MANAGING PRIVATE INVESTMENT IN NATURAL RESOURCES: A Primer for Pro-Poor Growth and Environmental Sustainability

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UNDP-UNEP Poverty-Environment Initiative

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The Poverty-Environment Initiative (PEI) of the United Nations Development Programme (UNDP) and the United Nations Environment Programme (UNEP) is a global UN effort that supports country-led efforts to mainstream poverty-environment linkages into national development planning. The PEI provides financial and technical assistance to government partners to set up institutional and capacity-strengthening programmes and carry out activities to address the particular poverty-environment context.

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Preface

This primer was prepared with funding from the Poverty-Environment Initiative (PEI). PEI is a joint programme of the United Nations Development Programme (UNDP) and the United Nations Environment Programme (UNEP) to provide financial and technical support to countries to build capacity for mainstreaming poverty-environment linkages into national development planning processes, such as poverty reduction strategy papers and Millennium Development Goal (MDG) achievement strategies. The PEI is supported by the governments of Belgium, Denmark, Ireland, Norway, Spain, Sweden, the United Kingdom, the United States of America and by the European Commission. More information can be found at www.unpei.org.

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The primer is designed to be tested at the country level. Feedback from country practitioners is useful in improving its content. Any comments or enquiries are welcome and should be directed to:

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1. Primer Purpose and Key Recommendations

Flows of foreign direct investment (FDI) to developing countries have risen steadily over the past two decades.[1] Evidence suggests that FDI can provide considerable economic, social and environmental benefits for host countries by generating economic growth, greater public revenues, new jobs or higher environmental standards. But if not properly managed, FDI can also foster natural resource degradation and depletion, or result in loss of access to resources for local communities. Furthermore, poorly designed investment projects may not deliver the expected economic benefits. For developing countries, attracting FDI is not an end in itself, but a means to an end—improving livelihoods while respecting the environment. Government policies and institutional settings in the host country play a central role in promoting this outcome.

1.1 Rationale and Methodology

This primer seeks to provide practical advice on how host countries can manage FDI inflows to promote national development aspirations (such as poverty reduction, environmental sustainability and achievement of the Millennium Development Goals). It is aimed at public decision makers in developing countries dealing with FDI, particularly officials in investment boards, investment promotion agencies and relevant ministries. The primer supports and promotes the objectives of the United Nations Development Programme (UNDP)–United Nations Environment Programme (UNEP) Poverty-Environment Initiative.

The focus is on FDI in the primary sector, including agriculture, forestry and extractive industries—an area of growing interest among international investors and a sector of high economic significance for many developing countries. Geographically, the primer focuses on FDI flows into low- and middle-income economies.[2] It draws on analyses of relevant literature and FDI data provided by the United Nations Conference on Trade and Development (UNCTAD).

1.2 Organization

The next four chapters of the primer each discuss a different stage of investment management:

[1] The major country groupings used in this primer ("developed countries," "transitional economies" and "developing economies") follow the classification of the Statistics Division, Department of Economic and Social Affairs of the United Nations (http://unstats.un.org/unsd/default.htm). The terms "developing economy" and "developing country" are used interchangeably throughout.

[2] See glossary for definition of these and other technical terms.

- Adopting and implementing a strategic approach for FDI within the country's overall development strategy (chapter 2)
- Establishing economic and institutional settings and implementing policies to attract and successfully manage FDI (chapter 3)
- Scrutinizing individual investment proposals and negotiating investment contracts (chapter 4)
- Monitoring investor compliance with relevant laws and project contracts (chapter 5)

1.3 Key Recommendations

Key findings and best practices are presented at the beginning of each chapter. Key recommendations for host governments on managing FDI to encourage sustainable economic growth are as follows:

- Design and implement a national FDI strategy that is consistent with the country's development priorities
- Identify and implement the most cost-effective fiscal and non-fiscal policy measures to address imbalances in FDI inflows between regions and sectors
- Assess risks and opportunities associated with IIAs, and address negotiating capacity of government officials before engaging in the IIA process
- Establish land cadastres, identify land available for investment, and improve tenure security in order to maximize the benefits from FDI in land
- Make comprehensive feasibility studies, social impact assessments and environmental impact assessments a mandatory component of investment approval process, and invest in government capacity to evaluate these documents
- Increase transparency in project approval and investor-state contract negotiation, including public disclosure of government contracts (without disclosing genuinely confidential commercial information)
- Identify and address the underlying causes of inadequate law enforcement and project monitoring (e.g. high levels of corruption, ambiguity in laws and regulations, lack of resources and technical capacity of government officials)

2. Towards an FDI Strategy

This chapter makes the case for developing countries to design and implement a strategy for managing FDI. It includes an analysis of recent trends and drivers in global FDI flows, and of the economic, social and environmental impacts on host countries.[1]

2.1 Recent Trends in Global FDI Flows

Key recent trends in global FDI flows were analysed via a statistical overview of the relevant literature. This review identified three key trends: the growth of South-South FDI; the emergence of China as a major FDI source; and the growth of FDI in primary industries.

Key Findings

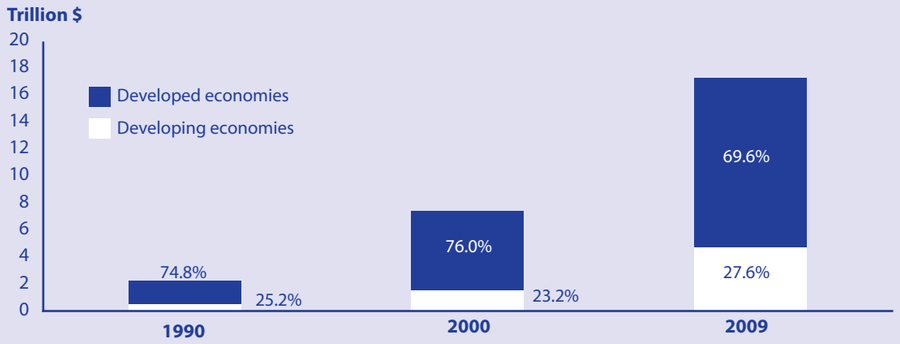
- **Over the last two decades, FDI flows into developing economies have risen in absolute and relative terms, and are likely to continue to grow.** This makes the management of these flows and their impacts a priority for host governments. The challenge is to ensure that FDI contributes to the development goals of host countries (such as economic growth, poverty reduction, achievement of the Millennium Development Goals and environmental sustainability).
- **South-South FDI flows have grown considerably, with China emerging as a major source, and a growing interest in primary sector FDI, particularly extractive industries and agriculture.** While this creates new growth opportunities for many developing countries, it is also likely to put greater pressure on the regulatory bodies of these countries to ensure positive social and environmental outcomes.
- **Economic, social and environmental impacts of FDI ultimately depend on the nature of the investment, and the economic and regulatory environment in the host country.** The latter includes (but is not limited to) enforcement of environmental policies, wealth distribution policies and the availability of skilled labour.
- **A host country needs to develop a strategy for managing FDI inflows. Such strategy should be consistent with the country's development priorities, in terms of sectors, geographical areas and investment models.** Vigorous public debate in host countries is key to developing a vision that is shared by key stakeholders.
- **The developed strategy needs to be implemented via a policy framework to promote priority investments and maximize their economic, social and environmental outcomes—**both locally and for the country as a whole.

[1] It should be noted that the distinction between private and public foreign investments is often blurred due to the range of tools through which governments can influence and support private investments, particularly in strategic sectors such as natural resources.

Growth of South-South FDI

As shown in figure 1, FDI flows into developing economies have risen in absolute and relative terms over the last two decades. Among developing countries, Hong Kong, China, Singapore, Mexico and Brazil are currently the largest FDI recipients (UNCTAD 2009b).

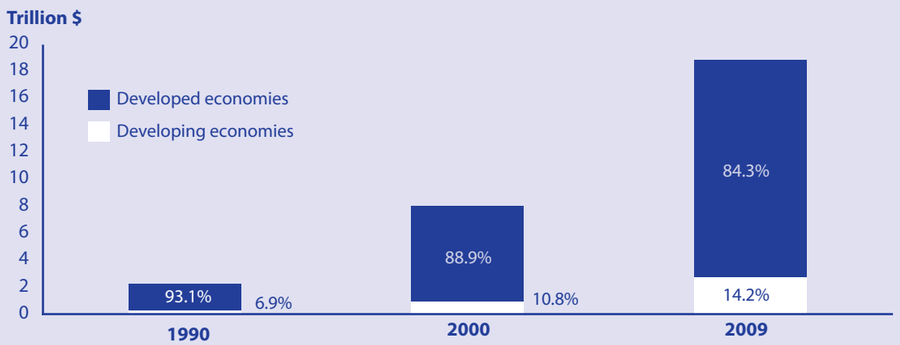
Figure 1: FDI Inward Stock by Economy Type



Source: UNCTAD 2010d.

Developed economies still account for the bulk of global stocks of outward FDI. However, there has been a clear trend towards an increased role for developing countries as sources—as well as recipients—of FDI (see figure 2).

Figure 2: FDI Outward Stock by Economy Type



Source: UNCTAD 2010d.

The rapid growth of FDI outflows from developing economies since 1990 and the tendency of developing-country investors to invest in other developing economies[2] have resulted in significant growth of South-South FDI flows. In terms of relative importance to developing countries, developing-country firms are now on par with developed-country counterparts (UNCTAD 2006).

For a number of least developed countries (LDCs), this dependency on other developing countries as a source of FDI is particularly strong. Among LDCs, reliance on FDI from other developing countries is especially high in Cambodia (73 percent of inward FDI stock), Ethiopia (77 percent), the Lao People's Democratic Republic (70 percent), Myanmar (61 percent) and Nepal (63 percent) (UNCTAD 2006).

Emergence of China as a Major FDI Source

Asian economies, especially China, dominate as FDI sources for many developing economies (UNCTAD 2009b). Over the last two decades, China has become an important source of outward FDI, as shown in table 1. In 2009, it ranked sixth in the world and second among developing and transition economies in FDI outflows (UNCTAD 2010d).

Table 1: FDI Outward Stock: China and the Rest of the World

Country/economy	1990	2000	2009	Average annual growth rate, 1990–2009 (%)
	(billion $)			
China	4	28	230	23.8
Developing economies excluding China	141	835	2,462	16.2
Developed economies	1,942	7,083	16,010	11.7
World total	2,087	7,967	18,982	12.3

Source: UNCTAD 2010d.

Reasons for and drivers of China's growing role as a provider of outward FDI include the following:

- Rapid expansion of the domestic Chinese economy
- Protectionist reaction in many host countries against the successful expansion of China's exports (prompting China to substitute FDI for exports)
- Large accumulation of foreign exchange reserves in China, giving rise to pressures on China to achieve equilibrium in its international financial flows

Another factor has been the Chinese government's official "go out" strategy to promote its overseas FDI in priority areas.[3] Implemented since 2000, the strategy consists of the following:

- Liberalizing China's outward investment regime
- Directly and indirectly assisting Chinese enterprises in winning natural resources exploration rights overseas

[2] In 2004, 98.3 percent of FDI outflow from developing and transition economies was destined for other developing or transition economies. Noting that transition economies account for a very small proportion of this investment, the United Nations Conference on Trade and Development (UNCTAD) argued that these figures can be used "as a proxy for the size of South-South FDI" (UNCTAD 2006, 117).

