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IISD COMMENTARY

# Public Consultation on Updating the Policy Framework for Investment:

## Submission by the International Institute for Sustainable Development

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## Background

The Organisation for Economic Co-operation and Development (OECD) is updating its Policy Framework for Investment (PFI) to reflect new global economic fundamentals and to incorporate feedback from the international investment policy community. As part of this process, the OECD is inviting public comment on the revised chapters, with a view to informing revisions of the updated text.

The Investment Program of the International Institute for Sustainable Development (IISD) has taken a global lead in calling for the reform of international investment frameworks, contracts and the arbitration of investment disputes in an effort to ensure that investment genuinely advances sustainable development. Having linked its robust technical credentials in economic and legal analysis with realistic prescriptions for change, with a focus on implementation and outcomes, IISD works to accelerate policy innovations to enhance sustainable development. In this spirit, IISD would like to submit its contribution to the OECD public consultation on updating the PFI.

We welcome the opportunity to comment and will focus on the following documents:

1. Draft Chapters: Horizontal policies and practices, and Investment policy
2. Draft Chapter: Responsible business conduct
3. Draft Chapter: Investment framework for green growth

* Please note the IISD submission to the OECD was later copy-edited and designed for this web posting

## 1.0 Draft Chapters: Horizontal policies and practices, and Investment policy

This discussion is organized in three parts. The first considers some key conceptual elements set out in the early paragraphs of each of the two draft chapters. Following these introductory comments, we provide additional and specific comments on a more detailed basis.

### 1.1 Introductory Comments on Key Conceptual Elements

Without fully understanding the architecture of the revised PFI, these two draft chapters appear to be critical components of the project. Their conceptual frameworks are central to the overall conceptual framework of the project.

IISD therefore sees the opening paragraphs of each of the draft chapters ("Horizontal Policies and Practices" and "Investment Policy") as extremely important. The current formulation, however, requires re-orientation in terms of the scope and objectives of sound investment policy for sustainable development.

#### *Paragraph 1*

Paragraph 1, leading the discussion on "Horizontal Policies and Practices," reads:

> 1. An effective investment policy is grounded in strong institutions and effective public governance. Investors expect government to develop and implement policies, laws and regulations in a reliable and fair manner. Strong institutions help to maintain a predictable and transparent environment for investors that lowers risk and reduces the hurdle rate for any given project, thereby increasing the overall rate of investment. Firms need to know what the rules of the game are and require some assurance that those rules will not change once they have invested. This applies to all investors, but is particularly important for SMEs and foreign firms. In terms of public governance, the key pre-requisites for investment policy include respect for the rule of law, quality regulation, transparency and openness and integrity. Effective action across these dimensions will encourage investment and reduce the costs of doing business.

IISD takes no issue with the first three sentences. Our fundamental disagreement begins with the fourth sentence: "Firms need to know what the rules of the game are and require some assurance that those rules will not change once they have invested. This applies to all investors, but is particularly important for SMEs and foreign firms." It is untrue that informed and high-quality investors expect that "rules will not change" once an investment is made. No responsible investor anticipates knowing prior to an investment what the rules will all look like 10, 20, 30 or more years later. Nor would the investor expect all the rules to remain exactly the same as when the investment is made. We recommend that the OECD omit suggesting that rules should not change in this draft chapter and throughout. The impact of this advice is distorting and irresponsible, particularly in developing countries.

Indeed, consider the long-time work of the OECD on enhanced environmental regulations and regulation-making, labour laws, competition policy, and its current focus on tax reform to prevent tax havens and related abuses. Should none of this apply to governments receiving new investments? Should the results only apply going forward and never to existing investors? Do the OECD recommendations consistently note the need to grandfather existing investments from recommended changes? Simply to ask the questions is to provide their obvious answers. Yet, paragraph 1 quoted above seems to suggest otherwise.

As this is an approach that is repeated in some form on multiple occasions throughout the entire draft chapter, it is critical for it to be addressed here. **Investors need to be clear that the rules to which they are subject will legitimately change over the course of the investment. This happens as a matter of routine in every country. Law is not frozen at different times and stages for different investors depending on when they made their investment**. This should be beyond any doubt, and the language of the draft chapter should clearly state this and reflect this reality in subsequent sections.

The issue for discussion is not whether change is to be expected, but what is meant by "legitimate" change. Turning back to the final sentences of paragraph 1:

> In terms of public governance, the key pre-requisites for investment policy include respect for the rule of law, quality regulation, transparency and openness and integrity. Effective action across these dimensions will encourage investment and reduce the costs of doing business.

To complete the circle, when laws and regulations are changed in a manner that reflects the rule of law, that seeks to enhance quality regulation, that is transparent (bearing in mind different levels of capacity), that is open and reflects the integrity of the good-faith purpose of the measure, investors have no legitimate right to expect more.

The concern with paragraph 1 is furthered by paragraph 7:

> 7. […] International trade and investment agreements can provide added transparency concerning the regulation of foreign investors in signatory countries. They can also provide policy predictability by locking in current policies or providing a mutually agreed mechanism to handle policy change. As in a domestic context, policy stability comes at a cost in terms of reducing flexibility if circumstances change. This trade-off is discussed in more detail in the investment and trade chapters.

