

# RECENT POLICY DEVELOPMENTS

## CHAPTER III

*Many countries continued to liberalize and promote foreign investment in various industries to stimulate growth in 2011. At the same time, new regulatory and restrictive measures continued to be introduced, partly for industrial policy reasons. They became manifest primarily in the adjustment of entry policies for foreign investors (e.g. in agriculture and pharmaceuticals), in extractive industries (e.g. through nationalization and divestment requirements) and in a more critical approach towards outward FDI.*

*International investment policymaking is in flux. The annual number of new bilateral investment treaties (BITs) continues to decline, while regional investment policymaking is intensifying. Sustainable development is gaining prominence in international investment policymaking. Numerous ideas for reform of the investor–State dispute settlement (ISDS) system have emerged, but few have been put into action.*

*Suppliers need support for CSR compliance. Corporate social responsibility (CSR) codes of transnational corporations (TNCs) often pose challenges for suppliers in developing countries (particularly small and medium-sized enterprises (SMEs)). They have to comply with and report under multiple, fragmented standards. Policymakers can alleviate these challenges and create new opportunities for suppliers by incorporating CSR into enterprise development and capacity-building programmes. TNCs can also harmonize standards and reporting requirements at the industry level.*

## A. NATIONAL POLICY DEVELOPMENTS

**Key features of investment policies included continuous liberalization and promotion, the adjustment of entry policies with regard to FDI, more state influence in extractive industries and a more critical approach towards outward FDI.**

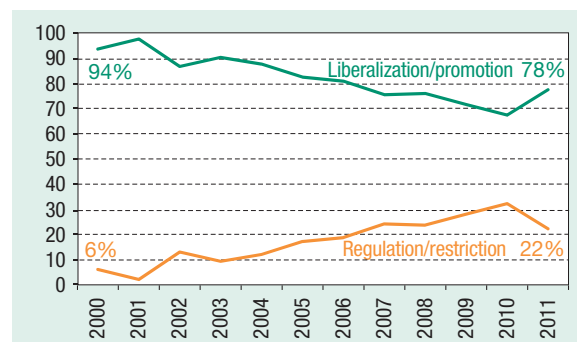
In 2011, at least 44 countries and economies adopted 67 policy measures affecting foreign investment (table III.1). Of these measures, 52 related to investment liberalization, promotion and facilitation, while 15 introduced new restrictions or regulations for foreign investors.

The percentage of more restrictive policy measures decreased significantly, from approximately 32 per cent in 2010 to 22 per cent in 2011. However, it would be premature to interpret this decrease as an indication of a reversal of the trend towards a more stringent policy environment for investment observed in previous years (figure III.1). The share of measures introducing new restrictions or regulations was roughly equal for both developing and transition economies, on the one hand, and for developed countries, on the other hand. To extract these figures, UNCTAD applied a revised methodology (see box III.1).

Of the 67 measures adopted, almost half (29) were directed specifically at foreign investment. These measures offered special incentives to foreign investors, reduced existing discrimination or introduced new restrictions on foreign investors. In total, 21 more favourable measures for foreign investors and 8 less favourable ones were reported. Of the more favourable policy measures, just over half (11) related to FDI liberalization, another 6 to promotion and facilitation activities, and 4 to the operational conditions of FDI. The less favourable

policy changes related in particular to new restrictions on the entry and establishment of foreign investment (6 measures). Finally, four measures were directed at outward investment, with two aiming at promoting investment and two having a restrictive or discouraging nature.

**Figure III.1. National regulatory changes, 2000–2011**  
(Per cent)



Source: UNCTAD, Investment Policy Monitor database.

The overall policy trend towards continuous liberalization and promotion of investment often targeted specific industries (table III.2). Extractive industries were again the main exception, inasmuch as most policy measures related to them were less favourable, although the effect was less pronounced than in previous years (see section A.2). Agriculture and financial industries also had relatively high shares of less favourable measures. In agriculture, new entry restrictions were introduced. For financial industries, these measures included two restrictions affecting ownership and control of foreign investors, one in banking and one in insurance, and a measure restricting access to local finance for foreign-funded investment firms.

**Table III.1. National regulatory changes, 2000–2011**  
(Number of measures)

Item	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Number of countries that introduced changes	45	51	43	59	80	77	74	49	41	45	57	44
Number of regulatory changes	81	97	94	126	166	145	132	80	69	89	112	67
Liberalization/promotion	75	85	79	114	144	119	107	59	51	61	75	52
Regulation/restriction	5	2	12	12	20	25	25	19	16	24	36	15
Neutral/indeterminate	1	10	3	0	2	1	0	2	2	4	1	0

Source: UNCTAD, Investment Policy Monitor database.

### Box III.1. Investment Policy Monitor database: revised methodology

UNCTAD has been collecting information on changes in national FDI policies on an annual basis since 1992. This collection has provided input to the analysis of global and regional investment policy trends in this *Report*, the quarterly *Investment Policy Monitor* (since 2009) and the *UNCTAD-OECD Reports on G-20 Investment Measures*.

Policy measures are collected in the Investment Policy Monitor (IPM) database. The measures are identified through a systematic review of government and business intelligence sources and verified, to the fullest extent possible, by referencing government sources.

In 2011, to further improve the quality of reporting, UNCTAD revised the methodology to monitor investment policy measures. The new approach allows a more detailed and focused analysis of policy changes by introducing three distinct categories of measures:

1. FDI-specific measures: measures which apply only to foreign investors, such as entry conditions or ownership restrictions for foreign investors, FDI screening procedures and investment incentives reserved to foreign investors.
2. General investment measures: measures which apply to both domestic and foreign investors, such as private ownership restrictions, licensing procedures for new businesses, privatization schemes and general investment incentives.
3. General business climate measures: measures which indirectly affect investors in general, such as corporate taxation changes, labour and environmental regulations, competition policies and intellectual property laws.

FDI-specific and general investment measures are divided into three types, on the basis of the policy area they address: entry and establishment, treatment and operation, and promotion and facilitation.

The count of national investment policy measures is limited to FDI-specific measures and general investment measures; in the past, relevant measures related to the general business climate were also included.<sup>a</sup> However, UNCTAD's analysis will continue to present main changes in the business climate when they provide relevant insights into investment-related policy developments.

Furthermore, the database registers whether the expected impact of a measure is likely to be more favourable or less favourable to investors. More favourable measures are measures that are directly or indirectly geared towards creating a more attractive environment for foreign investment, for instance, through liberalization or the provision of incentives. Less favourable measures are measures that have the opposite effect. They include, for instance, the introduction of new entry restrictions, discriminatory treatment and limitations on the repatriation of profits.

Source: UNCTAD.

<sup>a</sup> As a result of the exclusion of policy measures related to the general business climate, the number of annual investment policy measures reported in 2011 is significantly reduced from the number reported in previous *WIRs*. To maintain the tradition of presenting investment policy developments over an extended period of time and to allow comparisons between developments in different years, UNCTAD has recalculated the number of policy measures adopted over the last 10 years (table III.1).

**Table III.2. National regulatory changes in 2011, by industry**

Industry	Total number of measures	More favourable (%)	Less favourable (%)
<b>Total</b>	<b>71</b>	<b>78</b>	<b>22</b>
No specific industry	36	89	11
Agribusiness	2	50	50
Extractive industries	7	43	57
Manufacturing	7	71	29
Electricity, gas and water	2	100	0
Transport, storage and communications	7	86	14
Financial services	6	50	50
Other services	4	100	0

Source: UNCTAD, Investment Policy Monitor database.

Note: Overall total differs from that in table III.1 because some changes relate to more than one industry.

## 1. Investment liberalization and promotion remained high on the policy agenda

In 2011, at least eight countries undertook measures to open industries for FDI. Targeted industries included agriculture, media services and finance. By far the highest concentration of measures liberalizing

entry and establishment conditions for foreign investors occurred in Asia (see box III.2). Several countries pursued privatization policies, particularly in airport and telecommunications services.

**Countries worldwide continued to liberalize and promote foreign investment in various industries to foster economic growth and development.**

### Box III.2. Examples of investment liberalization measures in 2011–2012

*Brazil* adopted a law lifting the 49 per cent cap on foreign ownership of cable operators. The law also entitles telecom operators to offer combined packages including voice, broadband and television services.<sup>a</sup>

*Canada* increased the threshold for review for investors from WTO member countries from \$312 million in 2011 to \$330 million for 2012.<sup>b</sup>

*India* allowed full foreign ownership in parts of the agriculture sector, namely in the development and production of seeds and planting material, animal husbandry, pisciculture, aquaculture under controlled conditions and services related to agribusiness and related sectors.<sup>c</sup> In addition, the country expanded the degree of foreign investment allowed in single-brand retail trading to 100 per cent from the previous limit of 51 per cent.<sup>d</sup>

*The Russian Federation* relaxed the approval requirement for foreign acquisitions in companies that extract subsoil resources, from 10 per cent of shares to 25 per cent.<sup>e</sup>

*Thailand* allowed foreign banks operating branches in the country to convert such branches into subsidiaries.<sup>f</sup>

Source: UNCTAD, Investment Policy Monitor database. Additional examples of FDI-specific policy measures can be found in UNCTAD's *IPMs* published in 2011 and 2012.

<sup>a</sup> Law No. 12485, *Official Gazette*, 13 September 2011.

<sup>b</sup> Investment Canada Act: Amount for 2012, *Official Gazette* of the Government, 25 February 2012.

<sup>c</sup> Ministry of Commerce and Industry, Consolidated FDI Policy Circular 1 (2011), 31 March 2011.

<sup>d</sup> Ministry of Commerce and Industry, Press Note No. 1 (2012 Series), 10 January 2012.

<sup>e</sup> Federal Law No. 322-FZ, 17 November 2011.