[3] The government's priority areas include resource exploration projects, projects that promote exports, overseas research and development centres, and mergers and acquisitions that can enhance the international competitiveness of Chinese enterprises (UNCTAD 2007a).

- Providing subsidized loans, information and guidance
- Providing indirect assistance through China's official development aid programmes and diplomatic missions (OECD 2008)

Given these circumstances, the upward trend in China's outward FDI is likely to continue, and China appears set to become one of the world's largest FDI sources in the near future (OECD 2008; UNCTAD 2007c).

Growth of FDI in Primary Industries

Historically, FDI flows to developing countries have been dominated by the services sector, largely due to the dominance of Hong Kong as an FDI recipient. The primary sector—agriculture, forestry, fisheries, mining, quarrying and petroleum industries—currently makes up a relatively small share of inward FDI stock at 6.3 percent (UNCTAD 2009b), although this varies significantly between regions.[4]

Nevertheless, these flows have experienced strong growth in absolute terms since 1990 (UNCTAD 2009b), including in parts of the world previously of little interest to international investors.[5] Several factors underpin the growing interest in FDI in the primary industries of developing countries:

- **Increasing demand for natural resources (particularly minerals) by emerging economies such as China and India.** This demand, coupled with supply constraints, has resulted in a price boom. This, in turn, has driven strong growth in FDI in oil exploration and mining, with companies eager to capture rising profits (UNCTAD 2006, 2007d, 2008c).[6]
- **Growth in foreign investment in agriculture.** Expectations about long-term global growth in demand for and constraints in supply of agricultural commodities are fostering renewed interest in agricultural investments in low- and middle-income economies (see, for example, case study 1). Developing economies are becoming an important recipient of FDI in agriculture, accounting for 34.4 percent of the world total stock in 2004, compared to 14.5 percent in 1990 (UNCTAD 2006). Although much agricultural investment is in processing and distribution, growing agricultural commodity prices are increasingly making direct agricultural production an appealing investment option.[7] While media reports have focused

[4] For example, UNCTAD (2008b, 9) shows that extractive industries accounted for 35.4 percent ($8.7 billion of $24.6 billion) of total FDI inflow in Africa (for the available countries, for the latest available year).

[5] In sub-Saharan Africa, for example (where the primary sector accounts for a major share of FDI inflow), investment inflows amounted to nearly $64 billion in 2008, up from $30 billion in 2007 and $17 billion in 2005 (UNCTAD 2008c, 2009b).

[6] For example, China's investment in Africa's natural resource sector has grown dramatically since 2004, with Algeria, Nigeria, the Sudan and Zambia the major recipient countries (OECD 2008).

[7] A 2009 study by the International Institute for Environment and Development, the UN Food and Agriculture Organization (FAO) and the UN International Fund for Agricultural Development found that, in four African countries (Ethiopia, Ghana, Madagascar and Mali), approved land allocations for agricultural investments totalled some 2 million ha between 2004 and early 2009, including allocations to foreign investors for over 1.4 million ha. Land areas under negotiation are likely to be much larger (Cotula et al. 2009). A 2009 report by the International Institute for Sustainable Development also cites a "recent surge" in foreign investment in agricultural land in Southeast Asia by state-owned and private investors

Case Study 1: Rubber Plantations in Luang Namtha Province, Lao People's Democratic Republic

In recent years, Luang Namtha province in northern Lao People's Democratic Republic has experienced a surge in investment in rubber plantations. This surge has been driven by China's growing demand for rubber and its stagnant domestic supply (due to land scarcity). While there were no rubber plantations in Luang Namtha in 2002, by the end of 2006 a total of 12,585 ha had been established. The majority (11,119 ha) were planted by villagers themselves (Lao and Chinese), with the remainder planted by Lao and Chinese companies through contract farming and concessions.

Source: Shi 2008.

Rubber plantation, Muang Sing, Lao People's Democratic Republic. Courtesy Cameron Higgins.

on acquisitions by Middle Eastern and Asian investors, evidence suggests that European and African investors are also prominent. Private sector deals account for the bulk of these acquisitions, though host-country governments often provide diplomatic, financial and other support (Cotula et al. 2009).

2.2 Impact of FDI on Host Countries

Much has been written about the economic, social and environmental impacts of FDI.

Economic, Social and Environmental impacts

A large body of evidence shows that FDI can promote economic growth in host countries by increasing production capacity, employment, productivity and government revenues. FDI can also introduce organizational, managerial and technical skills not locally available, and enable technology transfers (OECD 2001; Sachs and Warner 1995; UNCTAD 2006). This is exemplified by the economic and social transformation of Viet Nam over the last 20 years (see case study 2). While empirical evidence remains mixed (see Dufey and Grieg-Gran, forthcoming), there is, however, a risk that FDI may crowd out local firms that are competing in the same domestic or export markets.

In terms of social impacts, FDI can be effective in alleviating poverty by driving economic growth (see case studies 2 and 3), while often providing better wages, working conditions and social security than local firms (Dollar and Kraay 2002; OECD 2001; UNCTAD 2006). However, some studies show that FDI leads to poverty reduction only if employment is generated for unskilled labour or if training is built into the activity. Furthermore, job creation may be jeopardized when foreign companies are capital-intensive and employ few local staff (Grieg-Gran 2002). Indirect job generation can also be limited if FDI companies have few linkages with local companies, relying instead on imports (Grieg-Gran 2002). In countries where local land

from China, South Korea and the Arab states, primarily for production of food and biofuel (Smaller and Mann 2009). This is supported by research from UNCTAD (2009b).

Case Study 2: Economic Reform Leading to Rapid FDI Growth and Poverty Reduction in Viet Nam

Between 1976 and 1986, Viet Nam was a largely unsuccessful centrally planned economy. In 1986, the government of Viet Nam initiated the Doi Moi policy of renovation and economic reforms which included a gradual transition to a market-based economy, integration into the world economy and opening up to FDI.

Although the economic opening has been gradual, Viet Nam succeeded in attracting significant inflows of FDI quickly. In 2008, it was the fourth largest FDI recipient among the members of the Association of Southeast Asian Nations (ASEAN), behind Singapore, Thailand and Malaysia. From a complete ban in 1986, annual FDI inflows grew to $180 million in 1990 and $8.1 billion in 2008. The total level of Viet Nam's FDI inward stock currently stands at $48.3 billion, with more than 4,200 foreign companies operating in the country.

The Doi Moi reforms and the subsequent development of the private sector have led to strong economic growth, economic diversification and unprecedented progress in poverty reduction. Annual real gross domestic product (GDP) growth averaged 6.8 percent in the period 1986–2006, with relatively little volatility. The poverty rate was reduced from 58 percent in 1993 to 19.5 percent in 2004, one of the fastest rates in history.

It is widely accepted that this progress would not have been possible without the involvement of foreign investors. FDI has played a key role in generating employment, boosting industrial output and exports, diversifying the economy away from agriculture and providing a significant contribution to the government's budget. Remarkably, foreign enterprises accounted for almost 13 percent of Viet Nam's economy by 2006.

Sources: Hemmer and Hoa 2002; Nguyen and Nguyen 2007; UNCTAD 2008a, 2009b.

rights are not properly protected by national legislation, FDI can result in loss of access to resources for local communities, with possible major negative impacts on local livelihoods and food security (Cotula et al. 2009; Smaller and Mann 2009).

FDI-generated public revenues can be used to support social programmes in health and education (Dufey and Grieg-Gran, forthcoming). However, without adequate wealth distribution policies, FDI inflow can exacerbate income inequality and lead to transitional disturbances in markets in which the poor operate (UNCTAD 2006).

From an environmental point of view, foreign firms may bring production techniques that translate into better environmental performance compared to domestic firms, particularly in low-income economies (Dufey and Grieg-Gran, forthcoming). FDI can also increase societal demand for a healthier environment, as "wealthier societies are more willing—and able—to pay for the protection of environment" (OECD 2001). Foreign investors can introduce more environmentally friendly technologies and consumption patterns (OECD 2001; UNCTAD 1999). However, without implementation of adequate environmental regulation, FDI-induced economic growth can result in loss of natural resources and environmental degradation (see case study 3). This is particularly the case for governments of developing countries, which often lack the required human and financial resources and technical expertise (UNCTAD 1999).

Case Study 3: Indonesian Palm Oil Industry

Indonesia's palm oil industry has been instrumental in driving socio-economic development in the country. Successfully adapted to suit the needs of smallholders, it has been a powerful tool for poverty alleviation, positively affecting millions. It has delivered significant improvements in living standards (including income, education and health level), secured edible oil, and generated large levels of foreign exchange and employment.

Oil palm plantation, Sumatra. Courtesy Nick Beresnev.

However, the industry has been criticized for its impact on the environment. The majority of plantations have been established by converting Indonesia's rainforest and peatland, with negative effects on biodiversity and climate change. Indonesia's forest cover has decreased dramatically in the last 40 years, with conversion to oil palm plantations a contributing factor.*

In recent years, the following incentives for Indonesia to halt or slow its conversion practices have emerged:

- Emergence of the Roundtable on Sustainable Palm Oil Production (RSPO), a voluntary private sector certification system for sustainable palm oil production and trade. RSPO criteria (with which all members must comply) require that oil palm plantations established since November 2005 not convert primary forest or areas with high conservation values. The majority of large palm oil growers, processors and traders are RSPO members.
- Emergence of private and public sector procurement policies requiring that palm oil (or products thereof) be produced in a sustainable manner. This includes the new European Commission directive on renewable energy.**
- Political pressure from various domestic and international environmental non-government organisations, including Greenpeace, WWF, Friends of the Earth and the Rainforest Action Network. These groups generally oppose the practice of forest and peatland conversion.
- Potential to raise revenue through the Reduced Emissions from Deforestation and Forest Degradation (REDD) mechanism. A formal REDD agreement was signed at the United Nations Framework Convention on Climate Change in Cancun, Mexico in December 2010. The mechanism has the potential to provide developing countries with financial incentives to reduce their rates of deforestation and forest degradation. The Indonesian government has been a strong proponent of REDD.

Sources: Casson 1999; CIFOR 2006; FAO 2009b; ITTO 2009; *PalmOilHQ* 2009; Reuters 2009; RSPO 2007; Thoenes 2006; USDA 2007, 2009.

* Indonesia's natural forest cover has been reduced from 143 million ha in 1967 to 88.5 million ha in 2005. Total area for oil palm plantations was 6 million ha in 2006.

** Directive 2009/28/EC sets renewable energy targets for all European Commission members, including a minimum 10 percent share in the transport sector by 2020. The directive's sustainability criteria exclude biofuels made from raw material obtained from land with primary forest, wetlands, or other land with high biodiversity value.

Impact of South-South FDI

As shown above, South-South FDI flows are becoming globally significant. It is therefore important to analyse the economic, social and environmental impacts which are specific to this type of FDI.