While some agreements have addressed investment liberalization policies through a lock-in and ratchet-up approach, we are not aware of any agreements that have locked in any policies related to the conduct of an investment or other public policy matters. Indeed, in no instance has IISD ever heard a government suggest or argue that the purpose of investment treaties is to lock in policies relating to an investment at the time any given investment is made. Further, we are unclear what the statement that trade and investment agreements establish a "mutually agreed mechanism to handle policy change" means. The suggestion that investment treaties should have such a lock-in effect is both misleading and misdirected. We suggest that the entire paragraph or the text quoted above be deleted.

### *Paragraph 8*

Turning to paragraph 8, which introduces the second draft chapter, "Investment Policy," similar concerns arise in terms of the orientation of what follows. Paragraph 8 reads, in full:

> 8. Investment policy refers broadly to the set of policies shaping how investors are treated and their assets protected. It relates to a country's laws, regulations and practices that directly enable or discourage investment and that, if well crafted, enhance the public benefit from investment. While it can take many different regulatory and institutional forms and fall under the responsibility of many different ministries and government agencies, the overriding focus of investment policy remains the treatment of investors: public and private, domestic and foreign, small and large, and in both the formal and informal sectors. Investment policy should be consistent with national development plans and other strategies to ensure sustainable and inclusive development.

The first sentence is incorrect. Investment policy, from the point of view of the government responsible for making that policy, refers to the full suite of laws, regulations and policy instruments relating to the entry and conduct of the investment, the goals and expectations of the contribution of the investment to sustainable development in the host state, and the treatment that the investor can expect to receive. To isolate only the latter and say this is what investment policy refers to is a serious misstatement. This is not made up for by saying that this "***relates to*** a country's laws, regulations and practices that directly enable or discourage investment and that, if well crafted, enhance the public benefit from investment." Investment policy does not "relate to" these elements as if they were ulterior, but is fully made up by these elements.

Indeed, the third sentence reinforces the position that "the overriding focus of investment policy remains the treatment of investors." The relation of investment to development, as restated in this paragraph, lies outside that overriding focus: "Investment policy should be consistent with national development plans and other strategies to ensure sustainable and inclusive development." In other words, the paragraph suggests that investment policy is only about the investor, and that other issues, including of the linkages between investment and development, sustainable development, inclusive growth, human rights, social development, etc., are not the subject of investment policy.

This approach will isolate the OECD as reflecting an outdated, one-dimensional conception of investment policy. It is not consistent with the UNCTAD Investment Policy Framework for Sustainable Development, the UN Guiding Principles on Business and Human Rights, or any other major initiatives in this field. Nor is it consistent with national or international expectations on the need to integrate fully the sustainable development dimensions of investment into a single holistic policy framework.

IISD suggests that this text be redrafted to clarify that investment policy today addresses the full suite of policies relating to the entry and establishment of investors and their investments, their conduct throughout the lifespan of the investment, and the treatment that investors can expect from government.

This is far from a semantic issue. Indeed, it is central to understanding and articulating the notion of investment policy and hence the appropriate scope for the section on "Investment Policy." In the sections below, we review in detail many of the specific implications of these conceptual concerns. However, dealing with certain details will not alleviate the concerns created by the broader conceptions unless they are also reconfigured.

## 1.2 Detailed Comments on "Horizontal Policies and Practices"

IISD does not disagree with the general intent of paragraph 3. However, it notes that these are the desirable traits; they are in most cases aspirational rather than facts on the ground. While we all wish this were so, it is not so in the vast majority of states. Implying that such ideals are in fact common practice creates a false image of reality, a false set of expectations on actual government practice, and unrealistic expectations for investors, especially in developing countries.

As the last quarter of the paragraph notes, "investment policies [...] have multiple objectives and involve many economic actors." This brings the language much closer to addressing the concerns voiced above.

### *Horizontal Questions*

Question 3 asks "How does the government reduce policy uncertainty and increase policy predictability for investors?" This question, evidencing a focus on the investor, stresses the concern expressed in the previous comments with the notion of investor treatment as the only objective of investment policy. IISD recommends that it be deleted or significantly rephrased as to shift the perspective adopted.

### *Supplemental Questions*

IISD's concerns here again relate to the issue of policy stability and predictability. The questions read:

- What does the government do to enhance policy stability and predictability?
- Does the government sign contracts with investors in particular sectors?
- When rules change, are pre-existing rules grandfathered?
- See also Chapters 1 and 3 on international investment and trade agreements.

The language implies that grandfathering old rules is normal when it is not, and that signing contracts that alter generally applicable law or include stabilization provisions are normal when they are not. It also suggests a linkage to the idea expressed in paragraph 7 that international trade and investment treaties should and do aim to create rules against changing policies and laws, which they manifestly should and do not.

Creating false expectations of government conduct based on false assumptions of what investors actually expect and require, and false views about how governments operate is not helpful to any process of identifying and building sound, long-term investment policy. Policy stability is a good thing, but policy change is a constant, and the idea that rules are frozen at the time any particular investment is made is false and dangerous.

## 1.3 Detailed Comments on "Investment Policy"

The second draft chapter, titled "Investment Policy," begins with paragraph 8, discussed in detail above. This chapter is structured as follows:

- Transparency and predictability
- The components of investment protection
    - Non-discrimination
    - Securing land tenure
    - Protection of property rights
        - Intellectual property rights protection
        - Contract enforcement and dispute settlement
        - Expropriation
    - International investment agreements

This structure indicates the focus of what the OECD seems to see as "investment policy." IISD views this as incomplete and too heavily focused on investor rights and investor protection, as will be explained below.