<sup>f</sup> Bank of Thailand, Policy Guideline Permitting Foreign Banks to Establish a Subsidiary in Thailand, 15 December 2011.

### Box III.3. Examples of investment promotion and facilitation measures in 2011–2012

*Angola* introduced a new investment regime applicable to national and foreign investors that invest in developing areas, special economic zones or free trade zones. Provided certain conditions are fulfilled, it offers investors several incentives in a wide range of industries, including agriculture, manufacturing, rail, road, port and airport infrastructure, telecommunications, energy, health, education and tourism.<sup>a</sup>

*China* published new guidelines encouraging FDI in strategic emerging industries involved in energy efficiency, environmental protection and high-tech, as well as some other industries in the manufacturing and services sectors.<sup>b</sup>

*The Russian Federation* issued a decree appointing investment ombudsmen, one for each of the country's eight federal districts. The decree states that ombudsmen are meant to assist businesses in realizing investment projects and to facilitate their interaction with authorities at the federal, regional and local levels.<sup>c</sup>

*The United States* established the "SelectUSA" initiative, the first coordinated federal initiative to attract foreign investment and to encourage United States investors abroad to relocate their business operations back home. The initiative aims to (i) market the country's strengths in a better way; (ii) provide clear, complete, and consistent information on the investment climate in the United States; and (iii) remove unnecessary obstacles to investment. It also aims to support private-sector job creation and retain industries needed for economic growth.<sup>d</sup>

*Uzbekistan* adopted a new decree that offers additional incentives and guarantees to foreign investors, including a "grandfathering" clause, assistance with the construction of infrastructure, and tax benefits.<sup>e</sup>

Source: UNCTAD, Investment Policy Monitor database. Additional examples of FDI-specific policy measures can be found in UNCTAD's *IPMs* published in 2011 and 2012.

<sup>a</sup> New Private Investment Law, *Republic Gazette*, 20 May 2011.

<sup>b</sup> National Development and Reform Commission, Catalogue for the Guidance of Foreign Investment Industries (amended in 2011), 29 December 2011.

<sup>c</sup> Presidential Decree No. 535-rp, 3 August 2011.

<sup>d</sup> United States Department of Commerce, Press Release, 15 June 2011.

<sup>e</sup> President of Uzbekistan, Decree No. UP-4434: "On additional measures for attraction of foreign direct investment", 10 April 2011.

A large share (32 per cent) of the policy measures undertaken in 2011 related to investment promotion and facilitation. Among them were administrative and procedural changes to facilitate foreign investments. Others provided new incentives for investors in industries such as extractive industries, electricity generation, information communications and technology, and education and health care. Some countries also took steps to set up new or expand existing special economic zones (see box III.3).

## 2. State regulation with regard to inward FDI continued

### Regulatory measures affecting FDI included the adjustment of entry policies in some key sectors and more state control of extractive industries.

The past year saw a continuation of regulatory policies on FDI. The manifold motivations for these policies included considerations of national security, food security and industrial policy, as well as the wish to control strategic industries and infrastructure (box III.4). Restrictions appeared not only in the regulatory framework itself, but also in more stringent administrative practices, for instance, in screening procedures for incoming investment and in a broader interpretation of national security concerns.

State regulation became manifest in particular in two policy areas: (i) an adjustment of entry policies with regard to inward FDI, and (ii) more regulatory policies in extractive industries. In both areas, changes were partly driven by industrial policy considerations (see also chapter II).

### a. Adjusting entry policies with regard to inward FDI

Some countries modified their policy approach with regard to FDI in 2011–2012 by introducing new entry barriers or by reinforcing screening procedures. Particularly in Latin America and Africa, concerns are growing about an excessive purchase of land by large-scale foreign firms and government-controlled entities (e.g. sovereign wealth funds), the environmental consequences of overexploitation; and their implications for the promotion of rural economic development among domestic rural producers.<sup>1</sup> At least two countries

(*Argentina* and the *Democratic Republic of Congo*) adopted restrictive measures on agriculture. These changes reflect the fact that agriculture is a strategic sector for food security and an important source for economic growth.

Despite similar concerns about FDI in agriculture, the two countries chose different forms and degrees of restriction on access to land by foreigners. The *Democratic Republic of Congo* opted for a strict nationality requirement, under which only Congolese citizens or companies that are majority-owned by Congolese nationals are allowed to hold land.<sup>2</sup> By contrast, *Argentina* opted for a solution that sets quantitative quota for foreign ownership of agricultural land (see box III.4).

Other means deployed in 2011 to enhance government control over inward FDI – without going so far as to formally restrict FDI entry – were admission and screening procedures. For example, *India* decided that FDI proposals for mergers and acquisitions in the pharmaceutical sector would have to pass through the Government approval route.<sup>3</sup> This decision was allegedly made to ensure a balance between public health concerns and attracting FDI in the pharmaceutical industry.

### b. More State influence in extractive industries

In 2011–2012, a number of countries rich in natural resources took a more regulatory approach to extractive industries. The several reasons for this development include Governments' desire to benefit from soaring global commodity prices and their wish to foster State control over natural resources, as well as their dissatisfaction with the performance of private operators.

To obtain more control over extractive industries, governments have chosen different paths. These paths have led to *nationalization*, *expropriation* or *divestment requirements* (see box III.4). Some countries preferred to *increase – to different degrees – taxes and royalties in extractive industries*; they include *Colombia*,<sup>4</sup> *Ghana*,<sup>5</sup> *Guatemala*,<sup>6</sup> *Honduras*,<sup>7</sup> *Peru*,<sup>8</sup> the *Bolivarian Republic of Venezuela*,<sup>9</sup> *Zambia*<sup>10</sup> and *Zimbabwe*.<sup>11</sup> A major difference between countries that introduced new taxes relates to the participation of the private sector in the reform process. In some countries,

### Box III.4. Examples of FDI restrictions and regulations in 2011–2012

*Argentina* adopted a law that declares to be in the public interest and subject to expropriation 51 per cent of the share capital of YPF S.A., owned by Repsol YPF S.A. (Spain), and 51 per cent of the share capital of Repsol YPF Gas S.A., owned by Repsol Butano S.A. (Spain).<sup>a</sup>

The country also adopted legislation on land, limiting ownership by foreigners (both individuals and companies) to 15 per cent of productive rural land, a restriction that is compounded by a limit of 30 per cent for foreigners of the same nationality. In addition, no single foreign person or firm may own more than 1,000 hectares of land in certain core productive districts.<sup>b</sup>

In the *Plurinational State of Bolivia*, the President ordered the take-over of the subsidiary of the power company REE (Spain), which owns and runs about three quarters of the country's power grid.<sup>c</sup>

The *Democratic Republic of the Congo* adopted a law allowing land to be held only by Congolese citizens or by companies that are majority-owned by Congolese nationals.<sup>d</sup>

*India* decided that FDI proposals for mergers and acquisitions in the pharmaceutical sector will be permitted only under the Government approval route – no longer under the “automatic” route.<sup>e</sup>

In *Indonesia*, new legislation requires foreign firms operating in coal, minerals and metals to progressively divest their holdings to Indonesians, including the central Government, regional authorities, State-owned enterprises and private domestic investors. Foreign holders of mining business permits are required to divest their shares gradually, starting five years after production, so that by the tenth year at least 51 per cent of the shares are owned by Indonesian entities.<sup>f</sup>

The *Russian Federation* amended the federal law “On mass media”. Foreign legal entities, as well as Russian legal entities that have a foreign share exceeding 50 per cent, are prohibited from establishing radio stations that broadcast in an area covering more than half of the Russian regions or in an area where more than 50 per cent of the country's population lives.<sup>g</sup>

*Sri Lanka* passed a law that provides for the appointment of a competent authority to control, administer and manage 37 domestic and foreign enterprises. The legislation aims to revive underperforming companies and underutilized assets in places where the land belongs to the Government.<sup>h</sup>

*Source:* UNCTAD, Investment Policy Monitor database. Additional examples of investment-related policy measures can be found in UNCTAD's *IPMs* published in 2011 and 2012.

<sup>a</sup> Law No. 26.741, *Official Gazette*, 7 May 2012.

<sup>b</sup> Law No. 26.737, *Official Gazette*, 28 December 2011.

<sup>c</sup> Decreto Supremo 1214, 1 May 2012.

<sup>d</sup> Loi No. 11/022 du 24 Décembre 2011 Portant Principes Fondamentaux Relatifs à L'agriculture. Available at: [www.digitalcongo.net/UserFiles/file/PDF\\_files/2012/loi\\_principes\\_fondam.pdf](http://www.digitalcongo.net/UserFiles/file/PDF_files/2012/loi_principes_fondam.pdf) (accessed 18 April 2012). The Law was due to come into effect in June 2012.

<sup>e</sup> Ministry of Commerce and Industry, Press Note No. 3 (2011 series), 8 November 2011.

<sup>f</sup> Presidential Decree No. 24/2012, 21 February 2012.

<sup>g</sup> Federal Law of 14 June 2011, No. 142-FZ, “On amending selected legislative acts of the Russian Federation in order to improve legal regulation of mass media”.

<sup>h</sup> Central Bank of Sri Lanka, Press Release, 17 November 2011.

the new laws that raised royalties and taxes were passed following negotiations with the mining business associations.

Yet another policy approach was the *renegotiation of investment contracts*. In 2010, *Ecuador* had passed a law compelling private oil companies to renegotiate their service contracts in order to

replace the taxation arrangement in production-sharing agreements with a flat rate per barrel of oil.<sup>12</sup> Several foreign companies renegotiated their contracts with the Government; however, in the case of Petrobras, the Government took over its operations after the contract renegotiation failed.<sup>13</sup>

### 3. More critical approach towards outward FDI

#### Several countries took a more critical approach towards outward FDI, including restrictions on FDI and incentives to repatriate FDI.

