovation and Scale-up Initiative (DISC study) in the Eastern partner countries".[28]

TEXTBOX 88.

EU Connecting Europe & Asia Strategy

The EU Connecting Europe & Asia Strategy is contributing to the enhanced prosperity, safety, and resilience of people and societies in Europe and Asia. Its aim is to increase digital connectivity and access to digital services, while maintaining a high level of protection of consumer and personal data. Its four main pillars are transport, energy, digitalization and the human dimension. The Strategy promotes efficient cross-border digital networks, strengthens bilateral, regional and international partnerships based on commonly agreed rules and standards, and leverages sustainable financing for investments.

There are three main components of the Strategy: 1) extending the EU's Trans-European Transport Networks to countries in Asia, which requires investments in both Asian and European countries; 2) developing the port of Gdansk as a major infrastructure investment (€1.3 billion); and 3) linking the European and Asian rail transport routes (through Kazakhstan) by introducing technologies to achieve sustainable and smart mobility.

In December 2020, the EU launched the Digital for Development (D4D) Hub. Establishing the D4D Hub, which is a global multi-stakeholder platform, marks a turning point in the EU's international partnerships to support a human-centric digital transformation. The aim of the D4D Hub is to bring together and co-ordinate a large number of digital initiatives by European actors, which will have an unprecedented impact. To date, 11 EU Member States have signalled their intention to co-operate under the D4D Hub towards a single European digital development strategy.

TEXTBOX 89.

The Digital for Development (D4D) Hub

The D4D Hub unites key stakeholders from EU Member States, tech companies, civil society and financial institutions. The platform includes all relevant stakeholders from Africa, Asia, Latin America, Caribbean, and from EU's Eastern Neighbourhood countries. A hackathon called "Smart Development Hack" called for innovative digital solutions to tackle the challenges caused by the COVID-19 pandemic in low- and middle-income countries. It was one of the first successes of the D4D platform. The Smart Development Hack was launched in April 2020 and has already amassed more than a thousand innovative digital solutions. The first EU digital co-operation has been with Africa, advancing new digital partnerships and investments for a fair and inclusive African digital economy.

TEXTBOX 90.

Central Asian Research and Education Network (CAREN)

The Central Asian Research and Education Network (CAREN), funded by the European Union, was launched in 2009. It has provided a high-capacity data-communications network for researchers, academics and students at institutions in Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan. A primary goal has been to link people working in the fields of telemedicine, seismology, distance education, energy and water resources management, and environmental studies. CAREN is contributing to regional connectivity through improved infrastructure and the replacement of current low-capacity satellite connections, thus helping to increase the internet capacity available to researchers in the Central Asia region. CAREN now links over half a million users at more than five hundred universities and research centres.

6.6.2. Eurasian Economic Union (EAEU) digital strategies

The Eurasian Economic Union (EAEU) is an economic union of States located in Eastern Europe, Western Asia and Central Asia. The Treaty on the Eurasian Economic Union was signed on 29 May 2014 by the leaders of Belarus, Kazakhstan and Russia, and came into force on 1 January 2015. Armenia and Kyrgyzstan acceded to the EAEU at the end of 2014.

The Union was created with the aim of increasing co-operation between the members' national economies, and to promote stable development in order to raise the living standards. These goals now include digitalization.

The EAEU has two strategic documents on digitalization of national economies: 1) the Statement of the EAEU Digital Agenda (2016), and 2) the Main directions of the EAEU Digital Agenda Implementation to 2025.

The main aims of digitalization in the EAEU are transition to new forms of economy, enhanced qualitative and sustainable economic growth, creation of an enabling environment for innovation development, formation of new industries and markets, updating of integration mechanisms, improvement of economic efficiency, and increase of competitiveness. All of the digitalization projects are having a positive impact on the socio-economic development of the region.

Examples of digital projects that are being implemented within the EAEU are:

- The Eurasian industrial co-operation network;
- Digital subcontracting and technology transfer;
- Digital traceability and labelling;
- Digital transport corridors.

Digitalization of international transport corridors is one of the most important EAEU projects. It is planned to implement digital transport corridors by 2025. The digitalization of transport corridors will help reduce transit times of both passenger and freight traffic. It will simplify cargo delivery and customs declarations, level barriers, and increase the competitiveness of carriers. The system will make it possible to identify convenient routes and transportation conditions. Moreover, it will optimize State control functions, for example by offering pre-booking of time slots in queues at international checkpoints.

6.7. Using a "systems thinking" approach to improve the digital economy

A major pillar of digital transformation is increasing interconnectivity among the various economic actors: customers, businesses and governmental structures. In some cases, digital transformation is disruptive since it breaks down traditional industry boundaries. But in their place it establishes new cross-industry ecosystems. In these new ecosystems, digital economy actors collaborate to develop and then commercialize new concepts. Digital transformation can also bring the physical and digital dimensions closer together, leading to the emergence of what are called hybrid ecosystems.

These various types of interconnected ecosystems provide new opportunities, such as the development of new networks, partnerships and communities. But they also involve challenges, such as increased exposure to information infrastructure breakdown, cyberattacks, or data fraud and theft. Moreover, since the current global political, economic and social setting is a complex system, these risks are not isolated but are interconnected to other risks, such as critical infrastructure failures or financial failures.

Systems thinking can help leverage the opportunities of digital transformation and address its challenges. It can help various national and regional governments to achieve ambitious plans and goals for digital transformation. The systems thinking paradigm was initially coined by Barry Richmond in 1987. It has been defined and redefined in many different ways since then. One of the most recent and comprehensive definitions is the following: "Systems thinking is a set of synergistic analytic skills used to improve the capability of identifying and understanding systems, predicting their behaviours, and devising modifications to them in order to produce desired effects."[29]

Conventional policy planning methodologies often have limited power in circumstances with high risks or uncertainties, or when different stakeholder groups have conflicting interests. Systems thinking can assist decision-makers in addressing such "wicked problems". It can also mitigate unintended negative consequences caused by focusing on a single part of a system and ignoring the effects of interdependencies.[30]

The need for systems thinking has been identified in agenda and strategic documents of several countries (see below).

TEXTBOX 91.
Systems thinking: Some best practices

- The Prime Minister's Office of Finland developed a new policy framework in 2015 to conduct Government projects using a combined systems and design thinking approach. Based on this framework, the Finnish Government in 2017 launched the digital platform Kokeilun Paikka to explore innovative ways to develop public services.
- The Government of Azerbaijan has used an integrated systems approach to develop the MyGov system, which provides an electronic government portal. Its users can review personal, financial, educational and other information, and access public services.
- Denmark, Norway and Portugal use centralized mechanisms for pre-evaluating investments in digital technologies to improve their coherence and sustainability. These mechanisms encourage systems thinking, foster co-operation and synergies across the different government sectors, and promote consistent public spending. They thus connect the public sector digitalization efforts to broader public sector goals and policy agendas.
- "Digital Kyrgyzstan 2019–2023" is a digital transformation concept that highlights the need for a systems approach to developing digital services, data sharing and cybersecurity issues.[31]
- The local government of the city of Toronto, Canada, adopted a system thinking-informed policy for regulating digital platforms for public transportation (e.g., Uber) in 2016.[32]
- A digital strategy for the city of Bristol, United Kingdom, was developed by the Engineering Systems and Design Institute of the University of Bristol in 2019.[33]

6.8. Tools and indices to measure progress towards the digital economy

There are various tools and indices for measuring the progress of countries in their digital transformations, particularly in areas such as digital government, digital economy and digital society. The various available digitalization indices enable policymakers to compare their countries with their peers, as well as their own position in previous years to track progress. Policymakers are therefore often interested in finding means for improving their corresponding ranking.[34]

Tools and indices can also help identify factors that are impeding digitalization. They can be used for analysing country-specific characteristics, such as the impact of specific policies on e-government development. They can help identify best practices and recommendations, and can support digital co-operation among different countries.[35]

Different countries use indices in different ways. For example, the Czech Republic and the Kyrgyz Republic use indices to identify economic pathways to digital development. Greece uses them to identify the impact of current policies on digital competitiveness and detect areas for further improvement. Russia uses indices for analyses at the regional level. The European Commission has developed its own index on digital economy and society to monitor technological development in EU Member States. One reason for monitoring this development is to ensure that performance in the EU keeps pace with that of Japan, the Republic of Korea, the United States and other digitally advanced countries. The European Commission also uses a digitalization index to measure the economic and social impact of digital agendas and the success of their implementation. The Eurasian Development Bank relies on various indicators to assess the digital development of its member countries.

