How international investment is shaping the global economy

Social, economic, and policy perspectives
This compilation, taken from the OECD Insights blog, has been prepared for distribution during OECD Week 2015. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

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Investment, investment, investment...

The 2015 OECD Ministerial is exploring the importance of investment not only to sustain growth but also to address inequalities, encourage innovation, help the transition towards low-carbon economies, and finance the UN’s Sustainable Development Goals (SDGs). As Dutch Prime Minister Mark Rutte put it, “Our priorities are three ‘I's: Investment, Investment and Investment!”.

International investment is so important because it makes economic globalisation and the growth and jobs it brings possible. Investment provides the finance needed to build value chains that stretch across the planet. It facilitates the trade that allows goods and services to be moved to where they are needed.

International investment also helps domestic economies to grow too, both directly by giving local firms the means to expand in home and export markets, as well as indirectly through access to the investors’ expertise, experience and networks.

The issue for governments is how to encourage international investment and to maximise its benefits. They have been successful in eliminating overt discrimination against foreign investors but it has become clear during the crisis that many structural impediments continue to hold investment back. Governments need to tackle these structural barriers so that investment can flow towards the projects, firms and places that need it most. Governments need to encourage longer-term productive investment in the firms and ideas that will be the sources of growth, rather than the short-term strategies that provided such a fertile breeding ground for the crisis.

Getting it right means finding the best balance between multiple, sometimes competing, economic goals, social needs, and political constraints as well as the interests of stakeholders ranging from huge multinational corporations to civil society.

The following eclectic collection of articles from the Insights blog brings together the personal views of authors from the OECD and outside the Organisation on the trends and challenges shaping international investment today. This represents how OECD, in an inclusive manner, deals with many issues linked with international investment. You’ll find discussions and debates on the state of investment in different regions of the world, the issues facing investment in particular sectors, the institutional frameworks that govern international financial flows, and the policy options that will allow investment to support better lives for all.

We hope you find this collection informative and stimulating.

Ana Novik, Head of the OECD Investment Division
Legislation on responsible business conduct must reinforce the wheel, not reinvent it

Roel Nieuwenkamp, Chair of the OECD Working Party on Responsible Business Conduct

The global economy has evolved at an impressive rate over the past several decades. Supply chains spanning dozens of countries are a common feature of businesses large and small. However, global regulatory frameworks have largely not kept pace with these trends. Rule of law remains weak in many developing countries and significant uncertainty and enforcement issues continue to exist in the context of transnational litigation and arbitration.

Some international instruments, such as the OECD Guidelines for Multinational Enterprises (the OECD Guidelines) and the UN Guiding Principles for Human Rights and Business (UNGPs) have been important tools for filling these regulatory gaps. For example the OECD Guidelines establish an expectation that businesses behave responsibly throughout their supply chains, not just within their direct operations, extending to activity in potentially institutionally weak contexts where international standards and domestic laws may not be adequately enforced.

Recently domestic law has also begun to follow suit in this regard by introducing legally binding obligations. Section 1502 of the US Dodd-Frank Act represents one of the first examples of legislation incorporating due diligence regarding human rights along the supply chain. Section 1502 provides that companies must report on whether they source certain minerals (tin, tantalum, tungsten and gold) from conflict areas. The OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas which was adopted as an OECD Recommendation in 2011 was the first instrument to define responsibilities in this context and is explicitly referenced in section 1502. Currently the EU is considering introducing similar obligations in a proposal aimed at regulating the import of conflict minerals into the EU. The proposed initiative will go through three separate reviews within the EU Parliament before being submitted to the EU Council level later this year.

Another example in the extractives sector where non-binding initiatives have acted as the harbinger for binding law is in the context of revenue transparency. The Extractive Industry Transparency Initiative (EITI), founded in 2003 was one of the first efforts to encourage government and private sector reporting on revenue streams of extractive operations as a strategy for battling corruption. Section 1504 of Dodd Frank, passed in 2010, requires that companies registered with the Securities and Exchange Commission (SEC) must publicly report how much they pay governments for access to oil, gas and minerals. The EU has since mandated similar obligations through Accounting and Transparency Directives and Norway and South Korea have expressed interest in doing the same.

In Drilling down and scaling up in 2015, I mentioned that the trend of hardening of soft law was among the top 5 issues to watch in RBC for 2015. I also noted that the UK, Switzerland and France had proposals in the pipeline to make due diligence regarding aspects of RBC mandatory. Since January, interesting progress has been made on these initiatives.
The Swiss motion, which proposed mandatory human rights and environmental due diligence for Swiss corporations was recently narrowly voted down in the Swiss Parliament. The deciding vote was 95 against and 86 in favour. In response to this result, the Swiss Coalition for Corporate Justice has announced that it will begin collecting signatures for a popular initiative on the proposal. If they gather 100,000 signatures in 18 months, the measure will be put to a binding public referendum.

The UK Modern Slavery Act was approved and enacted into law in March of this year. This act provides that commercial organisations must prepare a slavery and human trafficking statement annually detailing, among other matters, their due diligence processes in relation to slavery and human trafficking in their operations and supply chains.

The broadest scheme of the three remains the French legislative proposal which aims to mandate supply chain due diligence in accordance with the OECD Guidelines for Multinational Enterprises, thus covering a comprehensive range of RBC issues. Under the law French companies employing 5,000 employees or more domestically or 10,000 employees or more internationally would be responsible for developing and publishing due diligence plans for human rights, and environmental and social risks. Failure to do so could result in fines of up to 10 million euros.

An amended proposal approved by the French National Assembly will now be sent to the Senate, which might turn it down. However, in this case the National Assembly could still overrule the Senate. My assessment is that the proposal is likely to be adopted.

If such a law is passed in France there is speculation that it could generate spillover effects within the EU. The rapporteur for this proposal, Dominique Potier, has indicated that he will push the European Commission to develop a EU directive along similar lines.

The move from soft to hard law is a concern for many businesses. However, when it concerns the more severe issues of responsible business conduct, the jump between the two is not that high. Many companies already have due diligence systems in place. This means that the playing field for the more progressive companies will be levelled. That was one of the reasons why many British businesses supported the Modern Slavery Act. In addition, the UN Guiding Principle 23(c) already provides specific guidance on how companies should manage the risks of the most severe impacts; it says that businesses should “Treat the risk of causing or contributing to gross human rights abuses as a legal compliance issue wherever they operate”.

Another concern that businesses may have is that all these proposals will create a mess of different hard and soft standards. A proliferation of obligations (national, regional and international) has the potential to generate regulatory disarray and create challenges for businesses in navigating their obligations.

Uniformity and clarity around obligations and expectations will be important for establishing a level playing field for business. A large imbalance or contradictions in obligations regarding due diligence or reporting across jurisdictions may unfairly penalise companies operating in multiple jurisdictions or subject to more onerous standards. In ensuring that standards are aligned, administrative burdens for business will be eased and competitive risks will be mitigated.
Additionally such laws must be drafted carefully in order to be practical and fairly enforceable. Presently the language included in both the French legislation and UK law is highly general and therefore the obligations under the law remain somewhat abstract.

In order to ensure that such regulation is realistic, reasonable and effective, the regulations and guidance that will accompany these laws should be developed on the basis of carefully drafted non-binding standards, such as the UNGPs and the OECD Guidelines. They will also need multi-stakeholder input. In the context of the OECD, all due diligence guides interpreting the expectations of the Guidelines are developed in consultation with industry, government, civil society and worker organisations. This process has ensured that recommendations included in the guidance are endorsed by businesses, the ultimate users of the guidance, and that they are ambitious yet reasonable. Additionally, the role of non-binding instruments, as well as the organisations that crafted and implemented them should not be overlooked. The UN and OECD will be important sources of guidance on these issues.

Legislative proposals related to existing international instruments should not seek to reinvent the wheel, but to reinforce it. Existing instruments that are widely recognised and proven to be effective and reasonable should represent a foundation for their legally-binding counterparts.

Useful links

OECD Guidelines for Multinational Enterprises: mneguidelines.oecd.org


OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: mneguidelines.oecd.org/mining.htm

Global Forum on Responsible Business Conduct: mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct
Responsible gold also means supporting livelihoods of artisanal miners

Tyler Gillard, OECD Investment Division, and Roel Nieuwenkamp, Chair of the OECD Working Party on Responsible Business Conduct

Last year, a blind Congolese civil society leader named Eric Kajemba helped broker a deal between the Congolese army, local authorities, three powerful Congolese families and a Canadian mining company to de-militarise a lucrative gold mine in South Kivu province of the Democratic Republic of the Congo (DRC).

The mine, called Mukungwe, supports an estimated 5,000 thousand so-called “artisanal” gold miners, who work in harsh conditions and have for years lived under constant threat of extortion and violence by armed groups, the military and criminal gangs that operated in the area.

Kajemba’s efforts, and the support given by both the mining company and the Congolese government, were made in part because of growing international pressure on companies and governments to ensure that minerals used in everyday products don’t finance or fuel violent conflict or human rights abuses when mined in conflict zones.

Yet this same push for “conflict-free” minerals has also created new challenges for mines in eastern Congo, like Mukungwe, to access formal gold markets, mainly because of unreasonably high – and frankly counter-productive – compliance expectations.

To a certain extent this is normal. Formalising a previously informal economy will always create new compliance hurdles. At least this is an improvement over the challenges the miners had previously faced, namely escaping violence, extortion and forced labour at the end of a gun. Still there is a need for greater awareness among consumers and the gold industry that responsible gold also means sourcing responsibly from conflict areas and supporting artisanal miners in their efforts to meet the new demands of the market.

In 2010, US Congress spurred major action when it adopted section 1502 of the Dodd-Frank Act, obliging public companies to report on products containing certain minerals that may be benefiting armed groups in the Democratic Republic of the Congo (DRC). The European Union also proposed a draft regulation in March 2014 on responsible supply chains of minerals from any conflict area worldwide. OECD Due Diligence Guidance was singled out in both cases as the key standard for companies to maintain responsible mineral supply chains.

Gold is one of the minerals targeted by these efforts – and the big players in the gold industry have taken note. The London Bullion Market Association (LBMA), an industry body that maintains standards for the London gold market, made it mandatory for its gold refiners to undergo annual audits that would demonstrate they sourced gold responsibly and in line with the international standards set by the OECD. The World Gold Council and the Responsible Jewellery Council adopted voluntary certification schemes to implement the OECD’s due diligence guidance. Notably, the Dubai Multi-Commodities Centre also adopted audits requirements for its refiners in 2012.
Despite some challenges in rolling out these schemes, this is still a serious achievement. The audited LBMA refiners alone cover 85-90% of gold produced annually. It may even be tempting to say “mission accomplished”, since the gold market is basically conflict-free. However we cannot: there’s still a lot more to do.

Shrinking the last 10% of the informal gold market will be a challenge. And more should be done to strengthen some of the existing audit schemes too. But it’s necessary, and worth the effort. In 2013, more than $115 billion worth of gold was produced. Even if only 5% of that production benefited armed groups or criminal organisations worldwide, that’s still almost $6 billion that’s ended up in the wrong hands.

In contrast to the significant progress made in the formal gold industry, there has been little progress towards creating responsible supply chains of artisanal gold.

Artisanal gold mining generally means informal mining done with rudimentary tools, with little or no attention to health and safety, often rife with child labour and in areas of high-risk or conflict. Governments around the world often ignore the untapped potential of artisanal mining – which accounts for a whopping 90% of the global gold mining workforce – preferring instead to focus their efforts on attracting large-scale mining investments that bring far greater revenues to state coffers.

