

BRIDGES NETWORK

# BRIDGES AFRICA

Trade and Sustainable Development News and Analysis on Africa

VOLUME 5, ISSUE 5 – JUNE 2016



## Making investment work for Africa

### INVESTMENT

Towards an African approach to regulating investment?

### AGRICULTURE

A deeper look at the economic impacts of foreign agricultural investment in Africa

### SERVICES

How to leverage FDI to develop the service sector on the continent?



International Centre for Trade  
and Sustainable Development

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Trade and Sustainable Development News  
and Analysis on Africa

PUBLISHED BY

### ICTSD

**International Centre for Trade and  
Sustainable Development**

Geneva, Switzerland

[www.ictsd.org](http://www.ictsd.org)

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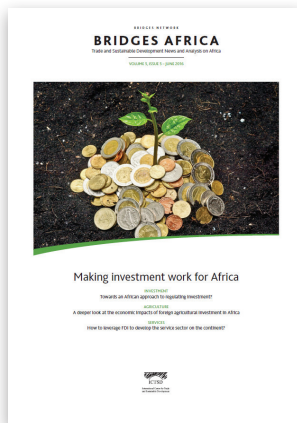
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## Making investment work for Africa



*When addressing the financing needs of African countries, in particular the continent's poorest economies, debates often tend to focus on the importance of official development assistance (ODA). In order to achieve its economic transformation, however, Africa will also need to attract private capital. The essential role of private investment is clearly recognized by the Addis Ababa Action Agenda, which was adopted in July 2015 as the outcome document of the UN's Third Financing for Development Conference, and was recently reaffirmed during the Midterm Review of the Istanbul Programme of Action for least developed countries (LDCs).*

*But mobilising investment flows is no easy task. It requires designing and implementing adequate policies and regulations. Moreover, while attracting investment is indeed crucial, ensuring that it contributes to sustainable and inclusive development in African economies, in line with the sustainable development goals (SDGs), is even more critical.*

*Today, foreign direct investment (FDI) in Africa tends to be concentrated in a few sectors related to the extraction of natural resources and often sidesteps the poorest countries. This presents a real challenge. After remaining stable in 2014, investment inflows to Africa declined in 2015 as a result of the end of the commodity super-cycle, further emphasising the need for the continent to attract more diversified investment.*

*Against this backdrop, what strategy should African countries adopt in order to foster investment flows that contribute to sustainable development and the economic transformation of their economies? Is there any sector that holds particularly promising opportunities, or specific risks that governments should be aware of? This issue aims at shedding light on those questions.*

*Within the previous year, African countries finalised the draft of the Pan-African Investment Code (PAIC), which is intended to become the backbone of a common and innovative approach to regulating investment on the continent. In the first article, Makane Mbengue offers insights on the potential added value of such an instrument.*

*Two other articles approach the issue of investment from a sector-specific angle. Focusing on agriculture, Manitra Rakotoarisoa presents an analysis aimed at informing the economic debate on the welfare impacts of foreign agricultural investment in Sub-Saharan Africa. Looking specifically at services, Nkululeko Khumalo identifies ways to leverage FDI in the African service sector so as to promote sustainable and inclusive growth in Africa.*

*This issue also contains a piece drawn from the work of the E15 Initiative's [task force](#) on investment policy. In this article, Karl Sauvart examines the state of the international investment law and policy regime at a systemic level and presents potential options for reform.*

*As usual, we welcome your substantive feedback and contributions. Write to us at [bridgesafrica@ictsd.ch](mailto:bridgesafrica@ictsd.ch).*

## INVESTMENT

# The quest for a Pan-African Investment Code to promote sustainable development

Makane Mbengue

*In late 2015, African countries finalised the drafting of the Pan-African Investment Code (PAIC). What is the added value of this continental instrument related to the regulation of foreign investment?*

The year 2015 was a crucial one for Africa regarding the negotiation of the first continent-wide investment agreement: the Pan-African Investment Code (PAIC). Although this legal instrument – presented in the form of a treaty – is not yet officially adopted, it reflects an African consensus on the shaping of international investment law. It has been drafted from the perspective of African developing and least developed countries focusing on Sustainable Development Goals (SDGs). The PAIC contains a number of Africa-specific and innovative features, making it a truly unique legal instrument.

The main objective of the PAIC is to foster coherence and consistency with respect to the rules and principles that will govern investment protection, promotion and facilitation on the African continent. As such, it has the potential to become a sustainable solution to solve the puzzle of international investment agreements (IIAs) in Africa.

## The puzzle of IIAs in Africa

African countries adopted the large bulk of their bilateral investment treaties (BITs) between the mid-90s and the early 2000s. Traditionally, BITs were concluded with capital exporting countries, mainly from Europe. African states hoped that the establishment of international rules to protect investment, intended to ensure stability and predictability, would promote and attract foreign capital into their economies. Today, African countries have signed around 870 BITs or IIAs, which corresponds to about a third of all IIAs signed worldwide.<sup>1</sup> However, since 2002, there has been a marked decline in the number of BITs signed by African countries.

Aside from BITs, regional investment agreements have emerged in the African context due to the proliferation of regional economic communities (RECs). Within West Africa, there are three RECs: the West African Economic and Monetary Union (UEMOA), the Mano River Union (MRU), and the Economic Community of West African States (ECOWAS). Central Africa has two groupings: the Economic Community of Central African States (ECCAS), the Economic and Monetary Community of Central Africa (CEMAC), and the Economic Community of Great Lakes Countries (ECGLC). In the Eastern and Southern African sub-regions, six groupings coexist: the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC), the Inter-Governmental Authority on Development (IGAD), the Indian Ocean Commission (IOC), the Southern Africa Development Community (SADC), and the Southern African Customs Union (SACU). North Africa shares two RECs, namely the Arab Maghreb Union (UMA) and the Community of Sahel-Saharan States (CEN-SAD). Today, in this complex mosaic, 28 countries retain dual membership, 20 are members of three RECs, the Democratic Republic of Congo belongs to four RECs, and six countries maintain single membership.

Most of these RECs adopted legal instruments concerning the regulation of foreign investment.<sup>2</sup> From the 1970s to the 1990s, various treaties were concluded to enhance cooperation and harmonisation in the area of investment, such as the 1965 CEMAC Investment Agreement, the 1982 ECGLC Investment Code, and the 1990 Arab Maghreb Union Investment Agreement. ECOWAS adopted two protocols that relate indirectly to foreign investment: the 1984 ECOWAS Protocol on Community Enterprises and the 1979 ECOWAS Protocol on Movement of Persons and Establishment. More recently, in 2007,

## 870

African countries have signed around 870 bilateral investment treaties and international investment agreements (IIAs), which corresponds to about a third of all IIAs signed worldwide.

COMESA developed a modern investment agreement, which was intended to establish the COMESA Common Investment Area. However, the agreement has not yet entered into force and the economic community is currently renegotiating its content. The 2006 SADC Protocol on Finance and Investment is another recent text which has been adopted in the region. The EAC has also launched various investment initiatives, notably adopting a model investment agreement in 2006 (which was revised in late 2015).

Consequently, each African REC has at least one instrument relating directly or indirectly to investment. However, the picture becomes more intricate when one considers that many African states are simultaneously member to two or more RECs. While regional economic integration is generally perceived as benefitting the economy and fostering foreign and domestic investment, the multiple and overlapping commitments in various RECs make Africa's integration efforts in relation to investment harmonisation inefficient. Nonetheless, recent developments give hope for more harmonised economic integration. In the summer of 2015, the SADC, COMESA, and EAC launched the Tripartite Free Trade Area (TFTA), which seeks to promote the harmonisation of trade and investment arrangements amongst the three RECs as a step towards the wider goal of African continental integration.

By formulating their own investment rules, African RECs play a prominent role in the development of international investment law. They have adopted investment instruments which they consider to be more adequate in light of the specific needs of African countries, the most recent of which seek to combine attracting foreign investment with achieving sustainable development objectives.

The aforementioned COMESA Investment Agreement is an innovative text. It contains significant reform approaches aimed at achieving more balanced investment protection and ensuring that investment benefits flow back to local communities. It also constitutes an attempt to render investment provisions clearer and more predictable. The 2006 SADC Investment Protocol, for its part, states the need to integrate foreign investment into the larger framework of sustainable development. In addition to this protocol, SADC also adopted a Model BIT,<sup>⑤</sup> which has at its heart the sustainable development concerns of developing countries. Today, it is considered as one of the leading models as regards treaties that not only focus on the protection of foreign investors, but also on sustainable development considerations. The SADC Model and the COMESA Investment Agreement have received tremendous attention in the current discussion on reform of the international investment regime.