In 2011–2012, some countries adopted more critical policies on outward FDI. In light of high domestic unemployment, concerns are rising that outward FDI

contributes to job exports and a weakening of the domestic industrial base. Other policy concerns include the stability of the foreign exchange market and improvements in the balance of payments. To address these concerns, countries took different policy approaches, including (i) restrictions on outward FDI and (ii) incentives to bring investments home.

With regard to measures falling into the first category, Argentina required its insurance companies to repatriate all their investments abroad before the end of 2011.<sup>14</sup> Through this measure, the Government sought to stem capital flight.

The second category includes incentives and other facilitation measures to repatriate investments abroad. For example, in June 2011, *India* allowed Indian-controlled companies abroad to disinvest – under certain conditions – without prior approval from the Reserve Bank of India, where the amount repatriated on disinvestment was less than the amount of the original investment.<sup>15</sup> In a similar vein, the “SelectUSA” initiative (see box III.3) encourages United States investors abroad to relocate their business operations to the United States.<sup>16</sup>

### 4. Policy measures affecting the general business climate remain important

#### Policy measures affecting the general business climate for FDI mainly related to changes in corporate tax rates.

In 2011, numerous policy measures related to the general business climate, affecting the treatment and operation of foreign investment.

Many measures included increases in corporate taxation rates, mainly in the extractive industries in Africa and in Latin America and the Caribbean (see section A.3). Other policy measures affecting the general business climate included changes in the competition regime, labour regulation, immigration rules and company laws (see box III.5).

#### Box III.5. Selected policy measures affecting the general business climate in 2011–2012

*Brazil* allowed the establishment of one-person limited liability companies (“EIRELI”).<sup>a</sup>

*Ecuador* issued a law on restrictive business practices.<sup>b</sup>

*South Africa* took additional steps towards the implementation of a new Companies Act, bringing a host of changes, such as a restructuring of corporate categories.<sup>c</sup>

Source: UNCTAD, Investment Policy Monitor database. Additional examples of policy measures related to the general business climate can be found in UNCTAD’s *IPMs* published in 2011 and 2012.

<sup>a</sup> Law 12.441, *Official Gazette*, 12 July 2011. The legislation entered into force on 9 January 2012.

<sup>b</sup> Secretary of National Planning and Development, “Organic Law on the Regulation of Restrictive Business Practices”, 29 September 2011.

<sup>c</sup> Act 34243, *Official Gazette*, 20 April 2011.

### 5. Conclusion: Common challenges in designing FDI policies

The policy examples given above show the considerable challenges that countries face in finding the “right” approach to foreign investment. These challenges may arise in making decisions in several areas: how much to liberalize or restrict FDI; what operational conditions to impose on FDI; and how to deal with outward FDI. This section discusses eight such challenges.

**Governments need to pursue a consistent approach when adjusting their FDI policies, and investment protectionism has to be avoided.**

First, when it comes to choosing whether to liberalize or restrict FDI, the decision often requires a more nuanced answer than a simple “yes” or “no”. Countries need to consider a menu of options, including the various alternatives of foreign ownership ceilings versus quantitative quota, formal restrictions versus more flexible screening procedures, and mandatory requirements versus voluntary measures. Even within an industry, different choices can be made about the extent to which it should be open for FDI.

Second, countries need to carefully consider the pros and cons of different policy options to find the “right” degree of State regulation. For instance,

although it is the sovereign right of each country to expropriate private property in the public interest – subject to conditions stipulated by the domestic law of the host State and its obligations under international law – such actions also carry numerous risks, such as potential damage to the investment climate, the likelihood of exposure to investment disputes, the danger of economic retaliation, and the risk of economic inefficiency owing to a lack of sufficient capacity and technical expertise. Compared with nationalization and expropriation, increases in taxes and royalties or renegotiations of investment contracts are likely to have less negative consequences and may therefore be less disruptive to the relationship between the host-country government and TNCs.

Third, deciding only on the degree of openness to FDI may not be sufficient to address the specific policy issue at stake. Attracting FDI requires a stable, predictable and enabling investment climate. To encourage FDI, countries also need to offer “hard” support through a qualified workforce and good infrastructure. Industry-specific challenges also exist. For instance, in agriculture, opening or restricting the degree of access to land by foreigners may be inadequate if authorities do not first create modern, harmonized registration and cadastre systems that can actually measure the extent to which foreign acquisitions take place. In addition, depending on the country, the definition of rural and urban land can vary by region, and productivity ratios may differ regionally or by crops grown. These variations open doors for loopholes in legislation that can be abused on both sides.

Fourth, the issue of openness to FDI also entails a range of sensitive and important issues in connection to trade. They include the potential effects of trade-related investment measures or investment-related trade measures on FDI, and the implications of re-introducing local content requirements or research and development requirements for existing obligations under the WTO or BITs. As recent examples in Latin America show (see chapter II), a raise in import tariffs can induce “barrier-hopping” FDI or trigger new patterns of FDI in the region, such as industrial re-clustering or the breaking down of global supply chains into multi-domestic industries.

Fifth, countries need to ensure that their FDI-related policies address the roots of the problem rather than curing only the symptoms. For instance, the most promising way to motivate domestic companies to keep their production and operations at home is to foster favourable conditions which encourage them to invest domestically rather than to create distortions by preventing or discouraging them from investing abroad. Policies to actively discourage outward FDI can hurt recipient countries, in particular developing countries that depend on the inflow of foreign capital, technology and know-how. They can also result in the disruption of international supply chains into which domestic companies are integrated.

Sixth, countries need to decide on their institutional set-up for designing and adjusting FDI policies. Many countries follow an approach of making policy changes ad hoc, as need arises. Others, such as *China* and *India*, have established specific guidelines and policies under which their approach to FDI is constantly reviewed and adapted if necessary. In *China*, new policies are reflected in specific lists that identify the industries where FDI is encouraged, restricted or prohibited. *India* regularly reviews its FDI policy measures and publishes changes in a “Consolidated FDI Policy” document, which contains general conditions of FDI as well as industry-specific conditions (e.g. industries in which FDI is prohibited or permitted).

Seventh, inconsistent policy changes and adjustment can create considerable uncertainty about the direction of FDI policies, potentially producing negative effects on the investment climate. These risks call for governments to have a long-term perspective on FDI policies and to focus on stable investment conditions. Prior consultations with affected stakeholders at the national and international levels, as well as full transparency in the process of regulatory and administrative changes, help to reduce uncertainty and at the same time promote good governance. Complementary institutional reforms can enhance government capacities to implement laws effectively.

Eighth, in times of economic crisis, there is a considerable risk of countries resorting to protectionist investment measures when addressing FDI. Attention is also warranted to ensure that



regulations related to sustainable development do not become a pretext for “green” protectionism (see box III.6). International organizations, such as UNCTAD and the Organization for Economic Cooperation and Development (OECD), continue to monitor national investment policies. In 2011 and

2012, the two organizations issued two joint reports on the investment measures of G-20 countries.<sup>17</sup> More international cooperation is needed to avoid creating unnecessary costs to the global economy or provoking instances of retaliation.

### Box III.6. FDI and “green” protectionism

Recently, a debate has started about whether policies aimed at “green” growth could have the side-effect of investment protectionism.<sup>a</sup> This is primarily a concern for developing countries.

The promotion of a “green economy” offers significant opportunities and benefits for countries, including the opening of new business fields, the improvement of production processes and improvements in energy efficiency, as well as positive effects on the local natural environment. In contrast, raising the level of environmental protection might both directly and indirectly discourage FDI.

As regards the *direct* effects, stricter requirements on emission standards and other energy-efficiency measures may significantly increase the costs of investment and production and therefore potentially discourage companies from investing. The issue also becomes relevant with regard to public investment projects, such as infrastructure development, for which the state seeks the participation of private investors. In particular companies from developing countries may not have the capital and know-how to comply with these requirements. In addition, government incentives in developed countries for investing in a green economy may have the side-effect of discouraging companies from investing in developing countries where they could not expect comparable government support.

Environmental considerations may also *indirectly* discourage FDI. For example, a country’s *trade policies* may impose import restrictions on goods (“investment-related trade measures”) that are produced by an investment in another country in a manner that the importing country considers not environmentally friendly. Companies may hesitate to make an investment in country A if they have to fear that subsequently they cannot export the produced goods to country B. Similar problems may arise in connection with *public procurement policies*.

There is no internationally accepted definition of “investment protectionism”. Broadly speaking, the term targets country measures that directly or indirectly hinder foreign investment without a public policy justification (see also chapter IV, section B.1). Countries may have different perceptions of whether any of the above-mentioned policies constitute a disguised investment restriction.

More international coordination could help avoid policy conflicts arising from the impact of environmental regulations on FDI. In particular, it could contribute to prevent a “race to the top” as regards incentives for FDI for a green economy, or a “race to the bottom” with regard to lowering environmental standards. UNCTAD, together with the OECD, already monitor investment protectionism at the general level, following a request from G-20 countries.

Source: UNCTAD.

<sup>a</sup> The issue has been discussed, for instance, in the context of the United Nations Sustainable Development Conference (Rio+20) and the OECD Freedom of Investment Roundtable. See “Countries agree to extend negotiations on Rio+20 outcome document”, UN news center, 5 May 2012. [www.un.org](http://www.un.org); OECD, “Harnessing Freedom of Investment for Green Growth”, 5 May 2011. [www.oecd.org](http://www.oecd.org).

