

# Investment agreements and Corporate Social Responsibility (CSR): contradictions, incentives and policy options

SOMO Discussion paper 1

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**Over the last 20 years bilateral investment agreements (BITs) between industrialised and developing countries have included less and less references or instruments for promoting the benefits that societies in developing countries can gain from foreign investments. Most foreign investments are done by multinational enterprises (MNEs).**

Current BITs assume that all investments are beneficial for development and that foreign investment will be attracted by agreements that guarantee the protection of foreign investors. Such protection measures include the guarantee that governments refrain from taking measures that limit profit making. The impact of foreign investors on societies, workers, consumers, the environment and other CSR-related issues is not adequately covered by the agreements. The responsibility for monitoring and improving corporate behaviour has so far remained in the arena of voluntary initiatives. These types of initiatives range from self-made corporate codes of conduct to voluntary governmental guidelines such as the Guidelines on Multinational Enterprises of the Organisation for Economic Co-operation and Development (OECD). As the limits of self-regulation and voluntary initiatives become apparent, this paper examines new ways to regulate corporate behaviour beyond the current reliance on voluntary initiatives and national legislation.

## Imbalance between rights and obligations for investors and governments

BITs are agreements between two governments that mostly regulate the behaviour of the host governments towards investors. By regulating governmental behaviour, BITs provide many guarantees and rights for investors, such as:

1. the right not to be treated less favourably than national and other foreign enterprises - the non-discrimination principle;
2. the right to receive "fair and equitable" treatment;
3. the right to transfer freely investment-related capital in and out of the country;
4. the right to get compensation in case of nationalisation or expropriation;
5. the right to get transparency and information about laws, regulations and administrative rulings that can affect investments, including social and environmental laws;
6. the right to use an international mechanism for settling disputes with the host state. The foreign investor has the right to choose which of the dispute mechanisms

mentioned in the BIT should handle its complaint. The complaint of a company can relate to any measure tantamount to expropriation or nationalisation. Such a measure is called “indirect expropriation” and can be a new law, for example relating to environmental protection that is considered to undermine the profit-making that a company had foreseen without the new law. Disputes have in the past resulted in exorbitant financial claims which even developed countries would not want to pay.

### Less obligations for foreign investors

While BITs state that foreign investors are subject to national laws, and to national courts, there is no link between this obligation and the rights provided by BITs. In other words, the rights under BITs are not linked to the compliance of companies to these national laws.

BITs do not compel investors to give “fair and equitable treatment” to the government and citizens of the countries in which they operate. When the labour, consumer and environmental laws, or their enforcement, of a host country are below the standards of international treaties, the foreign investors have no obligation to live up to these international treaties. While foreign investors can choose to implement the OECD Guidelines, or operate to other CSR initiatives, this however remains voluntary with no, or little, independent verification and rectification. There is thus no balance between the CSR behaviour of foreign investor and the rights they receive under a BIT. BITs do not even require foreign investors to report about the social and environmental impact of their investment, which is often an important element in CSR initiatives.

### Less rights for host countries’ governments relating to development and CSR issues

1. The non-discrimination principle of BITs undermines the right of developing countries’ governments to give privileges to domestic investors. This can undermine governments’ support for local companies to meet CSR standards such as offering infant industry measures to companies in order for them to be able to contribute to sustainable development.
2. Governments cannot rely on BITs to guarantee the right to be treated fairly and equitably by foreign investors.
3. The freedom of movement of foreign investment capital undermines the right of a country to provide incentives

## Defining Corporate Social Responsibility (CSR)

CSR can be defined as a concept that addresses the social, environmental and economic consequences of the activities of corporations, including their supply and value chains. CSR initiatives seek mechanisms to ensure corporations can be held accountable for these consequences, on the basis of internationally agreed standards and principles.







for such capital to stay longer in the country or to contribute to development, as has been the case with Egypt and Chile. Not all BITs provide the country the, conditional, right to prohibit movement of investors' capital in the case of balance of payment problems. Without such a right, developing countries' economies and societies can suffer a financial crisis, especially if investment protection of BITs covers foreign portfolio investment.<sup>1</sup>