Given the informal and often illegal nature of the activity, artisanal gold mining continues to be one of the easiest ways for armed groups and criminals across the globe to earn sizable revenues though mafia-style extortion tactics used on the miners and their gold traders. A UN expert group reported in January that artisanal gold is still a major source of financing for armed groups in the DRC, which has seen one of the worst conflicts in recent history, claiming an estimated 5.4 million lives since 1996.

As the Mukungwe mine shows, not all of the artisanal gold produced in the Congo supports conflict. But almost all of it is mined informally and smuggled out of the country, making it difficult for international buyers to establish traceability. As a result, markets take a very risk-adverse attitude towards artisanal gold worldwide. Refiners and traders are often expected to provide a sort of “100% conflict-free” guarantee to their financier banks and customers before buying artisanally-mined gold.

If European supermarkets can’t guarantee that the beef they’re selling isn’t horsemeat, how could the banks and other buyers expect refiners to provide guarantees on artisanal gold, which almost by definition is produced informally, without infrastructure, licensing, or really any type of government support and oversight that could help give such assurances?

Banks, buyers and even consumers today need a reminder of what is helpful, and actually expected. These types of “100% conflict-free” expectations are counterproductive, and based on a misperception of international standards.

Standards like the OECD Due Diligence Guidance actually encourage companies to work with artisanal miners, without demanding perfection. Responsible sourcing of minerals is about good faith efforts to work and improve conditions in the supply chain. Unless a buyer finds evidence of armed group involvement or serious human rights abuses in the mine or trader, on-going
engagement with artisanal miners is the recommended course of action. Otherwise, there’s a risk that the trade will become even more hidden, leaving the miners in a worse-off position.

Today the discourse within the international community on “conflict minerals” has changed. It’s not just about conflict-free. What’s important is promoting responsible sourcing of minerals from conflict areas, despite the challenges. Whole-scale disengagement with artisanal miners almost always has harsh consequences for miners’ livelihoods.

What can help solve this catch 22? Consumer demand, for starters – at least until local governments take on their responsibilities to help artisanal miners. Jewellers should tap into this demand and begin sourcing – and marketing – responsible artisanal gold from conflict areas (see the Enough Project below). Which consumer wouldn’t appreciate knowing their wedding ring helped support peace and development for some of the world’s worst-off miners living in a conflict zone?

An OECD report on the Mukungwe gold mine in the DRC is one of a series in the pipeline that show how buyers can get directly involved in gold supply chains from areas of conflict. These reports examine the risks associated with specific gold mines and trading routes, and provide concrete recommendations for buyers and governments to help them build responsible sourcing and engagement practices that help artisanal miners. Today, however, the Mukungwe mine still has no legal route to export gold, and no buyer that’s willing to help improve the miners’ conditions, maximise their gold yields, get their documentation in order to export securely, and guard against interference from armed groups.

How long will these miners wait for buyers before they themselves turn to criminal behaviour, for lack of other opportunities? How long before the armed groups decide to come back to the mine and re-establish their grip on the lucrative business? Apparently not very long. On 21 December, armed men stormed Mukungwe and killed at least 10 people, including a 15-year old boy. Although the attackers quickly vacated the mine soon after the attack, the need for responsible engagement could not be more urgent.

Useful links

OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: mneguidelines.oecd.org/mining.htm

Conflict minerals: demonise the criminals, not the miners by Chuck Blakeman, founder of the Crankset Group, on the Insights blog: oecdinsights.org/2011/10/10/conflict-minerals-demonise-the-criminals-not-the-miners

A recent campaign from the Enough Project noted Signet and Tiffany as industry leaders in responsible gold sourcing, followed by JC Penney, Cartier and Target. The Responsible Jewellery Council has also helped drive responsible practices in the gold sector. Some consumer-labelling schemes for jewellery have also emerged, such as Fairmined or Fairtrade Gold, which could help consumers looking to source gold responsibly.
Don’t supply chains: Responsible business conduct in agriculture

Patrick Love, OECD Public Affairs and Communications Directorate

Two questions today: which fictional character helped bring down a colonial empire and gave his name to a food label? If you’re Dutch, you probably know the answer, if not, I’ll save you an Internet search by telling you: Max Havelaar, eponymous protagonist of Multatuli’s Max Havelaar, of de koffi-veilingen der Nederlandsche Handel-Maatschappy, translated into English as Max Havelaar: Or the Coffee Auctions of the Dutch Trading Company. In the middle of the nineteenth century, the Dutch government ordered farmers in its East Indies, modern-day Indonesia, to grow quotas of export crops rather than food. The Dutch also reformed the tax system, creating a public-private partnership that allowed tax commissioners to keep a share of what they collected. The result was the misery and starvation the book denounces. Max Havelaar helped change attitudes to colonial exploitation in the Netherlands and was even described as “The book that killed colonialism” by Indonesian novelist Pramoedya Ananta Toer in the New York Times Magazine.

The name Max Havelaar was adopted by the Dutch Fairtrade organisation and other European members of their network. The movement describes itself as “an alternative approach to conventional trade and is based on a partnership between producers and consumers. When farmers can sell on Fairtrade terms, it provides them with a better deal and improved terms of trade”. The movement has its critics. For instance in this article on Fairtrade coffee in the Stanford Social Innovation Review, Colleen Haight argues that “strict certification requirements are resulting in uneven economic advantages for coffee growers and lower quality coffee for consumers” and that while some small farmers may benefit, farm workers may not.

Which brings us to the second question: what’s that got to do with the OECD? We’re asking for comments on the draft FAO-OECD Guidance for Responsible Agricultural Supply Chains. Government, business and civil society representatives, international organisations, and the general public are invited to send comments by email to coralie dot david squiggly sign oecd dot org by 20 February 2015. I’d like to say that winning entries will receive a guinea, but they won’t. We will however publish a compilation on this web page from the OECD division in charge of the Guidelines for Multinational Enterprises (MNEs).

The world’s population is increasing and, human biology being what it is, so is the demand for food. Agriculture is expected to attract more investment, especially in developing countries, and human nature being what it is, some rascals may be tempted not to trade fairly. Or as the call for comments puts it: “Enterprises operating along agricultural supply chains may be confronted with ethical dilemmas and face challenges in observing internationally agreed principles of responsible business conduct, notably in countries with weak governance and insecure land rights.”

Apart from the OECD MNE Guidelines, the guidance considers half a dozen other sets of standards and principles from the FAO, UN, and International Labour Organization among others, designed to encourage “responsible business conduct”. Intended users include everybody from farmers to financiers, in fact the whole supply chain from seed sellers to grocers. The guidance as it stands
today was developed by an Advisory Group with members from OECD and non-OECD countries, institutional investors, agri-food companies, farmers’ organisations, and civil society organisations.

The aim is not to create new standards, but to help enterprises respect standards that already exist “by referring to them in order to undertake risk-based due diligence”. Some unfamiliar language/jargon/special terminology is inevitable in a document like this, but the authors of the guidance have taken care to explain it all. “Due diligence” here refers to the process through which “enterprises can identify, assess, mitigate, prevent, and account for how they address, the actual and potential adverse impacts of their activities” (and those of their business partners).

The draft proposes a five-step framework for risk-based due diligence, covering management systems, identifying risks, responding to them, auditing due diligence, and reporting on due diligence. Some of the concrete proposals will provoke little or no discussion I imagine, such as “respect human rights”. On the other hand, “promote the security of employment” is likely to see a frank and open exchange of views. (The 2013OECD Employment Outlook has a chapter on enhancing flexibility in labour markets.)

The human rights and labour sections could apply to any sector of the economy, as could most of the proposals on governance (we’re against corruption) and innovation (we’re for appropriate technologies), but there are a number of proposals targeting agriculture in particular, for example “promoting good agricultural practices, including to maintain or improve soil fertility and avoid soil erosion”. Again, some of the draft focusing on agriculture is uncontroversial (respect legitimate rights over natural resources), but I can’t imagine owners of factory farms agreeing to grant animals “the freedom to express normal patterns of behaviour”.

I’m sure you’ll find plenty to agree or disagree with, so let us know and we’ll rid the agricultural supply chain of, as Multatuli would say, all the “miserable spawn of dirty covetousness and blasphemous hypocrisy”.

Useful links

The OECD Cleangovbiz Initiative “supports governments to reinforce their fight against corruption and engage with civil society and the private sector to promote real change towards integrity”: www.oecd.org/cleangovbiz/

OECD Integrity Week, 23-26 March, brings together stakeholders from government, academia, business, trade and civil society to engage in dialogue on policy, best practices, and recent developments in the fields of integrity and anti-corruption: www.oecd.org/cleangovbiz/oecd-integrity-week.htm

OECD work on agriculture: www.oecd.org/agriculture/
Rethinking due diligence practices in the apparel supply chain

Jennifer Schappert, OECD Investment Division

Two years ago today, the Rana Plaza building in Bangladesh’s capital Dhaka collapsed, killing over 1,100 people and injuring another 2,500. The dead and injured were garment workers, ordered to go back to work even though shops and a bank in the same building had closed immediately the day before when cracks appeared. The garment factories were indirectly supplying international retailers, highlighting the debate on whether multinational enterprises (MNEs) can make the apparel supply chain safe and healthy. Ensuing recommendations to MNEs have often focused on MNEs strengthening existing compliance mechanisms with individual suppliers. However, to transform the sector, we need to question whether the current approach to supply chain due diligence is the right one to begin with.

In the absence of strong regulatory frameworks in many producing countries, the traditional approach to compliance is for enterprises themselves to take on the role of monitoring and assessing each supplier against international standards, developing corrective action plans, and then using their leverage (for example through the incentive of future contracts) to influence suppliers to mitigate risks. It sounds fine in theory, but in practice the system breaks down.

The OECD Guidelines for Multinational Enterprises advocate an approach where the nature and the extent of due diligence correspond to risk. However, the short-term nature of contracts between MNEs and their suppliers and the sheer size and complexity of apparel supply chains means that MNEs often struggle to know where to prioritise risk assessment and mitigation. Within this context an enterprise’s compliance system becomes reduced to ongoing assessments of (almost) all suppliers across all risk areas. This leaves few resources for tailoring risk assessments, identifying root causes of risks, and effectively managing risks when adverse impacts are identified.

Effective monitoring of individual suppliers is further complicated by the well-documented shortcomings of social audits, such as factory visits announced well in advance; fraud; inconsistent quality across audits and auditors; lack of alignment with international standards; audit duplication and resulting fatigue; and the limited scope of social audits which seek to identify adverse impacts but rarely root causes. Efforts to improve the system, for example through long-term contracts and close collaboration with suppliers have led to better results in certain cases and should be encouraged. However, this alone will not transform the sector because improvements are isolated to a few strategic suppliers and may fail to adequately address risks which cannot be tackled at the individual supplier level.

A multi-stakeholder project underway at the OECD is questioning current due diligence practices in the apparel supply chain on matters covered by the OECD Guidelines (human rights, employment and industrial relations, environment and bribery) and, among other questions, asking whether trade unions and other representative worker organisations could play a role in helping MNEs take a risk-based approach to due diligence.
Historically, unions and other worker organisations have helped government regulators direct inspections towards high-risk workplaces. For example, in the United States, trade unions helped regulators direct occupational safety and health inspections towards high-risk workplaces by requesting inspections as risks arose. This enabled limited government resources to appropriately target the most risky workplaces. By contributing to inspections, trade unions also ensured that inspections targeted the most salient risks at each individual workplace.