Paragraph 9 overstates the business response issue, and is unhelpful:

> 9. The way that investment policy is developed and amended is a key consideration of investment decisions. *Investors will avoid or withdraw* [emphasis added] from investment destinations where policies are modified at short notice, where governments do not consult with industry on proposed changes and where laws, regulations and procedures are not clear, readily available and predictable.

Yes, the process for change should be clear, but in some cases legislative or regulatory change will happen at short notice, and investors will not rise up and flee all together. Of course, many will be concerned, and many will seek discussions with government, but affirming that "investors will avoid or withdraw" from certain investment destinations overstates issues and impacts. This does not help clarify the real issues and expectations of any of the multiple actors in the investment process.

In paragraph 10, IISD appreciates the acknowledgement that governments often include lists of sectors in the investment policies where FDI is either controlled or not allowed. Indeed, this is normal conduct seen around the world.

Paragraph 12 begins with the words, "Before turning to the various components of investment policy." The remaining text then addresses exclusively various formulations of investor protections. Like the existing PFI and in line with the above comments to other paragraphs, this paragraph denies the role of economic development policy, social development, human rights, environmental management, gender issues, inclusive growth, etc. as part of investment policy. All governments, especially in developing countries, should see the exclusion of those aspects from investment policy as unacceptable.

Paragraph 12 then turns once again to the idea of a predictable regulatory framework, without saying what this means. For the reasons discussed above, this lack of clarity in the face of the number of very open-ended statements in the draft chapter creates a need for greater specificity and accuracy.

Paragraph 12 ends with the sentence:

> Moreover, such ambiguity in the legal system can also foster corruption, both where investors aim to define their rights through informal means and systems and where government actors are able to take advantage of the lack of formal regulations to their advantage.

What ambiguity is being addressed here is not clear from the overall paragraph. On the other hand, the sentence does rightly identify the risk of corruption "both where investors aim to define their rights through informal means and systems and where government actors are able to take advantage of the lack of formal regulations to their advantage." Paradoxically, this is the exact situation created when investments are regulated by contracts instead of the generally applicable laws, regulations and permitting systems, which one of the questions in the previous sections seems to imply should be done.

Paragraph 13 itemizes reasonable points. However, the paragraph should note that these are important elements for governments to seek to implement on an incremental basis, rather than suggest they are facts fully on the ground in most cases.

The remaining paragraphs fall under the subheading "The components of investment policy," which should be titled "The components *of the investor protection element* of investment policy" to be appropriate and accurate.

Paragraph 14 makes it clear no change in the scope of the PFI is intended. In the existing version, the PFI is solely about the "investment environment." In the current draft chapter, this once again emerges as the goal of investment policy.

Paragraph 15 begins the first issue of non-discrimination. It states that the principle implies that all investors in like circumstances are treated equally. It later notes that one of the expressions of non-discrimination in treaties is that foreign investors are treated no less favourably than domestic investors (national treatment). The distinction is important.

There is no broadly based public international law principle that requires non-discrimination by a state as between domestic and foreign investors. The idea of non-discrimination based on national treatment is a function of treaties, not customary international law. And even here, most of the treaties that include this principle also include exceptions to the provision. Paragraph 16 importantly notes this.

Paragraph 17 notes that exceptions to national treatment are often enshrined in negative lists. This is true, but it is also true that non-discriminatory treatment is also often granted only through positive lists. The General Agreement on Trade in Services (GATS), the only World Trade Organization (WTO) agreement of significance here, and most services chapters in free trade agreements (FTAs) reflect this. Governments may legitimately use this approach to articulate the scope of non-discrimination under their investment regime. The text should note this clearly. It now appears to be absent, perhaps due to the mistaken view that an international law principle on non-discrimination exists regarding investment.

Paragraph 18 refers to a chapter on responsibly managing incentives for FDI. IISD could not identify such a chapter among the draft chapters published, and looks forward to an opportunity to review it.

Paragraphs 19–27 raise the issue of "Securing land tenure" for investor protection. IISD has significant reservations with this whole subsection, and the related core and supplemental questions. The starting point of this subsection seems wrong. It essentially argues that developing country governments must put in place land tenure and registration systems common in Western states, whether or not they are suitable to the social and economic environment of the developing country in question.

In IISD's view, however, the burden should be on investors to understand and work within the local land tenure systems rather than on governments to reshape those systems to meet the needs of foreign investors. In fact, if land tenure systems were to be reshaped for the investor, this would depend on the legal system—common law, civil law or other law—of the home state of the investor in whose interest the reshaping is carried out, which cannot be the approach proposed in the draft chapter.

IISD accepts the view in paragraph 19 that foreign "investors need to be confident that their land rights are properly recognised and protected and that they guarantee against forced evictions" (without compensation). It does not follow from this, however, that the land tenure, title and registry systems of Western states are the only way to do this, nor that existing local systems are unable to accomplish this.

