

# RECENT POLICY DEVELOPMENTS

## CHAPTER III

*Investment liberalization and promotion remained the dominant element of recent investment policies. Nevertheless, the risk of investment protectionism has increased as restrictive investment measures and administrative procedures have accumulated over recent years.*

*The regime of international investment agreements (IIAs) is at a crossroads. With close to 6,100 treaties, many ongoing negotiations and multiple dispute-settlement mechanisms, it has come close to a point where it is too big and complex to handle for governments and investors alike, yet remains inadequate to cover all possible bilateral investment relationships (which would require a further 14,000 bilateral treaties). The policy discourse about the future orientation of the IIA regime and its development impact is intensifying.*

*FDI policies interact increasingly with industrial policies, nationally and internationally. The challenge is to manage this interaction so that the two policies work together for development. Striking a balance between building stronger domestic productive capacity on the one hand and avoiding investment and trade protectionism on the other is key, as is enhancing international coordination and cooperation.*

*The investment policy landscape is influenced more and more by a myriad of voluntary corporate social responsibility (CSR) standards. Governments can maximize development benefits deriving from these standards through appropriate policies, such as harmonizing corporate reporting regulations, providing capacity-building programmes, and integrating CSR standards into international investment regimes.*

## A. NATIONAL POLICY DEVELOPMENTS

**Investment liberalization and promotion have continued to figure prominently on the policy agendas of many countries. At the same time, the trend of recent years towards increased investment regulation has persisted.**

In 2010, at least 74 countries around the globe adopted upwards of 149 policy measures affecting foreign investment (table III.1). Of these measures, 101 related to investment liberalization, promotion and facilitation, while 48

introduced new restrictions or regulations relevant to FDI. Compared to 2009, the percentage of more restrictive policy measures increased only slightly, from approximately 30 per cent to 32 per cent.

affecting the entry and establishment phase, and promotion and facilitation measures (table III.2). Overall, measures aimed at improving investment conditions continued to outnumber measures introducing new restrictions or regulations, but the margin is diminishing. The numerical difference was particularly large with regard to the entry and establishment category.

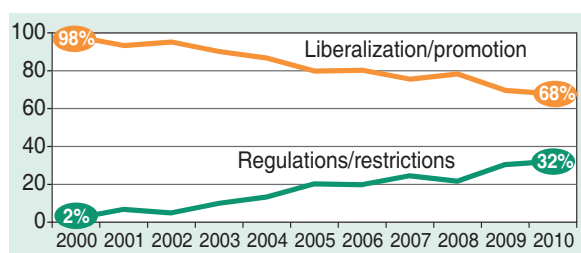
As regards the geographical distribution (table III.2), developing countries were especially active in revising investment policy. Asian countries (including West Asia) were the most active (56

**Table III.1. National regulatory changes, 2000–2010**  
(Number of measures)

Item	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Number of countries that introduced changes	70	71	72	82	103	92	91	58	54	50	74
Number of regulatory changes	150	207	246	242	270	203	177	98	106	102	149
Liberalization/promotion	147	193	234	218	234	162	142	74	83	71	101
Regulations/restrictions	3	14	12	24	36	41	35	24	23	31	48

Source: UNCTAD, Investment Policy Monitor database.

**Figure III.1. National Regulatory Changes, 2000–2010**  
(Per cent)



Source: UNCTAD, Investment Policy Monitor database.

This maintains the long-term trend of investment policy becoming increasingly restrictive, rather than liberalizing (figure III.1). Overall, the percentage of investment liberalization and promotion measures was slightly higher in developing countries and transition economies than in developed countries.

A closer look at the type of policy measures adopted reveals that most related to operational conditions for TNCs, followed by measures

measures), followed by Africa (29) and Latin America (25). Asia stands out, with a total of 46 out of 56 measures being more favourable to FDI. Measures from West Asia, for instance, were mainly in the area of liberalization of entry conditions, whereas for South, East and South-East Asia, promotion and facilitation also played an important role. In Africa, governments focused particularly on new promotion and facilitation measures to foster a more favourable investment climate. Due principally to developments in a small number of Latin American countries, this region stands out for the number of policy measures that were less favourable to FDI. These measures involved the strengthening of State control (up to and including nationalization) over natural resources-based industries, including both agribusiness and extractive industries. For developed countries the number of more favourable and less favourable entry measures was equal, while in transition economies these measures mainly related to the introduction of new privatization schemes.

**Table III.2. National regulatory changes in 2010, by type of measure and region<sup>a</sup>**

(Number of measures)

	Entry and establishment <sup>b</sup>		Operation <sup>c</sup>		Promotion and facilitation <sup>d</sup>
	More favourable to FDI	Less favourable to FDI	More favourable to FDI	Less favourable to FDI	
Total	40	16	34	33	35
Developed countries	6	6	10	6	4
Developing economies	30	10	19	24	27
Africa	4	2	8	4	11
South, East and South-East Asia	12	5	5	5	12
West Asia	10	0	4	0	3
Latin America and the Caribbean	4	3	2	15	1
South-East Europe and the CIS	4	0	5	3	4

Source: UNCTAD, Investment Policy Monitor database.

<sup>a</sup> Since some of the measures can be classified under more than one type, overall totals differ from table III.1.

<sup>b</sup> Entry measures and establishment: measures related to ownership and control or approval and admission conditions for (both inward and outward) FDI and other measures affecting the entry or establishment of TNCs.

<sup>c</sup> Operation: measures related to non-discrimination, nationalization or expropriation, capital transfer, dispute settlement, performance requirements, corporate tax rates and other measures affecting the operating conditions for TNCs.

<sup>d</sup> Promotion and facilitation: measures related to fiscal and financial incentives, procedural measures related to approval and admission, or investment facilitation and other institutional support.

Approximately half of the investment policy measures taken in 2010 related to one or more specific industries. Many different industries were involved, some more than others (in particular, extractive industries and financial services). For most industries, measures in the area of liberalization or promotion of FDI dominated those of a restrictive nature (table III.3). The main exceptions to this were the extractive industries and to a lesser extent agribusiness. These industries were responsible for a large share of the restrictive measures in 2010, including measures such as the introduction of performance requirements and new tax regimes, and the renegotiation of contracts.

## 1. Investment liberalization and promotion

**At least 56 countries adopted new investment liberalization or promotion measures in various industries. The number of these measures increased from 71 in 2009 to 101 in 2010.**

Of the 40 new investment liberalization measures implemented in 2010, 25 were specifically taken to liberalize foreign investment, and 15 were of a more general nature improving the overall policy framework for FDI. These measures were most pronounced in Asia and related to a broad range of industries (table III.2 and box III.1). Of the 34 measures improving operational conditions for

**Table III.3. National regulatory changes in 2010, by industry**

(Per cent)

	Liberalization/promotion	Regulations/restrictions
Total	67	33
No specific industry	84	16
Agribusiness	38	62
Extractive industries	7	93
Manufacturing	50	50
Electricity, gas and water	75	25
Financial services	59	41
Other services	61	39

Source: UNCTAD, Investment Policy Monitor database.

TNCs, most relate to the lowering of corporate tax rates.

Most of the measures to promote or facilitate foreign investment were taken by countries in Africa and Asia (table III.2). A few categories of facilitation and promotion measures stand out as having been frequently used. These include the streamlining of admission procedures and the opening of new – or the expansion of existing – special economic zones (box III.2).

From a practical point of view, facilitation measures can often be more important for investors than a formal easing of investment restrictions. Informal

### Box III.1. Examples of investment liberalization measures in 2010/2011

- *Bhutan* released its “FDI policy 2010”, according to which all activities not included in a “negative list” shall be open to FDI. It allowed 100 per cent foreign ownership in certain activities such as education, specialized health services, luxury hotels and resorts, and infrastructure facilities within the services sector.<sup>a</sup>
- *Canada* removed foreign ownership restrictions regarding international submarine cables, earth stations that provide telecommunications services by means of satellites, and satellites.<sup>b</sup>
- *Guatemala* passed a new insurance law that allows foreign insurance companies to establish branches.<sup>c</sup>
- *India* issued a new consolidated FDI policy, which facilitates the expansion of established foreign owned enterprises, allows the conversion of non-cash items into equity (with approval from the government) and permits FDI in certain agricultural activities.<sup>d</sup>
- *Indonesia* has partially liberalized construction services, film and health services, as well as parts of electricity generation.<sup>e</sup>
- *Syrian Arab Republic* issued a legislation that permits the private sector (both foreign and domestic) to invest in the generation and distribution of electricity.<sup>f</sup>
- *Taiwan Province of China* partially liberalized outward investment to China with regard to a number of activities related to agriculture, manufacturing, services, and infrastructure.<sup>g</sup> It also announced the opening of a large part of its core hi-tech business, including semiconductor manufacturing, to investors from mainland China.<sup>h</sup>
- *Turkey* adopted a law permitting foreign investors to hold up to 50 per cent of the shares in up to two broadcasting companies.<sup>i</sup>

Source: UNCTAD.

<sup>a</sup> Ministry of Economic Affairs, 21 May 2010.

<sup>b</sup> Canada Telecommunications Act amended 12 July 2010, Art. 16 (5).

<sup>c</sup> Decree No. 25-2010, published in the Official Gazette No. 3, 13 August 2010.

<sup>d</sup> Consolidated FDI Policy Circular No.1, 1 April 2011.

<sup>e</sup> Presidential Regulation No. 36, 2010.

<sup>f</sup> Law No. 32, 14 November 2010.

<sup>g</sup> Council for Economic Planning and Development, “Restrictions loosened on investment in China”, 9 April 2010.

<sup>h</sup> Investment Commission, “The second phase of opening up the mainland investment in Taiwan Industry Project”, 2 March 2011.

<sup>i</sup> Law No. 6112, 3 March 2011.

barriers are regularly cited as major investment hurdles in developing countries. Removing such bottlenecks is also politically less sensitive than investment liberalization. Moreover, the smaller the differences between countries in their formal openness to FDI, the greater the importance of “soft” investment conditions, like a welcoming, competent and efficient administration.

Investment promotion measures have also been taken in the context of industrial policy (section D). Several countries have taken steps to encourage FDI in specific economic activities, such as hi-tech industries or car manufacturing. Promotion measures included fiscal and financial incentives, and the establishment of special economic zones.

## 2. Investment regulations and restrictions

**The rebalancing of investor rights and obligations continued, with a particular focus on the financial sector. Several countries increased the role of the State in natural resources based industries, such as agribusiness and extractive industries.**

Notwithstanding the continuing predominance of investment liberalization and promotion, numerous countries have adopted measures to strengthen the regulatory framework for investment, both domestic and foreign. The number of measures restricting or regulating FDI increased from 31 in 2009 to 48 in 2010. This has been the case

**Box III.2. Examples of investment promotion measures in 2010/2011**

- *Bosnia and Herzegovina* amended its Law on Foreign Direct Investment Policy, simplifying the registration process for foreign investment.<sup>a</sup>
- *Fiji* adopted a one-stop shop policy to enhance processes relating to foreign and local investment applications in the country.<sup>b</sup>
- In the *Republic of Korea*, the Government is offering an improved package of incentives to attract foreign investors into special economic zones. The Government also extended FDI zones for the services sector.<sup>c</sup>
- *Myanmar* passed a “Special Economic Zone Law”, which provides incentives for foreign investors in banking and insurance.<sup>d</sup>
- The *Philippines* launched its Public–Private Partnership Centre to facilitate the coordination and monitoring of the PPP programmes and projects.<sup>e</sup>
- The *Russian Federation* created a new special economic zone in the Samar Region with a view to attracting investors particularly in the car-making and related industries.<sup>f</sup> The country also introduced simplified rules for employing highly qualified foreign specialists.<sup>g</sup>

Source: UNCTAD.

<sup>a</sup> Law on the Policy on Foreign Direct Investment, Official Gazette No. 48/10.

<sup>b</sup> Fiji Government Online Portal, “Cabinet approves one stop shop”, 18 January 2011.

<sup>c</sup> Ministry of Knowledge Economy, “Free Economic Zone Promotion Plan”, 1 September 2010; Ministry of Knowledge Economy, “Modification of the Enforcement Decree on the FDI Act”, 5 October 2010.

<sup>d</sup> Special Economic Zone Law No. 8/2011, Official Gazette of the Government of Myanmar, 27 January 2011.

<sup>e</sup> Official Gazette, “PPP center launches 5 PPP projects”, 4 March 2011.

<sup>f</sup> Government Resolution No. 621, 12 August 2010.

