IISD COMMENTS ON THE DRAFT OECD POLICY FRAMEWORK FOR INVESTMENT

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Introductory Comments

The OECD Investment Committee has published a draft Policy Framework for Investment for public comment. The International Institute for Sustainable Development (IISD) has reviewed the draft Framework and considered how best to respond to it. In the end, we believe that it is far more important to comment on the "big picture" issues than to focus on the details.

There are two major reasons for this approach. The first is that we have reviewed the NGO letter to the OECD, which is attached here as an annex for the convenience of readers. We agree fully with the thrust of this letter, and support it on this basis. The letter also enumerates a large number of details as illustrations of the flaws it points to. We feel no need to reiterate such an itemized list here.

Second, the major flaws of the draft Framework need to be understood, we believe, in and of themselves. We simply do not believe that parsing through the multitude of questions posed in the guise of neutral issues and answers subsequently provided from a singularly investor-oriented approach will accomplish much. It is, rather this very approach that lies at the root of the problem.

Thus, the IISD comments below fall into three more general categories:

- the failed assumptions that appear to lie behind the draft Framework;
- the flawed toolbox chosen to address these assumptions; and
- separation of governmental and business roles, rights and responsibilities that has outlived its utility from a sustainable development perspective.

Prior to entering into the discussion of these concerns, it is important to note that IISD has long been on record for noting the importance of investment – domestic and foreign – for sustainable development. Indeed, we have long considered that the only viable means to achieve sustainable development is through vastly increased levels of investments, in particular in developing and least developed countries. But for such investments to achieve their goals from a societal perspective, i.e. sustainable development and poverty alleviation, new thinking that ensures investments respond to these imperatives rather than merely hoping that they might must be incorporated into the international investment law and policy regime. The draft OECD Framework, in our opinion, utterly fails to achieve any such new thinking.

Finally, we wish to note that IISD's comments are based on our fifteen years of activity on sustainable development, and our eight year old programme on investment and sustainable development. The full breadth of this programme, including our pioneering work on a *Southern*

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The Failed Assumptions

The most basic flaw of the Framework is seen from the opening paragraph of the preamble:

> *"Sound and stable private investment supports economic growth and job creation, fosters innovation, promotes sustainable development and thus contributes to the prosperity of countries and their citizens."*

It is true that all of this *can* happen from what is referred to as sound and stable private investment. However, it is far from certain that all of this *will* happen from private investment. Indeed, how one defines sound and stable is critical from this perspective, and no definition is provided in the text. If it were, then perhaps the policy elements that follow would be more easily articulated in a manner that might achieve such a result.

The assumption that seems to permeate the rest of the Framework appears to be, however, that positive results *will* flow from all private investment. How else can one explain the resulting Framework which focuses almost exclusively on the steps a state should take to attract more and more investment, rather than ensuring that the investment it does attract is sound and stable from the perspective of the positive results the preamble suggests will flow from private investment?

Yet we know that not all investment is sound or stable or beneficial to the host country from a sustainable development or poverty alleviation viewpoint. Government policy decisions have to be made to ensure that these results are achieved. This is barely noted in the framework. The protection of core labour standards receives attention, but environmental protection and human rights protections are absent from all practical measures suggested for governments. At best, these only get addressed by reference to the non-governmental side of business responsibilities through the OECD Guidelines on Multinational Enterprises. This approach is simply inadequate to deliver what the preamble posits.

Fundamental to understanding this issue, in our view, is the need to refocus on the quality of all investments as opposed to the quantity of foreign investments as a driver of sustainable development. Again, this is scarcely reflected in the Framework, Indeed, is appears to maintain the view that the more foreign investment the better the result, without even beginning to build into the framework the necessary checks and balances to ensure that this is achieved.

These flawed underpinnings of the Framework infect virtually all that follows. It means that the Framework does not do what it says it seeks to do: promote … appropriate roles and responsibilities for governments, business and others with a stake in promoting development.

The Flawed Toolbox

The main tools in the OECD Draft Framework toolbox appear to be transparency, protection of private investor's property, and trade and investment liberalization.