In this regard, paragraph 20 usefully cautions that even formal land title may not create security if the local community views the title as illegitimate. However, the paragraph ends on a less appropriate note: "Thus, tenure security is not so much derived from the legal status of the rights held, as from social consensus on the legitimacy of these rights and *the reliability of mechanisms for arbitration should conflicts arise* [emphasis added]." We agree with the first part of this sentence, but understand the prescription of a single form of dispute settlement in the second part to be misplaced. Rather, IISD suggests that the sentence end with a more neutral formulation, such as "and the reliability of mechanisms for settling disputes should they arise." Paragraph 27 addresses this issue properly, in our view.

IISD agrees with the idea expressed in paragraph 22:

> Land use plans should be developed at all government levels and updated regularly through wide public participation to minimise the risks of land disputes and to ensure that the priorities and interests of local communities are reflected. They should take into account the multifaceted economic, social, cultural, environmental and political roles played by land.

Where such plans do not exist, comprehensive social and economic impact assessments must be undertaken to identify and address these issues before any land allocation and tenure decisions are made. The UN Guiding Principles places this due diligence responsibility on foreign investors. The absence of a comprehensive land use plan does not obviate the need for understanding these issues; rather, it enhances the business responsibility for doing so.

Paragraphs 23 and 24 highlight IISD's concern with the proper starting point for this discussion. The general approach is to put in place a westernized system, then adapting it to "identify the various types of existing tenure rights and rights holders through an inclusive consultation process and develop socio-culturally appropriate and locally-adapted ways of recording customary rights of local communities." Prioritizing the presumptive need for Western land title systems for investors over the traditional legal systems and rights in place in most developing countries should be avoided.

Paragraph 25 goes further, calling for the creation of a "dynamic land market" based on Western real estate market approaches, despite the identified risks of displacing local people from their land and livelihood, and of creating a highly speculative land environment. Promoting a "dynamic land market" of this type has nothing to do with security of tenure for investors. IISD recommends deleting this paragraph and all other references to creating land markets.

Paragraph 27 refers back to paragraph 20, but in a more appropriate manner:

> 27. Land tenure rights constitute a common cause for conflicts, for instance between large investors and local communities due to disputes over land over which the latter had informal land use rights and due to the lack of transparency, especially on the conditions and process for land acquisition. Competent, efficient, transparent and independent institutions should be set up to resolve land disputes. Negotiation, mediation and arbitration can facilitate a fair and accessible justice.

The emphasis should be on identifying culturally appropriate and fair processes that do, in practice, ensure equal access to justice, based on the appropriate legal systems in the location of the investment.

The first sentence of paragraph 33, concerning contract enforcement, refers to international arbitration. IISD strongly suggests adding domestic arbitration as well here. Many developing countries are seeking to improve commercial dispute settlement through arbitration mechanisms that would apply to commercial contracts (and in some cases state contracts) with foreign investors. Reference to these developments would help promote these mechanisms further, and reduce the heavy costs associated with international arbitration today.

The short section on expropriation, paragraphs 34–35, raises several specific issues. In particular, paragraph 35 states:

> 35. Expropriation can take different forms. It can be direct, where an investment is nationalised or otherwise expropriated through formal transfer of title or outright physical seizure. *It can also occur through interference by a state in the use of that property or in the enjoyment of the benefits even where the property is not seized and the legal title to the property is not affected. The determination, in judicial and arbitral awards, on whether governmental interference with the economic activity of an investor constitutes an indirect expropriation for which compensation should be paid is made on a case-by-case basis* [emphasis added]. Some recent agreements and legislation provide that, except in rare circumstances, non-discriminatory regulatory actions to protect legitimate public welfare objectives, such as public health, safety and the environment, are not considered to constitute expropriation.

The concerns arise from the italicized words. In particular, an expropriation is not made out simply by virtue of an interference with the use of property or the diminishment of profits from the use of property. The mere interference with economic activity does not create an expropriation either. These blanket references raise fears that every regulation can constitute an expropriation simply by impacting profits.

IISD recommends more careful drafting, so that the revised PFI is not read as supporting such an implication. Indeed, the language used in the last sentence, drawn from many current treaty texts, is almost always stated as being included "for greater certainty." The reason for this is that international law has historically not included impacts on profits or uses of property due to good-faith public interest legislation as grounds for expropriation. The treaty language is used to confirm that this customary international law view continues to apply to the treaty interpretation. Making this fuller context clearer in the text would reduce the risks that the OECD is seen to promote the notion of public interest legislation being regarded as an act of expropriation.

Paragraphs 36–43 close out the policy drafting by addressing international investment agreements (IIAs). Paragraph 36 states that IIAs:

> provide for standards of treatment of investors and their investments, e.g. non-discriminatory treatment (most-favoured nation [MFN], national treatment), obligations on the protection of assets, including guarantees against expropriation and nationalisation without compensation, guarantee of fair and equitable treatment and full protection and security, and investor-state dispute settlement mechanisms.

While certain elements of this are true in all cases, it is possible to read this sentence as suggesting that all of them are always included in IIAs, or that they must be included for the IIA to be legitimate. In fact, treaties today exclude or limit the MFN provision, exclude or redefine the fair and equitable treatment provision, and increasingly question the inclusion of investor–state dispute settlement (ISDS) mechanisms. Some now qualify access to ISDS based on certain types of investor conduct. Variations are increasing today. Thus, we suggest language to the effect of "IIAs today may provide for all or some of [...]," in order to avoid doubt here and to be consistent with the next paragraph.