<sup>g</sup> Federal Law No. 86-FZ, 19 May 2010.

particularly in the financial sector, where several countries tightened existing rules in order to prevent future financial crises. Most of these measures have been taken by G-20 countries, and other members of the Basel Accord. In general, these new financial regulations focus on an increase in bank capital and liquidity requirements, reducing the existing risks in connection with financial institutions that are “too big to fail”, and reinforcing oversight.<sup>1</sup> Different opinions exist as to the impact of the new regulations on FDI in the financial sector. Concerns have been expressed about the potential negative impact of the new regulations on existing investments, but regulators argue that the beneficial impact on the macro economy should more than offset the transitional adjustment costs.<sup>2</sup>

More State intervention also became apparent in the natural resources based industry. A number of countries, in particular in Latin America, pursued nationalization policies, with foreign investors being one target. Some nationalizations occurred also in other industries, including financial services.

Likewise, a move towards stricter regulations manifested itself in new operational conditions for foreign investors, such as local content requirements. Once again, the extractive industry was particularly affected (box III.3).

Compared to the quantity of nationalizations and new operating conditions for investment, new FDI *entry and establishment restrictions* have been less common (table III.2). In large part, these measures have related to screening and approval regulations (box III.4). No clear pattern emerged according to which certain industries would be specifically liable to new entry restrictions. The latter vary between countries due to individual political sensitivities. A few foreign investments have been rejected on national interest grounds.

The reported nationalizations and sector-specific entry restrictions are part of broader developments in industrial policy, characterized by an extension of protective measures to national champions and strategic industries and by the intrusion of national security concepts into industrial policy

considerations. Together, this raises important questions on how to safeguard adequate policy space for countries to adopt FDI restrictions that they consider necessary, while at the same time avoiding such policies degenerating into investment protectionism (section D).

Although still a minority, overall the number of restrictive investment regulations and administrative practices has accumulated to a significant degree over the past few years. Together with their continued upward trend, as well as stricter review procedures for FDI entry, this poses the risk of potential investment protectionism.

### 3. Economic stimulus packages and State aid

More than two and a half years after the outbreak of the financial crisis, some countries continue to hold considerable assets following bail-out operations, have substantial outstanding loans to individual firms, or continue emergency support schemes

for the financial and non-financial sectors.<sup>3</sup> However, in the financial sector, many countries have ceased to accept applications from financial firms to public assistance schemes.

The phasing out of some of these schemes had already started in late 2009, and continued in 2010. Part of this process is due to the expiry of support schemes in the European Union, which included sunset clauses set by the European Commission. The closure of aid schemes also reflects an uneven but often low demand by businesses for this aid, which has been further weakened by the gradual tightening of the conditions of State support by governments (EC, 2011).

With the closure of support schemes to new entrants, the main outstanding issue relates to the unwinding of assets and liabilities that remain on government books as a legacy of the emergency

**The unwinding of support schemes and liabilities resulting from emergency measures has started. So far this process has not overtly discriminated against foreign investors.**

#### Box III.3. Examples of new regulatory measures affecting established foreign investors in 2010/2011

- In the *Plurinational State of Bolivia*, the Government nationalized, among others, the country's pension system.<sup>a</sup>
- *Ecuador* passed a new hydrocarbons law. It requires private oil companies to renegotiate their contracts from a production-sharing to a service arrangement.<sup>b</sup> The Government started to take over the oil fields of the Brazilian national oil company Petrobras after renegotiation of its licence failed.<sup>c</sup>
- *Kazakhstan* adopted a Law on State-Owned Property, which regulates the nationalization of private property in cases of threats to national security.<sup>d</sup>
- The *Kyrgyz Republic* nationalized one of the country's largest banks, the foreign-controlled AsiaUniversalBank.<sup>e</sup>
- The *Russian Federation* tightened the rules for foreign automobile producers with assembly plants in Russia. In order for such producers to continue to enjoy duty-free importation of components, they will have to significantly increase the overall volume of production in Russia and achieve a higher level of locally produced parts.<sup>f</sup>
- In the *Bolivarian Republic of Venezuela*, nationalizations affected various industries, including in the area of agriculture and power generation.<sup>g</sup>
- *Zimbabwe* set out the requirements for the implementation of the Indigenization and Economic Empowerment Act and its supporting regulations as they pertain to the mining sector. This 2007 Act made provision for the indigenization of up to 51 per cent of all foreign-owned businesses operating in Zimbabwe.<sup>h</sup>

Source: UNCTAD.

<sup>a</sup> Law No.65, 10 December 2010.

<sup>b</sup> Ley Reformatória a la Ley de Hidrocarburos y a la Ley de Regimen Tributario Interno, 24 June 2010.

<sup>c</sup> Government press release, 23 November 2010.

<sup>d</sup> Law on State Property, No. 413-IV, of 1 March 2011.

<sup>e</sup> Decree No.56, 7 June 2010.

<sup>f</sup> Ministry of Industry and Commerce, Ministry of Economic Development and Ministry of Finance, Joint Order No.678/1289/184H, 24 December 2010.

<sup>g</sup> Decree No. 7.394, 27 April 2010; Decree No. 7.700, 4 October 2010; Decree No. 7.713, 10 October 2010; Decree No. 7.751, 26 October 2010.

<sup>h</sup> General Notice 114, 25 March 2011.

**Box III.4. Examples of entry restrictions for foreign investors in 2010/2011**

- *Australia* rejected Singapore Exchange's US\$8.3 billion offer to take over Australian Securities Exchange, which it concluded was not in Australia's national interest.<sup>a</sup>
- *Brazil* reinstated restrictions on rural land-ownership for foreigners by modifying the way a law dating back to 1971 is to be interpreted. The reinterpreted law establishes that, on rural land-ownership, Brazilian companies which are majority owned by foreigners are subject to the legal regime applicable to foreign companies.<sup>b</sup>
- The Minister of Industry of *Canada* announced the blocking of the Australian mining company "BHP Billiton's" US\$39 billion takeover of Potash Corp. (a Canadian fertilizer and mining company).<sup>c</sup>

Source: UNCTAD.

<sup>a</sup> Australian Treasury, Foreign Investment Decision, 8 April 2011.

<sup>b</sup> New Interpretation of Law No. 5.709/71, Parecer CGU/AGU No. 01/2008, 23 August 2010.

<sup>c</sup> Ministry of Industry Press Release, 3 November 2010. *Catas dolor sint facia niatur rerendi dit intur sinventendae vel eostis*

measures. So far, this process has advanced relatively slowly, and less than a fifth of the financial firms that received crisis-related support have repaid loans fully, repurchased equity or relinquished public guarantees.

In the non-financial sectors, legacy assets and liabilities are much lower, but the number of companies that benefited from crisis-related government support is much greater. The unwinding of emergency aid to the non-financial sector has also started. For instance, in the automotive industry – one of the main industries at which aid was targeted – companies in Canada, France and the United States have partly repaid loans, and some of the government equity holdings in the companies have been acquired by private investors.

In all, in April 2011, governments are estimated to hold legacy assets and liabilities in financial and non-financial firms valued at over \$2 trillion. By far the largest share relates to several hundred firms in the financial sector. This indicates a potential wave of privatizations in years to come.

Since 2009, following a request by G-20 leaders, UNCTAD, the WTO and OECD have monitored trade- and investment-related policy responses to the financial crisis. One of the main objectives is to scrutinize whether and to what extent countries resorted to trade or investment protectionism, as they grappled with the crisis. The five reports published so far by the three international organizations conclude that for the most part, emergency measures as well as unwinding of assets and liabilities did not overtly discriminate against foreign investors (*WIR10*; OECD-UNCTAD, 2010a, b and 2011; WTO-OECD-UNCTAD, 2009 and 2010). For instance, the United States has sold its holdings in financial institutions and an automotive company through auctions executed by private banks and parts of the assets were sold to foreign competitors.<sup>4</sup> Furthermore, a study by the European Commission shows that several EU member States, including Germany, France, and the United Kingdom, considered that emergency schemes for the non-financial sectors implemented in other countries did not harm their companies.<sup>5</sup>

## B. THE INTERNATIONAL INVESTMENT REGIME

### 1. Developments in 2010

**As the IIA universe continues to expand, the policy discourse about how to enhance IIAs' contribution to sustainable development is intensifying, at both the national and international levels.**

In 2010, a total of 178 new IIAs were concluded (54 bilateral investment treaties (BITs),<sup>6</sup> 113 double taxation treaties (DTTs)<sup>7</sup> and 11 IIAs other than BITs and DTTs ("other IIAs").<sup>8</sup> As a result, at the end of 2010 the IIA universe

contained 6,092 agreements, including 2,807 BITs, 2,976 DTTs and 309 "other IIAs" (figure III.2). The trend seen in 2010 of rapid treaty expansion – with more than three treaties concluded every week – is expected to continue in 2011, the first five months of which saw the conclusion of 48 new IIAs (23 BITs, 20 DTTs and five "other IIAs") and more than 100 free trade agreements (FTAs) and other economic agreements with investment provisions currently under negotiation. At the same time, it remains to be seen how the shift of responsibility for FDI from EU member States to the European level will affect the IIA regime (with EU member States being parties to more than 1,300 BITs with third countries) (box III.5).

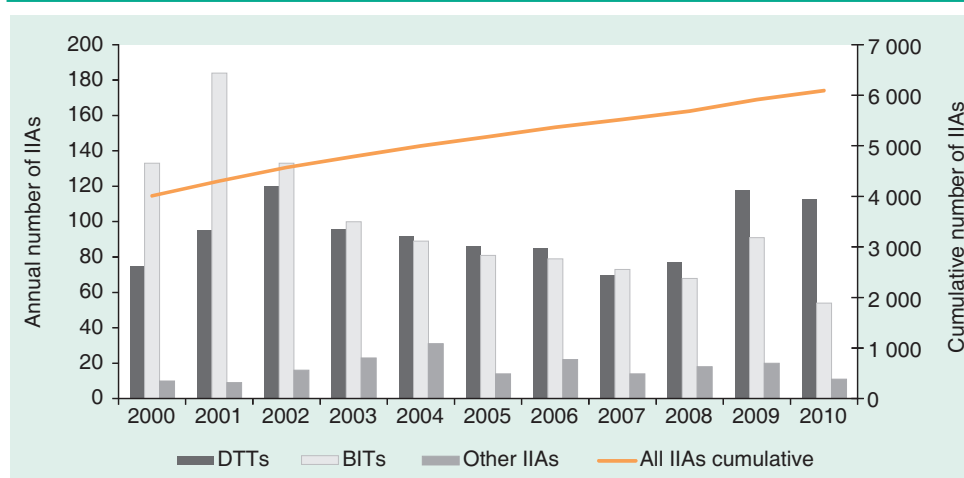
In terms of total numbers of IIAs, as of May 2011, the United Kingdom is party to 320 IIAs, followed by Germany (304) and France (297). Amongst

the developing countries, China tops the list, with 249 IIAs, followed by the Republic of Korea (190) and Turkey (183). The Russian Federation (141) and Croatia (118) rank first among the transition economies.

Twenty of the 54 BITs signed in 2010 were between developing countries and/or transition economies, as were four of the 11 other IIAs, a trend possibly related to developing countries' growing role as outward investors. With respect to "other IIAs", treaties concluded in 2010 continue to fall into the three categories: IIAs including obligations commonly found in BITs (three treaties in 2010);<sup>9</sup> agreements with limited investment-related provisions (five treaties);<sup>10</sup> and IIAs focusing on investment cooperation (three treaties).<sup>11</sup>

Countries continue to conclude IIAs, sometimes with novel provisions aimed at rebalancing the rights and obligations between States and investors and ensuring coherence between IIAs and other public policies. At the same time, the policy discourse about international investment policymaking intensifies at both domestic and international levels, amounting to a period of reflection on the future orientation of the IIA regime to make it work better for sustainable development. Nationally, different investment stakeholders have started to voice their concerns about the costs and

**Figure III.2. Trends of BITs, DTTs and "other IIAs", 2000–2010**



Source: UNCTAD, based on IIA database.



**Box III.5. EU FDI Policymaking**

The entry into force in December 2009 of the Lisbon Treaty shifted responsibility in the field of FDI from the member States to the EU (*WIR10*). While European member States continue concluding BITs<sup>a</sup> the shift of responsibility has given rise to a number of substantive and procedural questions about future EU investment policymaking at the international level. In that context, the relevant European institutions and non-governmental investment stakeholders have expressed their views.

While there seems to be agreement among EU institutions on the general orientation of future EU IIAs (i.e. that they should contribute to sustainable and inclusive growth and be guided by the principles and objectives of the Union's external action, notably human rights and sustainable development), differences of opinion have emerged regarding the details (e.g. provisions on scope and definition, the content and formulation of key substantive and procedural protection provisions, and the extent to which IIAs should refer to corporate social responsibility (CSR)).

Opinions differ even more when considering non-governmental investment stakeholders. A number of civil society groups consider IIAs a threat to the public interest, and suggest that it is time for a radically new approach to foreign investment. In contrast, some European industry groups highlight the positive role BITs play in increasing the competitiveness of European industry.