4. The right of companies to compensation for expropriation is not balanced by the right of governments to act through expropriation without high compensation sums in cases where a government has an obligation to implement internationally recognized social, economic and cultural rights. For example a foreign water company may set water prices so high that they are beyond the means of the majority of the population. Also, when companies divest and withdraw their investments, BITs do not impose upon them any obligation to compensate the government for the (now-unusable) investments it made to attract the company (e.g. building of roads) or to deal with the social and environmental costs of divestments.
5. The BITs' requirements about transparency by governments are not matched by BITs' rights for governments to get information from companies. Information requirements can only be dealt with on the national level.
6. The host governments can only use national courts to act against wrongdoing by the foreign investor while the latter can resort to international arbitration. It should be noted that some governments might not take action against foreign investors' wrongdoing, for instance because they are afraid of making the country unattractive for foreign investors or having to pay compensation. BITs do not give citizens of a host country any right to submit a complaint to an international dispute settlement mechanism in cases of social and environmental wrongdoing by foreign investors.

As a result of BITs' disciplining of governmental rights, regulations and policy space, the government's total capacity to deal with CSR issues is restricted. Moreover, there are no instruments in BITs by which host and home governments cooperate on CSR-related issues.

### Case:

## Investment in the tea sector

**The urgent need for fairer and more equitable corporate behaviour is illustrated by the situation of the tea sector in India. As a result of low prices on the world market and low quality of the tea in India (which is due to lack of investment in tea plantations), foreign tea multinationals are divesting from plantations and increasingly sourcing from small holders. By doing this, foreign investors avoid the Plantation Labour Act that provides plantation and estate workers with some rights and protection. Moreover, foreign investors are lobbying the government against the Plantation Labour Act with the result that the protection of workers would become a voluntary CSR initiative rather than a legal obligation. By restructuring and not buying tea from tea plantations, tea companies have left 60,000 workers in destitution in remote areas with infertile land and few alternative job options. While the foreign companies have received privileges in the form of exemptions of tax, land ownership and housing laws, they have no obligations to deal with the negative consequences of their withdrawal.**

## Undermining incentives to responsible investment behaviour

The non-discrimination principle in BITs conflicts with CSR initiatives and policies aimed at providing preferential treatment for companies that operate in a socially and environmentally responsible way. Under BITs companies get rights, whether they behave in a socially responsible way or not. The BITs even undermine the possibility of distinguishing between (foreign) investors with a good CSR record and those with a bad one, for instance through governmental measures that promote CSR.

The problem for governments in taking measures that promote CSR is illustrated by reactions to some Dutch investment policy proposals. After strong pressure by parliament, the Dutch government has linked the OECD guidelines to export credits. Investors that want to have their capital needs insured by the government are obliged to sign a declaration of intent that they will endeavour to implement OECD guidelines. At the Investment Committee of the OECD, some countries and companies have complained that this linkage contradicts the voluntary character of the OECD guidelines. But setting criteria for government export credits is quite different from making the OECD guidelines compulsory, as no company is obliged to seek export credits from the government. So far the Dutch government maintains its CSR policy in relation to export credits but governments of other countries refuse to make the link. It is unclear whether the Netherlands can continue this CSR policy in cases where companies formally protest against the linkage between OECD Guidelines, the best endeavour clause, and allocations of export subsidies.

## The responsibilities of OECD guidelines do not cover all MNEs that are protected under BITs

The Dutch government has repeatedly claimed that the freedom to invest is balanced by CSR through the OECD Guidelines for Multinational Enterprises. In practice, however, this claim cannot be sustained because the protection under BITs and the responsibilities under the OECD guidelines apply differently with regard to companies who are only registered but have no physical presence in the Netherlands, so called post box companies. The Dutch fiscal system has encouraged many MNEs to register in the Netherlands. Some dispute settlement cases<sup>2</sup> in which host governments were taken to arbitration have shown that BITs protect the rights of investors that are only post box companies in the Netherlands. However, not all, if any, post box companies are covered by the Dutch policy on promoting OECD Guidelines, according to officials of the Ministry of Economic Affairs. It is not clear which post box companies could be brought before the Dutch National Contact Point in case of non-compliance by a post box company.