Within the apparel supply chain, workers’ representatives could act as an on-the-ground monitoring mechanism to trigger third-party inspections by multi-stakeholder initiatives. Such a process would potentially reduce the duplication of broad social audits and facilitate the targeting of technical assessments to specific risks. By contributing to the assessments, workers would likewise help to improve the quality and conformity of assessments and provide important context in identifying root causes of adverse impacts and corresponding solutions. Furthermore, unions and worker organisations have a role to play in promoting the long-term sustainability of solutions by increasing worker awareness of their rights, offering assistance in the actual exercise of individual rights, and protecting the rights of individual workers through collective bargaining.

The focus of an enterprise’s due diligence would then shift from the seemingly impossible task of monitoring suppliers for all risks to focusing on targeted assessments and risk remediation. The primary role of the MNE would be: to actively promote freedom of association amongst suppliers; create or participate in a system by which workers can request inspections; support timely and targeted technical assessments at the site level when requested or when operating in high-risk contexts (e.g. building integrity); and contribute to the mitigation of risks by addressing root causes (where feasible) in collaboration with suppliers, trade unions, and other buyers.

Freedom of association therefore becomes the enabler of risk-based due diligence across an entire supply chain. In countries where legal or political constraints prohibit or limit this fundamental right, the sector should use its leverage broadly, in collaboration with trade unions, government and international organisations, to influence government to reform the regulatory framework and its implementation in producing countries.

This broader approach to due diligence applies to other salient risks in the sector, low wages for example, that cannot be effectively addressed at the individual supplier level. The Bangladesh Accord on Fire and Building Safety and the Alliance for Bangladesh Worker Safety are demonstrating how a paradigm shift is feasible.

To date, supply chain due diligence in the apparel sector has predominantly focused on direct suppliers. However, according to the OECD Guidelines, it should be applied across the full length of the supply chain. Effective due diligence of risks linked to upstream production should build on the lessons of the last 20 years: an individual and bilateral approach to due diligence will not transform the sector. Due diligence is the responsibility of all enterprises in the sector. It should therefore be carried out by enterprises operating at each segment of the supply chain and be mutually reinforcing.

Based on the findings of the multi-stakeholder project, the OECD will develop a practical guidance to support the development of a common understanding of risk-based due diligence in the apparel and
footwear sector supply chain. We welcome you to join us on 18-19 June 2015 as we carry this debate forward at the Global Forum on Responsible Business Conduct.

Useful links

**Remembering Rana Plaza** Institute for Human Rights and Business: [www.ihrb.org/remembering-rana-plaza.html](http://www.ihrb.org/remembering-rana-plaza.html)

**OECD Guidelines for Multinational Enterprises:** [mneguidelines.oecd.org](http://mneguidelines.oecd.org)

**Global forum on Responsible Business Conduct:** [mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct](http://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct)

**Responsible supply chains in the textile and garment sector:** [mneguidelines.oecd.org/responsible-supply-chains-textile-garment-sector.htm](http://mneguidelines.oecd.org/responsible-supply-chains-textile-garment-sector.htm)

**Corporate leaders: Your supply chain is your responsibility** Roel Nieuwenkamp (@nieuwenkamp_csr) Chair of the OECD Working Party on Responsible Business Conduct, in the OECD Observer: [www.oecdobserver.org/news/fullstory.php/aid/4366/Corporate_leaders:_Your_supply_chain_is_your_responsibility.html](http://www.oecdobserver.org/news/fullstory.php/aid/4366/Corporate_leaders:_Your_supply_chain_is_your_responsibility.html)
How to stop businesses behaving badly

Patrick Love, OECD Public Affairs and Communication Directorate

Forty of the 100 largest economic entities in the world in 2012 were corporations, not countries, according to business consultants *Global Trends*. The sheer size of multinational enterprises (MNEs) leads many citizens to worry that they will abuse their economic power and political influence. This is not a new concern, and in fact was one of the reasons the OECD produced its *Guidelines for Multinational Enterprises* in 1976. The original *Guidelines* were published as an Annex to a Declaration on International Investment and Multinational Enterprises. At the time, much of the pressure to create some kind of framework for MNE activities came from the firms themselves.

After the Second World War, government intervention in the economy was direct and widespread, through nationalisations and strategies designed to build strong national champions in key domains. At the same time, today’s highly integrated, globalised economy was starting to emerge, and companies at the forefront of the process wanted reassurances that their investments abroad would be safe and government regulation would not constrain them too much.

There were calls for new rules from other points of view too, for example trade unions, but also from developing countries. The OECD texts actually came two years after the UN’s *Charter of Economic Rights and Duties of States*.

Given the impenetrability of much official language, then as now, the *Guidelines* were remarkably clear and straightforward, saying in a few dozen pages what companies and governments could and could not do, and recognising that there are problems, not just “challenges”. Subsequent revisions have respected this approach, for example stating that enterprises should: “Contribute to the effective abolition of child labour”; or “Not discriminate against their employees... on such grounds as race, colour, sex, religion...”.

The big question of course is how useful the *Guidelines* are in making corporations behave responsibly and resolving conflicts between firms and the communities they operate in. The *Guidelines* are not legally binding and contain no means of punishing companies that don’t respect them. They operate through National Contact Points which are expected to help resolve issues concerning implementation of the *Guidelines*. points out, “In the specific instance mechanism, the *Guidelines* possess a unique feature that provides the means to actively attend to and potentially resolve conflicts between aggrieved communities and companies”.

The *Guidelines* act as a global benchmark of corporate social responsibility and a strong signal of a government’s attitude towards corporate behaviour. They can also inspire actions that will be pursued through other instances. However, their biggest impacts could be due to reasons the creators of the original text could not have foreseen.

At the time of the 2000 revision, NGO *Corporate Watch* published a particularly severe criticism of the *Guidelines*, saying they were little more than a PR handbook. This criticism was echoed elsewhere, since even if a National Contact Point made a strong recommendation, the means to verify its implementation were usually missing, or beyond the means of those bringing the case.
That’s still true to some extent, particularly in non-democratic countries, but the sudden, massive expansion of modern means of communication and social media over the past few years has changed things.

This is altering the balance of power between those with something to hide and those seeking to expose it. When the Guidelines were created, few cases got much attention in national let alone international media. In August 2010, when trade unions in France and the USA announced they were going to bring a case under the Guidelines concerning labour practices in Colombia, the news was published in the Internet editions of major newspapers even before the unions had time to update their own websites.

The fact that workers in North America, South America and Europe can mobilise so easily around a common grievance, and see the Guidelines as the best tool for doing so, suggests that an Annexe published nearly 40 years ago can be a useful weapon in the fight to make the 21st century economy fairer. And as the Colombia case shows, the company doesn’t have to be operating in the OECD area, it only has to be registered in a country that has signed up to the Guidelines. That’s why the WWF were able to bring a case against UK oil company Soco under the Guidelines last year to stop them drilling in the Virunga World Heritage site in the DR Congo. Earlier this month, Soco announced it was ending its operations in Virunga.

But despite every big company now boasting about their ethics and efforts, there is still a large gap between what responsibility means in theory and how it is implemented on the ground. At the OECD’s Global Forum on Responsible Business Conduct this week, policy makers, businesses, trade unions, and civil society are debating how to bridge that gap. There are some fairly technical sessions on how the Guidelines work, but most of the Forum will be looking at controversial issues including the clothing industry after the Rana Plaza tragedy in Bangladesh; investing in Myanmar; due diligence in the extractive sector; agricultural supply chains; and responsible business conduct in the financial sector.

Useful links

OECD work on corporate governance: www.oecd.org/corporate

OECD Watch, an “international network of civil society organisations promoting corporate accountability and responsibility”: oecdwatch.org
The Policy Framework for Investment: What it is, why it exists, how it's been used and what's new

Stephen Thomsen, OECD Investment Division

Of all the acronyms in existence, “PFI” has to be one of the most popular. For many people, it is the Private Finance Initiative but that is only one of at least 40 meanings of the PFI, including institutes devoted to everything from pet foods to pellet fuels. For us at the OECD and for the many emerging economies we have been working with, the PFI stands for the Policy Framework for Investment. Our PFI means exactly what it says: it is a policy framework to stimulate investment and to enhance the impact from that investment.

Most people would agree on the potential benefits of investment. It can bring increases in productive capacity and other assets, including intangible assets such as intellectual property – all of which can contribute to productivity increases. As Nobel-prize winning economist Professor Paul Krugman famously remarked, “Productivity isn’t everything but in the long run it is almost everything.”

But many of us would also agree that the benefits from investment can sometimes be disappointing, not only on efficiency grounds but even more importantly as to its development impact. Some investment can even be detrimental in social or environmental terms.

The PFI looks at the investment climate from a broad perspective. It is not just about increasing investment but about maximising the economic and social returns. Quality matters as much as the quantity as far as investment is concerned. The PFI also recognises that a good investment climate should be good for all firms – foreign and domestic, large and small.

So how does it work? The PFI looks at 12 different policy areas affecting investment: investment policy; investment promotion and facilitation; competition; trade; taxation; corporate governance; finance; infrastructure; policies to promote responsible business conduct and investment in support of green growth; and lastly broader issues of public governance. These areas affect the investment climate through various channels, influencing the risks, returns and costs faced by investors. But while the PFI looks at policies from an investor perspective, its aim is to maximise the broader development impact from investment and not simply to raise corporate profitability.

The PFI is essentially a checklist which sets out the key elements in each policy area. The value added of the PFI is in bringing together the different policy strands and stressing the overarching issue of governance. The aim is not to break new ground in individual policy areas but to tie them together to ensure policy coherence. It doesn’t provide ready-made reform agendas but rather helps to improve the effectiveness of any reforms that are ultimately undertaken. It’s a tool, not a magic wand.

The best way to understand the PFI is to see how it has been used. Over 25 countries have undertaken OECD Investment Policy Reviews using the PFI, most recently Myanmar. Several other reviews are in the pipeline. The PFI is a public good and hence it is possible for a country to
undertake its own self-assessment, but in practice the combination of part self-assessment by an inter-ministerial task force and part external assessment by the OECD has proven to be a good formula. The PFI has also been used for capacity building and private sector development strategies by bilateral and multilateral donors. It has also been used as a basis for dialogue at a regional level, such as in Southeast Asia.

The PFI was originally developed in 2006 and has been updated in 2015 to reflect developments in the many policy areas mentioned above. Approaches to international investment agreements have evolved over the past decade. The OECD Guidelines for Multinational Enterprises have been substantially updated, partly to reflect the development of the UN Guiding Principles for Business and Human Rights. The OECD Principles of Corporate Governance and OECD Guidelines on Corporate Governance of State-Owned Enterprises are currently under review. The new PFI also places even more focus on small and medium-sized enterprises and on the role played by global value chains. It has incorporated gender issues, a vital element of inclusive development, and now has a chapter on policies to channel investment in areas that promote green growth.

We have also taken advantage of the focus on the PFI to address issues of how to move from PFI assessments to actual implementation of reforms on the ground. For this reason, the donor community has been strongly involved in the discussions surrounding the update. Experience at country level and consultations on the PFI update have led to greater co-operation between the OECD and the World Bank Group on investment climate reforms. In this way, the PFI can provide a platform for co-operation among international organisations, allowing them to provide more effective and complementary advice and support.