The disagreement is compounded by questions about future development of the EU IIA regime, including how to deal with the selection of future negotiating partners, with ongoing negotiations and with existing EU BITs (both intra- and extra-EU BITs). The outcome of this debate is likely to have a major impact on the global IIA regime. EU member States are among the countries with the largest numbers of BITs (annex table III.1). Moreover, over the last three years, Europe as a whole accounted for approximately 30 per cent of global FDI flows.

The EU debate offers great potential in so far as it allows the putting into practice of lessons learned regarding the design and substance of IIAs and their impact on sustainable development. However, open questions, attendant uncertainties, lack of predictability and stability will all serve to complicate the situation for EU negotiating partners and the IIA regime generally.

Source: UNCTAD.

<sup>a</sup> Thirty of the 54 BITs concluded in 2010 involved an EU member State. Seventeen of the 30 European BITs were renegotiated ones.

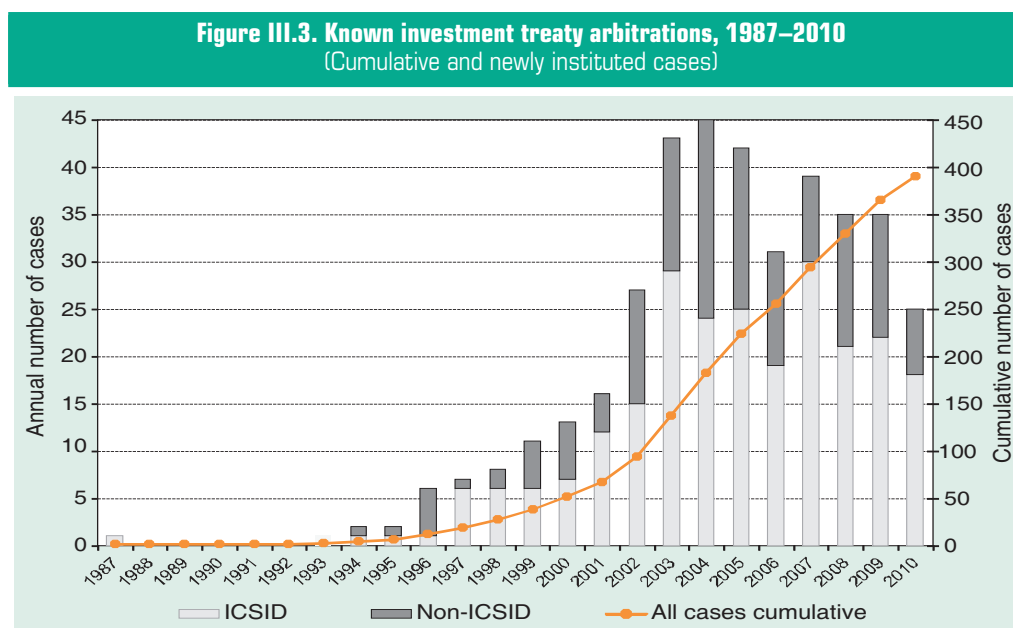
benefits and the future orientation of IIAs, including civil society, business and parliamentarians. While IIAs have traditionally been negotiated by the relevant government ministry, there is now an emerging trend of inter-ministerial or inter-agency coordination. This process is particularly prominent at the European level (box III.5), but is also evident in EU member States and other countries around the globe. To the extent that countries are reviewing their model BITs (*WIR10*), or that IIAs need to undergo domestic ratification processes, the call for increasing transparency and inclusiveness of IIA-related decision-making is gaining additional traction.

Internationally, the discourse was carried forward in forums such as the UNCTAD Investment Commission, the OECD Investment Committee, joint meetings of OECD and UNCTAD, regional conversations co-organized by UNCTAD to improve the investor-State dispute settlement (ISDS) system, and particularly in the UNCTAD World Investment Forum 2010, which involved a broad

range of investment stakeholders in the Ministerial Round Table and the IIA Conference 2010.

With respect to ISDS, at least 25 new treaty-based cases were initiated in 2010 – the lowest number filed annually since 2001. This brought the total of known cases filed to 390 by the end of the year (figure III.3).<sup>12</sup> These cases were mainly submitted to the International Centre for Settlement of Investment Disputes (ICSID) (including its Additional Facility), which continued to be the most frequently used international arbitration forum (with 18 new cases). This follows the long-term trend, with the majority of cases accruing under ICSID (245 cases in total).

In 2010, the total number of countries involved in investment treaty arbitrations grew to 83, with Uruguay and Grenada each contesting the first claims directed against them. Fifty-one developing countries, 17 developed countries and 15 economies in transition have been on the responding side of ISDS cases. The overwhelming



Source: UNCTAD, ISDS database.

majority of the claims were initiated by investors from developed countries. Forty-seven decisions were rendered in 2010, bringing the total number of cases concluded to 197 (UNCTAD, 2011c).<sup>13</sup> Twenty of these decisions were awards, 14 of which were decided in favour of the State, five in favour of the investor, and one award embodied the parties' settlement agreement. This has tilted the overall balance of awards further in favour of the State (with 78 won cases against 59 lost).

## 2. IIA coverage of investment

**Today's IIA regime offers protection to more than two-thirds of global FDI stock, but covers only one-fifth of possible bilateral investment relationships.**

The intended purpose of IIAs is to protect and to promote foreign investment. Today, about two-thirds of global FDI stock benefits from post-establishment protection

with comprehensive sectoral coverage granted by BITs or "other IIAs".<sup>14</sup> However, this represents only one-fifth of possible bilateral relationships. To provide full coverage another 14,100 bilateral investment treaties would be required (figure III.4).

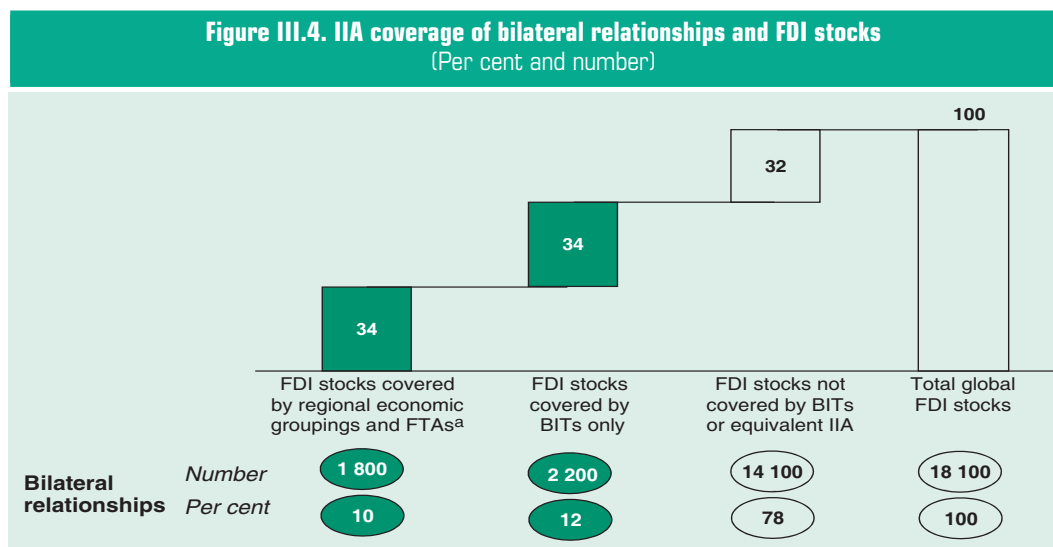
These 14,100 treaties would include, on the one hand, many bilateral relationships with little propensity to invest (i.e. where FDI flows are negligible) or with little propensity to protect (e.g.

between OECD member countries). On the other hand, they would also include a few bilateral relationships where substantial FDI stocks exist that are not covered by any existing investment protection agreement (e.g. China and the United States, Brazil and China).

These findings beg a number of questions with regard to the effectiveness of IIAs in terms of generating investment flows and promoting development gains (UNCTAD, 2009b). For example, the existence of considerable FDI stocks in the absence of post-establishment treaty coverage suggests that for some investment relationships, IIAs fall short of being a determining factor for investment.

Furthermore, some of the FDI stock is subject to protection offered by two or more IIAs. In fact, 570 BITs at least partially duplicate the post-establishment protection offered by other agreements. The extent of overlap and risk of contradictory provisions depends on the precise formulation used in BITs and/or "other IIAs" in terms of protection granted and flexibilities offered (*WIR10*). This raises questions about the efficiency of the IIA regime – an issue that is already discussed with regard to the future of EU member States' IIAs (box III.5).

A further 630 BITs overlap with "other IIAs" that contain investment liberalization provisions only



Source: UNCTAD FDI/TNC database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics)) and UNCTAD database on IIAs.

<sup>a</sup> Includes EU, OIC, UCIAC, LAS, COMESA, SADC, ASEAN, CEFTA, CAFTA, APTA, UMA, Eurasian Economic Community, MERCOSUR, TEPA, NAFTA, EFTA, the FTA between GCC-EFTA, as well as FTAs CARICOM, ASEAN, EFTA and GCC with third countries.

Note: FDI stocks are estimated on the basis of treaty-partner shares of world FDI inflows and outflows. 192 UN member countries only.

(e.g. EU partnership, association and cooperation agreements), resulting in a situation where post-establishment protection (offered by BITs) complements pre-establishment protection/liberalization (offered by “other IIAs”). Whether such comprehensive coverage is desirable is an important question, the answer to which is highly context- and situation-specific, and needs to be

assessed against the overall objective of ensuring that IIAs promote investment for sustainable development. Furthermore, investment relationships have to be seen from a dynamic perspective, as the propensities to invest, and hence to protect through IIAs, may change over time (as witnessed by the growing interest of some emerging outward investing countries in IIAs).

## C. OTHER INVESTMENT-RELATED POLICY DEVELOPMENTS

**Supported by the G-20 Development Agenda, various international initiatives are being developed to promote positive development impacts through private investment.**

### 1. Investment in agriculture

Since the publication of the *World Investment Report 2010*, work has continued on the Principles for Responsible Agricultural Investment (PRAI) that were developed jointly by UNCTAD, the Food and Agriculture Organization of the United Nations (FAO), the International Fund for Agricultural Development (IFAD) and the World Bank (*WIR10*). The agricultural

sector in low-income countries has been suffering from serious underinvestment for decades. Private investment can contribute to long-term solutions to food security and development, provided that such investment is socially responsible and environmentally sustainable (*WIR09*). The seven principles, once implemented, could contribute to enhancing the positive and reducing the potential negative effects of foreign investment in agricultural production.

The coverage of food security and responsible investment in agriculture by the G-20 Multi-Year Action Plan on Development reflects growing concerns among policymakers regarding access to

food and food prices, the potential negative impacts of speculation and profiteering in commodities and land, and the social and environmental impacts of international investments in agriculture. At the Seoul Summit on 11–12 November 2010, the G-20 leaders encouraged countries and companies to uphold the PRAI and requested UNCTAD, the World Bank, IFAD, FAO and other appropriate international organizations to develop options for promoting responsible investment in agriculture.

## 2. G-20 Development Agenda

At the Seoul Summit, the G-20 leaders considered the disproportionate effect of the financial crisis on the most vulnerable in the poorest countries, and the slow progress toward achieving the Millennium Development Goals (MDGs).<sup>15</sup> The G-20 leaders committed to work in partnership with other developing countries, low-income countries (LICs) in particular, to help build the capacity to achieve and maintain their economic growth potential in line with the mandate from the G-20's Toronto Summit.<sup>16</sup>

The Seoul Consensus consists of a set of principles and guidelines to achieve the MDGs. The six core principles focus on economic growth, global development partnership, global or regional systemic issues, private sector participation, complementarity, and outcome orientation. In addition, the G-20 leaders identified nine areas, or “key pillars”, where action is necessary to resolve the most significant bottlenecks to inclusive, sustainable and resilient growth in developing countries. These areas are: infrastructure, private investment and job creation, human resource development, trade, financial inclusion, growth with resilience, food security, domestic resource mobilization, and knowledge-sharing.

The G-20 leaders also endorsed the Multi-Year Action Plan on Development, with deadlines running from 2012 to late 2014. This Plan includes 16 specific and detailed actions on the nine key pillars identified in the Seoul Consensus. Three pillars in the Multi-Year Action Plan on Development are closely related to investment. Under the “Private Investment and Job Creation” pillar, the G-20 leaders emphasized the importance of domestic and foreign private investment as a key source of

employment, wealth creation and innovation, which in turn contributes to sustainable development and poverty reduction in developing countries. The leaders committed to support and assist investors, developing countries and key development partners in their work to maximize the economic value-added of private investment. At the G-20's request, UNCTAD, UNDP, ILO, OECD and the World Bank reviewed and developed key quantifiable economic and financial indicators for measuring and maximizing economic value-added and job creation arising from private sector investment in value chains, and developed policy approaches for promoting standards for responsible investment in value chains. G-20 leaders are expected to take further actions based on this work at their future summits in 2011 and 2012.

