



# Global Forum on International Investment

## ***Encouraging Modern Governance and Transparency for Investment: Why and How?***

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### **SESSION 2: ACHIEVING TRANSPARENCY FOR INVESTMENT: HOW?**

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#### **Introduction**

How to achieve transparency in an investment policy context poses a range of different questions. Transparency about what? Transparency for whom? Transparency by whom? While transparency about a country's investment policy is an essential prerequisite for a company's investment decision, so is transparency about other laws and regulations that affect the company. Nevertheless, there is a tendency to focus only on the investment framework. It is not enough for a host government to inform the investor of the legislation surrounding the investment; social and environmental requirements are equally important. Furthermore, business constitutes only one group of civil society, transparency should also include information to other groups such as trade unions and NGOs. Although governments have a responsibility to provide companies and others with information of their investment policies, companies also have a responsibility to provide information regarding their performance. Transparency goes both ways.

#### **Public sector transparency**

Public sector transparency is the effective communication on public policy between governments, business, trade unions and NGOs. This means that governments should inform not only investors of laws, regulations and practices in the countries where they operate, but trade unions and other interest groups should have access to the same information. This should also include information on labour laws, social and environmental requirements and government instruments such as the OECD Guidelines for Multinational Enterprises. However, information is not enough. Effective communication involves dialogue between governments, the social partners and NGOs, as well as consultation on regulatory changes. But this is not always the case. The lack of public sector transparency, primarily in

developing countries, facilitates the negative competition among governments to attract foreign direct investment (FDI).

Transparency is one of the key factors when companies decide on the location of an investment. Other factors include access to international markets, market size, natural resources, human resources, infrastructure and the regulatory framework. Since FDI generates growth, it can play a considerable role in economic development and poverty reduction in developing countries. FDI provides supplementary financial resources and compared to portfolio investment or development aid, it is often more durable and less volatile. FDI can also create positive externalities. It tends to raise productivity in the host country by the adoption of technical know-how. But the transfer and diffusion of technology depend on domestic markets and the ability of the host country to take advantage of the benefits. With infrastructure and a highly skilled labour force it is easier to reap the benefits.

Whilst trade unions recognise the contribution that FDI can make to development it is not an automatic relationship. In the least developed countries, the impact of FDI on growth is less certain. Developing countries normally need to reach a certain threshold of development in terms of education and infrastructure before being able to benefit from FDI. There are also negative effects associated with FDI. Some experience in the extractive industries has suggested the depletion of poor countries' resources at less than a true price. Another problem is the negative policy competition among governments to attract FDI.

To make countries more interesting to investors, governments offer special incentives to attract foreign companies. "In some instances, targeted competition for FDI has risen to the level of veritable bidding wars, where jurisdictions not only compete, but continue raising their bids until the eventual incentives reach levels that would appear unfounded in economics."<sup>1</sup> Trade unions are particularly concerned over regulatory incentives since they risk leading to a race to the bottom in terms of labour standards. There is support also in economic literature for the view that investment incentives cause more harm than good, and governments should strive to abolish them. A minimum requirement is therefore that governments make investment incentives totally transparent. That would also make it easier to differentiate between companies working on a long term basis and companies that are only seeking short term profit by taking advantage of various investment incentives.

The negative policy competition to attract investment is increasing. This can be seen in the rapid expansion of Export Processing Zones (EPZs), through which governments are competing to offer the most favourable conditions to companies. Because of lack of transparency and little co-operation among governments, companies can shop around for the lowest standards and the most attractive offers.

### *Export Processing Zones*

EPZs are known by many different names. In some countries, EPZs are called Special Economic Zones, Maquiladoras, Free Trade Zones etc, but the concept is more or less the same. The number of EPZs has grown very rapidly in recent years. The ILO estimates that there were about 3 000 EPZs in 2002, employing 37 million workers.<sup>2</sup> Not only has the

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<sup>1</sup> OECD, "Assessing the Usefulness of FDI Incentives: Toward a Checklist" (DAFFE/IME(2002)6/REV2), Working paper, 2002, page 4

<sup>2</sup> ILO, "Employment and social policy in respect of export processing zones (EPZs)", Report of the Committee on Employment and Social Policy, 2002, page 2

number of EPZs increased, but also the number of countries setting them up. In 1995, EPZs existed in 73 countries and in 2002, in 116 countries.<sup>3</sup>

There are many differences between EPZs around the world but they tend to have one overriding characteristic. In almost all zones, trade unions are not tolerated. In some cases, this is due to special exceptions to national laws so that freedom of association cannot be exercised. More often, it is not so much the law but simply the reality that trade union officers are physically prevented from entering the plants or even from entering the zones at all.

