Responsible Business and Sustainable Investment in the **Natural Resources Sector** in Asia and the Pacific

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Abbreviations and acronyms

BIT	bilateral investment treaty
CBD	Convention on Biodiversity
CEV	Corporate Ecosystem Valuation
CIT	corporate income tax
CSO	civil society organization
CSR	corporate social responsibility
ECA	Economic Commission for Africa
EIA	environmental impact assessment
EITI	Extractives Industry Transparency Initiative
EPs	Equator Principles
ESG	environmental, social, and governance
ESIA	environmental and social impact assessment
ESR	ecosystem services review
FDI	foreign direct investment
FPIC	free prior and informed consent
GPs	Guiding Principles
GRI	Global Reporting Initiative
ICMM	International Council on Mining and Metals
IFC	International Financial Corporation
IFI	international financial institution
IIA	international investment agreement
IIED	International Institute for Environment and Development
IISD	International Institute for Sustainable Development
ILO	International Labour Organization
IPFSD	International Policy Framework for Sustainable Development
IPIECA	Global Oil and Gas Industry Association for Social and Environmental Issues
ISO	International Standards Organisation
IUCN	International Union for Conservation of Nature
KPCS	Kimberly Process Certification Scheme
MIGA	Multilateral Investment Guarantee Agency
MRC	Mekong River Commission
NCP	national contact point
NGO	non-governmental organisation
NSB	national standards bodies
OECD	Organisation for Economic Cooperation and Development
PES	payment for ecosystem services
PS	Performance Standards
PWYP	publish what you pay
REDD	reduced emissions from deforestation and degradation
RSPO	Round Table on Sustainable Palm Oil
SEMS	social and environmental management systems

SIA	social impact assessment
SME	small and medium-sized enterprises
SOE	state-owned enterprise
TEEB	The Economics of Ecosystems and Biodiversity
TNC	transnational corporation
UNPRI	United Nations principles of responsible investment
UNCSD	United Nations Commission on Sustainable Development
UNCTAD	United Nations Conference on Trade and Investment
WBCSD	World Business Council for Sustainable Development
WRI	World Resources Institute
WTO	World Trade Organization
WWF	World Wildlife Fund

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Executive summary

Natural resources sectors such as mining, oil, gas, hydro, and forestry plantations are an integral component of most developing economies in the Asia-Pacific region, thereby making them attractive investment sectors for both transnational corporations (TNCs) and state-owned enterprises (SOEs). The region produces well over a quarter of the world's crude oil and natural gas, over 60% of the world's coal, sizeable percentages of other metals and minerals, and nearly a third of all energy produced from hydropower. It is also the world leader in exports of intensive plantation commodities such as timber, rubber and palm oil. China is the world leader in coal and timber. It also produces a fair amount of oil and gas, has the highest number of hydropower dams, and has the second largest non-fuel mining sector in the world. Oil and natural gas production are concentrated in the Russian Federation. Australia is the world leader in mineral production, though Indonesia, Kazakhstan, Mongolia, Papua New Guinea and the Philippines also have significant mineral mining sectors. Indonesia, Malaysia and Thailand have the world's largest rubber and palm oil plantations.

In a number of countries, exports of natural resources account for a significant percentage of GDP. Mongolia and Papua New Guinea are the two Asia Pacific countries most reliant on mining with mineral exports contributing 77.6% and 54.0% to their respective GDPs in 2010. Mineral exports account for over 40% of GDP in Australia, and significant shares of GDP in India, Indonesia and Kazakhstan.

Asia Pacific least developed countries attracted less than 1% of FDI inflows to the region, indicating strong growth potential. Natural resource exploitation is often highly dependent on foreign direct investment (FDI). Correspondingly, coal, oil and natural gas are the main destinations for FDI in the region. Developing countries like Indonesia, Myanmar, Viet Nam, Turkmenistan and Uzbekistan are especially dependent on FDI.

FDI in natural resources has the potential to bring about significant economic growth and development, but corruption and poor fiscal management have often led to greater inequality. Moreover, benefits are concentrated at the macroeconomic level rather than at the local level, which means that community level poverty reduction and development can be limited as a result of FDI. In fact, the contribution of the mining sector to national economies has been characterized as a downward pyramid with the largest macroeconomic contributions coming from FDI, followed by exports, government revenues, gross national income (through value added) and finally employment. Moreover, FDI in natural resources has a poor record with regard to human rights abuses and causing social ills through displacement of communities and disruptions to the environment. Involuntary resettlement and the use of violence against community members to defend corporate assets are among the worst of these abuses. However, health and safety issues and violations of labour rights are also

common. At the same time, these industries are putting increasing pressure on the environment and affect biodiversity. Mines and dams in particular can destroy entire ecosystems, while mining of fuels and minerals can cause heavy air, water and land pollution, not to mention the impacts derived from burning fossil fuels. The deforestation of high conservation value areas as a result of intensive plantations poses large risks to biodiversity and contributes to global warming. Governance challenges such as corruption indicate a strong need for greater transparency and accountability.

More responsible business practices are necessary for companies to avoid these problems and contribute to poverty reduction and social development at the local level. **Businesses and policy makers share the responsibility for ensuring the adoption and effective implementation of these practices.**

On the policy front, the main challenges are to maximize economic benefits at both national and local levels, while ensuring that the environment and human rights are well protected. In order to do this, governments must do a number of things. One is to establish strong national legal and regulatory frameworks governing natural resource use. This involves ensuring investment and mining laws are sound, transparent and incentivize the right kind of investments. Countries must govern the operations of TNCs by setting up incentives to ensure that they produce efficiently while respecting the social and environmental interests of local communities and global commons. In this context, the preparation of investment contracts and international investment agreements that correspond with national development objectives are essential and should be carefully scrutinized. Regarding international investment agreements, model agreements are emerging to guide countries through the negotiating process, and help them maximize local economic benefits. Comprehensive social and environmental regulations and their effective enforcement are also determining factors. In essence, government policies are a major factor in encouraging businesses to appropriately and adequately address the environmental and social impacts of their operations.

Meanwhile, businesses have the responsibility to adopt and implement international standards of responsible business practice to help them avoid the negative impacts from their operations. A number of **international standards, guidelines and initiatives have emerged to help businesses engage in more sustainable and socially responsible investment that contributes to inclusive and sustainable development.** These include voluntary principles-based initiatives such as the Global Compact and Guiding Principles on Human Rights; standards such as the OECD Guidelines for Multinational Enterprises, International Standard Organisation (ISO) 26000 series, International Financial Corporation (IFC) Performance Standards, and initiatives to increase transparency such as the Global Reporting Initiative (GRI). In addition to these instruments, a number of additional initiatives focus on the natural resources industries specifically. Among these are Publish What You Pay and the Extractive Industry Transparency Initiative, certification systems such as the Round Table on Sustainable Palm Oil (RSPO) and Kimberly Process, and industry associations

such as The Global Oil and Gas Industry Association for Environmental and Social Issues (IPIECA) and International Council on Mining and Minerals (ICMM) that are focused on driving corporate responsibility.

What are these instruments achieving? While they are surely helping to advance the uptake and implementation of responsible business practices, transparency and accountability, it is clear that they are not going far enough. None of them have truly achieved their goals. An increasing number of businesses have signed onto the Global Compact, published GRI reports, and claim to follow one or more of the other guidelines. However, enforcement mechanisms are weak or non-existent and cases of human rights abuses, corruption and environmental mismanagement are still commonplace. Moreover, human development of communities located in areas of natural resource wealth still lags behind.

What these instruments do achieve is to set clear expectations for business and provide a wealth of implementation guidance. Voluntary instruments are most effective with the biggest, most globalized and high visibility companies. They are particularly effective in cases where companies feel pressure and scrutiny from financial stakeholders, host governments or home governments. However, many of the smaller, lesser-known TNCs fall through the cracks, facilitated in part by many financial institutions in the Asia-Pacific region that are less concerned about these issues.

Several innovative efforts have emerged to shift the balance of environmental impacts from negative to positive. Companies are beginning to adopt methodologies such as The Economics of Ecosystems and Biodiversity (TEEB) and Corporate Ecosystem Valuation (CEV) that help to value the impacts of FDI in natural resources on ecosystems and biodiversity and inform on strategies that counteract such negative impacts.

Similarly, good processes can be put in place to avoid major social challenges and human rights abuses. Standards and guidelines developed by international organizations such as the International Labour Organization (ILO), Organisation for Economic Cooperation and Development (OECD) and IFC, and industry associations such as IPIECA aim to help companies address these challenges. Companies such as Sarawak Energy and others are beginning to take community consultations more seriously, while Rio Tinto has produced a set of guidelines for protecting human rights throughout its business. ICMM is pushing for greater stock taking of the social and environmental impacts of mining on countries and local communities.

What does this mean for policy? Governments need to drive these standards into enforceable business practice through policies and regulations. National legislation requiring corporate disclosure of payments such as the United States Cardin-Lugar Amendment on Payment Transparency (2010), Hong Kong, China's more stringent Stock Exchange listing requirements for minerals companies (2010) and the European Union's Accounting and Transparency Directives (2013) are examples of where this is starting to

happen. In many cases, the strengthening of the national regulatory framework, including investment laws and contracts, and the process for conducting environmental and social impact assessments (ESIAs) is essential. When possible, national regulations should clearly articulate sustainable development goals. Using a softer touch, governments can raise awareness about and promote compliance with these initiatives among both foreign and local companies. They can disseminate the practical implementation guidance of the United Nations Global Compact, GRI, IPIECA and ICMM, etc. among companies operating in their territories – either directly, via stock exchanges or in the investment contract negotiation process. They can also ensure that the standards and guidelines are being followed by SOEs. Where initiatives can be joined or followed by countries themselves – such as the Extractives Industry Transparency Initiative (EITI) – governments should do so.

The Mongolian case study presented in this study emphasizes the point that national efforts to redraft mining and investment laws should draw on international best practices on the formulation, negotiation and implementation of sustainable development laws, regulations, contracts and investment agreements. While Mongolia has fortunately managed to attract investment from relatively responsible companies, such as Rio Tinto, enforcement of social and environmental standards needs to be strengthened. Domestic firms should also be held to strict social and environmental standards. At the same time, the soundest laws and regulations will do little good in the face of corruption and volatile law making. Therefore, efforts to reduce corruption are also essential. One area where corruption does not seem to work is in securing financing from international financial institutions (IFIs). Development and financial institutions funding large-scale projects can thus have a significant impact on local communities by ensuring that standards such as the IFC Performance Standards or Equator Principles are strictly respected.

Countries need reliable information about the impacts of FDI in the natural resources sector on their territories and populations. They should thus consider conducting detailed assessments of these impacts – potentially with the support of civil society and (financial) support of key industries. Finally, governments should leverage the financial institutions within their territories to sign on to responsible investment principles such as the Equator Principles and UN Principles of Responsible Investment (UNPRI).

The Myanmar case study describing an incident where violence was used on people protesting the operations of a mine demonstrates the importance of engaging communities and civil society in a participatory manner. Especially in the case of resettlement, transparency and fairness in negotiations with villagers or indigenous populations and adherence to international standards are absolutely essential, not only to provide fair compensation for resettled people, but also to protect the host government and investors against liabilities from losing the social license to operate.

The Lao People's Democratic Republic case study on the approval process of the Xayaburi dam highlights the need to strengthen regional collaboration, and better align incentive structures to support cooperation and decision-making for sustainable development. International cooperation platforms such as the Mekong River Commission are necessary to manage resources with transnational impacts, but these platforms may need to be redesigned and reinforced.

The Papua New Guinea case study on the palm oil sector provides a good example of how one certification standard – the Round Table on Sustainable Palm Oil (RSPO) is benefitting smallholders.

Finally, not all companies are alike, and some have much better track records of performance on social and environmental issues than others. Countries can help themselves by attempting to attract companies with a proven commitment to social responsibility. This may include companies that are listed on internationally reputable stock exchanges or sustainability indexes such as the Dow Jones Sustainability Index and FTSE 4 Good; companies with the capacity to use the most up-to-date modern technology in mine design, recovery techniques, remote sensing, and processing technology; and those that demonstrate good transparency and disclosure.

Businesses and investors can also do their part by joining these initiatives and following their guidance. While joining the initiatives alone may bring only marginal improvements, businesses that concertedly use the tools developed and implement best practices can bring about big changes. It goes without saying that businesses should also follow local laws and regulations. They can reduce risks and protect the sustainability of their businesses by positioning themselves as innovators and leaders on social and environmental development.

INTRODUCTION

The natural resources sector merits special attention in the context of investment and development. Many Asian and Pacific countries, including least developed countries, are rich in natural resources which present significant opportunities for growth and development. However, these industries have important economic, social and environmental implications that must be managed. While there is great potential for natural resources development to bring social and economic gains to local populations, these endowments do not automatically translate into poverty reduction and development. In fact, investments in the natural resources sector often have a number of negative impacts that may outweigh many of the gains. More broadly, with rising world populations and the rapid development witnessed in emerging economies around the world, the demand for natural resources, including for energy and food, is rising exponentially. This is putting considerable pressure on fragile ecosystems. As a result, the social and environmental sustainability of these investments is of increasing concern.

The natural resources sectors covered in this study are oil, gas, mining, hydropower, and large tract plantations such as palm oil and rubber (but not agriculture). These sectors have been grouped together because these sectors share a number of common features relating both to the nature of FDI in these sectors and the social and environmental impacts of FDI. First, natural resources represent a large share of FDI inflows to the Asia-Pacific region. As highlighted in ESCAP's Asia-Pacific Trade and Investment Report 2012 (ESCAP, 2012), coal, oil and natural gas alone attracted 17.5% of all greenfield investments in the region between 2009 and 2011. Growing worldwide demand for these finite resources has made them increasingly attractive investment opportunities.

Secondly, the development of natural resources is often highly dependent on FDI and as such, the involvement of TNCs in this development is an important feature shared by all natural resources sectors. The extraction and hydropower sectors, in particular, are large scale, capital-intensive projects, many of which are technically challenging and require billions of dollars in investment. Investments of this scale often require the financial support of governments and/or TNCs. Large tract plantations are less capital-intensive by comparison, but are nevertheless commonly developed by foreign companies.

While FDI in the natural resources sectors usually boosts exports and government revenues, the benefits derived by the local economy will depend largely on the existence and extent of linkages between FDI in the sector and the host country's economy at large, as well as on the extent to which spill-over effects in terms of technology and skills development and local employment generation can be realized. The importance of FDI has strong implications for the conclusion of investment

contracts where there are concerns about unequal bargaining strengths, ownership of non-renewable resources, and transfer pricing which can impede host countries' abilities to benefit from these investments. UNCTAD's World Investment Report 2007 (UNCTAD, 2007) notes the threefold economic challenge related to FDI in the natural resources sector consisting of adding value, capturing that value locally and making the most of revenues generated.

Equally important are the significant negative social and environmental impacts that give rise to growing concerns about the sustainability of FDI in the natural resources sector. Weighty environmental impacts such as the destruction of landscapes, ecosystems and effects on biodiversity; social issues such as health and safety, land rights, displacement and livelihoods are strongly shared between extractives, hydro power, and large tract plantations alike. Moreover, these issues have been the source of extensive conflict and controversy raising well-founded doubts about the merits of FDI in these industries for sustainable development.

Despite the controversies, there is still hope that FDI in this sector can be a vital contributor to the economic growth of many developing and emerging economies in the region. So far, least developed countries have attracted less than 1% of all FDI into this sector in the region. This indicates an opportunity for these countries to improve their attractiveness as investment destination, and at the same time to ensure more equitable gains from realized investments.

Businesses can play an essential role in ensuring the environmental and social sustainability of their investments. Responsible business practices that adhere to international standards and guidelines for managing social and environmental impacts and for enhancing transparency and accountability will go a long way towards ensuring social, environmental and financial sustainability. A number of instruments have emerged to help guide businesses establish practices that minimize negative impacts. Voluntary international instruments including the United Nations Global Compact, Global Reporting Initiative (GRI), ISO 26000, and the United Nations Guiding Principles for Business and Human Rights are among some of the key guidance tools available to businesses. Similarly, the OECD Guidelines for Multinational Enterprises, which is mandatory for TNCs operating in signatory countries, and the IFC's Performance Standards, which must be met by all its clients, provide important guidance and clearly delineate expectations. These standards and guidelines have attracted growing attention from both governments and enterprises.

While the adoption of responsible business practices by business will surely contribute to sustainable development, the policy environment enabling or requiring both public and private companies to adopt responsible business practices is also essential in shaping their behaviour. Effective government policies, appropriate institutional frameworks and the promotion of existing international instruments relating to corporate social responsibility will be important factors determining whether

businesses adequately address the environmental and social impacts of their operations.

Over the past few years, ESCAP has been actively working to support increased implementation of more inclusive and sustainable business practices in the Asia and Pacific region. This study builds on this work by providing a review of the issues, challenges, instruments and tools related to responsible business and sustainable FDI in the natural resources sector in the Asia-Pacific region. The ultimate objective of the study is to promote FDI that brings a satisfactory return on investment for the business or investor and a positive social return on investment for the host country whilst ensuring environmental sustainability.

The study is structured as follows. Chapter 1 provides an overview of the natural resources sector in the region. It profiles the production of the main commodities by country, and assesses their relative importance in the economies of countries in the region.

Chapter 2 discusses the main economic, social, environmental and governance challenges associated with natural resource investments, starting with a review of the “resource curse” concept. It discusses each of the challenges in depth and provides an overview of the literature as well as suggestions, standards and practices that have emerged to promote improvements.

Chapter 3 discusses a number of the key policy challenges including regulatory and legal issues, aspects related to the policy making process, and existing intergovernmental initiatives with regard to FDI in the natural resources sector.