## B. INTERNATIONAL INVESTMENT POLICIES

### 1. Regional treaty making is gradually moving to centre stage

**Negotiations on BITs are losing momentum as regional investment policymaking is intensifying.**

With 47 international investment agreements (IIAs) signed in 2011 (33 BITs and 14 “other IIAs”), traditional investment treaty making continues to lose momentum. This trend is expected to persist through 2012, which saw only 10 BITs and 2 “other IIAs” concluded during the first five months of the year.<sup>18</sup>

“Other IIAs”, which include agreements such as free trade agreements or economic partnership agreements, continue to fall into one of three categories: IIAs including obligations commonly found in BITs (9); agreements with limited investment-related provisions (2); and IIAs focusing on investment co-operation and/or providing for a future negotiating mandate on investment (3).<sup>19</sup> Like chapter IV, this chapter takes a focused approach to IIAs and no longer covers double taxation treaties.<sup>20</sup>

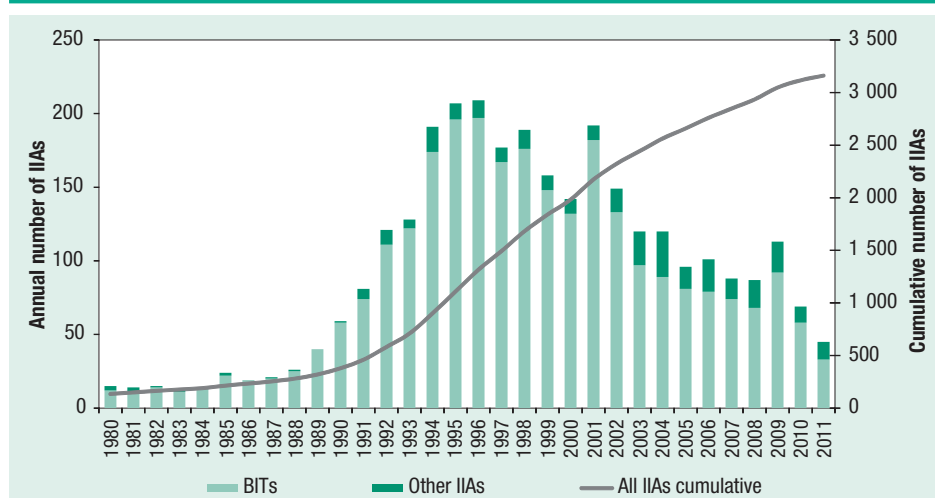
The overall trend of reduced treaty making may have several causes, including (i) a gradual shift towards regional treaty making, where a single regional treaty takes the place of a multitude of

bilateral pacts and where regional blocs (instead of their individual members) negotiate with third States, and (ii) the fact that IIAs are becoming increasingly controversial and politically sensitive, primarily owing to the spread of IIA-based investor-State arbitrations.

By the end of 2011, the overall IIA universe consisted of 3,164 agreements, which included 2,833 BITs and 331 “other IIAs”. In quantitative terms, bilateral agreements still dominate international investment policymaking; however, in terms of economic significance, there has been a gradual shift towards regionalism. Several developments in Asia, Europe and North America illustrate this trend.

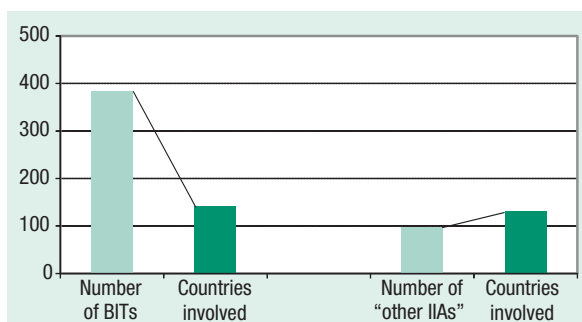
Discussions on the *Trans-Pacific Partnership Agreement* continue, with the 12th negotiation round concluded in May 2012. Currently, nine countries participate (Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, the United States and Viet Nam); Canada and Mexico have been formally invited to join the negotiations and Japan has also expressed an interest. The agreement is expected to establish a free trade area and to include a fully fledged investment chapter with high standards for investment liberalization and protection – an issue that has sparked some

Figure III.2. Trends of BITs and “other IIAs”, 1980–2011



Source: UNCTAD.

**Figure III.3. BITs and “other IIAs”, 2006–2011**  
(Numbers and country coverage)



Source: UNCTAD.

controversy among investment stakeholders.<sup>21</sup> If all 12 countries sign the deal, their combined economic weight would amount to 35 per cent of global gross domestic product (GDP), and the treaty could potentially replace 47 IIAs (18 BITs and 29 other IIAs) currently existing between these countries.

The 2012 trilateral investment agreement between China, Japan and the Republic of Korea has an economic weight that is not far from that of the North American Free Trade Agreement. Together, the three signatories, who have also agreed to start negotiating a free trade pact, account for one fifth of both world population and global GDP. Substantively, the investment agreement is a carefully crafted instrument that (i) offers detailed regulation of key concepts (e.g. definition of investment, fair and equitable treatment, indirect expropriation and most-favoured-nation treatment); (ii) does not apply to certain domestic investment policies (e.g. governments retain control over the establishment of investments, they can maintain existing discriminatory measures and they have not undertaken extensive commitments on performance requirements); and (iii) grants regulatory space for the pursuit of certain policy objectives (e.g. through detailed exceptions with respect to taxation, essential security interests and prudential measures as well as temporary derogation from the free-transfer obligation). The treaty also includes some new disciplines, most importantly regarding the enforcement of domestic intellectual property rights.<sup>22</sup> The agreement does not terminate BITs previously signed between the

parties and provides that nothing in the agreement shall be construed to prevent investors from relying on existing BITs that may be more favourable to them.<sup>23</sup> By including such a clause, the parties ensure that the new agreement does not lower the standards that otherwise exist under other treaties.<sup>24</sup>

At the *European Union* (EU) level, the European Commission now negotiates not only regarding the liberalization of trade and investment, but also on conditions related to protection of investment on behalf of all member States (see *WIR10*, *WIR11*). Given that the EU countries together account for a quarter of global GDP and almost half of global FDI outflows,<sup>25</sup> any agreement concluded by the EU will have significant economic weight. In September 2011, the EU Council issued the first three negotiating directives to the EU Commission to conduct negotiations on investment protection for free trade agreements (FTAs) with Canada, India and Singapore. As addressed in the Communication of the European Commission, “Towards a comprehensive European international investment policy”<sup>26</sup> and the Conclusions by the European Council,<sup>27</sup> the objective for future agreements containing provisions on investment protection is to preserve the high level of investment protection contained in existing member State BITs (e.g. the inclusion of intellectual property rights as protected investment; provisions for the fair and equitable, most-favoured-nation and national treatment of investors; and ISDS). In December 2011, the EU Council adopted negotiating directives for deep and comprehensive FTAs with Egypt, Jordan, Morocco and Tunisia, which will also include provisions on investment protection.

Taken together, EU member States account for about half of the world’s BITs. Since *new EU-wide investment treaties* will replace BITs between the EU’s respective treaty partner and individual EU member States, they will entail important changes to the global investment policy landscape. For example, once concluded, the EU–India FTA is expected to replace 21 BITs signed by India with individual EU members. At the same time, individual EU member States have continued to conclude BITs with third States: since the EU Lisbon Treaty’s entry into force (1 December 2009), 45 such agreements have been

signed, including 10 in 2011.<sup>28</sup> The BITs signed by member States will remain in force until replaced by EU agreements, but they will have to be amended if they are not in line with EU legislation.

Another example of a regional organization negotiating as a group with outside countries is the *Association of Southeast Asian Nations* (ASEAN).<sup>29</sup> For example, ASEAN has concluded agreements with Australia and New Zealand (2008) and China (2010) and is negotiating one with India. The conclusion of new ASEAN+ agreements has not led to the termination of existing BITs and FTAs between individual ASEAN members and third countries. This might be the case because the contracting parties may wish to ensure the most favourable treatment to foreign investors arising from the different treaties in force. The ASEAN–China Investment Agreement co-exists with nine BITs between individual ASEAN countries and China.<sup>30</sup>

The past year also saw the conclusion of negotiations on the *Mexico–Central America FTA* (Costa Rica, El Salvador, Guatemala, Honduras, Mexico and Nicaragua). Together, the six countries account for almost a quarter of Latin America's GDP. This treaty establishing a free trade area, with its fully fledged investment chapter, will replace three earlier FTAs which Mexico had in place with the participating countries.<sup>31</sup>

On the whole, the balance is gradually shifting from bilateral to regional treaty making, thereby increasing the impact of regions in IIA rulemaking. In most cases, regional treaties are at the same time FTAs. By comprehensively addressing the trade and investment elements of international economic activities, such broader agreements can better respond to the needs of today's economic realities, where international trade and investment are increasingly interconnected (see *WIR11*). It is also notable that investment chapters in new regional agreements typically contain more refined and precise provisions than in earlier treaties.

This shift can bring about the consolidation and harmonization of investment rules and represent a step towards multilateralism. However, where new treaties do not entail the phase-out of old ones, the result can be the opposite: instead of simplification and growing consistency, regionalization may lead to a multiplication of treaty layers, making the IIA

network even more complex and prone to overlaps and inconsistencies.