The last sentence of paragraph 37 is very important: "When deciding to conclude IIAs, governments should first and foremost ensure that they have the capacity to implement IIA commitments and the ability to negotiate IIAs that ensure sustainable development objectives." We agree with this sentence fully. However, the sentence highlights the gap between the current focus of this draft chapter on investor rights and protections, and the need for investment policy and IIAs to have as their core focus the linkage between investment and sustainable development.

Paragraph 38 goes back to the issue of policy stability:

> 38. The main goal of IIAs consists in ensuring greater policy stability and hence reduced political risk faced by foreign investors, by providing an additional layer of security to investors and granting them possible recourse to international investment arbitration to solve investor-state disputes. Investors crave policy stability and need some assurance that any dispute with the government will be dealt with fairly and swiftly. This may be particularly important in countries where investors might have concerns about the reliability and independence of domestic courts. This logic has led to the negotiation of hundreds of BITs each year in the 1990s by the vast majority of countries, resulting in the signing of over 3,000 such agreements.

The sentence opens with an incorrect assertion. The main goal of IIAs is **not** ensuring policy stability. No single government has argued that IIAs have that goal. In now 600 arbitrations under these treaties, we are not aware of governments having argued they bound themselves to a single, stable policy environment towards any investment once it has been made. Given that it is governments that negotiate and sign the treaties, governments could have been expected to make that argument frequently over the course of these arbitrations. But the contrary is the case: governments routinely argue that the treaties do not create or imply stability for investors, in the sense that seems to be used here and elsewhere in this draft chapter.

Policy stability—or investment treaties as stabilization agreements—may be the interpretive desire of some investors and their counsel, and may be the language used by some arbitral tribunals. However, that does not make it the goal of the governments that have negotiated the IIAs. Indeed, some investors may crave policy stability, but others have recognized that seeking stabilization of laws and regulations places legal rules that cannot achieve their goals over what most investors actually crave: operational stability of the investment. Most investors understand that the law does not and should not stand still. And thus they seek to participate in regulatory processes, engage with communities in which they are located, and look for engaged solutions to problems rather than reliance on legal guarantees of policy or regulatory stability.

As argued previously, however, it is critically important to clarify what is meant today by policy stability and regulatory stability. Is the revised PFI really intended to suggest that laws and regulations applying to an investment should not change after it is made? If so, the PFI should state it clearly, so that all readers can assess the PFI from this starting point, and accept or reject it accordingly. If not, the phrase should be clarified as to exactly what it is meant to say. Given that this is not linked in the draft chapter to the goal of IIAs, clarity is even more important.

The notion that investors should have disputes with the government addressed fairly and swiftly does not mean that stability is the key goal of IIAs. Increasingly, it also does not imply international arbitration as the best means of resolving disputes, given the growing length of arbitrations today. Cases lasting five to six years are increasingly common, and some have gone on quite a bit longer.

Beyond these comments, the section on IIAs generally takes a fairly balanced approach that IISD commends.

### *Core Questions*

Question 3 again turns to the issue of stability. "How does the government balance policy flexibility needs against efforts to increase legal stability and predictability and the objective of maximising the contribution of investment to development?" This question includes three separate issues that should not be so easily conflated. In addition, it boldly asserts the notion of "efforts to increase legal stability and predictability." The language here is even more concerning, as it goes from "policy stability" in other parts of the text to directly state "legal stability." Once again, the language is an important issue, but the intended policy prescription is an even bigger one.

Finally, how this issue relates to the "objective of maximizing the contribution of investment to development" is unclear. Nothing in the entire text of the draft chapter to this point even recognizes the fundamental need for proper investment policy to address this issue, as already noted above. IISD finds the absence of this discussion highly objectionable.

Question 9 reverts to the issues of access to land. It asks what steps are taken to ensure that land legislation is clear and easily accessible. The type of land legislation envisaged here is not clear at all. The remaining related questions seem to suggest that this question presupposes Western-style land rights legislation, which is simply adequate in many developing countries where tribal rights and communal rights dominate the legal and social environment in relation to land, especially in rural areas. As discussed in relation to the draft text on this issue, IISD suggests carefully reviewing and reconfiguring the starting point.

Question 11 raises the land registration issue. Prior comments apply here and place the value of this question into doubt.

Question 13 promotes the development of land markets. For reasons discussed above, IISD sees this as an unconvincing idea in this context, and moreover one that is entirely unnecessary for the purpose of securing land rights in a clear way. IISD recommends deleting this question.

Question 15 should be the starting point for the discussion, not the last question to be addressed after revamping the traditional system so that it then places traditional and communal land tenure rights in jeopardy. Investors' tenure requirements should be made to fit with these systems as the starting point.

On Question 16, mediation should be added to the list of options for dispute settlement.

Question 22 seems to take as a given that additional "legal protection guarantees" for foreign investors are required in most cases, if not all. This is a questionable view. Even more critically, question 23 goes on to again voice "the need to provide legal stability for investors." Again, what does "legal stability" mean? Is this what "policy stability" also means? Does it mean the laws should never change for an investor? What does it mean in addition to the "legal protection guarantees" for foreign investors in the previous question? Obviously legal stability is intended to be additional to that notion, though what "legal protection guarantees" means is not clear in itself.

