No investment agreement within the WTO

Re-directing investment to promote sustainable development

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This paper was written by Richard McNally. The paper aims to provide a platform for further discussion on setting a framework for sustainable investment policies and flows at all levels.

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Executive Summary

Over the last two decades the volume of foreign direct investment (FDI) has increased considerably. During this same period there has been an acceleration of environmental degradation – be it greenhouse gas emissions, deforestation or biodiversity loss. WWF recognises the importance of FDI for a country's economic development, but also that it can harm its prospects for future development. It is therefore vital that the links between FDI and the environment are clearly understood to ensure that FDI promotes rather than undermines countries' prospects for achieving sustainable development.

Research by WWF shows that the interactions between FDI and the environment are complex – these interactions can have a positive as well as a negative effect. For example, FDI can bring cleaner, more efficient technologies and working practices to foreign countries. On the other hand, investment can create irreversible environmental damage, particularly when it is on such a scale and pace as to overwhelm the host country's regulatory capacity. The negative impacts are most prevalent in the natural resource sectors that form the largest proportion of investment flows to the least-developed countries.

WWF believes that much of the current debate on foreign investment is overly simplistic and fails to address satisfactorily the issues of poverty reduction and the attainment of sustainable development. Current proposals for expanding the international legal regime governing FDI are oriented almost exclusively towards the liberalisation of capital flows as an end in itself. Rapid liberalisation of capital flows – if not set in a context that works in harmony with policies to promote conservation and sustainable development – may result more in benefits for private investors than in real improvements in public welfare.

Moreover, recent efforts to pursue pure investment liberalisation have run into problems of their own. In the mid-1990s, OECD countries were unable to complete negotiations for a proposed "Multilateral Agreement on Investment" (MAI) – in part because of fears raised by some governments about the impact the MAI would have on their ability to pursue legitimate public policies. Meanwhile, the investment chapter of the North American Free Trade Agreement (NAFTA) has generated a rash of cases brought by private parties seeking to use NAFTA in ways not intended by its drafters, as a tool to resist domestic environmental and other regulations.

Unfortunately, the lessons of these experiences have apparently not been fully learned. Some countries are now trying to develop a global agreement on investment within the World Trade Organisation (WTO), and are doing so without giving real attention to the problems outlined above.

WWF considers that negotiations towards an investment regime within the WTO should not be pursued. Until the international debate over investment rules begins to seriously address the relationship between FDI and the basic needs of conservation and sustainable development, all international investment negotiations will be premature.

Moreover, substantial doubt exists whether the WTO itself could ever be an appropriate forum for a new global investment regime. The WTO continues to act with a strong bias towards trade liberalisation above other policy objectives, such as equity and the environment. Also, its non-transparent operating culture is such that WTO rules are developed, interpreted and applied in a way that often excludes those countries and interests seeking to develop appropriate social and environmental policies to complement their trade policies.

WWF believes that better international investment can bring substantial benefits, especially to developing countries. However, this positive outcome will only occur inside a comprehensive regulatory framework that actively promotes sustainable development and ensures that environmental limits are preserved.

Creating the right regulatory framework for sustainable investment will be challenging and require actions at the national, regional and international levels. In some cases, this will be a long-term process. These frameworks should provide host countries with the flexibility and ability to control investment flows that undermine their sustainable development targets, as developed through transparent and consultative processes. WWF recommends the following actions that will help achieve this result:

At the international level there needs to be co-operation between states, in consultation with civil society, to ensure that:

- Existing and future bilateral or regional investment treaties are: (i) compatible with MEAs; (ii) allow host countries to set minimum environmental standards; and (iii) prohibit the lowering of environmental standards to attract investment.
- Legal barriers to suing foreign investors and enforcing judgment in home countries are removed.
- Detailed binding regulations are developed in environmentally sensitive industries, eg chemical and minerals.
- Restrictive business practices[1], transfer pricing[2], investment incentives and bribery and corruption are addressed.