#### **The PAIC and the challenge of investment facilitation in Africa**

At the continental level, the African Union (AU) has been mandated by its member states to enhance the political and socio-economic integration of the continent and promote sustainable development. Currently, the most important integration endeavours undertaken by the AU are the establishment of the African Economic Community by 2034, and the creation of the Continental Free Trade Area (CFTA) to be finalised by 2017.<sup>④</sup> In regard to the harmonisation of the African investment regime, the AU also appears to be the most appropriate organisation to initiate measures intent on disentangling the complex web of intra-African BITs and investment instruments adopted by African RECs.

In the spirit of enhanced economic integration, African ministers responsible for continental integration decided in 2008 to start working on a comprehensive investment code for Africa: the Pan-African Investment Code (PAIC). The declared aim of the initiative was to attract greater investment flows to the continent and to facilitate intra-African cross-border investment. A group of independent African experts – composed of representatives from various African RECs, academia, and the private sector – has drafted the text over several years, proceeding in two phases. In the first phase, the group compiled African best practices in the field and elaborated a first draft. The second and decisive phase, which took place throughout 2015, consisted in finalising the PAIC text at the expert level. Two meetings of African independent experts were held for this purpose in May 2015 in Tunisia and in September in Mauritius. Experts from AU member states

then reviewed the work of the independent experts during a continent-wide meeting in Uganda that took place in December 2015.

What is the potential added value of a continental instrument related to the regulation of foreign investment? As shown above, African regional integration is based on a complex web of legal instruments. As such, the overall landscape of investment law in Africa is very fragmented, which is counter-productive for African integration and for investment facilitation. When foreign investors, from Africa or elsewhere, invest in an African country, they currently have to comply not only with national laws and the investment contracts concluded with the host state, but also with the two or more regional instruments applicable in a given state, as well as with any potential BIT between their home state and the host state. The different levels of legal commitments raise many issues, in particular concerning their interrelationship, and this uncertainty regarding applicable or prevailing rules constitutes a serious challenge for investors in Africa.

The PAIC, which would be applicable to any investment made in AU member states, has the potential to solve the problems of legal uncertainty and fragmentation. The issue of the relationship between the PAIC and other investment agreements is addressed in the draft text of the PAIC, which clarifies that: "Member States may agree that in the case of a conflict between this Code and any intra-African BIT, investment chapter in any intra-African trade agreement, or regional investment arrangements, this Code shall take precedence." This crucial provision on the relationship between the PAIC and other investment agreements in Africa, despite its soft language, highlights the tremendous significance of the PAIC, which would thus seek to ensure continent-wide coherence and legal certainty for the purpose of investment facilitation.

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*The Pan-African Investment Code is intended to be a balanced instrument, meaning that it seeks to balance between investment protection and non-investment related public interests.*

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#### **The PAIC and the "Africanisation" of international investment law**

With a continent-wide instrument such as the PAIC, Africa provides its own investment rules. Over the last sixty years of international investment law practice, African countries have been perceived as investment rule consumers. African economies did and still do rely heavily on international private capital commitment. In the hope of attracting more foreign investment, various African countries thus concluded numerous BITs with capital-exporting countries, accepting the pre-drafted BIT models of these countries. Today, however, African states have initiated a shift and are increasingly becoming 'investment rule providers. The PAIC reflects this trend towards the "Africanisation" of international investment law in the current context of reform of the international investment regime.

The PAIC contains several innovative features. It reformulates traditional investment treaty language, introduces new provisions (such as unprecedented provisions on due diligence and obligations for investors in relation to human rights, corporate social responsibility, use of natural resources, and land-grabbing) and omits certain investment standards completely (for instance, there is no mention of the controversial fair and equitable treatment standard).

The PAIC is intended to be a balanced instrument, meaning that it seeks to balance between investment protection and non-investment related public interests, as suggested by the innovative UNCTAD Investment Policy Framework on Sustainable Development. The PAIC does not depreciate the need to attract and facilitate foreign capital into Africa, yet this objective should not overshadow the long-term goal of sustainable development. Consequently, sustainable development plays a prominent role throughout the draft

text of the PAIC. The very objective of the PAIC is "to promote, facilitate and protect investments that foster the sustainable development of each Member State."

Africa will certainly continue to attract foreign investment in the upcoming decades, notably because of its natural resources, but not only. What is at stake now is determining how to regulate these investment flows, and which type of investment and investor operating in Africa should be protected under international law. The answer given by the PAIC is that it has to be investments that foster the larger interests and needs of African societies and economies, while preserving the environment. Thus, future foreign investment in Africa needs to be responsible and based on corporate sustainability.

As the international investment law regime is going through a period of review and revision, countries, regions, as well as international governmental and non-governmental organisations are discussing various reform approaches. The drafters of the PAIC were inspired by the current international reform discussion. Several of the ideas found in the PAIC text are what can be called "common approaches" in the international discussion on the reform of the investment law regime as a whole. Such ideas mainly concern the reformulation of certain treaty standards, the inclusion of societal concerns, as well as the rethinking of investor-state dispute settlement. Africa, unlike Brazil for example, is not fundamentally contesting the system of IIAs. The PAIC is rather an attempt by African countries to shape an international investment treaty according to their own priorities. It shows that new IIAs are no longer based on either the North American or European models, and that other regions can meaningfully engage in shaping IIAs according to their level of economic development and social needs.

The legal nature of the PAIC is still uncertain. It might end up as a binding instrument applicable in all AU member states, as it might be adopted as a model treaty serving as a guide for individual member states' IIA negotiations. The pros and cons of these two options constitute a political question and AU member states need to decide upon the issue with their relevant stakeholders. Whatever the outcome, the elaboration of the PAIC has allowed African countries to deliberate on their vision of IIAs and to build awareness amongst themselves regarding the broader implications of foreign investment as a tool for sustainable development. The PAIC thus endows Africa with a voice in the international debate on the future and reform of the investment regime. Further, its strong emphasis on SDGs bears the potential for the PAIC to become a model for innovation outside of Africa.

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- ❶ UNCTAD. "International Investment Agreements Navigator." <http://bit.ly/1kMjsfc>
  - ❷ The following analysis is based on data from UNCTAD's "International Investment Agreements Navigator", available at <http://bit.ly/1kMjsfc>.
  - ❸ SADC Model Bilateral Investment Treaty Template With Commentary. 2012. Gaborone: South African Development Community. <http://bit.ly/25Txwfp>
  - ❹ Soininen, Ilmari. "The Continental Free Trade Area: What's Going On?" International Centre for Trade and Sustainable Development. <http://bit.ly/1tDbOli>.



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## AGRICULTURE

# The welfare impacts of foreign agricultural investment in Sub-Saharan Africa

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Manitra Rakotoarisoa

*Many resource abundant low-income countries in Sub-Saharan Africa have experienced a growing foreign agricultural investment inflow. What are the impacts on the welfare of host economies?*

The increasing involvement of foreign investors in Sub-Saharan Africa's agricultural sector, especially through the so-called "land grabbing" phenomenon, has stirred passionate debates among analysts, policymakers, and stakeholders alike. Host countries hope that foreign agricultural investment will provide employment opportunities leading to increased purchasing power and tax revenues from payroll and eventually on profits. From these investments, host countries also expect added benefits such as enhanced skills, new or improved infrastructure, and faster technology transfer. However, one important concern is that foreign agricultural investment may worsen the problem of food insecurity in SSA by raising food prices and increasing food imports. Likewise, some fear that agricultural investment leading to changes in factor input use may reduce the competitiveness of domestic sectors such as food and services. Consequently, is foreign agricultural investment in SSA something to fear or to hope for?

## **The focus of the debate**

The fervent debate about the effects of agricultural investment often hinges on specific aspects. Four important elements of this debate are summarised as follows.

### *Primary factor (land, labour) effects*

When foreign investors utilise SSA's idle land and its abundant unskilled labour, land use or employment may increase without affecting directly wages and the rental price of land. Similarly, if the investors import all inputs, including skilled labour, there is little or no direct effect on factor prices. However, if foreign investors use existing arable land and other local factor inputs (such as unskilled and skilled labour) whose supplies are price inelastic, local factor prices (especially land prices and wages) will be directly affected.