Under the “Infrastructure” pillar the G-20 leaders looked at gaps in infrastructure, in particular with respect to energy, transport, communications, water and regional infrastructure, that are significant bottlenecks to increasing and maintaining growth in many developing countries. They committed to overcoming obstacles to infrastructure investment, developing project pipelines, improving capacity and facilitating increased finance for infrastructure investment in developing countries, in particular LICs. They requested regional development banks and the World Bank Group to work jointly to prepare action plans to increase public, semi-public and private finance and improve implementation of national and regional infrastructure projects, including in energy, transport, communications and water, in developing countries.

Under the “Food Security” pillar, the G-20 leaders emphasized the need for increased investment and financial support for agricultural development, and encouraged additional contributions by the private sector, the G-20 and other countries to support country-led plans and ensure predictable financing.

## 3. Political risk insurance

In the past few years, the investment community has been mainly concerned with the financial crisis and its impacts on FDI and the global economy. However, political risk considerations are expected to return to the fore of investors' concerns, both

in the developed and in the developing world. According to the 2010 MIGA-EIU Political Risk Survey, political risk was perceived to be the single most important constraint on investment into developing countries over the medium term. This reflects numerous developments, including a trend towards greater regulation of FDI (section A) and recent political unrest in some parts of the world.

So far, however, these concerns have not yet resulted in greater reliance on political risk insurance. As a consequence of the global economic crisis, the volume of liability underwritten by Berne Union (BU) investment insurers fell by 6 per cent to \$137.1 billion from 2008 to 2009. Reflecting the recovery in new business, the volume of liability totalled over \$142 billion as of June 2010, an increase of 7.7

per cent in 12 months (MIGA, 2011). The slight pick-up in 2010 results from the modest recovery in FDI during the year.

Political risk insurance evolved in 2010. For example, the Non-Concessional Borrowing Policy (NCBP) was updated to avoid the re-accumulation of external debt in low-income countries that have benefited from the “multilateral” debt relief initiative of 2006. Since April 2010, the NCBP has been successful in attracting an increased number of creditors to adhere to NCBP for promotion of financing of low-income countries (MIGA, 2011).

Finally, political risk insurance has linkages with other areas of investment policymaking. For example, some entities condition the granting of political risk insurance on the existence of an IIA with the host country in question.

## D. INTERACTION BETWEEN FDI POLICY AND INDUSTRIAL POLICY

**FDI policy increasingly interacts with industrial policy, both at the national and international levels. The challenge is to make the two work together for development, to avoid investment protectionism and to enhance international coordination.**

Many governments have opted for more proactive industrial policy in recent years. The reasons for this are manifold and include, for instance, structural change and economic diversification, pressure from international competition, disappointment with the results of laissez-faire policy, the wish to “guide” development, a desire to strengthen and protect national champions, and State intervention in response to various crises. The success of industrial policy in countries such as Brazil, China, India or the Republic of Korea has given further impetus to this development.

FDI policy interacts closely with industrial development strategies. In general, countries promote or restrict foreign investment within this context, depending on the industry in question and on the role they want to assign to FDI in domestic development. Investment promotion policy can be an important means to build productive capacity

in developing countries, as TNCs bring capital, technology and know-how into the host country that can be crucial for the development of individual industries. Conversely, countries may choose to restrict FDI because they see a need to protect certain domestic industries – in particular infant or strategic industries – from foreign takeovers or competition. The interaction between FDI policy and industrial policy has both national and international dimensions.

### 1. Interaction at the national level

The interface between FDI policies and industrial policies is most pronounced in specific national investment guidelines that define the role of FDI in domestic industrial development strategies and identify the policy tools to apply in this context. A number of countries have created such documents that specify to various degrees the extent to which FDI is prohibited, restricted, allowed or encouraged, and what FDI-related policy instruments to apply (e.g. China’s “Foreign Investment Industrial Guidance Catalogue” and “Catalogue of Foreign Investment Advantageous Industries in Central

and Western China”, India’s “Consolidated FDI Policy”).<sup>17</sup> Some guidelines specifically address the use of investment promotion instruments (e.g. the Republic of Korea’s “FDI Promotion Policy in 2011”, the Malaysian Industrial Development Authority’s “Invest in Malaysia” policy, and the Thailand Board of Investment’s “Investment Promotion Policy for Sustainable Development”).<sup>18</sup> These guidelines may also relate to the interpretation of national laws and policies at the sub-national level.

Many countries have policies to target individual companies or specific categories of foreign investors considered capable of making a particularly significant contribution to industrial development, such as hi-tech investments, environmentally friendly projects or labour intensive technologies. Investment promotion agencies (IPAs) have an important supporting role in this context, namely through their matchmaking and aftercare services. These “targeting” policies may be reinforced through linkage programmes, the promotion of industrial clusters, and incubation programmes to maximize spillover effects and other benefits.

Industrial policy strategies often emerge with more general fiscal or financial incentive programmes. Investment incentives are subject to requirements related to development in certain industries, or regions, or with regard to specific development goals, such as export promotion, job creation, technology transfer and upgrading. Investment incentives are also used to help developing industries where as yet there is no sufficiently large market (e.g. renewables).

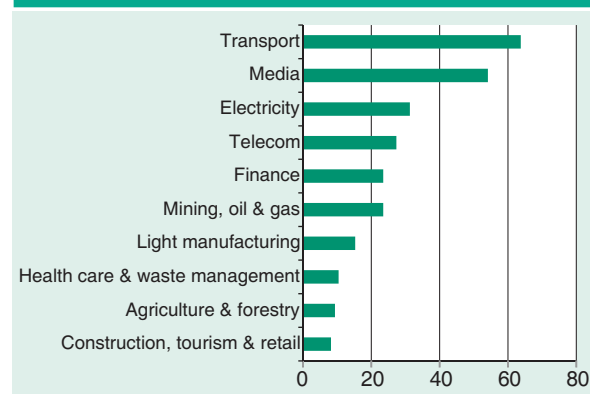
Industrial policy can further be supported by specific investment promotion and facilitation measures for FDI in particular industries, in line with their development strategies. The establishment of special economic zones and incubators, such as “hi-tech zones” (e.g. the “Electronic City” in Bangalore, India),<sup>19</sup> “IT corridors” (e.g. The Taipei Technology Corridor)<sup>20</sup> or “renewables zones” (e.g. “Masdar City” in Abu Dhabi),<sup>21</sup> which aim at improving the “hard” and “soft” infrastructure of the host country, are cases in point.<sup>22</sup>

Industrial policy may also be pursued through selective FDI restrictions. In the past, restrictive FDI policy has been applied particularly with a

view to promoting infant industries, or for socio-cultural reasons (e.g. land ownership restrictions). Nowadays, this relatively narrow policy scope has given way to a broader approach, under which numerous countries have strengthened their FDI-related policy instruments, in particular with regard to approval and screening procedures, and where the beneficiaries of government protection also include national champions, strategic enterprises and critical infrastructure. Moreover, governments may see a need to protect ailing domestic industries and companies at times of financial crisis or to discourage or restrict outward foreign investment in order to keep employment “at home”. Increasingly, industrial policy considerations to justify FDI restrictions have become blurred with other policies to protect national security, thus further enlarging the scope of State intervention vis-à-vis foreign investors.

The economic importance of such policies is huge. For instance, policies to protect national champions and strategic enterprises usually cover core industries such as natural resources, energy, telecommunications, financial services and the transport sector (OECD, 2009). Figure III.5 provides an indication of which industries are most often affected by certain foreign ownership limitations. Restrictions mainly apply to transport and media, with more than half of the countries limiting foreign investment in these industries, often allowing only minority ownership.<sup>23</sup>

**Figure III.5. Share of countries with industry-specific restrictions on foreign ownership, by industry, 2010**  
(Per cent)



Source: UNCTAD, based on World Bank, 2010.

## 2. Interaction at the international level

The interaction between international investment policy and industrial policy is characterized by the dual nature of IIAs, potentially both supporting and constraining industrial policy.

With respect to their potential to support industrial policy, IIAs are expected to encourage foreign investment through their functions of (i) protecting and liberalizing investment (e.g. by easing entry or by offering national treatment); (ii) improving the overall investment policy framework; and/or (iii) enlarging markets to serve (UNCTAD, 2009c). In addition, some IIAs include specific promotion-oriented provisions (UNCTAD, 2008b).<sup>24</sup> However, as most IIAs apply on a cross-cutting basis, potential foreign investment enhancing effects would occur for all industries.

On the other hand, IIAs also have the potential to constrain investment-related industrial policy. Provisions that deserve most attention in this context include, among others, IIA rules regarding (i) the entry of foreign investors (e.g. potentially precluding countries from restricting foreign investment at the entry level); (ii) national treatment (e.g. potentially precluding countries from granting subsidies exclusively to domestically owned enterprises);<sup>25</sup> and/or (iii) performance requirements (e.g. potentially constraining policies aimed at generating certain local linkages or ensuring positive spill-overs from foreign investment). A potentially constraining impact may also arise from investment-related provisions in international trade agreements, such as the WTO's Agreement on Trade-Related Investment Measures<sup>26</sup> and the Agreement on Subsidies and Countervailing Measures (box III.6).<sup>27</sup> The actual extent of constraints posed by IIA obligations is hard to anticipate in the abstract, and will depend on the industry, policy and IIA clause at issue.

To avoid creating undue policy constraints, a number of flexibility mechanisms have been developed in some IIAs (*WIR10*), taking, amongst others, the form of exceptions/exclusions to the treaty or of country-specific lists of reservations. Those particularly relevant for industrial policy include:

- Excluding certain industries, such as aviation, fisheries, maritime matters, financial services or cultural industries;
- Excluding certain policies, such as taxation, subsidies, government procurement, or agricultural policies;<sup>28</sup> and/or
- Including general or national security exceptions, which increasingly become relevant in the context of industrial policy (UNCTAD, 2009b).

Certain sectors and industries stand out as ones to which policymakers give particular attention when seeking to preserve space for industrial policy. For example, as revealed by UNCTAD case studies on investment reservations (figure III.6), countries are generally reluctant to accept far-reaching international commitments in the services sector, a trend that has remained broadly unchanged over recent decades.<sup>29</sup> Beyond specific industrial policy considerations a number of other aspects might also come within this context, notably: (i) the generally higher level of regulation (e.g. as a result of the greater scope for market failure in network services); (ii) greater political sensitivities (e.g. regarding the role of private – and foreign – providers in essential services sectors such as education, health and environmental services, including water distribution); (iii) national security concerns (e.g. with respect to strategic services); and (iv) the high level of State ownership (chapter I, section C.2) or governmental scrutiny (e.g. in sectors where monopolistic or oligopolistic market structures prevail) (UNCTAD, 2005, 2006).

Within the services sector, policymakers are inclined to preserve policy space particularly with regard to transportation, finance (e.g. banking and insurance), business/professional services and communication (e.g. postal, courier, telecom and audiovisual services) (figure III.7).<sup>30</sup> While the rationale for doing so may be different in each of the industries (e.g. (i) issues related to cabotage in the case of transport; (ii) issues regarding the integrity and stability of the sector in the case of financial services; and (iii) issues regarding the need to guarantee the supply of public services in the telecommunications sector), the quest for State ownership may also be relevant.

### Box III.6. WTO TRIMS Agreement

The WTO Agreement on Trade-related Investment Measures (TRIMs Agreement) precludes WTO members from adopting certain goods-related performance requirements, such as requirements to use predetermined amounts of locally produced inputs.<sup>a</sup> The TRIMs Agreement therefore directly touches upon measures that traditionally fall within the realm of industrial policy. Moreover, the fact that the TRIMs Agreement applies to both foreign and domestic producers of goods, including agriculture-related goods, and that its list of prohibited measures is indicative rather than exhaustive, may suggest that the Agreement's actual reach may be considerable.

However, it has to be noted that the TRIMs Agreement acknowledges that all exceptions under GATT 1994 shall apply, as appropriate, to its provisions.<sup>b</sup> The Agreement also provides for a temporary exception for developing countries to maintain flexibility in their tariff structure enabling them to grant the tariff protection required for the establishment of a particular industry.<sup>c</sup> Furthermore, TRIMs applies to goods-related policies only and hence does not apply to WTO Members' services-related policies (e.g. local services requirements).