IISD believes that transparency and accountability in governmental activities is a good thing. We also agree it is an important element for attracting quality investment. Our concern does not lie with this in principle, but in some of the more detailed elements that accompany this, most notably the linkages that arise from the very unclear jurisprudence on this issue in international investment agreements. Today, these agreements (more on this below) are being used to impose standards of transparency and accountability that are often not met in developed countries and are often impossible for developing countries to meet due to lack of capacity and resources. It is important that issues relating to transparency are carefully tied to the provision of the necessary capacity to achieve higher levels of transparent and accountable government so that appropriately high targets can be achieved.

The draft framework makes dozens of references to the need to protect the property of foreign investors. The creation of a rights-based legal system is advocated where this may not exist, and the adoption of the current form of bilateral investment treaties is advocated for enforcement of the rights based approach.

The protection of private property rights is reflected in different ways in different legal systems. At the same time, all legal systems provide a very broad range of rules governing how private property may or may not be used, and how benefits from the possession of private property may be required to be shared with other stakeholders. The key point here is that property rights are never absolute. They are balanced against the rights and interests of others. This is scarcely reflected in the advocacy of private property rights for foreign investors in the draft Framework. Again, more reliance is placed on non-legal approaches here, such as the Guidelines on Multinational Enterprises, than on the role of the state in creating well balanced and clear rights *and* responsibilities, in law, for property owners.

The most prevalent tool running through the draft Framework appears to be the call for very broad and deep unilateral liberalization of trade and investment rules at the domestic level. Running through the constant stream of calls for more and deeper liberalization is virtually every sector of the economy: agriculture, manufactures, services and so on. Yet there is absolutely no mention here of the potential legal risks associated with this: one of the preferred negotiating positions now in the WTO on trade and services negotiations is for the inclusion of a provision on entrenching extant levels of domestic liberalization into the multilateral regime. In other words, this approach would see any levels of domestic liberalization immediately enshrined as a multilateral commitment that would then not be retractable. The policy flexibility that unilateral liberalization implies would be completely removed. In the absence of a final result on this approach, any domestic liberalization by developing countries carries high risks of the loss of policy space for the future. This is not even noted in the draft Framework, even though such proposals have been circulating and were a feature of the recent discussions in Hong Kong.

This issue is not just relevant in the WTO context. The spread of regional and bilateral free trade negotiations and investment treaties makes the same concerns as to how to promote and manage steps to open sectors of the economy to foreign investment and trade a live issue.

Together with this one sees the undercutting of the WTO decision not to address the Singapore issues through their inclusion into unilateral strategies advocated by the OECD. There is also a very significant intrusion into the ongoing GATS negotiations, and on critical poverty and development related issues like the provision of water and energy. The simplistic placing of the perspective of the foreign investor's water use needs over the needs of local communities on such issues reeks of disregard for those very needs, however unintended such a result may be. The call for greater clarity of access rights to water for foreign investors foretells exactly the kinds of social battles that are likely to arise when the rights of ALL stakeholders to access water are not fully clarified before new foreign investors are allowed to share in the resource.

The patent endorsement of highly controversial policies on water sector liberalization further illustrates the degree of imbalance in this report. Indeed, reading farther on in the Framework, one sees exactly the kinds of juxtapositions that have led to innumerable failures of water privatizations to date: reduce regulations, incorporate more competition (which cannot be done for a natural monopoly) and allow market-based competition to ensure good water services. This is the precise recipe for failure that has plagued water privatizations over the last decade. But is appears to be fully incorporated into the Framework.

The Framework likewise has an undercurrent of deregulation running though it. Labeled variously as the removal of unnecessary regulations, continued reviews of existing regulations from the perspective of the foreign investor, and so on, there is scant attention paid to the need for regulations that ensure public welfare is improved and that private interests are fit into the broader picture of appropriate public interests. Terminating unnecessary regulation is well and good. Determining the full breadth of perspectives needed to make that assessment, however, is critical.