### *Price effects*

If foreign investment in agriculture contributes to rising factor prices, it may directly lead to increases in output prices in all sectors, not just in agriculture. But even when factor prices are fixed, newly empowered consumers – the formerly unemployed that become employed because of the investment – may boost the demand for output (including food products) as a result of their rising income; household consumption then rises, leading to a further hike in output prices.

The impact of foreign agricultural investment on food prices in host countries also depends on whether production is to be sold in the domestic (host) market, in foreign markets, or in both markets. The investment will have more direct and immediate impact on host country food prices if the investor targets the host market rather than only exporting the agricultural output.

### *Technological progress effects*

Whether foreign agricultural investment leads to technological progress that may be factor- or sector-specific has important implications for the approach to assess the economy-wide impact. As SSA countries seek to improve their currently low levels of productivity and human capital formation, the technological aspect of agricultural investment in both the production and processing of food and agricultural commodities is highly important. Foreign agricultural investment may introduce imported equipment



and improved seeds, or provide direct training or learning-by-doing of the labour force. Similarly, this foreign investment may entice innovation in production, distribution, or management, and may facilitate spillover effects stemming from increased trade on research and development. But again, these innovations and productivity gains are not always guaranteed.

#### *Trade effects*

The trade effects of foreign agricultural investment depend on how much a host's input and output markets are linked to its trading partners. In an open economy, any change in factor prices or output prices in the host country (or region) leads to changes in input and output trade, including food trade. But even if factor prices remain fixed in real terms in the host country, the increase in income as a result of the investment would lead not only to an increase in output demand and output prices, but also to a surge in import demand.<sup>1</sup> This means that foreign agricultural investment may affect the host countries' trade balance negatively.

#### **The total welfare effects matter**

When separately addressed, the factor-use, price, technology, and trade effects do not give a complete account of foreign agricultural investment's overall impact, which often leads to inconclusive debates. This is why an estimation of the total welfare effects, though complex, is required. Estimates of the impact of foreign agricultural investment on total welfare depend on how one models the complexity of the price linkages among sectors as well as the relative contribution of agents and stakeholders (government, firms, households) in the economy.

In order to get a better understanding of investment impacts, the following types and components of welfare effects should be assessed: the allocative efficiency effect that is obtained through a more efficient use of scarce resources (land, skilled labour); the endowment effect that arises from the use of previously untapped factors (skilled labour, idle land); the technical efficiency effect that estimates the gains from technology use; the terms-of-trade effects, which measure changes in welfare arising from variations in export and import prices; and the investment savings effects, which account for the gains or losses arising from changes in the price of capital. For the host region or country, it is important to assess the net effect of foreign agricultural investment and understand what drives these effects.

#### **What does the simulation say?**

To inform the debate, a basic accounting exercise through a simulation using the Global Trade Analysis Project (GTAP) model with three sectors (food and agriculture, manufacturing, and services) in three regions (SSA, the EU, and the rest of the world) has been performed.<sup>2</sup> The simulation considers three investment scenarios which differ only by whether or not the agricultural investment is using existing arable land, straining the labour market, and bringing an increase in technology in SSA.

Results show that in a scenario where foreign agricultural investment would take away an arbitrary 10 percent of arable land, we would expect a decline in SSA's food production for the local market by 1–3 percent and a rise in food prices by 3–5 percent. Although these impacts on food production and food prices are relatively small, they raise immediate concerns about the state of food insecurity in SSA countries. Investment in agriculture would also widen the current account deficit and increase SSA's dependence on food imports – simulation results show that food imports would increase by 6–9 percent, whereas food exports would decline by 10–17 percent.

However, these concerns related to food security and rising food imports should be put into perspective, as foreign investment in agriculture would also lead to an increase in factor returns, especially land (up to 20 percent) and labour (up to 5 percent), and would boost households' real income and consumption. Computing the total welfare effects shows that foreign investment in agriculture could actually increase welfare in SSA. The biggest welfare gains would come from the terms-of-trade effects, essentially due to

the increase in export prices in the food and manufacturing sectors. Thus, although the current account deficit would widen, the terms of trade would improve. Additional welfare gains would also stem from enhanced efficiency, because the increases in factor prices would lead to a better reallocation of factor inputs among the agriculture, manufacturing, and services sectors. The total welfare effects would even be higher if the agricultural investment uses previously idle land and hires from the pool of unemployed and unskilled labour. More importantly, the simulation results indicate that technology-enhancing investment would lead to greater domestic efficiency and hence welfare gains in SSA.

At the sectoral level, the simulation shows that while the food and manufacturing sectors play an important role in SSA's economy and in assessing the impact of investment, it is the services sector that would be the largest beneficiary of foreign agricultural investment. This investment would lead to a significant increase in both output and prices in the services sector, as the latter contributes considerably to the formation of capital goods (such as the construction of roads and other infrastructure) stemming from increased investment. Growth in the services sector would further be enhanced by stronger demand in domestic intermediate goods from the food and manufacturing sectors.

### Way forward

While the debates over the actual effects of foreign agricultural investments in SSA will remain alive for a long time to come, it is clear that decisions informed by hasty conclusions on any isolated aspect of the effects are misleading. Comprehensive and thorough analytical work is required. It is nevertheless clear that foreign agricultural investment would be more beneficial, or at least less damaging, if it is accompanied by the sort of technological transfer and innovation needed in SSA. Similarly, the formation of capital goods – and especially infrastructure – induced by agricultural investment also has a positive impact on welfare. Limiting the competition for resources between domestic sectors and new foreign investment is difficult, but also very important. If that is done successfully – i.e. if agricultural investment uses idle land and previously unemployed workers while not competing directly with domestic sectors for input resources – then welfare gains will be achieved in SSA countries and regions.

This article leaves beyond its scope the impact of foreign agricultural investment on the environment and natural resources. These impacts are nonetheless critically important to assess in order to account for full effects.<sup>①</sup> It is obvious that irresponsible investments that yield temporary gains while irreversibly destroying invaluable forests and biodiversity bear huge net welfare losses. But for the type of investment that shows net and lasting welfare gains, knowledge of the size and distribution of the investment effects – both among sectors and across input owners – matters and such analysis needs to be pursued. When the distribution shows that some sectors or input owners are badly harmed, whereas others are able to reap substantial benefits, accompanying measures should be considered to reduce the welfare imbalances while maintaining the net gains from foreign agriculture investment.

*This article is an adaptation of a working paper entitled "A Contribution to the Analyses of the Effects of Foreign Agricultural Investment on the Food Sector and Trade in Sub-Saharan Africa" published by the Food and Agriculture Organization (FAO).*



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① See Hertel, Thomas W. *Global Trade Analysis*. 1996. New York: Cambridge University Press.

② The details of this analysis, as well as its complete results, are available in the full working paper written by the present author from which this article is drawn: Rakotoarisoa, Manitra. *A Contribution To The Analyses Of The Effects Of Foreign Agricultural Investment On The Food Sector And Trade In Sub-Saharan Africa*. 2011. FAO. <http://bit.ly/1VVolFo>

③ See: Clapp, Jennifer. "Foreign Direct Investment in Hazardous Industries in Developing Countries: Rethinking the Debate." *Environmental Politics* 7, no. 4 (1998): 92-113. Woodhouse, P. and S. Ganho. *Is Water The Hidden Agenda Of Agricultural Land Acquisition In Sub-Saharan Africa?*. 2011. University of Manchester.

## SERVICES

# How to leverage FDI for service sector development in African countries?

Nkululeko Khumalo

*Against the backdrop of technological advances and new modes of production, how to leverage the potential of FDI to develop the service sector in African in African low-income countries?*

Services now constitute the largest sector in the world economy, accounting for approximately 63.5 percent of global gross domestic product (GDP). They also represent the biggest sector in 194 individual countries, among which 30 countries derive more than 80 percent of their GDP from services-related activities. Least developed countries (LDCs) and low income countries (LICs) have also seen a considerable share of their GDP coming from the service sector. As one of the key drivers of economic growth, services will have a significant role to play in enabling these developing countries to meet the sustainable development goals (SDGs) adopted by the international community.

For LDCs and LICs to take full advantage of the economic and social opportunities offered by service sector development, critical injections of foreign direct investment (FDI) are required. However, FDI in those countries is currently concentrated in the extractive sector and in a few economies, although evidence seems to indicate that this is gradually changing.