The multidimensionality of digitalization, its rapid development, and its diverse impact on the economy call for a comprehensive assessment of the corresponding indicators.[36]

However, digitalization indices often consider only certain aspects of digitalization, e.g., e-governance or cybersecurity. More inclusive indices suffer from other drawbacks, such as disputed data collection processes, unclear definitions of what is being measured, limited data availability, and subjectivity in choosing indicators. Moreover, in some cases interdependence between certain indicators is a problem.[37] Indicators also differ in the geographic areas they cover. Some measure only developments in a particular region, such as the Digital Economy and Society Index (DESI) for the EU countries. Others attempt to provide worldwide comparisons, such as the E-Government Development Index (EGDI) and E-Participation Index (EPI), which are compiled by the UN for 193 countries.

TEXTBOX 92.
Indices as indicators of progress: An example

The E-Government Development Index (EGDI) developed by the UN and covering 193 countries is one of the oldest indices of digital transformation. Since the index was already initiated in 2003, it enables the progress of countries in developing e-governance to be traced. Most high GDP OSCE participating States are relatively stable and show a high performance on this index. Other participating States have demonstrated significant progress since 2003. For example, Uzbekistan has gone up 87 positions in the rankings, and Albania and Kazakhstan have gone up 54. This indicates that these countries have made substantial improvements in applying digital technologies to provide government services.

In general, digitalization indices are criticized for their lack of an agreed upon holistic methodology to assess the development level of the digital economy of countries and position them according to this level.[38] The available indices provide rankings for countries, but do not offer guidance for policymakers regarding relevant aspects to focus on. More advanced statistical analysis would be required to identify the impact of each indicator in each country context.[39]

For example, while some indices measure investment in digitalization (e.g., the Network Readiness Index [NRI] measures indicators of investment in emerging technology and government promotion of such investment), current scores do not reflect the impact of such investments.[40] The actual use of the corresponding technologies or skills in the private and public sector is likely to be reflected only by related scores in subsequent years.

The following indices are often used as a basis for assessing the effectiveness of digital strategies as internationally recognized indicators, or as benchmarks of achievement of digital development goals (Table 10).

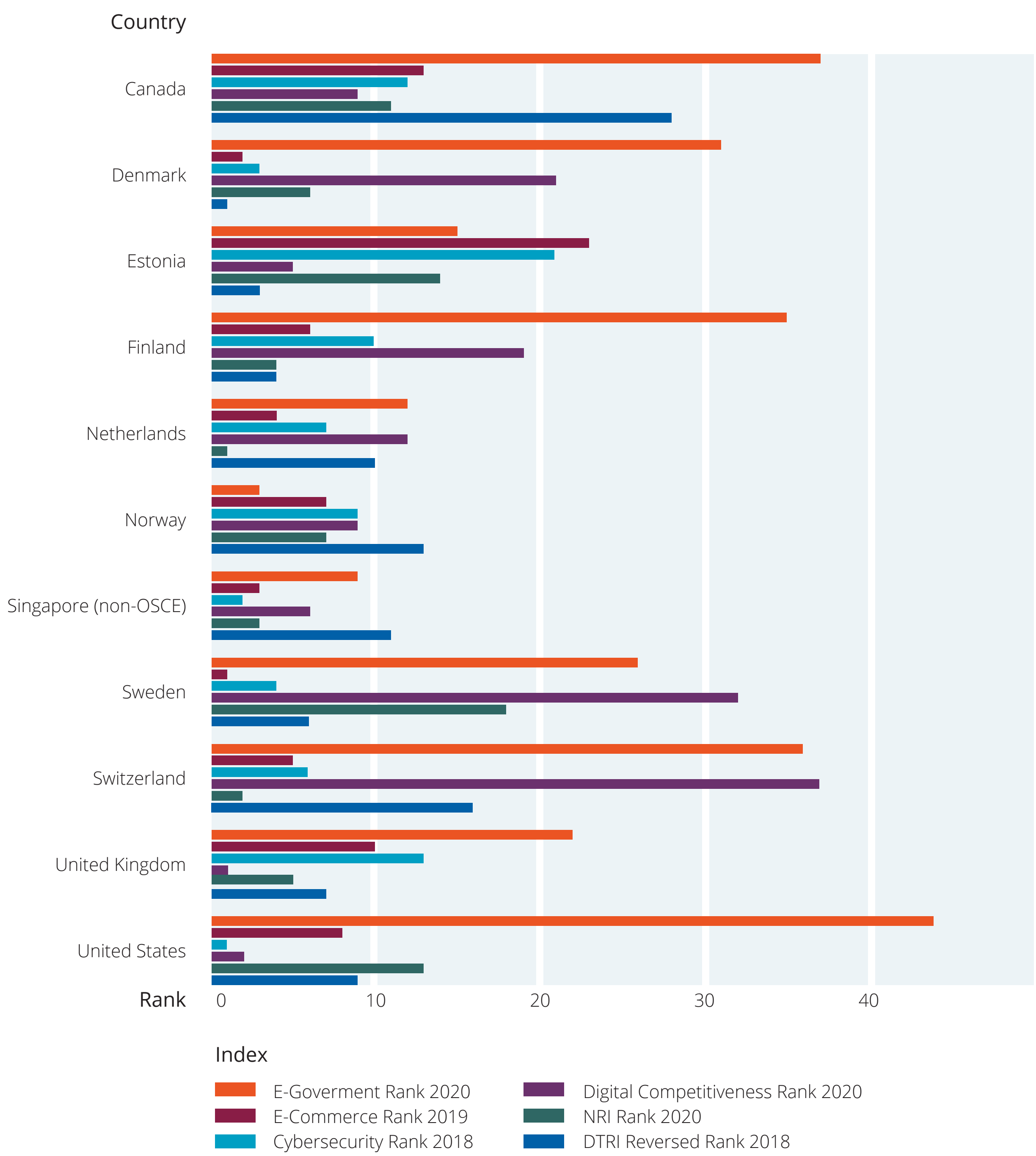
Table 10. Selection of indices relevant to the digital economy

Index name	Author (institution)	Coverage: OSCE participating States	Coverage: Time	Pillars
Digital Economy and Society Index (DESI)[41]	European Commission	Only EU	2015–2020 (yearly)	Connectivity Human capital Use of internet services Integration of digital technology Digital public services
ICT Sector Value Added[42]	Eurostat	EU, EFTA, candidate countries, potential candidate countries	2005–2017 (yearly)	Share of the ICT sector in GDP Share of the ICT personnel in total employment Change of value added by ICT sector at current prices Business expenditure on R&D in ICT sector R&D personnel in ICT sector
E-Government Development Index (EGDI)[43]	United Nations Department of Economic and Social Affairs	All except: Holy See	2003–2020 (once every 1 to 3 years)	Provision of online services Telecommunication connectivity Human capacity
E-Participation Index (EPI)[44]	United Nations Department of Economic and Social Affairs	All except: Holy See	2003–2020 (once every 1 to 3 years)	E-information sharing E-consultation E-decision making

Index name	Author (institution)	Coverage		Pillars
		OSCE participating States	Time	
Business-to-Consumer (B2C) E-Commerce Index[45]	United Nations Conference on Trade and Development (UNCTAD)	All except: Andorra, Holy See, Liechtenstein, Monaco, San Marino, Turkmenistan	2014–2019 (yearly)	Account ownership at a financial institution or with a mobile-money-service provider Individuals using the internet Postal Reliability Index Secure Internet servers
Global Cybersecurity Index[46]	International Telecommunication Union (ITU)	All	2014–2018 (once every 1 to 3 years)	Legal, technical, organizational, capacity building, co-operation
World Digital Competitiveness Ranking[47]	International Institute for Management Development	All except: Albania, Andorra, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Georgia, Holy See, Kyrgyzstan, Liechtenstein, North Macedonia, Malta, Moldova, Monaco, Montenegro, San Marino, Serbia, Slovakia, Tajikistan, Turkmenistan, Uzbekistan	2014–2020 (yearly)	Knowledge Technology Future readiness
Network Readiness Index[48]	World Economic Forum, Portulans Institute	All except: Andorra, Holy See, Lichtenstein, Monaco, San Marino, Turkmenistan, Uzbekistan	2003–2020 (once every 1 to 3 years)	Technology People Governance and impact
Digital Trade Restrictiveness Index (DTRI)[49]	European Centre for International Political Economy (ECIPE)	All except: Albania, Andorra, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Georgia, Holy See, Kazakhstan, Kyrgyzstan, Liechtenstein, North Macedonia, Moldova, Monaco, Mongolia, Montenegro, San Marino, Serbia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan	2012	Fiscal restrictions Establishment restrictions Restrictions on data Trading restrictions
Going Digital Toolkit[50]	OECD	OECD countries + Brazil, India, Indonesia, People's Republic of China, Russian Federation, South Africa	Yearly	Access Use Innovation Jobs Society Trust Market Openness

OSCE participating States are ranked high across the major digital transformation indices,[51] and occupy top positions in all the indices considered. The two best OSCE performers are Norway and the Netherlands. These two countries are ranked not lower than 13 on all indices.

