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OECD-ASEAN Training on Investment Policy Making

Module 2

Investment Policy:
Options for protecting and regulating investment

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BETTER POLICIES FOR BETTER LIVES

Key considerations for formulating investment policy and legislation

- Ultimate objective: attracting FDI flows while pursuing national development and public welfare goals: such objective is achieved through a **transparent and predictable investment legal framework**
- *How to balance the needs for predictability and stability with the needs of governments to safeguard their policy space for public policy purposes?* **Need to strike a right balance between regulations and openness**
- *How to balance the rights and responsibilities of investors and home states? How to incorporate sustainable development objectives in investment policies?*
- *What are the appropriate levels of protection and regulations of investment to be in line with the country's development strategy? How open does the country want to be to private investment?* **Avoid any protectionist provisions (national regulatory measures or administrative procedures) that are not motivated by legitimate policy concerns.**
- *How to ensure maximum coherence between national and international policies?* **Before setting up any discriminative measures against foreign investors, assess the proportionality of such measures relative to policy concerns and check the coherence between binding international commitments and domestic regulations.**

Three-tier legal framework for investment regulation and protection:

- *Domestic regulations:*
  - Dedicated investment law
  - Legal framework for land ownership and registration
  - Laws protecting intellectual property rights
  - Legal and institutional framework for contract enforcement
  - Expropriation laws and review processes
  - Access to justice and alternative dispute resolution
- *International investment agreements*
- *Investment contracts*

Objectives of the legal investment framework

Regulation

REDUCING

- Entry and establishment
- Ownership and control
- Operational restrictions
- Authorisation and reporting
- Sectoral limitations

Protection

STRENGTHENING

- Standards of treatment (NT, MFN, FET)
- Expropriation
- Transfer of funds
- Dispute settlement
- Transparency
- Etc.

What core provisions should an investment legislation contain?

- Definitional section
- Investor Protection
- Investor Obligations
- Restrictions
- Investment screening and approval procedures
- Investment Promotion
- Right to regulate

Options for delineating the scope of investment protection

- Definition of Investment:
  - *Inclusion of portfolio investment v. scope restricted to investment benefiting to the economic development of the country*
  - *Foreign investment only v. all encompassing law*
- Definition of investor:
  - *Criterion of incorporation v. criterion of control of the investor*
- Lists of prohibited or regulated sectors:
  - *Negative list of closed sectors: more investor-friendly practice*
  - *Positive list of sectors open to FDI*

Options for investment protection: the heart of IIAs and investment laws

1. Non discrimination:
   - Fair and Equitable Treatment
   - National Treatment
   - Most-Favoured-Nation Treatment
2. Guarantees against expropriation
3. Convertibility and repatriation of funds
4. Settlement of disputes

Non-discrimination

Governments discriminate in many ways among firms, both as a matter of policy and sometimes inadvertently: between public and private, large and small, or domestic and foreign (national treatment) – and sometimes even among foreign firms (MFN).

Four principal ways in which governments discriminate against foreign investors:.

- **Screening** (above a threshold or foreign equity share or all foreign investments
- **Equity restrictions** (by sector or overall, for acquisitions or greenfield projects)
- Restrictions on **key personnel** (managers, directors, technical experts)
- **Operational restrictions** (land ownership, profit/capital repatriation, branching, reciprocity, minimum capital requirements, etc.)