Host – or recipient – countries, supported by development assistance and in consultation with civil society, should strengthen their environmental and economic governance structures to support sustainable investment. This entails taking measures that:

- Integrate environmental objectives into key sectoral policies such as energy, transport and agriculture and develop integrated policy packages that balance investors' rights with public needs.
- Ensure foreign investors and domestic companies disclose any environmental and social impacts.
- Ensure investment-related activities are fully covered by environmental laws and policies, including the polluter pays principle.

Home – or investing – countries, individually and collectively, should ensure that their investors act in a manner supportive of sustainable development. In particular, they should:

- Create mechanisms to lever additional funds from investors for projects aimed at sustainable development.
- Make assistance to investors conditional on good environmental performance, for example through export-credit agencies.
- Provide development assistance that supports recipient country efforts to develop good environmental and social governance.

The private sector should ensure that best environmental practices are implemented throughout their enterprises. To this end, there should be:

- A mandatory code of conduct for companies to prevent those following environmental best practice from being undermined by unscrupulous competitors. At a minimum, companies must adhere to the existing OECD guidelines for multinational corporations.

Taken together these measures, and others, should ensure that a proper balance is struck between protecting the rights of investors and promoting public goods.

The World Summit on Sustainable Development in September 2002 and the meetings on Financing for Development in March 2002, present an opportunity to examine systematically the relationship between FDI and sustainable development, to develop a new approach to international investment discussions that incorporate sustainability concerns and propose concrete mechanisms to operationalise such an approach.

These processes provide an appropriate, legitimate and existing forum for negotiations on a broad framework for re-orienting international investment policies towards sustainable results. The challenge is not to prejudge outcomes with overhasty WTO negotiations.

1 Introduction

During the past two decades we have witnessed a proliferation in private investment flows. The amount of Foreign Direct Investment[3] (FDI) has increased from US$150 billion in 1991 to over US$350 billion in 1998. FDI has become an increasingly important ingredient of economic growth with the sales from foreign affiliates of multi-national corporations (MNCs) now exceeding the value of host countries' domestic exports.

Over this same period there has been acceleration in environmental degradation – be it greenhouse gas emissions, deforestation or loss of biodiversity. Although investments tend to be private transactions, they can have far-reaching affects on the economic welfare of host countries. It is therefore vital that the links between FDI and the environment are clearly understood to ensure that FDI promotes, rather than undermines, a country's prospects for achieving sustainable development.

This requires governments, both collectively and individually, to create the right mix of incentives and safeguards aimed at balancing investors' rights with the attainment of public well being.

As policy makers once again debate the merits of including an international agreement on investment inside the World Trade Organisation (WTO), this paper, drawing on the lessons learnt from past and present investment agreements, examines whether such a multilateral investment agreement can achieve this end. The paper also proposes actions that WWF believes are critical to ensuring that any increase in FDI works in the interests of the poorest and of the environment.

WWF is an international non-governmental organisation that works to preserve biodiversity by protecting species and habitats, promoting sustainable resource use and reducing pollution. It is currently active in over 80 countries. WWF has worked for over 10 years on trade and investment issues and has policy units in Geneva, Brussels and Washington with policy staff working on investment issues in eight countries, including Brazil.

WWF was closely engaged in the debates around the OECD Multilateral Agreement on Investment from 1996 until negotiations collapsed in late 1998. Currently, it is actively involved in negotiations at the WTO, the Free Trade Area of the Americas (FTAA), the EU-Mercosur Association Agreement and the Mediterranean Free Trade Zone (MFTZ).

2 Foreign Direct Investment, the Environment and Sustainable Development

The current policy consensus around international investment tends to portray its impacts in glowing terms, especially in transferring technology, creating jobs and stimulating managerial efficiency.

Although this may be the case for certain investments, the perception is based on little detailed analysis of whether the benefits for the host country are maximised and what the associated economic, environmental and social costs are. As a result, current approaches to fostering international investment fail to address adequately the issues of poverty reduction, environmental protection and the attainment of sustainable development.