The update of the PFI has not been a purely technocratic exercise. The new PFI represents the collective wisdom of experts, policy makers, business people and other stakeholders. It has been presented in regional forums in Southeast Asia, Southern Africa and Latin America, as well as in Brussels and Washington D.C., led by a Task Force co-chaired by Finland and Myanmar. As a result of these inclusive consultations, the PFI strikes a balance between what investors want and the broader interests of society. The updated PFI will be launched at the OECD’s Ministerial Council Meeting in June this year.

So the next time you hear someone speak of the PFI, it might well be the Policy Framework for Investment.

Useful links

More and better private investments

Erik Solheim, Chair of the OECD Development Assistance Committee

Extreme poverty has been halved in a few decades and more than 600 million people have been brought out of poverty in China alone. Child mortality was also halved and children born today will reach 70 years of age on average. The enormous development progress over the past decades is one of the most significant achievements in human history and business and private investments have played an integral part.

Business and private investments under strong national leadership have been instrumental in all the greatest development success stories. Just think of Singapore, Korea, China, Ethiopia, Turkey and Rwanda. More and better business and investments will be crucial to eradicate extreme poverty by 2030 and implement the sustainable development goals to be agreed at the United Nations later this year. Only businesses can provide jobs for the around one million young Africans joining the labour market every month. Private investments are hugely important to green our agricultural systems and invest in clean energy for billions of people with little or no access to electricity. Private business is generally a huge force for good. But strong national leadership and responsible business conduct is necessary to avoid super-profits, exploitation of workers and degradation of the environment.

More investments

More of the $20 000 billion estimated to be invested around the world annually over the coming years must be directed to green investments in developing countries. Good investment policies are the most important thing. China now receives much more foreign direct investment in a single day than it did in the whole of 1980. Investments to Ethiopia have increased 15 times in just seven years as a result of good policies and focus on manufacturing, agriculture and energy. Development assistance can also help by reducing risk and mobilizing much more private investment. By blending public and private investments, the EU used $2 billion in aid to mobilize around $40 billion for things like constructing electricity networks, financing major road projects and building water and sanitation infrastructure in recipient countries.

Better investments

We also need better investments and better business conduct. Corporate super-profits, corruption and tax avoidance must be stopped. Far too often, profits are private while the destruction of forest, pollution of rivers and the effects of climate changing gasses are borne by the public. Workers must make decent wages, work in safe environments and have the right to join unions.

The OECD has developed the Guidelines for Multinational Enterprises, which set out recommendations on what constitutes responsible business conduct in areas such as employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation.

Mechanisms are in place to deal with grievances and the Guidelines have had some great successes. The UK-based oil company Soco decided to halt oil exploration in Africa’s Virunga national park until
UNESCO and the government of the Democratic Republic of Congo agree that oil production does not threaten the unique biodiversity in the area. G4S, a major global security guard employer, stood accused of underpaying and denying rights to employers in Malawi, Mozambique and Nepal while blacklisting union members. After mediation by a global union of 900 national unions, G4S agreed to improve employment standards across the company and to help improve the standards in the whole global security industry. The Norwegian salmon farming giant Cermaq stood accused of inadequately considering the environment and the human rights of indigenous people in Chile. The company agreed to enter into mutually beneficial agreements with indigenous peoples and to even further minimise risk of any environmental damage. The parties also agreed that certain claims about the company made by civil society groups were baseless and that future dialogue should start with mutual trust and clarification of facts, a win-win solution for both parties.

States must be responsible for framing the market in such a way that companies can make a healthy profit and provide jobs while protecting the environment and people’s rights. But companies can also be advocates for more responsible business conduct. The world moves forward when the best companies push others to improve social and environmental standards. Wilmar, the largest palm oil producer in Asia, became an advocate for conservation and after they themselves committed not to cut down rainforests.

Such business norms works best when leading global companies take the initiative. Last year, China was ranked by Forbes as home to the three biggest public companies in the world and five of the top 10. The OECD and China are now working on moving towards common standards for businesses. More global guidelines would make a huge difference because China now provides 1 out of every 5 dollars invested in Africa. Chinese companies are building important infrastructure around the world like the East African railroad linking Kenya with Uganda, Rwanda and South Sudan. Chinese companies are increasingly moving manufacturing plants to Ethiopia and Rwanda.

More and better private investment is necessary to eradicate poverty and provide food, electricity and jobs for a future 9 billion people without destroying the planet. More responsible business conduct is a hugely important part of that.

Useful links

The Global Forum on Responsible Business Conduct 18-19 June 2015 is held to strengthen international dialogue on responsible business conduct (RBC) and provide a platform to exchange views on how to do well while doing no harm in an effort to contribute to sustainable development and enduring social progress: mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct
In my view: The OECD must take charge of promoting long-term investment in developing country infrastructure

Sony Kapoor, Managing Director, Re-Define International Think Tank

The world of investment faces two major problems.

Problem one is the scarcity – in large swathes of the developing world – of capital in general, and of money for infrastructure investments in particular. Poor infrastructure holds back development, reduces growth potential and imposes additional costs, in particular for the poor who lack access to energy, water, sanitation and transport.

Problem two is the sclerotic, even negative rate of return on listed bonds and equities in many OECD economies. The concentration of the portfolios of many long-term investors in such listed securities also exposes them to high levels of systemic – often hidden – risk.

Most long-term investors would readily buy up chunks of portfolios of infrastructure assets in non-OECD countries to benefit from the significantly higher rate of return over the long term, and to diversify their investments. At the same time, developing economies, where neither governments nor private domestic markets have the capacity and depth to fill the long-term funding gap, are hungry for such capital.

So what’s stopping these investments?

Financial risks in developing countries are well known and often assumed to be much higher than in OECD economies. Also, investing in infrastructure means that investors will find it hard to pull their money out on short notice, and therefore such investments pose liquidity risks.

Despite these easy answers, however, there are three significant caveats:

First, the events of the past few years have demonstrated that on average, political risk and policy uncertainty in developing countries as a whole have fallen, especially in the emerging economies.

Second, OECD economies are also exposed to serious risk factors, such as high levels of indebtedness and demographic decline. As the financial crisis demonstrated, they are also likely to face other “hidden” systemic risks not captured by commonly used risk models and measures.

Third, the kind of risks that dominate in developing countries, such as liquidity risks, may not be real risks for long-term investors (e.g. insurers or sovereign wealth funds). Given that the present portfolios of these investors are dominated by OECD-country investments, any new investments in the developing world may look more attractive and may actually offer a reduction of risk at the portfolio level.

So I ask again: Why aren’t long-term investors investing in developing country infrastructure in a big way?
The biggest constraint is the absence of well-diversified portfolios of infrastructure projects and the fact that no single investor has the financial or operational capacity to develop these. Direct infrastructure investment, particularly in developing countries, is a resource-intensive process.

The G20, together with the OECD and other multilateral institutions such as the World Bank, can facilitate the development of a diversified project pipeline on the one hand, together with mechanisms to ease the participation of long-term investors on the other. This work will involve challenges of co-ordination, more than commitments of scarce public funds.

In my view, the OECD – which uniquely houses financial, development, infrastructure and environmental expertise under one roof – must take charge.

Useful links

OECD work on institutional investors and long-term investment: www.oecd.org/dac/financing-development.htm

OECD work on financial markets: www.oecd.org/finance/lti
Investing in infrastructure

Patrick Love, OECD Public Affairs and Communication Directorate

William Topaz McGonagall is universally acknowledged as the worst poet who ever wrote in the English language, but that didn’t stop him having an intuitive grasp of the economics of infrastructure investment. As he argued in “The Newport Railway” published to celebrate the Tay Bridge and the trains it carried to Dundee, “the thrifty housewives of Newport/To Dundee will often resort/Which will be to them profit and sport/By bringing cheap tea, bread, and jam/And also some of Lipton’s ham/Which will make their hearts feel light and gay/And cause them to bless the opening day/Of the Newport Railway […] And if the people of Dundee/Shall feel inclined to have a spree/I am sure ‘twill fill their hearts with glee/By crossing o’er to Newport/And there they can have excellent sport”.

At the OECD, we’re more into free verse than rhyming, so we talk about investing “to meet social needs and support more rapid economic growth”. The social needs and benefits can be vast in developing countries in particular. Take sanitation for example. In many urban areas, infrastructure hasn’t expanded as much as population, leaving millions of citizens with no access to piped water and modern sanitation, or forced to live near open sewers carrying household and industrial waste. Water-related diseases kill more than 3.4 million people every year, making this the leading cause of disease and death around the world according to the WHO.

According to the OECD’s Fostering Investment in Infrastructure, it’s going to cost a lot to keep the thrifty housewives across the globe happy over the next 15 years: $71 trillion, or about 3.5% of annual world GDP from 2007 to 2030 for transport, electricity, water, and telecommunications. The Newport railway was privately financed, as was practically all railway construction in Britain at the time, but in the 20th century, governments gradually took the leading role in infrastructure projects. In the 21st century, given the massive sums involved and the state of public finances after the crisis, the only way to get the trillions needed is to call on private funds.

There are several advantages to attracting private capital for governments, apart from the money. Knowledgeable investors bring skills and experience in designing, building and running projects. But will fund managers be willing to commit to investments with long life cycles when their shareholders are demanding quick returns and high yields?

The opportunities are there, but the infrastructure sector presents specific risks to private investors, and since private participation in infrastructure delivery is relatively recent in many countries, governments do not necessarily have the experience and capacity needed to effectively manage these risks. Fostering Investment in Infrastructure brings together the lessons (both positive and negative) learned from the OECD’s Investment Policy Review series, and lists the most useful policy takeaways for the various components of the investment environment, such as regulation or restrictions on foreign ownership, based on the actual experiences of a wide range of countries.

Some of the advice sounds like no more than common sense, but given the difficulties many infrastructure projects get into, it seems that many governments fail to take what the report calls a “holistic” view before signing deals. For example, the report warns governments to make sure that
arbitration procedures are clear and coherent so that disputes that could be settled quickly don’t end up as lengthy, costly cases before international tribunals.

Likewise, given that most infrastructures are built on or under land, you’d think it wasn’t necessary to insist on having a “clear and well-implemented land policy”. Experience shows otherwise. For example, the US newspaper The Oklahoman describes how in its home state plans to develop wind farms met opposition from the oil and gas industry over access to the surface in the early 2000s, and that now, as development moves closer to suburban areas, there are calls for tighter regulation from property owners.

As the OECD report points out, investors are going to be unwilling to commit funds if they think policy regarding the basics is likely to change over the life-cycle of the project, and even less willing when policy changes within the term of a single administration.

Apart from the discussion on core conditions, there is a detailed look at investing in low-carbon infrastructure, such as wind farms. It makes sense to look at this separately because the business model of the sector is so different from traditional energy production and distribution. For electricity generation for instance, highly centralised power stations serving a wide area are replaced by small-scale distributed generators that may only serve a single building. Feed-in tariffs are a popular means of encouraging low-carbon renewables – paying producers for extra energy they feed into the main grid via a Power Purchasing Agreement (PPA). But awarding PPA purely on a least-cost criterion can tip the balance away from renewables in favour of incumbent producers, as happened in Tanzania.

The lessons then are a mix of useful checklist and interesting insights. In a poem written not long after the one quoted above, our man McGonagall describes how if you get it wrong, you may not live to regret it: “the cry rang out all o’er the town/Good Heavens! the Tay Bridge is blown down”.