In short, questions 22 and 23 again raise the lack of clarity of the concepts that play a central role in the draft chapter. The PFI should be crystal clear on these concepts given the role ascribed to them. They are not here, and, to the extent that they seem to be, they are rejected by governments and civil society alike, and indeed do not reflect the expectations of the great majority of informed, responsible investors.

### *Supplemental Questions*

Supplemental question 13, on land registration, again presupposes that national land registries are the way to go for developing countries. As per the comments above, this is highly doubtful. IISD again suggests deleting the questions related to establishing a land market.

In terms of land disputes, the question is posed as to "what agencies" are responsible for resolving land disputes. While there may be an agency engaged in this area, in many instances it will not lie with the government to resolve the disputes that may arise between private parties. The extent to which governments can resolve or impose resolution of disputes on citizens is at best unclear. In addition, if dispute resolution is taken to the courts, mediation, conciliation or arbitration by private parties, the government may have no or limited roles to play at that point.

The questions on alternative dispute settlement mechanisms are strongly skewed to promoting investor–state arbitration. While the section on IIAs is neutrally phrased, this section of questions appears to be less so. It is also an extensive set of detailed questions on a subject that is almost completely absent from the text of the discussion in the draft chapter. Hence it comes out as strongly promoting an option despite the absence of significant discussion of this in the text. In addition, it ignores the growing trend in domestic law and policy to promote domestic arbitration or other tools, such as specialized investment chambers of domestic court systems.

The questions on "regulatory actions tantamount to expropriation" suggest that a diminishment of economic value is a key independent test on this issue. We are aware of only one tribunal that has made this argument; governments have generally rejected this as a test. The issues are far more complex than this. Governments regularly encumber property with use limitations that are not seen as expropriations. Language matters a great deal and is too loose here. Moreover, the intentions behind the question are not clear, so IISD cannot offer specific textual suggestions.

# 2.0 Draft Chapter: Responsible business conduct

## 2.1 Paragraphs

The current text of this draft chapter suggests that additional thinking is required.

In particular, the draft relies too much on good regulatory practice of governments as a basis for responsible business conduct, as opposed to the pure and simple responsibility of businesses to ensure that their conduct meets international standards, irrespective of the state of the domestic law in the host state or its enforcement. IISD understands that responsible business conduct complements good government regulatory practices, rather than being dependent on them. The draft text is far from clear on this key relationship issue.

The draft starts out promisingly:

> 1. Responsible business conduct (RBC) enables enterprises to better contribute to economic development, sustainability, inclusiveness and social progress and to respect internationally recognised human rights. RBC focuses on two aspects of the business-society relationship: the positive contribution businesses can make to economic, environmental and social progress to achieve sustainable development, as well as the need to avoid adverse impacts and to address them when they occur. It is an essential component of a competitive and transparent business environment.

IISD agrees with the above. The role of responsible business conduct as an essential component of a competitive and transparent business environment should be emphasized here, as this draft chapter is seemingly about business conduct, not government regulatory practices.

While governments should enact laws and regulations relating to business conduct, the concept of responsible business conduct goes beyond that legislation. Paragraph 4 moves in this direction, but not clearly or forcefully enough:

> 4. For enterprises, RBC means above all complying with the host country's laws, including those on respecting human rights, environmental protection, labour relations and financial accountability, even where these are poorly enforced. However, it also means striving to go beyond minimum legal standards and act in accordance with increasingly high expectations of business behaviour, as reflected in international RBC standards. This entails the need for social responsibility, business ethics, and the goal to contribute to sustainable development to become part of business decisions and activities.

The problem is that the above paragraph states that business responsibility means "above all compliance with the host country's laws," and beyond that only "*striving to go* [emphasis added] beyond minimum legal standards and act in accordance with increasingly high expectations of business behaviour, as reflected in international RBC standards." If the notion of responsible business conduct is to be taken seriously, it must include an equally clear *requirement* to go beyond compliance when the domestic laws do not achieve international standards on human rights, transparency and accountability, and contribution to sustainable development, as enumerated in paragraph 4. "Striving to" is not such a requirement and thus falls short of the expectations for this draft chapter. Therefore, IISD recommends replacing "striving" with "being required."

While the draft acknowledges the need for laws and regulations regulating investor activity, it is not appropriate to say, as in paragraph 7:

> 7. Governments define and implement the laws and regulations that underpin RBC.

As highlighted above, responsible business conduct is separate from and independent of the scope of domestic law. RBC is underpinned by good corporate policy and good sectoral and international standards. Compliance with domestic law is the minimal component of this. Otherwise, responsible business conduct would simply mean the responsibility to implement domestic law. It is self-evident that this cannot be correct.

IISD recommends deleting paragraph 7 or amending it to "Governments define and implement the laws and regulations that set the minimum requirements for RBC." Businesses set the internal rules and standards, and the international standards required to go beyond this on the full scope of issues raised in, for example, paragraph 4.

Paragraph 11, introducing the unquestionably important notion of cooperation in promoting responsible business conduct, starts with the phrase, "The roles of government, business and civil society in RBC are interdependent."

In a general sense there is some truth to this. However, while interdependent to some degree, these roles are also independent. In particular, the business responsibilities are not, again, contingent on whether government or civil society acts. Thus, it is probably more accurate to say these roles are "complementary," noting that enhanced cooperation will produce enhanced results in this regard.