In fact, a variety of factors may lead to FDI having net negative impacts on a host (recipient) country. To begin with, the impact of FDI depends on the sector in to which the investment is taking place, and on the regulatory, social, and economic context in which the investment takes place.

The least developed countries, and those in transition, still receive a disproportionate amount of investment flows into their natural resource sectors. In 1994, foreign investment in the manufacturing sector of transition economies was a mere seven per cent compared with 57 per cent in primary commodities. By 1997, non-natural resource investment had dropped to just three per cent.[4]

FDI in natural resource sectors does not provide the host country with the same benefits as in manufacturing or services. The transfer of technology, knowledge and skills to the domestic companies, in particular, may be negligible.

Investment in extractive sectors can also often operate with few positive links to the national economy. This is particularly the case when output generated by the investment is geared for foreign markets, for example agriculture, mining, oil extraction and the trend towards "resort tourism" – with self-contained centres relying on imports and generating minor levels of local employment. Even the tax benefits that are often expected by the host government may prove elusive.

Too often, multi-national companies (MNCs) are hard to tax effectively given their ability to exploit transfer pricing and other methods to minimise their liabilities. As many as 84 per cent of developing countries recently surveyed by UNCTAD felt that MNCs were using these methods to avoid tax liabilities.

With much FDI dominated by large MNC actors, international investment can also be associated with restrictive business practices that harm the orderly development of domestic industries. This risk is especially present in cases where the foreign investment is in the form of mergers and acquisition by global oligopolistic MNCs, or where the domestic industry is not yet internationally competitive. A recent study, which spanned 30 years, found that at least 25 per cent of the investments had made host countries worse-off due to uncompetitive practices.[5]

The impacts of FDI also depend on a number of national factors, including the domestic regulatory context. There are a number of cases where investment has taken place on such a scale and pace – for example in the mining sector in South East Asia[6] – that it has overwhelmed the host country's regulatory capacity, resulting in large-scale environmental damage.

Much of the debate on FDI and the environment has focused on the "pollution havens" hypothesis[7] and the search for evidence to show that industries from industrialised countries move to countries with lower environmental standards. Though aggregate studies do not seem to show regulation as a primary cause of relocation, detailed studies in key sectors show clear examples of this effect – for example, in the tanning industry in Brazil, phosphate manufacturing in North Africa and logging in Central Africa.[8] As the case study in box one highlights, investors can try and use their economic clout to pressure host countries into removing environmental regulations.

Box One

P&O port development in Dahanu, India

Large infrastructure projects can cause significant social displacement. In 1997, WWF initiated a media and publicity campaign against a planned major port development in an ecologically fragile, legally protected area in Dahanu, Maharashtra, India, at the request of, and in collaboration with, some local NGOs. P&O Australia, a subsidiary of the UK multinational company P&O (The Peninsular & Oriental Steam Navigation Company) proposed the development.

The project would have destroyed the entire Dahanu environment and endangered the jobs and quality of life of tens of thousands of local inhabitants. P&O put pressure on the Indian authorities to denotify one of India's three designated eco-fragile areas so that it could go ahead with the development. In September 1998, partially as a result of NGO action, the local authority ruled that the proposed port was inadmissible and in November, P&O formally withdrew from the project.

The pollution havens debate has not helped progress international policy and must be replaced by a more advanced model based on those factors that truly determine investment location decisions. Though environmental regulations may not be the primary influence on a company's investment decision; they are an important consideration to some organisations – especially when choosing between countries in the same trading region or between different locations in the same country. Analyses of the effects of FDI on environmental regulation must also encompass both the competition for locating investment, and the credibility of threats to disinvest once established.

Arguably, the most pronounced effect of competition on investment flows is the "chilling" of environmental regulations. Countries are fearful that, by taking unilateral action to raise environmental standards, they will risk losing a competitive edge to other, less regulated countries. Recent examples include the failure of proposed EU and US energy taxes on account of intensive lobbying from industry fearing loss of international competitiveness. In other words, environmental commitments can become "stuck in the mud" for reasons relating to investment.