A National Contact Point is a governmental body that deals with complaints by non-state parties about non-compliance with OECD guidelines by companies that have the country's nationality. If a post box company is considered not to be of Dutch nationality, e.g. because it applies another country's laws, then the Dutch national contact point cannot consider the complaint.







# UNCTAD proposals on how to include CSR in investment agreements

UNCTAD proposes different options for incorporating social and environmental responsibility in bilateral, regional or multilateral investment agreements. Each of these options have advantages and disadvantages which are explained in the UNCTAD document.

## ❑ Option 1: No reference to CSR, which is now the case with most BITs, but some indirect coverage

- Foreign and domestic investors are equally subject to the social and environmental responsibility requirements of the host country.
- The investment agreement can contain a reference that entry of investors and investments should be done in accordance with laws and regulations of the host country.

## ❑ Option 2: Non-binding CSR standards included in the agreement

- CSR issues are included in a non-binding section of the investment agreement, for instance a non-binding annex includes the voluntary OECD Guidelines on Multinational Enterprises.

## ❑ Option 3: Reservation of regulatory powers on issues of social and environmental responsibility

- Option 3.1: The investment agreement allows the exclusion or exemption from investor protection in order to permit host countries to regulate investors and investment from a CSR perspective, for example by using an exemptions list in the investment agreement.
- Option 3.2: Inclusion of an article in the investment agreement that allows countries to adopt laws and measures, provided they are not discriminatory or arbitrary, that protect for instance human and animal health and life, public morals and treasures, exhaustible natural resources, sufficient supply to the population or domestic industry (see WTO: Art. XX of GATT1994).

## ❑ Option 4: No lowering of standards clause

- Inclusion in the investment agreement of an article that ensures that host countries can introduce or maintain environmental or social regulations that also apply to foreign investments or investors (see NAFTA art. 1114).
- An article in the investment agreements states that governments should not attract particular investments by relaxing standards on the environment, consumer protection, core labour standards, and human rights.

## ❑ Option 5: Home country measures to promote CSR

- Option 5.1: A non-binding obligation to ensure the “best efforts” of the home country to encourage CSR behaviour by its investors, for example by encouraging investors to adhere to the OECD Guidelines
- Option 5.2: A binding commitment is made under the investment agreement by home countries to supervise the CSR behaviour of its companies abroad.

## ❑ Option 6: Inclusion of a generally binding CSR provisions in the agreement

- Option 6.1: Inclusion of binding articles on CSR provisions.
- Option 6.2: Annexing existing CSR instruments or international agreements as binding provisions.
- Options 6.3: Linking the investment agreement with a range of agreements and codes by encouraging the parties to the investment agreement to sign up to these agreements and codes.

Source: UNCTAD, *International Investment Agreements - Key issues, Volume II, 2004*, p. 129-151 (summarised by M. Vander Stichele)

## Proposals to make BITs more supportive of CSR

Current BITs contain few incentives, let alone obligations, to promote and support CSR policies by governments and the implementation of CSR initiatives by companies. There is little willingness by governments around the world to introduce multilateral and bilateral regulation on multinationals, although the limits and deficiencies of self-regulation as well as voluntary and multistakeholder initiatives become clear. This fact necessitates the defining of new principles and international regulatory articles that improve multinationals' social and environmental behaviour and their impact on societies, especially in developing countries. The UN body dealing with trade and development, UNCTAD (the United Nations Conference on Trade and Development), has looked at the many existing bilateral, regional and international investment agreements and has identified different ways in which CSR can be included in investment agreements (see UNCTAD proposals on page 5). None of these options directly impose duties on multinational enterprises.

In the standard BIT text of the Netherlands there are some CSR clauses in the preamble. The standard BIT states that "recognizing that the development of economic and business ties will promote internationally accepted labour standards" and "considering that these objectives can be achieved without compromising health, safety and environmental measure of general application". However, the preamble is not enforceable.

In order to give CSR a higher status, each BIT should contain (a) free-standing article(s) that promotes the CSR of corporations, in combination with a number of amendments to core principles of the BITs.