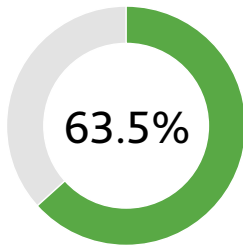
Moreover, in certain sub-sectors of crucial importance for economic development, such as core infrastructure services, FDI is often constrained by unfriendly regulations coupled with a generally unfriendly investment climate. Many African LDCs and LICs do not have sufficient domestic sources of financing and are unable to adequately fund core infrastructure services such as transport and electricity.

### **Effective participation in modern production and trade systems is imperative**

Two interrelated developments highlight the importance for African countries to give priority to developing their service sectors, as well as the imperative of attracting service sector FDI, among other measures, to achieve this objective: the servicification of production and global value chains (GVCs).

Servicification entails a process whereby non-service sectors in the economy buy and produce more services than before, and also sell and export more services, often as a package deal with goods. Servicification is also fuelled by consumer behaviour in that customers increasingly demand that producers deliver a full package of goods and associated services, thus compelling producers to add services to their business offers in order to stay competitive.❶

A closely related development is the increasing prevalence of GVCs, which are fuelled by technological advances and organisational changes in the world economy and within transnational corporations. Without doubt, GVCs are a game changer in regard to the way goods and services are produced. They operate on the basis of great levels of specialisation by individual participants, and while they have become the norm in the production of goods, their importance in trade in services has also dramatically expanded. Transnational corporations are increasingly outsourcing parts of their value chains in order to boost efficiency and competitiveness and utilise the lowest worldwide cost options, which in many cases involves contracting out manufacturing or services to an efficient, low-cost producer in a developing country. Today, transactions through GVCs among the various parts of a single corporate system (intra-firm trade) are estimated to account for one third of global trade.



Services now constitute the largest sector in the world economy, accounting for approximately 63.5 percent of global gross domestic product.

However, the economic viability of GVCs requires firms to have access to quality services at the right time and at a competitive cost. Core infrastructure services such as transport services, ICT services, financial services, and business services are essential for the functioning of GVCs and their presence in a country may have a bearing on whether FDI is channelled to that country or not.

Against the backdrop of limited domestic financing for the development of production capacity in goods and services as well as international trade, FDI in services is critical to enable African LDCs and LICs to be active participants in the servicification of production and to ensure that they are not left out of GVCs. While it is not a panacea for those countries' development financing needs, the importance of FDI relative to other forms of financing lies in its potential to bring in a package of resources – capital, technology, skills, management, know-how, marketing capabilities, among others – to a host economy.

### **Attracting FDI into the service sector: Some challenges**

#### *Policy Restrictions*

A number of restrictions and constraints hamper African LDCs and LICs' efforts to attract FDI into their service sectors. Restrictions on FDI usually affect both market entry and post-entry operations. The most common entry restrictions include exclusion of foreign investors from certain service sectors, quantitative limitations, whether in the form of quotas or economic needs tests, foreign ownership caps, limitations on the type of establishment, and joint venture requirements. In respect of post-entry barriers, the main restrictions include stipulations regarding the nationality and citizenship of managers or board members, limits to temporary entry of expatriate personnel, and other nationality requirements for staff.

Developing countries, including LDCs and LICs, have embarked on a plethora of policies aimed at increasing their participation in the global economy. Typically, such policies include more trade and investment liberalisation, privatisation, and deregulation. Where FDI is concerned, while the introduction of more welcoming policies to FDI has been the general global trend, individual country policies usually include a mixture of measures aimed at both attracting (i.e. tax breaks) and discouraging inflows. While policies intended to attract FDI are usually focused on manufacturing, those restricting inward FDI are mainly concentrated in the service sector.<sup>2</sup>

This is not surprising. In addition to the need for regulation of a prudential nature, which is due to tendencies towards natural monopoly and other market failures, host countries often treat service sectors such as telecommunications, banking, transportation, and electricity provision as strategic or sensitive. In some cases, infant industry protection arguments have been used in favour of discrimination against foreign investors. As such, FDI in services is typically subject to a broader array of restrictions than investment in the primary or manufacturing sectors.<sup>3</sup>

#### *Investment Climate Constraints*

Apart from restrictions of a policy nature, there are also constraints pertaining to the investment climate in African LDCs and LICs that pose serious obstacles to FDI in services, even in cases where the policy environment is fairly liberal.

Inadequate infrastructure and human capital constitute a serious constraints: many African LDCs and LICs still lack basic infrastructure services such as roads, health services, or electricity and water utilities. Unsurprisingly, UNCTAD identifies inadequate physical infrastructure as "one of the most fundamental constraints facing LDCs not just to attract diversified types of FDI, but more generally to develop productive capacities, reduce poverty and reap the benefits of economic globalisation."<sup>4</sup> Unlike in many developing countries, where foreign investors have contributed to bridging the infrastructure gap by building or operating ports, airports, electricity and telecommunication networks, or water systems, only few LDCs have so far been able to attract FDI for infrastructure development at a significant scale.

Another important obstacle lies in the lack of political stability and policy certainty. Some African LDCs and LICs are riddled by challenges of a political-economic nature, including the fact that many of them have unstable political systems characterised by a high level of uncertainty and political risk. In addition to political instability, the likelihood of expropriation contributes to the lack of investor confidence. Predictability of conditions and lack of arbitrariness may be the most important assurance that can be offered to would-be investors.

Further, most African LDCs and LICs have narrow and often fragmented domestic markets, which also represents a serious challenge for attracting FDI. This constraint are aggravated by insufficient liberalisation of intra-regional trade, and thus limited trading opportunities for potential investors. In addition, many African regional integration bodies currently do not include services trade liberalisation agreements (though negotiations in this regard are currently taking place in some regional groupings such as COMESA and SADC).

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*Most African LDCs and LICs have narrow and often fragmented domestic markets, which represents a serious challenge for attracting FDI. This constraint is aggravated by insufficient liberalisation of intra-regional trade.*

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Finally, African economies also have to face a negative image challenge. In Africa, one of the biggest obstacles LDCs and LICs have to overcome in attracting FDI lies in the negative attitudes towards the continent. Some of the negative perception is based on reality, but a part of it is also due to lack of information about the countries concerned, the reforms undertaken, and the available investment opportunities. The negative image issue is particularly difficult to eradicate, as would-be investors' lack of information also means that reforms will not have an immediate effect on investment decisions. For this reason, it is necessary for a reforming country – especially when it has a bad reputation due to the failures of previous governments – to embark on serious efforts to improve its international reputation.

#### **Policy recommendations**

Any substantial effort to attract investment to African LDCs and LICs should, of necessity, include specific measures targeted at making their service sectors attractive to FDI. These include the following.

- *Increasing liberalisation of core infrastructure services and adopting more aggressive marketing strategies about this liberalisation:* Some African LDCs and LICs are members of the WTO and have made liberalisation commitments under GATS Mode 3 (commercial presence). Such commitments need to be deepened and enhanced in order to be meaningful. Some of these countries have committed to deeper liberalisation under bilateral investment treaties and unilaterally, yet their true level of openness remains less known by potential investors. It would be in these countries' interest to liberalise more widely, so as to attract the most competitive firms internationally to establish in their markets, rather than limiting their liberalisation efforts to a few countries which may not have the most competitive services providers.
- *Deepening liberalisation regionally and ensuring that regional services liberalisation efforts go much deeper than what is already committed under the GATS:* In some regions that are pursuing services negotiations, such as SADC and COMESA, countries have identified core service sectors (mainly producer services, plus tourism) for liberalisation. However, the methodology followed, a positive list approach similar to the GATS, is not likely to lead to deeper or more meaningful liberalisation. If done

properly, regional integration has the potential to make LDCs and LICs more attractive to investment by making them part of a bigger market.