3 International Investment Agreements: Lessons and Challenges

The web of international rules on investment is extensive. The rapid growth in the international flow of capital has resulted in a vast set of international legal rules governing investment. In addition to the more than 1,856 bilateral investment treaties (BITS), most regional economic treaties (eg NAFTA, EU, and MERCOSUR) contain provisions that relate to investment.

The most extensive set of international investment rules and regulations were proposed under a Multilateral Agreement on Investment (MAI), which ended without result. The MAI was an attempt to apply liberalisation principles to the investment context, without allowing sufficient safeguards for non-commercial interests. It adopted a "top down" approach, whereby open access by investors would be the rule, but where individual countries could lodge exemptions for specific sectors. It also would have provided for an investor-state dispute settlement mechanism (see discussion under NAFTA Chapter 11 below).

In addition to its conceptual failures, the process to develop the MAI was flawed from the outset, both in approach (ie, that an agreement negotiated in the OECD could then be presented to the rest of the world), and in operation (in that the negotiations were primarily secretariat driven and non-transparent).

After a concerted campaign by environmental and developmental NGOs, the MAI was placed on a slower negotiation track, and some countries began to look more seriously at the implications of the draft agreement. In 1998 the initiative was abandoned after France withdrew, fearing that its cultural industries could become foreign dominated, and Germany decided to seek social and ecological guarantees.

Investment-related provisions also exist within the current WTO rules. Though not a fully-fledged investment regime, the agreement on Trade-Related Investment Measures (TRIMs) attempts to remove some barriers to investment. Potentially more significant is the General Agreement on Trade in Services (GATS), which will open up global markets for services. A more extensive international investment agreement has been proposed for the next round of WTO negotiations.

While over 90 per cent of recent unilateral changes in investment laws have been liberalising,[9] only rudimentary efforts have been made to construct international regulations in other areas where national governance might be limited. The most sophisticated system of treaties covers transfer pricing and double taxation issues. However, MNCs seem to be increasing efforts to avoid taxation through transfer pricing.[10]

The only other binding international regulatory instrument is the OECD agreement on combating bribery and corruption, which came into force in February 1999. Other processes on business practices, environment and labour are voluntary or lack strong implementation mechanisms.[11]

Very few of these treaties contain provisions relating to sustainable development (except perhaps in the preamble), and of those that do, the little experience gained in their operation so far casts doubt on their relative effectiveness. Rather, the evidence to date tends to show that the provisions in existing investment agreements tend to conflict with host nations' pursuit of sustainable development.

Box 2

Unexpected and serious problems with NAFTA

Chapter 11 of NAFTA is designed to ensure non-discriminatory treatment of foreign investors. To this end it includes concepts familiar to trade law, such as "National Treatment" and the "Most Favoured Nation" principle. However, it also includes the right of investors to be treated according to "minimum international standards", a prohibition on the imposition of performance requirements, the right to transfer profits and revenues out of the host state and, most significantly, that expropriation be for a public purpose and accompanied by compensation.

These provisions have taken on great significance through the dispute settlement mechanism in Chapter 11. In addition to the normal state-to-state dispute resolution mechanism, Chapter 11 also includes a powerful investor-state compulsory dispute resolution process that has been used 17 times so far, 10 of which to challenge environmental and natural resource management measures.

Ironically, this mechanism can result in granting foreign investors greater rights than their domestic counterparts. Under the NAFTA agreement the US company Pope and Talbot argued that it received less favourable treatment than domestic Canadian firms since it was subject to softwood lumber export quotas in its province of operation. All timber firms in the province were subject to these quotas but such restrictions are not present in other provinces.[13]

Most worrying has been the interpretation of the concept of "expropriation". The broad interpretations of Chapter 11, adopted by arbitration panels, raise the real possibility of restricting the ability of governments to develop effective environmental and social measures that adversely affect industry's commercial concerns. Metalclad is a case in point. It is not that Chapter 11 directly prohibits such government action, but granting such a broad right of compensation may lead to a "regulatory chill".