The TRIMs Agreement establishes transparency requirements<sup>d</sup> and an institutional setting, the TRIMs Committee, for discussion and consultation. Several debates in the TRIMs Committee have touched on industrial policies, including China's policies in the automobile and steel sectors<sup>e</sup> or Indonesia's policies in the telecommunications, the mineral/coal and mining sectors.<sup>f</sup>

Prohibitions on performance requirements can also be found in IIAs. A crucial difference, between these IIAs and TRIMs lies in the scope of application: IIAs are typically *narrower* than TRIMs, in so far as they do not restrain governments from regulating domestic investors; they may be *deeper* than TRIMs in so far as they sometimes add additional requirements ("TRIMs +") (e.g. performance requirements for services or intellectual property rights) or do not have TRIMs-type exceptions.

Source: UNCTAD.

<sup>a</sup> TRIMs prohibits trade-related investment measures that are inconsistent with the GATT's provisions on national treatment (Article III of GATT 1994) and quantitative restrictions (Article XI of GATT 1994).

<sup>b</sup> Article 3 of the TRIMs Agreement. "General Exceptions" are contained in Article XX of GATT 1994.

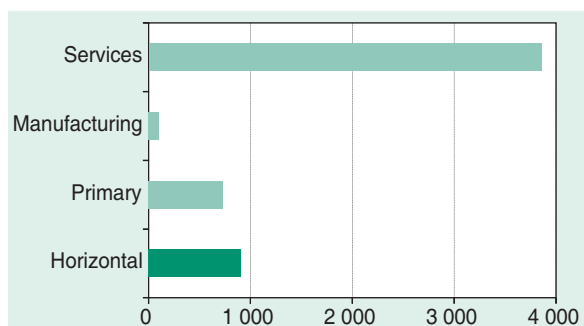
<sup>c</sup> Article 4 of the TRIMs Agreement, and Article XVIII of GATT 1994.

<sup>d</sup> Article 6.2 of the TRIMs Agreement requires each Member to notify the publications in which TRIMs may be found, including those applied by regional and local governments and authorities within their territories.

<sup>e</sup> E.g. the so-called "2+2" regulation, which stipulates that foreign investors cannot set up more than two Sino-foreign joint ventures for the production of passenger cars, and two for commercial vehicles. See G/TRIMS/M/27 and 29, and G/TRIMS/W/55.

<sup>f</sup> E.g. requirements to "prioritize" the utilization of local manpower and domestic goods and services in the mineral and coal mining sectors and to carry out processing and refining of the mining product inside the country. See G/TRIMS/W/70, G/TRIMS/W/71 and G/TRIMS/W/74.

**Figure III.6. Investment-related reservations in IIAs, across sectors**  
(Number of reservations)



Source: UNCTAD, based on IIA database and UNCTAD (2005, 2006). Based on a survey of 16 IIAs.

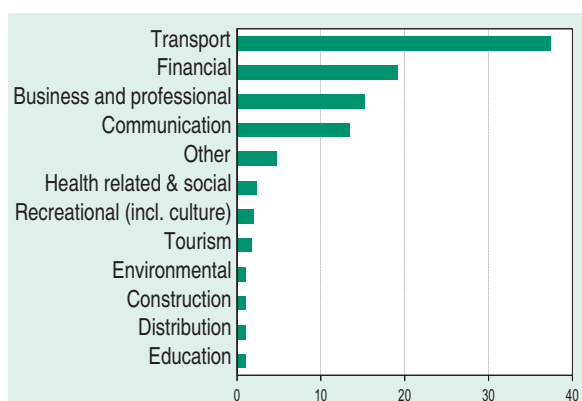
Sometimes, policy space is preserved for specific aspects of investment policy that are closely related to industrial policy. Issues related to subsidies, the nationality of ships, public utilities, State-owned enterprises or land ownership serve as examples.

The salient features characterizing the interaction between FDI policies and industrial policy at the international level correspond to what can be observed at the national level. At both levels, the services sector is much more affected by foreign ownership limitations, compared to manufacturing or primary (e.g. agriculture and forestry) sectors. Moreover, as indicated by figures III.5 (national policies) and III.7 (international policies), the services industries where countries are comparatively more



inclined to preserve regulatory space are similar at the national and international levels. On balance, this suggests that countries aim to consciously manage the interaction between investment and industrial policy, with a view to ensuring coherence at both the national and international levels.

**Figure III.7. Investment-related reservations in IIAs, across services industries**  
(Share of reservations)



Source: UNCTAD, based on IIA database and UNCTAD (2005, 2006). Based on a survey of 16 IIAs.

### 3. Challenges for policymakers

These different kinds of interaction between FDI policy and industrial policy raise a number of important challenges for policymakers to make the two policies work together for development.

#### a. “Picking the winner”

One of the strongest criticisms of industrial policy relates to the difficulty in identifying the “right” industries for promotion (“picking the winner”). This difficulty relates not only to picking “winning industries”, but also to picking “winning firms”; the risk of wasting valuable and scarce resources if support is provided to “losers”; the risk of distorting market mechanisms to the long-term detriment of the economy; and the risk of succumbing to the pressure of lobbying.

Industrial policy can be successful if governments are able to identify those industries or activities which possess existing or latent comparative advantages, and which will thereby benefit from new opportunities arising in a multi-polar growth

world (Lin, 2011). Export-generating choices do not always have the greatest impact on employment and value added; domestic industries, including services, even in developing economies, often account for more than half of value added. Policy tools are needed (a checklist of indicators against which to assess domestic potential), together with institutional mechanisms reducing the risk of governments making the “wrong” choice. Some first suggestions have already been made in this regard (Rodrik, 2004; Lin and Monga, 2010; Lin, 2011). Successful strategies to pick winners also include a readiness to let losers go. Sometimes even the most obvious choices for industrial priorities, seemingly sure winners, will not work out in today’s uncertain economic environment.

#### b. Nurturing the selected industries

The interaction between FDI policies and industrial policy also implies designing the “right” investment promotion instruments. Horizontal policies are the basis, aiming at improving the hard and soft infrastructure of the host country. What is actually needed depends on the type of business activity to be developed, the technology and skills required for it, and the form of TNC involvement (FDI vs. non-equity modes).<sup>31</sup> In countries with poor infrastructure and business environments that are perceived as unfriendly, special investment incentives may be needed to help overcoming barriers to entry. Such incentives may also be required with regard to emerging industries for which a market does not yet exist (e.g renewable energy) or where there is a “first mover” problem, because innovation is a risky process (Lin, 2011).

By focusing on increasing industrial productivity, industrial policy can contribute to strengthening international competitiveness. This underlines the need for close coordination between industrial policy, FDI policy and technology-related policy, so that they are coherent and mutually reinforcing. The dynamic nature of industrial development calls for regular review and adaptation of existing policy instruments. A case in point is recent changes in the international production networks of TNCs, resulting in a stronger emphasis on non-equity modes of international production (chapter IV).

### ***c. Safeguarding policy space***

Managing the interaction between international investment policy and industrial policy implies striking a balance between liberalizing and protecting FDI, while preserving space for the dynamics of industrial policy. This challenge extends to identifying industries and existing/potential future domestic policies, for which flexibilities are most needed; identifying IIA provisions that are particularly likely to impact on industrial policy; and recognising that industrial policy is likely to change over time.

The latter is important in light of the so-called “lock-in” effect, implying that once a commitment is made to open an industry to foreign investment, host countries are bound by it as long as the IIA remains in force.<sup>32</sup> The problem is further exacerbated if pre-establishment treaties contain “rollback” commitments with regard to remaining FDI restrictions, or so-called “ratchet clauses” according to which regulatory changes towards further liberalization are automatically reflected in a country’s commitments under the IIA (UNCTAD, 2006). In response, some selected IIAs establish a procedure for IIA signatories to modify or withdraw commitments in their schedules.<sup>33</sup> In sum, carefully crafting IIA obligations in conjunction with exceptions and reservations can go a long way to concluding IIAs that are conducive to countries’ industrial policy objectives.

### ***d. Avoiding investment protectionism***

The inclusion of elements of investment restrictions within industrial policy has given rise to concerns about investment protectionism. These concerns have grown in the light of the recent financial crisis, as countries may be tempted to protect their domestic industries, to the detriment of foreign competitors.<sup>34</sup>

Achieving a balance between the sovereign right to regulate an industry, and the need to avoid investment protectionism, remains a major policy challenge. It is complicated by the fact that there is no internationally recognized definition of “investment protectionism”. Clarifying the term would require distinguishing between justified and unjustified

reasons to restrict FDI. The motivations for FDI restrictions are manifold and include, for instance, sovereignty or national security concerns, strategic considerations, socio-cultural reasons, prudential policies in financial industries, competition policy, infant industry protection or reciprocity policies. In each case, countries may have very different perceptions of whether and under what conditions such reasons are legitimate.

One initiative to monitor investment protectionism has been taken by the G-20 (section A.3). Since September 2009, following a request from the G-20 London and Pittsburgh Summits, UNCTAD and the OECD have regularly published joint reports on G-20 Investment Measures.<sup>35</sup> Efforts to establish criteria for assessing whether investment restrictions are justified have been undertaken in the context of policy measures relating to national security reasons (OECD, 2009).

### ***e. Improving international coordination***

As more and more countries adopt forms of industrial policy, competition and conflict are bound to intensify and to become more complex. To avoid a global race to the bottom in regulatory standards, or a race to the top in incentives, and to avoid the return of protectionist tendencies, better international coordination is called for (Zhan, 2011). At the global level, such “coordination” is presently essentially limited to the control of certain forms of subsidies in the framework of the WTO Agreement on Subsidies and Countervailing Measures.

Better international coordination of industrial policy can also create important synergies through economies of scale, avoiding “beggar thy neighbour” policies, and strengthening the position of participating countries. Cross-border industrial cooperation can also present solutions in cases where the size, costs and risks of an industrial project are too big for one country alone to implement it. Efforts in this regard have materialized at the regional level, in particular the EU, where the example of the creation of the Airbus industry in the 1970s comes to mind. Other regions, such as ASEAN,<sup>36</sup> ECOWAS<sup>37</sup> and the Members of the Gulf Cooperation Council,<sup>38</sup> also have developed

joint industrial development strategies. Regional industrial policy is further reinforced when there is a common FDI regime among the participants.

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In conclusion, interaction between FDI policies and industrial policies is increasing, nationally and

internationally. Development stages and related strategies differ between countries, and there can be no “one size fits all” solution in dealing with this interaction. The policy challenges are numerous, with some of them being relevant only at the domestic level, while others call for international attention.

## E. CORPORATE SOCIAL RESPONSIBILITY

**The investment policy landscape increasingly includes a combination of voluntary and regulatory initiatives to promote corporate social responsibility standards.**

A further important investment policy development in recent years has been the emergence of corporate social responsibility (CSR) standards.<sup>39</sup> Such standards can be contained in binding “hard law” instruments, such as national laws and regulations, or in voluntary non-binding “soft law” instruments. At present, international CSR standards are almost uniformly voluntary in nature and so exist as a unique dimension of “soft law”. This emergence of CSR has been further reinforced in the post-crisis era, as efforts to rebalance the rights and obligations of the State and the investor have intensified (*WIR10*). CSR standards, though applicable to all types of enterprises, are increasingly significant for international investment, as they typically focus on the operations of TNCs which, through their foreign investments and global value chains, can influence the social and environmental practices of businesses worldwide. Governments can consider a number of practical measures to apply these standards to their investment and enterprise governance mechanisms, with a view to maximizing the development impact of corporate activities.

### 1. Taking stock of existing CSR standards

Over recent years, CSR standards have expanded in both number and form.<sup>40</sup> While it would be difficult to provide an exhaustive account of every such standard and initiative, the universe of CSR

standards can be categorized according to the organization that created them: i) intergovernmental organization standards, derived from universal principles as recognized in international declarations and agreements (three major sets of standards exist); ii) multi-stakeholder initiative (MSI) standards (dozens); iii) industry association codes (hundreds); and iv) individual company codes (thousands). This has resulted in a complex, multi-layered, multifaceted and interconnected universe of standards.

#### a. Intergovernmental organization standards

Universal principles as recognized by international declarations and agreements are the source of the most prominent and authoritative CSR standards. The three main sources of these international instruments are the United Nations, the ILO and the OECD. Three of the leading standards in this category are:

- United Nations declarations and instruments: one of the most prominent examples is the UN Global Compact: launched in 2000, this is an initiative of the UN Secretary General’s office to translate the most relevant UN declarations into 10 guiding principles for enterprises (box III.7).
- ILO conventions and declarations:<sup>41</sup> there are 188 ILO conventions, the most relevant for TNC operations being the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (“MNE Declaration”) (first adopted in 1977, latest revision in 2006)

and the Declaration on Fundamental Principles and Rights at Work (1998) (also known as “Fundamental Labour Standards”).

- The OECD Guidelines on Multinational Enterprises (“OECD Guidelines”) (first edition 1976; latest revision 2011). The 42 adhering governments are fewer in number than the signatories of UN and ILO conventions, but they include large developed economies whose corporations accounted for 70 per cent of FDI in 2010 (chapter I, section A.1).