Chapter 4 discusses some of the main concerns raised by both civil society and investors with regard to FDI in the natural resources sector and reviews the impacts of the initiatives of a number of civil society organizations targeting investors and initiatives designed by multilateral development banks in the promotion of responsible business practices. The chapter also reviews the main international instruments and initiatives promoting responsible business practices. It describes their objectives, scope and design, as well as the extent of their implementation in Asia-Pacific.

Chapter 5 presents five case studies intended to provide a glimpse of both good and bad examples of natural resource management. The case study of Mongolia discusses the country’s attempts to revise its mining and investment laws for the better despite a number of challenges. The case study of Myanmar describes an incident involving human rights abuse at a copper mine, and discusses the strengths and opportunities of the ongoing revisions to the mining and investment laws. The case study of the Xayaburi dam in Lao People’s Democratic Republic discusses regional cooperation and raises questions about the effectiveness of existing mechanisms. The case study from the United Kingdom presents innovative efforts to value and create

positive environmental impacts in mine restoration. Finally, the case study of the palm oil sector in Papua New Guinea discusses the benefits of the Round Table on Sustainable Palm Oil certification standard for smallholders and one company's efforts to improve its overall social performance.

Chapter 6 analyses the overall responsible business performance of Asian businesses vis-à-vis their Western counterparts, discusses the main drivers of responsible behaviour and presents some opportunities for greater regional collaboration in this area.

Finally, chapter 7 presents recommendations for businesses, for governments and for ESCAP to promote sustainable FDI in the natural resources sector.

CHAPTER 1

OVERVIEW OF THE NATURAL RESOURCES SECTOR IN ASIA AND THE PACIFIC

A. Snapshot of regional production

The Asia and Pacific region enjoys a wealth of natural resources and produces significant shares of the world's crude oil, natural gas, coal, metals, hydropower and forestry products. As shown in figure 1, the region produced about 26% of the world's crude oil, non-conventional oil and natural gas in 2010, second only to the Middle East. Between 1995 and 2010 production grew by 5.9%, and based on estimated reserves it is likely to grow further (Eni S.p.A, 2011).

Figure 1
Production of crude and non-conventional oil, natural gas liquids by region, 2011
(thousands of barrels/day)

Source: Eni S.p.A, 2011

* Asia-Pacific includes Russian Federation and Central Asia

According to the International Energy Agency (IEA, 2012), the Asia-Pacific region¹ and Russian Federation together produced 22% of the world's crude oil production in 2011. For natural gas, Asia and the Pacific (excluding Central and Northern Asia)

¹ IEA regional classification for Asia and the Pacific does not include UNESCAP's North and Central Asia subregion: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, the Russian Federation, Tajikistan, Turkmenistan and Uzbekistan.

produced 12.6% of the world's natural gas production in 2011, and production has grown substantially from previous years.

Asia is the world leader in coal production, with China accounting for nearly half of global production. In 2010, China was also the global leader in hydropower and produced 20.5% of the world total (figure 2). The rest of Asia and the Pacific (excluding North and Central Asia) produced 7.4%. Asia is also the world leader in production of palm oil and rubber (see figures 2, 3 and 4).

Figure 2
Shares of output of crude oil, natural gas, coal and hydro production,
selected countries

Coal 2011

Hydro 2010

Source: IEA, 2012

Note: Data on crude oil, natural gas and coal are for 2011; data on hydro are for 2010.

Figure 3
Shares of palm oil production of selected countries, 2012

Source: Index Mundi website, 2012.

Note: Estimates.

Figure 4
Shares of rubber production of selected countries, 2012

Source: International Rubber Study Group, 2013.²

² International Rubber Study Group (2013), *Statistical Summary of World Rubber Situation*, based on data from Rubber Statistical Bulletin, July – September 2013 edition. Available from: http://www.rubberstudy.com/documents/WebSiteData_2.0.pdf

Oil and gas reserves in the region are concentrated in West Asia (proven and probable reserves for oil and gas are 62% and 40% respectively), but with its production share considerably lower than its share of reserves, production has potential to grow in this region (UNCTAD, 2007). The Russian Federation is the leader in natural gas reserves and production, but the Islamic Republic of Iran is also poised to grow in natural gas production (UNCTAD, 2007). South and South-East Asian countries are also increasing oil and gas exploration and production, largely in efforts to catch up with demand.

Meanwhile, China is the world's largest producer of coal, responsible for 45.9% of all world-wide coal production. The rest of Asia produces 14.3% of the world's coal.

The region is also a rich source of non-fuel metals and minerals. It accounts for 82.5% of the world's mine production of antimony, 23.8% of gold, 41.3% of molybdenum, 29.1% of nickel, 79.1% of tin, and 42.3% of zinc. The Pacific contributes 33% of the world's bauxite production, and 14% of gold production (ESCAP, 2009).

Hydropower is becoming a growing source of energy in the region especially in China and along the Mekong River. The Three Gorges Dam in China is the biggest hydropower project in the world. The Nam Theun II dam on the upper Mekong subsequently paved the way towards an aggressive dam construction plan along the Mekong which is expected to unfold over the next five years. China is the world leader in timber production, while intensive palm oil and rubber plantations exist in South-East Asia.

The production value of these sectors is of very different orders of magnitude. In 2005, global production of crude oil and gas amounted to \$2.3 trillion while mining of metallic minerals amounted to \$265 billion. The total value of hydropower projects and intensive plantation forestry crops is much smaller. Nevertheless, many of the social and environmental development challenges across these sectors are quite similar. Box 1 discusses two countries which are hotspots with regard to possession and production of natural resources: China and the Russian Federation. Box 2 provides a snapshot of the world's leading producers of natural resources.

Box 1. Country hotspots: China and the Russian Federation

China is the world leader in coal production, responsible for nearly half of all global production (45.9%). It also has major hydropower dams and in 2010 produced 20.5% of all energy worldwide generated from hydropower. It has the world's second largest non-fuel mining sector. It is the fifth largest producer of crude oil (5.1% in 2011) and the seventh largest producer of natural gas at 3%. China is also the world leader in forestry products.

The Russian Federation is the largest global producer of natural gas, responsible for 20% of all world-wide production. It is the second largest producer of crude oil, producing 12.7% of the global total, the fifth largest producer of hydropower at 4.8% and it produces 4.3% of the world's coal.

Source: IEA, 2012.

Box 2. Commodity snapshots: global rankings and shares of global production

Coal – China 1st (45.9%); 14.3% from the rest of Asia

Crude Oil – The Russian Federation 2nd (12.7%); People's Republic of China 5th (5.1%)

Natural Gas – Russian Federation 1st (20%)

Minerals – Australia 1st; China 2nd; significant mining also found in Russian Federation, Indonesia, Kazakhstan, Philippines, and Papua New Guinea. Mongolia will soon be on this list.

Hydropower – China 1st (20% of all energy produced from hydropower); Russian Federation 5th (4.8%); India 7th (3.3%)

Timber – China 1st; Indonesia, Malaysia

Rubber – Thailand 1st; Indonesia 2nd; Malaysia 3rd; India 4th; Viet Nam 5th

Palm Oil – Indonesia 1st; Malaysia 2nd; Thailand 3rd

Sources: FAOStat; International Council on Mining and Metals, 2012; Index Mundi website; Responsible Research, 2010.

B. The Role of natural resources in the economy

In global terms, natural resources play a relatively small role in both the world economy and in Asia-Pacific economies. Nevertheless, they constitute significant economic forces in a number of Asia-Pacific countries, especially in developing countries with rich natural resource endowments. The biggest economic contributions from natural resources usually come from FDI, export revenues, government revenues and local employment generation. Mining in particular typically makes much larger macroeconomic contributions at the national level than at the local level (figure 5).

Figure 5
Macroeconomic contributions of the mining sector
to low and middle income countries

Source: International Council on Mining and Metals (ICMM), 2012.

FDI is a significant economic driver, not only in minerals mining, but across all natural resources sectors, including palm oil and rubber. Given rising worldwide demand for natural resources, and the finite nature of many of these resources, it is not surprising that coal, oil and natural gas represent the biggest share of FDI in the Asia-Pacific region. As highlighted in ESCAP's Asia-Pacific Trade and Investment Report 2012 (ESCAP, 2012), these commodities attracted 17.5% of all greenfield investments between 2009 and 2011.

In South-East Asia, more than a quarter of greenfield investments flowing into the subregion went to the coal, oil and natural gas industries, mainly in Indonesia and Viet Nam. In Turkmenistan, between 2009 and 2011, 71% of all greenfield investments went into coal, oil and natural gas, while in Uzbekistan the share was 57% (ESCAP, 2012). This signals a heavy dependence by Turkmenistan and Uzbekistan on FDI in this industry.

The share of FDI in the natural resources sectors compared to other sectors is the highest in Myanmar and Viet Nam. In Myanmar, one of the poorest and least

developed countries in the region, FDI is concentrated in oil, gas and mining and power. Among enterprises holding permissions to operate projects in Myanmar, 41% of the total approved dollar amount is for oil, gas and mining activities. Similarly in Viet Nam, the coal, oil and natural gas sectors represent 37.4% of all FDI inflows into the country (ESCAP, 2012).

Natural resources make up notable shares of national exports in a number of Asia-Pacific countries. For example, mineral exports alone make up a significant share of total exports in Australia, India and Papua New Guinea (table 1). National reliance on mining is quite high in some countries. Mongolia and Papua New Guinea are the two Asia-Pacific countries most reliant on mining with mineral exports contributing 77.6% and 54.0% respectively to their respective total exports in 2010 (ICMM, 2012). When combined with fuel, energy, palm oil and rubber exports, these shares can be quite large, though precise data for these sectors are not widely available.

The share of natural resources in GDP is often much smaller. For minerals mining, for example, the share of GDP is usually well below 10% (table 1), though again, accurate and reliable data on the relative share of GDP in each sector are not widely available.

Table 1
Rank of Asian countries in the global top 20 by production value from mining

Country	Rank	2010 Production value (\$ million)	2010 Production value as share of GDP (%)	2010 Mineral export contribution (%)	Change in production value 2000-2010 (%)
Australia	1	71,955	7.8	40.3	337.8
China	2	69,281	1.2	1.5	555.1
Russian Federation	5	28,680	1.9	6.6	166.1
India	7	26,042	1.5	17.9	788.8
Indonesia	11	12,225	1.7	10.6	147.1
Kazakhstan	14	7,248	4.9	13.1	203.3
Philippines	16	4,221	2.1	6.8	964.1
Papua New Guinea	20	3,166	33.4	54.0	136.5

Source: International Council on Mining and Metals (ICMM), 2012, drawing on statistics from World Bank, UNCTADstat and Raw Materials Group.

With regard to employment at the macroeconomic level, the natural resources sectors generally have a small impact on job creation. In the extractives industries, overall employment at the national level in most countries is very low. Oil, gas and mining typically generate relatively few jobs, and these are often unskilled, low paying jobs (UNCTAD, 2007). The sector is capital- but not labour-intensive and employs only about 1% of the global workforce. In Indonesia, and Viet Nam for example, the

extractive industry was responsible for 0.9% and 0.3% of total employment respectively in 1996 (UNCTAD, 2007). Even in countries where the sector is strong, employment figures are still low. For example, employment in the oil and gas sector is only as high as 4% in Equatorial Guinea and 1.5% in Saudi Arabia (UNCTAD, 2012a). In contrast to macroeconomic figures, large-scale extractive projects can generate a significant number of jobs at the local level (UNCTAD, 2007), though accurate employment data are not widely available.

The same is true in the hydropower sector. While macroeconomic job creation figures are low, local level employment from hydroelectric power projects can be high, though accurate figures are again generally unavailable. Direct job creation stems mainly from the initial construction of the dam. These can be skilled and unskilled jobs. A smaller number of long-term jobs are created to maintain the dam. The largest number of jobs is actually generated by new productive enterprises that are enabled by the provision of water (such as irrigated agriculture) or electricity (World Commission on Dams, 2000).

Large tract, intensive plantations such as palm oil and rubber are less capital-intensive and more labour-intensive than the other natural resource sectors. Though data are generally quite poor, they appear to be an important source of employment in rural areas. This is especially true during plantation and harvesting seasons. In countries with significant palm oil industries, such as Indonesia and Malaysia, where it is one of the largest agricultural crops, it provides a sizeable portion of rural employment. In 2008, the Malaysian palm oil industry estimated that palm oil was the second largest contributor to external trade, responsible for 6.9% of exports and provided about 570,000 jobs in Malaysia which would have been roughly 2.2% of employment.³ More speculative projections from the Palm Oil Industry Association in Indonesia suggest that direct and indirect employment in palm oil could reach 6 million people (Goenardi, 2008). In 2008, 41% of palm oil plantations in Indonesia were owned by smallholders who produced 6.7 million tonnes of fresh fruit bunches⁴, and the industry has continued to grow at a rapid rate. Palm oil and rubber plantations are often categorized under forestry, which is considered to be a significant source of rural employment (FAO, 2012), though FAO confirms that poor data make it difficult to determine the magnitude of employment in the sector. A great deal of employment in forestry is part time and seasonal, amounting for only a few days or weeks in a year. This is true of rubber plantations, for example. On a full time equivalent basis, the forestry sector was estimated in 2006 to employ 5.8 million people in the region (FAO, 2012).

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³ Sime Darby (2009). Palm Oil Industry in Malaysia. Presentation at Skills & Knowledge for Sustained Development in Africa, 24 June 2009. Available from: http://siteresources.worldbank.org/EDUCATION/Resources/278200-1121703274255/1439264-1242337549970/Malaysian_Palm_Oil_Industry.pdf.

⁴ World Growth (2011), *The Economic Benefit of Palm Oil to Indonesia*, A Report by World Growth, February 2011, Available from: http://worldgrowth.org/site/wp-content/uploads/2012/06/WG_Indonesian_Palm_Oil_Benefits_Report-2_11.pdf.

Despite relatively small impacts on GDP and on employment, FDI in natural resources has the potential to bring important collateral benefits to the rest of the economy. Increased government revenue can be used to finance important infrastructure projects, investments in health, education, or the development of other industries. The extent to which government revenues are used strategically for inclusive and sustainable development is an important factor in determining how much the country can benefit from these revenues.

Private investments in the development stage of extractives projects or in local community investment programmes can help finance public infrastructure (roads, bridges, medical clinics, etc). The presence of these industries can also spur development in many different ways, for instance by instigating growth of related industries up and down the value chain as well as laterally within the economy. The need for skilled labour can also lead to significant local training and education programmes, whether funded by the investor or by the government (UNCTAD, 2012a). These projects can also contribute to economic development in related sectors and industries that arise in response to the investment project, both up and down the supply chain as well as in related sectors that may benefit from similar skills or technology.

CHAPTER 2

SUSTAINABLE DEVELOPMENT CHALLENGES IN THE NATURAL RESOURCES SECTOR

FDI in the natural resources sector presents a number of economic as well as environmental, social and governance (ESG) challenges that must be managed if host governments and local communities are to benefit from these investments. This chapter discusses some of these challenges.

A. The resource curse

There is evidence that countries with abundant natural resource endowments have often witnessed lower economic growth than countries without such endowments, a phenomenon that is known as the “resource curse.” A number of factors can contribute to this phenomenon. Capital inflows to the natural resources sector can lead to an appreciation of the local currency reducing the competitiveness of other export sectors, a phenomenon that is known as “Dutch disease”. Swings in global commodity prices can lead to uncertainty in government revenue, especially in countries that are highly dependent on commodity markets. Natural resource wealth can also create governance challenges. Government mismanagement of resources through weak or unstable and often corrupt institutions can lead to the capture of revenue by elites, the stunting of tax systems, and can exacerbate economic disparities and heighten local/regional tensions.⁵

However, most development practitioners believe it is possible to overcome the “resource curse” and for FDI in these sectors to bring about economic and development benefits. This depends largely on the extent to which good governance is practiced, including the degree of transparency and accountability in tax collection and other payments made by investors, the level of controls to prevent corruption and measures to enforce high environmental standards (Moran, 2012).

The United Nations Economic Commission for Africa (ECA) recently published a paper which contained broad lessons on how to reap economic benefits from FDI in Africa. Many of these lessons have relevance for Asia-Pacific as well. In particular, the paper highlights several policy challenges:

- *The industry creation challenge* - creating a viable, integrated and diversified mining industry that can add economic value throughout the value chain;

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⁵ Extractive Industries Transparency Initiative (EITI) website. History of EITI, available at: <http://eiti.org/eiti/history>.

- *The investment challenge* - investing transitory mineral revenues to ensure lasting wealth and deciding how much ought to be saved and how much should be invested and where;
- *The distributional challenge* - distributing benefits from mining equitably, balancing and managing conflicting local and national-level concerns and interests and deciding what form the allocation should take to promote pro-poor growth;
- *The governance and macro-economic challenge* – ensuring sound systems of governance and a stable macroeconomic policy which curbs rent-seeking and corruption, addresses issues such as the Dutch disease and externalities such as unstable commodity prices, and enhances public interest in wealth conservation. (Pedro, 2012).

A number of ESG challenges must also be overcome in order to achieve sustainable development.

B. Environmental challenges

1. Environmental impacts of various natural resource sectors

Different types of natural resources exploitation have widely different environmental impacts, but common problems are land use change, pollution (resulting from processes used in extraction), deforestation, and loss of ecosystems and biodiversity. Combined, the environmental impact from these sectors is huge. The United Nations Principles of Responsible Investment (UNPRI) estimates that environmental externalities caused by the oil and gas and mining and quarrying sectors amount to well over \$500 billion, roughly 40% of the total environmental costs of the top five sectors that impact the environment (electricity, oil & gas, mining, food producers, construction and materials) (figure 6).

Figure 6
Environmental costs of the top five sectors affecting the environment
3,000 public companies

Source: Principles of Responsible Investment (PRI) and UNEP Finance Initiative, 2010.