These conflicts have occurred and are likely to occur at a number of levels:

a The conflict with domestic environmental regulation

Investment rules have taken on an increasingly anti-regulatory character, restricting public policies that may infringe on the economic activity of private businesses. In addition, new international mechanisms have been created to give private investors new international legal weapons, including the ability to sue governments directly if public policies infringe private investment rights.

These legal cases are heard in secret proceedings, beyond the reach of national laws, and often without the possibility of appeal. In the hands of a new breed of aggressive international investment lawyers, some investment agreements have become sophisticated tools in an anti-regulatory fight – in ways that even the original drafters of the agreements did not anticipate or intend.

Specifically, rules on expropriation have exposed governments to challenges from investors who claim their profits have been reduced by the imposition of unfair and discriminatory environmental regulations. NAFTA can be used as a case in point. The US company Metalclad sued the Mexican authorities for expropriation because a toxic waste dump it purchased was not allowed to re-open after a further impact assessment revealed it lay over a vulnerable aquifer.[12] Experiences under chapter 11 of NAFTA illustrate many of the potential conflicts between investment agreements and the environment (see Box 2).

b The conflict with sustainable use of natural resources

It is essential for multilateral agreements to address any issue of economic imbalance and allow countries to preserve national policy goals such as defined development priorities or environmental protection. Past agreements have ensured flexibility by allowing countries explicitly to nominate those sectors to which the agreement applies, or specifying exceptions from their provisions. [14]

In the MAI, natural resources tend to be treated like any other investment. Some countries objected strongly to the MAI proposals saying that they would conflict with sovereign resource rights given under UN treaties – a view not supported by all countries.[15] Under the MAI, the sale of all natural resource concessions had to be notified in advance to potential investors. It was unclear how this related to the re-allocation of resource rights from the state to local or communal ownership, which is a common part of conservation and development programmes. The agreement, basically, was in conflict with policies to strengthen local or communal control of natural resources and reduced the ability of governments to gain fair benefits from natural resource exploitation.[16]

In order for governments to achieve sustainable development it is vital for them to be able to impose requirements on foreign investors to transfer environmentally sound technologies, use local suppliers and participate in joint ventures. Without such links into the domestic economy even the OECD has realised that it is unlikely that FDI will raise domestic environmental standards.[17] However, all these measures breached the list of outlawed performance requirements in the MAI.

The NAFTA and TRIMs agreements also outlaw such measures. Given the economic pressures working against effective regulation without positive rules to raise standards, the competition to attract investment is likely to chill environmental regulation and promote unsustainable resource use.

c The potential conflict with Multilateral Environmental Agreements

Several MEAs contain rules that implicitly cover investment, particularly those that address the economic aspects of the environmental issue at stake. Those MEAs that provide for differential treatment of countries – for example between parties and non-parties, or developed and developing countries – could potentially conflict with international investment rules that do not explicitly provide for exceptions for MEAs, and that require non discrimination between investors. Most problematic appears to be the Clean Development Mechanism (CDM), see Box 3.

Conflicts could also arise under the Convention on Biological Diversity concerning access to genetic resources. The CBD requires that access is based on the prior informed consent of the host country and that it be granted on the basis of the fair and equitable sharing of benefits. Depending on the measures a host country adopts to achieve these objectives, it is possible that distinctions between foreign investors and between foreign and domestic investors need to be established.

These conflicts could potentially escalate into legal disputes, particularly in cases where investors are entitled to bring suits against states under the investment treaty. As with the legal uncertainty in the relationship between the WTO and MEAs, it is also unclear in this context whether a dispute panel under an investment treaty would defer to the rules contained in MEAs. This is even more uncertain in cases where a country takes investment-related measures to achieve MEA objectives, but which are not fully specified in the MEA.