Figure 5. **Ranking based on digital transformation indices.**



Source: authors' own calculation based on indices data publicly available from the corresponding institutions.

TEXTBOX 93.
Digitalization in Finland in various indices

Although the various indices have different methodologies, they can be helpful in diagnosing digitalization challenges in individual countries. They also allow for some types of comparisons between counties. Finland is known for its high level of digitalization and ranks among the top ten countries. Such a ranking is often the result of the broader introduction of specific technological tools and policies. But there is no blueprint for successful digital transformation. Digitalization processes are characterized by a multitude of actions, scientific focus, adaptive attitudes, business agility and IT integration. All these indices are part of the World Digital Competitiveness Ranking for Finland.[52]

6.9. Digital tools to improve the business and investment climate

Digital government involves the idea of providing government services through digital tools and platforms, as well as using government data to optimize, transform and create better government services.

Digital government has become instrumental for a positive business climate.

Digitalization helps reduce and ease administrative procedures, and increase the transparency of important administrative processes, especially government licensing and other steps essential for conducting business and investing. Digital government can also increase the predictability of administrative processes, and enable private companies dealing with governmental approval processes to better plan.

A number of countries have set ambitious policy goals to harness the benefits of digitalization through digital government and new forms of governance, such as participatory governance, which allows the engagement of all interested stakeholders, including citizens, civil society, NGOs, academia and business.

TEXTBOX 94. E-government in the Russian Federation

The e-government strategy of the Russian Federation for providing digital government services to its citizens has improved the country's investment climate significantly. Administrative procedures have been streamlined and government services made easier to use through the principle of "one window", whereby services can be accessed digitally from a single authority rather than clients having to go through several authorities. In line with this, multi-function centres and unified portals have been set up to link different government institutions, establish national databases, and introduce joint services, such as a single system for identification, authentication and payment. The implementation of the one window initiative has helped improve the Russian Federation's rating in the World Bank's ease of doing business index from 51 in 2016, to 28 in 2020.

6.10. The digital economy and foreign direct investment (FDI)

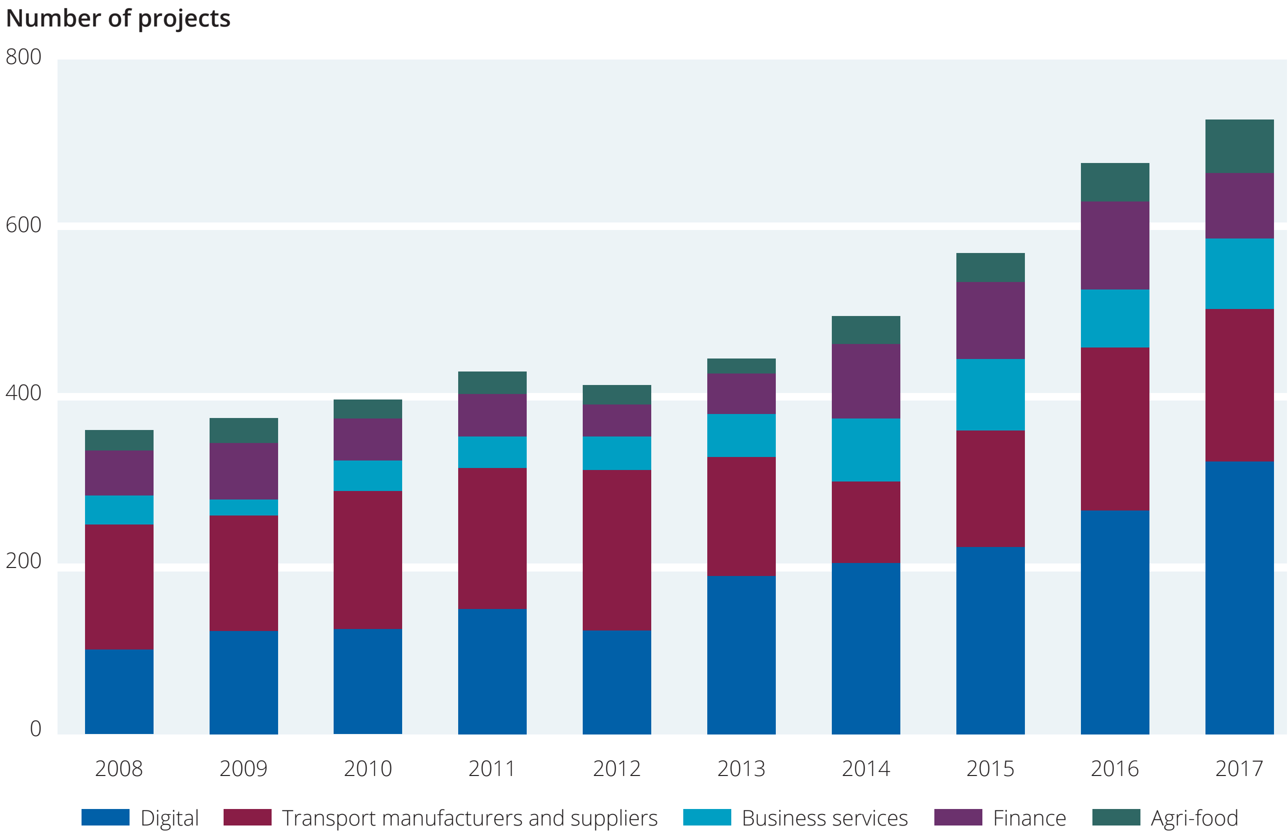
The digital economy has significant implications for investment, and investment is important for a thriving digital economy. Companies involved in technology, media, digital retail and telecommunications are drivers of increased foreign direct investment (FDI). FDI volumes flowing into digital economic activity in OSCE participating States are growing every year (see Figure 7, below).[53] Digital companies are thus considered one of the main drivers of socio-economic development.[54]

TEXTBOX 95. The Participatory Budget of Portugal

Portugal is currently implementing a Participatory Budget that allows civil society to decide on public investment in various governmental areas. The citizens can propose and vote on ideas for public investment to be funded by the National State Budget of Portugal. This is the first participatory budget in the world. The first edition concentrated on six areas: education and adult training, culture, science, agriculture on the mainland, and justice and home affairs in the autonomous regions. It is now being extended to all governmental areas.