## 2. Growing discontent with ISDS

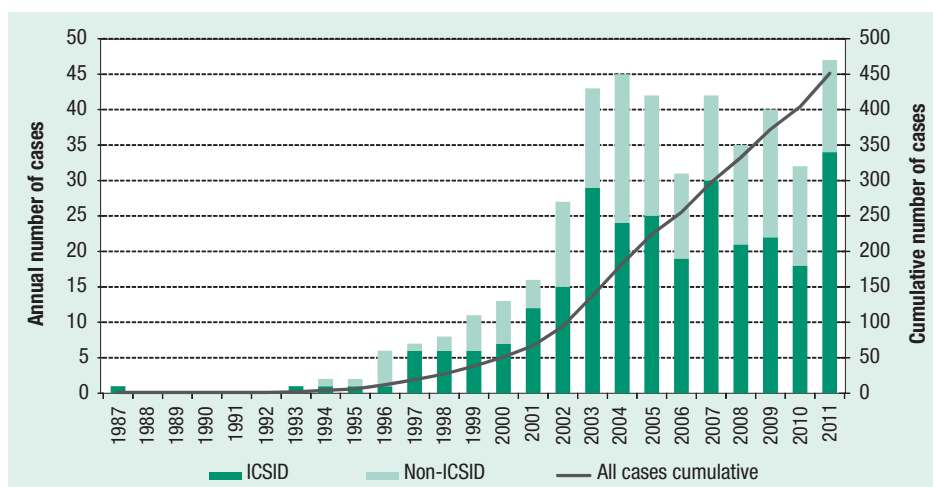
In 2011, the number of known ISDS cases filed under IIAs grew by at least 46 (figure III.4). This constitutes the highest number of known treaty-based disputes ever filed in one year. Venezuela faced 10 new cases, followed by Egypt (4) and Ecuador (4), Peru (3) and Poland (2), Philippines (2) and Turkmenistan (2).<sup>32</sup> By the end of 2011, the total number of known treaty-based cases had reached 450.<sup>33</sup>

**While investors continue to use the ISDS mechanism, some States have expressed their discontent with current dispute settlement proceedings.**

The rapid increase of ISDS cases in the last decade can be explained by a number of factors, including the growing number of IIAs, the increasing awareness about ISDS among investors and their legal counsel, and the significant rise of FDI flows. The growing number of ISDS cases may also – at least in part – reflect investors' responses to *governments' reassertion of their role in regulating and steering the economy*, as implemented through a number of national regulatory changes. Increased nationalizations, especially in Latin America, triggered multiple disputes and explain Venezuela's position as the "top respondent" in 2011. More recently, following Argentina's expropriation of Repsol's controlling stake in YPF, the country's largest oil company,<sup>34</sup> Repsol threatened the commencement of arbitration through the International Centre for Settlement of Investment Disputes (ICSID) (see box III.4).

In other recent cases, *investors challenged core public policies* that had negatively affected their business prospects. Having filed a similar action against Uruguay in February 2010, Philip Morris initiated arbitral proceedings against Australia, claiming that the country's new packaging and labelling requirements for cigarettes violate BIT provisions.<sup>35</sup> Vattenfall, a Swedish energy company, filed an ICSID case against Germany over that country's decision to phase out nuclear energy facilities.<sup>36</sup> Following cases against Argentina, notably the joint claim under the Argentina–Italy BIT (1990) by over 60,000 Italian bondholders arising

Figure III.4. Known investor–State treaty-based disputes, 1987–2011



Source: UNCTAD.

from Argentina's debt default and restructuring,<sup>37</sup> the restructuring of Greece's sovereign debt has led to considerations of how aggrieved bondholders can use IIAs to recover their losses.

Some *States* have expressed their concerns with today's ISDS system. In April 2011, the Australian Government issued a trade policy statement announcing that it would stop including ISDS clauses in its future IIAs. Explaining this decision, the Government stated that ISDS would give foreign businesses greater legal rights than domestic businesses and would constrain the Government's public policymaking ability (e.g. the adoption and implementation of social, environmental and economic law), explicitly referring to the country's tobacco packaging and labelling legislation.<sup>38</sup> In January 2012, Venezuela notified its intention to withdraw from the ICSID Convention, becoming the third State to do so (after the Plurinational State of Bolivia and Ecuador).<sup>39</sup> In June 2011, the Plurinational State of Bolivia denounced its BIT with the United States, thereby terminating the ISDS mechanisms (after the "sunset" period elapses).<sup>40</sup>

The *enforcement of awards* is not straightforward. Following Argentina's failure to pay two long-standing ICSID arbitral awards of more than \$300 million to United States companies and its insistence that the claimants must resort to Argentine courts for execution of ICSID awards in the country,

in March 2012 the United States suspended Argentina's right to benefit from the United States Generalized System of Preferences (GSP). The GSP entitles exporters from developing countries to pay lower customs duties on their exports to the United States.<sup>41</sup> This is the first time a country has been suspended from a GSP programme for failing to pay an arbitration award, raising concerns about "re-politicization" of investment disputes.

Another notable development is Ecuador's initiation, in June 2011, of *State-State proceedings* against the United States. By doing so, Ecuador effectively seeks to overturn the interpretation of a particular clause in the Ecuador–United States BIT, adopted earlier by an investor–State tribunal in the *Chevron v. Ecuador* case.<sup>42</sup> In the absence of a proper mechanism for an appellate review, this represents one way to pursue correction of perceived mistakes by an arbitral tribunal.

Increasing numbers of *requests for disqualification of arbitrators*, filed by both investors and States, are another sign of dissatisfaction with ISDS procedures.<sup>43</sup> This is particularly so where an arbitrator is perceived as biased owing to multiple appointments in different proceedings by the same party or by the same law firm, or where the arbitrator has taken a position on a certain issue in a previous award or in academic writings. So far, all such requests have been dismissed.

Over time, the *public discourse* about the usefulness and legitimacy of the ISDS mechanism has been gaining momentum (*WIR11*), sometimes taking place at the national level and focusing on a country's choice to embrace ISDS in a particular IIA (e.g. India, Republic of Korea) and sometimes having an international dimension, involving stakeholders from a wide range of countries (as with the open letter from lawyers about the TPP Agreement). All of this has led to an intensifying debate in international forums, including in the context of UNCTAD's Investment, Enterprise and Development Commission and its expert meetings, the annual IIA Conference, and UNCTAD's World Investment Forum, as well as the OECD's Freedom of Investment Round Tables.

### 3. ISDS: unfinished reform agenda

#### Ideas for reforming ISDS abound, but few have been translated into actions.

The shortcomings of the ISDS system have been well documented. Concerns include (i) an expansive use of IIAs that reaches beyond what was originally intended; (ii) contradictory interpretations of key IIA provisions by ad hoc tribunals, leading to uncertainty about their meaning; (iii) the inadequacy of ICSID's annulment or national judicial review mechanisms to correct substantive mistakes of first-level tribunals; (iv) the emergence of a "club" of individuals who serve as counsel in some cases and arbitrators in others, often obtaining repeated appointments, thereby raising concerns about potential conflicts of interest; (v) the practice of nominating arbitrators who are likely to support the position of the party appointing him/her; (vi) the secrecy of many proceedings; (vii) the high costs and considerable length of arbitration proceedings; and (viii) overall concerns about the legitimacy and equity of the system.

The growing engagement of policymakers, academics, businesses and civil society with ISDS issues has produced a variety of suggestions for reform:

- *Reining in the growing number of ISDS cases* by (i) promoting the use of mediation and conciliation instead of arbitration; (ii) implementing national dispute prevention policies (e.g. ombudsman offices); (iii) setting a time limit for bringing investor claims (e.g., three years) or (iv) more carefully circumscribing possible bases for claims.
- *Fostering legitimacy and increasing the transparency of ISDS proceedings* by allowing public access to relevant documents, holding public hearings, and accepting *amicus curiae* briefs.
- *Dealing with inconsistent readings of key provisions in IIAs and poor treaty interpretation* by (i) improving the applicable IIA provisions, thus leaving less room for interpretation; (ii) requiring tribunals to interpret treaties in accordance with customary international law; (iii) increasing State involvement in the interpretative process (e.g. through *renvoi* and joint interpretation mechanisms); and (iv) establishing an appellate body to review awards.
- *Improving the impartiality and quality of arbitrators* by establishing a neutral, transparent appointment procedure with permanent or quasi-permanent arbitrators and abolishing the system of unilateral party appointments.
- *Reducing the length and costs of proceedings* by introducing mechanisms for prompt disposal of "frivolous" claims and for the consolidation of connected claims, as well as caps on arbitrator fees.
- *Assisting developing countries in handling ISDS cases* by establishing an advisory facility or legal assistance centre on international investment law and increasing capacity-building and technical assistance.
- *Addressing overall concerns about the functioning of the system*, including the lack of coherence between awards, by establishing a fully fledged international investment court with permanent judges to replace ad hoc arbitrations under multiple rules, or by requiring the exhaustion of local remedies.

Some of these *changes have already made their way into recent IIAs*, e.g. those concerning time limits for bringing claims, enhanced roles for States in treaty interpretation, prompt disposal of "frivolous" claims, consolidation of related proceedings and transparency. Some States have preferred a more radical solution of "exiting" the system (e.g. denouncing the ICSID Convention, terminating BITs or avoiding ISDS in future IIAs). Still others have not changed anything in their IIA practice. What is lacking is a systematic assessment of

individual reform options – their feasibility, potential effectiveness and implementation methods (e.g., through IIAs, arbitral rules or institutions) – as well as an evaluation of the steps taken to date. A multilateral policy dialogue on ISDS could help in developing a consensus about the preferred course for the reform and ways to put it into action.

#### 4. Enhancing the sustainable development dimension of international investment policies

##### a. IIA-related developments

**Sustainability considerations are gaining prominence in the negotiation of IIAs as well as in other investment policymaking processes.**

A number of recent developments indicate that sustainable development elements are starting to play a more prominent role in international investment

policies. Although some IIAs concluded in 2011 follow the traditional BIT model that focuses solely on investment protection, *others include innovations*. Several of these features are meant to ensure that the treaty does not interfere with, but instead contributes to, countries' sustainable development strategies that focus on inclusive economic growth, policies for industrial development, and the environmental and social impacts of investment (see examples in table III.3).

In the IIA context, paying due regard to sustainable development implies that a treaty should (i) promote and protect those investments that are conducive to host-country development; (ii) provide treatment and protection guarantees to investors without hindering the government's power to regulate in the public interest (e.g. for environmental, public health or safety purposes); (iii) not overexpose a country to costly litigation and the risk of exorbitant financial liabilities; and (iv) stimulate responsible business practices by investors. (For a full appraisal of the sustainable development implications of IIA provision, see UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD) in chapter IV.)

