Investment Rules in Developing Countries: Trends and Approaches

A comparative analysis of investment rules affecting FDI in 10 middle-income countries: Brazil, China, India, Indonesia, Malaysia, Mexico, Nigeria, Thailand, Turkey, and Vietnam

By Priyanka Kher and Maximilian P. Eltgen
Abstract
This paper presents a comparative analysis of the investment rules affecting foreign direct investment (FDI) in 10 middle-income countries—Brazil, China, India, Indonesia, Malaysia, Mexico, Nigeria, Thailand, Turkey, and Vietnam. Given the relevance of these countries as host and source countries of FDI, rules passed by them provide an indication of widely prevalent investment rules, which include both converging and distinct approaches. The paper organizes a large amount of legal content into comparable, objective variables. It finds that entry and establishment restrictions are widespread in the 10 countries. The most frequently identified restrictions are equity ceilings and expatriate limitations, while mandatory export requirements, mandatory research and development (R&D) requirements, quotas for foreign firms, and restrictions based on the types of shares are least prevalent. Legal protection guaranteed to foreign investments varies significantly among the 10 countries. The weakest guarantees are on capital transfers and transparency of government conduct. The strongest guarantee is dispute settlement, although few countries have provisions on addressing grievances before they become legal disputes. There is variation in the level of transparency on tax and financial incentives. These findings highlight areas for further reforms in these countries, but more broadly can inform the reform efforts of other countries and be the basis for further analytical research.

* The findings, interpretations and conclusions expressed herein are those of the authors and do not necessarily reflect the view of the World Bank Group, its Board of Directors or the governments they represent. The authors are grateful to Christine Qiang, Ivan Nimac and Peter Kusek for their valuable inputs. This paper is part of the Analyzing Barriers to Investment Competitiveness Project, supported by the UK Government. The authors may be contacted at pkher@worldbank.org and meltgen@worldbank.org.
1. Introduction

A transparent, predictable, and open regulatory environment is crucial for attracting and retaining foreign investment. Foreign investors have consistently identified countries’ legal and regulatory framework as one of the key decision factors to invest in a country (World Bank Group 2018, 2020). The literature also suggests that improvements in the quality of a country’s legal and regulatory environment are associated with higher foreign direct investment (FDI) inflows (Akame, Ekwelle, and Njie 2016; Buchanan, Le, and Rishi 2012; Dauda and Stein 2007; Gani 2007; Globerman and Shapiro 2002; Vogiatzoglou 2016; Wei 2000; Wernick, Haar, and Singh 2009). Legal restrictions on FDI, such as foreign equity ceilings, screening mechanisms, or restrictions on expatriate managerial personnel, decrease FDI inflows in both developed and developing countries. A recent study by the Organisation for Co-operation and Development (OECD), covering 60 advanced and emerging countries over the period 1997–2016, shows that liberalizing FDI restrictions by about 10 percent, as measured by the OECD FDI Regulatory Restrictiveness Index, could increase bilateral FDI by 2.1 percent on average (Mistura and Roulet 2019). The study also shows that effects are greater for FDI in the services sector, but even manufacturing sectors, which are typically open to FDI, are negatively affected by countries’ overall restrictiveness. Other studies confirm similar findings, including in developing countries. Legal protections (against expropriation, arbitrary and unpredictable government conduct, and breach of contract), and the rule of law more fundamentally, help to promote predictability by limiting the ability of government actors to act arbitrarily. Importantly, institutional quality; honoring of property rights; and predictability of laws, regulations, and policies significantly affect countries’ investment attractiveness (Dauda and Stein 2007; Akhtaruzzaman, Berg and Hajzler 2017; Azzimonti 2018). High regulatory risk, that is, risks that result from arbitrary government actions, is associated with lower FDI inflows (Hebous, Kher, and Tran 2020). The legal and regulatory framework on incentives must be targeted, transparent, and well administered. Evidence on the impact of incentives to attract FDI is mixed, with several studies finding that they are of limited effectiveness at the aggregate level (Wells and others 2001; James 2009; James and Van Parys 2010; Klemm and Van Parys 2012; Van Parys 2012), but they may be effective in attracting efficiency-seeking investments. Indirect costs of incentives can be reduced by improving the transparency and administration of incentives. Reducing the discretion of agencies administering or awarding incentives enhances predictability for investors and reduces opportunities for rent-seeking and corruption. Good practice is to award incentives to qualified investors on the basis of criteria set out in the law, rather than through a separate approval process (World Bank Group 2018). Investment rules are set by countries within a broader global context. The global context that has influenced investment rules passed over the past few years has been characterized by growing protectionism and caution around FDI—in particular, investment that can affect national, strategic, security, and now health interests of countries. Concerns around the focus of earlier international investment agreements on investor protection, at the cost of governments’ ability to effectively exercise their right to regulate, have led to several countries adopting more restrictive investment rules (UNCTAD 2020). From an international perspective, investment is not governed by any multilateral agreement, unlike trade, which is subject to multiple World Trade Organization (WTO) agreements. International rules on investment are largely based on a patchwork of international investment agreements, at bilateral, regional, and

1 See Saurav and Kuo (2020) for a literature review.
2 For example, De la Medina Soto and Ghossein (2013) find a positive correlation between average openness to foreign equity investment across sectors and per capita FDI inflows across 103 economies. Arnold and others (2012) find that the liberalization of India’s services sectors in the 1990s significantly increased the inflow of services FDI.
3 See Kher and Chun (2020) for a literature review.
4 Incentives tend to matter more for efficiency-seeking investors, finding a stronger effect of tax incentives in dimensions that are often attributed to this type of investment, such as greenfield FDI (Hebous, Ruf, and Weichenrieder 2010), export-oriented FDI (James 2009), and vertical FDI (Overesch and Wamser 2008).
plurilateral levels. However, a multilateral agreement on investment facilitation, under the aegis of the WTO, is under consideration. As countries deliberate this proposed new agreement, they must understand both the widely accepted and distinct approaches used by major middle-income countries—FDI recipients and sources—to regulate investments.

Although the importance of the legal and regulatory framework for attracting FDI is well established, few studies examine this issue from a comparative perspective. Most notably, the OECD FDI Regulatory Restrictiveness Index (FDI Index) measures statutory restrictions on foreign direct investment in 22 economic sectors across 69 countries, including all OECD and G-20 countries (Kalinova, Palerm, and Thomsen 2010). The FDI Index quantifies the restrictiveness of a country’s FDI rules by looking at four types of restrictions on FDI: equity ceilings, screening or approval mechanisms, restrictions on the employment of foreigners as key personnel, and operational restrictions (for example, restrictions on branching, capital repatriation, or land ownership). The FDI Index is very useful for comparing the restrictiveness of different countries, by both country and sector; however, except for those in the Association of Southeast Asian Nations (ASEAN) region, the index publicly provides only an aggregate score of a country, without going into qualitative details. In addition, the index covers a limited number of entry, establishment, and operational restrictions. It does not consider the legal and regulatory framework more broadly, in particular, investment protection or the laws and regulations pertaining to investment incentives.

This paper will add to the available literature by presenting a comparative analysis of investment rules of 10 middle-income countries: Brazil, China, India, Indonesia, Malaysia, Mexico, Nigeria, Thailand, Turkey, and Vietnam. These 10 countries account for more than half of the global population, one-quarter of global GDP, and one-fifth of global trade. In 2018, they accounted for over a third of global investment inflows and three-fourths of inflows to developing countries. Investment rules passed by these countries therefore provide an indication of widely prevalent investment rules, including common and distinctive approaches. In doing so, the paper organizes a large amount of legal content into comparable, objective variables.