Scope is another issue with this draft chapter. Although paragraph 1 begins with references to "Responsible business conduct (RBC) enables enterprises to better contribute to economic development, sustainability, inclusiveness and social progress," the chapter is inconsistent as to its scope. See paragraph 5, for example:

> 5. The scope of RBC is broad and cross cutting and covers a range of substantive areas including disclosure, human rights, employment and labour, environment, anti-corruption, and consumer interests, science and technology, competition, and taxation.

Here, the only economic development dimensions explicitly mentioned are employment, labour and taxation. The draft could include and mention other critical economic development levers business has at its disposal, such as local purchasing, training for local purchasing needs, contributing to downstream value-addition efforts in many sectors, introducing research and development programs, etc.

Paragraph 8 hints at a greater scope, but falls short in articulating the necessary breadth for economic development, sticking to more traditional regulatory categories as opposed to forms of business responsibility.

> 8. […] Human rights are an important element of RBC however regulatory regimes should extend beyond basic human rights protection to cover other areas of RBC (e.g. employment and labour, environment, anti-corruption, and consumer interests).

## 2.2 Core Questions

Core question 2 asks:

*Q. 2: How does the government promote policy coherence and alignment with RBC standards?*

The intention behind this question is unclear. Is it intended to suggest coherence between government policies and responsible business standards? If so, which standards? Is it intended to suggest that government somehow should be limited by RBC standards? Trusting that no such suggestion is intended, we recommend greater clarity in identifying the goals behind this question and in the language of the question.

Beyond this specific note, the absence of any notion of scope for responsible business conduct within the core questions is noticeable, especially given the above discussion.

## 2.3 Supplemental Questions Checklist

On the first set of questions, "establishing and enforcing a legal and regulatory framework," the second question asks: "Does the national legal regulatory framework align with internationally recognised instruments on RBC?" The intentions behind this question are also unclear. What is "align" intended to mean here? That governments are limited by any such international instruments? IISD recommends making, unambiguously clear that they are not so limited. We bear in mind here that many aspects of responsible business conduct will be site specific or investment specific, or both, and will not be covered except at a most abstract level in any international standards. However, beyond this, RBD standards are meant as guidance to business on their conduct, not as limitations upon governments.

On the third set of questions, "promoting policy coherence and alignment with RBC," IISD recommends expanding the question "Do trade and investment agreements signed by the government make reference to RBC principles" to " . . . reference to RBC principles or investor obligations"?

On the fourth set of questions, "promoting RBC abroad," the use of "instruct" in the first sentence seems misleading. Governments cannot "instruct" private sector actors in any real sense, but only obligate them as a matter of law, or encourage them in a hortatory manner. "Instructing" portrays a false sense of somehow compelling behaviour without regulating. Very few governments of OECD member states, if any, can do this. IISD suggests clarifying the text, replacing "instruct" with "require" or "obligate."

On the eighth set of questions, "providing support and incentives for strengthened RBC," it is hard to see why governments should give incentives for proper business conduct. On the other hand, one can see the rationale for incentives in some areas, including R&D, and training for local employees and management. Some additional specificity should be added here. For example, there should not be incentives for respecting human rights, as this is so basic. However, incentives for going beyond minimum requirements for training for local purchasing opportunities, or allocating significant R&D budgets, as two examples, may be balanced by some incentives. The industry should not be able to use this type of documents as a basis to argue for incentives to go beyond compliance with weak environmental or human rights laws, for example.

# 3.0 Draft Chapter: Investment framework for green growth

## 3.1 Differentiating Among the Various Types of Investment

The draft chapter covers three fundamentally different types of investment, as noted in paragraph 1:

1. Investment in green infrastructure (e.g., in a solar generating facility, in landfill methane capture, or in rapid mass transit systems)
2. Investment in sustainable natural resource management (It's not clear exactly what this means; it is only really addressed in the last set of supplemental questions. See detailed comment on this below.)
3. Investment in the production of green goods and services (e.g., in the inputs to be used in green infrastructure—solar modules, wind power equipment; associated services like O&M, design, installation) (Note: this is basically **green industrial policy**.)

Ideally the chapter would be reorganized to consider each separately, or at least to devote a dedicated sub-section to discussing the salient features of each. However, it may be too late in the process for such recommendations. As an alternative, it is worth organizing the supplemental questions (and perhaps the key questions as well) such that it is clear when certain types of advice are specific to, or much more relevant to, only one of these types of investment (specific recommendations offered below). It might also be worthwhile to add after the bulleted list that follows paragraph 1 language along these lines:

> These three types of investment share many characteristics, but are ultimately distinct in nature. The investment vehicles used to achieve each will typically differ greatly as will the most relevant barriers to investment. The policy tools used to foster or govern them may also differ. These distinctions are highlighted throughout this chapter where they are most important.

An alternative would be to insert similar language in paragraph 5, which cautions against a one-size-fits-all approach.

### *Supplemental Questions*

IISD suggests to somehow designate within this section those questions that are relevant to particular types of investment. A "general considerations" designation is also needed, since many of the questions are relevant for more than one type. The easiest to segregate out is investment in sustainable natural resource management, which is almost completely confined to the last box.