(a) Mining

Intense mining activities have a serious impact on the environment including the destruction of landscapes and ecosystems, erosion and pollution (air, soil and water). With open pit mines, entire habitats and geological features may be completely removed, affecting biodiversity. Therefore, proper land management and waste disposal are essential. Specific challenges include mercury pollution and uranium tailings, which can have major detrimental effects on watersheds and rivers. In Central Asia for example, uranium tailings, a waste by-product of uranium mining, has caused significant

pollution, particularly of freshwater sources.⁶ In Papua New Guinea, the Ok Tedi mine – until 2002 majority owned by the Australian company BHP - discharged millions of tons of mining waste into the Ok Tedi River during the 1990's. Chemicals in mining tailings that were not properly managed severely polluted local rivers and fish populations, while mining operations caused flooding, affecting local populations.⁷ In Tibet, mining sites such as Shethongmon (In Chinese: Xietongmen) backed by Chinese and Canadian investors have also polluted rivers with minerals and chemicals and redirected water to mines depriving nearby agriculture of water resources.⁸

Mining has also led to deforestation, such as in Kalimantan, Indonesia (Cheng, 2010). Mining is a water-intensive industry, which can divert limited water resources away from other activities such as agriculture or drinking. This has been a serious concern in the Gobi desert in Mongolia, for example. The improper decommissioning of mines and rehabilitating sites is also a major environmental concern and can lead to prolonged negative environmental impacts (UNCTAD, 2012a) (TEEB, 2010).

(b) Oil and Gas

In the oil and gas sector, exploration activities such as seismic tests, drilling, compression, etc. can have severe negative impacts on the environment when carried out improperly. These impacts include environmental degradation and air, soil and water pollution around drilling sites. Examples of air pollution include exhaust fumes from drilling or other equipment, natural gas flaring, methane and volatile organic compounds released into the air from dehydrators and separators and dissolved hydrocarbons from wastewater that escape into the air. In terms of soil pollution, chemical additives, salts, metals and hydrocarbons from cuttings or “produced” water can contaminate soil and water (in the case of offshore drilling). Contaminants in pit sludge can seep into nearby soils, surface waters and ground water. Water produced from coal-bed methane operations or “produced water” can contaminate fresh water through spills, pipeline breaks, leaks from storage ponds, or movement of injected water into a freshwater aquifer.⁹

Environmental concerns also arise from the placement of gas pipelines, and their environmental and biodiversity impacts. For instance, the proposed Altai pipeline - a Gazprom project that will carry gas from Siberia to China - is said to threaten endangered species in the Altai region. Oil spills are generally the biggest risk, and can

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⁶ United Nations in Kyrgyzstan website (undated). What we do: Uranium Tailings in Central Asia. Available from: <http://www.un.org.kg/en/un-in-kyrgyzstan/what-we-do/article/233-what-un-does/3557-uranium-tailings-in-central-asia>

⁷ Bob Burton (1999). BHP admits Ok Tedi mine is environmental disaster. *Asia Times Online*, 13 August 1999. Available from: <http://www.atimes.com/oceania/AH13Ah01.html>

⁸ Nirmala Carvalho (2009). Chinese mining causing environmental disasters in Tibet, *Asia News*, 25 June 2009, available at: <http://www.asianews.it/news-en/Chinese-mining-causing-environmental-disasters-in-Tibet-15614.html>

⁹ Earthworks (undated leaflet). Oil and Gas Pollution, Oil and Gas Accountability Project. Available from: <http://www.earthworksaction.org/files/publications/Oilandgaspollution.pdf>.

extremely pollute land and water, with potentially devastating effects on ecosystems, biodiversity and economic activities like fishing and tourism (UNCTAD, 2012a).

Fracking, or hydraulic fracturing, a method of extracting shale gas, has raised alarm among environmentalists in Western countries as the practice is poised to move to Asia, particularly China.¹⁰ Fracking is extremely water-intensive and has high risks of water pollution.

Any discussion of the environmental impacts of the oil and gas sector needs to mention the impact on climate change, even though these impacts are not localized. Burning fossil fuels is one of the primary contributors to climate change. As a result, there is increasing pressure on extractives companies to reduce emissions in their own operations and invest in renewable energy sources.

(c) Hydroelectric Power

Dams have large environmental impacts such as the loss of land, forests and ecosystems as a result of large submerged areas. Blocking a river and changing its natural flow causes major changes in biological productivity and ecosystems both in submerged areas and downstream, including the blocking of fish migration and decrease in plankton, and generally negatively impacts fish, fauna and other riparian life (ADB, 1999; World Commission on Dams, 2000).

The Three Gorges Dam in China, the world's biggest hydropower project, displaced 1.2 million people and has led to water pollution from submerged upstream industrial centres, the erosion of riverbanks and associated landslides and has hindered fish migration and spawning which impacts downstream biodiversity.¹¹

(d) Forestry

The forestry sector in Asia-Pacific, including the production of timber and other forestry-related commodities such as rubber and palm oil, has reached unsustainable levels with significant environmental implications. Deforestation, in particular the loss of tropical forests and high conservation value areas, has major implications for both climate change and biodiversity. This is especially true in Indonesia and Malaysia where millions of hectares of palm oil plantations have led to huge losses of tropical forests, which are considered high conservation value areas, and are essential for greenhouse gas absorption. The loss of peat forests and dry lowland forests in Sumatra, for example, has endangered species such as the orangutan and the Sumatran tiger. Asia's forests also provide irreplaceable environmental services to people, especially the rural poor. Timber production and deforestation for intensive forest plantations can completely change the biodiversity through the elimination of natural species and introduction of new species. Finally, deforestation can negatively impact watersheds and water flows (Cheng, 2010).

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¹⁰ Wang Xiaocong (2012). Environmental Frets as Frackers Move In. *CaixinOnline*, 20 November 2012. Available from: <http://english.caixin.com/2012-11-20/100462881.html>

¹¹ International Rivers (undated website). Campaign on Three Gorges Dam. Available from: <http://www.internationalrivers.org/campaigns/three-gorges-dam>

2. Good practices in improving the net impact on the environment

Given the significant environmental impacts of natural resources exploitation, many efforts have been taken to shift the balance from a negative impact to a positive one. Businesses, including mining companies, increasingly recognize the importance of biodiversity and healthy ecosystems for their operations as well as the business opportunities provided by the conservation and sustainable use of biodiversity. The “Economics of Ecosystems and Biodiversity” (TEEB) study, which considers the economic value of nature, builds the case for valuing the benefits of conserving ecosystems and biodiversity in specific cases, and outlines an approach for doing so. Using this approach, mining and other companies are beginning to consider the ecological balance sheet of their operations. Rio Tinto, for example, announced a policy to pursue “net positive impact” on the environment as a long-term goal (box 3). It has developed a partnership with the International Union for Conservation of Nature (IUCN) and Earthwatch Institute to develop indicators and verification processes to measure their impact on the environment. In the United Kingdom, a Rio Tinto subsidiary used the “corporate ecosystem valuation” methodology to design a mine rehabilitation plan (see case study on corporate ecosystem valuation in chapter 5).

Box 3. Case study: Rio Tinto’s “net positive impact” policy

Rio Tinto established a policy goal of “net positive impact” on biodiversity within its operations. Under this policy, the company aims to minimize the impacts of their business on biodiversity and contribute to biodiversity conservation to ensure that a region in which they operate ultimately benefits from its presence. To achieve this, the company developed a partnership with IUCN. Using Madagascar as a pilot country for a conservation offsetting strategy, Rio Tinto and IUCN jointly published two technical papers: “Exploring ecosystem valuation to move towards net positive impact on biodiversity in the mining sector” in 2011 and “Forecasting the path towards net positive impact on biodiversity for Rio Tinto QMM” in 2012.¹²

C. Social challenges

According to John Ruggie, the United Nations Secretary-General's Special Representative for Business and Human Rights from 2005 to 2011,

“Extractive companies have had adverse impacts on a broad array of human rights, such as resettlement of communities without adequate consultation and compensation; environmental degradation and its effects on health, sources of livelihood and access to clean water; as well as charges of forced labor, rape and even extrajudicial killings by security forces protecting company assets, with some cases meeting the legal definition of corporate complicity”.¹³

¹² Available from: <http://data.iucn.org/dbtw-wpd/edocs/2011-062.pdf> and <http://data.iucn.org/dbtw-wpd/edocs/2012-049.pdf>

¹³ John G. Ruggie (2012). Keynote remarks at Association of International Petroleum Negotiators Spring 2012 Conference. Washington, D.C., 20 April 2012. Available from: <http://www.business->

Many of these issues are associated with FDI in the natural resource sector more broadly. A few of the most common issues are the following:

1. Land acquisition and involuntary resettlement

FDI projects in the natural resources sector commonly displace people from their land. As a result, land acquisition, resettlement (voluntary or involuntary) and compensation are among the toughest social issues faced by foreign investors in the natural resources sector. Moreover, land takings and resettlement frequently involve official coercion rather than a participatory process. Displacement of people is highly disruptive of their life, culture and heritage and thus has serious social implications. Efforts to develop alternative livelihoods are usually required and rarely sufficient. Land acquisition and resettlement can take place in extractives and forestry but occurs on the largest scale in hydropower projects. These projects can easily displace tens of thousands of people, destroying their livelihoods as well as the livelihoods of people living downstream (World Commission on Dams, 2000).

A common problem with land takings is that affected groups often lack land titles and land is often owned by the government. As a result, problems arise related to the recognition of land rights, and methodologies for and negotiations about compensation and resettlement. Indigenous people, ethnic minorities, aboriginals, hill tribes or other tribal groups are especially vulnerable to this problem as they frequently have informal or customary land rights which are easily infringed upon. For example, one fifth of those physically displaced by the Kao Laem dam in Thailand were from the Karen ethnic group, but were considered ineligible for resettlement because they lacked legal residence permits (World Commission on Dams, 2000). In Bangladesh, the Kaptai hydropower dam displaced 100,000 Chakma people submerging two-fifths of their cultivable land. As a result, 40,000 Chakma left for India, where they never gained citizenship for themselves or their children, and another 20,000 were supposed to have moved to Arakan in Myanmar. A conflict triggered by land shortage between the Buddhist Chakma people and Muslim Bengali settlers has cost 10,000 lives since the project was completed in 1962 (World Commission on Dams, 2000).

For most projects involving indigenous people, there is now a need for “free prior and informed consent” (FPIC) whereby the community has the right to give or withhold its consent to proposed projects that may affect the lands they customarily own, occupy or otherwise use. This is a powerful instrument and is much stronger than simple consultations which investing companies may organize to listen to local concerns, but they are not obliged to address these concerns. Public consultations should ideally start at the project preparation stage (box 4) but also continue during the implementation and monitoring of projects, which is usually not done.

Standards and guidelines have been developed to avoid these problems and ensure just treatment of indigenous people or vulnerable groups. These include, among others, the United Nations comprehensive guidelines on development-based displacement; IFC's Performance Standard 5: land acquisition and involuntary resettlement; and the World Bank's involuntary resettlement policy (and instruments).

Box 4. Case study: consultative process used by Sarawak Energy prior to dam construction

Sarawak Energy, a Malaysian SOE that provides electricity to Sarawak State adopted a consultative process prior to the construction of ten hydropower dams. This kind of project typically generates a lot of conflict with local communities and consultative processes are used as a tool to avoid such conflict. Previously under projects of this kind, compensation payments were made as necessary but any consultation was completely ad hoc. However, the company has adopted a new approach in efforts to keep communities more informed about the process. The company found that an information vacuum existed between the company and the community, which is quickly filled with vested interests. The greatest challenge, therefore, is to communicate with communities before people with vested interests do. Sarawak Energy developed a consultative process that starts with an analysis and mapping, then develops a strategy, puts together a team and prepares messaging material. Once that is completed, engagement takes place at several levels, starting with high level political figures and followed by local resident and district offices, then community leaders and then people at the grassroots level. A big challenge has been to secure time to consult community members at each level and manage expectations before the project teams go in to survey or start construction. However, by adopting this approach, the company managed to obtain consent to do the site investigation.

Source: Presentation by Steven Barthalemeusz, [Senior Manager Corporate Social Responsibility, Sarawak Energy Berhad,](#) at CSR Asia Summit in Beijing, 19 September 2012.

2. Respecting human rights

Human rights violations commonly occur in the context of constructing gas pipelines, mines and dams. As noted by John Ruggie, violations commonly include charges of forced labour, rape, and the use of violence associated with the protection of operations sites. For example, in a recent incident in Myanmar police burned monks with phosphorous gas while attempting to end their protest of the expansion of the Monywa copper mine in the country, sparking strong criticism of the Chinese investor and the Government of Myanmar (see case study on Myanmar in chapter 6 below).^{14 15}

There are a number of international standards to address human rights issues associated with FDI, including the OECD Guidelines for Multinational Enterprises, the

¹⁴ Associated Press (2013). Probe alleges Myanmar police used white phosphorus, 1 February 2013. Available from: <http://bigstory.ap.org/article/probe-alleges-myanmar-police-used-white-phosphorus>.

¹⁵ [Jason Burke](#) and Swe Win (2012). Burma: riot police move in to break up copper mine protest. *The Guardian*, 29 November 2012. <http://www.guardian.co.uk/world/2012/nov/29/burma-riot-police-mine-protest>.

Voluntary Principles on Security and Human Rights, the Global Compact and most recently the Guiding Principles on Business and Human Rights. The implementation of these instruments is beginning to improve performance and reduce human rights abuses as illustrated in box 5.

Box 5. Case study: Rio Tinto Resource Guide on Human Rights

In January 2013, Rio Tinto published a resource guide for integrating human rights into communities and social performance work. The guide was written in collaboration with the Center for Social Responsibility on Mining (CSRMin), part of the Sustainable Minerals Institute at The University of Queensland, and is accompanied by a background reader written by the Business and Human Rights Department of the Danish Institute for Human Rights (DIHR).

The guide is designed to be used by Rio Tinto's community and social performance practitioners as well as the general public. It focuses on explaining the meaning of due diligence, risk assessment and community engagement in a human rights context. It places a strong emphasis on inclusive engagement with communities and reviews practices for knowing and understanding the human rights issues present in the company's operations, integrating them into internal systems and controls, reporting and communicating performance, monitoring evaluating and improving. It presents a number of case studies from around the world.

Source: Rio Tinto (2013).

3. Respecting labour rights

Labour rights such as freedom of association and collective bargaining are also commonly infringed upon. In Kazakhstan, for example, Human Rights Watch recently drew attention to laws deemed repressive and Government practices deemed abusive and exposed a few oil companies that allegedly violated the labour rights of thousands of workers employed in the petroleum sector. The companies involved were alleged to have interfered with workers' rights to engage in collective bargaining and carried out massive dismissals after peaceful strikes. Workers attempting to negotiate with company management to resolve wage and other contractual disputes were apparently met with indifference or outright harassment.¹⁶

4. Ensuring occupational health and safety

Ensuring workers' health and safety is also a serious issue, especially in the mining sector. Incidents leading to the death or injury of workers continue to affect the mining sector, and occur from time to time in the oil and gas industry as well. The highest number of accidents reportedly takes place in the coal sector in China where at least 1,300 people died in 2012.¹⁷ But accidents affect the oil and gas sector as well. For

¹⁶ Human Rights Watch (2012). [Kazakhstan: Abusive Response to Oil Worker Strikes](http://www.hrw.org/news/2012/09/10/kazakhstan-abusive-response-oil-worker-strikes), 10 September 2012. Available from: <http://www.hrw.org/news/2012/09/10/kazakhstan-abusive-response-oil-worker-strikes>.

¹⁷ China Labour Bulletin (2013). Report claims coal mine deaths in China fell by one third in 2012, 29 January 2013. Available from: <http://www.clb.org.hk/en/node/110204>.

example, an explosion at Gazprom's arctic gas field killed several people in March 2013.¹⁸ In the context of intensive plantation forestry, both human rights and environmental groups in Asia have called for safer practices related to hazardous pesticides.¹⁹ ²⁰ A number of workers at oil palm plantations in Malaysia have been injured in transportation accidents.²¹ While international organizations like ILO have helped to advance national health and safety standards and legislation, a recent study by EIRIS shows that among ESG issues, health and safety is the one where Asian companies show the least progress, likely because the drivers for social issues are limited (EIRIS, 2011).

5. Reducing economic dependency

In oil, gas and mining in particular, local communities can become highly vulnerable to boom and bust cycles in commodity prices and changes in the level of mining activity. Mining activities can exacerbate local inequalities between regions receiving resource rents and those that are not. When operations cease, dependent communities are left in need of a new source of livelihood (UNCTAD, 2012a).

6. Recommendations for good processes

Good processes can be put in place to avoid major social challenges and human rights abuses. Standards and guidelines developed by international organizations such as ILO, OECD and IFC and industry associations such as IPIECA (discussed in chapter 4) aim to help companies avoid these social breaches.

New approaches call for greater public participation in natural resources development. This involves the identification of diverse and valid community representatives and working with them to address their concerns and expectations. In this regard, company efforts are required to invest in local communities and adopt strategies such as community equity in projects (Pedro, 2012). Moreover, community consultation and procedures for addressing grievances are increasingly required for companies to secure their social license to operate. These consultations are now mandated by IFIs in most projects, though on the ground implementation can be rushed and pro forma without proper understanding and appreciation of local culture and traditions. Positive examples of companies taking community consultation seriously are emerging. For example, Hess Corporation's community consultation programme includes benchmarks and objectives, and mechanisms to record and address community grievances resulting from its operations (Ceres and Sustainalytics, 2012). Another good

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¹⁸ [Trude Pettersen](http://barentsobserver.com/en/energy/2013/03/gas-explosion-arctic-gas-field-13-03) (2013). Gas explosion at Arctic gas field". *Barents Observer*, 13 March 2013. Available from: <http://barentsobserver.com/en/energy/2013/03/gas-explosion-arctic-gas-field-13-03>.