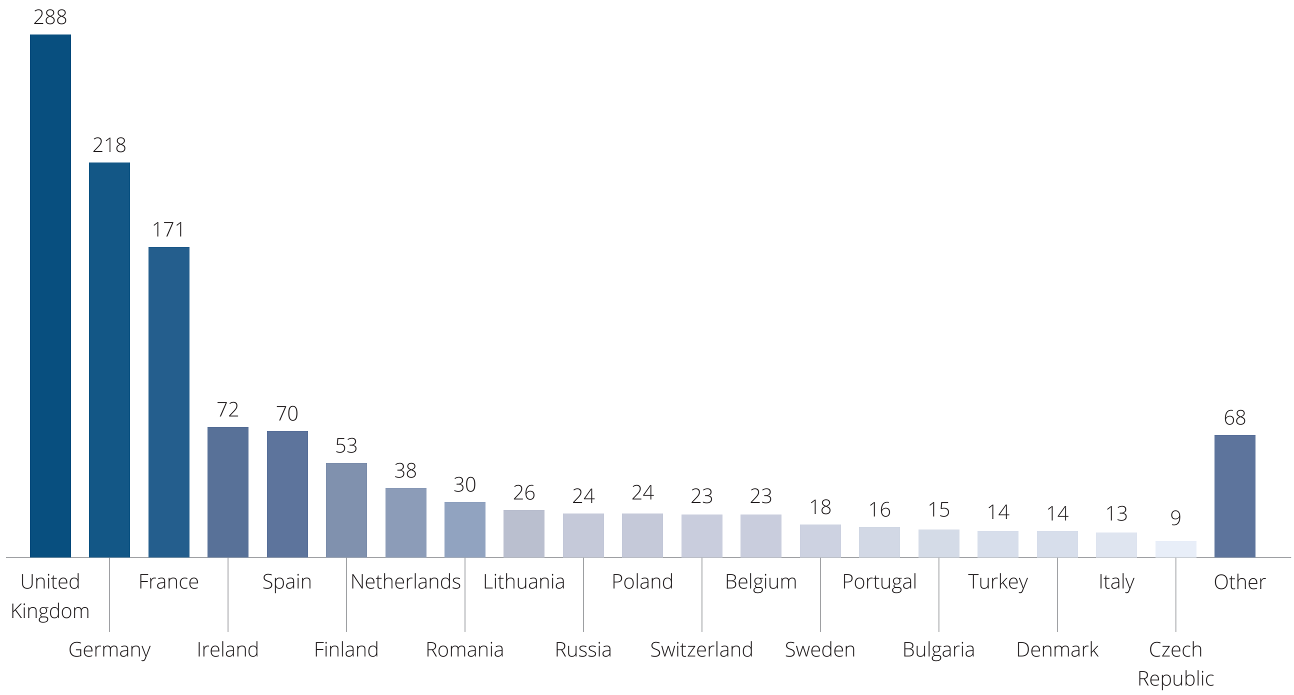
The Participatory Budget is a hybrid participatory model. It includes both face-to-face meetings and ICT tools to facilitate electronic participation. These tools also allow citizens to vote on the final set of proposals. During 2017 alone, more than 1,000 projects were submitted, of which 599 were put to a vote. Of these, 38 won financing. More than 78,000 people participated in the voting procedure.

Figure 6. Leading sectors for foreign direct investments (FDI) in the United Kingdom, 2008–2017, by number of projects.



In 2018, firms involved in the digital economy enjoyed the highest volume of FDI of all investment projects.[55] The United Kingdom, for example, became one of the most attractive destinations for FDI due to its thriving digital sector.

Figure 7. Number of FDI projects in Europe's digital sector in 2018



Companies adopting technology and digital tools in their business operations have several advantages over conventional companies, which is why there has been such fast growth of FDI in digitally oriented companies. New technologies also create new ways to facilitate investment processes. For example, investors can use virtual reality technology to pay a virtual visit to potential investment sites.

There are several tools available for facilitating FDI flows into the digital economy. One example is leveraging strategies and agreements to facilitate digital business. The digital dimension of the 2017 Canada–European Union Comprehensive Economic and Trade Agreement (CETA), for example, establishes new rules that address potential barriers to digital trade, and that protect the free flow of data across borders. CETA has helped increase FDI stock in information and communications technology (ICT) in Canada from the EU by nearly 130%, from US$2.48 billion in 2013 to US$5.65 billion in 2018.[56]

Large cross-border digital platforms are another important channel of FDI into the digital economy. These platforms are also opening new opportunities for local SMEs. Cross-border digital platforms are important because they are among the world's largest companies based on their market capitalization, the market value of these companies outstanding shares. In early 2021, for example, Vietnam's leading e-wallet firm announced it had won an FDI of nearly US$100 million to build a new super app platform.[57]

To attract more FDI into digital technologies and the digital economy, it is important to eliminate barriers to e-trade and capital mobility.

It is also vital to look into liberalizing the development and deployment of next-generation technologies (especially new financial technologies [fin-tech] and green technology) by granting economic incentives. In tandem with introducing new technologies, the "human factor" must be considered. This involves fostering conditions for human development and workforce quality.

As with other technological changes, digital transformation is not just about the diffusion of technology, but also about complementary investments that companies need to make, such as skill acquisition, organizational changes, process innovations, new systems and new business models.[58]

Digital economy can become an important driver for democratic and economic development, since it opens new market channels for local businesses, promotes inclusive trade, and promotes participatory governance and citizen engagement.[59]

TEXTBOX 96.

Digital FDI and the e-Estonia initiative

A highly advanced digital society is found in Estonia, which rebuilt its economy from scratch in 1991 and decided to go digital. A few decades later, Estonia's digital society is seen as one of the most technologically wired countries in the world. The citizens of Estonia view internet access as a basic human right. Digital public services are so embedded in the daily lives of individuals and organizations that the country is now commonly called "e-Estonia".[60]

Estonia is one of the most successful economies in capitalizing gains from digital FDI. Its success is due to a number of factors, including efficient and transparent public services, low levels of perceived corruption, political stability, a simple tax system, ease of doing business and trading across borders, high economic and internet freedom, and an educated and tech-savvy workforce.

The e-Estonia initiative has created conditions for a paperless and digital society. It is possible for everyone in the country to use online services to pay taxes, make bank transfers, sign documents and vote in elections. In 2019 Estonia attracted US$27 billion in FDI, with 34% of this going to financial and insurance activities, followed by real estate (18%) and manufacturing (12%).[61]

The majority of FDI in Estonia comes from Sweden (24%) and Finland (24%). The share from other countries is lower, as for example, Netherlands (6%), Luxemburg (5%), Lithuania (4%) and Latvia (3%).

Digitalization has allowed Estonia to raise its ranking substantially in various international indices. Notably, it currently ranks number one in the OECD Tax Competitiveness Index 2020, the World Economic Forum 2017 Entrepreneurial Activity report, and the Digital Economy and Society Index 2020 of the European Commission.

TEXTBOX 97.
The European Investment Bank portfolio and the digital economy

The European Investment Bank (EIB) holds a significant position in investing in the digital economy. In 2019, digital services for over 117 million people were improved as a result of EIB investments. The EIB is committed to supporting the growing data traffic in Europe. It has not only invested in high-speed internet, mobile networks and cloud computing, but also in TV broadcasting and transmission networks. The aim of these networks is to enable national and international connectivity through high-capacity fibre-optic cables, satellites and submarine cables outside the EU. The EIB also invests in data centre facilities and has hosted services such as manufacturing of handsets, network equipment, software, audio-visual equipment, displays (e.g., LCD displays) and chips (nano- and micro-electronics), ICT applications for various industries, including the automotive, electricity and healthcare industries, and public services such as e-government, e-health and e-business. The EIB investment portfolio also makes digital technologies available to small businesses.

The EIB investment portfolio has supported, for example, the digitalization of fitness facilities in Germany. It is also supporting the modernization of primary and secondary schools in Serbia by providing new digital equipment, connectivity and capacity building training for 50,000 schoolteachers.

6.11. Digital technologies for good governance

As mentioned in Section 3.1. of this Guide, open data are essential for good governance and for improving the investment climate, since they increase transparency and provide needed information for planning and realizing investments. But there are also other advantages of open data. For example, the possibility of comparing various data sets is a driver of co-operation and innovation, evidence-based policymaking and improved decision-making. It also contributes to equitable growth.

Various benchmark open data initiatives include the Open Contracting Partnership,[62] the Open Contracting Data Standard,[63] the Open Data Charter[64] and the Open Data Barometer.[65] These benchmarks provide important information for investors, such as procurement or government procedures. For example, calculations of internal rates of return depend on the length and number of governmental procedures: if such information is available on open data platforms, this can help investment decisions. Examples of open data centres are InfoCamere (Textbox 98) and DIGITALEUROPE (Textbox 99).

TEXTBOX 98.
InfoCamere

InfoCamere works on behalf of the Italian Chamber of Commerce to support the digitalization of public administration and provide a range of digital public services. Its computerized business register is well known across Europe as a best-practice service. InfoCamere provides information about private companies, thus increasing transparency. It also provides digital signatures and helps in the management of documents.

InfoCamere currently has ten million listed individuals (including entrepreneurs, shareholders, directors, auditors, managers, etc.) and more than six million registered businesses. Some 900,000 sets of company accounts are filed every year. Info-Camere safeguards and manages data held by the Italian Chamber of Commerce through a cloud based at the Operational Data Centre in Padua. A second Data Centre in Milan acts as a Disaster Recovery Centre and a second network access point.

