PPSDM, November 3rd, 2017

Company decision-making for geothermal projects

(GEOCAP course 1.07)

Topic: Business climate

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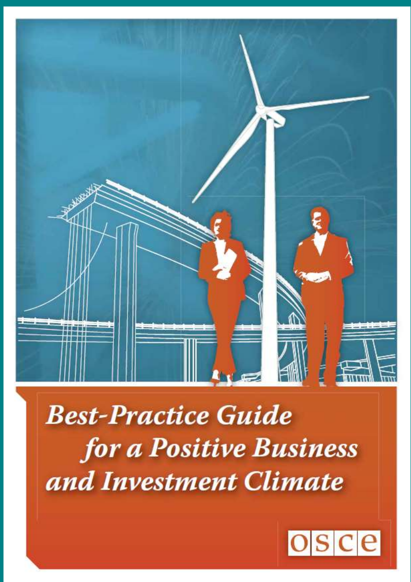
Investment Climate

The investment climate can be defined by three broad sets of variables:

1. Macroeconomic policies such as fiscal, monetary and trade policies;
2. Governance and institutions; and
3. Infrastructure.

The business and investment climate is made up of much more than just the tax rates and fiscal incentives available to businesses. Other critical components include:

- Political stability, rule of law, macroeconomic conditions, perceptions of government, and the regulatory environment.



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Country risk

- The WB investment climate surveys find that *policy-related risks* dominate the concerns of firms in developing countries.

- Uncertainty about the content and implementation of government policies is the *number one concern*, followed by macroeconomic instability, arbitrary regulation, and weak protection of property rights.

http://siteresources.worldbank.org/INTKNOWLEDGEFORCHANGE/Resources/491519-1193429621722/Understanding_the_IC.pdf
- New data sources about firms provide insights into helping economies grow

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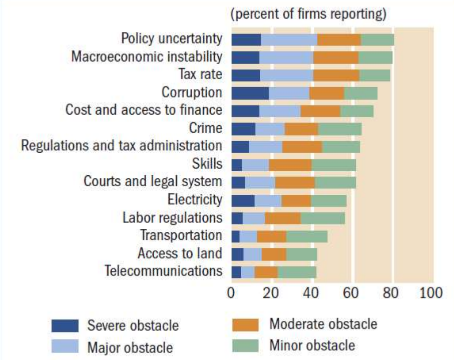
World Bank

- WB Investment Climate Survey
- 26000 firms
- 53 countries

Box 3

How do firms in developing countries rate various investment climate constraints?

Early results of the World Bank's Investment Climate Surveys cover more than 26,000 firms in 53 countries. While priority constraints can vary widely across and even within countries, the results highlight the importance of policy-related risks, including policy uncertainty and macroeconomic instability.



Source: World Bank Investment Climate Surveys.
Note: Firms were asked to rank the list of issues according to whether they were an obstacle to the growth and operation of their business on a 5-point scale, from "no obstacle" to "severe obstacle."

Chart 1

Troubling costs

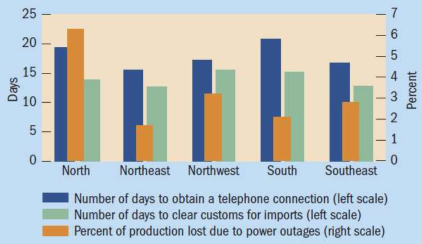
Costs vary widely in level and composition.

Source: World Bank Investment Climate Surveys. Countries chosen to illustrate range.

Chart 2

Irksome delays

Variations within Brazil can be considerable.



Source: World Bank Investment Climate Surveys.