The standards of the UN and its specialized agencies, including the ILO, along with the Guidelines of the OECD, cover the fundamental issues of CSR. In each of the categories of standards reviewed below, it is common to find references to these major intergovernmental organization standards. In addition to the three most commonly noted standards above, there is a large number of relevant intergovernmental organization standards and conventions emanating from the UN (and its specialized agencies, including the ILO) and the OECD.

### **b. Multi-stakeholder initiative standards**

Multi-stakeholder initiatives (MSIs) are “cross-sectoral partnerships created with a rule-setting purpose, to design and steward standards for

the regulation of market and non-market actors” (Litovsky et al., 2007). These partnerships contain a mix of civil society, business, labour, consumers and other stakeholders. MSI standards most often address non-product-related process and production methods (PPM), i.e. issues related to how a product is produced, such as the environmental or social aspects of certain production methods. Although MSI standards are mostly developed by civil society and business actors, they often make reference to the normative frameworks of international soft law instruments (annex table III.2).

A unique MSI is the International Organization for Standardization (ISO), a non-governmental organization whose members are national standard-setting bodies. ISO standards are widely recognized by international institutions (e.g. the WTO) and national governments. In 2010, ISO launched the ISO 26000 standard “Guidance on Social Responsibility”, which serves as a significant reference point for defining the terms of “social responsibility”.<sup>42</sup>

### **c. Industry association codes and individual company codes**

An industry-specific code typically involves the adoption of a code jointly developed by the leading companies within an industry, to address social and/or environmental aspects of supply chains

## **Box III.7. The 10 principles of the UN Global Compact**

### *Human Rights*

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and Principle 2: make sure that they are not complicit in human rights abuses.

### *Labour Standards*

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;  
Principle 4: the elimination of all forms of forced and compulsory labour;  
Principle 5: the effective abolition of child labour; and  
Principle 6: the elimination of discrimination in respect of employment and occupation.

### *Environment*

Principle 7: Businesses should support a precautionary approach to environmental challenges;  
Principle 8: undertake initiatives to promote greater environmental responsibility; and  
Principle 9: encourage the development and diffusion of environmentally friendly technologies.

### *Anti-Corruption*

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

Source: [www.unglobalcompact.org](http://www.unglobalcompact.org).

and international operations (annex table III.3). There are thousands of individual company codes in existence, and they are especially common among large TNCs: more than three-quarters of large TNCs from both developed and developing countries have policies on social and environmental issues (UNCTAD, 2011e, UNCTAD, 2008c). About half of TNC codes that apply to value chains make reference to one or more intergovernmental organization standards (UNCTAD, forthcoming b).



The universe of voluntary CSR standards consists of a multitude of standards, each differing in terms of source, functions, addressees, and interrelationships, and each yielding influence and impacting on development in different ways. The proliferation of these standards has resulted in a number of systemic challenges related to standard-setting and standard implementation.

## 2. Challenges with existing standards: key issues

### a. Gaps, overlaps and inconsistencies

Gaps between standards exist in terms of subjects covered and industry focus. The OECD Guidelines cover a broad range of responsible business practice, from human rights to taxation. However, they are negotiated by a more limited number of member States, compared to UN and ILO instruments. The ILO MNE Declaration focuses more specifically on employment practices and human rights, but applies to a larger group of member States that are directly addressed, alongside employers, workers and TNCs, to observe the MNE Declaration (OECD-ILO, 2008). Subject matter gaps exist among MSIs, as many standards focus either on the environment or on social issues, but not often to the same extent on both.

An emerging trend among MSIs is the inclusion of social issues within environmental standards.<sup>43</sup> Subject matter gaps can also include standards that focus on specific outcomes (e.g. minimum wage compliance) versus standards that focus on “process rights” (e.g. labour rights). Gaps also exist

in industry focus, with not all industries (or parts of the value chain) being the subject of a standard. While the absence of a standard may reflect a gap that has yet to be filled,<sup>44</sup> it can also represent either an area that does not necessarily require a standard, or where a standard is not considered the most appropriate way to address existing problems.

Gaps also exist in uptake among companies: as uptake is driven by the concerns of consumers, media, and investors, CSR standards are primarily adopted by those companies that are most exposed to such concerns (Utting, 2002). While the adoption of standards by large TNCs can create a cascade effect that pushes sustainability across the value chain, this does not necessarily have a uniform impact on all members. Indeed there may be a tendency for some standards to favour concentration at different levels and to crowd out small enterprises and producers (Reed, Utting and Mukherjee-Reed, 2011). Nevertheless, as leading firms adopt and implement CSR standards, they set a benchmark for best practice against which other firms are measured.

Among individual company standards, there can be both a high degree of overlap in the issues covered (e.g. labour practices, environment, human rights, bribery), and a high degree of inconsistency in detailed operational guidelines. As most companies refer to major intergovernmental organization standards for key issues, this reduces inconsistencies in the general subjects covered, but since many intergovernmental organization standards lack detailed micro-level operational guidance, companies are left to innovate these details themselves. The resulting inconsistencies mean that suppliers can be faced with differing requirements, adding complexity and higher compliance costs. The rise of industry-specific standards can help to alleviate this situation.

In some industries, more than one MSI or industry association standard exists. This can cause confusion among companies, often leading them to opt for multiple certifications to ensure that all relevant issues have been addressed. MSIs are increasingly working together towards alignment between standards that address the same subject or the same industry.<sup>45</sup>

### ***b. Inclusiveness in standard-setting***

The credibility of a standard is linked to the inclusion of a sufficiently broad range of stakeholders in the standard-setting process. Company codes and industry association codes are often challenged as being less credible because of the limited involvement of outside stakeholders. The intergovernmental organizations are perceived as authoritative standard-setters because they reflect international consensus. The popularity of MSI standards is due largely to their inclusive cross-sectoral process. Addressing the challenge of inclusiveness also means addressing the often limited participation of developing country stakeholders in CSR standard-setting processes, which arises out of resource constraints.

### ***c. Relationship between voluntary CSR standards and national legislation***

Voluntary CSR standards can complement government regulatory efforts; however, where they are promoted as a substitute for labour, social and environmental protection legislation, or where CSR standards are not based on national or international rules, then these voluntary standards can potentially undermine, substitute or distract from governmental regulatory efforts. Critics of voluntary standards have pointed out, for example, the contrast in the United States between legally required safety inspections of the Trans-Alaska Pipeline, and voluntary commitments from companies to ensure the safety of feeder pipelines; they note that the oil company BP only discovered severe problems with its feeder pipelines after it was required by the United States Government to undertake inspections, following a spill of over a quarter of a million barrels of oil (Reich, 2007).

### ***d. Reporting and transparency***

Despite tremendous growth in CSR reporting in recent years among TNCs of developed and developing countries, such reporting continues to lack uniformity, standardization and comparability. A number of initiatives promote a standardized CSR reporting framework, including UNCTAD's

Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR)<sup>46</sup> and several MSIs (e.g. the Global Reporting Initiative (GRI), the Carbon Disclosure Standards Board, and the International Integrated Reporting Committee). While uptake of such frameworks among companies is growing rapidly, it nevertheless remains relatively low<sup>47</sup> and even among companies adopting a voluntary CSR reporting framework, implementation of the framework can be selective and incomplete.

The reporting of MSIs and industry associations also raises transparency issues that make it difficult for stakeholders to evaluate and compare the performance of different initiatives. Some initiatives, however, have started to implement reporting programmes: the Fair Labour Association publishes an annual report and discloses information about the progress made by the companies that have adopted its standard. Some MSIs (e.g. Fair Wear Association) have created a reporting framework for companies adopting their standards.

### ***e. Compliance and market impact***

A critical challenge is to ensure that companies voluntarily adopting a standard actually comply with the standard. Failure to demonstrate compliance can lower the standard's credibility and market impact.<sup>48</sup> The compliance promotion mechanisms embodied in existing CSR standards range from none, to reporting requirements and redress mechanisms, to proactive mechanisms such as audits, factory inspections, etc. (table III.4). The major intergovernmental organization standards contain compliance mechanisms, including the UN Global Compact (the "integrity measures" and the "communication on progress"), the ILO MNE Declaration (the "interpretation procedure"), and the OECD Guidelines ("the specific instance procedures" and the system of "National Contact Points"). MSI standards and industry association standards often have certification or accreditation programmes which typically include inspections/audits, corrective action programmes, reporting and consumer labelling schemes. To enhance credibility, many MSIs have separated their standards-setting process from the certification process, relying increasingly on professionalized third parties for the

monitoring and auditing processes.<sup>49</sup> The dynamic nature of the field of CSR standards also includes significant practices of “ratcheting-up” compliance mechanisms over time, e.g. adding new standards, tightening up inspection procedures, adding complaints procedures.

While compliance promotion mechanisms can be an integral part of a standard, they can also be associated to a standard by third parties. As noted above, many intergovernmental organization standards are key references for some of the certifiable standards of the MSI. In this way, company compliance with “soft law” intergovernmental organization standards can be driven by other CSR standards with proactive compliance mechanisms.

A challenge associated with certification schemes and audits is that they may impose a higher burden on companies, and thus lead to lower rates of adoption of the standard, and reduced market impact. Conversely, a lack of compliance mechanisms can lead to high rates of voluntary adoption of the standard, but low, unclear and/or immeasurable rates of implementation. However, a number of MSI and industry association codes employ proactive compliance mechanisms and are nonetheless having a significant impact, with some influencing more than half of the global market for the industry in question (table III.5).

**Table III.4. Compliance mechanisms of selected international CSR standards**

Source of standard	Proactive mechanisms (audits, inspections)	Reporting requirements/redress mechanisms	No formal compliance mechanisms
Inter-governmental Organization	-	<ul style="list-style-type: none"> <li>UN Global Compact</li> <li>OECD Guidelines</li> <li>ILO Tripartite Declaration</li> </ul>	-
Multi-stakeholder/NGO	<ul style="list-style-type: none"> <li>ISO14000</li> <li>MSC</li> <li>FSC</li> <li>FLA RSPO</li> <li>SA8000</li> <li>4C Assoc.</li> </ul>	-	<ul style="list-style-type: none"> <li>ISO 26000</li> <li>GRI</li> </ul>
Company/Industry association	<ul style="list-style-type: none"> <li>C.A.F.E. Practices</li> <li>Leather Working Group</li> <li>BSCI</li> <li>International Council of Toy Industries</li> </ul>	-	<ul style="list-style-type: none"> <li>EICC</li> <li>Pharmaceutical Industry Principles for Responsible Supply Chain Management</li> </ul>

Source: UNCTAD.

With global market shares ranging between 5 and 10 per cent for some standards (such as the Marine Stewardship Council (MSC) and the Forest Stewardship Council (FSC)), the “proof of concept” phase has been passed; the challenge now is how to achieve widespread uptake of these standards. This is particularly so in highly fragmented industries, where adoption by many companies would be required to cover a large market share. In less fragmented industries, even individual company codes can have a significant impact (table III.5).

#### **f. Concerns about possible trade and investment barriers**

There are unresolved questions about whether social and environmental standards, especially non-product-related PPM standards, could potentially become barriers to trade and investment. It is not clear under WTO rules whether non-product PPM standards are covered by the WTO’s Technical Barriers to Trade (TBT) agreement or other WTO agreements (e.g. sanitary and phytosanitary measures; Agreement on Government Procurement). Outside of the TBT agreement, there was the “shrimp-turtle” case from the late 1990s, where environmental regulations in the United States led to an import ban for shrimp-exporting countries that did not use turtle-safe harvesting practices (which had already been introduced by the United States fishing industry on the basis of consumer demands).<sup>50</sup>

Similarly, it is possible for CSR standards to create barriers to (inward and outward) investment for companies that are unable to meet the requirements of the standards. In Guatemala, for example, forestry companies without FSC certification are prohibited from operating within the Mayan Biosphere reserve (FSC, 2009), and in Denmark, only companies meeting the Government’s CSR standard qualify for outward investment assistance. In both cases, the challenge is to distinguish where the use of a standard constitutes a legitimate application, and where it constitutes an abuse of protectionist intent. For example, the use of CSR standards can become a form of protectionism if they are applied in a discriminatory way, differentiating between companies by national origin. It is important therefore to monitor the application of CSR standards and to

identify discriminatory practices where they arise.