Much of this is reflected in the call for developing countries to be more sensitive to the need of large corporate (mainly OECD-based) supply chains. It is true that an ever increasing proportion of trade is intra-company. And appealing to such investors is important. Yet one must also be careful that the efforts to have such an appeal do not lead to disproportionate rights of foreign investors to access raw materials and underpaid labor resources in developing countries. Here, one must bring in the call for more bilateral and regional investment agreements, and an expansion of investment liberalization through such agreements. There is an ever growing risk that such agreements are abusing the role of international law as a tool for development and in fact creating corporate rights that are completely disconnected from the sustainable development and poverty alleviation needs of developing countries. This situation becomes exacerbated when the existing regulatory systems lack the capacity to control access and the impacts such access may create on the local communities and the environment. The superior financial resources of many foreign investors that can be used to obtain access to resources generate potentially high risks in this regard. Thus, great care must be taken when considering how and how far states should respond to the supply chain economics of foreign investors.

The Archaic Separation of Government and Investor Rights and Responsibilities

Finally, we note the continued separation in the draft Framework of the business dimensions from the development, social and environmental dimensions of foreign investment. All of our learning on sustainable development over the past thirty or so years has taught us that sustainable development requires exactly the opposite: the integration of all of these issues so that the appropriate balances can be achieved.

Nowhere is this more evident than in the call for more uptake of bilateral and regional investment agreements that manifest the current model of investor rights and nothing else. The creation of rights without commensurate legal responsibilities and liabilities is a dangerous road, and one the OECD should well know from its own effort to enter into this field through the Multilateral Agreement on Investment negotiations of the mid 1990s. The failure of those negotiations should not simply be shifted by the OECD to call for more of the same result through often secretive bilateral means that lack the same kind of transparent and accountable dispute settlement processes that the OECD in this framework rightly says should be applied by governments. How can the OECD promote this for governments, while promoting secret, non-transparent and unaccountable processes for the benefit of foreign investors and they alone?

Conclusion

IISD is of the view that the draft OECD Policy Framework for Investment is fatally flawed in its underlying assumptions, is imbalanced in its content, and intellectually stagnant in its limited choice of tools to achieve what must be achieved today: investment policies that will actively contribute to sustainable development and poverty alleviation. These problems are very similar to the ones that led to the collapse of the OECD's effort to spearhead a Multilateral Agreement on Investment in the previous decade. They are no less serious now for the design of a major policy instrument as they were then for the design of a major legal instrument. We believe that more can and should be expected of this initiative.

Annex: NGO Letter

Dear Members of the OECD,

We, the undersigned NGOs, acknowledge the consultation period for the public and civil society organisations to comment on the Draft Policy Framework for Investment. However, at this late stage in the Framework's development, we disagree with the claim that the Framework has been developed "in cooperation with civil society" [www.OECD.org]. While the Framework has indeed received input from business (BIAC) and trade union (TUAC) stakeholders, only a few NGOs have commented, and NGO concerns are scarcely reflected in the Framework. The undersigned NGOs want to make clear that we do not want to be seen as supporting the current Framework text.

The Framework does consider some concerns for developing country governments seeking investment beneficial to their economies. In the area of tax policy, these considerations include para. 5.7, which highlights the revenue losses associated with tax holidays, and para. 5.4, which even mentions that tax incentives may discourage investment. Also, in para 6.3 it is explicitly stated that governments need effective methods to obtain redress for grievances and the need for more disclosure of materials from companies. Para 7.3 underscores the protection of the rights framework to secure a balance with investment.

Despite these positive elements, the undersigned NGOs believe that the Framework is largely based on misplaced priorities and incorrect assumptions. The current draft Framework does not offer a balanced contribution that "enhances the benefits of investment to society" – the stated aim of the Framework – nor does it sufficiently contribute to economic development in developing countries, let alone a development based on sustainability, equality and Human Rights. The Framework does not adequately reflect the current debate raised by UNCTAD surrounding the impact of foreign investment and investment incentives on development. Instead of examining whether investment is beneficial for development, the Framework takes as its starting point that all investment is desirable. Also, the draft Framework is not consistent with the Monterrey Declaration, which urges business to take "not only the economic and financial but also the developmental, social, gender and environmental implications of their undertakings" into account. The Monterrey Declaration also warns against rapid deregulation of capital flows and the crowding out of domestic investors.