Useful links

OECD work on investment: www.oecd.org/investment
Overcoming barriers to international investment in clean energy

Geraldine Ang, OECD Investment, and Climate, Biodiversity and Water Divisions

Most of us would agree that clean energy is a worthwhile goal, and the world has invested more than $2 trillion on renewable-energy plants in the past decade. In 2014, energy generators added more renewable capacity than even before. But are we doing enough? According to the IEA, cumulative investment in low-carbon energy supply and energy efficiency will need to reach $53 trillion by 2035 to keep global warming to 2°C. It sounds a lot, and it is, but it’s only 10% more than the $48 trillion that would likely need to be invested in any case in the energy sector if the economy continues to expand and demand for power continues to grow as it has been doing in recent decades.

And the price difference with other types of energy is shrinking. Clean energy, especially electricity generation from renewable-energy sources, is increasingly competitive with new-built conventional power plants. It could therefore play a significant role in the transition to a low-carbon economy and help to meet broader economic and development goals. For example, the fact that electricity generation from renewables such as wind or solar power can exploit small distributed systems makes this form of energy suitable for areas not served by the large, centralised grids of traditional systems.

However, the deployment of low-carbon technologies is heavily influenced by government support, in particular in the solar- and wind-energy sectors. In the past decade, governments have provided substantial support to clean energy that has benefited both domestic and international investment. Globally, public support to clean energy amounted to $121 billion in 2013. At least 138 countries had implemented clean-energy support policies as of early 2014. Incentive schemes have contributed to enhancing clean energy investment worldwide, even if clean energy investment had to coexist with disincentives to investing in the sector, for example fossil-fuel subsidies, and the difficulties inherent in shifting away from fossil-fuels in the electricity sector, given the massive investments already made in traditional generation and the way electricity markets function.

Largely driven by government incentives, new investment in clean energy increased six-fold between 2004 and 2011, reaching $279 billion in 2011, before declining in 2012-13. Solar and wind energy have received the largest share of new investment – $114 billion and $80 billion respectively in 2013.

Prices of the equipment needed to generate clean energy, such as wind turbines and solar panels, have been falling, in part thanks to international trade and investment helping the solar photovoltaic (PV) and wind energy sectors to become more competitive. However, since the 2008 financial crisis, the perceived potential of the clean energy sector to act as a lever for growth and employment has led several OECD countries and emerging economies to design green industrial policies aimed at protecting domestic manufacturers, notably through local-content requirements (LCRs).
Local-content requirements typically require solar or wind power developers to source a specific share of jobs, components or costs locally to be eligible for policy support or public tenders. A forthcoming OECD report on *Overcoming Barriers to International Investment in Clean Energy* shows that as of September 2014, such requirements have been designed or implemented by at least 21 countries, including 16 OECD and emerging economies, mostly since 2009.

New, empirical evidence presented in the report shows that LCRs have hindered global international investment flows in solar PV and wind energy, reducing the potential benefits from international trade and investment mentioned above. This might be related to the fact that such policies increase the cost of intermediate inputs (the components needed to build the final products). This could lead to less competition in downstream segments of the value chain such as installation. Downstream activities are associated with more value creation than midstream manufacturing activities or upstream raw materials production and processing. The estimated detrimental effect of LCRs is slightly stronger when both domestic and international investments are considered. This indicates that LCRs do not have positive impacts on domestic investment flows.

In addition, according to results from a 2014 OECD Investor Survey of leading global manufacturers, project developers, and financiers in the solar-PV and wind-energy sectors on “Achieving a Level Playing Field for International Investment in Clean Energy”, LCRs stood out as the main policy impediment for international investors in solar PV and wind energy. It’s not surprising that a majority of international investors involved in downstream activities of the solar and wind-energy sectors selected LCRs as an impediment. More unexpectedly, a majority of international investors involved in upstream or midstream activities also identified LCRs as an impediment. This result suggests that LCRs can hinder international investment across the value chains.

As demonstrated in the OECD report, evidence-based analysis is needed to help policy makers design efficient clean-energy policies. Policy makers should reconsider measures in favour of domestic manufacturers for enhancing job and value creation in the clean energy sector if, as the OECD study suggests, the overall result is less investment and probably fewer opportunities for the very sector protectionism is supposed to help. Co-operation at a multilateral level is needed to address barriers to international trade and investment in clean energy.

**Useful Links**

OECD work on mobilising investment opportunities in clean energy infrastructure: www.oecd.org/investment/investment-policy/clean-energy-infrastructure.htm
Vital statistics: Taking the real pulse of foreign direct investment

Maria Borga, OECD Investment Division

Let’s start with a quiz. Which country is the second biggest direct investor in China? Who are the largest investors in India and Russia? You probably won’t believe it, but the answers are (a) British Virgin Islands, (b) Mauritius and (c) Cyprus. It’s not a sordid tale of hot money but rather a more mundane story of companies investing abroad through a holding company or affiliate located in a third country. They might be driven by the presence of a double taxation or bilateral investment treaty, or it might simply reflect corporate strategy to invest through an existing affiliate rather than by sending cash from the parent company.

Whatever the reason, it’s all perfectly legal. But as a consequence, we sometimes know very little about who owns what. Those Cypriot investors in Russia are almost certainly owned by an investor in another country, sometimes even a Russian investor. As a result, national statistics on flows of foreign direct investment (FDI) tell us less and less about what we want to know. Who is investing in our country and where are our own companies investing? To know the truth about a country’s FDI you need a comprehensive standard for measurement, which is why the OECD produced its standard: the Benchmark Definition of Foreign Direct Investment, 4th Edition (BMD4).

BMD4 makes two key recommendations which address the problems posed by the complex ownership structures of MNEs. The first is to compile FDI statistics separately for resident special purpose entities (SPEs). But what are SPEs? The OECD defines them as “entities with no or few employees, little or no physical presence in the host economy and whose assets and liabilities represent investments in or from other countries and whose core business consists of group financing or holding activities”. You may have seen images of them in TV reports about tax avoidance, when the camera shows a wall in a grubby building lined with mail boxes representing gigantic multinational firms. SPEs are often used to channel investments through several countries before reaching their final destinations. By separately compiling FDI statistics for SPEs, you can derive FDI into real businesses, giving countries a much better measure of the FDI into their country that is having a real impact on their economy. The second is to compile inward investment positions according to the ultimate investing country (UIC) to identify the country of the investor that ultimately controls the investments in their country.

This boils down to less double counting and more meaningful FDI statistics.

By recommending that countries compile FDI statistics separately for resident SPEs, BMD4 eliminates a layer of complication due to the ownership structures of MNEs.

The figure below shows the percentage of the inward stock of FDI—that is the accumulated value of investment by foreigners in the economy—accounted for by resident SPEs for 13 OECD economies. SPEs are very significant in Luxembourg and the Netherlands, accounting for more than 80% of all inward investment. SPEs are also significant in Hungary, Austria, and Iceland, where they account for more than 40% of inward investment. SPEs play smaller, but still important, roles in investment for
Spain, Portugal, Denmark, and Sweden. In contrast, SPEs are not significant in Korea, Chile, Poland, and Norway.

Share of FDI into SPEs and non-SPEs, at-end 2014

![Image of bar chart showing share of FDI into SPEs and non-SPEs at-end 2014]

Source: OECD Foreign Direct Investment statistics (BMD4) database

BMD4 also eliminates the lack of transparency regarding the country of the direct investor who ultimately controls the investment and, thus, bears the risks and reaps the rewards of it by recommending countries compile statistics by ultimate investing country (UIC) in addition to the standard presentation by immediate investing country.

The presentation by UIC can shed light on another important issue: round-tripping. Round-tripping is when funds that have been channeled abroad by resident investors are returned to the domestic economy in the form of direct investment. It is of interest to know how important round-tripping is to the total inward FDI in a country because it can be argued that round-tripping is not genuine FDI. The presentation by UIC identifies round-tripping by showing the amount of inward FDI controlled by investors in the reporting economy.

We can illustrate this by looking in more detail at France and Estonia and comparing the inward stock of FDI of the top ten ultimate investors to the amounts coming from the immediate investing country.

On the UIC basis, the United States is a much more important investor in France than it appears when presented by immediate partner country. Indeed, the inward stock of the United States increases from USD 79.6 billion to USD 142.1 billion. The inward investment stocks from Luxembourg and the Netherlands drop considerably, indicating that US companies may be using affiliates in these countries to handle business done in France. French investors are the 8th largest source of FDI into France. While this indicates there is some round-tripping, it accounts for less than 4% of the inward stock of FDI in France.
Inward direct investment by immediate partner country and by ultimate investing country, France at end of 2012 (USD millions)

Source: OECD Foreign Direct Investment statistics (BMD4) database

On the UIC basis, Estonia becomes its own second largest source of investment, indicating that round-tripping is more common than in France. Given that Sweden, Finland, the Netherlands, Russia, and Norway become less important as sources of investment when measured according to the ultimate investor, it appears that some of the round-tripping from Estonia is going through some or all of these countries. In contrast, the United States, Austria, Germany and Denmark are all more important sources of FDI in Estonia than the standard presentation indicates.

Inward direct investment position by immediate partner country and by ultimate investment company (excluding resident SPEs), Estonia at end of 2013 (USD millions)

Source: OECD Foreign Direct Investment statistics (BMD4) database
Does removing these layers of complexity matter? Yes. Every country has a strategy to attract investment and high quality statistics must be the empirical basis for any informed policy dialogue. Following the recommendations in BMD4 produces more meaningful FDI statistics that enable us to better understand who is really investing where internationally.

**Useful links**

For the latest FDI statistics: [www.oecd.org/investment/statistics.htm](http://www.oecd.org/investment/statistics.htm)


OECD’s newsletter, **FDI in Figures**, discusses recent developments in FDI: [Error! Hyperlink reference not valid.](http://Error! Hyperlink reference not valid.)
International investment in Europe: A canary in the coal mine?

Michael Gestrin, OECD Investment Division

At the start of the 2007 crisis, global foreign direct investment (FDI) stocks actually declined, and even today, global flows of FDI are still 40% below their pre-crisis peak. Generally, OECD countries were the sources of the biggest declines while many emerging economies experienced increases in FDI flows. Europe has been one of the worst affected regions. EU inflows are down 75% and outflows are down 80% from their pre-crisis levels.

Inflows into the EU are currently around $200 billion, down from $800 billion at the peak of the global FDI cycle in 2007 (see figures*). Outflows are also currently around $200 billion, down from $1.2 trillion in 2007. For the rest of the world, a global economy “without” the EU is doing quite well. In this global economy, inflows recovered strongly starting in 2010 and reached new record heights in 2011, at just over $1.2 trillion. With respect to outflows, the FDI crisis was limited to a one-year decline of 20% in 2009. Although world-minus-EU outflows have not grown over the past three years, they have been at record levels.

Part of the strong performance of the world-minus-EU can be explained by the growing importance of the emerging markets, in particular China, as sources and recipients of FDI. In 2012, emerging markets received over 50% of global FDI flows for the first time, and China is now consistently among the world’s top three sources of FDI.

The crisis initially gave rise to a significant gap between the non-EU OECD countries and the rest of the world with respect to both inflows and outflows, just as it did for the EU (see figures*). A big difference, however, is that for the non-EU OECD countries the gap closed after only two years. While the EU and the world-minus-EU group have been going in different directions ever since the start of the crisis, the non-EU OECD group and its rest-of-world counterpart appear to have returned to a similar cycle after parting ways for a much shorter period during 2008-9.