Voluntary CSR standards may be less susceptible to challenge through WTO trade agreements, and less prone to questions of investment protectionism, since there is no requirement that firms must follow them. For example, a voluntary standard pertaining to organic foods gives firms the option of using the approach adopted in the

standard, but does not require that firms use this standard as a condition of market entry. In this way, voluntary CSR standards may be less problematic than mandatory requirements, in terms of achieving public policy objectives (Webb and Morrison, 2004). That said, voluntary standards alone can create a risk of neglect and indifference on the part of firms. The balance between mandatory

**Table III.5. Impact of selected MSI and industry association CSR standards and individual company codes**

Standard	Compliance mechanisms		Market impact
	Certification/Audits	Public reporting	
<b>Multi-stakeholder initiative standards</b>			
Forest Stewardship Council (1993)	Yes	Annual Report, Audit Results	Covers 11% of global forests used for productive activities
ISO14001 (1996)	Yes	Annual Report	As of December 2009, 223,149 organizations in 159 countries are certified to ISO 14000
SA8000 (1997)	Yes	Annual Report	Over 1.4 million workers are employed in over 2,400 SA8000 certified facilities in 65 countries, across 66 industrial sectors
Marine Stewardship Council (1997)	Yes	Annual Report, Audit Results	Covers 6% of global landed fish
Fair Labor Association (1998)	Yes	Annual Report, Audit Results	Covers 75% of the athletic footwear industry
Fair Wear Foundation (1999)	Yes	Annual Report Audit Results	FWF affiliates in 2009 sourced from a total of 1,153 factories, with an estimated total of 300,000 workers (growth rate of 60% in the last 3 years)
UTZ CERTIFIED (1999)	Yes	Annual Report	Covers 5% of global coffee production
4C Association (2004)	Yes	Annual Report with performance data of member companies	Covers 30% of global coffee production
Roundtable on Sustainable Palm Oil (2004)	Yes	Audit Results	Covers 8% of global palm oil production
<b>Industry association codes</b>			
Business Social Compliance Initiative (BSCI) Code of Conduct (2002)	Yes	Annual Report	11,200 suppliers audited according to the BSCI code of conduct and 4,000 suppliers trained in 9 different countries
International Council of Toy Industries (ICTI) Code of Conduct (2004)	Yes	Biennial Report	75% of the global toy business is committed to only source from suppliers certified by ICTI in the future
Leather Working Group Principles (2005)	Yes	No	The working group covers 10% of the global leather production
<b>Individual company codes</b>			
Nike Supplier code of conduct	Yes	Yes	31% of the global market for athletic footwear; through its supplier code of conduct Nike influences the conditions of more than 800,000 employees in 700 factories in 45 countries
Adidas Supplier code of conduct	Yes	Yes	22% of the global market for athletic footwear; through its supplier code of conduct Adidas influences the conditions of more than 775,000 employees in 1,200 factories in 65 countries

Source: UNCTAD, based on data from MSI, industry associations, companies and FAO.



and voluntary standards is delicate, but legitimate restrictions based on objective criteria of necessity and proportionality are permitted under trade and investment agreements.<sup>51</sup> Equally, the State's right to regulate may create legitimate restrictions on investors and their investments in the interests of public policy and economic development.<sup>52</sup> Thus the challenge is to maintain an appropriate balance between mandatory and voluntary standards.

### 3. Policy options

Governments can play an important role in creating a coherent policy and institutional framework to address the challenges and opportunities presented by the universe of CSR standards. In this regard, some governments are beginning to apply CSR standards to the architecture of corporate governance and international trade and investment. This approach aims to promote best practice in corporate compliance with national laws and international agreements in order to maximize the sustainable development impact of TNCs. A number of policy options follow.

#### *a. Supporting CSR standards development*

Governments can encourage and support the development of CSR standards, including through the provision of material support, technical expertise, and mobilizing the participation of relevant stakeholders (Vermeulen et al., 2010). For example, the 4C Association is a sustainability standard for the coffee industry, initiated by the Government of Germany and implemented by the German development agency. With support from the Government of Switzerland and other public and private sector representatives, the 4C Association has become an influential industry standard.

Governments can support the development of national certifiable management system standards (MSSs). This approach provides enterprises with a certifiable standard to distinguish themselves in the area of CSR. Recent years have seen the creation of a number of national CSR MSSs, including standards in Brazil and Mexico in 2004, Portugal in 2008, Spain in 2009, and the Netherlands and Denmark in 2010. In some cases these national

MSSs are based on or aligned with ISO standards. As national CSR MSSs proliferate, there may be increased interest in an international CSR MSS.<sup>53</sup>

#### *b. Applying CSR to public procurement policy*

Governments can consider applying CSR standards to their purchasing policies, to promote good business practices on more environmentally friendly products, while being careful to avoid discriminatory practices that would be a form of protectionism. The Government of China, for instance, maintains a "green list" of environmentally friendly products which should be given preferential treatment in public procurement.<sup>54</sup> The Government of Germany has made a commitment to purchase only wood and wood products that are verified as coming from legal and sustainable sources, and accepts the FSC certification as verification of this. The Netherlands also has a sustainable procurement policy; the Government of Switzerland is in the process of developing such a scheme; and the Government of the United Kingdom has laid out a strategy ("Government Sustainable Procurement Action Plan") and has already committed to source fish for its public institutions (e.g. schools) exclusively from MSC-certified suppliers. While applying CSR standards to procurement policies can help promote the uptake of such standards by companies, it can also negatively effect the competitive position, and hence operations, of companies – especially those from poorer countries – that have limited capacity to adhere to such standards.

#### *c. Building capacity*

One factor that can lead to low uptake of standards is a lack of knowledge, skills and capabilities at various stages of a value chain. Thus, implementation of standards often requires a capacity-building component. This is part of creating "shared responsibility" within a value chain (which involves TNCs providing assistance to suppliers), as opposed to what critics call "off-loading responsibility" (wherein the compliance burden falls solely on developing country suppliers that may have little capacity for meeting CSR standards).

Developing country governments wishing to promote standards in their countries can partner with donor States to deliver capacity-building initiatives and technical assistance to local industry and regulatory bodies. A project between the Government of Bolivia and USAID, for example, promotes FSC certification in the Bolivian forestry industry. This has included capacity-building for companies that are willing to be certified, and assistance linking certified companies with export markets. As a result of this programme, Bolivia now has the largest area of FSC-certified tropical forest in the world (FSC, 2009). In Gambia, the Ministry of Fisheries works in partnership with USAID to obtain MSC certification for the country's fisheries (USAID, 2010). Governments can further strengthen CSR capacity-building by engaging in the exchange of best practice at international forums, such as UNCTAD.

#### ***d. Promoting CSR disclosure and responsible investment***

To enhance transparency and comparability of CSR practices, a number of stock exchanges – especially in emerging markets – have employed stock exchange listing rules to promote the uptake of CSR reporting to facilitate responsible investment practices (Responsible Research, 2010). In close cooperation with national policymakers, the Malaysian stock exchange, for example, has made CSR reporting mandatory for all listed companies, and the Shanghai Stock Exchange in China has published the Shanghai Environmental Disclosure Guidelines, with which listed companies are urged to comply.<sup>55</sup>

An alternative to developing a national CSR reporting framework is to adopt an existing framework developed by an international initiative. The Johannesburg Stock Exchange in South Africa, for example, requires companies to use the GRI guidelines in preparing sustainability reports. Using a common framework like this can promote international comparability between reports. Policymakers interested in promoting an internationally harmonized approach to CSR reporting and encouraging responsible investment, including in the area of “impact investing” (box III.8), can work together through forums such

as UNCTAD's ISAR working group<sup>56</sup> and/or the Sustainable Stock Exchanges initiative.<sup>57</sup>

#### ***e. Moving from soft law to hard law***

Governments can consider adopting some of the existing CSR standards as part of regulatory initiatives, turning hitherto voluntary standards (soft law) into mandatory requirements (hard law). For example, organic food standards originated in most countries as voluntary standards from civil society or industry associations, but today are usually regulated under national legislation.<sup>58</sup> This model allows governments to use the dynamic space of voluntary standards as a laboratory for future government regulations.

Another option is a mixed “public–private regulatory regime”, wherein regulatory initiatives ensure compliance with standards developed by civil society and/or the private sector. In Sweden, for example, State-owned enterprises are required to prepare reports using the GRI standard. In Guatemala, the Government has made FSC certification mandatory for forestry firms operating in the Mayan Biosphere reserve. This approach can be useful for preserving the dynamism and aspirational nature of many multi-stakeholder standard-setting processes, while adding uniformity of implementation through regulation.

#### ***f. Strengthening compliance promotion mechanisms among intergovernmental organization standards***

Governments could consider further strengthening the compliance promotion mechanisms of existing intergovernmental organization standards. As noted above, many intergovernmental organization standards already have some compliance promotion mechanisms in place. These organizations periodically review the efficacy of such instruments, including their redress mechanisms. In the case of the UN Global Compact, for example, the UN Joint Inspections Unit recently recommended that the UN “reinforce the implementation of the Integrity Measures and accountability in implementing the ten principles” (UN JIU, 2010).

### ***g. Applying CSR to investment and trade promotion and enterprise development***

Governments could play an active role in promoting socially and environmentally sustainable inward and outward investment, while avoiding discriminatory practices that would be a form of protectionism. Governments can consider offering incentives for investments in sustainable industries (e.g. renewable energy) or for compliance with CSR standards. For example, the Brazilian National Economic Development Bank has introduced a code of ethics, based on intergovernmental organization standards, to which all of its clients must adhere. Similarly, the Government of Denmark requires companies receiving financial support from the Danish Industrialization Fund for Developing Countries (IFU) to comply with IFU's CSR policy. Some governments are also providing incentives through preferential trade agreements. For instance,

the European Union has complemented its General System of Preferences (GSP) with the "GSP Plus" scheme, which offers additional tariff reductions for developing countries that have ratified and implemented 27 key international conventions related to CSR practices (e.g. the ILO Core Conventions).<sup>59</sup> Care has to be taken, however, to ensure that those countries that do not a priori fulfill the criteria receive the required technical assistance in order to do so, and hence may benefit from such initiatives, in line with their overall development priorities and strategies.

### ***h. Introducing CSR into the international investment regime***

Governments can also consider introducing CSR into the international investment regime. While CSR-specific clauses do not currently feature prominently in IIAs, a small but growing number of agreements,

#### **Box III.8. Impact investing: achieving competitive financial returns while maximizing social and environmental impact**

Over time, responsible investment has become a multitrillion dollar industry. Responsible investing has various themes. It can be focused on negative screens that prohibit investment in firms that manufacture or promote certain products and services. It can also be focused on shareholder advocacy and positive environmental, social and governance (ESG) screens, to target investment in particular companies. "Impact investing" takes this a step further. It is the explicit incorporation of social, environmental and developmental objectives into the fabric of business and financial models. It is based on the fundamental belief that it is possible for investors to achieve competitive financial returns and social change simultaneously.

The potential range of impact investment opportunities remains largely unknown. Analysts estimate that impact investments could reach between \$500 billion and several trillions over the next decade. To illustrate the magnitude of opportunities in impact investing, a few examples are given below.

To address climate change, the International Energy Agency estimates that \$1.3 trillion in investment will be required to halve greenhouse gas emissions from the energy sector by 2050. Another \$41 trillion is needed by 2030 to modernize infrastructure systems worldwide. Water infrastructure, at \$23 trillion, is the largest portion of this investment. McGraw Hill Construction estimates that the green building market will more than double worldwide to between \$96 and \$140 billion by 2013. Further, according to the World Resources Institute, the 4 billion people with annual incomes below \$3,000 constitute a \$5 trillion global consumer market. Moreover, the 1.4 billion people with per capita incomes between \$3,000 and \$20,000 represent an even larger \$12.5 trillion market globally.

Despite the enormous potential of impact investing, there are critical gaps in understanding the market conditions necessary for success, together with inadequate policy and regulatory frameworks, and limited knowledge of financial models that sufficiently incorporate environmental, social and developmental factors into valuations and alpha forecasts.

Through its "20ii – Investing with Impact" initiative, the United States Department of State will work with UNCTAD, the OECD, and other institutions to address these gaps and galvanize sources of private capital to tackle high priority social and environmental challenges.

*Source:* Contributed by the United States Department of State, in collaboration with Harvard University's Initiative for Responsible Investment.

especially recent FTAs with investment chapters, include such provisions. While this process has its origins in the mid-1990s,<sup>60</sup> specific references to CSR started appearing more recently. Today, three Canadian FTAs with investment provisions<sup>61</sup> refer to CSR in the preamble and contain substantive provisions. For example, Article 816 of the Canada-Colombia FTA, the earliest of these references, states that:

“each Party should encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their internal policies, such as statements of principle that have been endorsed or are supported by the Parties. These principles address issues such as labour, the environment, human rights, community relations and anti-corruption. The Parties remind those enterprises of the importance of incorporating such corporate social responsibility standards in their internal policies.”

In addition, the preambles of the European Free Trade Association’s 2009 FTA with Albania and 2010 FTA with Peru refer to CSR-related issues.<sup>62</sup> While BITs by EU member States do not include CSR clauses, the European Parliament has called for the inclusion of a CSR clause in every future FTA investment chapter concluded by the EU.<sup>63</sup>

Finally, a few countries have included innovative CSR provisions in their model agreements, referring to specific corporate contributions, such as human capital formation, local capacity-building, employment creation, training and transfer of technology.<sup>64</sup> However, the implementation of CSR provisions in “real” IIAs remains to be seen.