Developing-country transnational corporations (TNCs) generally have greater employment-generating potential, as they tend to operate in labour-intensive industries and use simple, labour-intensive technologies. They also tend to be more effective at facilitating technology transfer, as the gap in the levels of technology is often small enough for local firms to acquire and absorb the new technologies. However, this type of FDI is also more likely to have a negative impact on the environment: research shows that environmental damage tends to be greatest where obsolete technology and outdated work methods are used (UNCTAD 1999).

TNCs from developing countries have performed better than their developed-country counterparts in establishing linkages with domestic firms, as they tend to "engage in standardized production activities with non-proprietary technologies that are more conducive to external procurement of suppliers" (UNCTAD 2006, 198). In addition, a 2005 survey by the United Nations Industrial Development Organization found that developing-country TNC affiliates in Africa spent more on training than those of developed-country TNCs (UNIDO 2005).

As illustrated in section 2.2, developing-country TNCs tend to invest in poorer, riskier and more remote regions than developed-country TNCs. They are consequently more likely to invest in "greenfield" projects (i.e., establishing new production facilities, rather than taking over existing companies or facilities), as this is the only option in many LDCs. The benefit of such investment is that it immediately adds to the production capacity of the host country (UNCTAD 2006). Because many LDCs have not been able to successfully integrate into global markets, it can be argued that developing-country TNCs are providing investment in areas where it is needed most (OECD 2001).

The social impact of FDI in high-risk regions (with weak governance or armed conflict, for example) is a debated topic. It can be argued that investment in these regions contributes to peace-building by providing employment and better livelihoods for the local population. However, there have been incidents where such investment has "aggravated or reignited conflict, directly or indirectly contributed to the violation of human rights, or prolonged autocratic governance" (UNCTAD 2006, 237).

The "Resource Curse"?

FDI flows into primary industries promote their growth, both in absolute and relative terms. Since the 1980s, an argument has emerged that countries rich in natural resources (in particular, non-renewable resources such as crude oil) tend to perform worse in terms of economic and social development than countries with few natural resources.

This so-called "resource curse" phenomenon has a number of plausible explanations:

- Conflicts over control of natural resources can emerge within societies. These can range from disputes among different ministries over access to revenue to open armed conflict (Bannon and Collier 2003).
- A government with guaranteed income from natural resource exports (a so-called "rentier state") is less dependent on its citizens as taxpayers. Consequently, citizens have less political power to demand services and accountability. This breakdown of a political relationship can lead to corruption, lack of law enforcement and wasteful use of revenue (Bräutigam 2008).
- Natural resource exports can inhibit the growth of other sectors in the economy, such as manufacturing. This can be caused by the appreciation of the exchange rate, making the exports of other sectors less competitive on global markets—the so-called "Dutch disease" (Ebrahim-zadeh 2003). Governments may also neglect economic diversification in light of the high profitability of the resource sector, as witnessed in Papua New Guinea (see case study 6).

While the empirical evidence on the prevalence of the "resource curse" is mixed (Davis 1998; Mikesell 1997; Pedro 2006; Sachs and Warner 1997, Wright and Czelusta 2004), it should be noted that resource abundance does not automatically condemn countries to poor or unsustainable economic growth. Indeed, there are many examples of successful mineral-based development (Australia, Canada, New Zealand, Norway, etc.). Investment in natural resources *can* lead to positive economic, social and environmental outcomes, if managed well. The aim of this primer is to provide policy makers with practical guidance in such management.

2.3 Implications for Host Countries

FDI inflows into developing countries are growing rapidly. The large proportion of this FDI is sourced from developing countries, with China emerging as a major provider in recent years. There is a growing interest in investment in the primary sector. The above analysis also shows that economic, environmental and social impacts of FDI ultimately depend on the nature of the investment and the regulatory environment in the host country.

These findings have the following implications for host developing countries:

- FDI flows into developing countries are likely to continue to grow, making their management a priority for host governments. The challenge for policy makers is to ensure that FDI contributes to their development goals (such as economic growth, poverty reduction, achievement of the Millennium Development Goals and environmental sustainability).
- The growth of South-South FDI has a number of social and economic benefits. However, it also increases the regulatory responsibility of the host governments, as employment conditions and corporate social and environmental responsibility practices of developing-country TNCs may fall short of those followed by developed-country firms.
- Increased investment in primary industries creates new growth opportunities for countries with natural resource potential. However, positive social and economic outcomes are by no means guaranteed, and such investment is likely to put greater pressure on the quality and level of their natural resources. This, once again, places a greater level of responsibility on regulatory bodies to avoid or reduce negative economic, social and environmental outcomes.

2.4 Need for a Strategic Approach

The above implications suggest that a strategic approach for managing FDI is needed. Investment decisions can have major and lasting implications for the development goals and pathways pursued by a host country. Host governments need to identify national development priorities (in terms of sectors, geographical areas and investment models) and ensure that FDI

supports their achievement. Strategic vision and vigorous public debate about development goals and pathways are essential to make strategic choices about what is best for the country.

Where foreign investment is seen as an element of the national development strategy, it is imperative that the strategic vision is translated into a policy framework. This challenge is discussed in the subsequent chapters.

3. Investment Promotion and Preparedness

Low- and middle-income economies often place much policy emphasis on attracting foreign investment. In some cases, these policy efforts result in increased FDI flows. However, such flows might target non-strategic sectors (for example, industries where few jobs or links with local businesses can be created). Within a country, some regions may receive investment and flourish, while others may be neglected. Overemphasis on economic growth may result in significant social and environmental damage, and sweeping policy commitments

Key Findings and Best Practices

- **Host governments should strive to provide a supportive economic and institutional environment, which is the most important factor for attracting FDI.** This includes macroeconomic stability, availability of basic infrastructure, and a clear and well-enforced regulatory framework.
- **A range of policy measures is available to host governments to address imbalances in FDI inflows between regions and sectors.** While fiscal tools tend to dominate, host governments should pursue the most cost-effective solutions. This may include subsidizing the establishment of special economic zones, investing in infrastructure in poorer regions, or providing training facilities for unskilled workers.
- **Investment promotion agencies (IPAs) can facilitate FDI inflows by providing a range of services, including marketing and one-stop-shop facilities.** IPAs are more effective if they are well resourced, have a clear mandate and focus their efforts on selected priority sectors.
- **IIAs can promote FDI inflow by protecting it against certain political risks in the host country.** However, undertaking international commitments potentially reduces the policy space of host countries, and IIA commitments are extremely difficult to reverse. Host governments need to consider these risks and opportunities before engaging in the IIA process. They also need to ensure that they have the capacity to successfully negotiate and implement such agreements.
- **Besides promoting FDI, host governments have the responsibility to maximize its benefits in economic, social and environmental terms.** This involves promoting appropriate business and contract models, improving the capacity of local businesses and workers to benefit from FDI projects, and reinvesting natural resource revenues into economically sustainable activities.
- **FDI in land-intensive activities, such as agriculture may require concerted efforts by host governments to ensure optimal outcomes.** Host governments can play a role in encouraging FDI in land investment and ensuring optimal outcomes. This includes establishing land cadastres by documenting and acknowledging all existing forms of land use, identifying land available for investment, and improving tenure security.

entered into by the government as an inducement to investors may constrain public policy for decades to come. Well-designed investment promotion strategies that consider economic, social and environmental outcomes are therefore crucial to successfully managing private investment flows.

This chapter looks at economic and institutional requirements and policy options available to host countries to attract and successfully manage FDI. Particular attention is paid to the role of investment promotion agencies (IPAs), international investment agreements (IIAs) and foreign investment in land.

3.1 Investment Promotion

This section reviews ways in which host governments can attract and direct FDI. It looks at the required economic and institutional settings, policy tools available and the role of IPAs.

Economic and Institutional Settings

A supportive economic and institutional environment in the host country is the most important factor in attracting FDI. This environment includes the following:

- Macroeconomic stability
- Predictable and realistic exchange rates
- Availability of basic infrastructure, such as electricity, roads, transport and communication networks
- Clear division of responsibility between relevant ministries and departments at all levels of government involved in FDI management (national, provincial, district and local), and avenues for effective communication between these bodies
- Unambiguous investment legislation with clear incentives and implementing regulations that are not in conflict with other, sector-specific laws

These characteristics play a major role in attracting FDI at both the national and regional levels (as shown in **case study 4**). Their absence is the primary reason why FDI flows to developing countries are dominated by middle-income rather than low-income economies.

Policy Measures to Promote FDI

While economic and institutional settings are essential, government policy can serve to attract FDI or to address imbalances in FDI inflows between regions and sectors.

The most commonly used policy tool is fiscal incentives. For example, in Cambodia, Costa Rica, Malaysia and Viet Nam, IPAs offer tax incentives in high-technology sectors so as to encourage technology transfers. Host countries can offer tax and monetary incentives for investments that generate extensive linkages with the local economy (Malaysia), promote renewable energy (Ghana, Argentina, Nicaragua), or involve training for local staff (South Africa) (Grieg-Gran and Edlund 2008).

However, tax incentives tend to negatively affect public revenues, and host governments need to be aware of the wider range of policy options available. Policy measures can be direct (such as tax incentives for investment in poor or isolated regions), or aim to attract FDI indirectly by improving the country's economic and institutional settings. The key is identifying the

Case Study 4: Determinants of the Spatial Distribution of FDI in Viet Nam

As discussed in **case study 2**, Viet Nam has achieved spectacular growth in FDI inflows in the last 20 years. Apart from the liberalization of its investment regime, reasons behind this include the following:

- Strategic location in a rapidly growing geographic region
- Stable economic and political environment
- Large endowment of natural resources (including oil and coal)
- Efficient and competitive infrastructure network
- Relatively skilled, low-cost workforce
- Large and growing domestic market
- Opening up of export opportunities through ratification of bilateral trade agreements with a number of countries (including the United States) and accession to the World Trade Organization (WTO).

Terraced rice fields, Sapa, Lào Cai Province, Viet Nam. Courtesy Panida Charotok.

However, while all of Viet Nam's 64 provinces have received some level of FDI in the last two decades, the more developed regions account for a large share, both in absolute and per capita terms. The poorest regions—clustered in the north near the Chinese border as well as inland provinces of the Central Highlands—have largely missed out.

Studies of provincial distribution of foreign investment in Viet Nam have pointed to the importance of the following factors in attracting FDI:

- Large markets or market potential
- High-quality infrastructure
- Skilled labour
- Presence of industrial and export processing zones

Not surprisingly, Viet Nam's less-developed regions rate poorly on all of the above criteria.

Sources: Hemmer and Hoa 2002; Nguyen and Nguyen 2007; UNCTAD 2008a.

underlying causes of low FDI inflows, and pursuing the most cost-effective solutions. Some of the non-tax options available include the following:

- Subsidizing establishment of special economic zones in poorer regions to provide quality infrastructure and services (which are often lacking)
- Investing in education, skills training and transport infrastructure
- Training civil servants in more effective administration of investment regulations
- Improving investment marketing (UNCTAD 2008a)

Role of IPAs

IPAs can encourage investment through dissemination of information about investment opportunities. They can also act as one-stop-shop facilities—serving as the main contact for prospective investors, supporting them in dealings with relevant government agencies and facilitating

access to land or tax incentives. The prospective role of IPAs in facilitating access to land investment is discussed further in section 3.4.