One of our main concerns regarding the Framework is the inequality between the promotion of investors' rights and the specification of investors' responsibilities and obligations. Another principal concern is the imbalance between the instruments the Framework promotes to protect foreign investors' rights and interests, on the one hand, and the lack of instruments it suggests to protect the rights, interests and development needs of host governments, their citizens and their natural environment, on the other hand.

The Framework claims to be based on three basic principles:

1. Policy coherence between various policy areas on investment protection and openness,
2. Transparency in policy formulation and implementation, and
3. Continuous evaluation of policies on the investment environment.

A balanced approach should also include:

1. Policy coherence to protect and safeguard government's obligations to implement Human Rights conventions, including core labour standards, and democratic policies to protect against unwanted effects of investors;
2. Transparency of business operations, government-business contracts and business revenues to enhance corporate accountability; and
3. Continuous evaluation of business practices and effects of their investment.

In order to complement some of the positive elements of the draft Framework, the following imbalances need to be addressed:

The protection of investors' rights that the Framework considers the best way to attract investment is not balanced by governments' responsibility to fulfil the different aspects of Human Rights and environmental protection.

There is too much focus on host countries' responsibilities and regulatory frameworks to support investors and a lack of emphasis on legally binding regulations for responsible behaviour by foreign investors.

The Framework focuses on attracting foreign investment but gives little specific advice with regard to promoting domestic investment.

The Framework warns against targeting (foreign) investment in particular sectors (para. 1.6) and against promoting domestic industries (para. 1.7 and 4.5), but it does not offer instruments to attract quality investment that is needed or desired according to the development policy of the country and that contributes to sustainable development, fair employment and the transfer of needed technology.

The promotion of the principle of non-discrimination fails to recognize a de facto discrimination against local investors, tax payers and citizens as well as the unequal competition between small, domestic companies and large, foreign, corporate investors.

The Framework thoroughly delineates host countries' obligations to (foreign) investors, but provides few recommendations about how home countries can support sustainable investment.

The Framework promotes greater input and lobbying by (foreign) investors (paras. 7.4 and 3.2.), but it fails to recognize investors' elevated financial power compared other stakeholders and, thus, the need for more parliamentary input in investment policies.

The promotion of free transfer of capital and profits is not balanced with equal promotion of guarantees and policy options for reducing financial instability and for increasing the sharing of the benefits of investment.

The Framework promotes investor-to-state dispute settlement mechanisms (para. 1.8) but does not advocate fully exhausting domestic court avenues. This reduces governments' ability to protect essential social and environmental rights from expropriation rules (para. 1.5).

Other important principles and issues that are missing from the Framework include:

Preventing countries' desire to attract FDI from leading to a 'race to the bottom' in which human, labour and environmental rights are undermined;

Disciplining and balancing corporate lobbying;

Increased participation of parliamentarians in investment policy development and assessment;

Providing balanced policy space to uphold human rights and protect public health, safety and the environment even if this goes against the principles of non-discrimination and expropriation rules.

Promoting a Policy Framework on Investment as it currently stands should not be done without more obligations by home countries to enforce the OECD Guidelines for Multinational Enterprises and have the National Contact Points play a positive role in making the OECD Guidelines fully operational. This could be done, for instance, by questioning whether host countries should provide investors' rights to companies that do not respect the OECD Guidelines by linking home country export finance and insurance or other subsidies to obligations to respect the OECD Guidelines (see the OECD Working Group on Export Credits and Credit Guarantees). The NCPs should also be made more receptive and instrumental in effectively tackling breaches of OECD Guidelines.

The following are a few concrete examples that illustrate the imbalances and explain why the undersigned NGOs do not agree with the current draft of the OECD Policy Framework on Investment.

The investment policy annotations regarding intellectual property rights (para. 1.3) ignores principles of benefit sharing and the need for access to essential medicines and other essential technologies to promote sustainable societies. The investment policy annotations (para. 1.5) about timely and adequate expropriation measures do not mention that states should limit investors' rights to compensate indirect expropriation in cases of regulations that are essential to implementing Human Rights and internationally agreed social or environmental standards.