As policy makers rekindle the debate over a new international investment agreement inside the WTO, it is necessary to investigate whether the lessons have been learnt from these past failings. To do this, it is necessary to examine the current proposals to bring investment inside the WTO and to assess whether such an agreement would be capable of delivering sustainable development.

Box 3

By definition, the CDM covers foreign invest-ment, but compliance with the terms of the Kyoto Protocol may clash with rules contained in investment treaties. For example, the Protocol requires that the investor be from an Annex I country, which entails differentiating among investors based on their country of origin. Emissions credits eventually provided for these projects may be altered depending on whether the party of origin is in compliance with the Protocol.

There are also a number of other potential areas of conflict. Host country actions to build domestic capacity – so that it can implement the provisions requiring that CDM projects bring sustainable develop-ment benefits – could infringe performance requirements in investment treaties.

Provisions that allow developing countries to elaborate selection criteria for CDM projects may violate prohibitions in investment treaties on “pre-establishment screening”. Host country action to build domestic capacity, taken to implement the provisions requiring that CDM projects bring sustainable development benefits, could infringe performance requirements in investment treaties. Of note is the WTO decision in the case on Indonesia, where a tax credit aimed at encouraging local manufacturing was held to be inconsistent with Article 2.1 of the TRIMS Agreement (requiring the application of the GATT “national treatment” principle). It should be recalled that the measure at issue in that case did not require any specific action but was an incentive for voluntary pursuit of a national objective.

Finally, notions of “expropriation” in investment treaties could hinder host countries from re-evaluating the baselines of CDM projects; thereby possibly reducing expected credits.

4 Current proposals to bring investment into the WTO

At present the EU, supported by a number of countries including Chile, Costa Rica, Korea, Japan, Morocco and the Czech Republic, is pressing for a new multi-lateral agreement on FDI (excluding short term capital) to be concluded in the context of a new WTO negotiation round. These nations argue that such an agreement could increase transparency, confer the benefits of increased investment to developing countries, minimise the risk to investors and create better entry opportunities for small and medium sized enterprises.

The EU proposal takes a "bottom up" approach that allows each member state to decide which sectors should be opened up to foreign investment. This is similar to the approach taken under the GATS agreement. Although it confers more flexibility than the "top down" approach as drafted under the MAI (where open access is the presumption and each country then applies exceptions in certain circumstances) it is still problematic. Countries are likely to come under strong pressure to opt-in to key sectors and once this has happened, new restrictions on FDI will be prohibited (standstill) and progressive future liberalisation will be mandated (roll-back).

Although the "bottom up" approach may be more palatable to domestic policy makers than the "top down" approach, there is no a priori reason to conclude that it will be any better at striking the balance required for attaining sustainable development. The WTO has not proven sympathetic or able to cope properly with what it considers as "non-trade concerns", neither in its committees nor its dispute settlement body.

The WTO remains mainly concerned with increasing market access and seems less able to accommodate the needs of the poorest and the environment. Meeting the comparatively straight-forward challenge of ensuring that MEAs are not undermined by WTO rules has not been possible.

Despite commitments from the WTO secretariat that any investment agreement within the WTO would allow governments the flexibility and right to promote sustainable development, it is unclear how this will occur. The WTO does not give adequate scope for countries to follow their development priorities or to protect the environment, natural resources or human health and safety.

The problems of trying to balance policy flexibility with liberalisation received scant attention from OECD countries and was all but ignored in the MAI negotiations despite its ambitions to be a multilateral agreement. The fact that they have not been addressed indicates that an investment agreement inside the WTO would come up against the same, seemingly insurmountable, obstacles.

The stakes are generally much higher with foreign investment than with trade in goods. This is because investments can profoundly influence the host country's economy as well as its capacity to regulate on social, cultural and environmental matters. For example, WTO cornerstones such as the "national treatment" principle – based on what the WTO would see as "like" investments [18] – would deprive host countries of encouraging investments based on sustainable process and production methods (for example, investments in sustainable forestry as opposed to simply forestry).