IPAs are more effective if they are properly mandated, structured and resourced, and focus efforts on a few priority sectors. Private sector experience among IPA staff, competitive salaries, competency in English and other international languages, and networks of overseas offices also tend to improve IPA performance (Ortega and Griffin 2009).

3.2 Promoting FDI through International Investment Agreements

IIAs seek to protect, promote and liberalize cross-border Investments. IIAs consist of the following:

- Bilateral investment treaties (BITs)
- Regional economic agreements with provisions on foreign investment
- Multilateral agreements with direct implications for FDI, such as the World Trade Organization General Agreement on Trade in Services and the Agreement on Trade Related Investment Measures

There has been a great expansion of IIAs in the last two decades, particularly between developing countries.[1] A positive change in attitudes towards FDI among developing countries has been a contributing factor, leading to policies promoting liberalization and protection of FDI (UNCTAD 1996).

Provisions of IIAs

Although the content of IIAs varies from case to case, these treaties typically seek to protect foreign investment from arbitrary interference by host governments. This includes measures to prevent host governments from discriminating against foreign investors, to treat investors in a fair and equitable way, and to provide compensation in cases of expropriation. IIAs also commonly contain provisions allowing investors to initiate arbitration if they believe the provisions of the treaty have been breached by the host state (UNCTAD 2007b).

A growing number of BITs are addressing public policy concerns, such as public health and safety, environmental protection and the promotion of internationally recognized labour rights. This has taken the form of clauses prohibiting or discouraging a lowering of relevant standards in order to attract FDI, or making explicit the responsibilities of contracting parties to safeguard these values. This development reflects a growing global consensus that "investment promotion and protection must not be pursued at the expense of other key policy objectives" (UNCTAD 2007b).

Impact of IIAs on Host Countries

IIAs aim to promote foreign investment by protecting it against certain political risks in the host country. However, empirical evidence on the extent to which IIAs promote FDI inflows is mixed

[1] By the end of 2008, there were 2,676 signed BITs (compared to 385 in 1989), as well as 273 regional and bilateral agreements with investment provisions. Currently, 26 percent of all BITs are between developing countries (UNCTAD 2009b).

(Hallward-Driemeier 2003; Neumayer and Spess 2005; Perry 2000; Salacuse and Sullivan 2005; Tobin and Rose-Ackermann 2005).

By binding themselves to IIAs, host countries may limit their policy options in regulating foreign investment. Performance requirements—provisions that require the investor to employ and train local staff and contractors, or procure local goods and services during the implementation of the investment project—are a case in point. By giving up the right to impose performance requirements,[2] host governments are potentially foregoing a tool for generating employment, increasing the demand for local inputs, boosting exports or augmenting foreign exchange (UNCTAD 2007b). It should be noted, however, that the effectiveness of performance requirements is itself a topic of debate: critics argue that rather than promoting economic growth, these measures deter foreign investment and promote inefficiency in local industries (UNCTAD 2007b, 2007c).

IIA provisions on expropriation and "fair and equitable treatment" may enable investors to challenge the adoption of more stringent environmental regulations by the host government, as these may adversely affect the economics of an investment project (Smaller and Mann 2009). Simultaneously, the prospect of having to compensate investors may discourage host governments from implementing stricter environmental regulations.

Implications for Policy Makers in Host Countries

With regard to existing IIAs, signatory governments are responsible for identifying their obligations and honouring commitments made. In order to avoid investor-state disputes, governments should explore policies that help achieve their development objectives without violating commitments made (for example, by avoiding arbitrary discrimination against foreign investors).

With regard to future IIAs, their content is determined by the negotiating parties.[3] It is extremely important for host countries to assess the full implications of various options before signing new agreements, and to actively put forward their views during negotiations. Addressing the capacity needs of government officials responsible for IIA negotiation and implementation is crucial in achieving the above objectives, particularly in light of a growing myriad of bilateral and regional agreements.

3.3 Investment Preparedness

As well as promoting FDI, host governments have a responsibility to maximize its benefits in economic, social and environmental terms.

Not surprisingly, the institutional requirements for investment promotion and investment preparedness are often the same—that is, unambiguous investment legislation and implementing

[2] The Agreement on Trade Related Investment Measures bans performance requirements that restrict or distort international trade in goods, such as local content requirements, trade balancing requirements, foreign-exchange balancing requirements, and restrictions on exportation (UNCTAD 2007b). A growing (albeit still small) number of BITs and regional agreements also include prohibitions on performance requirements (UNCTAD 2007b).

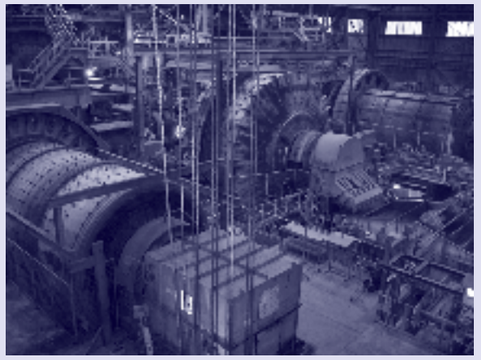
[3] It should be noted that the agreement model currently followed tends to focus on investment protection, and addresses only the rights of the foreign investor. However, the International Institute for Sustainable Development recently developed a model treaty that is specifically designed to maximize the investment's contribution to sustainable development (Mann et al. 2006).

regulations, and a clear division of responsibility among relevant ministries and departments at all levels of government involved in FDI management.

In terms of policy, maximizing the benefits of FDI may require the following:

- Selection of appropriate business and contract models to be promoted—among different types of investor-government contracts (e.g. concessions, production sharing agreements or joint ventures) or the promotion of models that include local farmers (e.g. through incentives for contract farming) (Cotula 2010)
- Improving policies that improve the capacity of local businesses and workers to benefit from FDI projects (e.g. capacity building for local industries, skills training for workers)
- Maximizing public revenues and optimizing their distribution over time
- Establishing robust, transparent and accountable mechanisms for the management of these revenues
- Reinvesting revenues from extraction of non-renewable resources into economically sustainable activities. This ensures that alternative livelihoods and revenue sources will be available when commercial exploitation comes to an end. The latter point is highlighted in case study 5.

Case Study 5: Papua New Guinea and Minerals Extraction



SAG Mill, Ok Tedi Mine, Western Province, Papua New Guinea. Courtesy CMCA Review.

Since the 1960s, the economy of Papua New Guinea (PNG) has relied heavily on minerals extraction. The mining sector (primarily copper and gold) has regularly accounted for over 50 percent of the nation's exports, and over 20 percent of its gross domestic product (GDP). At the time of PNG's independence from Australia in 1975, the Bougainville copper mine accounted for 60 percent of the country's total exports. Independence also coincided with the discovery of large gold and copper deposits on Mount Fubilan near the Ok Tedi River, Western Province, leading to the opening of the Ok Tedi gold and copper mine in 1984.

The collection and expenditure of mineral revenues consequently formed an essential part of the government's National Development Strategy. According to Filer and Imbun (2009), this approach was based on the assumption that "the revenues derived from two very large and profitable mines, if properly applied to the tasks of national development, would enable the government and the country to escape their dependence on Australian aid and expertise before those mines had been exhausted." In essence, the dependence on mineral wealth was meant to be temporary, with government revenues used to establish a more diverse national economy.

Despite PNG's natural endowments, it is widely agreed that this development strategy has not produced the desired results. This has been due at least in part to the government's "failure to apply its own share of revenues to a broader national process of economic and social development" (Filer and Imbun 2009, 108). Consequently, PNG's dependency on minerals and foreign aid continues.

Sources: Filer and Imbun 2009; UNDP et al. 2003.

- Establishing robust safeguards for social and environmental risks of FDI projects, including social and environmental impact assessments and management systems, local consultation requirements and redress mechanisms (see chapter 4)

3.4 Land Availability and Tenure

Access to land by foreign investors—either via long-term leases or outright purchases—is affected by both investment promotion and preparedness of the host country. It is currently a hotly debated topic,[4] and warrants a separate discussion.

Role of IPAs in Facilitating Land Access

Some host governments have taken steps to facilitate access to land for prospective investors. IPAs, for example, can accompany investors in their dealings with other government agencies, or have direct involvement in identifying and providing available land.[5] Promptly providing information to prospective investors about the nature, size and location of available land is seen by some as a key ingredient for effective investment promotion (Ortega and Griffin 2009). Case study 6 discusses land inventories in more detail.

Case Study 6: Land Inventories in Africa

In recent years, a number of African countries have undertaken national land inventories. For example, the Tanzania Investment Centre is setting up a "land bank," identifying land suitable for allocation to incoming investment. In Mozambique, following growing demand for land for biofuels, in 2008 the government carried out a land inventory at a scale of 1:1 million. It showed that the country has about 7 million hectares available for allocation to land-based economic activities (a smaller area than was expected).

Sources: Nhantumbo and Salomão, forthcoming; **www.tic.co.tz**, accessed 10 December 2010.

Taking Existing Land Use into Account

When developing land inventories and identifying land that may be used for FDI, host governments need to ensure that all existing forms of land use are properly acknowledged and protected. Concepts such as "idle" land often neglect the fact that local people may have occupied that land for many generations, but these local land rights may not be formally recognized, or existing resource uses may not be perceived as "productive" by the government. These perceptions about productivity are not necessarily backed up by economic evidence, and low-productivity uses may still play an important role in local livelihood and food security strategies (Cotula et al. 2009). In many societies, land also has an important non-economic value, providing the basis for social identity and relations, traditional ways of life and the collective sense of justice.

[4] See, for example, Cotula et al. 2009; Nhantumbo and Salomão, forthcoming; Smaller and Mann 2009; UNCTAD 2009b; and http://farmlandgrab.org/, accessed 23 February 2011.

[5] The Tanzania Investment Centre, for example, identifies and directly provides land to investors.

Tenure Security

Secure local land rights are a key to ensuring that local communities are not arbitrarily deprived of the land they depend on for their livelihoods, and have an asset in negotiations with prospective investors. Historically, secure land rights have been pursued via individual titling. However, it is now recognized that one-size-fits-all solutions of individual titling and ownership are too simplistic and, in many cases, counterproductive. Tenure security can be significantly improved through collective registration and protection of customary land rights, even if land ownership ultimately remains vested with the state (Cotula, Toulmin and Quan 2006). In Africa, the past 15 years have witnessed a wave of legal reforms to improve tenure security (see case study 7).

Institutional Preparedness for Land Investment

As with FDI in general, certain institutional structures need to be in place before host governments are able to effectively manage land investments. This is exemplified in case study 8.

Case Study 7: Protecting Customary Land Rights in Africa

Acknowledging the shortcomings of the law in protecting the interests of their rural majorities, some countries have recently taken steps to strengthen the protection of local land rights, including customary rights—even where land is state-owned or vested with the state in trust for the nation.