The paper is structured in the following way: Section 2 discusses the methodology for conducting the research and benchmarking. Sections 3, 4, and 5 discuss the main findings on investment entry and establishment, investment protection, and investment incentives. Section 6 concludes.

2. Methodology and Approach

The primary research presented in this paper was undertaken in 2019 for the Investment Policy and Regulatory Reviews conducted in the 10 middle-income countries (World Bank 2020a). The research was guided by a standardized questionnaire, which covered a limited set of topics, including foreign investment entry, establishment, and protection (see figure 1). Given the constantly evolving nature of legal and regulatory frameworks, a cut-off date of May 31, 2019, was set for the research. Therefore, the comparative analysis presented in the paper is based on the laws and regulations as of this cut-off date. It should be noted that since May 31, 2019, there have been changes in the laws and regulations of the 10 reviewed countries.

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5 In 2017, during the 11th WTO Ministerial Conference in Buenos Aires, 70 WTO members adopted a “Joint Statement on Investment Facilitation for Development,” announcing discussions toward a multilateral framework on investment facilitation (WTO 2017). The discussions aim primarily at achieving transparency and predictability of investment measures; streamlining and speeding up administrative procedures and requirements; and enhancing international cooperation, information sharing, the exchange of best practices, and relations with relevant stakeholders, including dispute prevention. In the second half of 2020, negotiations officially started.

6 In this regard, much work has been done by various international organizations in creating an inventory of investment facilitation measures (see Sauvant and others 2020).

3. Entry and Establishment

In reviewing the 10 countries’ legal frameworks for entry and establishment, research was focused on 12 different restrictions across the 10 countries. On the basis of the literature review and operations experience of the World Bank Group, the 12 restrictions have been identified as the most common restrictions and the most likely to affect entry and establishment of foreign investors.

The number and types of restrictions vary significantly by country (see figure 2). India, Indonesia, Malaysia have the most, with eight restrictions each, and Turkey has the least. With the exception of Thailand (with five restrictions), all ASEAN countries reviewed exhibit a relatively high number of restrictions.

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8 These restrictions are equity ceiling, types of shares, legal form, quota of foreign firms, minimum investment or paid-up capital, geographic location, mandatory local hiring, expatriate limitations, mandatory R&D, mandatory export, license and approval, and mandatory local sourcing. Equity ceilings generally apply to foreign investors only, but when an activity is prohibited, ceilings may also apply to both foreign and domestic investors. In such cases, economic activity is reserved to the state. Some countries also completely prohibit FDI in some sectors (and allow domestic investment). On average, each country (of the 10 reviewed) prohibits or partially prohibits about 10 sectors (a sector can be partially prohibited if the prohibition applies only to select activities).
Some restrictions may have a greater impact on foreign investors than others, depending on the country context and the investor’s business model. For example, a foreign equity ceiling may be a more significant barrier than a mandatory R&D requirement in some countries. In addition, the degree of restrictiveness varies within the same category of restriction; for example, India has a large number of sectors with equity ceilings, with ceilings ranging from 20 percent to 74 percent.

Figure 2. Number of Entry and Establishment Restrictions (out of 12) in Reviewed Countries

![Bar chart showing the number of restrictions in each country.

Source: WBG analysis.

Note: 12 types of entry restrictions were reviewed: equity ceiling, types of share, legal form, quota of foreign firms, minimum investment/paid-up capital, geographical location, mandatory local hiring, expatriate limitations, mandatory R & D, mandatory export, license/approval, mandatory local sourcing. In comparing legal and regulatory frameworks of countries, the review makes certain generalizations. Where a particular type of entry restriction is prevalent in even one sector, it is considered to be prevalent for ease of comparability.

The prevalence of each type of restriction across countries varies (see figure 3). The most frequently found restrictions are equity ceilings and expatriate limitations, with both types found in all 10 countries reviewed. Less prevalent are license and approval requirements and mandatory local hiring requirements, both of which were identified in eight countries. The least prevalent types of restrictions are mandatory export requirements (not found in any of the 10 countries), mandatory R&D requirements, quotas of foreign firms, and restrictions based on the types of shares. Figure 4 provides a detailed overview of entry and establishment restrictions identified in each country.

Figure 3. Number of Countries Having Select Entry and Establishment Restrictions (Out of 10)

![Bar chart showing the number of countries having each type of restriction.

Source: WBG analysis.
Figure 4. Reviewed Countries’ Use of Entry and Establishment Restrictions

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<th>Types of shares</th>
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**Source:** WBG analysis.

**Note:** ● means this type of restriction exists in this country, either for at least one specific sector or activity or horizontally across sectors or activities. No country has mandatory export requirements in place.

**Equity Ceilings**

Equity ceilings are among the most prevalent types of restrictions observed in the 10 middle-income countries. In each of the 10 countries, some types of equity ceiling exist. Although some equity ceilings apply to sectors, others are more specific and target certain activities. Equity ceilings also have different sizes, the most common being an equity ceiling of 49 percent—limiting the ability of foreign investors to get equal or majority stake in a company. A distinction is sometimes made between foreign investors from different countries, especially in the ASEAN region. For example, in Malaysia, foreign equity in accounting and audit services companies is limited to 30 percent for non-ASEAN investors, whereas up to 51 percent foreign equity is allowed for ASEAN investors (World Bank 2020d). In rare cases, equity ceilings may also be tied to a geographical location. For example, in Brazil, companies that perform mining activities in metals and metal products within a frontier area have a cap of 49 percent for foreign investors (World Bank 2020a). Finally, equity requirements may be linked to approval and screening requirements. For example, in India, up to 49 percent foreign equity is permitted in insurance, 9 but investments may be made only with government approval.

To illustrate the different dimensions, this review looks at two sectors in more detail: health services and medical devices manufacturing and wholesale and retail services. With regard to health services and medical devices manufacturing, the COVID-19 pandemic has focused new attention on the provision of health care services and the production of medical devices. The only country that has equity ceilings for medical devices production is Indonesia, where FDI in medical equipment supply is permissible up to 49 percent, and the production of class A medical equipment up to 33 percent (World Bank 2020c).10

Health care services in the 10 middle-income countries differ significantly. India, Mexico, Nigeria, Turkey, Thailand, and Vietnam impose no equity ceilings (although other restrictions such as approvals may apply).

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9 This ceiling has now been increased to 100 percent for insurance intermediaries (such as insurance brokers, reinsurance brokers, insurance consultants, corporate agents, third-party administrator, surveyors, and loss assessors) (see Foreign Exchange Management (Non-debt Instruments) (Second Amendment) Rules, 2020).

10 In Indonesia, the medical equipment industry is subdivided into four classes (A–D). Class A includes medical cotton, bandage, gauze, cane, IV drip pole, sanitary pad, adult diaper, patient’s bed, and wheelchairs.
Brazil has a list of activities in which FDI is allowed in the health services sector, including running hospitals and clinics (World Bank 2020a).\(^{11}\)

In China, Indonesia, and Malaysia, foreign investment in certain types of health care services providers is prohibited or limited. In Malaysia, no foreign equity is allowed in general medical and dental clinics, blood banks, maternity homes, psychiatric hospitals, and pathology laboratories. Ambulatory care centers and nursing homes are allowed up to 70 percent foreign equity. In some institutions such as hospices or psychiatric nursing homes, only 49 percent foreign equity is allowed (World Bank 2020d).\(^{12}\) In China, investment in medical institutions is limited to joint ventures and cooperative operations. The Chinese Communist Party’s investment must account for at least 30 percent of the total capital, in effect capping foreign investment at 70 percent. An exception is made for investments in clinics in Guangdong province by investors from Hong Kong SAR, China, and Macau SAR, China, for which 100 percent ownership is allowed (World Bank 2020b). Indonesia has a 67 percent equity ceiling for basic and special medical clinics, with some exceptions for ASEAN investors. For example, ASEAN investments in hospitals can be up to 70 percent foreign equity in all capital cities of provinces in Eastern Indonesia, except Makassar and Manado (World Bank 2020c).