TEXTBOX 99.
DIGITALEUROPE

DIGITALEUROPE is a leading trade association, representing over 35,000 digitally transformed businesses that operate and invest in Europe. It includes 77 corporations that are global leaders in their field of activity, as well as 40 national trade associations from across Europe. The association facilitates the free flow of data across borders, and enhances trust by extending high-level privacy protection. This ensures international interoperability, technology neutrality, transparency, and responsible data handling practices. It also enhances overall cybersecurity and provides industry-led and internationally recognized standards and best practices. It helps protect citizens from fraudulent or deceptive commercial activities on the internet, and facilitates data usage and access to open data and to machine-readable data sets.

A number of OSCE participating States have taken important steps forward in transparency and e-government, as well as in working with open data portals, digital identity systems and other digital tools.

Among countries that have implemented open data programmes are Austria, Belgium, the Czech Republic, Finland, Italy, Kyrgyzstan and Poland. The example of Kyrgyzstan and other Central Asian States is presented in Textbox 100.

TEXTBOX 100.
Open data programmes in Central Asian States

Key components of Kyrgyzstan's National Sustainable Development Strategy 2040 are the Tunduk programme and the Open Government Partnership. The Strategy's aim is to create conditions for effective, transparent, and accountable government through the digital transformation of government services and enhanced participation by citizens. The Tunduk programme has supported the implementation of 110 information systems and 43 databases. In 2018–2019, Tunduk facilitated 9.6 million transactions between State agencies and was used 3.2 million times between commercial organizations. The number of digital services implemented increased 72-fold during 2018–2019. The number of data exchanges between State bodies via Tunduk also increased significantly. The OSCE Programme Office in Bishkek has been supporting the development of the Tunduk Programme since 2018.

Kyrgyzstan's Digital CASA (Central Asia South Asia) initiative is a part of a regional programme, which also includes Afghanistan, Tajikistan and Uzbekistan. Its purpose is to integrate the landlocked Central Asian States and selected countries in South Asia into the regional and global digital economy, and to help them receive digital dividends. The Digital CASA project has been implemented with financial support from the World Bank. It covers infrastructure development, provision of broadband internet access, construction of data processing centres, and development of legal frameworks for the digital economy, financial audits, monitoring and control. One impact of the programme, which has supported the development of a modern telecom infrastructure in Kyrgyzstan, has been the number of internet users in the country increasing from 8% to 68%.

Open single data portals facilitate access to information for the public sector. These are web-based interfaces such as catalogues or datasets designed to make it easier to find reusable information.

Open single data portals are an important element of open data initiatives, and are frequently used by public administrations at local, national and regional levels of governance. Many OSCE participating States are currently implementing various types of open single data portals.

TEXTBOX 101.

Open single data portals in OSCE participating States

- Austria has implemented an open single data portal with over 2,000 data sets.
- Belgium has implemented the Federal Service Bus to ensure the coherent use of digital data across various policy areas and levels of government.
- The Czech Republic has developed data boxes, which are electronic delivery and archival systems to facilitate communication between citizens, businesses and public administration offices. The system replaces traditional documentation, as for example, the submission of tax returns.
- Italy has implemented the Digital Identity Public System to ensure greater transparency, openness, and inclusiveness of government processes and operations. The system aims at providing citizens with safe and protected access to digital services delivered by the public administration.
- Poland has implemented the National Open Data Portal to create a data-driven culture in the public sector.

6.12. Adopting new digital technologies to sustain competitiveness

Deploying digital technologies may be especially beneficial for SMEs and for areas in remote locations, since it can facilitate their participation in global markets. Digitalization thus plays a special role in increasing the competitiveness of landlocked developing countries, whose producers have difficulty accessing world markets. Many countries are also geographically remote from international supply and value creation chains. Digital development could connect these countries to international value chains and make them more economically secure.

Digital solutions also play an important role in facilitating inclusion by enabling the participation of underrepresented groups in economic activities and empowering marginalized communities in national markets. This can give such groups access to a broader market with more flexible working conditions.

Digital technologies are today becoming the main global driver of chain development.

Digitalization increases the volume, coverage and speed of international trade, and significantly reduces the cost of participation. Network communications accelerate transitions to decentralized distribution production models. In turn, this simplifies the co-ordination of global value chains. Countries searching for effective sources for growth can use digitalization to integrate into new global chains, as well as to improve their position in existing ones. Digitalization and its accompanying trends are opening up a number of new opportunities and growth drivers for many countries.

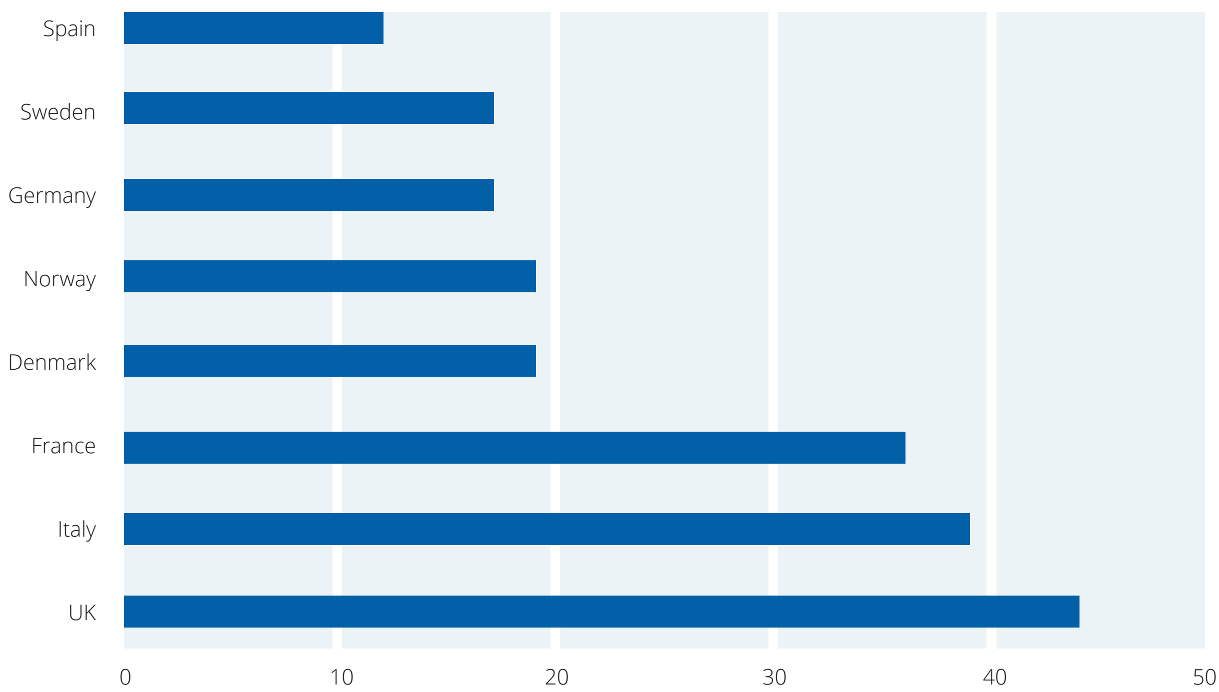
Different economies use different ways of generating technology and manufacturing components. There is, however, a large divide between countries that are developing digital technologies and those that are using them.

The ten leading countries developing digital technologies account for 90% of all patents and 70% of all exports. These economies are China, France, Germany, Japan, the Netherlands, the Republic of Korea, Switzerland, Taiwan Province of China, the United Kingdom and the United States. According to UNIDO's Industrial Development Report 2020, there are many economies engaged in new technology development, both by producing and using such technologies, but at lower rates. And there are many countries that show very low activity in the area of digitalization.[66] This digital divide can be a result of lack of access to technology due to cost or infrastructure availability. It can also be a result of lack of digital skills or knowledge of how to handle technology, or the lack of information about the benefits and potentials of digitalization. To overcome this digital divide, countries should ensure the availability of technology, facilitate digital skills, and support awareness about the benefits of digitalization.

6.13. Re-shoring

Digitalization can also accelerate processes of re-shoring, which can boost new capital investment in countries. The European Reshoring Monitor includes information about 250 re-shoring cases from 2014 to 2018 in the EU, Norway, Switzerland and the United Kingdom.[67] UK companies had the highest number of re-shoring cases, followed by Italy, France, Denmark, Norway, Germany, Sweden and Spain.

Figure 8. Number of re-shoring cases per country, 2014–2018.