- In Mali, while post-independence legislation abrogated customary rights, the Land Code (*Code Domanial et Foncier*) of 1986 and its successor of 2000 legally recognize customary land rights and grant them some legal protection (Articles 43–48 of the Land Code 2000).
- Mozambique's Land Act 1997 reaffirms the principle of state ownership over land but protects "rights of use and benefit," which are acquired either on the basis of customary law or through good-faith occupation for at least 10 years. Legally defined "local communities" can register their collective land holdings, including rights based on customary law.
- Similarly, customary land rights on "communal land" are legally protected under Namibia's Communal Land Reform Act 2002 (Article 19(a)).
- Tanzania's Village Land Act 1999 states that customary rights of occupancy have "equal status and effects" to statutory rights (Section 18(1)).
- In Uganda, while the Land Reform Decree 1975 made customary landholders tenants at will of the state, the 1995 Constitution and the 1998 Land Act (as amended) protect customary land rights.

Wetlands near Nile River, Egypt. Courtesy Nick Beresnev.

However, even in these cases legal protection may be conditional to "productive use." Also, in some countries customary rights are only protected as lesser forms of legal entitlement, which can be "upgraded" into ownership through the formal land titling procedure (for example in Mali). In some jurisdictions, the actual legal protection granted to customary rights remains vague and incomplete. In Mali, for instance, the Land Code 2000 devotes only a few provisions to customary rights (Articles 43–48), and the implementing decree required to regulate the procedure for recording and taking these rights has not yet been adopted. Finally, a lack of political will to implement the legislation adopted may undermine even the most innovative legislative reforms.

Sources: Cotula et al. 2009; Cotula, Toulmin and Quan 2006.

Case Study 8: Managing Land Investment in the Lao People's Democratic Republic

In recent years, the Lao People's Democratic Republic has embraced FDI as a source of economic development. Subsequently, the country's FDI inflow has grown significantly, particularly in agriculture, hydropower and mining.

However, an overall lack of investment management, particularly regarding land allocation, has hindered this progress. Underlying causes include the following:

- Unclear roles and responsibilities of numerous government agencies involved in land allocation, at both national and provincial levels
- Lack of coordination and information flows between these agencies
- A degree of incoherence between laws governing the work of these agencies, such as the Law on Land, the Law on Forestry and the Law on Agriculture
- Lack of comprehensive and centralized land cadastre, which has resulted in incidents where the same plot of land was allocated to two different investors or to two different uses (for example, agricultural plantations being located on future mineral exploitation sites)
- Lack of up-to-date information on the state of the nation's natural and social environment

Appreciating the importance of a centralized land information system, the National Land Management Authority is now developing a geographic information system (GIS)–based database that would provide comprehensive information on all land-based concessions, including investment licenses, contractual agreements and concession boundaries (mining, agriculture, forestry). The database will be used to monitor existing concessions and for future allocations.

Truck loaded with sugar cane heading for the Lao People's Democratic Republic–China border. Courtesy Cameron Higgins.

Sources: ADB 2006; Pommier 2009; Ramboll Natura 2008; Shi 2008.

4. Investment Approval and Contract Negotiation

This chapter focuses on approval and contract negotiation of individual investment projects. It shows that flawed investment approval procedures and contract negotiations can lead to socio-economic and environmental outcomes that are detrimental to local communities, to the host country more widely, and to investors themselves (for instance, failed projects due to local conflict).

Key Findings and Best Practices

- **Thorough assessment of proposed investment projects is essential to ensuring their economic viability.** Proposed projects should be subject to state-of-the-art feasibility studies as well as social and environmental impact assessments (conducted by host governments or project proponents). Formal consultations with local communities are important in gauging local aspirations and priorities, and ensuring local support for the project.
- **Host governments need to ensure that contracts with private investors maximize benefits for host countries.** Issues to be addressed include clearly defined and enforceable work programmes and financial commitments, creation of direct and indirect employment, transfer of technology, welfare of local communities, maximization of revenues and optimization of their distribution over time, local procurement of inputs, environmental protection and dispute settlement mechanisms. A clear negotiation strategy, a strong negotiation team, and political will can make a significant difference to the outcome of contract negotiations.
- **Host governments can also facilitate contracts between investors and local groups.** These include, for example, contract farming arrangements where villagers provide land and labour, and investors contribute capital, technical know-how and market access. In these cases, effective collective action and support from government or development agencies are important to help local groups address imbalances in negotiating power.
- **Transparency in project approval and contract negotiation, and public disclosure of government contracts, can increase accountability and promote contractual terms that are in the public interest.** For major investment projects, parliamentary approval of deals negotiated by the government can also increase public scrutiny. In these cases, parliamentarians need adequate time, information, expert assistance and stakeholder input to make informed decisions.
- **Industry-specific transparency schemes such as the Extractive Industry Transparency Initiative can improve governance.** They also send a clear signal to investors and international donors about the country's commitment to greater transparency.

4.1 Project Approval

The following procedures during the project approval process can promote desirable economic, social and environmental outcomes:

- Proposal assessment and feasibility studies
- Social and environmental impact assessments
- Formal consultations with local and affected communities

Proposal Assessment and Feasibility Studies

Careful assessment of investment proposals by host governments is crucial in identifying costs and benefits likely to be generated by the project. These include public revenues, employment creation, linkages to the local economy, infrastructure development, and social and environmental risks. Feasibility studies, in turn, are a key to ensuring that only economically viable projects proposed by credible investors are allocated rights over natural resources. Governments may need to invest in their own capacity to undertake these tasks.

Impact Assessments

Proposed investment projects should also be subject to comprehensive social and environmental impact assessments**.** Such assessments should cover all feasible project designs, allowing host governments to make informed decisions if circumstances change and to avoid "unexpected" environmental and social outcomes (see case study 9). If project circumstances encounter significant change, new feasibility studies should be conducted before taking the decision to go ahead with the new design.

Governments may need to invest in their own capacity to scrutinize impact assessments prepared or commissioned by prospective investors. For example, it is reported that lack of technical capacity in the Lao People's Democratic Republic prevents provincial government from reviewing the content of environmental and social assessments prepared by investors (Pommier 2009).

Formal Consultations

Conducting formal consultations with local communities is important in gauging local aspirations and priorities, and ensuring local support for the project (if it is approved). Lack of effective consultation is likely to lead to investor-community disputes and implementation difficulties, possibly resulting in failed projects (Shi 2008).

Environmental and social impact assessments may involve interactions with local and affected people. However, these are often scientific studies in which the subjects are passive respondents. In countries such as Ethiopia and Madagascar, impact assessment procedures specifically require consultation with communities—that is, eliciting and reporting their opinions. Consultation requirements may also exist outside the framework of impact assessments; in Mozambique, for example, they are built into land and forestry legislation (see case study 10).

While consultation provides voice for affected people within the process, it does not confer any authority to veto or shape the terms of the investment. It therefore falls far short of consent. Its

Case Study 9: Comprehensive Environmental and Social Assessments of the Ok Tedi Mine

OK Tedi River at Tabubil, Western Province, Papua New Guinea. Courtesy CMCA Review.

Located at Mount Fubilan in Papua New Guinea's (PNG's) Western Province, the Ok Tedi mine produces copper, gold and silver concentrate for export. The mine has been operated by Ok Tedi Mine Limited since its opening in 1984; it is scheduled for closure in 2013. The company is one of the world's largest copper producers, and has made a significant contribution to PNG's economy in terms of revenue, foreign exchange earnings, employment and infrastructure.*

However, Ok Tedi Mine Limited is more famous for its negative environmental and social impact than its economic contribution. Since the beginning of its operations, the company has been discharging millions of tons of waste rock and mine tailings into the Ok Tedi tributary of the Fly River every year. Environmental and social consequences have been well-documented, and include the following:

- Over-bank flooding (due to build-up of waste on the river bed) blanketing forests and gardens with fine mud, smothering vegetation and contributing to forest dieback
- Consequent alteration of the riparian environment and loss of fish habitat, leading to animal migration and a dramatic decline in numbers and diversity of fish
- Consequent erosion of traditional subsistence lifestyles of indigenous communities along the Ok Tedi and Fly rivers, with villagers forced to hunt and fish over large distances, and some forced to relocate

Although some sand dredging has been taking place in the lower Ok Tedi region since 2002, this waste disposal technique continues to this day. An examination of the investment approval process for the mine provides insight into how this project came into existence.

The original project design (as envisaged in the feasibility studies) included a tailings dam and a stable waste-rock dump to protect the river. Notably, environmental and social impact assessments of the project were based on this single alternative, rather than examining a range of options. As a result, the studies concluded that impacts on the river, terrestrial resources and downstream communities would be insignificant, and suggested that downstream communities and their resources did not require monitoring during the life of the project. When a landslide halted the work on the construction of the tailings dam, the PNG government—unaware of likely social and environmental consequences—waived the requirement for a dam, hence allowing the mine to go into production without the environmental protection agreed upon.

Another major shortfall of the feasibility studies and impact assessment was the lack of geological assessment of the project area, which contributed to the failure of the tailings dam and the dump site. Townsend and Townsend (2004, 20) suggest that "had adequate geotechnical investigation preceded the attempt to build the Ok Ma tailings dam and the dumping of waste rock, the environmental history of the project might have been very different."

Sources: **www.oktedi.com**, accessed 12 December 2009; Townsend and Townsend 2004; UNDP et al. 2003.

*Between 1984 and 2007, Ok Tedi Mine Limited contributed an estimated 2.9 billion kina ($1.1 billion) to the economy of Western province. In 2007, its operations accounted for 22.9 percent of PNG's gross domestic product (GDP) and 32 percent of PNG's exports, while employing 2,000 people. The company "has effectively taken on some functions of the local government" in the Western Province, constructing and operating infrastructure such as the airstrip, power and water supplies, hospitals and a local road network (UNDP et al. 2003, 195).

Case Study 10: Local Consultations in Mozambique

Although all land in Mozambique is formally state-owned, the Land Act 1997 requires prospective investors to consult legally defined local communities before receiving a land lease from the government. In other words, local users and investors are expected to negotiate terms and conditions under which local users may benefit from the investment. In addition, local communities are meant to receive 20 percent of the public revenues generated by forestry and wildlife projects on their land.

Overall, the implementation of this legislation has fallen short of expectations. In many cases, consultation processes only involved customary chiefs and local elites. In some cases, the consultation did not take place at all. Even where consultation takes place as required, communities lack the bargaining power and technical skills to negotiate with foreign investors on an equal footing. However, in the cases where external organizations supported local people, outcomes improved (for example, negotiations for community joint ventures in tourism are underway in several locations).

Source: Tanner and Baleira 2006.

effectiveness can also be undermined by poor information flows to communities and by local elites capturing the consultation process.

4.2 Negotiating Investment Contracts

Host governments can enter into investment contracts with individual investors. The extent to which the negotiation of these contracts can shape the investment project varies between countries and sectors. In some countries, national legislation provides detailed rules as well as model contracts to be used as a starting point for negotiations; in these cases, negotiations tend to focus on fiscal matters. At the other end of the spectrum, some contracts are wholly negotiated between the parties and provide much of the legal regime governing the investment.