Both theory and practice show that the extent of liberalisation must necessarily be limited by other policy goals, especially in the absence of adequate international and domestic regulation. Each sphere of sustainable development – economic, social and environmental – requires international markets to be limited to some extent.

The needs of development, competition and human rights justify limits in the economic arena. Maintenance of local cultural diversity and community economic control may necessitate limits in the social arena. Potential irreversible impacts and maintenance of communal-use rights provide a rationale for limits in the environmental sphere. There are strong arguments for increased regional and international regulation of investment flows that have failed to evolve at the same pace as liberalisation.

The EU and its allies appear to be asking the basic question: "What multilateral rules are necessary to ensure that international investment is provided with sufficient security?" Instead they, and other WTO member countries, should be asking (and answering): "How can investment fit into international and domestic frameworks aimed at promoting sustainable development?".

National and international efforts need to re-focus on putting in place the basic framework that allows foreign direct investment to promote, rather than undermine, a country's pursuit of sustainable development. Such measures could be introduced inside regional investment agreements or through other national and international bodies.

5 Setting a Framework for Sustainable Development

Creating the right regulatory framework to harness investment to support sustainable development will be challenging and will require a variety of actions at all level. This framework should provide host countries with the flexibility and ability to control investment flows that undermine their pursuit of sustainable development. Consequently, WWF calls for the following actions:

At the international level there needs to be co-operation between states, in consultation with civil society, to ensure that:

- Existing and future bilateral or regional investment treaties develop balanced investment rules that:

(i) are compatible with MEAs. Existing and future bilateral and regional investment treaties should contain explicit exceptions for measures taken pursuant to MEAs. At the same time, MEA provisions relevant to investment should be further developed to create specific investment rules. This will help forge international consensus on how investment should be balanced against the objectives of the MEA concerned. This increased legal certainty will also render it less likely to a challenge under an investment treaty and will further provide greater security for investors. More fundamentally, MEAs are better frameworks for ensuring that investment supports sustainable development by virtue of their ability to balance environmental, economic and social objectives;

(ii) allow host countries to set minimum environmental standards. The "chilling effect" present in some investment treaties must be removed so that countries can exercise their regulatory authority to protect their environment and promote sustainable development;

(iii) prohibit the lowering of environmental standards to attract investment. Home countries should not be permitted to sacrifice long term environmental assets for short-term economic gain. States should establish mechanisms to ensure that any such prohibitions are effectively implemented.

- Detailed binding regulations are developed in environmentally sensitive sectors, for example, minerals, fossil fuels, agricultural commodities and bulk chemicals. This should include stipulations on technical assistance to small and medium sized enterprises that lack access to environmentally sound technologies and management approaches to address their environmental problems.

- Legal barriers to suing foreign investors and enforcing judgment in home countries are removed, for example, through instruments developed under the Hague Conference on Private International Law. Home countries should provide access to justice in their own courts to host country nationals adversely affected by actions taken by the MNCs in the host country.

- Restrictive business practices, transfer pricing, investment incentives and bribery and corruption are addressed. Host countries can be challenged in regulating the economic impacts of powerful foreign investors. They should be equipped with regulations and capacity to eliminate the restrictive practices of MNCs, transfer pricing and corruption. A way to combat bribery and corruption is to join in and apply to the OECD Convention against Bribery.

- Knowledge about the impacts of FDI on environment and development is improved, co-ordinated and shared. This includes providing data, exchange of information, jointly developing methodologies for assessing impacts of FDI, monitoring and research as well as creating the fora for sharing experiences in harnessing investment in support of sustainable development.

Host – or recipient – countries, supported by development assistance and in consultation with civil society, should strengthen their environmental and economic governance structures to support sustainable investment. This entails taking measures that:

- Ensure that environmental impacts are addressed from the start rather than cleaned up later. For example, governments need to integrate environmental objectives in key sectoral policies such as those in energy, transport and industry and to incorporate environmental concerns and impacts in developing and implementing their investment promotion strategies and programmes;

- Ensure foreign investors and domestic companies disclose any environmental and social impacts;

- Ensure investment-related activities are fully covered by environmental laws and policies, including the polluter pays principle and environmental impact assessments;

- Ensure financing to monitor and enforce environmental conditions, pollution levels and other environmental impacts through fees on FDI activities in the industrial and natural resource sectors.