Source: Reshore Now.[68]

Companies were most frequently re-shored from China, Germany, India, Poland, Sweden, the United Kingdom and the United States.

The robotization of production processes is an example of how industrial digitalization can reduce labour costs and increase efficiency.[69]

By comparison, the operating cost per hour for a robot in the automotive industry is expected to go down to US$2 in the next decade (from US$8 in 2015), whereas for a human being the cost per hour is over US$25.[70] Developing countries may be strongly affected by this, with up to two-thirds of their populations in danger of losing their jobs.[71] However, on a global scale, only 12% of employers plan to decrease the number of workers due to automation.[72]

Eastern European countries are considered attractive for nearshoring due to their high-skilled work forces, cultural similarities, time zones, data protection capacities and growing labour market.

This also includes non-EU countries. For example, in 2017, Ukraine was selected as the UK's offshoring destination of the year, mostly due to its IT sector.[73] The main advantages of Ukraine as listed by specialists in the IT branch are its inexpensive professional services, high number of specialists, number of educated IT specialists, the country's focus on the international job market, ease of access due to its convenient time zone (for the UK), "no-visa" entry regulations, low language barriers among programmers, and the large number of annual IT events.[74] Other popular destinations for the IT sector are Belarus, Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Poland, Romania, Russia, Serbia and Slovakia.[75] For Germany, the top five destinations for IT outsourcing are Ukraine (17%), India (15%), Romania (10%), Poland (9%) and Belarus (4%).

TEXTBOX 102.

Digital Kazakhstan

In 2006, an e-government portal was introduced in Kazakhstan (eGov.kz), and online public services became possible after the introduction of digital signatures for citizens free of charge. Kazakhstan's ongoing digitization programme, although still in its early stages, has helped the country to develop exponentially. Improvement of knowledge and skills, and well as development of the required work experience in the digitalization field are seen as vital to the programme's success.

The state programme "Digital Kazakhstan" was launched in 2018. By 2019, 8,000 jobs had been created. The total economic effect of the programme for 2018 and 2019 exceeded KZT 600 billion (US$1.4 billion). Significant progress has been achieved in introducing digital technologies into public services, education, healthcare and finance, as well as the transport, mining and metallurgy sectors. The programme has five major priority areas: 1) digitalization of the economy while increasing labour productivity and growth; 2) transition to a digital State by providing e-services to businesses and the general population; 3) implementing the "Digital Silk Way" by developing high speed infrastructure for the transfer, storage and processing of data; 4) transition to a knowledge-based economy, with investment in human capital and skills; 5) innovation in ecosystem formation, including the creation of conditions for technological development and innovation.

TEXTBOX 103.

The German–Russian Initiative for the Digitalization of the Economy

The German–Russian Initiative for the Digitalization of the Economy (GRID) was formed at the St. Petersburg International Economic Forum in 2017. Its main aim is to elaborate a roadmap with concrete measures and solutions for optimizing digitalization processes in the economic sector, activating a Russian–German dialogue on digitalization and "Industry 4.0", accelerating the digitalization of the Russian economy, and expanding the competitive advantages of German and Russian IT products by exchanging competences and strengthening interaction between companies in the two countries. The initiative foresees the development of new business models and mechanisms for effective international and intersectoral co-operation in the implementation of the "Industry 4.0" concept, and includes large industrial partners, including Skolkovo, Siemens, Kaspersky, SAP, Bosch, Rostec, Volkswagen and Remondis.

6.14. Digital trade and e-commerce

Digital trade and e-commerce are the fastest growing forms of trade around the globe. During the last decade, the volume of internet traffic and the number of individuals using the internet have increased significantly.

By

2017,

the annual volume of e-commerce sales had reached

US$29 trillion.

According to the UNCTAD B2C E-Commerce Index 2020, this share became even higher in 2019, with 27% of the world's population 15 years old or older shopping online. This represents a 7% increase from 2018. However, the share of people using e-commerce services is spread unequally between developed and developing countries. In some countries, such as Denmark, Germany, Netherlands, Norway, Sweden and the United Kingdom, e-commerce is utilized by 80% of internet users; in some developing countries that share is less than 10%.

The term "digital trade" is usually related to e-commerce and defined as trade that "covers all cross-border trade transactions that are digitally ordered, digitally facilitated or digitally delivered".[76] Another definition is "the delivery of products and services over the Internet by firms in any industry sector, and of associated products such as smartphones and Internet-connected sensors".[77] While such definitions include the provision of e-commerce platforms and related services, they exclude the value of sales of physical goods ordered online, as well as physical goods that have a digital counterpart (such as books, movies, music or software). The term "e-commerce" covers "goods and services sold and bought online, including transactions via platform-based companies".[78] E-commerce was defined in 1998 by the WTO in its Declaration on Global Electronic Commerce as "production, distribution, marketing, sale or delivery of goods and services by electronic means".[79] The digital transformation can be defined "as a technological change". Since new business models are changing the e-commerce landscape, policy responses are needed in many areas, including consumer protection, taxation, competition and environmental policy.[80]

E-commerce transactions involve digitally ordered goods and services. Such transactions facilitate the sale or purchase of goods or services conducted over computer networks through methods specifically designed for the purpose of receiving or placing orders. There are platformed ordered transactions and digitally delivered transactions. Platform ordered transactions are facilitated via online intermediary platforms that match buyer and supplier. These platforms may be based domestically or abroad, and may be foreign or domestically owned. Digitally delivered goods and services are "downloadable" services and data flows (software, data, database services, etc.)

A significant share of digitally delivered transactions is ordered digitally, as for example, software, music, e-books, data and database services.

However, there are also digitally delivered services that are not digitally ordered, such as mobile communication

6

roaming charges and most large-scale service transactions between firms. Digitally delivered services can also include ICT-enabled services, such as insurance and pension services, financial services, charges for the use of intellectual property, telecommunications, computer and information services, research and development services, professional and management consulting services, architectural, engineering, scientific and other technical services, business services, audio-visual and related services, and health, education, heritage and recreational services.

The last decades have seen an exponential rise in the diffusion and use of electronic communications, propelled by their broader availability (often anytime and anywhere) and the ever-increasing possibility of reusing and analysing data. This applies in particular, but not only, to commercial transactions. Digitalization has changed trade patterns.

The sectoral composition of trade has also been affected. For instance, trade in services (especially digitally enabled services) has been growing. There are projections that it will continue to grow, with its share increasing from 21% today to 25% over the next decade. Trade in time-sensitive, certification-intensive and contract-intensive goods has also been increasing.[81]

An e-commerce transaction can be between enterprises, households, individuals, governments and other public or private organizations. E-commerce already makes up a high share of the GDP in most countries.

In

2020

worldwide e-commerce retail sales amounted to 2020,

US$4.28 trillion,[82]

making up around a half of the total GDP of all 78 low-income and lower middle-income countries.

The total global share of e-commerce retail sales is expected to almost double soon, from 12% in 2018 to 22% in 2023. Total e-commerce sales (B2B and B2C) amounted to US$25.6 trillion in 2018, the equivalent of 30% of the global GDP. A leader in e-commerce is currently the Republic of Korea, where in 2018 total e-commerce sales reached 84% of the national GDP (see Textbox 104, below).[83]

TEXTBOX 104.
E-commerce in the Republic of Korea

The Republic of Korea is an affluent, high-tech society whose citizens are amongst the most tech--savvy in the world, not just among the young but in older age groups as well. The country is the third largest retail market in Asia, worth approximately €400 billion. Several factors make e-commerce successful in South Korea, such as the large number of single-family households (around 30% of all households) with less time to shop offline, and well-developed digital infrastructure that is open for innovation. This infrastructure includes easy-to-pay mobile payment systems, as well as well-developed logistics centres, which make many deliveries possible within one day.

Long accustomed to their own home-grown technologies South Korean consumers are increasingly purchasing a greater variety of goods from foreign e-commerce sites. Online retail growth has been supported by the development of advanced mobile-friendly shopping apps by retailers, since South Koreans prefer using mobile devices for day-to-day tasks.

One example of the success of e-commerce in South Korea is Coupang, the country's largest online shopping outlet. Founder Kim Bom said during the company's first anniversary celebration in 2011 that he planned to list the company on the Nasdaq within two years. Less than ten years later, Coupang announced that it had applied to be listed on the New York Stock Exchange, with an initial public offering of US$2 billion. Coupang's revenue grew by roughly 91% in 2020, to US$12 billion, with people rushing to e-commerce during the COVID-19 pandemic.