In addition, a number of other recent developments in investment policymaking indicate increased attention to sustainable development considerations.

The *2012 revision of the United States Model BIT* turns the best-endeavour commitment not to relax domestic environmental and labour laws into a binding obligation. It also explicitly recognizes the importance of environmental laws and policies, and multilateral environmental agreements and reaffirms commitments under the International Labour Organization Declaration on Fundamental Principles and Rights at Work.<sup>44</sup>

The *2012 Joint Statement by the European Union and the United States*, issued under the auspices of the Transatlantic Economic Council, sets out a number of principles for investment policymaking. They include broad market access for foreign investors, non-discrimination, a high level of legal certainty and protection against unfair or harmful treatment of investors and investments, and effective and transparent dispute settlement procedures. The Joint Statement also refers to the need to promote responsible business conduct, preserve government authority to regulate in the public interest and avoid attracting foreign investment by weakening or failing to apply regulatory measures.<sup>45</sup>

This year saw the continuation of the work by the *Southern African Development Community (SADC) on its model BIT template*. Expected to be finalized later this year, the template is meant to embody harmonized approaches that will assist the 15 SADC member States in their individual and collective IIA negotiations with third countries. The draft template represents a distinct effort to enhance the sustainable development dimension of future IIAs, by including provisions on environmental and social impact assessments; measures against corruption; standards for human rights, environment and labour; corporate governance; and the right of States to regulate and pursue their development goals.

The *Secretariat of the Commonwealth*, a voluntary association of 54 countries, is preparing a handbook entitled "*Integrating Sustainable Development into International Investment Agreements: A Guide for Developing Countries*". Scheduled for release in the summer of 2012, the guide is designed to help developing countries to negotiate IIAs that better promote sustainable development. It does so by identifying best practices in existing IIAs, proposing new and innovative sample provisions, and discussing pros and cons of various policy options.

Table III.3. Examples of sustainable-development-friendly aspects of selected IIAs signed in 2011

Sustainable-development-friendly aspects of IIA provisions (in order of frequency)	Policy Objectives																								
	United Republic of Tanzania–Turkey BIT	Nigeria–Turkey BIT	Mexico–Peru FTA	Republic of Korea–Peru FTA	Panama–Peru FTA	Japan–Papua New Guinea BIT	India–Slovenia BIT	India–Nepal BIT	India–Malaysia FTA	India–Lithuania BIT	India–Japan EPA	Guatemala–Peru FTA	Czech Republic–Sri Lanka BIT	Costa Rica–Peru FTA	Colombia–Japan BIT	China–Japan–Republic of Korea TIA	Central America–Mexico FTA	Bosnia and Herzegovina–San Marino BIT	Azerbaijan–Czech Republic BIT	Australia–New Zealand Investment Protocol	Stimulate responsible business practices	Avoid overexposure to ISDS claims	Preserve the right to regulate in the public interest	Focus on investments conducive to development	
Detailed exceptions from the free-transfer-of-funds obligation, including balance-of-payments difficulties and/or enforcement of national laws	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Omission of the so-called "umbrella" clause		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Clarification of what does and does not constitute an indirect expropriation																									
Fair and equitable treatment standard equated to the minimum standard of treatment of aliens under customary international law																									
References to the protection of health and safety, labour rights, environment or sustainable development in the treaty preamble																									
Explicit recognition that parties should not relax health, safety or environmental standards to attract investment																									
A carve-out for prudential measures in the financial services sector																									
General exceptions, e.g. for the protection of human, animal or plant life or health; or the conservation of exhaustible natural resources																									
Exclusion of sovereign debt obligations from the range of assets protected by the treaty																									
Exclusion of portfolio investment (shares representing less than 10 per cent of a company's capital) from the range of assets protected by the treaty																									
No provision for investor–State arbitration																									

Source: UNCTAD.

Note: Based on treaties signed in 2011 for which the full text is available.



### **b. Other developments**

Sustainable development considerations also figure prominently in a number of other policy developments related to foreign investment.

The *2011 UN Guiding Principles on Business and Human Rights*,<sup>46</sup> a set of non-binding recommendations for governments and businesses, recommend that IIAs preserve States' ability to protect human rights (principle 9)<sup>47</sup> and that businesses assess their human rights impact, prevent and mitigate adverse effects (principles 17–20), and provide information on their human rights impact to relevant stakeholders (principle 21). Because the Guiding Principles concern a broad range of human rights including civil, political, economic, cultural, social and labour rights, they contribute to a comprehensive effort to ensure that business is conducted sustainably and ethically.

The *2011 Revision of the OECD Guidelines for Multinational Enterprises (1976)*<sup>48</sup> primarily focuses on public policy concerns such as human rights,<sup>49</sup> employment and the environment, while strengthening the principles relating to bribery and taxation. The Guidelines remain voluntary, but the new proactive and detailed implementation agenda can help to ensure stricter adherence by individual enterprises, thereby fostering more responsible and sustainable investment.

The *2012 revision of the International Chamber of Commerce's Guidelines for International Investment (1972)*<sup>50</sup> calls for responsible investment that would benefit sustainable economic development in host States. In addition to the general obligation of investors to comply with host-State laws, the Guidelines call on investors to respect national and international labour laws even where they are not effectively enforced. They encourage investors to conduct environmental impact assessments before starting a new activity or project and before decommissioning a facility or leaving a site. The Guidelines also call on home States to promote outward FDI that would contribute to the economic development of the host country. The revision includes a new chapter on CSR.

The *Doha Mandate*,<sup>51</sup> adopted at the *UNCTAD XIII Ministerial Conference 2012*, highlights sustainable development and inclusive growth as the two

guiding principles for UNCTAD's work on investment and enterprise, placing it in the context of productive capacity-building, industrialization and economic diversification, and job creation. Building on the 2008 Accra Accord, the Doha Mandate will guide the work of UNCTAD's Investment and Enterprise Division for the next four years, accentuating four linkages – namely, between FDI and trade, official development assistance, domestic investment and regional integration – and highlighting the importance of non-equity modes, global supply chains, quantifiable indicators, operational methodologies and policy guidelines, barriers to investment and investment in agriculture. With respect to IIAs, the Doha Mandate recognizes the need to balance the interests of different investment stakeholders.

The *June 2012 G-20 Los Cabos Summit*<sup>52</sup> reiterated the G-20's support for the *Principles for Responsible Agricultural Investment (PRAI)*, developed jointly by UNCTAD, the Food and Agriculture Organization, the International Fund for Agricultural Development and the World Bank (*WIR11*).<sup>53</sup> In addition, the Summit commended the progress achieved and supported by the G-20 Development Working Group, which includes, in the private investment and job creation pillar, work by an Inter-agency Working Group under coordination from UNCTAD to develop key indicators for measuring and maximizing the economic and employment impact of private sector investment (*WIR11*).<sup>54</sup> Within the same pillar, work on the report, "Promoting Standards for Responsible Investment in Value Chains", was also concluded.<sup>55</sup>

At the *2012 Rio+20 Conference*, world leaders adopted the Outcome Document, "The Future We Want",<sup>56</sup> which urges governments to create enabling environments that facilitate public and private sector investment in relevant and needed cleaner-energy technologies; encourages the promotion of investment in sustainable tourism, including eco-tourism and cultural tourism; notes the role of foreign direct investment in the transfer of environmentally sound technologies; and calls upon countries to promote investment in science, innovation and technology for sustainable development including through international cooperation. Governments also took note of

the PRAI. They also acknowledged the importance of corporate sustainability reporting.

The Conference, which government representatives attended along with thousands of participants from the private sector, NGOs and other groups, focused on two themes: (i) a green economy in the context of sustainable development and poverty eradication; and (ii) the institutional framework for sustainable development,<sup>57</sup> with the overall objective of shaping future steps to reduce poverty,

advance social equity and ensure environmental protection.

The run-up to the Conference also saw a new commitment by stock exchanges to promote long-term, sustainable investment in their markets through the Sustainable Stock Exchanges Initiative, which had been co-convened by UNCTAD, the UN Global Compact, the UN-backed Principles for Responsible Investment, and the United Nations Environment Programme in 2009.<sup>58</sup>

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## C. CORPORATE SOCIAL RESPONSIBILITY IN GLOBAL SUPPLY CHAINS

### 1. Supplier codes of conduct and implementation challenges<sup>59</sup>

**The complexity of CSR codes among TNCs in global supply chains poses compliance challenges for suppliers, particularly SMEs. Policymakers and TNCs can alleviate these challenges and create new opportunities for suppliers through various capacity development initiatives.**

An ongoing investment policy issue is the corporate social responsibility (CSR) of TNCs. As noted in WIR11, the past decade has seen the rise of an increasingly complex mix of CSR codes and standards. CSR codes in global supply chains hold out the promises of promoting sustainable, inclusive development in host countries and transferring knowledge on how to address critical social and environmental issues. Compliance with such codes presents challenges for many suppliers in developing countries, especially SMEs. Policymakers can support SME suppliers by, inter alia, mainstreaming CSR into domestic enterprise development programmes and working with TNCs to harmonize standards and simplify compliance procedures.