Comparing the EU and non-EU-OECD shares of world inflows and outflows highlights the extent to which the positions of these two groups have reversed in recent years (see figures*). At the turn of this century the EU accounted for over 50% of global inflows and 70% of global outflows. By 2013 both shares were down to 20%. Conversely, the non-EU-OECD countries have seen their shares of global FDI inflows and outflows recover to pre-crisis levels. This group overtook the EU in 2010 in terms of its share of both inflows and outflows, thus reversing the historical relationship.

Why? The greatest declines in inward FDI in the EU have been from within Europe itself (see figures*). Before the crisis around 70-80% of the region’s inward FDI consisted of intra-EU investment. Today only 30% of inward FDI is intra-EU. This sharp decline in the share of FDI that EU countries receive from their EU neighbours also helps to explain the decline in outward EU FDI.

The decline in the share of intra-EU in total EU inward FDI would seem to suggest a lack of confidence on the part of EU investors in their own regional market. One tempting explanation for
this is that these declines have been concentrated in a sub-set of EU countries that have experienced particularly difficult economic conditions (such as Greece, Ireland, Portugal, and Spain) during the crisis.

This has not been the case. The FDI crisis in Europe has been broad-based, with the bulk of the declines in FDI flows concentrated in the largest economies. France, Germany, and the UK accounted for 50% of the $600 billion decline in FDI inflows between 2007 and 2013. Over the same period, Greece, Ireland, Portugal, and Spain accounted for only $14 billion, or 2%, of the inflow decline. With respect to outflows, France, Germany, and the UK accounted for 59% of the $1 trillion decline between 2007 and 2013. Over the same period, Greece, Ireland, Portugal, and Spain accounted for 12% of this decline.

Part of the explanation for the decline in investment in Europe is linked to an increasing share of international divestment relative to international mergers and acquisitions (M&A, see figures*). While pre-crisis levels averaged around 35%, they reached almost 60% in 2010-11 and now stand at around 50%. In other words, for every dollar invested, 50 cents is divested. Consequently, net international M&A investment in Europe is currently at its lowest levels in a decade, at around $100 billion.

The clear “leader” in this regard is the consumer products segment, with a divestment/investment ratio of 148%. This means that for every dollar invested in consumer products over the past six years, around one and a half dollars was divested. This is an example of investment de-globalisation. Domestic and international M&A in Europe have generally followed the same pattern: both are on track to reach their lowest levels in a decade (see figures*). Conditions that are holding back international investment in Europe would seem to be discouraging domestic investment as well.

From a policy perspective, the challenges of breaking out of this regional investment slump are daunting but urgent. A useful starting point is the recognition that a supportive environment for productive international investment needs to reflect the evolving needs of international investors. Such a supportive environment has three dimensions.

First, investors generally favour predictable, open, transparent, rules-based regulatory environments, much along the lines put forward by the OECD’s Policy Framework for Investment. Where impediments to investment have not been addressed by governments this often has more to do with implementation challenges rather than disagreement over principles. For example, it is widely accepted that excessive ‘red tape’ is an obstacle to investment but in many countries this is still often cited by business as being one of the most important impediments to doing business. In Europe, many such impediments represent relatively easy opportunities for improving the regional investment climate.

The second dimension concerns important changes in the structures and patterns of global investment flows as well as in the way MNEs are organising their international operations. This is reflected in investment de-globalisation and “vertical disintegration” which has seen MNEs become more focused on their core lines of business over time and more reliant upon international contractual relationships for organizing their global value chains.
Finally, Europe would seem to be confronting a competitiveness puzzle in which declining competitiveness is discouraging investment, and declining investment is in turn undermining competitiveness. A few years ago, OECD Secretary General Angel Gurría outlined six policy recommendations for getting Europe back on a sustainable growth path that also hold for investment:

1. Further develop the Single Market.
2. Ease excessive product market regulation;
3. Invest more in R&D and step up innovation.
4. Make sure that education and training institutions deliver highly sought after skills.
5. Increase the number of workers participating in labour markets and make markets more inclusive to address social inequalities.
6. Reform the tax system, including by reducing the tax wedges on labour.

Useful links


* Figures available in the online version of this article: wp.me/p2v6oD-1Ua
The growing pains of investment treaties

Angel Gurría, OECD Secretary General

International investment treaties are in the spotlight as articles in the Financial Times and The Economist last week show. An ad hoc investment arbitration tribunal recently awarded $50 billion to shareholders in Yukos. EU consultations on proposed investment provisions in the Transatlantic Trade and Investment Partnership (TTIP) with the United States generated a record 150,000 comments. There is intense public interest in treaty challenges to the regulation of tobacco marketing, nuclear power and health care.

Some 3000 investment treaties provide special rights for covered foreign investors to bring arbitration claims against governments. Principles of fair and equitable treatment included in many treaties are uncontroversial as general principles of good public governance. But the treaty procedures for interpreting and enforcing them in arbitration claims for damages are increasingly controversial.

A trickle of arbitration claims under these treaties has become a surging stream. Over 500 foreign investors have brought claims, mostly in the last few years. Investor claims regularly seek hundreds of millions or billions of dollars. High damages awards and high costs have attracted institutional investors who finance claims.

Providing investors with recourse against governments is valuable. Governments can and do expropriate investors or discriminate against them. Domestic judicial and administrative systems provide investors with one option for protecting themselves. The threat of international arbitration gives substantial additional leverage to foreign investors in their dealings with host governments, especially when domestic systems are weak.

At the same time, there is mounting criticism. Arbitration cases can involve challenges to the actions of national parliaments and supreme courts. As Chief Justice Roberts of the US Supreme Court wrote earlier this year, “by acquiescing to [investment] arbitration, a state permits private adjudicators to review its public policies and effectively annul the authoritative acts of its legislature, executive, and judiciary”. In a similar vein, Chief Justice French of the High Court of Australia recently noted that the judiciary in his country had not yet made any “collective input” to the design of investment arbitration and that it was time to start “catching up”. This broadening interest in the system will enrich the debate on the future of investment treaties.

Governments and business leaders are also seeking to reform treaties so as to ensure that they help attract investment, not litigation. Some major countries, such as South Africa, Indonesia and India, are terminating, reconsidering or updating what they perceive to be outdated treaties that excessively curtail their “policy space” and entail unacceptable legal risks. Germany opposes the inclusion of investment arbitration in TTIP. The B20 grouping of world business leaders recently called on the G20 to address investment treaties.
International organisations such as the OECD can help governments and others to shape the future of investment treaties. I propose the following agenda for joint action to reform and strengthen the investment treaty system.

**Resolve investor claims in public.** The frequently secretive nature of investment arbitration under many treaties heightens public concerns. The treaties of NAFTA countries and some other countries have instituted transparent procedures. But nearly 80% of investment treaties create procedures that fall well short of international standards for public sector transparency. This is a major weakness. In July, UNCITRAL (the United Nations Commission on International Trade Law) approved a multilateral convention on transparency. Governments can now easily make all investor claims public. Over a century ago, Lord Atkinson emphasised that a public trial is “the best security for the pure, impartial, and efficient administration of justice, the best means of winning for it public confidence and respect”. Governments – with the support of major investors — should rapidly take action to ensure that investment arbitration adopts high standards of transparency.

**Boost public confidence in investment arbitration.** Governments have borrowed the ad hoc commercial arbitration system for their investment treaties. But this borrowing is increasingly questioned. Sundaresh Menon, as Attorney-General of Singapore, has observed that “entrepreneurial” arbitrators are subject to troubling economic incentives when making decisions on investor state cases. Advanced domestic systems for settling disputes between investors and governments go to great lengths to avoid the appearance of economic interests influencing decisions. Investment arbitration needs to do the same.

**Do not distort competition.** The concept of national treatment is a core component of investment and trade agreements. It promotes valuable competition on a level playing field. Investment treaties should not turn this idea on its head, giving privileges to foreign companies that are not available to domestic companies. Governments should protect competition and domestic investment by, for example, ensuring that treaty standards of protection do not exceed those provided to investors under the domestic legal systems of advanced economies. Some case law interpretations of vague investment treaty provisions go beyond these standards, and are unrelated to protectionism, bias against foreign investors or expropriation. Governments that allow for such interpretations should either make public a persuasive policy rationale for these exceptional protections for only certain investors, or take action to preclude such interpretations of their treaties.

**Eliminate incentives to create multi-tiered corporate structures.** By allowing a wide range of claims by direct and indirect shareholders of a company injured by a government, most investment treaties encourage multi-tiered corporate structures. Each shareholder can be a potential claimant. Indeed, many treaties encourage even a domestic investor to create foreign subsidiaries – it can then claim treaty benefits as a “foreign” investor.

If complex structures were cost-free, perhaps it wouldn’t matter. But they aren’t. Complex structures increase the cost of insolvencies and mergers. They also interfere with the fight against bribery, tax fraud and money laundering because they can obscure the beneficial owner of the investment. Governments should promptly eliminate investment treaty incentives to create multi-tiered corporate structures.
We need international capital flows to support long-term growth through a better international allocation of saving and investment. But the investment treaty system needs to be reformed to ensure that the rights of citizens, governments, enterprises and investors are respected in a mutually beneficial way.

Useful links

OECD work on international investment: www.oecd.org/daf/inv

OECD work on international investment law: www.oecd.org/daf/inv/investment-policy/oecdworkoninternationalinvestmentlaw.htm

Legal principles applicable to joint government interpretation of investment treaties was one of the issues discussed at the March 2014 OECD Roundtable on Freedom of Investment: www.oecd.org/daf/inv/investment-policy/20thFOIroundtableSummary.pdf
Aiming high: The values-driven economic potential of a successful TTIP deal

Karel De Gucht, former EU Trade Commissioner

A year ago, Presidents Barroso and Obama launched negotiations for a Transatlantic Trade and Investment Partnership, or TTIP. A deep and comprehensive free trade deal in generic terms, but much more than that from political, commercial and civil perspectives. We have now held five formal negotiating rounds, and it’s time to re-state the importance of this deal not only to us in Europe and the US, but for people around the world.

The overall figures are impressive. The EU and the US trade goods and services worth around EUR 2bn every day, and together we make up one third of global trade. Independent assessment indicates that both sides could gain significantly in terms of GDP growth over ten years (EUR 120bn in the EU, EUR 90bn in the US) – and equally so does the rest of the world (EUR 100bn). Such opportunity for growth is not something to leave by the wayside in a time of hesitant economic recovery.

But these macro figures don’t tell the whole story. The EU and the US have much more in common than our trade relationship. We share values: on democracy, on human rights and freedoms, and on a global rules-based trading system. Each of us enjoys a vibrant civil society and business sector, and broad political debate over things that matter. TTIP’s potential to deliver results depends very much on our ability as negotiators to meet the interests of all our stakeholders.

That’s why we are looking at three distinct areas: market access, regulatory cooperation and trade rules. Market access is a traditional element of trade negotiations. Tariffs between the European Union and the United States tend to be low in general but are still very high on certain important products, such as dairy and textiles. Even for products that have lower tariffs, such as chemicals, the volume of trade is so large that the tariffs add up to a significant extra tax on business.