The COVID-19 pandemic has had a strong impact on international trade.

According to a recent WTO report,[84] G20 economies implemented several restrictive trade measures, particularly for exports, due to the pandemic. Export bans connected with the pandemic accounted for more than 90% of restrictive trade measures. Travel restrictions also severely affected international trade. Sectors with complex value chain linkages were hit hardest, with one exception – IT services – which boomed during the crisis period. Social distancing measures adopted by governments boosted demand for audio-visual content, for both entertainment and information purposes.

According to WTO negotiations on e-commerce in October 2020, the COVID-19 pandemic has increased the urgency of developing global rules on digital trade.

Countries have adopted various policy and legal frameworks for digital trade according to their level of economic and technological development. However, the transnational dimension of electronic communications and IT solutions are similar in different countries. While approaches favouring national standards may be effective at the domestic level, promoting digital trade across borders requires technological neutrality and technical inter-operability based on broadly accepted international standards. Significant standards, both technical and legal, have already emerged.

There have been discussions about the possibility and desirability of concluding a plurilateral agreement on electronic commerce, taking place at the WTO under the "Joint Statement Initiative". Regional trade agreements, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the Regional Comprehensive Economic Partnership, provide significant guidance on the matters and guiding principles relevant for promoting digital trade domestically and across borders. The most recent trends in implementing these agreements can be found in dedicated implementing instruments, such as the Digital Economy Agreements concluded between Singapore and other countries.

6.15. Paperless trade

Paperless trade means the digitalization of information flows that facilitates the electronic exchange of trade-related documents. This is important since it facilitates cross-border trade transactions and allows the use of electronic data instead of paper-based documents.

A global benchmark for best practices in digital trade and paperless trade facilitation is the WTO's Trade Facilitation Agreement (TFA). This Agreement is complemented by the Framework Agreement on Facilitation of Cross-border Paperless Trade in Asia and the Pacific, which, albeit limited to the Asia-Pacific region, provides a stepping stone for developing and implementing technical and legal standards, as well as for related capacity-building. Together with paperless and cross-border digital trade facilitation measures, it is projected that these steps could lead to a decrease in trade costs of more than 26% in the Asia–Pacific region. This, in turn, would lead to a reduction in trade costs of US$673 billion annually.[85] In China, trade costs could be reduced by 16% and in the EU by 14%.[86] While digital technologies are not part the TFA, they can be used in their implementation.

To harness the benefits of digitalization and address its challenges, regional trade agreements (RTAs) are also useful for countries when developing national digital development strategies or further provisions related to digital technologies. As of September 2017, there are at least 69 RTAs in existence that include either an e-commerce chapter or one or more articles dedicated to e-commerce.[87] In addition, half of the OECD's 38 member States have included digital trade issues in international trade pacts, such as measures to prohibit the imposition of digital customs duties, protecting the movement of cross-border data flows, preventing localization requirements for computing facilities, ensuring data privacy and security, restricting certain types of internet content, and other related matters.[88] Digital trade is also part of negotiations on new trade agreements. The proposal for the EU–Australia Free Trade Agreement has a chapter on digital trade.[89] The Negotiations on a Deep and Comprehensive Free Trade Agreement between the EU and Tunisia also include a proposal for a digital trade title.[90] The countries of the CIS are interested in creating common rules for e-commerce. And a chapter on e-commerce is part of the EU–Canada Comprehensive Economic Trade Agreement (CETA).

6

The UNCTAD Programme on Rapid eTrade Readiness Assessment (also known as eT Ready) has proven to be a good tool for many countries (especially LDCs) to assess barriers, identify opportunities, and provide policy recommendations.

The assessments show that the LDCs are inadequately prepared to capture the many opportunities emerging as a result of digitalization. Given the cross-cutting nature of e-commerce, better synergies and co-operation between development partners and governments are needed to accompany the implementation of the recommendations contained in such assessments.

Further instruments are certain WTO agreements on digital trade. The WTO framework, in particular its General Agreement on Trade in Services (GATS), is relevant for digital trade. WTO members have taken certain steps to promote digital trade within the existing framework. It is currently being debated as to whether more can be done to support inclusive digital trade, or to what extent. Existing WTO rules governing digital trade are considered outdated. They need not only definitional and classification changes, but also new regulations in the areas of market access, cross-border data flows, consumer-related measures, security-related measures and trade facilitation.

In 2017, the WTO Ministerial Conference issued a Joint Statement Initiative signalling the intention to launch plurilateral e-commerce talks. In January 2019, 76 of 164 WTO members launched e-commerce negotiations. The number of participating members now stands at 86. Key issues in the negotiations include e-contracts and e-signatures, data flows, data localization requirements, disclosure of source code, and customs duties on electronic transmissions.

Canada was one of the countries to launch consultations at the WTO about potential future negotiations on e-commerce. Canada can also present a range of best practices in the area of e-commerce. The World Economic Forum (WEF) has used the Canadian electronic single window as an example for a successful implementation of paperless trade.[91] It has been able to reduce the required data elements for cross-border movement of commercial goods from 1,800 to 80, improve release decisions, efficiently allocate border service officers, and perform more effective risk assessments.

6.16. Conclusions and recommendations

This review of best practices in various countries has resulted in the creation of six sets of recommendations for stimulating the deployment of digital technologies and driving digital transformation towards the advancement of digital society, digital markets and digital governments. These are: monitoring digital economy policy frameworks; adopting and actively deploying new technologies; embedding principles of good governance into the development of digital economy strategies; securing adequate investment in digital economy; recognizing the value of high-quality data and actively pursuing its development; and focusing on human development vis-à-vis digital skills and digital literacy.

MONITORING POLICY FRAMEWORKS

- Conduct feasibility studies and assessments of market conditions and potentials for implementation of the digital technologies that are essential for the development of digital government, digital society, and the digital market. These include 3D printing, artificial intelligence, big data, blockchain and the “internet of things”;
- Include systems analysis in the evaluation of digital transformation strategies and its impact;
- Look up one’s country’s position on various indices to show its progress towards digitalization and the barriers standing in the way;
- Consider various methodologies to conduct diagnostic analysis of the national economy and the challenges for digital transformation.

ADOPTING TECHNOLOGY

- Improve the infrastructure needed for the digitalization of government, markets and society;
- Consider digital technologies to facilitate participation and engagement, such as participatory budgets or an open referendum initiation system;
- Enhance digital regional connectivity and efficient cross-border digital networks;
- Create conditions for a paperless and digital society in which it is possible for anyone to use online means to pay taxes, make bank transfers, sign documents and vote in elections;
- Introduce measures and technologies to guarantee cybersecurity;
- Facilitate the deployment of infrastructure needed for digital trade and e-commerce, including easy-to--pay mobile payment systems and well-developed logistic centres.

GOOD GOVERNANCE

- Develop a comprehensive digital transformation strategy, including an action plan for its implementation;
- Consider the use of digital technologies to improve transparency and good governance;
- Increase the institutional capacities of various public agencies to design, develop and implement digital innovation programmes;
- Create hubs to bring together policy stakeholders, civil society, technology companies and financial institutions to allow for multi-stakeholder dialogue;
- Consider implementing multi-functional centres and unified portals for streamlining and unifying government services based on the “one window” principle.

INVESTMENT

- Deploy and stimulate measures to facilitate and foster various kinds of investment, including foreign direct investment, into the digital economy;
- Create favourable conditions for investment in the digital economy, such as political stability, efficient and transparent public services, low levels of corruption, and a simple tax system;
- Consider new investment opportunities offered by digitalization.

DATA

- Take advantage of digital data to create, optimize and transform government services;
- Facilitate open data usage, access to open data, provision of machine-readable data and single data portals for various kinds of data;
- Consider various open databases to improve the quality of government services, increase transparency, improve outcomes of public contracting, facilitate innovation, and improve social impact;
- Consider digital platforms to facilitate the free flow of data.

HUMAN DEVELOPMENT

- Create conditions to improve digital literacy;
- Deploy measures to facilitate digital learning, increase digital literacy and improve human capacities.

6

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Annex

Over the past 30 years, several OSCE Ministerial and Permanent Council decisions, as well as the 2003 Strategy Document for the Economic and Environmental Dimension adopted in Maastricht, have given the OSCE an increasing role in promoting a positive business and investment climate in the OSCE region.