With regard to wholesale and retail services, six of the 10 middle-income countries apply no equity ceilings on wholesale and retail services (Brazil, China, Mexico, Nigeria, Turkey, and Vietnam).

Except for Vietnam, all of the ASEAN countries only allow foreign participation in relatively large stores, but they all use different approaches. In Indonesia, equity ceilings are partially tied to the size of the store: foreign investment is prohibited in supermarkets with retail space less than 1,200 square meters and in minimarkets with retail space less than 400 square meters. Up to 67 percent equity participation is allowed in wholesale and retail trade department stores with retail space of 400 to 2,000 square meters (World Bank 2020c).\(^{13}\)

In Malaysia, equity ceilings depend on the type of store: hypermarket (up to 70 percent foreign equity allowed); supermarket (generally no foreign equity allowed; up to 70 percent if operated by hypermarket operator); department store, specialty store, or superstore (up to 100 percent foreign equity allowed); general convenience stores (up to 30 percent foreign equity allowed); and 24-hour stores (no foreign equity allowed) (World Bank 2020d).

Thailand makes foreign participation dependent on operating capital; retail and wholesale are restricted unless the operator’s capital is at least B 100 million for operating a wholesale business with one wholesale store (B 100 million per wholesale store), or at least B 100 million for operating a retail business with not more than five retail stores (B 20 million per retail store), or alternatively, the operator obtained a foreign business license (World Bank 2020g).

Another different regime governing wholesale and retail trade can be found in India, where a distinction is drawn between single-brand and multibrand product retail trade. Although 100 percent FDI is allowed in single-brand product retail trade without approval, for multibrand product retail permits only 51 percent FDI with the requirement that the operator obtains government approval (Jain 2018).

In summary, depending on the country, equity ceilings may be found in a centralized place in the form of a negative list or in sector-specific laws. With the exception of Brazil, Malaysia, and Turkey, all countries have a negative list which lists sectors that are closed or partially closed to foreign investment. Such a list is good practice; it allows foreign investors to easily assess the level of restrictiveness in a specific sector, since the list needs to be updated or amended if the policy changes.

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\(^{11}\) Direct or indirect participation of foreign companies or foreign capital in health care in Brazil, except that FDI, is permitted in legal entities carrying out certain activities in Brazil, such as running of hospitals, clinics, and laboratories; production and distribution of medicines and other health products; research and services related to human genetics; clinical analysis, diagnostic imaging, and analysis of anatomical pathology; and family planning (as allowed under Law 13097/2015).

\(^{12}\) The 49 percent equity ceiling applies to the following institutions: hemodialysis center, hospice, psychiatric nursing home, and community mental health center.

\(^{13}\) Retail business in a number of specific areas, such as jewelry, antiques, textiles, games and toys, commercial vehicles and spare parts, and others, is closed to FDI.
Legal Form
In five of the 10 reviewed countries (Brazil, China, Indonesia, Malaysia, and India), restrictions exist on the legal form a foreign investment may take. Such restrictions can be categorized in two groups: (a) restrictions on establishing a partnership, a limited liability partnership (LLP), or a sole proprietorship; and (b) restrictions on branch offices, liaison offices, project offices, or representative offices.

In China, Indonesia, and Malaysia, the ability of foreign investors to create partnerships, LLPs, or sole proprietorships is limited. Indonesia does not allow foreign investors to establish or invest in a partnership or an LLP (World Bank 2020c). Malaysia allows foreigners to set up a partnership only if they have permanent residency, but allows establishment of LLPs by foreigners on the condition that a compliance officer is selected among the partners or persons acting as secretaries, who must be a citizen or permanent resident of Malaysia and must ordinarily reside in Malaysia (World Bank 2020d). In China, foreign investors are prohibited from establishing foreign-invested partnerships for sectors with equity ceilings in the negative list. In addition, foreign investors are forbidden to engage in investment activities as individual businesses, investors of sole proprietorship enterprises, or members of farmers’ professional cooperatives (World Bank 2020b). Generally, concerns about allowing FDI in partnerships, LLPs, or sole proprietorships are regarding the higher level of regulatory supervision that may be needed. Given the reduced compliance requirements (in comparison with companies) and lower tax liability, foreign persons stand to gain from such structures, but the burden on governments for regulatory supervision may end up being high.

Some countries have limitations on the ability to set up branch offices, liaison offices, project offices, or representative offices. Such restrictions can be sector-specific, as is the case in Indonesia and in Brazil, for example. In Indonesia, foreign investors can establish a branch office only in certain sectors, such as the banking and energy resources exploration sectors (World Bank 2020c). In Brazil, the organization of branches or subsidiaries of foreign financial institutions and the increase of such equity interest are prohibited (World Bank 2020b). On the other hand, restrictions also occur in the form of targeted approvals for a specific legal form. For example, in Malaysia, the registration of a branch office is at the discretion of the Companies Commission of Malaysia, which under the Malaysian Companies Act 2016 has statutory powers to impose conditions on such registration. In India, prior permission of the Reserve Bank of India is required to open a branch office, liaison office, project office, or representative office in the following circumstances: (a) The foreign investor is registered or incorporated in Pakistan. (b) The foreign investor is registered in Afghanistan; Bangladesh; China; Hong Kong SAR, China; Iran; Macau SAR, China; or Sri Lanka and applies to open offices in areas such as Jammu and Kashmir, Andaman and Nicobar Islands, and Northeast India. (c) The principal business of the foreign investor falls in four sectors: defense, telecommunications, security, and information and broadcasting. (d) The foreign investor is a nonprofit organization or the department of a foreign government.

Minimum Investment and Paid-Up Capital Requirements
Minimum investment or paid-up capital requirements exist in six of the reviewed countries (in China, India, Indonesia, Malaysia, Thailand, and Vietnam). Minimum investment requirements, requiring minimum amount of investment to be made by an investor as a precondition to invest in a country, are more common than paid-up capital requirements. China, Indonesia, and Malaysia have paid-up capital requirements, wherein a specific amount of paid-up capital is required for company formation (see further below). The requirements may apply horizontally or be limited to specific sectors. The aim of both types of requirements is generally to achieve a certain size of investment in order to maximize the benefits of FDI for the host country. The mandatory minimum foreign contribution can be burdensome for some investors, especially those who would rather start with a low sum to decide whether or not to put the full amount of the investment in the country, or those seeking to make less capital-intensive investments and who are more focused on other types of asset creation.