*General considerations* would include:

- Trade policy
- Regional cooperation
- Public governance (bullet 1)
- Financial market policy and financial instruments
- Investment policy and enabling policies for green investment (bullets 1, 6, 7)
- Investment promotion and facilitation: key policies and incentives for green investment (bullets 3, 4, 5, 6, 8, 9, 10, 11)
- Government's commitment toward green growth
- Overview of green investment opportunities (bullets 2, 3, 5, 6, 7, 9)

*Green infrastructure* would include:

- Making and implementing the choice between public and private provision for green growth
- Public governance (bullets 3, 4, 5)
- Competition policy
- Investment policy and enabling policies for green investment (bullet 5)
- Investment promotion and facilitation: key policies and incentives for green investment (bullets 1, 2, 7, 12)

*Green industrial policy* would include:

- Promoting green business conduct and stakeholder participation in green growth
- Public governance (bullet 2)
- Investment policy and enabling policies for green investment (bullets 2,3,4)
- Investment promotion and facilitation: key policies and incentives for green investment (bullet 13)
- Overview of green investment opportunities (bullets 1, 8)

## 3.2 Sustainable Natural Resource Management

The draft chapter should either expand the coverage of investment in sustainable natural resource management, or delete it altogether. For one thing, while the other two types of investment above are sometimes similar in their challenges, this one is completely distinct and so, even more than the other two, would benefit from separate treatment.

The supplementary questions on this subject give us a working definition of investment of this type that includes:

- Investment in water infrastructure (Treatment? Provision? Capture? It is not clear.)
- Investment in environmentally sound treatment of natural resources
- Investment for biodiversity (e.g., facilitated by PES)

What is envisioned for any of these is unclear. While policy-makers in country may have a better grasp, IISD recommends explaining better the types and definitions above. This might be done after the bullet in paragraph 1; the other two types of investment could be followed by bracketed examples that illustrate how they are defined—this one is not, but should be.

The last of the supplementary questions raises a valid concern: ensuring that resource and land rights regimes safeguard the interests of those that depend on natural resources. However, this is not about green investment as per the narrower scope used in this chapter; it is rather about *all* types of investment. IISD understands that this is outside the scope of what this draft chapter calls "green investment," and therefore suggests deleting this bullet.

## 3.3 Difference Between Green and Conventional Policy Framework

The draft chapter is missing a key argument for active support of green growth and attracting green investment: most green investments are characterized by uninternalized environmental benefits. So, for example, investment in renewable energy infrastructure reduces human health impacts and mitigates climate change, but the prices received for such energy on the wholesale market do not reflect those benefits. This is a key rationale for government incentives to investment in renewable energy generation. IISD suggests fitting this argument into paragraph 2, which discusses the benefits of green investment.

## 3.4 Industrial Policy

One of the problems with not directly addressing the different types of investment is that the draft chapter cannot then directly address the most interesting questions around targeted policy; it seems to assume that anything other than horizontal policies (those that create indiscriminate fertile ground for investment across the board) would be unwise. So, for example, it does not help policy-makers discover in concert with the private sector what broad sectors might offer promising returns on support. It does not discuss how to avoid common government failures such as capture by vested interests, or how to ensure that specific support is targeted only at new activities with large potential for spillovers. It does not advise that such support only be directed at those areas where significant market failure (e.g., uninternalized environmental externalities) exists, etc. In other words, it does not impart much of what we have learned over the recent decades about the potential and shortcomings of so-called vertical industrial policies. IISD commends that it does, however, warn that such policies should be time-limited and updated to be specific to new technologies, and it recommends measurement of results, which is a prerequisite to conditioning continued support on measured success.

The lack of this sort of discussion may arise from a conviction that such policies are doomed to be unsuccessful. If so, that argument should be made explicit, since there is a substantial resurgence of interest in such policies among policy-makers in countries at all levels of development. Assuming the outcome, in other words, does policy-makers a disservice in precisely the areas that this document should be aiming to elucidate. If this argument is made in draft chapters of the revised PFI that IISD has not had an opportunity to analyze and comment on in this submission, references should be added here to those other chapters.

IISD would prefer to see this chapter delve into this range of questions, but understands that major revisions may not on the table at this time. As a compromise, IISD suggests inserting a paragraph 4 *bis* with language along these lines:

> Recent years have seen a resurgence of interest in targeted policies to attract investment in particular sectors, as opposed to policies that aim to improve the investment climate across the board. Often that interest has focused on green growth via investment in domestic production of environmental goods and services, with support such as targeted subsidies, local content requirements and other performance requirements. While there are successful cases of such "green industrial policy," it is hard to get right, particularly for smaller developing countries with low domestic demand and relatively poor supporting infrastructure. Unless they target sectors where there is potential to eventually compete on world markets—a difficult criterion to assess ex ante—policies of this type may simply drain government revenues or increase the costs of domestically purchased environmental goods.

## 3.5 Miscellaneous

One of the bullets in the supplementary questions reads: "What are the effects of climate change in the country? What challenges do they present for adaptation and mitigation policies?" The effects of climate change are indeed an adaptation policy challenge, but not a mitigation policy challenge. More fundamentally, this question, especially as modified by the second sentence, is germane for those planning climate change policy, but not particularly so for those planning investment. Therefore, we suggest deleting the bullet.

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