¹⁹ Pesticide Action Network Asia and the Pacific. RSPO Background: Call for Immediate Ban of Paraquat and Class 1 Pesticides and Progressive Ban of Highly Hazardous Pesticides in Oil Palm Plantations. Available from: <http://www.panap.net/en/fs/page/food-sovereignty-rspo/104>

²⁰ Asian Food Worker, various articles. Available from: <http://asianfoodworker.net/?cat=24>.

²¹ Tan Fang Qun and Tsuyoshi Kawakami, eds. (2009). *ASEAN-OSHNET Good Occupational Safety and Health Practices 2008/2009*, ASEAN Occupational Safety and Health Network, Vientiane, 2009. Available from: http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---sro-bangkok/documents/publication/wcms_120410.pdf

example is the Malaysian SOE Sarawak Energy, which adopted an in-depth consultative approach following the approved construction of 10 hydropower dams (see box 4 above).

D. Governance challenges

1. General overview

The need to improve governance of natural resource investments by strengthening institutions, combating corruption and enhancing transparency is universally considered as one of the most important factors in enhancing the contribution of FDI in natural resources to inclusive and sustainable development. Good governance in this regard includes enhancing the degree of transparency and accountability in taxes and other payments made by investors, controls to prevent corruption and measures to enforce high environmental standards (Moran, 2012). Investments bring huge inflows to governments, and such investments, without transparent management, can lead to corruption and conflict that exacerbate poverty rather than reduce it. Good governance of local institutions is also needed to use revenue resulting from FDI for poverty reduction, growth and development. This is not easy to accomplish, especially since, as UNCTAD notes, when “governments obtain more resources from one single source (e.g. mining royalties), they become less dependent on their population as a source of revenue and at the same time less accountable and responsive to the societies they govern”(UNCTAD, 2012a).

One important recommendation for improving governance is to develop better modalities for the preparation of investment contracts (Cotula, 2010). In this regard, governments may benefit from external assistance in negotiating contracts to help secure the most beneficial terms for tax revenues and local communities (Moran, 2010).

2. Addressing corruption

High levels of corruption in the Asia-Pacific region are alarming because they signal risks such as the uneven distribution of wealth and low investor confidence. With regard to FDI in natural resources, bribes and corrupt payments are common and there is a well-established need for transparency in revenue streams and for controls to prevent corruption (Moran, 2010).

It is important to note that key tools in this area have not been working well. For example, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business is ineffective, partly because it is defined too narrowly to cover many types of partnership agreements such as those where people close to public officials are invited to form “partnerships”, but don’t invest capital of their own or personally bear any repayment responsibility. This type of non-genuine business partnerships in a host country also allows investors to circumvent home country anti-bribery laws such as the United States Foreign Corrupt Practices Act (UNCTAD, 2007). According to Transparency International’s Corruption Perception Index 2012 which rates countries on a scale of 1 (very corrupt) to 100 (very clean), 68% of Asia-Pacific countries

and 95% of Eastern Europe and Central Asian countries scored below 50. The highest scoring countries in the region were New Zealand, Singapore, Australia, Hong Kong, China; and Japan (in descending order), while the Democratic People's Republic of Korea, Afghanistan, Myanmar, Uzbekistan, Turkmenistan and Lao People's Democratic Republic had the lowest scores (Transparency International, 2012). To overcome this challenge, greater vigilance in preventing corrupt payments and bribes on the part of international investors is necessary (Moran, 2006).

3. Enhancing transparency

Closely related to reducing corruption is enhancing transparency. Transparency is essential to ensure that public revenue is put to good use rather than diverted by public officials (Moran, 2006) or simply captured by the elite. International initiatives like Publish What You Pay and the Extractives Industry Transparency Initiative (EITI) (discussed in detail in chapter 4) are starting to address this issue.

In their 2011 study of oil and gas companies titled "Promoting Revenue Transparency", Transparency International and Revenue Watch assessed the performance of 44 oil and gas companies, representing over 60% of global oil and gas production, across three fronts: reporting on anti-corruption policies²², organizational disclosure and country level disclosure. It found that, compared to global companies, Asian national oil companies are doing a poor job of reporting on any anti-corruption programmes they may have (figure 7). And, over half of the companies with the lowest scores for disclosure of anti-corruption programmes (11 out of 21) are from the region (Transparency International and Revenue Watch, 2011).²³

Transparency is a key requirement for companies seeking to maintain their reputations and credibility. It also helps governments ensure that FDI contributes to inclusive and sustainable development. Organizational disclosure of partnerships and subsidiaries for all companies was 65% on average, but only 59% among Asian companies with a few very poor performers in the region.

What is truly lacking, however, is the disclosure of country level data including financial data, transfers to governments and operational information. The average score across all companies was only 16%, and among national oil companies (NOCs) it was even lower. Five Asian companies were among the six worst performers globally. Across

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²² The analysis in this section follows the elements of Transparency International – United Nations Global Compact (UNGC) Reporting Guidance on the tenth principle against corruption. The questions refer to reporting on different elements of anti-corruption programmes, including policies, management systems and performance. The assessed sample includes two Australian companies, nine European, nine North American, seven Asian, five African and five from Russian and Central Asia.

²³ Rosneft (Russian Federation) 41%, PetroChina 35%, CNGC (China) 32%, Sinopec (China) 32%, Petronas (Malaysia) 30%, CNOOC (China) 28%, CNPC (China) 16%, KazMG (Kazakhstan) 13%, Inpex (Australia) 9%, Gazprom 0%, SOCAR (Azerbaijan) 0%.

all categories, international oil companies (IOCs) are much more transparent than NOCs, especially NOCs that are not listed or have no listed subsidiaries (Transparency International, 2011).

Source: Transparency International and Revenue Watch, 2011.

Note: The assessed sample includes two Australian companies, nine European, nine North American, seven Asian, five African and five from Russian and Central Asia.

Transparent and accountable systems combined with social and community participation programmes can help ensure that host country populations and local communities in particular benefit from the exploitation of natural resources. Managing all these issues and ensuring greater, more equitable development gains will require shared responsibility among stakeholders, including host and home government, the international community, civil society and TNCs.

CHAPTER 3

POLICY CHALLENGES

A. Introduction

In order to realize development benefits from FDI in natural resources exploitation, governments must secure economic benefits to themselves and to local populations while ensuring that ESG issues are addressed. With regard to FDI this involves striking a delicate balance between creating the right investment climate that attracts the desired investment and offers appropriate protection to investors on the one hand and ensuring inclusive and sustainable development benefits to host countries on the other hand. Once investments are secured, countries face the threefold economic challenge of determining: (1) how to add value to extractive activities, (2) how to capture that value locally, and (3) how to make the best use of the revenues generated to bring about development benefits (UNCTAD, 2007).

In this context, the policy challenges therefore include:

- establishing proper national legal and regulatory frameworks governing natural resource use,
- preparing investment contracts and signing international investment agreements that correspond with national development objectives,
- governing the operations of TNCs and setting up incentives to ensure that they produce efficiently while respecting the social and environmental interests of local communities and the global commons,
- optimizing fiscal revenues and management,
- maximizing national and local economic benefits.

There is extensive literature describing these policy challenges and providing guidance on key areas of focus. These include: (1) creating a conducive policy, legal and regulatory environment and framework for business development; (2) improving governance and management systems anchored in strong and capable institutions; (3) opening up economic growth opportunities; and (4) promoting linkages between the minerals sector and other sectors of the economy (Pedro, 2012). Companies' willingness to invest depends on the risk-reward relationship they perceive. A clear and stable investment environment significantly reduces the main sources of risk. National laws should link to local systems of natural resource management to protect the rights of affected communities to participate in investment decisions and benefits (UNCTAD, 2012a). Adopting a "people centred approach" to development by empowering communities through developing knowledge, competencies and community participation has also been stressed (Pedro, 2012).

Development professionals agree that a strong legal framework to govern the exploration and exploitation of natural resources is necessary. Such a framework should establish clear ownership and property rights, provide an administering framework for issuing contracts and licenses, establish a system of revenue management, include regulations protecting the environment, and address social issues such as the interests of local communities and the health and safety of workers (UNCTAD, 2007 and 2012). While some of these issues can be addressed in individual investment contracts, a well-developed national regulatory system is preferable (Cotula, 2010).

Governments therefore have a large responsibility of putting in place effective policies. For that purpose, they need institutions that are capable of drafting, implementing and enforcing high quality, effective legislation. In many cases, further capacity building in these areas is needed.

This chapter is organized in three parts. Section B explores regulatory and legal issues; section C discusses the policy-making process while section D discusses inter-governmental initiatives.

B. Regulatory and legal issues

1. Investment and mining laws

Presently, the investment policy climate is changing at both the national and international level. At the national level, governments have become more proactive in formulating investment policy (UNCTAD, 2012b). In some natural resource based economies, such as Kazakhstan, Mongolia and the Russian Federation, there has been a trend towards increasing control of natural resources by blocking foreign ownership of “strategic industries” (UNCTAD, 2007). In Mongolia, a 2012 Strategic Foreign Investment Law restricts foreign investment in strategic sectors by stating that Parliament must approve foreign takeovers of assets in strategic sectors like mining.²⁴ The Russian Federation reserved majority shares in strategic industries for state or other national investors, while in Kazakhstan the Government reserved the right to block the sale of energy assets in the country (UNCTAD, 2007).

Yet policy shifts in other Asian countries aim to attract foreign investors. Myanmar’s new mining law, for instance, is easing restrictions on foreign ownership (box 6). Similarly, Indonesia’s 2007 investment law provides for equal treatment of foreign and national firms and its 2009 mining law replaced the contract-based system

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²⁴ William MacNamara (2012). Boom in Mongolia Deflates After Deal That Started It Is Threatened. *New York Times*, 10 December 2012. Available from: <http://dealbook.nytimes.com/2012/12/10/boom-in-mongolia-deflates-after-deal-that-started-it-is-threatened-2>.

with a licence-based system that applies equally to foreign and domestic investors, allowing foreigner investors to hold 100% ownership of projects.²⁵

Box 6. A new mining law in Myanmar

Myanmar will likely pass a new mining law in 2013-14, replacing the previous 1994 law. The new law is expected to follow Myanmar's broader liberalization strategy and help attract more FDI to the sector. At the Mining Summit held in Yangon in January of 2013, the Minister of Mines pledged "the highest level of transparency, accountability and reliability," to encourage both foreign and domestic investment in the sector. It is anticipated that the new law will ease some restrictions on foreign ownership as well as ownership ratios between foreign and domestic firms. The law is expected to allow 100% foreign ownership in some cases, and up to 50 year leases on mines. The law will have tax holidays and guarantees against nationalization.

The new law may, however, close some segments of the sector to foreign investment and require profit-sharing agreements in others. Such agreements would allow the Government to take a large share of earnings without necessarily taking on capital costs. A ban on raw ore exports may also remain. This could benefit the country in the long run by helping to stimulate production and exports of value-added secondary and tertiary products. Other countries in the region such as Indonesia and Malaysia are also engaged in efforts to develop value-added processing of their natural resources. (Oxford Business Group, 2013)

A new mining law that promotes transparency and accountability, offers environmental protection and is structured to foster economic linkages throughout the value chain would help accomplish both investment and development goals. With regard to promoting forward linkages through a ban on exports, such a ban would only work if the technology and skills to effectively add value to raw ore are also developed.

2. Investment contracts

Investment contracts can help strengthen the contribution of FDI in natural resources to inclusive and sustainable development. They do this by (a) determining the distribution of risks, costs and benefits from a project, and (b) structuring public revenue that will flow from the project and other income generating opportunities, and (c) potentially protecting people, livelihoods and ecosystems that will be affected by the investment. Traditionally, however, investment contracts have been biased towards protecting investor rights.

For that reason, countries have sometimes demanded contract renegotiations, in some cases demanding a shift from minority to majority ownership or nationalizing operations. Often, renegotiations are aimed at raising tax rates, revising accounting terms (such as depreciation) or adjusting regulatory agreements once the project is

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²⁵ Asia Law (2009), Indonesia's New Mining Law, March 2009. Available from: <http://www.asialaw.com/Article/2121729/Channel/22098/Indonesias-New-Mining-Law.html>.

successful and commercial benefits increase (Moran, 2006). The likelihood that countries may demand a renegotiation of a contract creates a climate of uncertainty that investors evaluate negatively when assessing the risks associated with making investments. In order to attract investments it is thus important to resolve investor concerns related to stability, while a priority for the host government is to identify the most appropriate type of contract models and be clear on what terms and conditions it is willing to accept before signing.

The main contractual arrangements are modern concessions, joint-venture arrangements, production-sharing agreements, risk service contracts and pure service contracts. The distinction between different kinds of contracts can be opaque, yet it is important for host governments to identify and negotiate the most beneficial contract for each circumstance, taking into consideration a number of factors including the maturity of the industry, the fiscal regime, regulatory framework, costs, import or export dependency, etc. Strengthening government's capacity to negotiate contracts with beneficial terms will be essential to allow host countries to reap the maximum benefits of FDI in these sectors for development. The International Institute for Environment and Development (IIED) has developed specific recommendations for structuring contracts so that host governments and local communities can maximize development benefits (Cotula, 2010).

Since they are essential for shaping both fiscal and non-fiscal economic benefits from a project, contract negotiation strategies should include clear articulation of sustainable development issues and objectives. While fiscal aspects are discussed below, non-fiscal economic benefits for host governments and local populations include infrastructure commitments, investment commitments, technology transfer and downstream activities, all of which should be considered in the preparation of contracts. Obtaining public input in contract negotiations and parliamentary approval of contracts is also important to ensure an inclusive outcome because inputs from different stakeholders allow governments to assess a broader range of interests and lowers the risk that a change in parliamentary majority or pressure from civil society will lead to a request for renegotiation.

Another form of protection for international investors has been the emergence of political risk insurance, often provided by a multilateral political risk insurer such as the Multilateral Investment Guarantee Agency (MIGA) of the World Bank group, or a national risk insurer. In many cases, however, efforts to provide political risk insurance have gone awry. One reason is a lack of differentiation between political risk and economic risk related to financial crisis contagion in which cases host countries no longer have the commercial wherewithal to uphold the contract. In these cases, better planning of measures to deal with anticipated difficulties in investment projects related to changes in the macroeconomic context would be more helpful. Official political risk insurance can also lead to moral hazard whereby international companies simply pursue enforcement of contracts rather than seek reasonable ways to find solutions. Excessive

contract stability can also create undue strain on host countries, including endless and expensive litigation. Therefore, investment contracts should properly balance the need of investors for contract stability and the need for governments to have the option to renegotiate the terms and conditions of the contract if changing conditions so require (e.g. economic crisis). One recommendation is that regulatory systems covering FDI should meet the same three goals as regulatory systems covering domestic investors, namely, inducing investment at a reasonable cost of capital, providing incentives for efficiency in investment and operation, and ensuring a reasonable amount of flexibility to adapt to changing conditions and circumstances (Moran, 2006). Issues can also emerge with “umbrella clauses”, which can make contractual breaches a violation of international or bilateral investment treaties (Cotula, 2010).

The International Institute for Sustainable Development (IISD) has also developed a checklist called “assessing sustainable development impacts of investment incentives” (Thomas, 2009). It is designed to support governments in approving individual projects, formulating investment policy and negotiating international investment agreements (IIAs).

3. International investment agreements

There is also an active debate on the benefits of IIAs, including bilateral investment treaties (BITs) for attracting FDI. Like investment contracts, these agreements are seen by many to overly favour investors while unduly constraining domestic policy makers in meeting national development goals (UNCTAD, 2012b) and failing to provide sufficient social and environmental safeguards to local communities (UNCTAD, 2007; UNCTAD 2012a). Amnesty International has raised concern about the implications of BITs, investment contracts and stabilization clauses for governments’ ability to defend human rights (Peterson, 2006). John Ruggie (2012) has also expressed his concern about stabilization provisions in investment contracts and IIAs:

“Governments need to be able to construct a proper non-discriminatory regulatory framework without fear of being sued under binding international arbitration. We cannot, in all good conscience, call for good governance, and at the same time undermine the capacity of governments to develop the instruments for it”.

At the same time, a misalignment of host country and investor interests often emerges in the form of “local content” requirements in IIAs, which run the risk of conflicting with international legal obligations, for instance those contained in the WTO Agreement on Trade-Related Investment Measures (TRIMS), the General Agreement on Trade in Services (GATS), and others. These obligations prohibit measures that favour domestic suppliers over foreign competitors (Cotula, 2010). Thus, governments must be aware of restrictions on local content and ensure that investment contracts and IIAs conform to international obligations. Local content clauses can still be used and there are ways of drafting them in such a way so that they don’t conflict with international regulations. For example, regarding hiring of local labour, they can require that “all else

being equal” priority should be given to locals for employment contracts. In terms of training, they could require investors to set up training or education funds. In terms of goods and services, they could require investors to “prioritize local goods and services if the cost, quality and/or time of delivery are comparable internationally, or within a certain percentage of international prices” (Cotula, 2010).

Still, the central problem remains that legitimate measures to increase the contribution of FDI to inclusive and sustainable development of the host country can be found to be misaligned with provisions under IIAs or WTO rules (UNCTAD, 2012b).