14 See Article 52 of the ADCT (‘Ato das Disposições Constitucionais Transitórias - Transitory Constitutional Disposition Act)
15 See Reserve Bank of India Master Direction, Establishment of Branch Office (BO)/Liaison Office (LO)/Project Office (PO) or any other place of business in India by foreign entities, RBI/FED/2015-16/6.
Horizontal minimum investment or paid-up capital requirements can be found in Thailand and Indonesia. In Thailand, the amount of the minimum investment requirement is determined by the type of investment. Generally, the minimum capital of a foreign investor for commencing business in Thailand must be no less than B 2 million. If the foreign investor’s business activity falls under List 2 of the Foreign Business Act (that is, it is a restricted activity) for which a foreign business license is required, the minimum investment is increased to B 3 million or 25 percent of the annual average of three-year projected expenses, whichever is greater (World Bank 2020g). In Indonesia, foreign investors are subject to a minimum investment as well as paid-up capital requirements. Minimum issued and paid-up capital for foreign investors is Indonesian rupiah (Rp) 2.5 billion, while the minimum investment value for foreign investors is more than Rp 10 billion per line of business (excluding the investment in land and building).\textsuperscript{16} In other words, the total minimum investment threshold is Rp 10 billion, with 25 percent of total investment to be injected as equity. The remaining balance may be injected as a shareholder loan. At the same time, this general capital requirement applicable to foreign investors may be superseded by minimum capital requirement thresholds or other conditions in sector-specific regulations (World Bank 2020c).\textsuperscript{17}

China, India, Indonesia, Malaysia, and Vietnam have sector-specific minimum investment or paid-up capital requirements. For example, in Vietnam, the minimum investment in hospital services must be at least US$20 million for a hospital, US$2 million for a polyclinic unit, and US$200,000 for a specialty unit (World Bank 2020i). Such sector-specific requirements, though they may still deter foreign investments, are generally preferable to horizontal requirements, since they can be targeted toward the situation of the specific sector. That being said, they are more prone to regulatory capture from domestic interest groups.

Geographical Location

In six of the reviewed countries (Brazil, China, India, Indonesia, Mexico, and Vietnam), investments are restricted based on the geographical location. Two different types of restrictions have been identified: (a) restrictions in a general area, mainly for security reasons, and (b) sector-specific provisions that allow investment in certain clearly defined locations.

Restrictions apply in a general area for security reasons in Brazil, Mexico, and Vietnam. In Brazil, approval from the National Security Council is required if the land is located in areas considered to threaten national security (usually within 150 kilometers of the country’s borders, including the territorial sea). In cases where this acquisition is important for the development of projects of national interest, the president may authorize the acquisition by means of a presidential decree (World Bank 2020a). In Mexico, foreign investors similarly may not hold direct title to real estate in Mexico that is located within 100 kilometers of the border or 50 kilometers of the coastline. However, such individuals and entities may hold the beneficial interest in such real estate under a Mexican trust (World Bank 2020e).\textsuperscript{18} In Vietnam, foreign investors are not allowed to undertake FDI in restricted or sensitive areas, such as national natural reserve parks, in military zones, or near the border (World Bank 2020i).

Sector-specific restrictions based on the geographical location of the investment can be found in China, India, Indonesia, and Vietnam. For example, in India, FDI retail sales outlets may be set up only in cities with a population of more than 10 lakh (100,000 per the 2011 census) or any cities approved by state governments. In Indonesia, hospital business is open to a maximum of 67 percent foreign investment; however, foreign investors originating from ASEAN countries may hold up to 70 percent equity in companies engaging in

\textsuperscript{16} See Article 6 of the BKPM (Investment Coordinating Board of the Republic of Indonesia) Regulation No. 6 of 2018.

\textsuperscript{17} For example, Article 8 of the Ministry of Transportation Regulation No. PM 49 of 2017 stipulates that a freight forwarder with a status of foreign investor must have a minimum investment of US$4 million, and a minimum 25 percent of the authorized capital must be issued and paid up.

\textsuperscript{18} Under Art. 10 of the Ley de Inversión Extranjera Mexican, companies with foreign equity participation that have included in their bylaws the agreement provided by Section I of Article 27 of the Federal Mexican Constitution may hold direct title to real estate located in the Restricted Zone as long as the real estate is used for nonresidential activities (commercial, industrial, or tourism-related activities). If the real estate is used for residential activities, then companies may hold the real estate in trust, that is, they may not hold direct title.
hospital business, provided that the hospital is located in a capital city in Eastern Indonesia provinces, other than Makassar and Manado (World Bank 2020c).

Expatriate Limitations
Expatriate limitations are among the most common restrictions identified in the reviewed countries. All 10 reviewed countries use such measures, which include restrictions on appointment of expatriates to boards or other technical positions as well as restrictions on granting work permits. For the majority of countries, expatriate limitations are sector-specific. Only Nigeria and Thailand exhibit broad, horizontal limitations that apply to expatriates regardless of the sector. Most restrictions apply to companies' boards of directors or managerial positions, but some target technical-level positions, such as human resources experts.

Nigeria and Thailand have broad or horizontal expatriate limitations. In Nigeria, foreigners can only be employed to fill approved expatriate quota positions in a company duly registered in Nigeria. The Ministry of Interior has discretion to disapprove a quota position if it is of the opinion that the expertise exists in Nigeria. A specific quota (Permanent Until Reviewed, or PUR, quota), may be obtained if the company registered in Nigeria intends to employ only one expatriate for the position of a CEO or country manager. The PUR quota is obtained from the Ministry of Interior and has the advantage that, as the name suggests, it is usually granted for a longer period than the regular expatriate quota of two years (World Bank 2020f).

In Thailand, Thai nationals must make up at least 40 percent of the total number of directors of companies operating businesses under List 2 of the Foreign Business Act. The majority of directors of public limited companies are required to reside in Thailand (World Bank 2020g).

In all 10 reviewed countries, there are sector-specific expatriate limitations. These may be in the form of outright restrictions, quotas, or specific approval processes. For example, under Vietnamese aviation law, the number of foreigners must not account for more than one-third of the total number of members of the executive board of a foreign-invested airline company in Vietnam (World Bank 2020i). In China, legal representatives of general aviation companies and public air transportation companies must be Chinese citizens (World Bank 2020b). An example of a specific approval process can be found in Brazil. For entities operating in the insurance and private pension sector, the appointment of a foreign citizen to a managerial position or the board of directors must be ratified by the Department of Private Insurance (SUSEP). Similarly, with respect to financial institutions and other companies authorized to operate in Brazil by the Central Bank of Brazil or the Securities and Exchange Commission, the appointment of a foreign citizen must be approved by the bank or the commission, as applicable (World Bank 2020a).

In some cases, limitations apply to specific technical-level positions. For example, a company in Vietnam (including foreign-invested companies) according to Art. 170 of the Labor Code 2020 is allowed to employ foreign citizens in positions such as manager, managing director, expert, and technical worker only if Vietnamese employees are unable to fill the positions to meet production and business requirements. Similarly, in the Mexican aviation sector, commercial pilots and flight crews of commercial planes registered in Mexico must be Mexican by birth (World Bank 2020e). In Indonesia, foreigners are prohibited from holding positions that handle matters related to human resources, such as personnel directors, human resources managers, or career advisers.19

Mandatory Local Hiring
With the exception of China and India, all 10 reviewed countries impose mandatory local hiring requirements. Most of the countries have clearly defined rules, such as quotas for hiring nationals, but in some cases a general, undefined obligation to give priority to nationals is applied. Countries also differ on having horizontal and sector-specific rules on local hiring.