Getting results on market access for our services industries is also important. Both the EU and the US have very strong services sectors, ranging from finance and commercial services, via the professions such as doctors and architects, to transport and environmental services. TTIP would help our world-class industries to be able to establish themselves and work in the US without many of the restrictions that they face today. Furthermore, EU firms are highly competitive in many of the things that governments need to buy: for example energy services, rail transport equipment, aircraft, pharmaceuticals and textiles. TTIP could open up more public tendering by the US federal government and US states to EU bids, generating new contracts and jobs for European firms.

Market access isn’t everything, however. From a global perspective, the regulatory and rules parts of TTIP are key. In the regulatory part of the negotiations, we are looking at how the EU and the US could cooperate better together in the future on new regulations, for example in breakthrough industries such as medical devices. We are also finding ways to align existing regulations, for example to stop unnecessary, unjustified duplication of tests, or to remove barriers to trade caused by two different ways of achieving the same result. These may seem unimportant by themselves, but
taken together, reducing these trade obstacles would give a significant boost to transatlantic trade. If the authorities of both sides work together from the early stages, we could avoid problems for businesses, share our limited resources and probably produce better outcomes.

As I have underlined many times, this is not about lowering regulatory standards. Where we agree with each other we will see what we can achieve together; where we don’t, we will continue with our own approach.

Given the economic heft of the US and EU, any shared standards, policies or practices that we can agree in TTIP would almost certainly have spill-over effects on the rest of world trade. Producers in developing countries would not have to choose between US and EU market requirements – they would be able to start selling to the other side without incurring extra regulatory costs. The influence of strong US and EU standards would make it more worthwhile for other countries to develop their own policies based on the transatlantic model. In areas such as trade in raw materials, high environmental and labour standards, the role of state-owned enterprises and the importance of intellectual property rights, a strong transatlantic statement of intent would help steer the multilateral debate in a positive direction for traders, workers and consumers worldwide.

This, then, is our ambition. A trade partnership that opens our markets wide for goods, services and public procurement, that provides a framework for us to cooperate in the long term on regulatory issues affecting trade, and that sets high standards across a range of globally significant economic issues.

After five rounds, we are making good progress – but it won’t be easy. Many of these things are deeply intertwined and we need to work hard to get the right results for our citizens. This is a complicated choreography to work with: with Member States and US states, EU and US regulators, EU and US legislatures, transatlantic business and civil society. That’s a lot of voices to bring together. So a key element to success is making sure that we listen to the important concerns and interests of our stakeholders. This is what I have in mind when talking about the current EU consultation on investment protection, about the importance of safeguarding the EU’s high standards of consumer and environmental protection, and about what TTIP could deliver for the global economy.

In this electoral year for the EU and the US, I want to highlight that it is Congress and the European Parliament – as well as the heads of 28 EU Member States that form the European Council – that will eventually need to examine, debate and approve the deal. The public debate about TTIP is very welcome in this context, and I look forward to continuing to take full part in it.

**Useful links**

OECD work on the benefits of trade liberalisation: [www.oecd.org/trade/benefitlib](http://www.oecd.org/trade/benefitlib)
The transatlantic trade deal must work for the people, or it won’t work at all

Bernadette Ségol, General Secretary, European Trade Union Confederation and Richard Trumka, President, AFL-CIO and TUAC

In 2013, the United States and the European Union began talks on the Trans-Atlantic Trade and Investment Partnership (TTIP). The AFL-CIO and the European Trade Union Confederation (ETUC) believe that increasing trade ties could be beneficial for both American and European workers, but only if TTIP promotes a people-centred approach which considers the interests of the public and not just those of corporations. As with all other economic relationships, the rules of the TTIP will matter because TTIP is about much more than just trade. Its rules will make the difference between a Trans-Atlantic New Deal, which envisions an important role for democratic decision making, and a Trans-Atlantic corporate hegemony that privatizes the gains of trade while socializing the losses. Increasing trade between the U.S. and the E.U. can only help create quality job growth with shared prosperity on both sides of the Atlantic if the project is approached and concluded in an open, democratic, and participatory fashion and with these goals in mind.

Unions believe that TTIP could represent a “gold standard” agreement that improves living and working conditions on both sides of the Atlantic and ensures that standards are not lowered. However, the risk of the current model of trade and economic integration agreements to democratic decision making cannot be overstated. The U.S. has already lost state-to-state challenges to its anti-smoking, meat labelling, and tuna labelling policies, and even now, European multinationals are using the investor-to-state system to challenge decisions to phase out nuclear energy and raise minimum wages. Simply put, these policies are part of a government’s most basic responsibility to promote the general welfare of its people.

Trade and investment rules that not only allow but promote such challenges undermine support for trade even as they reduce the ability of governments to be more responsive to their publics than they are to well-heeled global corporations. This is no accident. Global corporations have long wanted to “overcome regulatory sovereignty,” See, for example Trade on the Forefront: US Chamber President Chats with USTR, and NAFTA Origins: The Architects Of Free Trade Really Did Want A Corporate World Government.

We envision a set of rules that respect democracy, ensure state sovereignty, protect fundamental labour, economic, social and cultural rights and address climate change and other environmental challenges. In a people and planet-centred agreement, the negotiators should consider: how will this decision create jobs, promote decent work, enhance social protection, protect public health, raise wages, improve living standards, ensure good environmental stewardship and enshrine sustainable, inclusive growth? If negotiators are not pursuing these goals, the negotiations should be suspended.

Rules on the protection of workers should not in any way be regarded as trade barriers. The TTIP should not undermine provisions for the protection of workers set down in laws, regulations or collective agreements, nor collective trade union rights such as freedom of association, the right to collective bargaining and the right to take industrial action. The TTIP must ensure that all parties
adopt, maintain, and enforce the eight core conventions of the International Labour Organisation for all workers, as well as the Decent Work Agenda, and that those minimum standards set a starting point for regular improvements that are built into the architecture of the agreement. The U.S. and EU should also explore adopting transatlantic mechanisms in line with EU instruments to provide for information, consultation and participation of workers in trans-national corporations; stronger protections for workplace safety and health; and requirements to ensure “temporary” workers receive equal treatment with regard to pay, overtime, breaks, rest periods, night work, holidays and the like. In other words, the TTIP should not just raise standards for those whose standards currently do not measure up, it should create a system for continuous improvement.

This must include advancing democracy in the workplace. Only when workers are free to organize, associate, peacefully assemble, collectively bargain with their employers and strike when necessary can they provide a vital balance to the economic and political influence held by global corporations.

The TTIP must be aligned with—and never work at cross purposes to—international agreements to protect the environment, including commitments to slow catastrophic climate change. As part of its rules, the TTIP must advance a sustainable balance between human activity and the planet. Rules must not encroach or dilute national and subnational efforts to define and enforce environmental rules, measures and policies deemed necessary to fulfil obligations to citizens, the international community and future generations. Rules must respect the right of parties to prohibit corporations from capturing gains through predatory extraction, unsustainable resource utilization, and “dumping” of pollutants and refuse.

The TTIP must have at its core state-to-state commitments and modes of conflict resolution; it must reject all provisions that allow corporations, banks, hedge funds and other private investors to circumvent normal legislative, regulatory and judicial processes, including investor-to-state dispute settlement (ISDS). State-to-state commitments and enforcement mechanisms reinforce the notion that the agreement is between sovereign nations, for the benefit of their citizens. It also recognises the right of different states to make different choices about how to best promote the general welfare. A hold-over from the discredited era of market fundamentalism, ISDS is used by private actors to constrain the choices democratic societies can make about how best to protect the public interest. It gives the government’s duty to secure the general welfare the same status as private interest in profit—undermining public trust and placing governments in the position of having to pay a ransom to protect the public interest. At the same time, investors must assume their responsibilities, and it is imperative that respect for instruments such as the OECD Guidelines for Multinational Enterprises be fully be integrated in TTIP. We also ask that Contact Points meet the highest standards and those in EU countries be better coordinated.

Only when American and European workers can meaningfully participate in the development and design of the TTIP will they be confident that it is being created for their benefit, rather than as a secret deal that will amplify the influence of global corporate actors and diminish the voice of the people. Secret trade deals may have been appropriate when they were limited to tariffs and quotas, but given the broad array of issues covered under “trade” agreements – including healthcare, intellectual property, labour, environment, information technology, financial services, public services, agriculture, food safety, anti-trust, privacy, procurement, and supply chains – secrecy can
no longer be defended. The proper place to debate and reach agreement on these domestic policy issues is in the public forum—if an idea cannot stand the light of day, it must not be pursued.

The AFL-CIO and the ETUC are united in a commitment to ensure that the TTIP represents a global new deal that would create high quality jobs, protect worker rights and the environment and benefit workers on both sides of the Atlantic. A new trade model that puts people first can create a high standard for not only the US and the EU, but for global trade. Workers deserve a deal that delivers improved living and working conditions on both sides of the Atlantic.

Useful links

OECD work on the benefits of trade liberalisation: www.oecd.org/trade/benefitlib
Making the most of international capital flows

Angel Gurría, OECD Secretary-General

International capital flows have increased dramatically in the past decades. Gross cross-border capital flows rose from about 5% of world GDP in the mid-1990s to historical highs of about 20% in 2007. This growth was around three times stronger than growth in world trade flows. The contraction caused by the crisis affected mainly international banking flows among advanced economies and subsequently spread to other countries and assets. Capital flows have rebounded since the spring of 2009, driven by portfolio investment from advanced to emerging-market economies and increasingly among emerging-market economies themselves.

Financial globalisation, and the associated increase in the movement of capital across international borders, can be both a blessing and a challenge. As we argued in the 2011 OECD Economic Outlook, increasing international capital flows can support long-term income growth through a better international allocation of saving and investment, but they can also make macroeconomic management more difficult, because of the faster international transmission of shocks and the increased risks of overheating, credit and asset price boom-and-bust cycles and abrupt reversals in capital inflows. Volatility indeed is one of the hallmarks of capital flows.

Several countries, including in the OECD area, have dealt with the adverse effects of such volatility by taking measures to limit capital inflows. Others are considering doing so. At the same time, some emerging economies with restrictive regimes are opening up. These contrasting situations are a good enough reason in themselves to bring together experts and officials from the public and private sectors to exchange experiences, analyses and opinions.

But there’s another reason for today’s seminar too. In June this year, the OECD invited non-members to join our Codes of Liberalisation of Capital Movements and of Current Invisible Operations. These codes are an important tool to promote orderly liberalisation, learn from each other’s experience, and ensure mutual accountability. While the two OECD Codes constitute legally binding rules, implementation involves “peer pressure” and dialogue exercised through policy reviews and country examinations.

Countries that adhere to the Codes are expected to fulfil three core principles. First, non-discrimination, meaning they grant the benefits of their liberalisation measures to all other adherents and do not discriminate against other adherents when applying any remaining restrictions.

Transparency is the second principle. Adherents must report up-to-date information on barriers to capital movements and trade in services that might affect the Codes’ obligations and the interests of other adherents.

“Standstill” is the third principle. This means that adherents should avoid taking new restrictive measures or introducing more restrictive measures except in accordance with the Codes’ provisions or established understandings regarding their application.
By adhering to the Codes, a country receives international support and recognition for its openness, and joins a community of countries that refrain from a “beggar-thy-neighbour” approach to capital flows. In other words, countries that adhere to the Codes will not try to improve their own situation by harming others.

An adherent also enjoys the liberalisation measures of other participants, regardless of its own degree of openness. It is protected against eventual unfair and discriminatory treatment of its investors established in other participating countries.