A number of efforts have emerged to drive the development of better IIAs such as the IISD Model International Agreement on Investment for Sustainable Development – Negotiator’s Handbook. As one of the first significant efforts recognizing the need for greater guidance to governments to negotiate IIAs with the specific aim of linking investment flows to sustainable development, it addresses fair treatment of investors as well as their obligations, the roles and rights of both home and host states, and provides a model agreement as a tool for negotiators (IISD, 2006). It was welcomed for its pointed efforts to maximize the contribution of FDI to sustainable development (Mann et al., 2006; Cotula, 2010).²⁶ Since then, work in this area has continued. In 2012, the United States produced an updated model BIT that recommends procedures to enhance transparency and public participation, stricter adherence to and enforcement of domestic labour and environmental laws, strengthening of international commitments under the ILO and better consultation procedures (U.S Department of State, 2012). However, it also provides greater protection to American firms against domestic technology requirements and clarifies the governmental authority of SOEs.²⁷

UNCTAD has developed an “Investment Policy Framework for Sustainable Development” that aims to address the twin policy challenges of preparing sound national investment policies and international investment agreements (IIAs). It provides concrete guidance to national policymakers on formulating investment policies and regulations while ensuring their effectiveness. It offers negotiators clause-by-clause options to strengthen the sustainable development aspects of IIAs. With regard to national policy formulation, it provides guidelines to address issues related to enhancing

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²⁶ As described by Cotula, the IISD model treaty features the ‘classical’ provisions that protect investors’ rights, for example with regard to forced nationalization. At the same time, however, it entrenches mechanisms to maximize the sustainable development contribution of FDI. It also features safeguards for people who may be affected by investment projects protected under the treaty. For example, the IISD model treaty requires the investor to undertake a pre-establishment sustainable development environmental and social impact assessment of IIAs that complies with either the laws of the host country or those of the home country of the investment, whichever is more rigorous. Investors are also required to maintain an environmental management system and uphold human rights in the state and community where the investment takes place. The IISD model treaty is accompanied by a handbook for government negotiators.

²⁷ The full text of the United States Model BIT is available here:
<http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>.

local content, productive capacity building and strengthening competitiveness, as well as policy areas such as trade, taxation, intellectual property, access to land, corporate responsibility and environmental and labour protection. With regard to negotiating IIAs, it addresses issues such as public policy exceptions and dispute settlement, establishes a hierarchy with other international agreements, includes a “not lowering standards” clause and covers issues related to special and differential treatment. Figures 8 and 9 present a summary of the topics covered by the Framework.

Figure 8
UNCTAD’s IPFSD - structure of the national investment policy guidelines

Investment and sustainable development strategy	• Integrating investment policy in sustainable development strategy • Maximizing the contribution of investment to productive capacity building and international competitiveness
Investment regulation and promotion	• Designing investment specific policies regarding: ○ Establishment and operations ○ Treatment and protection of investments ○ Investor responsibilities ○ Investment promotion and facilitation
Investment-related policy ideas	• Ensuring coherence with other policy ideas including: trade, taxation, intellectual property, competition, labour market regulation, access to land, corporate responsibility and governance, environmental protection, infrastructure and public private partnerships
Investment policy effectiveness	• Building effective public institutions to implement investment policy • Measuring investment policy effectiveness, and feeding back lessons learned into new rounds of policy making

Source: UNCTAD (2012b)

Figure 9
UNCTAD’s IPFSD - international investment agreements – summary of policy guidance

Sections	Description
Part A. Post establishment	
1 Preamble	...sets out objectives of the treaty and intentions of the Contracting Parties
2 Treaty scope	...defines the investment and investors protected under the treaty and its temporal application
3 Admission	...governs the entry of investments into the host state
4 Standards of treatment and protection	..prescribes the treatment, protection and rights which host states are required to accord foreign investors/investments
5 Public policy exemptions	...permit public policy measures otherwise inconsistent with the treaty, to be taken under specified, exceptional circumstances
6 Dispute settlement	...governs the settlement of disputes between Contracting Parties, and those between foreign investors and host states

7	Investor obligations and responsibilities	...promote compliance by investors with domestic and/or international norms at the entry and operation stage
8	Relationship to other agreements	...establishes a hierarchy in case of competing international norms
9	Not lowering of standards clause	...discourages Contracting Parties from attracting investment through the relaxation of labour and environmental standards
10	Investment promotion	...aims to encourage foreign investment through additional means beyond investment protection provisions in IIAs
11	Institutional set-up	...establishes an institutional platform for collaboration between the Contracting Parties
12	Final provisions	...define the duration of the treaty including its possible prolongation

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Part B. Pre-establishment

1.	Pre establishment obligations	...govern establishment of foreign investments in the host state

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Part C. Special and Differential Treatment (SPD)

1.	Asymmetric obligations	...enable imposition of less onerous obligations on a less developed Contracting Party
2.	Additional tools	...encourage positive contributions by a more developed Contracting Party

Source: UNCTAD (2012b).

These guidelines elegantly bring together all of the major issues relevant to FDI-related national policy making and IIAs in one document, offering a solid framework for ensuring that investment policy meets sustainable development objectives (UNCTAD, 2012b).

4. Arbitration and dispute settlement

In some cases, investment contracts and IIAs provide for international arbitration, which can be more favourable to foreign investors than arbitration by domestic courts. From a sustainable development perspective, it is important that investment contracts are written carefully so as to enable protection of environmental and social goals in arbitration. A challenge in international arbitration is ensuring that the public interest and third party interests are properly represented (Cotula, 2010).

The opacity of international dispute settlement bodies also raises the concern that proper attention is given to protecting human rights (Peterson, 2006).

5. Optimizing taxation and fiscal management

Another important and related policy issue is that of optimizing government revenue through solid fiscal frameworks and fiscal management. This includes the need for stable, clear and transparent taxation policies and efficient processes for the issue of licenses (UNCTAD, 2012a).

Taxation is an important vehicle for governments to benefit from FDI in natural resources, and strategies for maximizing public revenue vary significantly based on the types of contracts, expectations about commodity prices, and the prevailing fiscal regime. Striking the right balance in taxation is not easy. If taxes are too low, the host country forgoes necessary revenue to address development issues. If taxes are too high, FDI may be discouraged and be diverted to other countries with more liberal tax regimes. As commodity prices fluctuate, governments are prone to make fiscal or contractual changes that increase their share of profits. These include windfall taxes activated by high commodity prices, increases in royalties, and increases in taxes on profits (UNCTAD, 2012a).

A number of countries have amended tax laws and contractual arrangements to increase the government's share of profits. For example, China amended its fiscal regime applicable to natural resources exploitation in 2011 to increase the threshold for the windfall levy on oil and gas, first established in 2006. It also established a resource tax on oil and gas - amounting to 5% of the sales price - that replaced previous royalties. Kazakhstan also made important changes to its fiscal regime in 2009. The generally applicable fiscal regime that applies in Kazakhstan to exploration and production contracts in the petroleum industry consists of a combination of corporate income tax (CIT), rent tax on export, bonuses and royalty-type taxation, including windfall taxes. In its new Petroleum Exploration & Production Policy of 2009, Pakistan increased the rate of corporate tax to 40% of the amount of profits or gains from all new production-sharing agreements (Ernst and Young, 2012).

The TNC practice of transfer pricing is an important policy challenge as it is essential for host governments to ensure that they receive their fair share of taxes and royalties. Too often, TNCs evade tax payments by trading with their subsidiaries in other countries at below market prices, depriving host country governments of millions in foregone revenues. The OECD has established "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" and a number of countries including China, Kazakhstan, Malaysia, Papua New Guinea and Viet Nam have put transfer pricing regulation in place (Ernst and Young, 2012).

Safeguards to the fiscal regime can be put in place to help stabilize or increase public revenue. These include measures to deal with tax avoidance or tax regimes that combine taxation with royalties (based on volume and not on profits) and strict accounting controls that help limit a company's ability to pay lower taxes by using transfer pricing and make profits appear lower than they actually are (UNCTAD, 2012a). Additional measures include minimum capitalization of subsidiary companies, flexible contracts, windfall taxes, progressive fiscal regimes or other methods to capture a share of higher-than expected profits (Cotula, 2010).

Asia-Pacific is less vulnerable than Africa to large macroeconomic imbalances caused by fluctuations in commodity prices, though exceptions include Azerbaijan,

Turkmenistan and Kazakhstan, which are relatively dependent on oil and gas (UNCTAD, 2012a). Sovereign wealth funds or other stabilization funds can help protect against negative macroeconomic impacts from fluctuating commodity prices and negative effects on the balance of payments (UNCTAD, 2012; Pedro, 2012), though in Asia-Pacific natural resources are usually not the only source of sovereign wealth fund endowments (Truman, 2011).

Finally, a system of revenue management governing the sharing and distribution of rents from extractive industries is essential. Maximizing government revenue will do nothing for development unless this revenue is invested properly in infrastructure, education, health, etc., to bring about local development gains (UNCTAD, 2012a; Cotula, 2010).

6. Environmental and social regulation

There is widespread consensus that government regulation plays a central role in protecting against environmental degradation and ensuring decent treatment of local communities and workers. Legislation of social and environmental impacts is seen by investors and businesses as one of the most significant drivers of responsible investment in Asia-Pacific (EIRIS, 2011). Across all sectors, national efforts to increase environmental protection are growing and regulations limiting carbon emissions and incentivizing greener investments are appearing in countries like China, Japan, and the Republic of Korea (EIRIS, 2011). Similarly, national stock exchanges in Asia-Pacific are encouraging increased disclosure by companies on their social and environmental impacts.

There are a number of regulatory mechanisms to minimize social and environmental risks. These include environmental management systems, safeguards in land takings, enforceable social investment commitments, and accessible and effective remedies for people adversely affected by investment project (Cotula, 2010). Among the most important are environmental impact assessments (EIAs) and social impact assessments (SIAs) or environmental and social impact assessments (ESIAs).

Given their importance, there are several ways in which these assessments could be strengthened. For example, the World Wildlife Fund (WWF) argues that ESIAs should cover all processes starting with exploration, should be made mandatory and should be improved.²⁸ National law should clarify the criteria and procedures for determining whether a project may significantly affect the environment, and stipulate that an ESIA be undertaken during the early stages of project design. Robust methodologies for conducting an ESIA, collecting baseline data, independent evaluation of impacts, etc., will ensure its credibility (Cotula, 2010), especially if the data to be collected extend beyond the project site and are collected regionally as part of a broader development

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²⁸ See:

http://wwf.panda.org/what_we_do/where_we_work/congo_basin_forests/wwf_solutions/extractives/impact_assessments/.

planning process (Barclay, 2012). Public participation in ESIA is important and they should provide modalities to allow the public or affected people to comment on early drafts of investment projects or policies (Cotula, 2010). Similarly, governments and civil society should closely scrutinize how ESIA are conducted (UNCTAD, 2007). Local authorities should also provide inputs and should have the necessary resources to do so (Barclay, 2012).

“The Economics of Ecosystems and Biodiversity” is a seminal report that has advanced the discussion on the need for countries to value their natural capital and make better regulations and fiscal policy decisions, among other things. Several valuable policy recommendations have emerged from this report, which highlights:

- the essential role of regulation – in setting clear rules for the use of natural resources, ecosystems and biodiversity, setting limits and boundaries and establishing a framework for sustainable use and reduce pollution etc.;
- the complementary role of market-based instruments – such as taxes – which can create incentives and shape behaviour with respect to natural resource use;
- reforming subsidies which contribute to environmental harm – which is among the most urgent steps needed;
- rewarding the provision of ecosystem services, in particular rewarding communities or individuals involved in providing or managing ecosystem services over time through modalities such as Payment for Ecosystem Services (PES) or Reduced Emissions from Deforestation and Degradation (REDD) schemes;
- supporting national capital investments – by investing in efforts to strengthen resilience, natural capital management and restoration (TEEB, 2009).

It could be argued that economic valuations should be incorporated into standard cost/benefit analyses in preliminary project assessments, a move that could significantly change the balance between costs and benefits in some cases.

The Convention on Biodiversity (CBD) has also led to extensive international work and discussion on economics, trade and incentive measures to protect biodiversity as well as impact assessments that incorporate biodiversity.²⁹

With regard to social issues, key regulatory challenges include the protection of local community rights and workers’ rights such as minimum labour standards, workers’ health and safety, local and indigenous land rights, including compensation and respecting the international principle of “free prior and informed consent (FPIC), and inclusive public consultation processes, in particular participation by indigenous minorities and women. National law should regulate the compulsory confiscation of land for public interest (which may include commercial interests), while such

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²⁹ See: <http://www.cbd.int/abs>.

confiscation out of purely commercial interests should require the consent from local landholders through negotiations (Cotula, 2010). In order to protect customary land rights and ensure companies practice FPIC, governments will need to help clarify who has these land rights. Regarding displacement, for example, China's Reservoir Resettlement Act specifies the rights of affected people and defines the obligations of the state, procedures for settling conflicts and the redress of complaints, and could serve as a model for other countries (World Commission on Dams, 2000). In Myanmar, for example, along with many other countries, companies find it difficult to determine who should be consulted in order to seek informed consent (Institute for Human Rights and Business, 2012).

One policy option for ensuring local investment meets social development goals is through the use of legally enforceable "community development plans." In this regard, national legislation can require: (a) that legally written and legally enforceable agreements between the investor and local communities are necessary for the award of natural resource rights; (b) the public disclosure of important information that will help local people to develop a negotiating position and to monitor the project (e.g. with regard to current and projected project revenue); (c) downward accountability of community representatives; (d) that such agreements are legally binding and enforceable; and (e) that government agencies have a clear mandate and adequate resources to monitor compliance (Cotula, 2010).

Finally, to make such legislation effective, legal recourse for adversely affected people must also be accessible. For that purpose, laws that may constrain people's access to courts or other remedies should be minimized.

7. Effective enforcement of regulation

The effectiveness of government regulations is a determining factor for improving corporate performance regarding disclosure, capital markets regulation and reducing petty corruption, and reducing negative social and environmental impacts of company operations. While most countries have some form of regulation of environmental and social issues, more effective enforcement is often needed. In Viet Nam, for example, implementation guidelines remain unclear and the low capacity of the labour inspection system makes it rather ineffective and enables businesses to circumvent regulatory requirements (Brown et. al, 2011). To overcome this barrier, the capacity of agencies responsible for enforcing social and environmental regulations needs to be strengthened.

C. Two important policy areas

Within the context of this chapter, two important areas of policy-making can be identified: maximizing local economic benefits through local content and improving transparency and accountability.

1. Maximizing local economic benefits through local content

An important policy challenge is how to ensure that FDI in natural resources contributes to broader economic development by adding value along the supply chain. Natural resources companies in particular can do this by generating employment, developing the workforce, buying supplies and services locally, transferring technology and knowledge and by supporting community development work.

UNCTAD, in its report on “Extractive Industries, Optimizing Value Retention in Host Countries” makes the point that establishing linkages between the natural resource investment and the rest of the economy, commonly called “local content” are essential to maximizing economic benefits for local communities and host country economies in general. Policies can help achieve these linkages by addressing any number of barriers.

One common problem is the lack of human capacity and skills. Where human capacity and skills are not sufficient, higher level positions are instead filled by expatriates. Investments in education and skills development can help develop the skills needed by the sector and build local capacity of the direct workforce and in the provision of goods and services that are competitive and can meet international standards. Ideally, this should be done in collaboration with the industry. Competitiveness in the provision of local goods, services, and employees takes time to develop, so capacity building should be built as a requirement into contracts with companies from the time they are given access to natural resources. Policies can also help develop the necessary infrastructure and strengthen the industrial base. Good governance and a proper business environment are obviously required, including measures that address rent-seeking behaviour and enable the growth of local entrepreneurs in the industry. If value retention is to be increased through competitive local participation then there is also a need to establish good institutions and benchmarks to effectively monitor progress. Finally, the task of monitoring and enforcing local content policies is essential (UNCTAD, 2012a).

Such efforts may be an integral part of the investment projects (e.g. with regard to hiring labour), or alternatively they may extend beyond the project (e.g. training of suppliers that can service the project as well as other projects) or they may be separate from the project altogether (e.g. scholarships/training for general workforce).³⁰

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³⁰ For an example from Timor Leste on such efforts, see: ODI (undated). Briefing Note 8. *Incentivising Local Economic Development in the Extractive Industries Sector through Transaction Chain*. Available from: <http://led.co.za/sites/led.co.za/files/cabinet/orgname-raw/document/2012/848.pdf>.

One way to help stimulate local economic growth is to encourage or require companies to develop local procurement strategies. Excellent guidance for corporate local procurement has been developed. For example, the Center for Social Responsibility in Mining in Australia developed the “Procuring from SMEs in Local Communities” that offers detailed guidance and case studies on how to enhance opportunities for locally based businesses through their resource investments (Esteves, 2010). Additional work by IPIECA, the World Business Council on Sustainable Development (WBCSD), Engineers Against Poverty, and the ICMM can guide companies who wish to do this voluntarily. Reports by UNCTAD and the Center for Social Responsibility in Mining provide a number of case studies of how companies have done this (UNCTAD, 2012; Barclay, 2012). One example is provided in box 7.

Box 7. Case study: Nexen’s local workforce development in Yemen

In Yemen, Canadian Nexen Petroleum invested in the Masil Block oil exploration and development project. Its partnership and profit-sharing agreement with the Ministry of Oil, Gas and Minerals included a plan to enhance local economic growth by building the capacity of the local workforce as part of a 2007 Government programme that required oil companies to help train local staff. The partnership thus evolved from a pure profit-sharing agreement to one that would help increase the capacity of Yemen’s national oil industry and contribute to the implementation of the Government’s “Yemenization” plan. Nexen’s “Yemenization” programme thus included several stages of personalized, formal training of all local employees, with the aim to promote locals into positions previously occupied by expats. Recruitment to the programme was carefully managed by Nexen’s human resources division in close collaboration with the governorate while collaboration with oil ministry’s “Yemenization” manager took place to advertise, test candidates and fill positions as they became available. Subsequently, a scholarship programme was introduced to enable Yemeni students to obtain secondary education at the University of Calgary and Southern Alberta Institute of Technology, and then return and take positions at or outside Nexen. As a result of the programme, Nexen increased the number of local employees in its workforce to a total of 77 per cent. . The employees became more skilled and held more responsible positions within the company.