### The following free standing article(s) could be included:

#### □ Co-operation clause, the principle of enabling before requiring:

An article in which the countries, signed up to the BIT, commit themselves to co-operate on CSR issues and maintain responsible behaviour among foreign and national investors. The co-operation includes:

- Regular and clear consultation procedures regarding CSR, and specific consultation procedures in cases where the host country requests support from the home country in tackling irresponsible behaviour by an investor; such consultation procedures should involve multiple stakeholders or at least allow stakeholders to monitor governmental consultations.

- Financial resources and technical assistance provided by the industrialised home country to the host developing country to promote CSR among foreign and domestic investors.

#### □ Implementation obligation:

An article in which the parties commit themselves to implement key international agreements relating to CSR. In cases where countries have not signed such agreements: the article should determine a deadline by which the parties will sign up to such agreements. The parties should agree among themselves which key international agreements should be covered by this obligation.

- Important agreements to be included are four core labour standards of the International Labour Organisation (ILO):
  - Freedom of association and effective recognition of the right to collective bargaining
  - The elimination of all forms of forced or compulsory labour
  - The effective abolition of child labour
  - The elimination of discrimination in respect of employment and occupation
- Important multilateral environmental agreements and instruments that could be included are:
  - the Montreal Protocol on Substances that Deplete the Ozone Layer
  - The Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal
  - The Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals in International Trade
  - The Convention on biological diversity
  - The Rio Declaration of the UN conference on Environment and Development, and especially the precautionary principle.

#### □ Not lowering of standards clause:

The parties commit in an article not to lower social and environmental standards in order to attract investment. In case one of the parties has a complaint about the behaviour of the other party related to this issue, there will at least be a consultation procedure. Such a complaint can include protest against the lobbying behaviour of foreign investors that attempt to dilute social and environmental laws and standards.



## The following articles constitute amendments to some core principles of a BIT:

### □ A clause limiting "indirect expropriation":

- In general a BIT should guarantee governments the space for policy related to CSR issues including the right to regulate on labour, social, environmental, consumer and other aspects to develop an equitable and sustainable society. The burden of proof that such laws act against foreign investors should lay with the investors.
- A specific provision in the expropriation article should state that no case brought by an investor before an international investment arbitration panel for "indirect expropriation" can be accepted by the arbiter if the case relates to governmental laws that follow from a state's obligation to implement international labour and environmental agreements signed by that state.

### □ A clause on divestment:

The article in investment agreements that allows foreign investors the freedom to divest and transfer investment capital out of the country should also provide more flexibility for governments to stop the free transfer of investment capital when there are severe negative consequences (beyond balance of payment problems). In addition, the article should include an obligation for investors to take into account the negative social and environmental consequences of such divestments.

### □ Limiting non-discrimination "in like circumstances":

The non-discrimination articles should state the right of host governments to promote small local infant industries in agriculture, industrial goods and services, especially with regard to promoting responsible and sustainable behaviour, even if that results in discriminatory behaviour towards large foreign investors in these sectors.

#### Endnotes

- 1 See for instance: UNCTAD, *International Investment Agreements - Key issues*, Volume I, 2004, p. 274-278.
- 2 See for instance the "Cochabamba case" i.e. *Aguas del Tunari S.A. v. Republic of Bolivia* (ICSID Case No. ARB/02/3), and the case of *Central European Media (CME) vs. the Czech Republic* (arbitration award made in March 2003).



## Colofon

This paper has been written by SOMO as part of its CSR & Trade project, financially supported by NCDO, Novib and FDHT (Human Rights at Work Foundation).

This project seeks to identify the differences, similarities and gaps between the trade, investment and corporate social responsibility agendas. Where on the one hand, rights of Multinational Enterprises (MNEs) when investing and trading internationally are increasingly being regulated in different forums (such as the WTO), rules for the behaviour of MNEs are being developed on a voluntary basis (i.e. the OECD Guidelines). The project aims to come up with concrete policy proposals in the areas of CSR, investment and trade policies at the (inter) governmental level. For comments, please contact SOMO.

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