A more subjective, but equally important benefit is that the country reassures market participants that it does not intend to maintain controls broader or longer than necessary. This is crucial in today’s economy where expectations and attitudes play such a significant role in financial markets and investment decisions.

There is obviously an issue of sovereignty in any discussion of openness (whether to capital flows or trade). I'd argue that the Codes help reinforce national influence because as an adherent, a country fully participates in shaping jurisprudence and improving the rules of the framework.

Moreover, the Codes recognise the right of countries to regulate markets and operations. The liberty to conduct transactions is subject to national regulations, as long as they do not introduce discriminatory treatment, in like circumstances, between residents and non-residents. Countries have the right to set prudential measures to protect users of financial services, ensure orderly markets, and maintain the integrity, safety and soundness of the financial system.

It’s also worth emphasizing that while economies are increasingly interdependent and interconnected, they are not identical, and the Codes recognise this.

Countries can pursue liberalisation progressively over time, in line with their level of economic development. Emerging economies such as Chile, Korea and Mexico have adhered to the Codes. Some OECD countries used a special dispensation from their obligations under the Codes for countries in the process of development, while still enjoying the same rights as other adhering countries.

Last the Codes also provide countries with flexibility to cope with situations of short-term capital volatility including the introduction of controls on short-term capital operations and the re-imposition of controls on other operations by invoking the Codes’ “derogation” clause in situations of severe balance-of-payments difficulties or financial disturbance. This clause has been used 30 times since 1961, most recently in 2008 when Iceland introduced exchange controls and measures restricting capital movements in response to a severe banking and balance of payments crisis.

Hence the Codes are the only multilaterally-backed instruments promoting the freedom of cross-border capital movements and financial services while providing flexibility to cope with situations of economic and financial instability. They were also the first instruments created by the OECD when it was founded in 1961. For 50 years adhering countries have used the Codes to support reform, to cooperate to reap the full benefit of open markets and to avoid unnecessary harm from restrictive measures.
The OECD Council decided last June to open the Codes to adherence by all interested countries outside the OECD membership with equal rights as OECD countries. This is an important step in expanding international co-operation, maintaining deep liquid global capital markets, and making the most of international capital flows as a tool to finance growth and development. Time has also come to think about how the Codes should be improved to ensure we can continue to maximise the benefits from open capital markets while avoiding their downside effects.

Today’s seminar will, I hope, give us insight into how to adapt the Codes’ highly effective mixture of principle and pragmatism to the coming decades.

Useful links

OECD work on capital flows: www.oecd.org/investment/investment-policy/capitalflowsandtheoecdcodeofliberalisationofcapitalmovements.htm
Capital controls in emerging markets: A good idea?

Adrian Blundell-Wignall, Director of the OECD Directorate for Financial and Enterprise Affairs and Special Advisor to the OECD Secretary-General on Financial Markets

A couple of years ago the IMF produced some (cautious) comments and studies arguing that currency management and capital controls were OK in some circumstances. Many emerging market countries took this as an endorsement of their approach to policy which has not been limited to temporary crisis measures. The Figure below shows the national investment-saving correlations for the OECD countries over 1982-2010 and for a group of emerging countries (China, Brazil, India, South Africa, Mexico and South Korea) in the manner of Martin Feldstein and Charles Horioka.

In a 1980 paper, Feldstein and Horioka looked at two views of the relation between domestic saving and the degree of mobility of world capital. If capital is perfectly mobile, you would expect there to be little or no relation between the domestic investment in a country and the amount of savings generated in that country, since capital would flow freely to wherever the returns were highest. On the other hand, if the flow of long-term capital among countries is impeded by regulations or for other reasons, investors will be more likely to keep their money in their own country and increases in domestic saving will be reflected primarily in additional domestic investment. Feldstein and Horioka’s analysis supported the second view more than the first.

Three decades later, the OECD economies have more-or-less achieved an open economy without capital controls (led in large part by Europe). But the emerging markets have a high correlation of national savings to investment (0.7), indicating a prolonged lack of openness.

National Investment-Savings Correlations: OECD versus Emerging Economies

Source: OECD

The growing gap between the correlations for the OECD (highly open) and the emerging economies (impeded) is pointing to a fundamental imbalance in the world economy. Does it matter? The IMF
study mentioned above showed that countries with stronger capital controls had a lesser fall in GDP in the post-crisis period. While the original authors were cautious in interpreting their results, this was not so for the users of those findings. This is all the more worrying given that the OECD exactly reproduced the IMF study and found that the results were not robust to a simple stability test. In other words, the OECD tests show that these results certainly should not be used as a basis for claiming some form of general support for long-term use of capital controls.

The OECD also ran a simpler study using the IMF’s own measures of capital controls, with both the IMF’s original sample period and updating it. The OECD study found significant and contradictory results, which were much more consistent with an exchange rate targeting and “impossible trinity” interpretation of outcomes:

1. In the good years prior to the crisis, capital controls are indeed good supporters of growth. This is likely because combined with exchange rate management there is a foreign trade benefit, companies are not constrained for finance, and containing inflows reduces the build-up of money and credit following from exchange market intervention (and associated asset bubbles).

2. However, in the post-crisis period the exact opposite is found and the results are highly significant. Capital controls are negatively correlated with growth. The pressure on the exchange rate is down, not up, as foreign capital retreats, and international reserves are used up defending against a currency crisis (contracting money and credit). Companies are more constrained by cash flow and external finance considerations. Just at the time when foreign capital is needed, countries with the most controls suffer the greatest retreat of foreign funding. Investment and GDP growth suffer.

3. The full sample period (data from both before and after the crisis) shows significant negative effects of capital controls. That is, the overall net benefit appears negative compared to less capital controls.

These results have an intuitive appeal, consistent with economic theory. While it is early days, and some caution is required, the findings suggest that in the long-run dealing with the global investment-savings imbalances could be of benefit not only to developed countries, but also to the developing world itself.

Useful links

*Capital Controls on Inflows, the Global Financial Crisis and Economic Growth: Evidence for Emerging Economies* by Adrian Blundell-Wignall and Caroline Roulet of the OECD Directorate for Financial and Enterprise Affairs

This paper discusses the issues mentioned above in detail. It investigates whether countries that had controls on inflows in place prior to the crisis were less vulnerable during the global financial crisis. More generally, it examines economic growth effects of such controls over the entire economic cycle, finding that capital restrictions on inflows (particularly debt liabilities) may be useful in good times but may have adverse effects in a crisis.

Macroprudential Policy, Bank Systemic Risk and Capital Controls by Adrian Blundell-Wignall and Caroline Roulet of the OECD Directorate for Financial and Enterprise Affairs
This paper looks at macro-prudential policies in the light of empirical evidence on the determinants of bank systemic risk, and the effectiveness of capital controls. It concludes that complexity and interdependence is such that care should be taken in implementing macro-prudential policies until much more is understood about these issues.


OECD work on Institutional investors and long-term investment: www.oecd.org/finance/lti
Capital flow measures used with macroprudential intent are on the rise, why should you care?

Angel Palerm and Annamaria De Crescenzio, OECD Investment Division

The post-2008 crisis policy landscape is characterised by a major overhaul of financial sector regulation, with potential impact on capital mobility and international financial services. On-going re-regulation to address risks arising from high interconnectedness and complexity of large financial institutions are directed at enhancing the stability of the financial system, but can have an impact on the openness and integration of financial systems. In this context, on one side advanced economies have pursued accommodative unconventional monetary policies to revive growth; on the other, Emerging Market Economies (EMEs) have been exposed to a surge in volatile capital flows, and have intervened in some cases with capital controls, in other cases with an increased use of capital flow management (CFMs) measures with a Macro-Prudential (MPM) intent, designed to limit systemic vulnerabilities from inflows. As it is the case for all CFMs, these CFMs with MPM intent can equally support the attainment of a country’s exchange-rate or other external balance objectives.

Recent data collection exercises point at an increase in the use of restrictions in the post-crisis period. OECD recent research has focused on stocktaking the category of CFMs that are also MPMs, showing more frequent use of restrictions on banks’ foreign-currency operations by 7 G20 non-OECD countries and 14 OECD Members over 2005-2013 (De Crescenzio et al., 2015) (Figure 1). These measures, which discriminate on the basis of the currency of an operation rather than on the basis of the residency of the parties to the transaction, comprise, among others, limits on use of foreign exchange derivatives, levies on foreign currency liabilities, and differentiated reserve requirements on foreign-currency liabilities.

Average number of foreign currency measures targeting banks by country has increased in all groups, 2005-2013

Source: OECD calculations, adapted from De Crescenzio et al. (2015)
The OECD *Codes of Liberalisation of Capital Movements and of Current Invisible Operations* are the only multilaterally-backed instruments promoting the freedom of cross-border capital movements and financial services while providing flexibility to cope with economic and financial instability. They were also the first instruments created by the OECD when it was founded in 1961. The experience and expertise the OECD has developed thanks to the *Codes* can be used to analyse how CFM introduced by particular countries could affect other countries and have unintended consequences for the system as a whole. The G20 has therefore recently asked the OECD and the IMF to look at CFMs that are also macroprudential measures.

We looked at the issues in the context of the Codes because the Codes foster transparency, monitoring and accountability on CFMs, whose increased use calls for multilateral co-ordination, to limit the unintended spillovers and implications for the international financial system.

It’s worth emphasizing, as the OECD Secretary-General does here, that: “The Codes recognise the right of countries to regulate markets and operations. The liberty to conduct transactions is subject to national regulations, as long as they do not introduce discriminatory treatment, in like circumstances, between residents and non-residents. Countries have the right to set prudential measures to protect users of financial services, ensure orderly markets, and maintain the integrity, safety and soundness of the financial system.” So, while economies are increasingly interdependent and interconnected, they are not identical, and countries can pursue liberalisation progressively over time, in line with their level of economic development.

In the report we submitted to the G20 in April, we give examples of CFMs that are macroprudential, and how we and the IMF analyse them. We can use a tax on non-deposit foreign exchange liabilities with maturities shorter than one year as an illustration. A non-deposit liability could be for instance a bank draft used by importers to pay for goods from abroad. The levy is designed to raise the price of this kind of funding and thereby discourage banks from relying on it excessively, given the high volatility of capital flows the systemic impact of large movements in capital flows.

For the IMF, the measure is macroprudential because it limits banks’ reliance on short-term external funding and the exposure of the financial sector to risk associated with a sudden stop in capital flows. And since it is designed to limit capital flows, it is also considered a CFM. For the OECD, to the extent that the measure limits the freedom for residents to freely decide on the use of currency for operations with non-residents, the measure has a bearing on Code obligations, but countries that adhere to the Code may introduce such measures at any time by lodging a reservation.

It’s important to strengthen prudential national regulations to improve banks’ risk management and address broader systemic risk issues. At the same time, using CFMs with a macroprudential intent needs to be carefully considered to analyse their overall impact on financial openness. While some of these measures may enhance resilience to shocks, analysis on their actual impact and spillovers is still limited. We should also consider the potential implications of use of these tools by several countries on the functioning of the deeply integrated global financial markets that we have become accustomed to reply upon.

These issues are currently being discussed by the Advisory Task Force on the OECD *Codes of Liberalisation*, a body that examines issues related to the OECD Codes. In September, we’ll be
reporting on our work with the IMF to the meeting of the G20 finance ministers, and to you of course.

Useful Links

How international investment is shaping the global economy

www.oecd.org/investment