The consequences of the lack of union representation can be seen in poor and often dangerous working conditions and low wages. There is an appalling abuse of workers in many zones. Beatings are common. The majority of the workers in EPZs are women. There are numerous examples of women workers being abused in the zones. One controversial issue relates to the pregnancy tests imposed on workers in some maquiladoras in Mexico.

In the past, most EPZs were publicly provided and owned. Now, however, many such zones are privately owned and operated. This has resulted in even worse working conditions and greater difficulties in organising.

The use of EPZs is also questionable from an economic point of view. Few EPZs can show that the presence of foreign companies has led to transfer of technology and skills. Many EPZs fail to attract substantial investment and the costs, in terms of the benefits offered to the investors such as tax concessions, may exceed the gain. Particularly in the electronics sector, there is a high degree of imported inputs in the final product, thereby reducing the benefit to the host country. EPZs can also lead to an uneven playing field when these benefits are not offered to all companies.

Yet there is little awareness of the failure of many EPZs, both in terms of economic and social development. Increased transparency in government investment policy including EPZs could help reverse the trend towards a race to the bottom.

### **The OECD Guidelines for Multinational Enterprises**

The implementation of the OECD Guidelines for Multinational Enterprises is one way to achieve transparency for investment. They deal with both private and public sector transparency. Several of the provisions addressed to multinational enterprises cover issues of transparency. In addition, transparency is one of the guiding-stars when governments implement the Guidelines.

#### *Background*

The Guidelines form part of the OECD Declaration on International Investment and Multinational Enterprises. Their purpose is to ensure that corporate activity is consistent with government policies, to improve the foreign investment climate and to enhance the contribution of multinational enterprises to sustainable development.

The Guidelines are governmental recommendations for good corporate behaviour, primarily directed to corporations based in those countries that adhere to them but applying to their

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<sup>3</sup> Ibid, page 2

operations worldwide. These include the 30 OECD countries<sup>4</sup> plus Argentina, Brazil, Chile, Estonia, Israel, Lithuania and Slovenia. More countries are in the process of adhering to them. The Guidelines are comprehensive with chapters covering: general policies, disclosure of information, employment and industrial relations, environment, combating bribery, consumer interests, science and technology, competition and taxation.

The Guidelines were first agreed upon in 1976 following public concern that multinational enterprises were becoming too powerful and unaccountable in the light of the role of some US based companies in the Pinochet coup d'état that overthrew the Allende government in Chile. They were rapidly followed by the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, and negotiations opened at the UN in New York to establish a UN Code on Transnational Corporations. The UN Code did not survive the political shift to deregulation in the 1980's and the Guidelines themselves fell into partial disuse as most OECD governments showed little political will to enforce them.

The collapse of negotiations on the Multilateral Agreement on Investment at the OECD in 1999 and the appearance of company codes and other initiatives of corporate social responsibility in the late 1990's led to a swing back in the political climate on company responsibility and opened the way for a substantial revision of the Guidelines and notably their implementation procedures in 2000. The revision was concluded in June 2000 and resulted in major changes such as the strengthening of the implementation procedures, clarifying their global applicability, the coverage of all core labour standards, and their extension to suppliers and sub-contractors.

The Guidelines may not be binding in a legal sense at the international level, but they are not optional for corporations either. If companies could simply pick and choose among the provisions of the Guidelines or subject them to their own interpretations, then they would have no value. Nor does their application depend on endorsement by companies. The Guidelines are the only multilaterally endorsed and comprehensive rules that governments have negotiated, in which they commit themselves to help solve problems arising with corporations. Most importantly, the ultimate responsibility for enforcement lies with governments. The key therefore is implementation.