- *Unilaterally liberalising where feasible:* Provided regulations are in place, African LDCs and LICs should be more aggressive in their liberalisation efforts and not be held back by regional and multilateral efforts that typically take several years or decades to conclude. The situation in those countries requires them to take the initiative, while participating in the regional and multilateral negotiations to “lock-in” such unilateral reforms.
- *Prioritising appropriate reforms at both local and regional levels:* It is trite that mere liberalisation of FDI in the service sector would not automatically produce the desired results. Such liberalisation does require matching regulations. For instance, permitting FDI in a state's telecommunications monopoly provider without creating conditions of competition or having a strong institutional framework fostering competition may result in merely transferring monopoly rents to foreign investors. Some African LDCs and LICs have very small markets and may not have sufficient clout to properly regulate or protect themselves from powerful monopolies operating at regional levels, hence the need for quality regulation at both local and regional levels. For example, some countries, including some LDCs (i.e. The Gambia), have either set up competition authorities or are in the process of doing so, while also being party to regional competition bodies. A good example of a regional competition authority is the COMESA Competition Commission, which started operations in 2013 and aims to discipline anti-competitive practices that have a regional dimension.
- *Building competitiveness in the service sector:* Servicification and GVCs make it imperative for all countries to develop services competitiveness, in order not only to avoid being marginalised, but also to be part of and benefit from these new patterns of production and trade in both goods and services. It is critical for LDCs and LICs to build domestic productive capacities through, inter alia, human capital development, capital accumulation, and innovation, in order to be able to maximise the positive effect of FDI across all sectors, and in the service sector in particular.<sup>6</sup>

African LDCs and LICs need to prioritise the service sector by tackling the remaining entry barriers and other constraints related to the investment climate as a whole. Such efforts would include unilateral, regional, and multilateral liberalisation of FDI in the service sector, coupled with appropriate regulation to enhance the benefits of FDI for host countries.

*This article is an adaptation of a forthcoming conceptual paper to be published by ICTSD.*



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## LIBERIA

# Liberia's bold tourism experiment: Lessons and opportunities

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Rahul Bhatnagar

*Liberia is on an impressive march towards developing its tourism sector. How can the country's ongoing efforts provide an example for peer countries in Africa to follow?*

When thinking about Liberia, "idyllic" is not an attribute that typically comes to mind, but this may soon prove to be the case if the country's resolute march towards reforming the tourism sector continues. For the first time in its history, Liberia is pursuing a determined path towards developing tourism as a pillar of its economy. In the context of several competing priorities, this strategic thrust is a courageous one, and can lead to Liberia becoming a successful case study for tourism development in the region. However, in a country where tourism has been such a low priority that the country does not even issue tourism visas, what is the outlook on this ambitious goal, and if successful, can Liberia offer important lessons to other economies?

## **Liberia: A tortured history**

Liberia is blessed with tremendous natural resources, but luck is not one of them. Time and again, the country has battled adversity – natural and man-made – and forward steps have often been matched by reversals. The tourism sector is a case in point. Prior to the two civil wars, the tourism infrastructure was relatively good relative to West African standards, and tourism receipts were increasing at a 10 percent growth rate annually. Then the first civil war hit, followed within a few years by the second, which plunged the country into an abyss between 1989 and 2003. Hotels were destroyed, and feeder services were disrupted along with security services and other support infrastructure. With many alternative choices, including in the region, investors and tourists stopped viewing Liberia as a viable destination for their hard-earned dollars. In recent years, after the conflict, modest gains have been made in the tourism sector, but these have now been wiped out due to the effects of the Ebola crisis.

When Ebola hit, nearly all international aid partners pulled out of the country, leaving skeleton staff behind or freezing operations altogether, apart from select national and international health agencies. Hundreds of Liberians suddenly found themselves unemployed. Ebola has been contained in the country thanks to mobilisation and efforts of the international community and national actors. While reconstruction efforts are now paramount to bring the economy back on track, the government has decided to take a bold step forward in developing the tourism sector in Liberia, which will require to change the brand image of the country. The President has declared the development of the sector a priority for the country, and the tourism and commerce ministers are jointly developing – with the technical support of the Geneva-based International Trade Centre - a Tourism Trade Strategy for 2015-2020. The strategy will initially focus on four niche segments – surfing, wildlife, culture, and ecotourism. Efforts are ongoing to establish a Tourism Board, and an exploratory committee on tourism has been instituted by the President's office to conduct interim due diligence.

## **Liberia's tourism assets: A wealth of unexplored resources**

The Atlantic coast of Liberia features an abundance of maritime resources, with species such as marlins, swordfishes, whales, and dolphins, which offers significant opportunities for touristic services such as sail fishing or dolphin and whale watching. On the other hand, Liberia's 560 kilometres of coastline are characterised by a near unbroken sand strip, unexplored beaches, and "world class" waves. Surf in Liberia is slowly gaining a good reputation among the global surf community, notably with the emergence of surfing

competitions and related events in recent years. Moreover, local initiatives have had a relatively high impact among local youth through employment, training, and the provision of youth mentoring programmes.

Liberia enjoys a rich natural capital with high touristic potential, including two UNESCO heritage sites – the Mount Nimba Strict Nature Reserve, and Providence Island, which is also a cultural treasure. Liberia's natural attractions include two natural forest reserves, wetlands and mangroves, and biological and landscape diversity. The country is endowed with approximately 42 percent of the Upper Guinea Forest, rich in endemic flora and fauna, including including biodiversity hotspots: East Nimba Natural Reserve and Sapo National Park. Both are home to rare birds, and a high diversity of mammals such as elephants, monkeys, antelopes, and Liberia's national symbol, the pigmy hippopotamus. All sorts of touristic services can be tapped around these natural sites.

Liberia has also remarkable historical and cultural assets. There is a great ethnic, religious, and linguistic diversity in the country. Sixteen major tribes coexist in Liberia, each with their own traditions and religious beliefs. Historical locations include Providence Island, where freed slaves from the US first set foot and lived before moving inland.

According to the World Travel and Tourism Council (WTTC), the tourism industry generated US\$2,364.8 billion globally in 2014, and this figure is expected to grow at an annual rate of 3.3 percent until 2025. The World Tourism Organization estimates that the number of international arrivals will more than double in Africa between now and 2030 (from 50 million to 134 million visitors). Tourism is a strong driver of employment – the WTTC reports that in Sub-Saharan Africa, the tourism sector has directly supported approximately 6 million jobs at the regional level, representing 2.5 percent of total employment. In recognition of this potential, African countries, including Liberia's neighbours such as Sierra Leone and the Gambia, have stepped up efforts to develop the tourism sector.

### **Changing the narrative**

So what are some of the lessons learned and success stories that Liberia can share with policymakers in other countries with a comparable profile and similar aspirations? There are several aspects to consider.

#### *Important prerequisites must be met*

Several important prerequisites exist without which tourism development will not occur. First and foremost, the policy focus on tourism needs to stay in place. Continued political stability also needs to be ensured. A safe and secure environment for tourists is a must, along with essential health infrastructure. Another precondition is to avoid any other major health crisis, such as the recent Ebola epidemic.

#### *Pilots! Pilots! Pilots! (think big, start small, scale appropriately)*

In an untested and risky environment, using an approach based small pilot projects, and retaining, discarding, or scaling up based on the results of those pilots may be preferable to investing significant resources in areas that are uncertain. Short pilots spanning several months, and accompanied by a strong monitoring and evaluation framework to measure success, offer effective and quick mechanisms for gauging the real potential in technical areas. This way, the return on investment per development dollar is stronger. In the implementation of Liberia's tourism strategy, this is the approach that is being followed.

#### *Involvement of local communities in sector development is key*

Tourism development needs to involve local communities if it is to be sustainable and acceptable, especially in a post-conflict context like Liberia where the root causes of conflict still ferment under the surface. The Liberian tourism strategy is touted as a roadmap developed "in Liberia, for Liberians, by Liberians." Two aspects are paid particular attention: inclusive participation of the local communities, notably through regional consultations, and due consideration to the environment in all project design and implementation activities. The government has laid emphasis on ensuring that the local



communities stay involved and reap the benefits of any tourism-related activity on their land.

*Involvement of youth in the tourism value chain is critical*

With 70 percent of the population under the age of 35, the business case for involving youth has been clear from the start in Liberia. In Africa, 60 percent of the unemployed are youth, a worrisome sign when considering that Africa's youth population is expected to double by 2045. Tourism is an excellent sector for youth to get involved in productive economic activities, and indeed the sector starts to benefit from the energy and enthusiasm that youth bring to the table. All that is required is a robust skills infrastructure and a will to learn the "tools of the trade" so as to build human capital. Skills in the tourism sector are, moreover, transferable to other sectors, creating a multiplier effect. Skills development, youth employment, and entrepreneurship are thus cross-cutting focus areas that Liberia has identified as priorities.