Principles for non-discrimination

- Enshrine national treatment (NT) as a general principle in national law and in international agreements, and consider inserting MFN And FET standards of treatment
- State clearly where NT does not apply: negative list
- Establish clear lines of responsibility for implementing regulations on foreign entry and operations and a clear mechanism for evaluating restrictions and modifying them, if necessary
- Justify the rationale for each restriction and measure the results against that rationale
- If screening exists, state clearly who is responsible for deciding and upon what basis. Limit the amount of discretion and allow for the possibility of appeal

Guarantee against expropriation: options

- Main political risk for investors
- Protection should cover nationalisation, direct & indirect expropriation
- The protection standard should preserve the State's right to expropriate:

  - for public purposes

  - in a non discriminatory manner

  - in accordance with due process

  - against fair, adequate and effective compensation

Convertibility and repatriation of funds

- Increasing number of investment legislations recognise the freedom of transfer
- Best practice is to guarantee the access, convertibility and transfer of foreign exchange
- Possibility to insert a BOP safeguard clause, subject to the respect of IMF rules

Settlement of disputes

- Reliable and impartial domestic adjudication of investment disputes
- Availability of alternative Dispute Resolution mechanisms:

  - Conciliation and mediation

  - Possibility to bring cases before key arbitral institutions

  - Consent to arbitration: options

  - Legal framework for domestic and international arbitration
- Enforcement and recognition of arbitral awards

Options for investment regulation

1. Entry of foreign investment

- Trend towards an open-admission approach

  - with restrictions for national security reasons or economic development objectives

- if not, examples of entry barriers:
  - Sector restrictions in negative of positive lists
  - Limitations on foreign ownership
  - Screening
  - Minimum investment requirements
  - Performance requirements

2. Regulation of expatriate labour
3. Performance requirements
4. Other investor obligations

Possible regulatory approaches to entry of investment

- Allow full foreign ownership in all sectors = full National Treatment
- Allow foreign ownership only in specific sectors listed in a positive list
- Allow foreign ownership but with a negative list of restricted sectors
- Allow foreign majority ownership, but apply screening and approval procedures only for the granting of incentives or imposition of performance requirements, in line with international requirements
- Allow foreign majority ownership, but apply screening and approval procedures based on specific criteria (national interest, development purposes) to all investments

Regulation of investment: options for setting out restrictions

- **3 options** to inform investors on what are the sectors where they can and can not invest and under which conditions:
- Use a **positive list** : a list that enumerates all the sectors, activities or areas that are open to foreign investment.
- Use a **negative list** : a list that enumerates all the sectors, activities or areas where :
  - foreign investors can not invest (prohibited)
  - can only invest up to a certain percentage of the equity
  - can only invest after going through a special screening/approval process.
- Use a mixed system combining the positive and negative list.

Which approach is better?

- The **negative list** approach is usually considered as a better practice than the positive list and the mixed list approaches.
- A mixed approach might be too complex and is to be avoided
- P**roblems with the positive list approach**: (a) the list cannot cover all sectors and keep up with the development of new industries and (b) the treatment of the sectors <u>not</u> on the list is ambiguous. Did the government expressly intend to prohibit FDI in this sector? Or is it just an omission? In doubt, most governmental agencies would conclude that any activity not on the list is <u>automatically closed</u> to FDI.

Which approach is better?

- On the contrary, under the negative list approach, all activities are <u>automatically open</u> to FDI unless explicitly mentioned on the list.
- Such a list provides <u>maximum transparency</u> by eliminating doubt or discretion over which types of investments will be prohibited, restricted or screened. Gives potential investors a clear sense of where they stand.
- Trend: Increasingly, countries around the world are adopting the negative list approach.

Other clauses for regulating investment

- Regulation of expatriate labour :

  -Board of directors

  - Entry of personnel

  - Senior management

- Performance requirements:

  - To induce certain behaviours in pursuance of particular policy objectives

  - some PR may have distorting effects on international trade and investment

- Specific investor obligations:

  - Responsible Business Conduct

  - Transparency and disclosure requirements

How to balance investment protection and the right to regulate

- Include public policy exceptions in IIAs to allow measures otherwise inconsistent with IIA obligations
- Provide for detailed explanations of the core investment protection standards
- Exclude certain investment protection standards that may be perceived as excessively limiting governments' regulatory sovereignty
- Regardless of the degree of restrictiveness, provide for the most transparent and predictable legal and procedural framework for investment