Every adhering government has to set up a National Contact Point (NCP) for promoting and implementing the Guidelines. These NCPs are supposed to operate by four core principles: visibility, accessibility, transparency and accountability. NCPs may however be organised in different ways. Some involve a single government agency, while others are multi-agency (involving several ministries). Some are tripartite (government, labour and business), e.g. in France, Belgium and Sweden, but governments are ultimately responsible. Whatever the form, representatives of labour, business and NGOs must be informed of the availability of the NCP, which itself is expected to develop and maintain relations with these groups. Furthermore, prospective investors should be informed about the Guidelines.

When a company is believed to be in violation of the Guidelines, a trade union, an NGO or another interested party can raise this as a case with the relevant NCP. The NCP should then try to resolve the issue. A range of options is available, including offering a forum for

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<sup>4</sup> Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States, Japan, Finland, Australia, New Zealand, Mexico, the Czech Republic, Hungary, Poland, Korea and the Slovak Republic.

discussion for the affected parties, conciliation or mediation. In deciding what course of action to take, the NCP is required to make an initial assessment as to whether the case “merits further examination”. It must then respond to the party that raised the case. If the NCP decides that the issue does not merit further consideration, it must give reasons for its decision.

If the parties in the end are unable to agree on how to solve a problem, the NCP is normally required to issue a public statement on the case. It could also make recommendations to the parties on how the Guidelines apply to the case. NCPs may, therefore, inform a company that its activities breach the Guidelines. Whilst the Guidelines are not legally binding, the mere fact that the conclusions of NCPs are to reach the public domain can have an impact and affect company behaviour.

#### *Transparency in NCPs*

The trade union experience so far indicates that there is a general problem of transparency in the implementation of the Guidelines. Although some NCPs keep a low profile and are practically invisible, more worrying is the fact that they are not transparent.

More than 30 cases have been raised by trade unions since the review of the Guidelines was finalised in 2000, and a further dozen have been raised by NGOs. A majority of the cases refer to corporate conduct in non-adhering countries and/or violations of trade union rights. Another common issue is the closure or transfers of companies or parts of companies. Since trade unions are disseminating the Guidelines to raise awareness in developing countries, an increasingly number of cases concern corporate activities in non-adhering countries.

Thanks to the efforts of NCPs, some of the cases have been satisfactorily resolved or led to recommendations to companies. One good example is the handling by the Czech NCP of two cases filed by the Czech Trade Union Confederation (CMKOS) regarding two subsidiaries of the German companies Siemens and Bosch. The NCP acted in a transparent and efficient manner as set out in the procedural guidance of the Guidelines. Both cases concerned the right to organise. In the case of Siemens, the management wanted to do away with the trade union, and in the case of Bosch, the management tried to prevent the workers from establishing a trade union. The Bosch subsidiary also threatened to move and dismiss workers if a trade union was formed. The NCP, therefore, convened a number of meetings with the CMKOS and the companies. It also consulted the German NCP and informed the German Embassy of the companies’ behaviour. Furthermore, it issued press releases on the cases. Eventually, the companies agreed to respect the trade unions and to start constructive negotiations, although it took a change in management before Bosch changed its policy towards the workers.

Some of the cases have been withdrawn as the mere submissions of cases have made companies more inclined to negotiate and find solutions to the problems. Sometimes it has been enough merely to inform a company that the trade union intends to raise a case in order to resolve the issue. There are several examples of “cases” that never became cases.

Unfortunately, there are also some NCPs that have not taken their responsibilities seriously. They have been very slow to respond, afraid to criticise corporate conduct not compatible with the Guidelines and reluctant to set up tripartite meetings in order to solve the problems. After cases have been raised with NCPs, it is not unusual that trade unions and NGOs have had to wait for several months to get a first response. The party raising a case is too often not being kept informed of eventual measures taken by the NCP. Another problem is the lack of

transparency surrounding the outcomes of the cases. NCPs are supposed to report publicly of the outcomes, but this is not always the case.