When Nexen’s production-sharing agreement expired in 2011, however, the Government did not renew it, opting instead to have a new state-controlled company, Petro Masila, take over the project. While there was a certain level of awareness in the country that this company lacked skilled workers, especially skilled technicians specialized in exploration, the 2007 Government programme is seen as having been effective. In 2012, the country reported that there were 214 skilled Yemeni exploration technicians and Petro Masila announced that 97% of its manpower was Yemeni.

Still, the future of the industry is uncertain. In a 2011 report, the World Bank predicted that current reserves will be exhausted by 2017, and while only 25% of the country’s areas have been explored, the Government must now quickly find additional reserves. In 2012, the oil sector contributed between 30 and 40% of Yemen’s national economy, and represented more than 90% of the country’s exports. While the Government believes that a shift from FDI to domestic investment was the best strategy to develop the national economy, the

“Yemenization” plan is now facing a real test and the next few years will reveal the effectiveness of this plan.

Sources: IPIECA (2006), Oil Industry Workforce Development in Yemen; ; The Globe and Mail (2011), and Qaed (2012).

Governments can also help enhance local economic benefits from FDI projects by providing greater direction to companies for more effective social spending. In 2012, the Center for Social Responsibility in Mining at the Sustainable Minerals Institute of the University of Queensland Australia produced a final report summarizing two years of research titled “Local government, mining companies and resource development in regional Australia” that made several recommendations for collaborative approaches including: greater collaboration between mining companies, state authorities and local authorities; a reassessment by mining companies of their social spending to better align such spending with the priorities of local authorities; the pooling of social spending among mining companies to enable support for larger scale social programmes that contribute to a lasting legacy for mining communities (Barclay, 2012).

2. Improving transparency and accountability

Improving transparency and accountability is one of the most fundamental policy challenges associated with improving the development impacts of FDI projects. This refers in particular to ensuring transparency of investment contracts, investment incentives and payments to stakeholders such as the community, labour unions, and NGOs through, among others, publishing information on investment contracts and putting in place measures to prevent bribery of government officials (Thomas, 2009). Domestic policy can also support international initiatives such as the Extractives Industry Transparency Initiative (EITI) that are beginning to make headway.

For example, in its 2008 “Promoting Revenue Transparency” report, Transparency International and Revenue Watch recommended that “home governments and appropriate regulatory agencies should consider introducing mandatory revenue transparency reporting for the operations of companies at home and abroad”. Since then, legislation have been passed in Hong Kong, China and the United States that require listed extractives companies to disclose payments made to host governments (Transparency International, 2011) (box 8). A separate section of the same United States legislation also provides an interesting example of how domestic legislation and international initiatives can complement each other (box 9).

Project level reporting has also been highlighted as a requirement that would enable communities near extraction sites to access financial information on projects in their area as well as commitments made as part of project contracts. It is a requirement of Section 1504 of the United States Dodd-Frank Act, which may lead to changes in EITI requirements as well. Given that royalties and other revenue payments are often negotiated on a project-by-project basis, the access to project level data would allow

governments to better monitor company compliance and allow local communities to track who is benefitting from resource extraction (Global Witness, 2013a).

Box 8. National legislation enhancing transparency of payments

United States of America (hereinafter “United States”) - Section 1504: “Cardin-Lugar Amendment” on Payment Transparency

In 2010, an amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act was passed that requires all extractive companies listed on United States stock exchanges to publish payments made to both to the Government of the United States and foreign governments in the countries where they operate. The information about payments includes taxes, royalties and related fees (including license fees), production entitlements and bonuses. They must report both the type and total amount of payments made for each project and to each government. It must be disclosed in an annual document to the United States Securities and Exchange Commission. Compliance will be required starting in 2013. Subject to the law are eight of the ten largest mining companies and 29 of the 32 largest internationally active oil companies.

Hong Kong, China - Listing rules of the stock exchange

In 2010, the stock exchange in Hong Kong, China, developed new disclosure rules for minerals companies that require new applicants to include information on taxes royalties and other payments to host government in their listing applications. The new rules require disclosure of the following:

- (a) project risks arising from environmental, social, and health and safety issues;
- (b) any non-governmental organization impact on sustainability of mineral and/or exploration projects;
- (c) compliance with host country laws, regulations and permits, and payments made to host country governments in respect of taxes, royalties and other significant payments on a country-by-country basis;
- (d) sufficient funding plans for remediation, rehabilitation and closure and removal of facilities in a sustainable manner;
- (e) environmental liabilities of its projects or properties;
- (f) its historical experience of dealing with host country laws and practices, including management of differences between national and local practice;
- (g) its historical experience of dealing with concerns of local governments and communities on the sites of its mines, exploration properties, and relevant management arrangements; and
- (h) any claims that may exist over the land on which exploration or mining activity is being carried out, including any ancestral or native claims.

European Union – accounting and transparency directives

On 19 April 2013, the European Parliament and Council agreed that the European Union’s accounting and transparency directives will require all EU-listed and large, privately owned oil, gas, mining and logging firms to disclose the payments they make to governments. Companies will be required to publish all payments over €100,000 including taxes, royalties and license fees and do so wherever they operate around the world. The directive brings Europe in to line with the United States Dodd-Frank Act.

The directive will require the publication of information made for each individual resource

project companies invest in – thereby allowing communities to monitor payments from extraction projects in their local areas. The European Union has also rejected calls from industry to include a loophole in the law which, if adopted, would have exempted companies from publishing payments in certain countries, potentially enabling illicit payments to be made invisible.

Sources: Publish What you Pay (2011); Hong Kong Exchanges and Clearing Limited (undated); and Global Witness (2013b).

Box 9. Complementary national legislation and international initiatives to drive corporate responsibility in host countries

United States: Dodd-Frank Wall Street Reform and Consumer Protection Act (2010)

In 2010, the United States Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 1502 on Conflict Minerals which directs the Securities and Exchange Commission to issue rules requiring certain companies to disclose their use of conflict minerals including tantalum, tin, gold and tungsten, if those minerals are “necessary to the functionality or production of a product” manufactured by those companies

The legislation was driven by concerns that the exploitation and trade of conflict minerals by armed groups was helping to finance conflict in the Democratic Republic of Congo and surrounding countries and was contributing to an emergency humanitarian crisis. The legislation was expected to prompt companies to source from non-conflict areas to mitigate their reputational risks. In 2012, the Securities and Exchange Commission adopted a rule requiring companies to publicly disclose their use of conflict minerals that originated in the Democratic Republic of Congo or an adjoining country.

The ruling is expected to affect about 6000 United States companies and foreign firms across a wide variety of sectors by requiring them to disclose the origins of any sourced conflict minerals. The ruling also provides opportunities for investors to work with companies to address their preparedness for compliance.

In relation to this rule and to help all companies perform better due diligence on this issue, the OECD developed “OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas”. In particular, this document helps companies overcome practical challenges to practicing due diligence, especially in relation to establishing ground traceability schemes for minerals (which are lacking) and increasing transparency of their supply chains.

This is an example of a positive linkage between international voluntary guidance on a sustainability issue and legislative requirements that help drive compliance in some countries (or with some companies). This type of model could be highly effective broadly on a range of sustainability issues.

Sources: U.S. Securities and Exchange Commission, 2012; Barg and Padhye, 2012; and OECD, 2013.

D. Inter-governmental initiatives

Several intergovernmental initiatives have emerged either in Asia-Pacific or involving Asia Pacific countries to facilitate collaborative approaches to tackling policy challenges related to promoting sustainable FDI in natural resources.

The APEC Mining Task Force was formed in 2007 and given direction by the “Ministers for Responsible Mining Statement”. Since then, several activities have focused on social and environmental development (APEC, 2013). A 2009 conference on Sustainable Development of the Mining Sector in the Region led to a report on “Sustainable Development in Mining in APEC” that was presented to the United Nations Commission on Sustainable Development (UNCSD) in 2011. Several workshops have been held to improve stakeholder dialogue, and implement policies that incorporate a deeper consideration of the environmental and social implications of mining. At the Fourth Meeting of APEC Ministers Responsible for Mining (MRM4), held on 27 and 28 June 2012 in Saint Petersburg, Russian Federation, ministers placed sustainable development in mining among their future priorities. The Seventh Meeting of the Mining Task Force was planned to take place in 2013 in Indonesia.

The ASEAN “Minerals Cooperation Action Plan 2011-2015” was presented at a conference on “Dynamic Mineral Sector Initiatives for a Prosperous ASEAN” held in Viet Nam in October 2011. Promoting environmentally and socially sustainable mineral development was one of three strategic pillars of the Plan.

Finally, the Intergovernmental Forum on Mining, Minerals and Sustainable Development was formed following the World Summit on Sustainable Development in Johannesburg in 2002. Within the context of the Forum, 45 member countries worked together to formulate a Mining Policy Framework which was presented to the United Nations in New York City in 2011. Members of the Forum include India, Kazakhstan, Kyrgyzstan, Mongolia, Philippines, Papua New Guinea and the Russian Federation.

CHAPTER 4

BEYOND POLICY: THE ROLE OF CIVIL SOCIETY, INTERNATIONAL ORGANIZATIONS AND INVESTORS

A. Overview

With regard to issues such as enhancing benefit sharing, mitigating adverse social and environmental impacts and creating a more inclusive and enabling environment for business and investment, civil society, international organizations and investors all have highly interconnected roles.

Civil society organizations (CSOs) have been instrumental in raising awareness on the social, environmental, economic, policy and governance issues outlined in previous chapters, and in particular, on the impacts these issues have. Many CSOs have developed important policy recommendations on how to manage these issues – targeting governments, investors and international organizations alike.

WWF, for example, has recognized mining as a potentially important sector in alleviating poverty and creating employment, and has therefore been working on policy and governance to enhance sustainability in the mining sector in Africa. In addition to its work on ESIAs (as mentioned above), it is enhancing planning and governance by assessing any overlaps between mining licenses and protected areas; identifying contradictions between oil and mining codes, environmental codes and forestry codes and their application; and by developing a land use map.³¹

Amnesty International has raised concerns about international treaties, in particular BITs and investment contracts and the stabilization clauses contained in these treaties and their implications for countries' ability to protect human rights, and highlighted the need for greater education of the human rights community on the growing relevance of foreign investment law to human rights (Peterson, 2006).

Transparency International and Revenue Watch have compiled substantial information on the impact of transparency and have recommended that governments and regulatory agencies consider the mandating of greater transparency of payments related to mining. Work by CSOs such as Publish What You Pay have given rise to significant international momentum on the uptake of transparency.

Transparency International has urged international rating agencies and risk analysts to include transparency measures in their risk evaluation models, while the International Accounting Standards Board requires companies to report key information

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³¹ For more information, see WWF website: Responsible extractive industries in the Green Heart of Africa: Balancing development needs and conservation of biodiversity. Available at: http://wwf.panda.org/what_we_do/where_we_work/congo_basin_forests/wwf_solutions/extractives

on a country-by-country basis and include information on anti- corruption programmes, organizational disclosure and country-level disclosure in their corporate responsibility reports (Transparency International, 2008).

Investors are concerned of many of the same ESG risks that worry civil society and governments in relation to the natural resources sector. Poor performance on addressing environmental and social issues can create significant reputational risks and costs both near the project site and internationally. Locally, this can limit a company's social license to operate and lead to conflicts with communities or governments that can delay or even stop projects, at great cost.

As a result, investors are increasingly pursuing more responsible investments and applying greater scrutiny to the social and environmental impacts of these investments. This is largely driven by socially minded investors and by increasing public pressure on investors to mitigate ESG risks. Investors who are serious about mitigating ESG risks want to see greater attention directed towards these issues in companies' investment analysis and decision-making, ownership policies, and business practices. Greater attention to ESG risks can only be observed through greater disclosure and transparency, which has become a high priority for investors. Investors are thus calling on companies to disclose more information on their activities through sustainability reports, and other initiatives like EITI. They also welcome efforts by stock exchanges to require greater transparency by listed companies.

International organizations such as the ILO, OECD and the World Bank have developed important standards, guidelines and safeguards that address many of the issues highlighted by civil society. A growing focus of both civil society and international organizations is on the role of the investment community in driving responsible business practices, especially in governance issues where other efforts have been less effective. International organizations such as the IFC have also been instrumental in driving this forward by, among others, promoting the Equator Principles and funding the development of enhanced stock market indices and financial instruments for sustainable investment. The United Nations PRI initiative also aims to raise awareness among investors on sustainable investment. These international initiatives are discussed in detail in section B below.

B. International instruments and initiatives driving corporate responsibility

1. Introduction

A number of voluntary international initiatives and instruments contribute to raising awareness and accountability of companies, foreign investors and governments on social, environmental and governance issues. In addition to several global initiatives, a number of industry-specific initiatives help increase the uptake of responsible business practices. This section examines issues associated with the implementation of and compliance with these voluntary international instruments, and assesses the extent to which they have had an impact.

The main general instruments driving corporate responsibility on various fronts are:

- Global Compact
- ISO 26000
- GRI – Oil and Gas Sector Supplement
- Guiding Principles
- OECD Guidelines for MNEs
- IFC Performance Standards

At the sector level, the following initiatives have driven greater corporate responsibility:

Extractives industry initiatives

- Publish what you Pay
- Extractives Industry Transparency Initiative
- Kimberly Process Certification Scheme (diamonds)

Forestry

- RSPO

Industry-driven initiatives

- IPIECA (oil and gas)
- ICM (mining)

Table 2 shows the main issues addressed by each of these instruments.

Table 2
Topics addressed by international corporate responsibility instruments

Instrument and issues addressed	Industry	Organizational Governance	Human Rights	Labour Practices	Environmental Management	Corruption and Fair Operating Practices	Biodiversity	Community Investment, Economic Development	Taxation	Transparency
Global Compact	All		√	√	√	√				
ISO 26000	All	√	√	√	√	√		√		
GRI Guidelines	All	√	√	√	√	√	√	√		√
Guiding Principles for Business and Human Rights	All		√	√						
OECD Guidelines for Multinational Enterprises	All	√	√	√	√	√			√	
IFC Performance Standards	All		√	√	√		√	√		
Publish What You Pay	Oil, Gas and Mining								√	√
Extractives Industry Transparency Initiative	Oil, Gas and Mining								√	√
Kimberly Process	Mining Diamonds		√							√
Round Table on Sustainable Palm Oil	Palm Oil		√	√	√		√	√		
IPIECA	Oil and Gas	√	√		√	√	√			
ICMM	Mining	√	√		√		√	√		√

These instruments are further described and analyzed in the sub-sections below.

2. General international instruments driving corporate responsibility

(a) *United Nations Global Compact*

The United Nations Global Compact (UNGC) is a global platform consisting of companies, development agencies, labour organizations and CSOs that commit to support ten fundamental principles in four issue areas: human rights, labour standards, the environment and anti-corruption. The primary purpose of the UNGC is to catalyse corporate commitment to these issues by inviting them to sign on to its principles and to embrace, support and enact, within their sphere of influence, its core values. Corporate participants are expected to integrate these principles into their business strategy, day-to-day operations and organizational culture, and to report on their progress in an annual “Communication on Progress” or public CSR or annual report.

Implementation in Asia-Pacific

In general, Asia accounts for 14% of all UNGC participants (figure 10). The UNGC has been relatively effective in capturing the attention of Asian and Pacific companies and particularly of companies in the oil and gas sector (table 3. Asia has the second highest number of business participants following Europe. China, India, Indonesia, Japan and the Republic of Korea have the highest number of signatories in the region. Local UNGC networks are fairly strong in Asia-Pacific, where 65% of companies indicate that they are involved with a Global Compact Local Network. Globally, 149 oil and gas companies, 34 mining companies and 108 forestry and paper companies have joined the UNGC signalling widespread recognition of the UNGC in the natural resources sector. In the region, participation of oil and gas companies in the UNGC is fairly good. However, in the mining sector, participation in the UNGC from businesses operating in China, Kazakhstan and the Russian Federation is relatively low considering the size of the mining sectors in those countries.

Figure 10
Participation in the UNGC by region, 2011 (all types of participants)

Source: United Nations Global Compact (2012).

Table 3
Number of businesses in selected Asian countries participating in UNGC, by country and sector

	Number of active* participants (of total participants)	Oil & Gas Producers*	Mining*	Forestry and Paper*
Australia	56 (75)	1	1	1
Bangladesh	20 (23)	0	0	0
China	127 (227)	5	1	5
India	91 (152)	8	1	0
Indonesia	34 (41)	0	1	4
Japan	210 (220)	5	0	5
Kazakhstan	11 (12)	1	0	0
Malaysia	34 (57)	1	0	1
Maldives	14 (14)	2	0	0
Nepal	2 (7)	0	0	0
New Zealand	3 (3)	0	0	0
Pakistan	39 (56)	3	0	1
Philippines	8 (13)	0	0	0
Republic of Korea	127 (155)	5	0	0
Russian Federation	28 (34)	3	0	0
Singapore	35 (51)	1	0	2
Sri Lanka	24 (28)	0	0	0
Thailand	22 (28)	4	0	0
Viet Nam	12 (26)	1	0	0
Total	897 (1,222)	40	4	19

Source: United Nations Global Compact website, www.unglobalcompact.org/participants/search (last accessed on 19 December 2013).

Note: * Only 'active' companies counted for sector related numbers, with active defined as having an "active COP status".

In the UNGC's annual implementation survey of signatories, more than 60% of companies indicated that the UNGC had significantly helped to improve their corporate responsibility policies and 28% of participating companies ranked their own implementation of the principles as 4 or 5 (on a scale of 1-5 with 5 indicating full implementation). Companies that have been longer involved with UNGC find it more helpful, which suggests that its benefits accrue over time.

The question arises what changes are companies making in implementation of the UNGC, and what impact do they have. At the policy level, companies are increasingly enacting policies designed to improve their performance in the areas of human rights, labour, the environment and anti-corruption (figure 11).

Figure 11
Extent of UNGC implementation by signatories

Source: United Nations Global Compact (2012)..