Maximizing Benefits for the Host Country

Host governments need to ensure that project agreements with private investors are structured to maximize benefits for host countries. Issues that should be addressed include clearly defined and enforceable financial commitments, creation of direct and indirect employment, technology transfer, provision of infrastructure for local communities, revenue generation, local procurement of inputs, environmental protection and dispute settlement mechanisms. Case study 11 illustrates how these issues were addressed in Zambia's copper industry.

At the same time, host governments should be aware of the investor's concerns, in order to avoid a breakdown of negotiations. They should also ensure that provisions of investment contracts are not in conflict with international trade rules, and environmental, labour and international investment agreements to which the country is party.[1]

[1] These aspects cannot be treated in depth here, but are covered in a 2010 International Institute for Environment and Development guide on negotiating investment contracts to maximize sustainable development outcomes (Cotula 2010).

Case Study 11: Negotiating Privatization of Zambia's Copper Mines

Privatization of Zambia's copper industry in 1990s led to significant investments in mines by new owners and subsequent industry revival. However, the so-called "development agreements" between the Government of the Republic of Zambia (GRZ) and private investors have been criticized by various stakeholders.

Copper ore treatment plant, Ndola/Copperbelt, Zambia. © Cordier Sylvain/BIOSphoto/Still Pictures.

As part of the privatization process, the investors were able to negotiate 20-year legal stability contracts which contained special fiscal terms for their operations. In hindsight of strong copper prices, these terms have been criticized as too generous, with GRZ missing out on significant revenue. Critics suggest that GRZ should have retained a larger stake in the industry, waited until copper price picked up before selling, or negotiated more favourable price-participation agreements.* As a result, there is growing pressure on GRZ and investors to renegotiate the terms of the agreements.

At the peak of its operations, government-owned Zambia Consolidated Copper Mines provided significant infrastructure and services in mining towns. These included construction and maintenance of schools and hospitals, and provision of housing, sanitation services, electricity and water. According to numerous sources, new foreign owners have shown significantly less interest in providing similar infrastructure and services, instead considering it a function of the government. GRZ, in turn, has not been able to adequately fill the gap. Subsequently, mining towns face serious health and environmental problems, including lack of waste collection systems and outbreaks of cholera and typhoid.

Sources: Boocock 2002; World Bank 2007.

*A number of mining companies have agreed to price-participation agreements, under which the host government would receive an increased share of sales from companies in which it held shares once copper exceeded a certain price, and once the company concerned began to pay a dividend (World Bank 2007).

Implementing a Negotiating Strategy

A clear negotiating strategy by the host government can make a significant difference to the outcome of negotiations. This strategy should include the following:

- Identification of the key sustainable development objectives to be pursued
- Identification of likely expectations of the other party
- Identification of areas where concessions and compromises are possible
- A plan for the flow of negotiations and negotiation tactics (Cotula 2010)

As is the case with IIAs, negotiation of a successful contract with private investors requires officials to have sound legal expertise and negotiation skills. This is highlighted in case study 12.

Case Study 12: Contract Negotiation in Liberia

The renegotiation of a number of mining and agricultural concessions in Liberia in 2006 illustrates the difference that investing in the government's capacity to negotiate can make. An independent evaluation of this renegotiation noted significant improvements in the terms of the contracts—namely, an increase in public revenues, requirements to source labour, goods and services locally, and the relocation of certain processing activities to the host country. Determined political will at the highest level, a clear negotiating strategy, a strong negotiating team within an influential government institution, and world-class external legal and other advice were all crucial to this outcome.

Source: Kaul, Heuty and Norman 2009.

Contracts between Investors and Local Groups

Governments may also facilitate direct contracts between investors and local groups. However, it is important to ensure that contractual arrangements are economically viable and agreed to by both parties (as seen in case study 13). Effective collective action by the local government and support from development agencies can also help local groups address unfavourable imbalances in negotiating power.

Case Study 13: Choosing the Right Contract Model—Experience in Northern Lao People's Democratic Republic

Sugar cane farming, Muang Sing, Lao People's Democratic Republic. Courtesy Cameron Higgins.

Provincial governments in Bokeo, Luang Namtha and Oudomxay in the Lao People's Democratic Republic officially promote a contract farming arrangement for agricultural plantations, with villagers providing land and labour; and investors contributing capital, know-how and market access. However, research shows that "the model all too often dissolves into concession-type arrangements where companies are responsible for the entirety of plantation management for the first several years and villagers contribute only land, in exchange for 30 percent of the future plantation and current wages (if they also choose to work for the company as laborers)" (Shi 2008, 3). This is mainly due to the fact that rubber plants take seven to eight years before yielding any income, with villagers not able or not willing to contribute years of uncompensated labour (preferring to be paid wages instead). In certain cases, contract farming arrangements have fallen apart altogether.

The provincial governments recognize the potential risks of such systems, and are seeking to address them. The government of Luang Namtha, for example, is carrying out assessments for developing "model contracts" to be followed in future negotiations.

Source: Shi 2008.

4.3 Transparency

Public Disclosure of Investment Contracts

Contracts between host governments and private investors are not simply commercial transactions. They are also tools for public policy which affect the livelihoods and environments of many. Transparency in project approval and contract negotiation, and public disclosure of government contracts—without disclosing genuinely confidential commercial information—can increase accountability and reduce the likelihood of future disputes and allegations of corruption (as exemplified in case study 14).

Case Study 14: Transparency in Privatizing Zambia's Copper Industry

As discussed in **case study 11**, privatization of Zambia's copper industry in the 1990s led to significant investments in mines by new owners and to industry revival. However, interviews conducted by the World Bank in 2007 showed that the negotiation of agreements between the government and private investors was widely perceived to have been an "opaque process." Several government stakeholders felt that the secrecy surrounding the negotiations "was so significant that it continued to make it very difficult for anyone to trust either the government agencies or the companies operating in the sector" (World Bank 2007, 14). A number of companies also recognized that the secrecy of the negotiation and implementation processes created an impression of a lack of transparency and accountability. Civil society groups, on the other hand, argued that the lack of transparency of the mining development agreements was a tool which allowed political figures and government officials to engage in corruption.

Source: World Bank 2007.

Public disclosure of contracts can also promote contractual terms that maximize the public interest. Firstly, transparency can increase pressure for more balanced contracts because the parties can be held accountable for commitments made. Secondly, a pool of publicly available contracts can be a powerful way of strengthening the negotiating capacity of host governments, by illustrating different contractual options available (Rosenblum and Maples 2009).

Parliamentary Approval of Investment Contracts

Parliamentary approval of major Investment projects negotiated by the government can increase public scrutiny. It can also provide greater safeguards for investors, as the contract in effect becomes an Act of Parliament. Parliamentary approval is already a legal requirement for natural resource contracts in some countries.[2]

However, some conditions need to be in place for this mechanism to enable genuine scrutiny. In order to make well-informed decisions, parliamentarians need adequate time and information, as well as technical assistance from experts in the field. Politicians may also consider using parliamentary processes as a forum for public debate, for instance by inviting civil society organizations to express their views on proposed contracts. Finally, for parliamentary

[2] For example, Ghana's Constitution of 1992 (Chapter 21, Section 268) states that any contract for the exploitation of natural resources of Ghana shall be subject to ratification by Parliament (Ghana Review International 2010).

scrutiny to be robust, parliamentarians should be able to propose amendments to the contract, rather than making a "take-it-or-leave-it" decision.

Industry-Specific Transparency Schemes

Transparency in contracting and in multi-stakeholder dialogue can be improved by industry-specific transparency schemes. For example, the Extractive Industry Transparency Initiative (EITI) requires member companies and governments to publish figures on revenues generated by extractive industry projects.[3] From a host-country perspective, joining initiatives like EITI can improve the investment climate (by sending a clear signal to investors and international donors about the country's commitment to transparency), strengthen accountability and good governance, and promote greater economic and political stability.

[3] www.eiti.org, accessed 28 February 2011.

5. Law Enforcement and Monitoring of Investment Projects

This chapter analyses how the host government's monitoring of investors' compliance with relevant laws and project contracts can influence the economic, social and environmental outcomes of FDI projects.

5.1 Impact of Poor Law Enforcement and Monitoring

It is widely accepted that investment projects can have negative economic, social and environmental outcomes if relevant laws and regulations are not enforced and monitoring is neglected by host authorities. These outcomes can include the following:

- Foregone government revenue
- Inadequate benefits to local communities

Key Findings and Best Practices

- **Law enforcement and project monitoring should be a high priority for host authorities.** FDI projects are likely to have negative economic, social and environmental outcomes if relevant laws and regulations are not enforced and monitoring is neglected.
- **Lack of law enforcement and monitoring can be caused by various factors.** These include the lack of resources and technical capacity of government officials, high levels of corruption, ineffective coordination between responsible authorities, lack of clear laws and regulations, and hesitance to impose sanctions due to fear of investor withdrawal. Host governments have the responsibility of identifying these underlying causes, an essential step in designing effective solutions.
- **Measures to address shortcomings in law enforcement and monitoring are inevitably context-specific.** They may include establishing new regulatory agencies, improving the structure and mandate of existing agencies, separating regulatory and commercial functions to prevent regulatory capture, and addressing the lack of resources and human capacity.
- **Voluntary third-party certification schemes can promote producer compliance with internationally accepted social and environmental standards.** However, governments must ensure that promoted schemes do not create barriers for smaller-scale producers. The voluntary nature of third-party certification means that it should not replace law enforcement.

- High incidence of dispute between local communities and investors (sometimes leading to project failure)
- Undue negative impact on the environment and natural resources

The need for effective law enforcement and monitoring is highlighted in case study 15.

Case Study 15: Lack of Environmental Oversight in Zambia's Copper Industry

Prior to the 1980s, the environmental impacts of Zambia's state-owned mining industry were largely unregulated, resulting in serious air and water pollution and soil contamination. The handling of this 70-year "environmental mortgage" was a key issue during negotiations with private buyers in the 1990s. The development agreements exempted the buyers from environmental liabilities related to the past activities, which were deemed to be the responsibility of the Government of the Republic of Zambia (GRZ). Subsequently, each buyer was expected to prepare an environmental management plan (EMP) to address its environmental obligations; in counterpart, GRZ was to prepare an EMP indicating how it would address the liabilities excluded by the investor. Development agreements also allowed companies to defer compliance with any new environmental regulations.

A 2003 report by the World Bank highlighted the weak capacity of Zambia's regulatory bodies (specifically, the Environmental Council of Zambia and the Mines Safety Department) in implementing environmental regulations. The report argued that, as a result, GRZ would "play from a weak hand" when negotiating, reviewing and monitoring the implementation of investors' EMPs, with consequent negative environmental and social outcomes:

> Poorly negotiated EMPs are equivalent to handing out pollution credits, thus further shifting the environmental and social costs of pollution from the investors to GRZ. Poor public disclosure of EMPs can lead to misunderstandings or social conflict. Poor monitoring and enforcement will inevitably result in lax implementation of agreements. Without a dramatic increase in the [government] capacity… to effectively control pollution, the mining sector's "environmental mortgage" will continue to accrue.

Sources: Boocock 2002; World Bank 2003.