Part of any government's efforts to increase transparency for investors must include the dissemination of the Guidelines. They have been underestimated as an instrument for developing countries. Governments in the South often maintain that they are in a weak position vis-à-vis multinational enterprises, therefore they tend to overlook infringements of labour laws. The Guidelines can be used to strengthen governments in developing countries as they are recommendations from industrialised countries to companies operating on their territories. By disseminating the Guidelines widely, governments are sending a strong signal to companies regarding their expected behaviour. In a recent case raised by the International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations with the UK NCP concerning the British American Tobacco's operations in Burma, the company stated in connection with its withdrawal from Burma that "it is hard to ignore the political will of your government". This shows that the Guidelines can be effective despite the fact that they are not legally binding.

#### *Transparency in corporate activities*

As stated before, transparency in investment does not only apply to governments, but to businesses and corporations as well. They too have an obligation to disclose information on their activities. The Guidelines contain a special chapter on disclosure of information suggesting that companies should ensure that timely, regular, reliable and relevant information is disclosed regarding their activities, structure, financial situation and performance. They should also apply high quality standards for disclosure, accounting, audit and for non-financial information such as social reporting. The chapter on combating bribery also encourages companies to enhance the transparency of their activities in the fight against bribery, for example by disclosing management control systems that discourage bribery. Moreover, companies should not give or demand a bribe or make illegal contributions to political parties.

### **Improving transparency through the fight against corruption**

Achieving transparency for investment involves fighting corruption. The fight against corruption must take place on two levels simultaneously: the private and public sector. As mentioned above, the Guidelines are relevant when fighting corruption since they deal with bribery and corruption in the private sector. Up till now, very few cases raised with NCPs have referred to the chapter on combating bribery, suggesting that it is too general to be of practical use. Another explanation is that the protection of whistleblowers is not sufficiently strong. The Guidelines contain language on whistleblowers in the chapter on general policies, but as the Guidelines are not legally binding they do not provide workers with the necessary protection. Workers that decide to blow the whistle do not only risk losing their jobs, they may also face other repercussions. Unless they are properly protected, it will be difficult to make any real progress on the fight against corruption. BIAC's initiative to use NCPs as information channels for reports on bribes and corruption is one possible step forward.

Another OECD instrument aimed at fighting corruption is the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. It requires all OECD countries to criminalise the act of bribing a foreign public official. The Convention is the most targeted of the international anti-corruption instruments and is

specifically focused on curbing the corrupt activities of multinational enterprises. It does not however provide protection for whistleblowers. The OECD monitors the implementation of the Convention through hearings of the member countries to assess the progress being made.

Not surprisingly, in countries where corruption is most widespread, violations of trade union rights are most common. These are often the countries that have not ratified the ILO core labour standards. Workplaces where trade unions are respected normally have an open and transparent climate, which makes it less likely that bribery and corruption frequently occur. In several developing countries, trade union rights are restricted, e.g. the right for public sector workers to organise and bargain collectively. Abolishing these obstacles to freedom of association would remove one of the reasons for bribery as the salaries for public officials in some countries are so low that they can hardly support a family.

## **Conclusions**

To achieve transparency for investment, governments must communicate effectively on public policy, laws and regulations. This should include information on labour laws, social and environmental requirements and government instruments such as the OECD Guidelines for Multinational Enterprises. This communication must be directed not only at investors or businesses, but also at trade unions, NGOs and other groups of civil society. Furthermore, companies have an obligation to be transparent in their operations worldwide, one of the issues covered by the Guidelines.

Governments need to increase their efforts to improve transparency in their investment policies, e.g. on investment incentives. This could reduce the growth of Export Processing Zones and short term investment that does not benefit the host country. Governments adhering to the Guidelines need to take further measures to properly implement the Guidelines. They should ensure that:

- The Guidelines are broadly disseminated, including to multinational enterprises and governments in non-adhering countries;
- National Contact Points (NCPs) deal with cases in a transparent and efficient manner; and that
- NCPs always report publicly on the outcomes of the cases they have dealt with.

Further measures are also needed to fight corruption. The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions is an important tool in this respect, but it does not provide protection for whistleblowers. Such protection should be guaranteed, either in the Convention or national law. Linked to the fight against corruption is the enforcement of trade union rights.