Brazil, Mexico, Thailand, and Turkey have quotas in place that set a specific ratio of foreign to national employees. Under Turkish law, Turkish companies in principle have to employ five Turkish nationals for each foreign employee.20 In Brazil, a company must hire two Brazilian employees for each foreign employee. The so-called two-thirds rule is mandatory not only relative to the total number of employees, but also relative to

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19 See Mexico’s Ministry of Employment Decree No. 40 of 2012.
20 Article 7 of the Turkish International Labor Law
the corresponding payroll; that is, two-thirds of the payroll must be directed to Brazilian employees (World Bank 2020a). In Mexico, all companies must employ at least 90 percent Mexican workers. In addition, workers in technical and professional positions should be Mexican. If no Mexican candidates are available because of the specialization of such positions, the employer company may temporarily hire no more than 10 percent foreign workers with that specialty, and the hiring company has the obligation to train Mexican workers for such positions. Employers are also required to select Mexicans over non-Mexicans for positions and promotions when they are similarly qualified. In Thailand, it is generally required that the ratio of foreign to Thai employees be 1 to 4. As such, a foreign investor must employ at least four Thai nationals to be able to sponsor the long-term visa of one foreign employee, although the requirement may be waived (World Bank 2020g).

In the six other countries, a general obligation to give priority to nationals is applied. For example, in Indonesia, no regulation expressly requires foreign investors to hire local employees, but Article 10 of the Law on Capital Investment states that an investment business has an obligation to give priority to Indonesian employees in meeting its hiring needs. It also obligates an investment business to increase the competencies of Indonesian employees through training in accordance with applicable laws.

Oftentimes, sector-specific rules impose local hiring requirements. For example, in Nigeria, the Nigerian Oil and Gas Industry Content Development Act (NOGICD Act) requires all operators and companies in the oil and gas industry to employ only Nigerians in junior and intermediate cadres, and it permits only 5 percent of the management positions to be retained for foreigners. The NOGICD Act also requires operators in the Nigerian oil and gas industry to submit a Nigerian content plan to the Nigerian Content Development and Monitoring Board before carrying out any project. The plan must demonstrate and ensure, among other things, that Nigerians are given first consideration for training and employment. In Malaysia, it is commonplace for regulatory licenses or approvals in the oil and gas industry and distributive trade industry to impose, through guidelines and written policies, minimum participation of Bumiputera (indigenous population) or Malaysians on boards of directors, management, and employee levels of the company (World Bank 2020d).

**Foreign Investment Licenses and Approvals**

All reviewed countries except Nigeria and Turkey require foreign investments to obtain a license and approval. Such licenses/approvals may need to be obtained from a centralized authority or from sector-specific ministries or agencies. Depending on the federal structure of the respective government, licenses/approvals may also need to be obtained from local or provincial governments.

In Thailand, Mexico, and Indonesia, a license/approval is required from a central government authority in specific cases. For example, in Thailand, a foreign investor is required to obtain a foreign business license to operate a business in any of the restricted categories in List 2 or List 3 of the Foreign Business Act. The process for obtaining a foreign business license takes four to six months, and there is no guarantee that the license will be granted. Foreign applicants for FDI in a business activity under Lists 2 and 3 must file a license application with different departments of the Ministry of Commerce. Several exceptions apply to the foreign licensing requirements: (a) the foreign investor qualifies under relevant treaty protection; (b) the foreign investor obtains an Investment Promotion Certificate from the Board of Investment; or (c) the foreign investor obtains a license to operate in the industrial or export estate from the Industrial Estate Authority of Thailand (World Bank 2020g). Similarly, in Mexico, FDI approval from the National Foreign Investment Commission is required in the following cases: (a) if the contemplated foreign investment exceeds 49 percent in a regulated sector pursuant to Article 8 of the Foreign Investment Law, or (b) if the foreign investment exceeds 49 percent of the capital stock of a Mexican entity with an aggregate value of assets higher than the amount annually determined by the commission, which is currently set at US$211 million (Article 9).

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23 This requirement may be waived if the employer company obtains an “investment promotion” from the BOI. However, the company will still need to justify the need to hire expats over Thai nationals for approval. The approvals are the sole discretion of the officials, who determine the necessity for and suitability of employing foreign nationals in such positions.
Brazil, China, India, Malaysia, and Vietnam deploy decentralized systems where licenses/approvals need to be obtained from sector-specific regulators. For example, in India, FDI approval by the concerned ministry and the sectoral regulators (as applicable) is required for investments that fall within the government approval route. The concerned ministries for FDI approval vary by sector. For example, defense sector projects are subject to approval by the Ministry of Defense, aviation projects by the Ministry of Civil Aviation.\(^{24}\)

In China and Vietnam, it is further necessary to obtain licenses/approvals from different levels of government. In Vietnam, foreign investors (including foreign-invested joint ventures with majority foreign ownership) are required to apply for and obtain investment project approval in the form of an investment registration certificate from the relevant local or provincial investment authority. Certain types of investment projects may also require a higher level of approval prior to obtaining a certificate, depending on the nature, scale, and scope of investment. Such investments require approval from the National Assembly, the prime minister, or Provincial People’s Committees (World Bank 2020i). Similarly, in China, depending on the industry or sector and the investment scale, approval from the national or local counterparts of the Ministry of Commerce, national or local counterparts of the National Development and Reform Commission, or industry- or sector-specific regulators may be required (World Bank 2020b).

Dedicated screening processes that are based on national security and are performed in addition to licensing and approval procedures are rare. In China, an investment may trigger a national security review by the Ministry of Commerce and its local counterparts if it invokes issues of national interest. For instance, if a merger or acquisition falls within a key sensitive sector such as defense manufacturing, military equipment, key agricultural products, energy resources, infrastructure, and so forth, the investment will be subject to the scrutiny of an interministerial joint committee consisting of the Ministry of Commerce and the National Development and Reform Commission, which will oversee the review (World Bank 2020b). In other countries such screening may be included as part of a licensing/approval process.

**Other Types of Restrictions**

The review identified several other restrictions, such as the following:

- **Mandatory local sourcing requirements.** Five reviewed countries deploy mandatory local sourcing requirements (India, Indonesia, Malaysia, Nigeria, and Vietnam). These are always sector-specific. For example, in the oil and gas sector in Nigeria, exclusive consideration is given to Nigerian indigenous service companies with respect to the award of contracts. First consideration is also given to Nigerian operators and indigenous service companies in the award of oil blocks, licenses, and works in the sector (World Bank 2020f). In Malaysia, mandatory local sourcing requirements may be imposed as regulatory licensing/approval conditions. For example, a distributive trade company with foreign involvement is required to, among other conditions, increase the use of local airports and ports in the export and import of the goods as well as use local companies for legal and other professional services that are available in Malaysia (World Bank 2020d).

- **Mandatory R&D requirements.** In India, such requirements exist in certain sectors. For example, brownfield FDI in the pharmaceutical sector is subject to a requirement that R&D expenses be maintained in value terms for five years at an absolute quantitative level at the time of induction of foreign investment.\(^{25}\)

- **Quota of foreign firms.** In Malaysia, quotas exist for certain professional services sectors. For example, a foreign law firm can be licensed as a qualified foreign law firm (QFLF) in Malaysia, subject to certain conditions. However, only up to five QFLF licenses will be granted under the current regime (World Bank 2020d).

- **Restrictions based on the type of share.** In Mexico, foreign investment is limited to up to 49 percent of T shares in companies owning land used for agriculture, livestock, or forestry purposes. T shares, for tierra (land), are equivalent in value to the capital contributed in agriculture, livestock, or forestry.

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\(^{24}\) See the Department for Promotion of Industry and Internal Trade Ministry of Commerce and Industry Government of India, Consolidated FDI Policy (2020).