5.2 Identifying Causes

Shortcomings in project monitoring and law enforcement can be caused by a number of factors, which need to be identified in order to design the most effective remedies. These include the following:

- Ineffective coordination between different agencies responsible for law enforcement and monitoring
- High levels of government corruption
- Lack of resources and technical capacity of government departments
- Lack of clear laws and regulations
- Non-application of sanctions for non-compliance

5.3 Designing Solutions

Measures to address the lack of law enforcement and monitoring are inevitably context-specific. A number of options are discussed below.

Improving Regulatory Structures

Establishing dedicated host-government units is one option for improving project monitoring and law enforcement. These units must have strong expertise and high-level political backing for managing investment contracts, collecting revenues, monitoring implementation and penalizing non-compliance.

Improving the performance of existing regulatory agencies is another option. For example, a national environment protection agency can monitor compliance with environmental legislation—but only if it has a clear mandate to do so, as well as adequate resources to access required information and sanction violations (Cotula 2010).

Establishing a clear division of responsibilities between authorities responsible for monitoring, and improving information sharing (particularly between different levels of governments) is important. For example, a study of investment management in the Lao People's Democratic Republic's Savannakhet province found that district authorities were often not provided with copies of the investment contracts by provincial authorities, preventing them from effectively monitoring compliance and dealing with disputes. Consequently, there was evidence of investors failing to provide villagers with compensation stipulated in the contracts (Pommier 2009).

It is also important to protect monitoring agencies from regulatory capture. For instance, if a national oil company has both regulatory functions and commercial duties (as an equity holder in an oil project, for example), there may be the risk that it does not scrutinize the project as thoroughly as it should. Separating commercial and regulatory functions may be a useful way of addressing this problem (Cotula 2010).

Addressing Lack of Resources and Human Capacity

Monitoring authorities require technical skills to review the content of environmental and social assessments prepared by investors. They also require financial, physical and human resources to conduct on-site audits and deal with disputes. Measures to address this may include increasing the budgets of these authorities and improving the performance of domestic educational institutions (see case study 16).

Ensuring Application of Sanctions for Non-Compliance

National laws commonly enable the host government to impose sanctions if the investor does not comply with investment plans. These can include fines and suspension or withdrawal of land or resource rights. For example, under Mozambique's Land Act 1997 land allocations are subject to compliance with the investment plan within two years (for foreign investors) or five years (for domestic investors); in both cases, non-compliance entails termination of the land lease, while compliance guarantees a definitive title for 50 years (renewable).

In practice, however, provisions of this kind are rarely enforced. Causes for this can be numerous, including the host government's lack of capacity to monitor investor's compliance, lack of clear mandate for any particular agency to enforce sanctions, or fear of discouraging other investors or facilitating investment withdrawal (Pommier 2009). However, cases of land withdrawal from agricultural investments that failed to deliver on their promises do exist, as illustrated by the recent cancellation of a land lease for a 30,000-ha biofuel project in Mozambique (Nhantumbo and Salomão, forthcoming).

Case Study 16: Papua New Guinea Forestry Enforcement and Monitoring—Impacts of Limited Capacity

The lack of effective law enforcement and monitoring is widely recognized as a major obstacle to sustainable forest management in Papua New Guinea (PNG). Ongoing problems include the following:

Transport of tropical wood. © Jochem Wijnands/Lineair/Still Pictures.

- Unsatisfactory monitoring and reporting by the Papua New Guinea Forest Authority (PNGFA) on legal compliance of logging operations and development projects
- Unsatisfactory monitoring and reporting by the Department of Environment and Conservation (DEC) on forestry companies' compliance with their environmental responsibilities
- Inadequate resolution of disputes between landowners and forestry companies by Provincial Forest Management Committees (a division of PNGFA)
- Unsatisfactory management of protection areas by DEC (including Wildlife Management Areas declared under the Wildlife Act)

The causes are primarily related to lack of staff, training and resources for responsible agencies:

- **Lack of physical and human resources at PNGFA and DEC.** PNGFA suffers from inadequate staff levels and lack of equipment and infrastructure (such as transportation) for its field staff. The resource problems of DEC appear to be even greater, with very few staff stationed in the field and a minimal presence at the provincial level. A 2006 mission by the International Tropical Timber Organization noted that "the human resources of both PNGFA and DEC, especially the field staff, appeared overworked, under resourced and, therefore, not surprisingly, unmotivated" (ITTO 2007, iv).
- **Ineffective collaboration between PNGFA and DEC**. A number of sources cite a weak institutional working relationship in field monitoring between the two bodies.
- **Lack of resources at forestry research and education institutions.** There appears to be no meaningful government funding for the PNG Forest Research Institute or the PNG University of Technology (the latter being the only PNG university offering tertiary-level education in forestry science). This has a negative impact on the level of technical competence among PNGFA and DEC staff, particularly in emerging issues such as climate change, carbon stocks and carbon trading.
- **Excessive complexity of PNG forestry laws and procedures.** It has been suggested that the laws governing the sector contain far more steps and complexities than necessary. For example, the current government process for approving a logging operation consists of 34 steps. Given the resource problems identified above, unnecessary procedures and administrative constraint further diminish the performance of PNGFA and DEC.

Sources: FAO 2009a; ITTO 2005, 2007; National Parliament of Papua New Guinea 1991; PNGFA 2009.

5.4 Third-Party Certification: An Alternative to Government Monitoring?

Since the 1990s, voluntary third-party certification initiatives have emerged in a number of primary industries.[1] This process has been primarily driven by non-governmental organizations and consumers in developed countries, in response to what they perceive to be inadequate labour and environmental regulation in producer countries. In addition, certification has been embraced by certain TNCs seeking to ensure desirable characteristics of their products (including quality, environmental friendliness, safety, reliability and efficiency) (ISO 2010)

Compliance with social and environmental standards stipulated by certification schemes has a number of potential costs and benefits for producers.

Depending on the certification standard in question, **producer benefits** may include the following:

- Securing market segments by targeting environmentally and socially conscientious consumers
- Rationalization of production, increased productivity and reduced input cost
- Improved management of the supply chain
- Improved corporate image of the company
- Improved management of natural resources on which farmer livelihoods depend
- Improved relations with the local community and workers unions
- Reduced worker turnover, absenteeism, accident and sickness rates (Liu 2009; Arias et al. 2003)

Costs of certification depend on the certification requirements and the initial mode of production. These may include the following:

- Increased labour input and lower yields (if switching to organic farming)
- Increased overhead costs of developing internal control systems, undertaking record keeping, and employing extra accounting and management staff (Liu 2009)
- Increased overhead costs of compliance with additional environmental requirements such as non-conversion of primary forests and integrated pest management and waste management
- Cost of the certification process (including the cost of audits by the certification body)

It should be noted that the cost of required institutional and organizational changes is likely to marginalize small-scale producers and contract farmers.

Host governments need to consider these factors for the industry in question before taking any steps in promoting certification. Furthermore, the voluntary nature of third-party certification means that it should not replace government efforts to improve the quality and enforcement of its environmental and labour laws. The impact of third-party certification on the Latin American banana industry is described in case study 17.

[1] Some of the better-known international initiatives include the Forest Stewardship Council and the Programme for Endorsement of Forest Certification Schemes (forestry), the Roundtable on Sustainable Palm Oil (palm oil production), the Round Table on Responsible Soy Association (soy production), and the Marine Stewardship Council (fisheries).

Case Study 17: Third-Party Certification in the Banana Industry

Bananas are the world's most exported fresh fruit, both in volume and value. The perishable nature of bananas means that exporting requires a close control of the entire supply chain at all stages (from production to retail sale). Consequently, the banana trade has historically been dominated by a small group of large TNCs controlling the production, packing, shipping, importing and ripening processes. Latin America and the Caribbean dominate international trade, accounting for 70 percent of global exports in 2006.

Since the 1990s, the environmental and social impacts of the industry have been under scrutiny from non-governmental organizations, the media, and, ultimately, retailers, consumers and shareholders. In response, TNCs have gradually turned to voluntary third-party certification schemes.

Organic agriculture, fair-trade, Rainforest Alliance, SA8000 and ISO14001 certification schemes have been the most significant for the banana trade in terms of quantities certified. These schemes vary in their scope, requirements and benefits offered. Only organic agriculture, fair-trade and Rainforest Alliance schemes offer product labelling, and hence have the potential to attract price premiums. Sales of bananas certified under these standards have expanded rapidly since the late 1990s, and accounted for nearly 15 percent of global banana exports in 2007 (with a value of almost $3 billion).

Banana plantation, Village Koyali, Gujarat, India. Courtesy Vasant Dave.

A 2009 study found that organic- and fair-trade-certified bananas receive price premiums of up to 50 percent (with large country-level variations). However, a relatively small share of the premium accrued to the exporting country, with retailers capturing the largest share of the retail price. This was attributed to the bargaining power of retailers, stemming from market oversupply and high level of concentration in the retail market. The same study found that following a surge in agricultural commodity prices in 2007, "some organic farmers have gone back to conventional farming as their product prices were too high for a majority of consumers" (Liu 2009, 91).

For TNCs, the widespread uptake of certification has helped them reduce—but not completely eliminate—criticism of their own plantations. The attention of human rights activists and environmentalists has instead turned to their national suppliers (Human Rights Watch 2002).

Sources: Arias et al. 2003; BananaLink 2009; Human Rights Watch 2002; Liu 2009; UNCTAD 2009a.

Abbreviations and Acronyms

BIT	bilateral investment treaty
ASEAN	Association of Southeast Asian Nations
DEC	Department of Environment and Conservation (Papua New Guinea)
EITI	Extractive Industries Transparency Initiative
EMP	environmental management plan
FDI	foreign direct investment
GRZ	Government of the Republic of Zambia
IIA	international investment agreement
IPA	investment promotion agency
ITTO	International Tropical Timber Organization
LDC	least developed country
PNG	Papua New Guinea
PNGFA	Papua New Guinea Forest Authority
REDD	reduced emissions from deforestation and forest degradation
RSPO	Roundtable for Sustainable Palm Oil
TNC	transnational corporation
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme

Glossary

arbitration. A legal technique for the resolution of disputes outside the courts, where the parties to a dispute refer it to a third party, which reviews the case and imposes a decision that is legally binding for both sides.

bilateral investment treaty (BIT). An agreement between two countries for the reciprocal encouragement, promotion and protection of investments in each other's territories by companies based in either country. Treaties typically cover the following areas: scope and definition of investment, admission and establishment, national treatment, most-favoured-nation treatment, fair and equitable treatment, compensation in the event of expropriation or damage to the investment, guarantees of free transfers of funds, and dispute settlement mechanisms (both state-state and investor-state) (UNCTAD 2010c).

concession. Investment arrangement whereby land is transferred to investors who are then responsible for all production activities (contrast with contract farming).

contract farming. Agricultural production carried out according to an agreement between the investor and farmers. Typically, the farmers agree to provide agreed quantities of a specific agricultural product, in accordance with quality standards and timelines determined by the investor. In return, the investor commits to purchase the product and, in some cases, to support production through the supply of farm inputs, land preparation and provision of technical advice (FAO 2010).

customary land tenure. Land tenure associated with indigenous communities and administered in accordance with their customs, as opposed to statutory tenure (FAO 2002).