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Factors affecting foreign direct investment

https://www.economicshelp.org/blog/15736/economics/factors-that-affect-foreign-direct-investment-fdi/

- Wage rates
- Labour skills
- Tax rates
- Transport and infrastructure
- Size of economy / potential for growth
- Political stability / property rights
- Commodities
- Exchange rate
- Clustering effects ('agglomeration effect')
- Access to free trade areas

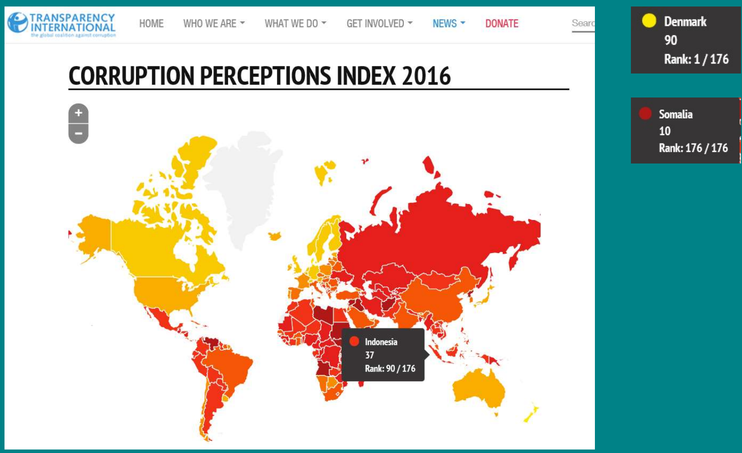
Country rankings (Forbes)

Rank	Name	GDP Growth	GDP per Capita	Trade Balance/GDP	Population
#1	Sweden	4.2%	$50,300	5.2%	9.9 M
#2	New Zealand	3%	$37,800	-3.2%	4.5 M
#3	Hong Kong	2.4%	$42,400	3.1%	7.2 M
#4	Ireland	26.3%	$51,300	12.2%	5 M
#5	United Kingdom	2.2%	$43,700	-5.4%	64.4 M
#6	Denmark	1%	$52,000	7%	5.6 M
#7	Netherlands	2%	$44,400	8.6%	17 M
#8	Finland	0.2%	$41,900	0.1%	5.5 M
#9	Norway	1.6%	$74,700	9%	5.3 M
#10	Canada	1.1%	$43,200	-3.2%	35.4 M
#11	Australia	2.4%	$56,300	-4.3%	23 M
#12	Singapore	2%	$52,900	19.8%	5.8 M
#13	Estonia	1.1%	$17,300	2.1%	1.3 M
#14	Luxembourg	4.8%	$101,400	5.5%	0.6 M
#15	Lithuania	1.6%	$14,200	-1.7%	2.9 M
#16	Switzerland	0.8%	$80,200	11.4%	8.2 M
#17	Belgium	1.4%	$40,200	-	11.4 M
#18	Taiwan	0.6%	$22,300	14.5%	23.5 M
#19	Portugal	1.5%	$19,200	0.4%	10.8 M
#20	Slovenia	2.3%	$20,700	5.2%	2 M
#21	Germany	1.5%	$41,200	8.5%	80.7 M
#22	Iceland	4%	$50,200	4.2%	0.3 M
#23	United States	2.6%	$55,800	-2.6%	324 M
#24	Austria	0.9%	$43,400	2.6%	8.7 M
#25	Latvia	2.7%	$13,700	-1.2%	2 M
#26	France	1.3%	$36,200	-0.2%	66.8 M
#27	Israel	2.5%	$35,300	4.7%	8.2 M
#28	South Korea	2.6%	$27,200	7.7%	50.9 M
#29	Spain	3.2%	$25,800	1.4%	48.6 M
#30	Malta	6.2%	$23,200	10%	0.4 M
#71	Jordan	2.4%	$4,900	-9%	8.2 M
#72	Barbados	0.9%	$15,700	-7.2%	0.3 M
#73	Indonesia	4.8%	$3,300	-2%	258.3 M
#74	Ukraine	-9.9%	$2,100	-0.3%	44.2 M
#75	Armenia	3%	$3,500	-2.4%	3.1 M
#76	Trinidad and Tobago	-2.1%	$20,400	-4.8%	1.2 M
#77	Moldova	-0.5%	$1,800	-3.8%	3.5 M
#78	Rwanda	6.9%	$700	-13.9%	13 M
#79	Russia	-3.7%	$9,100	5.2%	142.4 M
#80	Saudi Arabia	3.5%	$20,500	-8.3%	28.2 M