*Everybody wants (needs) success stories*

One of the frequent refrains of Liberian tourist operators used to be that in an underdeveloped sector, no one – from donors, to banks, to policymakers – is seeking to push the tourism agenda. Indeed, as a case in point, only the International Finance Corporation is pursuing a direct skills development program in the Liberian hospitality sector, while the majority of traditional donors are focused on humanitarian and economic development. The reality is that tussles between competing priorities will always exist in developing country environments, and success stories will guide prioritisation for decision makers. This is another reason why pilots are an appropriate choice for kick-starting activity in the tourism sector.

*Fostering collaboration and coordination among value chain stakeholders is a must*

Liberian hotel receptions typically lack any tourism brochures, and with only two registered tour guide companies in the country, there is very little collaboration between hotels, taxi companies, food outlets, and other stakeholders in the value chain. Deprived of a menu of choices, expats and domestic tourists tend to therefore frequent the same establishments and tourism attractions. To solve this, existing tourist associations have made efforts to develop end-to-end "products" such as facilitated day-long excursions for individual and group tourists. Efforts are also on to practice active outreach to tourists, in order to bridge the information gap and build trust. Development in this sector will be closely tied with development in other sectors such as transportation (feeder services), hospitality (training schools for hotel management, catering, etc.), wood products (handicrafts), etc.

*Gaining experience catering to the market nearest to you and building from there*

An international flight to Liberia's Robertsfield airport is more likely to disembark visitors such as missionaries, staff of one of the many concessionaires operating in the country, or staff of the UN or other international organisations (intergovernmental or not), rather than "typical tourists." Even with the recent drawdown of the United Nations Mission in Liberia, a significant number of UN and NGO expat staff remains in the country. These represent a very real tourism market segment – with a high spending power on a per capita basis – that is "starved" of good tourism products. Then, there is also the domestic market. While this market segment represents consumers with only a low-medium purchasing power, it is an essential platform on which tourism businesses can build and expand their products. Therefore, this market must not be neglected.

**Conclusion**

Promoting tourism in Liberia is arguably a difficult value proposition against the backdrop of two civil wars in the recent past, and the Ebola epidemic that has ravaged the economic and social fabric of the country. However, the country's authorities have taken impressive steps to develop this sector. The next decade will be decisive and there is much hard work ahead, but Liberia's resilience may yet pay dividends through tourism.



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## E15 TASK FORCE ON INVESTMENT POLICY

# The evolving international investment law and policy regime: Ways forward

Karl P. Sauvant

*How to encourage the flow of sustainable FDI for sustainable development? This article examines the state of the international investment law and policy regime and presents potential options for its reform.*

International investment has already become the single most important form of international economic transactions and the most powerful vector of integration among economies. It has become more important than trade in delivering goods and services to foreign markets, and it interlocks national economies through increasingly integrated production networks and global value chains.

The presence and commercial links of multinational enterprises (MNEs) across different international markets has led to a substantial share of international trade taking place within global value chains, thus tightly intertwining investment and trade. Emerging markets are increasingly participating in these developments, as both major recipients of foreign direct investment (FDI) and major outward investors. This new reality makes it all the more important to re-examine the governance of international investment.

As part of the E15 Initiative, ICTSD, in partnership with the World Economic Forum, convened a Task Force on Investment Policy to examine the state of the international investment law and policy regime and how its governance might be enhanced to encourage the flow of sustainable FDI for sustainable development. The regime covers the international investment typically undertaken by MNEs, primarily through FDI and various forms of non-equity modes of control, including management and supplier contracts, as well as portfolio investment. The purpose was to identify key policy options to help meet the challenge of enhancing the investment regime.

In reforming the investment regime, priority needs to be given to special efforts to promote substantially higher flows of sustainable FDI for sustainable development, particularly to developing and least developed countries, within an encouraging and generally accepted international investment framework. The policy recommendations as regards an enhanced investment regime focus on the need to expand the regime's purpose beyond the protection of international investment and the facilitation of efficient investor operations to encompass also the promotion of sustainable development (and allow for the pursuit of other legitimate public policy objectives) and further to institutionalise the regime's dispute-settlement mechanism, complemented by an Advisory Centre on International Investment Law. Negotiation of a multilateral/plurilateral investment agreement could provide an overall framework for international investment, preceded (or accompanied) by an informal consensus-building process.

## Background to rule-making on international investment

Despite the economic importance of international investment, there is no overarching set of rules governing this subject matter. Instead, the international investment regime consists of over 3,000 international investment agreements (IIAs), the great majority of them bilateral investment treaties (BITs). The investment regime, in turn, increasingly provides the legal yardstick for national rule-making on investment. The international and national investment frameworks together regulate what international investors and governments can and cannot do.

Having the right international investment framework in place is not an objective in itself. In the face of prospects that the world economy may face a decade or more of slow

## E15 Initiative

Implemented jointly by ICTSD and the World Economic Forum, the E15 Initiative convenes world-class experts and institutions to generate strategic analysis and recommendations for government, business, and civil society geared towards strengthening the global trade and investment system. <http://e15initiative.org/>

growth, it is unfortunate that world FDI inflows declined substantially from their peak of US\$2 trillion in 2007 as a result of the financial crisis. Flows need not only to recover, but surpass this earlier record. There is no economic reason why FDI flows could not be double or triple what they were in 2007, although the issue is not only more FDI, but more FDI that helps to put the world on a sustainable development path.

Mobilising such investment requires, first of all, that the economic, regulatory, and investment-promotion determinants in individual countries are in place. But the international framework dealing with the relations of governments and international investors needs to be enabling as well: the framework needs to provide clear rules of the road and a suitable mechanism for resolving disputes between these two actors, should disputes arise. Moreover, the framework needs to provide international support to help all economies that are not members of the Organisation for Economic Co-operation and Development (OECD) become more attractive for international investors. An improved investment regime, with enhanced legitimacy, provides the enabling framework for increased flows of sustainable FDI for sustainable development.

The policy options presented below focus on a limited number of topics that have systemic implications, with a view towards suggesting ways of enhancing the international investment regime. These topics are discussed separately for analytical reasons, but they are closely interrelated.

### **Updating the purpose and contents of IIAs**

Any discussion of strengthening the international investment regime needs to begin with the very purpose of the regime. Given the origin of IIAs, it is not surprising that its principal purpose has been, and remains, to protect foreign investors, and, more recently, to facilitate the operations of investors, seeking to encourage in this manner additional FDI flows and the benefits associated with them.

#### *Broaden the regime's purpose to promote sustainable development*

But this purpose alone is no longer sufficient – it needs to be expanded. In particular, IIAs need to recognise, in addition, the need to promote sustainable development and FDI flows that support this objective. Further objectives include the protection of public welfare and human rights, including public health, labour standards, safety, and the environment. Especially more vulnerable economies may require dedicated international support, including through IIAs, in pursuing some of these objectives, a situation further accentuated by the international competition for investment.

#### *Recognise the need for adequate policy space*

Promoting such an expanded purpose of the regime, in turn, necessitates that governments preserve a certain amount of policy space that gives them the right to regulate in the interest of legitimate public policy objectives, a right that needs to be acknowledged in a dedicated article in IIAs. It also means that investors commit themselves to responsible business conduct. The contents of IIAs need to reflect this broadened purpose.

“Policy space” is a vague and sometimes politicised concept. Care needs to be taken that it is not interpreted as a *carte blanche* for governments to disregard international commitments such as non-discrimination. This is similar to the challenge of ensuring that other key concepts and protections contained in IIAs are not interpreted too broadly.

#### *Clarify key concepts and interrelationships*

Accordingly, an important aspect of enhancing the investment regime concerns clarifying the key concepts in IIAs, by providing tighter wording that defines as clearly as possible the sort of injuries for – and circumstances in – which investors can seek compensation, and the type of actions governments can and can not take. The development and generalised use of standardised wording would help in this regard. Clarifications are also needed concerning the inter-relationships of the international investment regime with other substantive areas of international law, especially those pertaining to human rights, the environment, labour, and trade, as well as taxation and incentives.

*Establish a working group to prepare a list of FDI sustainability characteristics*

Progress has been made on the above, but more needs to be done. This includes the difficult challenge of defining sustainability characteristics of international (and domestic) investments. A working group should be established to prepare, in a multi-stakeholder process, an indicative list of FDI sustainability characteristics that could be utilised by interested governments seeking to attract sustainable FDI.