\(^{25}\) The benchmark for this level is decided with reference to the highest level of R&D expenses incurred in any of the three financial years immediately preceding the year of the FDI’s induction.
land, or those funds destined for the acquisition of such land, depending on the value of the land at the moment of the contribution or acquisition (World Bank 2020e).

4. Investor Protection

In reviewing the 10 countries’ legal frameworks for investment protection, research was focused on 15 elements that protect investment that fall within five topics: (a) foreign investment law, (b) expropriation, (c) capital transfer, (d) nontransparent government conduct, and (e) dispute settlement. These elements cover the fundamental guarantees, which are critical for investors to continue their operations and protect their property rights.

The number of protections guaranteed to foreign investments by the 10 countries varies significantly (see figures 5; figure 6 lists the investor protection elements). The countries with the fewest elements in their laws are Malaysia, Brazil, and India. The countries with the most protections are Vietnam and China. Notably, the countries with the most elements also tend to have a foreign investment law. China and Vietnam include key aspects of investor protection in their foreign investment laws.

**Figure 5. Number of Missing Investor Protection Elements by Country**

![Bar chart showing the number of missing or partial protection elements by country.]

*Source: WBG analysis.*

*Note: The 15 elements reviewed are listed in figure 6. This figure shows the absence or existence of partial provisions for the 15 elements.*

The prevalence of each type of element also varies across countries (see figure 6). The weakest guarantees are capital transfers and transparency of government conduct. In six of the 10 countries, unrestricted capital transfer (apart from standard compliances) is not provided for, and in all of the countries, the processing of transactions is not time bound. Although public access to laws and regulations is guaranteed in all 10 countries, public consultation on legislation is not provided for in seven countries. The strongest guarantee is dispute settlement, with all countries providing for dispute settlement in domestic courts and arbitration, and all but one (Brazil) offering international arbitration. At the same time, only three countries (Brazil, China, and Turkey) have a grievance management mechanism that addresses grievances before they turn into a dispute. Figure 7 shows the investment protection elements identified in each country.

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26 The 15 elements cover good practices on investor protection and are identified on the basis of literature review, new-generation international investment agreements, jurisprudence, and recent investor perception surveys.
Figure 6. Prevalence of Investor Protection Elements in 10 Middle Income Countries

- **Investor protection elements**
  - Foreign Investment Law (FIL) Exists
  - Legal Guarantees included in FIL
  - Expropriation
  - Time and amount of compensation
  - Currency transfer
  - Legally prescribed process
  - Time-bound processing of transactions
  - Non-transparent government conduct
    - a) Public access to laws and regulations
    - b) Public consultation of legislation
    - c) Specified period for comments in legislation
    - d) Online portal publishing laws and regulations
  - Due process
  - Dispute settlement
    - International arbitration
    - Domestic court and arbitration
    - Grievance management

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Source: WBG analysis.

Note: Countries shown as having one of the 15 investor protection elements may have either a complete provision or partial legal provision on these dimensions.

Figure 7. Legal Protection for Foreign Investors in Reviewed Countries

- **Legal provision exists**
- **Partial legal provision exists**
- **No legal provision exists**

Source: WBG analysis.

Note: Unrestricted capital transfer includes standard compliances.
Foreign Investment Law
Seven out of the 10 countries have a foreign investment law, that is, a single consolidated statute, law, or code focused on foreign and domestic (local) investment promotion, entry, protection, and facilitation. Although having a foreign investment law in itself does not guarantee adequate legal protection, a review of the prevalence of such a law in the 10 countries suggests a correlation. The countries that do not have such law (Brazil, India, and Malaysia) are also the three countries exhibiting the least number of elements related to investment protection. Thus, countries that use investment laws appear to explicitly guarantee high levels of protection to foreign investors. In addition, such a law has the advantage of increasing transparency for foreign investors, because it consolidates the most important legal dimensions pertaining to foreign investment in one central source.

In addition, the extent to which a foreign investment law covers the most important protection guarantees—expropriation, transfer, transparency, and dispute settlement—differs by country. Among the seven countries that have a foreign investment law, only China’s newly passed Foreign Investment Law (FIL) includes all main legal guarantees, which can be explained by its recency.27 On the other side of the spectrum, Thailand’s Foreign Business Act B.E. 2542 (1999), as amended, does not include any of the guarantees. The other countries’ investment laws include only some of the guarantees. For example, the Nigerian Investment Promotion Commission Act (the NIPC Act) includes guarantees on transfer, expropriation, and dispute settlement, but it does not cover transparency.

Expropriation
The review of the domestic legal framework shows that, with the exception of Malaysia, all 10 middle-income countries provide protection against expropriation. In Malaysia, there is no domestic omnibus legislation that governs expropriation, and domestic sectoral laws generally do not provide for explicit protection against (direct and indirect) expropriation (World Bank 2020d). However, the countries differ in the extent to which they stipulate conditions for legal expropriation and, more specifically, conditions for the payment of compensation. Overall, there is a discrepancy between the standard offered to foreign investors under most countries’ international investment agreements and the standard guaranteed under the domestic legal system. Such agreements more often include protection against both direct and indirect expropriation (that is, against measures that have equivalent effects on direct expropriation), specify the types of assets that are protected against expropriation, and list conditions for expropriation. In the domestic legal frameworks, such differentiation and specification is often not made.

Only four countries stipulate all conditions for a lawful expropriation (Brazil, China, India, and Turkey). Under international law, for an expropriation to be lawful, it must be for a public purpose, follow due process, be nondiscriminatory, and oppose payment of compensation. With the exception of Malaysia, which does not provide for protection against expropriation, the other reviewed countries stipulate some, but not all, of the conditions, or only provide protection against expropriation for specific assets or types of investment. For example, in Thailand, the Foreign Business Act does not expressly include protection against direct and indirect expropriation. Only where investors obtain an investment promotion certificate from the Board of Investment are they granted protection against nationalization. Conditions for legal expropriation are provided only for land, not other assets.

Similarly, five countries (Brazil, China, Nigeria, Turkey, and Vietnam) stipulate that compensation must be adequate (that is, fair market value or other similar benchmark), effective, and paid in a timely manner. Except for Malaysia, the other countries only partially list these conditions. For example, in Indonesia, in the event of nationalization or taking, the government will compensate foreign investors for their investments based on the “market price” of the nationalized assets, that is, the price determined in accordance with internationally accepted methods by an independent appraiser appointed by the parties. The currency and time frame for payment are not included in the stipulations (World Bank 2020d).

27 China’s law, passed March 15, 2019, protects foreign investors against expropriation, subject to the public interest exception (Article 20).
Capital Transfer

In majority of the reviewed countries, either inbound or outbound capital transfers are restricted. In Mexico, Turkey, Thailand, and Vietnam, capital transfers are not restricted but are subject to applicable taxes and other standard compliances. Such standard compliances can, for example, be related to a bankruptcy, insolvency, or the protection of the rights of a creditor; to a criminal or penal offence; or to compliance with an order or judgment in judicial or administrative proceedings.