Transparency International

The most important factors in establishing a political environment that supports a strong business and investment climate are:

1. Security
2. Protection and guarantee of foreign investor rights
3. Legislative stability
4. Transparency
5. Freedom from corruption
6. Good governance



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Ranking of countries (Indonesia #84)

www.heritage.org/index/country/indonesia, 2017 Index of economic freedom

- Indonesia’s reform-minded government has undertaken some necessary structural adjustments with a focus on stamping out corruption, better managing public finance, and improving the business environment. Fuel subsidies have been cut dramatically in an effort to narrow fiscal deficits. The administration has also moved to dismantle some of the barriers that had been imposed on foreign investment.

- Despite this progress, however, lingering institutional shortcomings continue to undercut momentum for more dynamic economic development. In the absence of a well-functioning legal and regulatory framework, lack of transparency remains a serious impediment to the emergence of a more dynamic private sector. The state’s presence in the economy remains extensive through state-owned enterprises.

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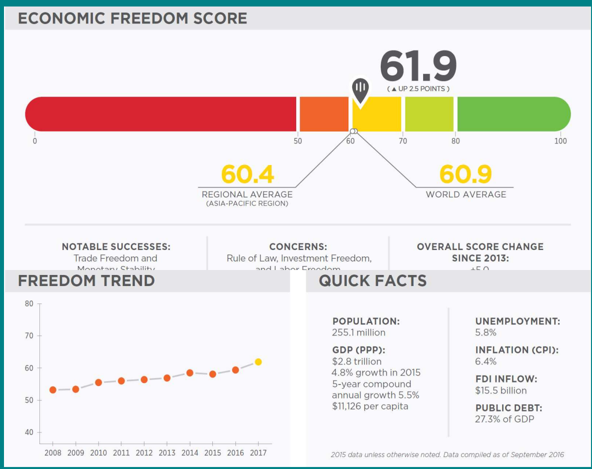
Indonesia



- www.heritage.org/index/country/indonesia, 2017 Index of economic freedom
- www.heritage.org/index/about

Q.3. How do you measure economic freedom?
We measure economic freedom based on 12 quantitative and qualitative factors, grouped into four broad categories, or pillars, of economic freedom:

1. Rule of Law (property rights, government integrity, judicial effectiveness)
2. Government Size (government spending, tax burden, fiscal health)
3. Regulatory Efficiency (business freedom, labor freedom, monetary freedom)
4. Open Markets (trade freedom, investment freedom, financial freedom)

Each of the twelve economic freedoms within these categories is graded on a scale of 0 to 100. A country's overall score is derived by averaging these twelve economic freedoms, with equal weight being given to each. More information on the grading and methodology can be found in the appendix.

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Investment Climate, Growth & Poverty

(Berlin Workshop Series 2005, IBRD / World Bank, Kochendorfer & Pleskovic Eds.)

- Policy areas related to IC cover a broad field. Categories:
  - Economic and political stability, security of property rights, contract enforcement, crime, threats of govt expropriation
  - Regulation and taxation
  - Finance and infrastructure, incl. scope and quality of services to firms, incl. IC of providers of financial and infrastructure services.
  - Workers and labour markets (skills, job market regulation….)
- Formal laws & policies is not all: *quality of governance* affects firms' investment decisions. Also:
  - Rent-seeking, corruption, patron-clientelism, capture
  - Policy credibility (do firms feel confident about relying on a govt policy?)
  - Public trust & legitimacy when implementing reform
  - Govt capacity (resources, expertise; do policies take into account capacity constraints?)

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