There is also the issue of the responsibilities of investors, to promote desirable corporate conduct and discourage undesirable behaviour. Host country governments, as sovereigns, can of course impose obligations on investors in their national laws and regulations, and have done so. Investors have to abide by them, making them liable for any infringements that might occur.

*Recognise the responsibilities of investors in IIAs*

But there is the question of the extent to which IIAs limit the ability of host countries to impose obligations on investors, or discourage them from doing so, for fear of transgressing on treaty provisions. The introduction of investor responsibilities in IIAs could remedy this situation by providing international standards, although it would not be easy to obtain broad consensus on such standards. Moreover, broad consensual international standards on this matter could also help countries with limited capacity to implement their own laws and regulations in this area, at least to a certain extent.

Expanding the purpose of IIAs, providing greater clarity of key concepts, acknowledging interrelationships with other legal regimes, and recognising investor responsibilities should all be pursued going forward.

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*International investment needs are tremendous, requiring that the international investment regime constitutes a framework for increased flows of sustainable FDI for sustainable development.*

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**Developing an international support programme for sustainable investment facilitation**

One particular aspect of the purpose and contents of the international investment regime deserves special attention, namely the efforts of virtually all governments to attract FDI and benefit from it as much as possible. But a number of governments, especially of the least developed countries, have weak capabilities to compete successfully for such investment in the world FDI market. For that reason, an international support programme for sustainable investment facilitation should be launched, focused on improving national FDI regulatory frameworks and strengthening investment promotion capabilities. Such a programme should concentrate on practical ways and means of encouraging the flow of sustainable FDI to developing countries and, in particular, the least developed among them. It should be geared towards strengthening the capacity of investment promotion agencies (IPAs) in developing countries.

*Choose an option to implement such an international support programme*

In fact, one option to implement such a programme would be to extend the Aid for Trade Initiative to cover investment as well, and fully so, into an Aid for Investment and Trade Initiative. Another, medium-term, option would be to expand the Trade Facilitation Agreement to cover sustainable investment, turning it into an Investment and Trade Facilitation Agreement. A third option is for all – or a group of interested – countries to launch a Sustainable Investment Facilitation Understanding that focuses entirely on practical ways to encourage the flow of sustainable FDI to developing countries.

## ISDS

Investor-state dispute settlement (ISDS) is a procedural mechanism that allows investors to use dispute settlement proceedings against the government of a foreign country in which they have invested. Provisions regarding ISDS are contained in various international agreements on investment.

The proposal's key premise is the importance – and urgency – of creating more favourable national conditions for higher sustainable FDI flows to meet the investment needs of the future. As governments and the private sector increasingly share this view, they need to muster the political will to put an international support programme for sustainable investment facilitation in place.

### **Addressing the challenge of preventing, managing and resolving disputes**

#### *Develop national investor-state conflict management mechanisms*

Even if the investment regime's purpose is enhanced and its contents are clarified, disputes between international investors and host country entities can arise. Governments therefore need to develop national investor-state conflict management mechanisms that allow governments and investors to address their grievances well before they escalate into full-blown legal disputes.

#### *Establish ISDS appeals mechanisms or a world investment court*

But it is unavoidable that some disputes reach the international arbitral level. It may be possible to deal with some of them through alternative dispute-settlement mechanisms, and the use of such mechanisms needs to be encouraged further. But given the centrality of the investor-state dispute-settlement (ISDS) mechanism to the investment regime, that mechanism has to be beyond reproach. This is not only a technical matter, but also one that has implications for the very legitimacy of the international investment regime. A number of steps have already been taken to improve this mechanism, but more needs to be done.

The principal major reform would involve the establishment of appeals mechanisms for the current *ad hoc* tribunals or (as recently proposed by the European Commission) a world investment court as a standing tribunal making the decision in any dispute-settlement case, or a combination of both. Further institutionalising dispute settlement in this manner could be a major step towards enhancing the investment regime, comparable to the move from the *ad hoc* dispute-settlement process under the GATT to the much-strengthened Dispute Settlement Understanding of the WTO. Institutional development in this direction could not ensure the full consistency of the application of IIAs, given that the underlying treaties are not uniform, even though these agreements share certain principles and recurrent core concepts. However, it could, over time, enhance consistency, help make the dispute-settlement process more accountable, and develop a body of legally authoritative general principles and interpretations that would increase the coherence, predictability, and, ultimately, the legitimacy of the investment regime.

#### *Allow governments direct access to ISDS as claimants*

Finally, there is the question of access to any dispute-settlement mechanism. In particular, if the contents of IIAs are expanded to include investor responsibilities, governments arguably should have direct access to the regime's dispute-settlement mechanism. The question would also arise – and this would be a profound and very ambitious change – whether the dispute-settlement process should then be opened up to other stakeholders too.

#### *Consider, long-term, turning ISDS into an investment dispute-settlement mechanism*

Steps in this direction would profoundly change the nature of the international investment dispute-settlement process by turning it from an investor-state dispute-settlement mechanism into an *investment dispute-settlement mechanism*. This, in turn, could dramatically modify the dynamics of the current international ISDS discussion.

However challenging the task of improving the current dispute-settlement mechanism may be in terms of overcoming numerous political and technical difficulties, embarking on the process of exploring how this could be done with a view towards developing a better mechanism would send a strong signal that governments recognise that this mechanism requires improvement. This is not merely a technical question but (as the public discussions of ISDS show) a matter of what is considered fair by public opinion.

### **Establishing an advisory centre on international investment law**

An independent Advisory Centre on International Investment Law would help to establish a level playing field by providing administrative and legal assistance to respondents that face investor claims and are not in a position to defend themselves adequately. While a number of issues would have to be considered before establishing such a facility, the experience of the Advisory Centre on WTO Law shows that it can be done – to the benefit of the world trading system.

#### *Create a small-claims court for small and medium-sized enterprises*

Similar considerations apply to small and medium-size enterprises, as these too typically do not have the expertise and resources to bring claims. They too require support. Costs and delays could become even more of an obstacle if an appeals mechanism were to be established. A small-claims settlement mechanism, with an expedited process, set deadlines, and sole arbitrators, could be of help in this regard.

Independently of these two institutions (the Centre and the small-claims mechanism), and as a low-cost alternative dispute-settlement mechanism of potential value to both governments and (in particular small) firms, an International Investment Ombudsperson could be designated, cooperating with an *ad hoc* ombudsperson in a respondent state.

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*An independent Advisory Centre on International Investment Law would help to establish a level playing field.*

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### **Negotiating a multilateral/plurilateral framework on investment**

The discussion so far has focused on individual – but key – aspects of the international investment regime and how they could be improved. But one could also take a holistic approach to the governance of international investment, namely to negotiate a comprehensive universal framework on international investment, preferably a multilateral framework on investment, possibly starting with a plurilateral framework on investment that would be open for future accessions by other states. Such a framework would have to start from the need to promote sustainable FDI for sustainable development. The convergence of policy interests that has been underway between home and host countries with the growth of outward FDI from emerging markets could facilitate reaching such an objective.

Moreover, it is significant that governments continue to show a great willingness to make rules on international investment, as revealed in the proliferation of IIAs. This is particularly reflected in the negotiation of BITs between key countries, as well as in the negotiation of mega-regional agreements with investment chapters. Together, these negotiations represent significant opportunities to shape the investment regime by narrowing the substantive and procedural investment law differences between and among the principal FDI host and home countries. If this should occur, the result of these negotiations could become important stepping stones towards a subsequent universal investment instrument. Still, the negotiation of such an instrument, especially a high-standards one, would face significant challenges, in light of the unsuccessful efforts of the past and the wide range of views and the considerable passion surrounding IIAs.

#### *Initiate an exploratory process towards a comprehensive universal investment framework*

Given these and other challenges, it would be desirable to begin a process of exploring the possibility of negotiating an international framework on investment, ideally of a multilateral nature. This may be particularly pertinent in light of the July 2015 decision by the Third International Conference on Financing for Development to mandate UNCTAD to work with member states to improve IIAs, and the experience of that organisation in this area, not least in its comprehensive recent effort to facilitate the formulation of a new generation of investment policies through its Investment Policy Framework for Sustainable Development.