Inbound transfer of capital restrictions are mostly related to the capital account. For example, in India, although current account transactions are fully liberalized, government approval is required for certain capital account transactions (for example, the acquisition and transfer of immovable property in India). Similarly, in China, though regulations for current account transactions have become flexible, government approval is required for certain capital account transactions. These transactions are generally related to items of a nontrade, nonrecurring nature, such as real estate purchases, repayment of principal of foreign currency loans, and contributions to registered capital. In addition, various regulations apply to the permitted use of funds in the capital account (World Bank 2020b). For example, the capital of Foreign Invested Enterprises (RMB or foreign currency) in China cannot be directly or indirectly used for the following purposes:

- Payment beyond the business scope of the FIEs or the payment prohibited by national laws and regulations;
- Investment in securities unless otherwise provided by laws and regulations;
- Granting entrustment loans in RMB (unless permitted by the scope of business), repaying interenterprise borrowings (including advances by the third party), or repaying bank loans in RMB that have been sub-lent to the third party; and
- Paying expenses related to the purchase of real estate not for self-use, except for foreign-invested real estate enterprises.28

In a number of countries, the restriction on inbound transfer is related to foreign loans. For example, in Malaysia, inflow approval from Bank Negara Malaysia is required if a foreign shareholder provides a loan to the Malaysian entity in excess of RM 1 million (World Bank 2020d). In Brazil, though no prior approval from the central bank is required for foreign currency loans, the central bank may refuse to accept loans on which interest is charged over and above the prevailing rate in the country of origin (World Bank 2020a). In India, loans from foreign entities have to conform to various parameters, such as minimum maturity, permitted and nonpermitted end use, and a maximum all-in cost ceiling. The Reserve Bank of India introduced new external commercial borrowing (ECB) rules in 2018 and 2019, under which all entities eligible for FDI are permitted to borrow through the ECB route up to US$750 million or its equivalent per financial year (irrespective of specified activities or sector) via the Automatic Route. The end use of ECB funds cannot be to invest in capital markets, or construction and development of industrial parks or special economic zones, or a chit fund or Nidhi company.

Restrictions on the outflow of funds are limited to specific types of funds or to particular sectors. In Brazil, remittances for technology transfers, including patents and trademarks, require the central bank’s prior approval. Remittance limits apply to payments related to patents, trademark license, and other agreements that involve transfer of technology. For example, payments that are due from a Brazilian subsidiary to its foreign parent related to patents are limited to 1 and 5 percent, and payments for trademarks up to 1 percent of the net revenues of the product manufactured or sold (World Bank 2020a). In Nigeria, restrictions are placed on the remittance of technical fees, as stipulated by the National Office for Technology Acquisition and Promotion. The technical fees are usually based on the percentage of turnover and range between 0 and 5 percent of net sales, depending on the complexity of the technology. Agreements involving high technology such as petrochemicals, space, biotechnology, complex engineering, and so on usually attract a higher percentage of technical fees (World Bank 2020f). In India, certain sectors may impose limitations on outflows. For instance, a lock-in period of three years is imposed on each tranche of foreign investment in the

construction development sector (with the exception of hotels and tourist resorts, hospitals, special economic zones, educational institutions, and old-age homes).

In almost all countries, the process of converting and transferring outbound currency is clearly stated in a regulation, notification, or similar instruments. Exceptions are Thailand and Mexico. For example, in Thailand, apart from requirements on permissible transactions and supporting documents to effect the transfer, the Exchange Control Law does not stipulate a procedural step in making the conversion and transferring the proceeds to a foreign jurisdiction. The process depends largely on the procedures prescribed by each commercial bank (World Bank 2020g).

None of the 10 reviewed countries sets a requirement that transfers should be made in a timely manner. Such a standard is often included in international investment agreements, which may require a prompt transfer, a transfer without delay, or a transfer within a specific time period. For foreign investors, such a time limit is important to ensure that the transfer of funds is not unnecessarily delayed.

Non-transparent Government Conduct
Due process is guaranteed in all 10 countries’ legal frameworks, but transparency in rulemaking is generally included to a limited extent. All 10 countries guarantee public access to laws and regulations and publish their laws and regulations on an online portal. Yet public consultation of legislation is fully offered in only three countries and is offered partially in one, and only three countries specify a period for comments in their legislation.

China, Thailand, and Vietnam mandate public consultation of legislation. For example, in Thailand, the constitution requires that before the enactment of every law, including laws regarding foreign investment, the government must consult with stakeholders. Further, the 2019 Act on the Criteria for Drafting the Law and Assessing the Effectiveness of the Law underscores that principle and mandates the government to consult with stakeholders in the drafting process for subordinate regulations. A 2017 cabinet resolution included a guideline for government agencies to conduct public hearings during the drafting of laws and regulations for at least 15 days via websites or by other means (World Bank 2020g).

In Mexico, a partial legal provision exists concerning the public consultation of legislation. Regulatory impact assessments, public consultations, and stakeholder engagement on draft regulations are mandatory for all regulatory proposals and primary laws coming from the executive level. At the same time, Mexico has no formal requirement for consultation or for conducting impact assessments when development primary laws initiated by parliament (World Bank 2020e).

A specified statutory period for which laws, regulations, and other measures are required to be made publicly available for comments is provided for in China, India, and Vietnam. For example, in India, pursuant to the 2014 Pre-Legislative Consultation Policy, the legal instrument must be placed in the public domain for a minimum of 30 days. At the same time, consultation with stakeholders is discretionary. The concerned ministry or department may decide the degree of participation and mode of consultations, which may vary according to the subject and the potential impact on the stakeholders affected by such legislation.

Dispute Settlement
Regarding category dispute settlement, three aspects were reviewed: (a) the availability of international arbitration to foreign investors, (b) the availability of domestic courts and arbitration, and (c) the existence of grievance management mechanisms to precede or prevent legal dispute. Overall, investors have access to a wide range of disputed settlement mechanisms in the 10 reviewed countries. Access to domestic courts and arbitration is guaranteed in all 10 countries, and with the exception of Brazil, foreign investors in all countries have access to international arbitration. At the same time, grievance management is provided in the legal framework in only three countries (Brazil, China, and Turkey), largely because grievance management is a relatively novel concept that is only beginning to emerge in different countries.

Brazil is the only country that includes a partial legal provision on access to international arbitration alone. Foreign investors can resort to Brazilian domestic courts to resolve their disputes, but they generally do not have access to investor-state arbitration. Brazil is not a party to the Convention on the Settlement of Investment
Disputes Between States and Nationals of Other States of 1965 and has not ratified any bilateral investment treaty, which would provide an investor-state dispute settlement mechanism through international arbitration. At the same time, an investor can resort to commercial arbitration—either domestic or international—whenever it has entered into an agreement with a Brazilian public entity containing a valid arbitration covenant (World Bank 2020a).

Brazil, China, and Turkey include a provision in their legal framework that provides for grievance management. For example, in Turkey, natural and legal persons, including foreign entities and nationals, may lodge complaints to the Ombudsman Institution.29 The decisions of the Ombudsman Institution are nonbinding. However, administrations that do not act in compliance with the decisions must explain the reasons for noncompliance. Administrations that do not comply with the ombudsman’s decisions will also be disclosed to the public in an annual report published by the Ombudsman Institution at the end of each year. In China, Article 26 of the new Foreign Investment Law states that the state will establish a complaint mechanism for foreign-funded enterprises, solve the problems reported by foreign-funded enterprises or their investors in a timely way, and coordinate and improve relevant policy measures. The exact composition of such a mechanism is yet to be determined.

Other countries have begun installing an investor grievance mechanism but have not yet included a legal provision. For example, Vietnam has begun implementing an investor grievance mechanism to retain existing investment. The Ministry of Planning and Investment is currently in the process of implementing a mechanism to proactively resolve investor grievances, especially those generated from interactions with provinces. There is no legal provision on this yet (World Bank 2020i).