With respect to trade policy, by promoting free trade and investment agreements through the WTO and regional agreements in para 3.3, the Framework does not take into account that developing countries are not always able to have their interests included in such agreements, nor does the Framework recognize that such agreements limit policy space that developing countries need to stimulate sustainable societies and protect human rights. The Framework's focus on cheap and smooth international supply chains for investors (paras. 3.1, 3.2, 3.5, 4.4) discourages the development of local agricultural, industrial and services sectors. The Framework does not consider that crowding out local suppliers and removing protection for infant industries can have negative social and economic effects that outweigh the benefits of investment. Nor does the Framework link supply chain strategies and trade policies to the observation of labour or environmental standards by suppliers.

The Framework encourages governments to take unilateral measures that have not yet been agreed upon multilaterally in the current WTO Doha round of negotiations, for example:

- uniform tariffs (para 3.4), which are to be agreed upon in the WTO agricultural and NAMA negotiations;
- liberalisation of mode 4 in trade in services, which is a complex and controversial issue in the GATS negotiations (para. 3.5);
- removing restrictions on participation by foreign companies in domestic financial service companies (para. 9.7) is a matter of GATS negotiations; and
- promoting the least trade and investment restricting policies (para. 3.7) while, in the GATS negotiations on Art. VI, the appropriate degree of domestic regulation is yet to be determined (note that around 60% of investment is in the services sector).

All paragraphs and sentences relating to issues still on the WTO negotiating table should be removed from the Framework. Countries that take unilateral measures before they are agreed upon in trade negotiations undermine their own negotiation positions and have no guarantee that their companies will receive the same treatment and advantages from other countries.

Regarding competition policy, another area where no international binding agreement has been reached, the Framework provides a few useful elements (e.g. in paras. 4.6 and 4.7), but is too focused on the principles of non-discrimination (para. 4.1), market opening for foreign investors (paras. 4.2 and 4.4). At the same time, the Framework fails to take into account elements of competition policy that promote domestic investment, avoid concentration at the international level, effectively deal with restrictive business practices (RBPs, including predatory pricing) and address the buyer power of foreign investors who have the capacity to lobby or threaten governments. Why is no reference made to the Set of Principles and Rules for the control of Restrictive Business Practices and the lack of support from rich countries for the implementation thereof?

Regarding corporate governance and corporate responsibilities (chapters 6 and 7) the recommendations for coherent and consistent regulatory frameworks, backed by effective enforcement, in order to protect the rights of incoming investors and shareholders are clear and explicit. In contrast, when corporate responsibility is discussed – i.e. when the question is about public, rather than private, interests – no such strong measures are required. The concept of corporate accountability is not at all mentioned, in contrast with the outcome of the WSSD. The language is general, focusing on the promotion and stimulation of measures and favouring voluntary action by corporations. Accountability in corporate governance should not only be towards shareholders, but also other stakeholders such as consumers, local communities, trade unions, etc. Corporate governance should have more emphasis on foreign investors contributing to social inclusion and environmental sustainability, including through greater consideration of directors' duties and responsibilities.

While the whole Framework should strive to be an instrument that achieves the fulfilment of the OECD Guidelines, the Framework only promotes the Guidelines under the weakly drafted chapter on business responsibility.

The Framework's questions and annotations relating to investment policy in infrastructure provide some useful elements to balance investors' rights and the rights and needs of the population they burden. However, too much of the responsibility for protecting the rights of the poor by, for example, providing universal access to water and communication equipment (paras. 9.4, 9.6) is placed upon governments and not enough upon (foreign) investors. The Framework's suggestions in the area of financial services do not provide enough guarantees that the foreign financial industry's current practice of neglecting domestic farmers and small and medium-sized enterprises in favour of rich clients will be reversed in order to enable broader economic development of the country.

This letter by no means constitutes a full response from the undersigned NGOs because the consultation period did not provide adequate time for all interested NGOs to comment. Please note that many NGOs have not been, and still are not, aware of this consultation document and have thus not been able to respond.

The undersigned NGOs hope that their comments will be heard and no Policy Framework on Investment will be launched without redressing the current imbalances.