Unfortunately, these policies are not necessarily translating into action. Figure 12 shows the share of signatories actually taking action on these issues. The highest number of actions is in the area of environment followed by labour, human rights and finally anti-corruption. As the UNGC (2012) states, “while the majority of companies are putting policies in place, related actions to support implementation is conducted at significantly lower levels – showing a gap in moving from policy to action for all issue areas, as well as with subsidiaries and the supply chain..”

Figure 12
Share of signatories taking actions to advance the ten UNGC principles, 2011

Source: United Nations Global Compact (2012).

The UNGC (2011) concludes that: “A new level of corporate performance is needed to address key global challenges and deliver on the sustainability promise. This will involve increasing the scale and intensity of sustainability work globally – reaching companies that have yet to embrace corporate responsibility, motivating less advanced companies to deepen their commitment, and spurring front-runners to lead the way to the next generation of sustainability performance.”

The real question arises whether the voluntary nature of the UNGC gives companies sufficient incentive to improve their sustainability performance. Can governments support visibility of the UNGC and improve corporate performance by raising awareness through local networks, dissemination of relevant guidelines, and collaborating with state-owned or listed companies? Or would improvements be achieved more quickly if some of the voluntary principles were actually embedded into regulation? The latter may be more effective in the two areas where the UNGC is making less headway, i.e. human rights and corruption.

(b) Global Reporting Initiative’s Sustainability Reporting Guidelines

The Global Reporting Initiative (GRI) is a non-profit organization that provides a sustainability reporting framework for companies and organizations to help guide their disclosure on economic, environmental, social and governance performance. The number of companies publishing sustainability or CSR reports has risen significantly over the past few years, as well as the number of companies publishing reports that attempt to follow the GRI reporting framework. It can be very difficult to assess corporate performance and responsibility on these issues. Disclosure has thus assumed a high

level of importance in this area because it is seen to drive transparency and accountability.

Implementation in Asia

Globally, forestry and paper, mining, and oil and gas are the leading sectors in terms of reporting, and they are improving fast (figure 13).

Source: KPMG International Survey of Corporate Responsibility Reporting, 2011.

At the sectoral level, the number of natural resources related companies in Asia-Pacific that are reporting has increased significantly in the last few years (table 4).

Table 4
Number of sustainability reports submitted by Energy, Mining and Forestry and paper companies from selected Asian economies, 2007-2012

	2012	2011	2010	2009	2008	2007
Energy	55	49	35	29	19	10
Mining	26	14	10	12	9	2
Forestry and Paper	5	3	1	3	0	0

Source: Data compiled by author from GRI's Sustainability Disclosure Database: <http://database.globalreporting.org>, last accessed 19 December 2013.

Notes: (a) Data includes companies from China, India, Indonesia, Japan, Kazakhstan, Pakistan, Republic of Korea, Singapore, Thailand, and Turkey.

(b) Many 2012 reports will be completed during the course of 2013 and are not yet reflected in the 2012 figure.

GRI also issued sector supplements for mining and metals in 2002 and for oil and gas in 2012. The sector supplements provide additional guidance on the disclosure of material issues and performance indicators for the respective industries. For example, the Oil and Gas sector supplement urges disclosure of local content, indigenous groups, reporting on payments to governments, participation in EITI, the number of sites where biodiversity risks have been assessed, volume and disposal of produced water, volume of flared hydrocarbon, amount of drilling waste and operations where involuntary resettlement occurred, etc. Already 17 reports have been issued which make reference to the sector supplement of which four are from companies in Asia: Gazprom Neft, OAO Nizhnekamskneftkhim, and Bashneft (Russian Federation) and Reliance Industries Limited (India). Of the two reports available in English, i.e. of Gazprom Neft and Reliance Industries Limited, a limited number of the additional indicators were included, but the companies were able to report a generally good track record of support for communities and absence of major conflicts with indigenous groups.

GRI's Sustainability Disclosure Database, which tracks published reports, also indicates whether the submitted reports also referred to other voluntary frameworks such as the UNGC, OECD Guidelines for Multinationals, ISO 26000 and IFC performance standards. It thus gives some idea about the extent to which reporting companies are implementing these guidelines.

Among companies reporting in Asia, the UNGS and ISO 26000 are the most widely referenced instruments and energy companies refer to these instruments more often than mining or forestry companies (table 5).

Table 5
Number of sustainability or CSR reports in Asia 2007-2012 that make reference to voluntary CSR instruments

Energy Companies (172 reports)				
Country	UNGC	OECD	ISO 26000	IFC
China	I			
India	II			
Malaysia	I			II
Philippines	I			II
Republic of Korea	IIII IIII II	IIII	IIII I	
Thailand	IIII	II	IIII	I
Turkey	III			

Mining (60 reports)				
Country	UNGC	OECD	ISO 26000	IFC
China	II	I	III	
India	IIII	I		I
Japan	I			
Philippines	I			
Republic of Korea	I		I	I

Forestry and Paper (9 reports)				
Country	UNGC	OECD	ISO 26000	IFC
China			I	
Japan			I	

Source: Data compiled by author from GRI's Sustainability Disclosure Database, <http://database.globalreporting.org>.

Note: (a) Data in this table includes companies from China, India, Indonesia, Japan, Pakistan, Republic of Korea, Singapore, Thailand, and Turkey. It presents an overview reports over the years 2007-2012, thus in some cases including more than one report by the same company.

It is not always clear to what degree greater disclosure actually drives more responsible corporate behaviour. GRI's sustainability reporting framework focuses on disclosure, not performance. Generally, however, there is a high degree of association with good performance and high levels of disclosure (Clarkson et.al 2006), which is why the movement has gained so much momentum. So far, efforts made by Asian stock exchanges to encourage listed companies to report have been effective. The policy question thus becomes: how can governments build on this reporting trend and stimulate greater disclosure?

(c) ISO 26000

The ISO 26000 Standard on Guidance on Social Responsibility, released on 1 November 2010, distils a globally relevant understanding of what social responsibility is and what organizations need to do to operate in a socially responsible way. It lays out seven principles (accountability, transparency, ethical behaviour, and respect for stakeholders, the rule of law, international norms of behaviour and human rights) and seven subjects of social responsibility (organizational governance, human rights, labour practices, environmental management, fair operating practices, consumer issues, community investment and development) and emphasizes the importance of stakeholder engagement across all of them.

ISO 26000 differs from other ISO standards as it cannot be certified and has no enforcement or auditing mechanism. It was published after a lengthy global multi-stakeholder development process with the intent of providing guidance rather than requirements to help clarify what social responsibility is. Businesses and organizations translate principles into effective actions and guidance for implementation. Its seven principles and seven core subject areas build on international conventions and other

sustainable development and social responsibility initiatives, resulting in a comprehensive definition of social responsibility.

Implementation in Asia

Because of its non-certifiable nature, it is impossible to measure the number of companies and organizations applying this standard. Among energy, mining and forestry companies in Asia, 14 companies have referenced ISO 26000 in their CSR or sustainability reports. However, the degree to which their operations actually follow the guidelines, however, is difficult to know. A host of auditing firms and sustainability consulting organizations around the world such as Bureau Veritas, SGS, and CSR Asia, have developed services to assess a company's business practices against the ISO 26000 guidelines. Many companies, including CSR China, SGS, PECB and CSR Asia also offer training courses around the region. In Thailand, the Ministry of Energy offers low cost training on implementing the standard. The China Training Institute, in partnership with Business for Social Responsibility (BSR), has offered free training in China and governments in other countries may be doing this as well. Such initiatives signal a high level of interest in and awareness of the standard but do not provide concrete evidence of changes in organizational performance.

Another way to measure its influence is by observing the development of national standards modelled in reference to the guidance under the Standard. Austria has developed a national version to mandate actions recommended by the ISO 26000 standard. Denmark has referenced it in a national standard offering certification of a socially responsible management system, while Sweden has referenced it in developing a local government procurement standard (Entine, 2012). The Stock Exchange of Thailand has translated ISO 26000 into the Thai language and blended it with local principles to provide guidance to listed companies. In 2012, participants from 70 developing countries gathered in Geneva for a workshop on their experience with implementing and promoting the ISO 26000 guidelines. One of the objectives was to show how national standards bodies (NSBs) can further promote ISO 26000.

In 2012, The IIED published the first significant review of the impact of ISO 26000 and found the following:

"There are currently 11 countries with some kind of national sustainable development standard which appears to be based on ISO 26000. In 2012, China will not only have published its translation of ISO 26000, but will begin development of a family of social responsibility standards (Wang, 2011) that may be expected to show considerable influence of ISO 26000. At the inter-governmental level, ISO 26000 is showing itself to be influential in the formulation of positions of the NGO movement in preparation for the Rio+20 Conference. This is evident in, for example, the Bonn Declaration and the proposals of the Stakeholder Forum" (Henriques, 2012).

Although ISO 26000 is a voluntary standard, it is helping to broaden companies' understanding of social responsibility as a concept that goes beyond philanthropy and spans across seven principles and seven core subject. It is also raising awareness of

companies on the need to adopt social responsibility as a strategic issue. IIED concludes that while it is too early to measure its specific impacts, one key contribution of the standard has been to legitimize a broader definition of organizational responsibility by focusing on organizational governance that pays attention to sustainable development and to the interests of a wide range of stakeholders. The standard also has potential to broaden the accepted horizon of responsibility adopted by those companies that use it (Henriques, 2012).

ISO 26000's non-certifiable nature is seen by many as a limitation in securing concrete change. However, it has significantly advanced the mainstream understanding of CSR to include a much broader array of operational issues. Moreover, the impact it has on national legislation (voluntary and mandatory) is already significant. On the policy front, this is the area that can be built upon. Where this is not happening already, the ISO 26000 guidelines could be influential in helping expand and shape national guidelines and legislation in Asian and Pacific countries.

(d) *United Nations Guiding Principles on Business and Human Rights*

The Guiding Principles on Business and Human Rights, or Guiding Principles (GPs) in short, cover the duty of the state and the responsibility of businesses to “protect, respect and remedy” human rights violations. They were finalized in 2011 after a lengthy consultation process led by John Ruggie. Drawing on existing conventions such as the Universal Declaration of Human Rights and the ILO core conventions, the GPs go a step further to delineate the respective roles of the State and of private enterprises. For states, the GPs outline operational principles relating to five areas:

- (i) general state regulatory and policy functions;
- (ii) state-owned or controlled enterprises;
- (iii) supporting business respect for human rights in conflict-affected areas ;
- (iv) ensuring policy coherence;
- (v) ensuring access to remedy through state based and non-state based judicial and other grievance mechanisms.

For businesses, the GPs outline the expectation that businesses must respect human rights in their own operations and sphere of influence and also remedy violations.

Implementation in Asia

The GPs have attracted significant attention from companies, governments and NGOs alike. A host of implementation guidance documents have been produced for companies and governments as well as for other stakeholders. A report issued by Mazars based on a survey of mining companies listed on the London, Johannesburg, Toronto and Australian stock exchanges showed a positive response. It found that 94% of respondents agreed that they should take responsibility for compliance with human rights within their own organizations as well as those of their subcontractors. While 65% of respondents were working towards complying with GPs, only 55% of companies said

they were planning to implement human rights policies and procedures in the next two years. Of those companies, 37% said they were seeking to commission and publish an independent report evaluating their compliance with the human rights agenda (Mazars, 2012). John Ruggie was invited by the Association of International Petroleum Negotiators Conference to give a speech on incorporating the GPs in investor/state contract negotiations. He emphasized the significant and often underestimated financial costs to companies of losing their social license to operate and flagged three shortcomings in current contract negotiations: (i) a lack of awareness of human rights risks and therefore the absence of a plan to address these risks when they arise, including a clear delineation of the respective roles of companies and governments; (ii) the incidence of stabilization provisions in investment contracts that constrain governments' ability to develop proper non-discriminatory regulatory frameworks and submit governments to the threat of international arbitration; (iii) the lack of explicit and extensive references to the need for public and private security providers to be subject to international human rights standards. Improvements in these areas would help both reduce human rights abuses and reduce corporate risks with stakeholders.

The consulting firm INCAS produced a guide for assessing and implementing corporate compliance with the GPs.³² Its "risk-based" approach to helping companies reduce their risk is indicative of one of the key drivers of corporate uptake of the GPs. IPIECA, the oil and gas industry association for environmental and social issues has produced a somewhat similar "due diligence" guide for companies: the Human Rights Due Diligence Process.³³ The Institute for Human Rights and Business is has developed additional guidance on corporate responsibility to respect human rights under the GPs for the oil and gas sector (one of three sectors for which additional guidance was prepared).³⁴ Rio Tinto has produced, and made public, a detailed resource guide for integrating human rights into communities and social performance work at Rio Tinto.³⁵ The guide includes 12 case studies, eight of which are from Asia.

Thus, while it is still early to assess the full impact of the GPs, these developments suggest that they have a positive impact on raising the level of corporate awareness and sense of accountability on human rights. Of course, the GPs are not directed only at companies but also at states. In that regard, more work can be done to help states operationalize policies and practices across the five main areas mentioned above. Companies may certainly feel the pressure to improve their level of responsibility on this topic but, as the GPs make clear, much of the responsibility on this topic will have to come from states through appropriate regulations that ensure that the human rights abuses are not committed in association with SOEs, that policies are coherent and that functioning grievance mechanisms are in place.

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³² See: <http://www.business-humanrights.org/media/documents/incas-guiding-principles-guide-2012.pdf>.

³³ See: http://www.ipieca.org/sites/default/files/publications/Due_Diligence.pdf.

³⁴ See: <http://www.ihrb.org/project/eu-sector-guidance/draft-guidance-consultation.html>.

³⁵ See: http://www.riotinto.com/documents/ReportsPublications/Rio_Tinto_human_rights_guide_-_English_version.pdf.

(e) OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises are a set of far-reaching recommendations for responsible business conduct. They were drafted by 44 adhering governments (34 OECD members plus 8 others) to provide guidelines for TNCs operating in their countries. They cover all major areas of business ethics, and advise companies to obey the law, observe internationally recognized standards and respond to other expectations from society. Importantly, they seek to protect human rights and foster good governance through recommendations on anti-corruption, transparency, disclosure and taxation. While the Guidelines are not legally binding, companies are expected to adhere to them. Originally drafted in 1976, the Guidelines have been updated a number of times, most recently in 2011. The only adhering countries in the Asia-Pacific region are those who are members of OECD, namely Australia, Japan, New Zealand, Republic of Korea and Turkey.

National Contact Points (NCPs) in each adhering country bear the onus of addressing complaints and of holding companies accountable. A key implementation tool for the Guidelines is the, NCPs are government-run offices in signatory countries which are responsible for encouraging observance of the guidelines and promoting and explaining them to the business community, workers and other stakeholders.

Implementation

Many extractives and agribusiness companies operating globally have committed themselves to adhere to the OECD Guidelines and have followed the Guidelines in their operations around the globe. A number of implementation tools and additional guidance documents have also been produced by the OECD as well as by third parties.

However, some CSOs have strongly criticized the Guidelines for failing to ensure greater enforcement, largely due to weaknesses of the NCPs and of the mechanisms to enforce the decisions of NCPs (OECD Watch, 2011).³⁶ In its report “10 Years On”, OECD Watch (2010), a network of 80 NGOs from 45 countries, assessed the effectiveness of the Guidelines and found that lack of political will, lack of sanctioning powers and lack of coherent implementation have significantly diminished the potential value of the instrument. Specifically, Joseph Wilde-Ramsing of OECD Watch said:

"Only 5 of the 96 cases filed by NGOs have resulted in real improvements in corporate behaviour. In another 10 cases, National Contact Points have made useful recommendations to improve business conduct, but these have ultimately not materialized in concrete improvements. The remaining 84% of cases have failed to make any significant contribution to resolving the conflict".³⁷

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³⁶ For an example of complaints against NCPs in the Asia-Pacific region, see: <http://www.earthrights.org/publication/governance-gap-failure-korean-government-hold-korean-corporations-accountable-oecd-guide>

³⁷ http://www.foeeurope.org/press/2010/Jun30_make_or_break_for_oecd_guidelines.html.

This raises the issue that, as with other instruments, weak or non-existent enforcement mechanisms hinder the effectiveness of the well thought-out Guidelines. In order to enhance their impact, some provisions could be made legally binding, by incorporating them in national regulations, or linking them to contracts or licenses. This could make particularly sense for provisions addressing more common problems such as human rights violations.

(f) International Financial Corporation Performance Standards and Equator Principles

The IFC Performance Standards (PS) defines clients' responsibilities for managing their environmental and social risks throughout the life cycle of an investment funded by IFC. They include eight performance standards addressing the main social and environmental risks and impacts that can arise from operations and provide guidance on how to identify risks and impacts. They are designed to help avoid, mitigate, and manage risks and impacts as a way of doing business in a sustainable way, including stakeholder engagement and disclosure obligations of the client in relation to project-level activities. By holding companies accountable to these standards, they are a powerful lever in shaping the business practices of companies that have sought funding from the IFC. They have been influential outside of the IFC as well since they have provided the foundation for the Equator Principles (EPs), a set of responsible lending principles launched in 2003 and voluntarily adopted by banks and financial institutions in order to help them identify, assess, and manage environmental and social risks and impacts in project finance.³⁸

Implementation

Meeting IFC's performance standards over the life of the project is required of all projects that go through IFC's credit review. Still, perfect application of the standards is not easy. A 2009 internal review of IFC's application of the PS notes that social development issues, such as consultation with affected communities, broad community support, project level disclosure, resettlement, labour issues and retrenchment policies, and human rights, are among the main challenges (IFC, 2009). These challenges are common in extractives projects.

What is the impact of the PS? While a public assessment of the revised PS is not yet available, the 2009 review suggests that the main project level impacts are from those PS that are triggered most frequently: PS 1-4 (which relate to labour standards, climate change, greenhouse gas emissions, community health, safety, security). In these areas, the IFC has an opportunity to manage risks and create benefits from projects.