#### a. Proliferation of CSR codes

Across a broad range of industries, it is now common for TNCs to set supplier codes of conduct that detail social and environmental performance standards for their global supply chains. Since the early 2000s, there has been a significant proliferation of CSR codes in global supply chains, both individual TNC codes and industry-level codes. Thousands of individual company codes exist. They are especially common in large TNCs: more than 90 per cent have policies on social and environmental issues.<sup>60</sup> Together with company codes, the many dozens of industry association codes and multi-stakeholder initiative codes create a broad, interconnected web of CSR codes.<sup>61</sup>

Furthermore, CSR codes and standards themselves are becoming more complex and their applications more complicated. TNCs send suppliers CSR auditing questionnaires that can be more than

20 pages, covering up to 400 items. Supplier that have more than one factory have to fill in a questionnaire for each facility. Furthermore, many questions are formulated using non-specific terms. Questions such as “Are all workers free to leave your employment upon giving reasonable notice?” are very common. If the customer does not define in specific terms what is meant by “reasonable”, the answer will be, at best, difficult to produce, and at worst, meaningless. Because processes in each company differ, it might not be possible to answer a question with a simple “yes” or “no”, yet the questionnaires rarely provide suppliers the option for further explanation.<sup>62</sup>

Most leading companies not only adopt a supplier code of conduct and communicate this code to their suppliers, but also have an implementation programme to try to ensure suppliers comply with the code. Such implementation programmes consist of multi-step assessment and monitoring procedures. Although the use of self-evaluation and capacity-building initiatives varies among companies and industries, the majority of companies focus their code implementation programmes on on-site audits, improvements and re-audits.

#### b. Challenges for suppliers (particularly SMEs) in developing countries

The proliferation and application of CSR codes poses a series of serious challenges for suppliers, particularly SMEs in developing countries. Challenges include, inter alia:

- the use of international standards that exceed current regulations and common market practices in the host country;
- the existence of diverging and sometimes conflicting requirements from different TNCs;
- the capacity constraints of suppliers in understanding and applying international standards in their day-to-day operations;
- an overload of multiple on-site inspections and complex reporting procedures;
- consumer and civil society concerns about technical or quality standards for products and

for marketing, in addition to suppliers' existing challenges in meeting them; and

- competitiveness concerns for firms that bear the cost of fully complying with CSR standards relative to other SMEs that do not attempt to fully comply.

Suppliers that operate in countries that are categorized by TNCs as “high-risk sourcing zones” are subject to particularly strong scrutiny from their customers. These suppliers are more frequently subject to CSR assessments, such as self-evaluation questionnaires and monitoring or auditing processes. Because most suppliers serve multiple customers, they often need to undergo multiple social audits throughout the year. This is especially challenging, because each auditor or purchasing company has its own factory evaluation checklist, differing in specificity, length, requirements and topics addressed.

An additional structural challenge results from the fact that the purchasing practices and the CSR practices of many TNC buyers remain independent of one another. As a consequence, suppliers receive messages that are sometimes at odds (i.e. CSR demands vs. price, quality and delivery-time demands). In the absence of greater coordination among companies to harmonize CSR codes and simplify evaluation processes, and within companies to align CSR with other more conventional business demands, SMEs face the burden of a large number of audits and the challenge of meeting sometimes contradictory policies on CSR and purchasing.

Almost all companies expect their suppliers to implement “corrective action plans” to address deficiencies identified during audits, yet these plans are often inadequate for creating long-lasting change in a supplier's operation. Some companies have begun to create supplier development programmes with a CSR focus. However, most only offer such programmes to their key suppliers, which are often large companies in their own right, leaving SMEs without direct support.

To fill the gap left by the private sector, various civil society and governmental stakeholders have engaged in supplier development programmes for SMEs. However, such programmes are still limited in number and scope. Where they exist,

they are mostly initiated, funded and implemented by development agencies, intergovernmental organizations or civil society, with very limited involvement of local governments. The main challenges with externally funded programmes are scalability (i.e. how to apply them to a broader group of companies) and sustainability (i.e. how to ensure the programmes can continue over the long term). To address these challenges, some stakeholders are calling for government action in CSR capacity-building. Most national governments, however, have not yet mainstreamed CSR into their SME and supplier development programmes.

## 2. Policy options for effective promotion of CSR standards in global supply chains

To ensure continued growth and international competitiveness, SME suppliers in developing countries need support to cope with the challenges presented by CSR codes. Ways and means of providing such support include the following four:

- *National governments and international organizations should mainstream CSR issues into national enterprise development programmes.* CSR has become a commonplace demand in most industries, yet SMEs in developing countries are rarely provided the tools they need to address this challenge. Policymakers should therefore consider promoting training on environmental management, human resource management, and occupational safety and health.
- *National governments and international organizations should do more to assist enterprises with operational guidance for international standards.* Because most private codes of conduct refer to international standards, it is necessary to provide more practical guidance on how to implement these standards on the factory floor.
- *TNCs should be encouraged to harmonize their CSR codes at the industry level and to streamline application procedures.* Suppliers today can be subject to multiple audits or factory inspections per year. Most of these inspections are largely redundant, with different buyers asking the same questions. Initiatives such as the Supplier Ethical Data Exchange<sup>63</sup> can help rationalize supplier inspections, promote sharing of information

among buyers, harmonize reporting practices and generally reduce unnecessary burdens on suppliers. Policymakers should encourage and support such initiatives.

- *TNCs should be encouraged to integrate CSR policies into purchasing policies, with the aim of ensuring that suppliers are effectively motivated and supported to meet all the demands being placed on them.* There is a need for greater policy coherence within TNCs. For example, purchasing policies on price and delivery time, on the one hand, and CSR policies on pay and excessive overtime hours, on the other, need to have some degree of alignment to avoid mutual exclusivity. Private CSR policies that are not fully aligned with private purchasing policies send mixed signals and can create situations in which compliance becomes impossible.

Consumer and civil society concerns are driving CSR, raising the bar for market entry for developing-country suppliers. Meeting these demands will require an upgrade of management skills. Governments can assist through capacity development programmes and by strengthening national institutions that promote compliance with labour and environmental laws. Countries that equip their SMEs with the capacity to meet CSR codes will create new opportunities for their enterprises in global supply chains.



All in all, investment policies – at both the national and the international level – are developing in a constantly changing economic environment with evolving political goals. Whereas in the past the focus was very much on investment liberalization and quantitative growth, policy concerns are nowadays more about how to make FDI instrumental for qualitative and inclusive growth, how to find the “right” balance between investment liberalization and regulation for the public good, and how to harness CSR in this context. This raises considerable challenges in terms of how best to calibrate FDI, how to promote responsible investment and how to improve the international investment regime. Chapter IV is devoted to these issues.

## Notes

- <sup>1</sup> See FAO (2011) *Land Grabbing: Case studies in 17 countries of Latin American and the Caribbean*, p. 27. Available at: [www.rlc.fao.org/es/prensa/noticias/estudio-de-la-fao-halla-intensos-procesos-de-concentracion-y-extranjerizacion-de-tierras-en-america-latina-y-el-caribe](http://www.rlc.fao.org/es/prensa/noticias/estudio-de-la-fao-halla-intensos-procesos-de-concentracion-y-extranjerizacion-de-tierras-en-america-latina-y-el-caribe) (accessed 11 April 2012).
- <sup>2</sup> See Loi No. 11/022 du 24 Décembre 2011 Portant Principes Fondamentaux Relatifs a L'agriculture. Available at: [www.digitalcongo.net/UserFiles/file/PDF\\_files/2012/loi\\_principes\\_fondam.pdf](http://www.digitalcongo.net/UserFiles/file/PDF_files/2012/loi_principes_fondam.pdf) (accessed 18 April 2012).
- <sup>3</sup> Previously, foreign investment in the pharmaceutical sector of up to 100 per cent was permitted under the automatic route of the FDI Scheme.
- <sup>4</sup> Ministerio de Minas y Energía, Resolución 18.0241, “Por la cual se declaran y delimitan unas áreas estratégicas mineras y se adoptan otras determinaciones”, 24 February 2012.
- <sup>5</sup> Ministry of Finance and Economic Planning, “Ghana Budget 2012 – corporate tax rate of mining companies”. 16 November 2011. Available at: [www.ghana.gov.gh/documents/2012budgethi.pdf](http://www.ghana.gov.gh/documents/2012budgethi.pdf).
- <sup>6</sup> “Gobierno y mineras suscriben acuerdo voluntario de regalías”, *Diario de Centroamérica*, 27 January 2012.
- <sup>7</sup> Decree 105, *Official Gazette* No. 32561, 8 July 2011.
- <sup>8</sup> See laws No. 29788, 29789 and 29790, *Official Gazette*, 28 September 2011.
- <sup>9</sup> Decree 8163, *Official Gazette* No. 6022, 18 April 2011.
- <sup>10</sup> “Zambia Budget Highlights 2012”. Available at: [www.zra.org.zm/BudgetHighlights\\_2012.pdf](http://www.zra.org.zm/BudgetHighlights_2012.pdf).
- <sup>11</sup> Commissioner General, 2012 Budget Overview of Tax Changes, 11 November 2011. Available at: [www.zra.org.zm/BudgtHighlights\\_2012.pdf](http://www.zra.org.zm/BudgtHighlights_2012.pdf).
- <sup>12</sup> Ley Reformatoria a la Ley de Hidrocarburos y a la Ley de Régimen Tributario Interno, 24 June 2010.
- <sup>13</sup> See *WIR11*, p. 98.
- <sup>14</sup> See *Official Gazette*, “Government orders repatriation of assets owned by insurance companies abroad”, 27 October 2011. Only under exceptional circumstances could certain types of investments be authorized to remain abroad, and in any case they could not exceed 50 per cent of the assets of any individual firm.
- <sup>15</sup> Address delivered by Shri. Harun R. Khan, Deputy Governor, Reserve Bank of India at the Bombay Chamber of Commerce & Industry, Mumbai, 2 March 2012.
- <sup>16</sup> President of the United States, Executive Order 13577 of 15 June 2011 “On the Establishment of the SelectUSA Initiative”. Available at: [www.gpo.gov/fdsys/pkg/FR-2011-06-20/pdf/2011-15443.pdf](http://www.gpo.gov/fdsys/pkg/FR-2011-06-20/pdf/2011-15443.pdf).
- <sup>17</sup> See *OECD-UNCTAD Report on G-20 Trade and Investment Measures* (6<sup>th</sup> Report, October 2011, and 7<sup>th</sup> Report, May 2012). Available at: <http://unctad.org/en/Pages/DIAE/G-20/UNCTAD-OECD-reports.aspx> (accessed 13 June 2012).
- <sup>18</sup> For regular reporting on IIA developments, see UNCTAD’s *IPMs* at [www.unctad.org/ipm](http://www.unctad.org/ipm).
- <sup>19</sup> See also chapters III in *WIR10* and *WIR11*.
- <sup>20</sup> It is notable, though, that 2011 saw the conclusion of 57 double taxation treaties (on income or income and capital), bringing the total number to 3,091.
- <sup>21</sup> For example, over 100 lawyers from future signatories to the TPP Agreement voiced their concern with the prospect of including investor–State arbitration in the agreement and signed an open letter that calls for “rejecting the Investor–State dispute mechanism and reasserting the integrity of our domestic legal processes”. See <http://tpplegal.wordpress.com/open-letter>.
- <sup>22</sup> More specifically, it includes a novel provision which may be interpreted as giving investors a direct right of action for damages against host States that fail to enforce their Intellectual property rights laws.
- <sup>23</sup> Article 25 of the trilateral investment agreement between China, Japan and the Republic of Korea.