While it is difficult to assess their impact on conditions “on the ground”, such clauses nevertheless serve to flag the importance of CSR in investor–State relations, which may also influence the interpretation of IIA clauses by tribunals in investor–State dispute settlement cases, and create linkages between IIAs and international CSR standards. Again, care has to be taken to ensure that increasing consideration of CSR does not open the door to justifying policy interventions with undue protectionist purposes.

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Governments have a range of policy options for promoting CSR. Pioneering examples in both developing and developed countries suggest that it is time to mainstream CSR into national policies and international trade and investment regimes, while devising mechanisms for addressing unintended consequences and preventing possible protectionist abuses. While there are a number of policy implications, the various approaches already underway are increasingly taking the form of a combination of regulatory and voluntary instruments that work together to promote responsible business practices. Two critical components of this mix will be improved CSR reporting by companies (to better inform future policy development), and strengthened capacity-building programmes (to assist developing country enterprises to meet international best practice in this area).

## Notes

- <sup>1</sup> The Basel III rules were issued by the Basel Committee on 16 December 2010. A gradual schedule for the implementation of these rules will start in 2013 and should be fully phased in by January 2019. At the Seoul Summit in November 2010, G-20 leaders endorsed these and other recommendations to strengthen financial stability.
- <sup>2</sup> Bank for International Settlements (2010) “Basel III rules text and results of the quantitative impact study issued by the Basel Committee”. Available at: [www.bis.org](http://www.bis.org).
- <sup>3</sup> For further information see the UNCTAD-OECD Fifth Report on G-20 Investment Measures (2011).
- <sup>4</sup> E.g. British bank Bradford & Bingley was sold to a Spanish bank, United States automaker GM, then majority-controlled by the United States Government, sold its Swedish subsidiary Saab to a Dutch/Austrian company, and United States Government co-owned Chrysler was partly sold to Italian automaker Fiat.
- <sup>5</sup> The European Commission conducted consultation using “Questionnaire on the application of the Temporary Framework”, from 18 March 2010 to 26 April 2010.
- <sup>6</sup> Twenty of the 2010 BITs were renegotiated, including seven by the Czech Republic, in an effort to bring its IIAs into conformity with EU law.
- <sup>7</sup> This includes DTTs on “income” and “income and capital”.
- <sup>8</sup> This includes, e.g., free trade agreements (FTAs), economic partnership agreements (EPAs) or framework agreements.

- <sup>9</sup> The first category of “other IIAs” is those that contain substantive investment provisions, such as national treatment, most favoured nation (MFN) treatment, fair and equitable treatment (FET), protection in case of expropriation, transfer of funds and investor–State dispute settlement (ISDS) (*WIR10*).
- <sup>10</sup> The second category focuses more on granting market access to foreign investors than on protecting investments once they are made (*WIR10*).
- <sup>11</sup> The third category of IIAs are agreements dealing with investment cooperation (*WIR10*).
- <sup>12</sup> Since most arbitration forums do not maintain a public registry of claims, the total number of actual treaty-based cases could be higher. UNCTAD, 2011c and UNCTAD’s database on investor–State dispute settlement cases (available at [www.unctad.org/ia](http://www.unctad.org/ia)).
- <sup>13</sup> This includes 20 awards, five decisions on liability, 11 decisions on jurisdiction, and 11 other decisions.
- <sup>14</sup> This includes all post-establishment IIAs, including those that are only signed but not yet ratified. Treaties that offer post-establishment national treatment only, but no other typical protection provisions such as those on expropriation or ISDS (e.g. some of the EU treaties), are excluded. If individual treaty exclusions and reservations are taken into consideration a more nuanced picture would emerge. Multilateral investment-protection related agreements such as the TRIMs, and sector-specific agreements such as the Energy Charter Treaty are excluded, as well as DTTs.
- <sup>15</sup> See “The G-20 Seoul Summit Declaration” and “Annexes”, 11–12 November 2010.
- <sup>16</sup> At the Toronto summit on 26–27 June 2010, the G-20 leaders had agreed that “Narrowing the development gap and reducing poverty are integral to our broader objective of achieving strong, sustainable and balanced growth and ensuring a more robust and resilient global economy for all.”
- <sup>17</sup> For China, see <http://works.bepress.com> and [www.chinalawinsight.com](http://www.chinalawinsight.com); for India see [business. http://mapsofindia.com](http://business.mapsofindia.com), <http://business.mapsofindia.com> and [www.indiaground.com](http://www.indiaground.com).
- <sup>18</sup> For the Republic of Korea, see Foreign Investment Committee, “FDI Promotion Policy in 2011”, endorsed and published on 31 January 2011. For Malaysia see [www.mida.gov.my](http://www.mida.gov.my); for Thailand, see [www.boi.go.th](http://www.boi.go.th).
- <sup>19</sup> Other examples are the University of the Philippines Science Technology Park – joint venture between the university and private sector to establish an incubation centre for hi-tech projects, the “Technology Park Malaysia” – centre for research and development for knowledge-based industries, and Shenzhen Economic Zone.
- <sup>20</sup> Other examples include the “Ontario Technology Corridor” and the “Illinois Research & Development Corridor”.
- <sup>21</sup> Examples are the “Aurora Pacific Economic Zone” in the Philippines to utilize wind power and solar cells for energy and fresh water springs for potable water, and the “Saemangeum Gunsan Free Economic Zone” in the Republic of Korea.
- <sup>22</sup> Examples of “hard” infrastructure are power, transport, telecommunication systems, health facilities and test bed facilities for R&D. “Soft” infrastructure includes the financial system and regulation, the education system, the legal framework, social networks, values and other intangible structures in an economy.
- <sup>23</sup> The World Bank IAB 2010 report surveyed sectors with restricted entry for foreign investors for 87 countries, including 14 developed countries, 57 developing countries and 16 transition economies. The number of countries with data for specific sectors is: health care 86, telecoms 84, electricity 83, transport 80 and for all other industries 85 countries. Finance is a combination of banking and insurance from the original WB report and the share represents those countries that allow only less than full ownership for at least one of these sectors.
- <sup>24</sup> E.g. institutional mechanisms, financial or fiscal incentives.
- <sup>25</sup> The actual impact of the national treatment clause depends on its specific formulation, notably whether it contains the qualification of only applying to investments/investors “in like circumstances”.
- <sup>26</sup> For example, by requiring the use of local services or mandating technology transfer.
- <sup>27</sup> For example, the SCM Agreement disciplines the use of certain subsidies (e.g. by prohibiting subsidies that require recipients to meet certain export targets, or to use domestic goods instead of imported goods).
- <sup>28</sup> Some of the provisions refer explicitly to the industrial-policy related objectives of the subsidy in question, such as training or employing workers, or providing a service, locating production, constructing/expanding particular facilities, or carrying out research and development in a particular territory.
- <sup>29</sup> Case studies were conducted for 16 IIAs, including the OECD National Treatment Instrument (1991), NAFTA (1992), G3 (1994), Mercosur (1994), Canada-Chile FTA (1996), draft OECD Multilateral Agreement on Investment (1998, but never concluded), Andean Community (2001) and the Chile-United States FTA (2003), CAFTA (2004), Panama-Singapore FTA (2005), United States-Uruguay BIT (2005), Canada-Peru BIT (2006), Rwanda-United States BIT (2007), Japan-Peru BIT (2009), Japan-Uzbekistan BIT (2009) and Japan-India FTA (2011). For further details on the eight earlier IIAs see UNCTAD, 2006.
- <sup>30</sup> Of interest is also the social services sector, where reservations have, over time, become

more frequent. An increasing consciousness of the pros and cons of submitting social services to international obligations, and experiences with ISDS touching upon essential services or social considerations, might have contributed to this development.

<sup>31</sup> See also chapter IV.

<sup>32</sup> The risks of the lock-in effect are particularly pronounced with regard to liberalization commitments based on a “top-down/negative list” approach. See UNCTAD, 2006.

<sup>33</sup> For example, the WTO’s General Agreement on Trade in Services (GATS), and the draft Norwegian model BIT (2007).

<sup>34</sup> See the WTO-OECD-UNCTAD Reports on G-20 Investment Measures (WTO-OECD-UNCTAD, 2009 and 2010; OECD-UNCTAD 2010a, 2010b and 2011).

<sup>35</sup> Ibid.

<sup>36</sup> ASEAN Secretariat (2003), “What is AICo?”, available at [www.asean.org/6402.htm](http://www.asean.org/6402.htm).

<sup>37</sup> ECOWAS (2010) “West African Common Industrial Policy (WACIP)”.

<sup>38</sup> Gulf Cooperation Council (2000) “Unified Industrial Developments Strategy for the Arab States of the Gulf Cooperation Council”.

<sup>39</sup> The text in this section is based partially on UNCTAD’s contribution to a recent G-20 document on “Promoting standards for responsible investment in value chains”, which also benefited from comments by UNDP, ILO, OECD and the World Bank, and the Governments of Germany and Saudi Arabia. See report to the G-20 High-Level Development Working Group, June 2011.

<sup>40</sup> Among others, the governments of the G-8 and the G-20 have taken a strong interest in CSR standards in recent years, focusing on promoting dissemination, adoption and compliance. See G-8 Leaders Declaration: Responsible Leadership for a Sustainable Future, 2009 (para. 53) and G-20 Multi-Year Action Plan on Development, 2010 (page 5).

<sup>41</sup> The ILO is a specialized agency of the UN. It is unique among UN agencies in that it has a “tripartite” governance structure, involving representatives of governments, employers and employees.

<sup>42</sup> See [www.iso.org/iso/social\\_responsibility](http://www.iso.org/iso/social_responsibility).

<sup>43</sup> For example the Forest Stewardship Council (FSC).

<sup>44</sup> There are a number of standards still emerging in new areas, e.g. sustainable meat production and conflict minerals.

<sup>45</sup> The 4C Association and the Rainforest Alliance for example have created a translation mechanism between each other’s standards, such that Rainforest Alliance certificate-holders can now apply for the 4C Licence without having to go through the entire 4C Verification Process.

<sup>46</sup> See [www.unctad.org/isar](http://www.unctad.org/isar) for more information.

<sup>47</sup> The most popular and comprehensive CSR reporting framework is that of the GRI, which in 2010 was used by approximately 1,800 corporations.

<sup>48</sup> Impact assessment of CSR standards is critically important. While various efforts are underway (e.g. the Committee on Sustainability Assessment), there is no consensus approach. UNCTAD currently uses an industry-level analysis examining factors such as the market share of the companies using the standard or the number of enterprises or workers influenced by the standard.

<sup>49</sup> For example ISO, MSC, FSC and UTZ, among others, use third party certification.

<sup>50</sup> WTO cases No. 58 and 61.

<sup>51</sup> See GATT 1994, e.g. GATS 1994 Art.XIV, Canada model BIT Art.10.

<sup>52</sup> See further *WIR03*.

<sup>53</sup> Note that ISO 2600 is not an MSS, rather it is a guidance standard, and not intended for certification.

<sup>54</sup> See Ministry of Finance and State Environmental Protection Agency: Implementation Guidance on Public Procurement Based on Environmentally Labeled Products. [www.cccp.gov.cn](http://www.cccp.gov.cn) (Chinese language).

<sup>55</sup> See [www.world-exchanges.org](http://www.world-exchanges.org).

<sup>56</sup> For more information, see [www.unctad.org/isar](http://www.unctad.org/isar).

<sup>57</sup> For more information, see [www.unpri.org](http://www.unpri.org).

<sup>58</sup> EU policy on organic farming: <http://ec.europa.eu/agriculture>.

<sup>59</sup> See [www.europa-eu-un.org](http://www.europa-eu-un.org).

<sup>60</sup> See references to environmental and labour considerations (e.g. NAFTA preamble) and a recognition that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures (e.g. NAFTA investment chapter).

<sup>61</sup> These are Canada’s FTAs with Colombia (2008), Peru (2009), and Panama (2010).

<sup>62</sup> There are references to responsible corporate conduct and ILO Conventions in the former, and references to good corporate governance, corporate governance standards of the United Nations Global Compact and relevant ILO Conventions in the latter.

<sup>63</sup> On 6 April 2011, the European Parliament adopted its Resolution on the future European international investment policy, INI/2010/2203.

<sup>64</sup> For example, in Art. 12, Ghana’s model BIT (2008) states that foreign investors “shall to the extent possible, encourage human capital formation, local capacity building through close cooperation with the local community, create employment opportunities and facilitate training opportunities for employees, and the transfer of technology”. See also Art. 11, Botswana’s model BIT (2008).