Outlined below are select Ministerial Council decisions, declarations, and strategy documents that stipulate the mandate as well as strategic and policy commitments for OSCE's work on improving the business and investment climate:

The 1990 Bonn Document on Economic Co-operation highlights how the then 35 CSCE states aspired to work on improving business and investment conditions in the OSCE region.

Also, in the 1990 Charter of Paris for a New Europe, marking the institutionalization of the OSCE, it is stipulated that successful transition to a "market economy by countries making efforts to this effect is important and in the interest of us all. It will enable us to share a higher level of prosperity which is our common objective."

"Economic dimension [will] receive appropriate attention" with a view "to ensure the rule of law and the development of a transparent and stable legal system in the economic sphere" (Charter for European Security, 1999 paragraph 31).

Participating States "will step up exchange of information and experience on the best means of attracting investment, in particular foreign direct investment, and removing the obstacles to it" (OSCE Strategy Document 2003, paragraph 2.1.13)

- MC.DEC/7/08 of 5 December 2008 mentions the relationship between rule of law and a favourable business climate.
- MC.DEC/5/09 of 2 December 2009 on migration management encourages participating States "to take necessary measures to minimize negative impacts of the global financial and economic crisis on migrants by intensifying economic co-operation, creating attractive conditions for investment and business development, and facilitating the flow of remittances."
- MC.DOC/1/11/Corr.1 of 7 December 2011 on human trafficking encourages participating States "to work with the business sector to apply principles of due diligence and transparency in assessing and addressing risks of exploitation throughout supply chains and ensuring that workers have access to mechanisms for the redress and remedy of abusive practices". It also encourages "the dissemination and implementation of the newly adopted United Nations Guiding Principles on Business and Human Rights" and requests governments in the OSCE "to consider incorporating similar standards, including "zero-tolerance" policies, in government procurement of goods and services."
- MC.DOC/2/12 of 7 December 2012 declaration recognizes that "good governance requires a framework of economic policies, legislation and institutions in which businesses and investments can grow." OSCE participating States reaffirm "the determination to have clear legal frameworks conducive to the development of business, including small and medium-sized enterprises, which are critical to economic growth, and to the promotion of investment." It also mentions, in the context of promoting good corporate governance, the updated OECD Guidelines for Multinational Enterprises.
- MC.DEC/5/13 of 6 December 2013 encourages participating States "to promote multi-stakeholder co--operation among governments, international, regional and non-governmental organizations, civil society, the business community, academia, development agencies and financial institutions in order to improve the environmental footprint of energy-related activities, including through the promotion of public–private partnerships and technological innovation aiming at sharing best practices among participating States."

Good governance and connectivity anchored 2016 priorities towards the second dimension , with explicit links to the business and investment climate.

- MC.DEC/4/16 of 9 December 2016 acknowledges that "good governance, rule of law, the prevention of and fight against corruption, money laundering and the financing of terrorism; sound regulatory frameworks, including adequate protection for whistle-blowers; a public sector based on integrity, openness, transparency and accountability as well as good corporate governance based on efficient management, proper auditing, accountability and adherence to and respect for laws, rules and regulations, business ethics and codes of conduct established in close consultation with business and civil society are critical components for promoting a positive business and investment climate in the OSCE area."

  It also recognizes "the importance of the active participation of the private sector, including small and medium-sized enterprises, civil society and media, in preventing and combating corruption and promoting a sound business and investment climate."

  The decision "encourages participating States to, where appropriate, implement and adhere to other relevant international standards, such as those prescribed by the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the Financial Action Task Force's (FATF) "International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation", and to contribute to intensifying the involvement of all relevant stakeholders, including civil society and the business community in their implementation, as laid out in these international instruments."

  It also "encourages participating States that are members of the WTO to sign and ratify the 2014 WTO Trade Facilitation Agreement and to support its full implementation;"

  And it "tasks relevant OSCE executive structures, including field operations, within their mandates and available resources, to contribute to enhancing co-operation between participating States, the private sector and civil society and to actively involve the private sector and civil society in their activities on strengthening good governance, promoting transparency and improving the business and investment climate."

  The MC decision subsection on Promoting connectivity through transport and trade facilitation, among other things, "invites participating States to implement additional trade facilitation measures, aimed at making customs, administrative and regulatory processes more predictable, transparent and accountable, including by harmonizing, simplifying and streamlining norms and procedures without weakening current standards, by strengthening cross-border and regional co-operation of relevant authorities including customs, and by strengthening dialogue and co-operation between relevant government authorities and the private sector." It recognizes that" connectivity through transport and trade facilitation, including through measures at different levels of government, can enhance economic co-operation that is mutually beneficial and contribute to good-neighbourly relations, confidence-building and trust in the OSCE area."

- MC.DEC/8/17 of 8 December 2017 on promoting economic participation in the OSCE region calls upon participating States, among other things, to "promote good governance and strengthen the legal and institutional frameworks conducive to a positive investment climate and the development of businesses, including small and medium-sized enterprises, thereby promoting social inclusion and economic participation;

  Further strengthen the co-operation of labour market institutions, including local employment services and training institutions, trade unions and employers' organizations as social partners, business community, higher education institutions and other relevant stakeholders to improve labour market transparency, access and conditions for employment and entrepreneurship;

  Continue their efforts to promote economic participation of and employment opportunities for young people by, inter alia, ensuring the necessary conditions for the education and vocational training of youth, and through programmes facilitating youth access to the labour market;

  Strengthen measures that enable the development of women's entrepreneurial and other work-related skills, and promote and protect equal opportunity for participation of women in the labour market";

  "Encourages participating States to make use of the OSCE to foster the exchange of best practices and to promote capacity-building initiatives in line with the provisions of this decision;"

"Tasks relevant OSCE executive structures, including field operations, within their mandates, to assist participating States, upon their request, in implementing the provisions of this decision;"

- MC.DEC/5/18 of 7 December 2018 encourages participating States "to support the development of human capital so as to manage the transition to increasingly automated and digital economies, including through public–private partnerships and multi-stakeholder collaboration."

  "Calls upon participating States to promote access to quality education, training, upskilling and reskilling opportunities in order to enhance employability – promoting non-discriminatory access for women, youth and persons with disabilities and with special attention to those working in labour-intensive industries;

  Encourages the participating States, as appropriate, to promote education, vocational training and retraining, in particular for women and girls, and especially in the fields of science, technology, engineering and mathematics, as a key measure to reduce digital divides and to advance the empowerment of women by promoting opportunities, including in the economy;

  Invites the participating States to strengthen policy and institutional frameworks to facilitate innovative business models and a positive investment climate, to promote job creation and sustainable, inclusive economic growth;

  Encourages the participating States to involve the private sector, civil society, trade and labour unions, academia, and other relevant stakeholders to identify and address the needs in terms of human capital development and to work together to develop and implement relevant policies and regulations;"

  In 2018, the Declaration on the Digital Economy a Driver for Promoting Co-operation, Security and Growth MC.DOC 2/18 highlighted areas where dialogue and cooperation of OSCE participating States can be enhanced such as: "assessing the security aspects of the digital economy, in the context of, inter alia, anti-money-laundering and combating the financing of terrorism (AML/CFT); promoting security of and in the use of information and communications technologies (ICTs) in the private sector, including among small and medium-sized enterprises; and encouraging the sharing of experiences." It also included the following areas where stronger co-operation can "maximise the benefits and mitigate the security risks associated with digital transformation" such as:

  - Promoting an enabling environment for digital innovation in the business sector;
  - Fostering competition in the digital economy;
  - Bridging the digital divides, including through collaboration between higher education institutions;
  - Promoting international labour standards;
  - Promoting better social policies;
  - Strengthening good governance and promoting connectivity;
  - Upholding the rule of law and protecting human rights;
  - Broadening access to digital technologies and services in all sectors of the economy;
  - Exchanging experiences on digital transformation, digitalisation of government and innovative models."

- MC DEC. 6/20 of 4 December 2020 on preventing and combating corruption through digitalization and increased transparency encourages participating States to promoting "the use of digital tools for early detection and prevention of corruption through enhancing national and international secure electronic identification processes consistent with applicable domestic law." Relevant areas highlighted in the Tirana 2020 MC Decision include promotion of transparency in public administration, especially in public procurement and asset declaration mechanisms for public officials and politically exposed persons, strengthening tools that can facilitate access to information and effective delivery of public services, and encouraging transparency in beneficial ownership information.

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