5. Investment Incentives

In reviewing the 10 countries’ legal frameworks for investment incentives, research was focused on the transparency and accessibility of incentives. To that end, the review covered three topics: (a) the basis of incentives (whether tax and financial incentives are provided by law or policy), (b) accessibility of incentives (with information available on electronic portals) and existence of defined approval processes, and (c) and existence of objective eligibility criteria.

The level of transparency and accessibility of incentives varies by country (see figure 8). The countries with the fewest transparency and accessibility elements are Brazil, India, and China. Whereas Brazil and India both have partial legal provisions in a number of aspects, China does not cover four out of five aspects. To some extent, this is because China only recently passed a new foreign investment law, which also covers the administration of incentives, but not in great detail. Implementing regulations are expected to be released shortly, which may provide greater legal clarity for foreign investors.

29 The Ombudsman Institution was established with the Law on the Ombudsman No. 6328, published in the Official Gazette on 29 June 2012, http://www.mevzuat.gov.tr/MevzuatMetin/1.5.6328.pdf.
30 For the research, tax incentives included (a) full or partial reduction in corporate income tax (that is, tax holiday or lower tax rate); (b) performance-based incentives (e.g., allowances and accelerated depreciations); (c) VAT exemption and/or remission; and (d) customs duty exemption and/or remission.
31 For the research, financial incentives included (a) matching or conditional cash grants; (b) public sector equity participation; and (c) reduced rates on land, utilities, and transportation.
Figure 8. Number of Incentives Transparency Aspects Missing in Countries' Legal Frameworks

Source: WBG analysis.

Note: The scores are from a total of five aspects reviewed: tax incentives provided by law or policy, financial incentives provided by law or policy, availability of information on a portal, defined approval process, and objective eligibility criteria.

The prevalence of each aspect across countries also varies (see figure 9). The weakest aspects are availability of comprehensive information on incentives (two countries have partial legal provisions, four countries have no provisions) as well as the clarity on approval processes (two countries with partial legal provisions, three countries with no provisions). Many countries do not have a portal to provide information on available incentives. Furthermore, a difference is observed between tax and financial incentives. Whereas tax incentives are generally provided under written law or policy, financial incentives more often are not. Eligibility criteria, as well as defined approval processes, are also more often provided for tax incentives than for financial incentives.

Figure 9. Number of Countries with Missing Incentives Transparency Provisions

Source: WBG analysis.
Whether incentives are provided to foreign investors through published law or policy (for example, investment law, tax code, or customs ordinance) depends on the type of incentive. Tax incentives are generally provided by law or policy. The basis of financial incentives, on the other hand, that are seen in Brazil, China, and Malaysia are not expressly stated in a law or policy. Mexico does not offer financial incentives at the federal level. In India, although most tax and financial incentives are provided under a specific law, notification, circular, or other official announcements, in some cases central and state governments also grant discretionary, case-by-case incentives.

Many countries do not have a publicly accessible, centralized government source or portal that lists all tax and financial incentives offered to foreign investors in the country. A comprehensive source or portal exists only in Malaysia, Mexico, Nigeria, and Turkey. Brazil and Indonesia both publish a list of incentives but include only tax incentives (for example, some information regarding federal tax incentives is available on the website of the Brazilian Federal Revenue).32 Also in Brazil, some entities that are focused on supporting commercial relations between local and foreign companies or foreign investors have online materials regarding tax incentives (World Bank 2020a).

Most countries state the process for approval of incentives in a law, regulation, or official notification or other similar instrument. China, Malaysia, and Nigeria do not include a defined approval process. In India, those incentives provided through published law, notifications, circulars, or other official announcements also generally set out the eligibility criteria and the approval and preapproval process to apply for the relevant incentive. In Brazil, only the approval process for tax incentives is stated (World Bank 2020a).

Similarly, with the exception of China, all countries grant incentives based on clear and objective eligibility criteria provided in a law, regulation, or policy. Again, this may be on account of the pending implementing regulations that cover incentives. In Brazil, eligibility criteria are limited to tax incentives, and in India they are stated only for those incentives that are provided under a specific law, notification, circular, or other official announcement (World Bank 2020a).

6. Conclusion

Global FDI is governed by a patchy network of investment rules set by international investment agreements (bilateral and plurilateral), domestic legal frameworks, and transaction-specific contracts. Countries are working to bring about greater coherence and consistency on some aspects of investment through WTO’s structured discussions on investment facilitation. However, key rules on investment entry and establishment (market access) and on protection (including dispute settlement) are beyond the scope of the prospective multilateral agreement and will continue to be governed by other instruments. Understanding the investment rules adopted by leading home and host countries is important as countries consider various options on the content of proposed multilateral rules on investment. To that end, this review of the FDI legal and regulatory frameworks of the 10 countries covered in this paper highlight some areas where approaches converge and where they remain distinct. Even where countries use similar types of measures, the effect of those measures on restrictiveness can vary greatly depending on specifics such as sector, activity, business model, nationality, type of legal form, size of investment, and so on. This paper thus adds to the existing literature by providing nuance and granularity to how FDI is regulated.

Of the 12 types of entry and establishment restrictions reviewed in this paper, the most widely prevalent are equity ceilings and expatriate limitations. Research shows that those two types can also have the deepest effect on FDI inflows (Thomsen and Mistura 2017). Other common restrictions are license/approval requirements and mandatory local hiring requirements. Information on the procedures and details of the restrictions is generally available in most of the reviewed countries. The least prevalent restrictions are mandatory export requirements, mandatory R&D requirements, quotas for foreign firms, and restrictions based on the types of shares.

Regulatory risk—including risks of expropriation, restrictions on transferring currency, breach of contract, and arbitrary and unpredictable government actions—can deter FDI flows. By addressing these risks in their domestic legal frameworks, such as by including investor protection guarantees, countries can create greater predictability and certainty for foreign investors. Of course, even with good rules, the well-known challenges around effective enforcement persist. Nonetheless, legal protections establish the baseline treatment that foreign investors can expect in a country.

Section 4 of this paper maps 15 elements of investor protection that cover the major types of regulatory risks in the 10 countries. There is convergence on some of the elements reviewed, in particular relating to expropriation and dispute settlement. The least-covered aspect across the countries is the guarantee on currency transfers and transparency of government conduct. In six of the 10 countries, unrestricted capital transfer (apart from standard compliances) is not provided for, and in all of the countries, the processing of transactions is not time bound. In all 10 countries, public access to laws and regulations is guaranteed, but public consultation on legislation is not provided for in seven countries. The strongest guarantee is dispute settlement, with all countries providing for dispute settlement in domestic courts and arbitration, and all but one offering international arbitration. At the same time, only three countries have provisions on a grievance management mechanism that addresses grievances before they turn into a dispute. Notably, countries with stronger protection guarantees tend to have a foreign investment law.

Across the 10 countries, whereas tax incentives are generally provided under written law or policy, financial incentives often are not. Eligibility criteria, as well as defined approval processes, are also more often provided for tax incentives than for financial incentives. Across the 10 countries, ensuring the availability of comprehensive information on incentives and of clear approval processes is a challenge. Many countries do not have a portal to provide information on available tax or financial incentives.

This paper sets the foundation for further research on several related aspects of foreign investment. Using a standardized questionnaire, this review compared aspects of countries’ legal and regulatory frameworks along the dimensions of entry and establishment, protection, and incentives. By subdividing each dimension into clearly measurable categories, it provides an indication of widely prevalent as well as distinct investment rules and approaches. Further research could add new dimensions, disaggregate the existing dimensions, and extend the scope of the analysis to additional countries.
7. References