Home – or investing – countries, individually and collectively, should ensure that their investors act in a manner supportive of sustainable development. In particular, they should:

- Create mechanisms to lever additional funds from investors for projects aimed at sustainable development;

- Make assistance to investors conditional on good environmental performance, for example through export-credit agencies;

- Provide development assistance that supports recipient country efforts to develop good environmental and social governance, including capacity building and knowledge, skills and technology transfer;

The private sector companies should ensure that best environmental practices are implemented throughout their enterprises. To this end, there should be:

- A mandatory code of conduct for companies to prevent those following environmental best practice from being undermined by unscrupulous competitors. At a minimum, companies must adhere to the existing OECD guidelines for multinational corporations.

Taken together these measures, and others, should ensure that a proper balance is struck between protecting the rights of investors and promoting public goods. The World Summit on Sustainable Development in September 2002 and the meetings on Financing for Development in March 2002, present an opportunity to systematically examine the relationship between FDI and sustainable development, to develop a new approach to international investment discussions that incorporate sustainability concerns and propose concrete mechanisms to operationalise such an approach.

These processes provide an appropriate, legitimate and existing forum for negotiations on a broad framework for re-orienting international investment policies towards sustainable results. The challenge is not to prejudge outcomes with overhasty WTO negotiations.

The political question remains whether countries will be willing to negotiate additional disciplines on investment outside investor protection and further liberalisation, for the intermediate and long-term benefit of the people and the environment.

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Endnotes

1 Restrictive business practices are practices by firms to prevent new entrants into the sector. These include acquisition of potential competitors, predatory (below cost) pricing, restrictive contracts with suppliers or outlets not to stock competitors products, monopolisation of knowledge capital through patenting or acquisition of licensing rights which are then not used, lobbying for high tariff barriers and lobbying for high regulatory costs in a sector.

2 Transfer pricing: A tax avoidance practice commonly associated with MNCs. With transfer pricing a subsidiary in a highly taxed country sells components to another subsidiary in another country and records an artificially low price for the sale. This means that profits in the highly taxed country are artificially low and therefore subject to lower tax.

3 FDI in overseas subsidiaries or joint ventures is distinct from more volatile capital flows, such as portfolio investment and foreign bank lending.

4 Speech by Joe Stiglitz on Foreign Direct Investment in Transition Economies, ABCDE Conference, Valdivia; June 24, 1999.

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7 Under the pollution havens hypothesis, countries lower, or do not enforce, environmental standards to encourage investors (by reducing their production costs) to relocate from countries with higher environmental standards.

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10 In 1994 the US tax authorities made $3.5 billion worth of tax adjustments because of transfer pricing irregularities. In a recent UNCTAD survey, 84 per cent of developing countries surveyed felt that TNC affiliates in their countries were shifting income to avoid tax liabilities, UNCTAD (1999), Transfer Pricing, United Nations Conference on Trade and Development (UNCTAD) series on issues in international investment agreements, Geneva.

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16 WWF-UK (1998), *Memorandum of WWF-UK to the Environmental Audit Committee on the Environmental Protection and Sustainable Development Implications of the Multilateral Agreement on Investment,* WWF-UK, Godalming, Surrey, UK.

17 OECD (1997), *FDI and the environment – An Overview of the Literature,* [DAFFE(97)33], OECD, Paris.

18 According to GATT Article III countries cannot treat imported products any less favourably than "like" domestic ones. A key issue, therefore, is what is meant by "like". The jurisprudence on this article has so far ruled that "likeness" is to be determined on the basis of the end product, rather than the way in which the product was produced (production and processing methods). However, recent cases such as the asbestos decision, have revealed that this differential is not always watertight.

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