On the other hand, the WTO offers the best platform for the trade and investment regimes to be combined and consolidated, as a unified system providing systematic legal and institutional support for the future growth of global value chains, turning that organisation into a World Investment and Trade Organization. If this course were to be pursued, the WTO's Working Group on the Relationship between Trade and Investment could be reactivated in due course, or a new working group could be established. Another alternative is to build on existing agreements, especially the WTO's General Agreement on Trade in Services, to cover other types of investment and obligations. There might also be the possibility that the international investment court and appellate mechanism sought by the European Commission could become a stepping stone towards a permanent multilateral system for investment disputes, which, in turn, could become the nucleus around which a universal framework could be built.

If a truly universal and comprehensive strong investment framework is out of reach at this time, a plurilateral framework on international investment could serve as a first step in that direction. Following the example of the Trade in Services Agreement, it could be an agreement negotiated by interested parties that would be open for future accessions by other states. The situation may be favourable for such an initiative, in particular if the China-United States BIT should be concluded expeditiously. If that should occur, the most important home and host countries among developed and developing countries would have negotiated an agreement that could serve as a template that could be taken forward. The 2016 G20 summit in China could initiate such a process.

#### **Next steps: an informal and inclusive consensus-building process**

As the public debate about the investment regime and the debate within the international investment law community suggest, improving the regime has become a matter of urgency. Improvements in the regime should be sought subject area by subject area, when negotiating individual IIAs. Where new initiatives need to be taken, they should be launched as soon as possible. Finally, preparations for the negotiation of a multilateral/plurilateral investment agreement should be seriously considered. In the end, any systematic process to improve the investment regime needs to be government-led and -owned.

#### *Launch an informal consensus-building process*

However, considering the range of stakeholders involved in international investment matters, it would be advisable to launch an (accompanying) informal but inclusive confidence-, consensus-, and bridge-building process on how the international investment law and policy regime can best be enhanced. Such an informal process should take place outside an intergovernmental setting, to stimulate and encourage a free and open discussion of all the issues involved. It should be a process organised by a trusted institution, perhaps with the support of a few individual countries particularly interested in this subject. It should take a holistic view of what needs to be done, drawing on the important work carried out in recent years by established international organisations. It should identify systematically any weaknesses of the current regime and advance concrete proposals on how to deal with them – not only regarding the relationship between governments and investors, but also with a view towards increasing sustainable FDI flows and the benefits of these flows. It would have to be an inclusive process that involved the principal stakeholders to ensure that all issues are put on the table and all key interests are taken into account.

The outcome of such a process could be a draft agreement that could be made available to governments to use as they see fit. In any event, the outcome should be made available widely, to help governments improve the international investment law and policy regime as the enabling framework for increased flows of sustainable FDI for sustainable development.

*This article is an adaptation of a longer paper published under the E15 Initiative.*



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# The newsroom

Be sure to visit [ictsd.org/news/bridgesafrica](http://ictsd.org/news/bridgesafrica) regularly for breaking African trade and development news.

## Southern African countries and EU sign Economic Partnership Agreement

On 10 June, six countries from the Southern African Development Community (SADC) – specifically, Botswana, Lesotho, Mozambique, Namibia, South Africa, and Swaziland – signed an Economic Partnership Agreement (EPA) with the EU in Kasane, Botswana. Those SADC countries will now have to ratify the regional agreement before it can enter into force.

The signature of the EU trade pact comes almost two years after the SADC EPA group concluded negotiations with Brussels in July 2014, making it the first of its kind between the 28-nation European bloc and an African regional economic community in its EPA configuration.

The trade deal secures access to the EU market without any duties or quotas for all members of the SADC EPA group, removing customs duties on 98.7 percent of imports from South Africa and eliminating them entirely for the other five countries.

## African countries hold second CFTA Negotiating Forum

Representatives from the African Union's (AU) member states held the second session of the Continental Free Trade Area Negotiating Forum (CFTA-NF), continuing their work aimed at laying the foundation for the upcoming substantive negotiations. If successfully concluded, the CFTA would constitute the largest FTA in the world, covering 54 member states.

The meeting approved the rules of procedure for the CFTA negotiating institutions and the guiding principles for the CFTA negotiations. Additionally, Nadir Merah, head of the AU trade division, indicated during the meeting that the organisation's department of trade and industry stands ready to provide technical and administrative support to the negotiators through a recently established CFTA support unit.

## International community calls for renewed support to LDCs

UN officials and various other representatives met in Turkey on 27-29 May to discuss the progress achieved by the international community in its efforts to help the world's least developed countries (LDCs) reduce poverty and develop economically.

The three-day midterm review acted as a follow-up to the now five-year-old Istanbul Programme of Action (IPoA), a results-oriented programme that was adopted in 2011 to cater to the needs of the LDCs. Although some non-negligible progress has been made over the five years since the adoption of the IPoA, LDCs did not significantly improve their overall economic situation.

Participants in the review expressed their renewed commitment to addressing the immediate needs of the LDCs, and identified in the political declaration various steps needed to fully realise the objectives set forth by the IPoA.

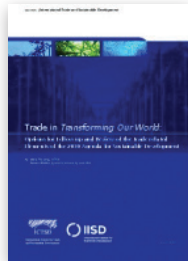
## US farm subsidies increased to US\$14 billion in 2013, new data suggests

New figures from the US government suggest that Washington's trade-distorting agricultural domestic support increased to US\$14 billion in 2013, nudging close to the US\$14.5 billion that was proposed as a new limit on Washington's overall trade-distorting support in 2008. Trade-distorting payments were concentrated on just a few products, with dairy at US\$3.2 billion and corn at US\$3 billion. These two products accounted for 45 percent of the government's US\$14 billion spending in overall trade-distorting support.

Trade officials have warned that lack of recent US farm subsidy figures could hamper efforts to make progress on improving WTO rules in this area ahead of the trade body's eleventh ministerial conference at the end of next year – dubbed MC11.

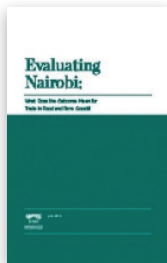


# Publications and resources



## **Trade in Transforming Our World: Options for Follow-up and Review of the Trade-related Elements of the 2030 Agenda for Sustainable Development – ICTSD – June 2016**

Trade and trade policy are central to transforming our world, the objective of the 2030 Agenda for Sustainable Development. This paper details how progress towards the trade-related commitments in the 2030 Agenda could be reviewed over the next 15 years. It identifies six clusters of trade-related elements in the agenda and, for each cluster, it identifies options for indicators. <http://bit.ly/1Yp4EpZ>



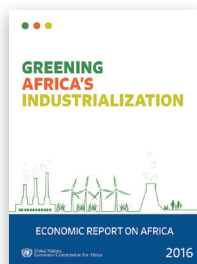
## **Evaluating Nairobi: What Does the Outcome Mean for Trade in Food and Farm Goods? – ICTSD – June 2015**

This compilation of short pieces intends to provide policy-makers, negotiators, and other stakeholders with an impartial, evidence-based analysis of the potential trade, food security, and rural development implications of the agriculture outcomes of the WTO's Nairobi ministerial conference and to help them situate these in the longer-term systemic context. <http://bit.ly/1On20Py>



## **Bringing SMEs onto the e-Commerce Highway – ITC – May 2015**

Technology has fundamentally altered the way we trade goods and services. This report acts as a starting point for public-private dialogue to address e-commerce bottlenecks, especially for small firms in developing countries. Small firms face policy challenges in four processes typical to all e-commerce: establishing online business, international e-payment, international delivery and aftersales. To improve competitiveness, challenges must be met within the firm, in the business environment and by governments. <http://bit.ly/1WWLrNk>



## **Economic Report on Africa 2016: Greening Africa's industrialization – UNECA – April 2016**

Structural transformation in Africa's economies remains the highest priority, and industrialization is the top strategy for achieving it in practice. This report underlines that as a latecomer, Africa must seize the opportunity to adopt alternative economic pathways to industrialization. It also notes that dispelling the myths currently surrounding green growth will promote the re-shaping of Africa's economic growth in favour of sustainable development. <http://bit.ly/1smAqHG>



## **Assessing Regional Integration in Africa (ARIA) VII – UNECA – April 2016**

The 2016 edition of UNECA's Assessing Regional Integration in Africa report examines how the three elements of regional integration, innovation and competitiveness are interlinked. It explores the prospects for harnessing them within the framework of Africa's normative regional integration development model oriented to foster structural change. The report aims to shed light on innovation and competitiveness in the broader context of development policy and strategy in Africa. <http://bit.ly/1WBLLpj>

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Price: €10.00  
ISSN 1996-919