- <sup>24</sup> China–Japan BIT (1988); China–Republic of Korea BIT (1992) replaced by a new agreement in 2007; and Japan–Republic of Korea BIT (2002).
- <sup>25</sup> In 2005–2010, the EU countries on average accounted for approximately 47 per cent of the annual global FDI outflows. See also *WIR11*, p. 187.
- <sup>26</sup> See COM(2010)343, 7 July 2010.
- <sup>27</sup> Conclusions on a comprehensive European international investment policy (3041st Foreign Affairs Council meeting, 25 October 2010).
- <sup>28</sup> The Czech Republic has signed the highest number of agreements (10), followed by Romania (5) and Portugal (4). Estonia, Germany, Malta and the Slovakia have signed 3 BITs each. The most frequent treaty partner for post-Lisbon BITs has been India (4 treaties), which is surprising given that the EU is negotiating an FTA with India that will have an investment chapter. Twenty out of the 45 signed BITs are the renegotiated ones.
- <sup>29</sup> Member States of ASEAN are Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam. ASEAN member States also continue concluding BITs and other IAs individually. For example, in 2011–2012, Viet Nam concluded a BIT with Oman, and Malaysia concluded FTAs with India and with Australia.
- <sup>30</sup> Each ASEAN country, except for Brunei Darussalam, has a BIT with China.
- <sup>31</sup> Mexico–Costa Rica FTA (1994), Mexico–Nicaragua FTA (1997) and Mexico–El Salvador–Guatemala–Honduras FTA (2000).
- <sup>32</sup> Over the past years, at least 89 governments have responded to one or more investment treaty arbitrations. The largest number of claims were filed against Argentina (51 cases), Venezuela (25), Ecuador (23), Mexico (19), and the Czech Republic (18). The number of concluded cases had reached 220 by the end of 2011. Of these, approximately 40 per cent were decided in favour of the State and approximately 30 per cent in favour of the investor. Approximately 30 per cent were settled.
- <sup>33</sup> For more statistical data and substantive analysis of the 2011 developments in ISDS, see UNCTAD (2012a), "Latest Developments in Investor–State Dispute Settlement", *IIA Issues Note*, No. 1.
- <sup>34</sup> See box III.4 for details.
- <sup>35</sup> *Philip Morris Asia Limited v. Australia*, UNCITRAL, Notice of Claim, 22 June 2011.
- <sup>36</sup> *Vattenfall AB and others v. Federal Republic of Germany* (ICSID Case No. ARB/12/12).
- <sup>37</sup> See also UNCTAD (2011f). "Sovereign Debt Restructuring and International Investment Agreements", *IIA Issues Note*, No. 2.
- <sup>38</sup> See Australian Government, Gillard Government Trade Policy Statement: "Trading our way to more jobs and prosperity", April 2011. Available at: <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.pdf>.
- <sup>39</sup> Venezuela's announcement of 24 January 2012 is available at: [www.mre.gov.ve/index.php?option=com\\_content&view=article&id=18939:mppre&catid=3:comunicados&Itemid=108](http://www.mre.gov.ve/index.php?option=com_content&view=article&id=18939:mppre&catid=3:comunicados&Itemid=108). See also UNCTAD (2010) "Denunciation of the ICSID Convention and BITs: Impact on Investor–State Claims", *IIA Issues Note*, No. 2.
- <sup>40</sup> The termination of the treaty took effect on 10 June 2012; pursuant to the treaty terms, it will continue to apply for another 10 years to investments established by the time of termination. United States, *Federal Register*, "Notice of Termination of United States–Bolivia Bilateral Investment Treaty", 23 May 2012.
- <sup>41</sup> United States, Presidential Proclamation, "To Modify Duty-free Treatment Under the Generalized System of Preferences and for Other Purposes", *Federal Register*, 26 March 2012.
- <sup>42</sup> The provision in question, enshrined in Article II(7) of the BIT, prescribes that Governments provide foreign investors with "effective means" for asserting claims and enforcing rights. Arbitrators in *Chevron v. Ecuador* held that Article II(7) prohibited "undue" delay in local court systems and that the threshold for finding a violation of this obligation was lower than for denial of justice under international law. See *Chevron Corporation (USA) and Texaco Petroleum Company (USA) v. The Republic of Ecuador*, UNCITRAL, PCA Case No. 34877, Partial Award on the Merits, 30 March 2010.
- <sup>43</sup> In 2011, at least seven arbitrators were challenged by one of the disputing parties.
- <sup>44</sup> [www.state.gov/documents/organization/188371.pdf](http://www.state.gov/documents/organization/188371.pdf).
- <sup>45</sup> [http://trade.ec.europa.eu/doclib/docs/2012/april/tradoc\\_149331.pdf](http://trade.ec.europa.eu/doclib/docs/2012/april/tradoc_149331.pdf).
- <sup>46</sup> The principles, adopted by the UN Human Rights Council in 2011, are aimed at the implementation of the "Protect, Respect and Remedy" Framework presented by UN Special Representative John Ruggie in 2008. The UN Guiding Principles (UN Doc A/HRC/17/31) and the "Protect, Respect and Remedy" Framework (UN Doc A/HRC/8/5) are available at: [www.ohchr.org/EN/Issues/Business/Pages/Reports.aspx](http://www.ohchr.org/EN/Issues/Business/Pages/Reports.aspx). See also UN Human Rights Council resolution (UN Doc A/HRC/RES/17/4). Available at: [http://ap.ohchr.org/documents/dpage\\_e.aspx?si=A/HRC/RES/17/4](http://ap.ohchr.org/documents/dpage_e.aspx?si=A/HRC/RES/17/4).
- <sup>47</sup> Principle 9 recommends that, when concluding investment treaties, "States should maintain adequate domestic policy space to meet their human rights obligations".
- <sup>48</sup> The Guidelines establish a comprehensive code of responsible business conduct adhered to by 42 Governments and apply to companies operating in or from the relevant countries. Available at: [www.oecd.org/dataoecd/43/29/48004323.pdf](http://www.oecd.org/dataoecd/43/29/48004323.pdf).
- <sup>49</sup> This is set out in a new chapter in line with the UN Guiding Principles on Business and Human Rights.
- <sup>50</sup> Available at: [www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2012/2012-ICC-Guidelines-for-International-Investment](http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2012/2012-ICC-Guidelines-for-International-Investment).
- <sup>51</sup> The "Doha Mandate" (TD/L.427) was adopted at the UNCTAD XIII Conference, held in Doha, Qatar. Accompanying the Mandate, UNCTAD member States also adopted the "Doha Manar", a political declaration in which member States commend UNCTAD as the focal point of the United Nations system for the integrated treatment of trade and development and interrelated issues in finance, technology, investment and sustainable development and reiterate their commitment to the organization.
- <sup>52</sup> G-20 Leaders Declaration, G2012 Los Cabos, [www.g20.org/images/stories/docs/g20/conclu/G20\\_Leaders\\_Declaration\\_2012.pdf](http://www.g20.org/images/stories/docs/g20/conclu/G20_Leaders_Declaration_2012.pdf).
- <sup>53</sup> For more information, see UNCTAD website and UNCTAD (2011e).
- <sup>54</sup> See UNCTAD website and UNCTAD (2011d).
- <sup>55</sup> *Ibid.*
- <sup>56</sup> Available at: [www.unctad2012.org/content/documents/727The%20Future%20We%20Want%2019%20June%201230pm.pdf](http://www.unctad2012.org/content/documents/727The%20Future%20We%20Want%2019%20June%201230pm.pdf).
- <sup>57</sup> See Rio+20 Conference website, available at: [www.unctad2012.org/rio20/about.html](http://www.unctad2012.org/rio20/about.html) (accessed 30 June 2012).
- <sup>58</sup> Stock exchange leaders committed to the following pledge: "We voluntarily commit, through dialogue with investors, companies and regulators, to promoting long-term sustainable investment and improved environmental, social and corporate governance disclosure, and performance among companies listed on our exchange." See also [www.unctad.org/diae](http://www.unctad.org/diae) and [www.SSEinitiative.org](http://www.SSEinitiative.org).
- <sup>59</sup> For a deeper analysis of this subject, see UNCTAD (2012) "Corporate Social Responsibility in Global Value Chains: evaluation and monitoring challenges for small and medium-sized suppliers in developing countries".
- <sup>60</sup> UNCTAD (2011g).
- <sup>61</sup> UNCTAD (2011c).
- <sup>62</sup> UNCTAD (2012b).
- <sup>63</sup> SEDEX is a not-for-profit organization whose membership comprises private companies that use SEDEX's information sharing platform. See [www.sedexglobal.com](http://www.sedexglobal.com) (accessed 10 June 2012).