developed countries. Member countries of the Organisation for Economic Co-operation and Development (OECD) (other than Mexico, the Republic of Korea and Turkey), plus the new European Union member countries that are not OECD members (Bulgaria, Cyprus, Estonia, Latvia, Lithuania, Malta, Romania and Slovenia), plus Andorra, Israel, Liechtenstein, Monaco and San Marino (classification of the United Nations Statistical Office).

developing economies. All economies not listed as "developed countries" or "transition economies" (classification of the United Nations Statistical Office).

economic diversification. The process by which a growing range of economic sectors and industries are developed within an economy (e.g. manufacturing, agriculture, financial services).

environmental impact assessment (EIA). An assessment of the intended and unintended environmental consequences of a proposed investment project. The purpose of an EIA is to ensure that environmental impacts are taken into account during project approval.

expropriation. The seizure of private property by the state for public use or benefit.

extractive industries. Primary activities involved in the extraction of non-renewable resources, such as mining, quarrying, dredging, and oil and gas extraction.

fair and equitable treatment. A standard of treatment in international investment agreements that requires host governments to accord full or constant protection and security to foreign investments and not to impair the management, maintenance, use, enjoyment or disposal of foreign investments by unreasonable or discriminatory measures (UNCTAD 2009b).

feasibility study. An assessment of the strengths and weaknesses of a proposed investment project, including the opportunities and threats as presented by the environment, the resources required, and the prospects for success.

foreign direct investment (FDI). Investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate) (UNCTAD 2010a).

foreign-exchange balancing requirements. Host government policies stipulating that the foreign exchange made available for imports should be a certain proportion of the value of foreign exchange brought in by the firm from exports and other sources (ITC/CS 1995).

greenfield investment. A form of FDI where a parent company starts a venture in a foreign country by constructing new operational facilities, rather than taking over existing facilities (commonly known as "mergers and acquisitions").

international investment agreement (IIA). A treaty between two or more countries that addresses protection, promotion and liberalization of cross-border investment (including FDI). IIAs include bilateral investment treaties, regional economic agreements with provisions on foreign investment, and multilateral agreements with direct implications for FDI.

investment contract. A written agreement between a foreign investor and the host government or a local community that (1) grants rights with respect to natural resources or other assets controlled by the host government or a local community; and (2) is relied upon by the foreign investor in establishing or acquiring a covered investment (UNCTAD 2004).

investment promotion agency (IPA). A government agency responsible for attracting investment to a specific country, region or city.

joint venture. A business entity having the following characteristics: (1) the entity was established by a contractual arrangement, with two or more parties contributing resources towards the business undertaking; (2) the parties have joint control over activities carried out according to the terms of the arrangements (UNCTAD 2010b).

land cadastre. A comprehensive register of real property of a country. A cadastre commonly includes details of ownership, tenure, location, dimensions, area and the value of individual parcels of land.

land tenure. Rules, whether legally or customarily defined, among individuals or groups with respect to land. Rules of tenure define how rights to use, control and transfer land are to be allocated within a given society (FAO 2002).

land titling. A form of land reform in which private individuals or groups acquire formal property rights for land which they have previously occupied informally or used on the basis of

customary land tenure. Formal land titles have the potential to increase security of land tenure and support development of land markets.

least developed country (LDC). The name given to a country which, according to the United Nations, exhibits the lowest indicators of socioeconomic development of all countries in the world. As of late 2010, the current list of LDCs consists of Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, the Niger, Rwanda, Samoa, São Tomé and Príncipe, Senegal, Sierra Leone, Solomon Islands, Somalia, the Sudan, Timor-Leste, Togo, Tuvalu, Uganda, the United Republic of Tanzania, Vanuatu, Yemen and Zambia (UN-OHRLLS 2010).

legal stability contract. A contract between an investor and host government which protects the investor from future adverse regulatory action that undermines their investment. Legal stability contracts aim to attract investors by providing a higher degree of legal certainty and stability.

local content requirements. Host government policies requiring investors to use a certain proportion of locally made goods as inputs in their production process.

local procurement. The process of obtaining personnel, services, supplies, and equipment from local (host country) sources.

low-income economy. An economy with 2009 per capita gross national income of $995 or less (World Bank 2010).

middle-income economy. An economy with 2009 per capita gross national income between $996 and $12,195 (World Bank 2010).

Millennium Development Goals (MDGs). Eight international development goals to be achieved by 2015, as agreed to by all 192 United Nations member states. Goals include eradicating extreme poverty and hunger; achieving universal primary education; promoting gender equality and empowerment of women; reducing child mortality rate; improving maternal health; combating HIV/AIDS, malaria, and other diseases; ensuring environmental sustainability; and developing a global partnership for development (UN 2010).

minerals. Non-renewable, naturally occurring solid chemical substances used as raw materials for production of a wide range of industrial and consumer goods. Minerals can be classified into three main categories: (1) energy minerals (oil, gas, coal and uranium); (2) metallic minerals (iron ore, aluminium, copper, etc.); and (3) non-metallic minerals (industrial and construction minerals and precious stones).

natural resources. Resources occurring naturally within, and derived from, the environment. These can be divided further into renewable resources (those that can be replenished or reproduced easily, such as water and forests) and non-renewable resources (those that exist in fixed amounts, or are consumed much faster than nature can recreate them, such as metals, coal, oil, gas).

non-renewable resources. *See* **natural resources**.

one-stop shop. A facility that offers a multitude of services to an investor during the investment approval service. A one-stop shop is based on the principle that investors can submit

an investment application and receive a reply at the same place where the application was submitted.

organic farming. A form of agricultural production that excludes or strictly limits the use of manufactured fertilizers and pesticides, plant growth regulators such as hormones, livestock antibiotics, food additives, and genetically modified organisms. Techniques used include crop rotation, compost and biological pest control.

performance requirements. A specific category of host-country measures imposed on foreign investors to act in ways considered beneficial for the host economy. The most common ones relate to local content, export performance, domestic equity, joint ventures, technology transfer and employment of nationals. The requirements can be mandatory (e.g. precondition for entry or access) or voluntary (e.g. condition for obtaining an incentive) (UNCTAD 2004).

primary sector. A sector of the economy concerned with obtaining or providing natural raw materials for conversion into commodities. Industries in this sector include agriculture, agribusiness, fishing, forestry and extractive industries.

primer. A textbook that serves as an introduction to a subject of study.

production sharing agreement. A contract between a host government and an investor (usually a resource extraction company) concerning what percentage of the extracted resource each party will receive. The investor usually bears all exploration risks, development and production costs.

regulatory capture. A form of government failure, where a state regulatory agency created to act in the public interest instead acts in the commercial or special interests of the industry it is charged with regulating.

renewable resources. *See* **natural resources**.

social impact assessment (SIA). An assessment of the intended and unintended social consequences of a proposed investment project. The purpose of the SIA is to ensure that social impacts are taken into account during project approval.

South-South. A term historically used by policy makers and academics to describe interaction between developing countries.

special economic zone (SEZ). A geographic region with economic regulations which are more free-market-oriented (and hence more conducive to FDI) than a country's national laws and regulations. SEZs cover a broad range of zone types, including Free Trade Zones, Export Processing Zones, Free Zones, Industrial Estates, Free Ports, Urban Enterprise Zones and others.

technology transfer. The process whereby systematic knowledge for the manufacture of a product, for the application of a process or for the rendering of a service is disseminated (UNCTAD 2004).

tenure security. The certainty that a person's rights to land will be recognized by others and protected in cases of specific challenges. People with insecure tenure face the risk that their rights to land will be threatened by competing claims, and even lost as a result of eviction (FAO 2002).

third-party certification. A system of standards and conformance which aims to provide consumers with assurance that products were produced in compliance with specified

environmental or social standards. Third-party certification includes audits of company's operations by independent certification bodies.

transnational corporation (TNC). Incorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates. A parent enterprise is defined as an enterprise that controls assets of other entities in countries other than its home country, usually by owning a certain equity capital stake. An equity capital stake of 10 percent or more of the ordinary shares or voting power for an incorporated enterprise, or its equivalent for an unincorporated enterprise, is normally considered as the threshold for the control of assets (UNCTAD 2009b).

trade balancing requirements. Host government policies requiring imports to be equivalent to a certain proportion of exports in the production process (ITC/CS 1995).

transition economies. Economies of South-East Europe and the Commonwealth of Independent States (classification of the United Nations Statistical Office).

Key Resources

- **Food and Agriculture Organization of the United Nations (FAO) Contract Farming Resource Centre.** www.fao.org/ag/ags/contract-farming/index-cf/en/ (accessed 28 February 2011). A "one-stop" site providing information and technical support on planning and implementing contract farming operations.
- **International Institute for Sustainable Development Model International Agreement on Investment for Sustainable Development (2005).** www.iisd.org/pdf/2005/investment_model_int_agreement.pdf (accessed 28 February 2011). A model investment agreement which aims to promote foreign investment that supports sustainable development, in particular in developing and least developed countries. The text is intended to be adaptable to bilateral, regional and multilateral negotiations.
- **International Institute for Sustainable Development Model International Agreement on Investment for Sustainable Development—Negotiators' Handbook (IISD 2005).** English, Français, Español. www.iisd.org/pdf/2005/investment_model_int_handbook.pdf (accessed 28 February 2011). This publication provides both the text of the model agreement and a commentary on each article. The aim of the commentary is to elucidate key elements of the text from a policy or legal perspective, and to provide a sense of the options or alternative approaches to issues raised by the text.
- **Investment contracts and sustainable development: How to make contracts for fairer and more sustainable natural resource investments (IIED 2010).** http://pubs.iied.org/pdfs/17507IIED.pdf (accessed 28 February 2011). This guide discusses options to structure investment contracts in ways that maximize the investment's contribution to sustainable development. The focus is on foreign investment in the natural resource sector and on lower- and middle-income countries.
- **Organisation for Economic Co-operation and Development (OECD) International Investment website.** www.oecd.org/department/0,3355,en_2649_34863_1_1_1_1_1,00.html (accessed 28 February 2011). A forum for international co-operation, policy analysis and advice to governments on how best to enhance the positive contribution of foreign investment.
- **United Nations Conference on Trade and Development (UNCTAD) InfoComm—Market Information in the Commodities Area.** www.unctad.org/infocomm/anglais/indexen.htm (accessed 28 February 2011). An electronic portal which provides profiles for over 40 commodities, including information on market structures and innovations.

- **UNCTAD Investment Policy Reviews.** www.unctad.org/Templates/StartPage.asp?intItemID=2554 (accessed 28 February 2011). The reviews evaluate national legal, regulatory and institutional frameworks for FDI. This includes FDI entry and establishment, treatment and protection of investment, taxation, the business environment and sectoral regulations. Strategic analysis and recommendations are also provided.
- **UNCTADstat.** http://unctadstat.unctad.org/ (accessed 28 February 2011). UNCTAD's data dissemination system, with focus on FDI and international trade.
- **UNCTAD World Investment Reports.** www.unctad.org/Templates/Page.asp?intItemID=1485&lang=1 (accessed 28 February 2011). This annual publication covers the latest trends in FDI around the world and provides and in-depth analysis of one selected topic related to FDI and development.

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