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³⁸ The Equator Principles are a credit risk management framework for determining, assessing and managing environmental and social risk in project finance transactions. Project finance is often used to fund the development and construction of major infrastructure and industrial projects. The EPs are adopted by financial institutions and are applied where total project capital costs exceed US\$10 million.

IFC also applies the PS to investments made through financial intermediaries and funds, where they are generally seen as helpful. In its three year review of the PS, “over 80 percent of survey respondents from among the FI subset think that a Social and Environmental Management System (SEMS) in their institutions help them better understand risks in their portfolios. About 85 percent of respondents consider an SEMS useful for gaining better access to international finance, and almost 60 percent see it as having a positive impact on their brand name and value” (IFC, 2009).

An important aspect of the PS is its broader impact on global financial markets via the EPs. These have been adopted by 80 financial institutions from 33 countries - covering over 70% of international project finance debt in emerging markets. However, they have not yet been adopted by many Asia-Pacific banks. Only four Australian institutions, two Japanese institutions and one Chinese institution have become members. The IFC PS have also been used as “best practice” guidance by companies that consider themselves to be leaders in the CSR field, particularly companies in high impact, high risk operations such as extractives, agribusiness and forestry.

(g) Principles of Responsible Investment

The Principles of Responsible Investment (PRI) are another similar initiative aimed at encouraging investors to scrutinize social and environmental implications of their investment decisions. The PRI provide guidance on a number of possible actions for incorporating ESG issues into investment practices across asset classes. Investment managers, asset owners and professional service partners are invited to become signatories to the PRI. While the number of signatories globally is notable, in Asia-Pacific it is still quite low (table 6).

Table 6
Financial institutions in Asia and the Pacific that are signatories to the PRI

Economy	Total number of signatories	Asset owner signatories	<i>Of which:</i> Investment Manager signatories	Professional service provider signatories
Australia	124	34	77	13
China	3	0	2	1
Hong Kong, China	9	0	6	3
India	3	0	1	2
Indonesia	3	1	1	1
Japan	29	6	18	5
Malaysia	1	0	1	0
New Zealand	17	9	8	0
Singapore	5	0	4	1
Republic of Korea	9	1	4	4

Thailand	1	0	1	0
Turkey	5	0	4	1
Viet Nam	2	0	2	0
Total Asia-Pacific	211	51	129	31
Total WORLD	1229	277	774	178
% Asia of World	17%	18%	17%	17%

Source: PRI website: <http://www.unpri.org/signatories/signatories/>, accessed 18 December 2013.

The Performance Standards, Equator Principles and Principles of Responsible Investment are three examples of initiatives that recognize the important role that banks and investors can have in requiring or encouraging better business practices. This role is powerful and should be expanded where possible.

3. Industry-specific initiatives driving corporate responsibility

Global attention to the “resource curse” has led to a number of initiatives specifically focused on the extractives and other natural resources based industries. Some have been initiated by civil society, while others represent efforts by industry associations themselves to address these issues.

(a) *Publish What You Pay and the Extractives Industry Transparency Initiative*

Two of the most interesting and arguably most effective civil society driven initiatives targeting the extractives sector are Publish What You Pay (PWYP) and the Extractives Industry Transparency Initiative (EITI). PWYP is a global campaign led by a network of CSOs that in 2002 began calling for extractives companies to publish what they pay. It emerged in response to evidence that the lack of such information enabled embezzlement and mismanagement of oil revenues by elites. It has since been working to enhance revenue transparency in the oil, gas and mining sector by urging multinational, private and state-owned extractives companies to publish net figures covering all types of payments (royalties, taxes, bonuses, etc.) made to governments for every country of operation in their annual financial accounts as well as the level of government to which payments are made. It also calls for governments to publish the payments they receive and finally for governments of OECD countries, bilateral and multilateral institutions to require companies to follow these disclosure guidelines. Its advocacy focuses on supporting the EITI but, recognizing the limitation of voluntary measures, it also advocates mandatory measures to enhance transparency such as stock market listing regulations, international accounting standards, contracts transparency, lending requirements of IFIs, export credit agencies and the protection of activists. It also does capacity building to empower local groups to contribute to policy debates in demanding greater transparency.

The experience of PWYP found that an international multilateral approach targeting both companies and governments was needed, giving rise to EITI. It is a global standard for ensuring transparency of payments from natural resources. It is based on

tripartite action of companies, governments and civil society whereby companies publish what they pay and governments publish what they receive in a joint report allowing for independent audits. In order to compare corporate payments to government receipts, EITI requires (i) regular publication of all payments by oil, gas and mining companies to governments and all revenues received by governments from oil, gas and mining companies; (ii) payments and revenues to be subjected to independent audits; and (iii) reconciliation of discrepancies by a credible, independent administrator whose report is published as part of efforts to contribute to the public debate and making improvements in this area.

Implementation

EITI has become the primary global standard for revenue transparency in the sector. To date, 32 countries have produced EITI reports covering government revenues of \$960 billion. Of these, 20 countries are compliant with the EITI standard meaning that their reports have completed EITI validation. More than 900 companies have participated in this reporting process, while 70 major oil, gas and mining companies have chosen to become EITI supporting companies. In Asia-Pacific, Afghanistan, Azerbaijan, Mongolia, Kazakhstan and Kyrgyzstan have submitted reports, while Australia and Myanmar have committed to doing so.

How well is EITI working? In the Asia-Pacific region, several countries are participating. Azerbaijan, Kyrgyzstan and Mongolia have been designated as EITI compliant countries, in other words their financial reporting meets EITI's standards. In Azerbaijan, BP has supported the Initiative, which it views as "a means to the end – and not the end in itself", according to Richard Paniguan, BP's group Vice President for Africa, Middle East, Russian Federation and the Caspian Region. In BP's view, the extent to which the development benefits that go along with transparency can be realized largely depends on the capacity of host governments (IPIECA case study).

If one assumes that a smaller discrepancy between company payments and government receipts signal improvements in transparency, then the Initiative has a positive impact. In Mongolia, for example, the first EITI report in 2006 showed a discrepancy of over \$83 million, but by 2011 this was down to \$59,000 (see case study of Mongolia in chapter 5). Still, the Initiative is a work in progress and many options to improve its effectiveness are being explored. One suggestion is to incorporate EITI provisions into project lending terms. This would allow financing to be withheld if EITI commitments are not met by the companies. Many companies currently oppose the move to disclose their payments (IPIECA case study), but as the voluntary nature of EITI was important in launching the Initiative, incorporation of EITI provisions in project lending terms and operating licenses could have a significant impact on sustainable and responsible behaviour of companies.

In their report “Promoting Revenue Transparency”, Transparency International and Resource Watch analysed 44 companies out of which 18 supported EITI.³⁹ It finds that companies that support EITI performed, on average, 46% better on transparency than companies that do not. Among national oil companies, the difference is even greater. On organizational disclosure of partners and subsidiaries, supporters of EITI scored 25% better than non-EITI supporters (80% compared to 55%). Finally, with regard to country level disclosure of financial data, transfers to governments and operating data, EITI supporters scored more than twice as well as non-EITI supporters (22% versus 10%) (Kowalczyk-Hoyer, 2011). This suggests that EITI makes a difference on transparency. Governments should be encouraged to prepare EITI reports and may need assistance putting in place the accounting mechanisms to enable them to manage the financial aspects of natural resource extraction in a transparent manner.

(b) *Kimberly Process Certification Scheme*

The Kimberly Process Certification Scheme (KPCS) for diamonds is a unique, intergovernmental system of collaboration to ensure conflict free standards in the origin of diamonds. It emerged in efforts to curb “conflict diamonds” and ensure that diamond purchases were not financing violence by rebel movements and their allies seeking to undermine legitimate governments. It was introduced by a United Nations General Assembly resolution and established in 2003 as an international certification scheme for rough diamonds. Participating states must certify all shipments of rough diamonds as “conflict-free” and prevent conflict diamonds from entering into legitimate trade. To do this, participants must establish relevant institutions and put in place relevant national legislation as well as export, import and internal controls on diamonds. They must also commit to transparency and the exchange of statistical data. Participants can only legally trade with other participants who have also met the minimum requirements of the scheme and international shipments of diamonds must be accompanied by a KPCS certificate guaranteeing that they are conflict-free. Many Asian countries have signed on as participants including Bangladesh, Cambodia, China, India, Indonesia, Kazakhstan, Russian Federation, Singapore, Sri Lanka, Thailand and Viet Nam. Working groups on monitoring, technical aspects and statistics monitor the performance of each participant, review issues of implementation and diamond trade statistics. The internal review conducted after three years found that the KPSC was broadly effective in curbing the sale of conflict diamonds and the scheme is hailed as global cooperation at its best.

Some exceptions clearly stand out, such as Cote d’Ivoire which found that conflict diamonds were sold illegally with no repercussions. Since 2009, several founding members of the KPSC have withdrawn. Ian Smilie of the Canadian NGO Partnership Africa Canada (PAC) who was one of the founding members, Dr. André Jackson,

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³⁹ Signatories to EITI among oil companies are assessed, analysed and reviewed in the questionnaire which addresses three requirements: reporting on anti-corruption programmes according to the United Nations Compact’s tenth principle on corruption; organizational disclosure of structure, operations, partnerships, financial data; and country level disclosure on technical and financial issues. Results are broken down by region, so the report presents a view of how Asian companies are performing.

Chairman of the African Diamond Producers Association and member of African Diamond Council, and Global Witness, an NGO involved in founding the scheme have all withdrawn their participation and support for the scheme citing major failures in its process and its ability to stem violence in counties like Angola, Zimbabwe, Côte d'Ivoire and Venezuela.⁴⁰

Although this particular initiative is focused on Africa, the model of international, intergovernmental cooperation could offer valuable insights on how to improve human rights and security and avoid conflict associated with other natural resources in Asia-Pacific.

(c) Round Table on Responsible Palm Oil

The Round Table on Responsible Palm Oil (RSPO) is an international multi-stakeholder organization and certification scheme, established in 2004, for the production and use of sustainable palm oil. It is working towards transforming the market to make sustainable business practices the norm. The RSPO principles and criteria are the global guidelines for sustainable palm oil production. The eight principles relate to transparency, compliance, long-term economic and financial viability, use of best practices, environmental responsibility, respect for employees and communities, responsible development of new plantings and a commitment to continuous improvement. The certification scheme ensures that certified palm oil has been produced according to the RSPO principles, and signals that the producer is committed to sustainable production practices. Producers are certified by accredited agencies after verification of the production process. Along the supply chain, each facility that processes or uses certified oil should be certified to ensure traceability.

While not perfect, RSPO is widely viewed as having had a significant positive influence on the industry by helping to promote better business practices. Some criticisms have nevertheless emerged. On the one hand, some palm oil companies say the criteria are costly to adopt and therefore discriminatory, while on the other hand, environmental critics argue that the bar for sustainable palm oil is too low, and producers can claim “membership” even if they aren’t RSPO certified across all their holdings.⁴¹ Nevertheless, after ten years, about 12% of global production of palm oil is now RSPO certified. Upstream establishments have also increased production of certified palm oil and between 2009 and 2011 market supply grew by 250% while sales grew by about 620%.⁴² An interesting aspect of RSPO’s strategy for increasing uptake in two of the largest importing countries of palm oil in the world, China and India, involves engaging in open channels of communication with the Government, civil society and traders.

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⁴⁰ http://en.wikipedia.org/wiki/Kimberley_Process_Certification_Scheme#cite_note-Failed-33.

⁴¹ Mongabay (2012). Roundtable on Sustainable Palm Oil hits 10 year mark, 4 October 2012. Available from: <http://news.mongabay.com/2012/1004-hance-interview-webber.html>.

⁴² 2011 RSPO CSPO Growth Interpretation Narrative: http://www.rspo.org/files/pdf/2011%20RSPO%20CSPO%20GIN_web.pdf.

The “Prospects and Challenges of Sustainable Palm Oil for China” project makes an interesting link between voluntary certification schemes and national policy that may offer some broader insights for policy development. Under the auspices of the China-United Kingdom Sustainable Development Dialogue (SDD), a project was initiated in July 2010 sponsored by the United Kingdom Department of Environment and Rural Affairs (DEFRA) the United Kingdom Department for International Development and supported by the Department of WTO Affairs of the Ministry of Commerce. The project is implemented by the China Chamber of Commerce for Import & Export of Foodstuffs, Native Produce & Animal By-Products (CFNA), which provides policy suggestions to the Government of China on promoting production and use of sustainable palm oil in China.⁴³ It makes five policy recommendations:

- (i) Establish a national policy objective to import and utilize only sustainable palm oil;
- (ii) Establish a Chinese market-based sustainability certification standard for palm oil traders, food processors, and industrial users;
- (iii) Support domestic awareness raising and demand for sustainable palm oil;
- (iv) Issue guidelines on governing environment and sustainable development requirements for Chinese overseas investment and operations of Chinese enterprises abroad;
- (v) Initiate an international cooperation programme to address China’s expanding ecological footprint related to estate crop commodity imports.

Though the precise value of each of these recommendations could be debatable, they are a good starting point for discussion on how national governments can build upon existing instruments such as RSPO that attempt to transform commodity markets. Certifications schemes like RSPO and the Forest Stewardship Council that aim to provide guarantees that the products were produced in a responsible manner are processes that national governments could incentivize domestically. Alternatively they should develop their own national initiatives.

(d) World Commission on Dams Report

Though not an initiative or instrument, *per se*, the World Commission on Dams was set up by the World Bank and IUCN in 1998 with the mandate of reviewing the development effectiveness of large dams, assessing alternatives and developing practical guidelines for decision making.⁴⁴ The Commission produced a report that included a number of guidelines, key recommendations for a new policy framework and several additional recommendations for implementing effective policy to help manage the social and environmental impacts of dams (World Commission on Dams, 2000). Given the limited number of standards and initiatives relating specifically to

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⁴³ For more information, see:

http://www.rspo.org/file/Prospects_and_Challenges_of_Sustainable_Palm_Oil_for_China.pdf.

⁴⁴ http://wwf.panda.org/what_we_do/footprint/water/dams_initiative/dams/wcd.

hydropower, they are still considered to constitute the leading guidelines for sustainable hydropower projects.

4. Industry-driven initiatives on corporate responsibility

In many cases, industry associations have taken a proactive role in addressing the negative social and environmental impacts caused by their own industries with some making valuable contributions to corporate responsibility.

(a) *The Global Oil and Gas Industry Association for Environmental and Social Issues*

The Global Oil and Gas Industry Association for Environmental and Social Issues (IPIECA) was formed in 1974 following the launch of the United Nations Environment Programme (UNEP) and has a membership of 32 of the world's largest oil and gas companies including those involved in upstream and downstream operations, representing over half of world's oil and gas production. IPIECA promotes good practices in the industry through a vast array of guidance documents on over 50 specific social and environmental issues including biodiversity, climate change, human rights, etc. It also serves as a platform for collaboration between other industry players and key stakeholders such as United Nations agencies and other international organizations. Much of its work is carried out by specialist working groups to address biodiversity, climate change, health, oil spill preparedness, operations and fuels, reporting, social responsibility and water.

The guidance documents and other relevant work carried out by the working groups are quite valuable. They have essentially developed guidance on all topics relevant to operating in a socially and environmentally responsible way, as well as a wealth of case studies of companies that have managed to do a good job addressing issues such as biodiversity management, social investment, enhancing transparency, etc. Also, 84% of IPIECA's member companies have produced sustainability reports in the last few years, signalling a growing attention to transparency by the major players in the industry.

IPIECA's extensive guidance documents are likely underutilized by non-members. Governments and United Nations agencies can encourage closer adherence to this guidance at the project level.

(b) *International Council on Mining and Metals*

The International Council on Mining and Metals (ICMM) is another industry initiative that was launched in 2001 to represent the world's leading mining companies and help them advance their commitment to sustainable development. Its members include 22 major companies and 34 mining associations and it operates under a leadership council formed by the CEOs of member companies.

ICMM has done some interesting work. For instance, as a result of work done with the IIED, it developed a Sustainable Development Framework that commits its

members to integrating a set of ten principles into their corporate policy and set up transparent, accountable reporting. The principles relate to ethical business standards, sustainable development, human rights, health and safety, environmental protection, biodiversity, etc.

In 2010, it launched a “Partnership for Development” initiative that commits its members to forging partnerships with governments, NGOs, donors and international organizations. This builds on the Resource Endowment Initiative, done partly in collaboration with UNCTAD and the World Bank, which found that multi-stakeholder partnerships can be instrumental in deepening mining’s social and economic contributions and avoiding the “resource curse.” The IIED has called this a “potentially important initiative linking resource extraction to sustainable development, given the scale and number of ICMM members”.⁴⁵ One outcome is a Partnership for Development Toolkit, designed to measure the contribution of mining to development. The toolkit was applied in Lao People’s Democratic Republic (see box 10). The assessment provides a snapshot of the social and economic impacts of mining operations in the country, but appears to have done little to improve mining policy aimed at promoting sustainability.

In 2012, the ICMM launched a publication series on the mining sector’s contribution to sustainable development which includes a preliminary Mining Contribution Index (MCI) which is designed to fuel discussion and collect data on the contribution of mining to national economies.

Most of ICMM’s member companies have submitted sustainability reports following GRI’s G3 guidance at the A+ application level of disclosure while 18 companies have sought external assurance.

Box 10. ICMM Country Case Study: Lao People’s Democratic Republic – An assessment of mining’s economic and social impacts

In late 2011, the ICMM launched a Partnerships for Development Toolkit designed to provide a systematic approach to measuring the mining sector’s positive and negative economic and social contribution to a country using quantitative and qualitative methods. The first country to apply the toolkit was Lao People’s Democratic Republic (although several countries used an earlier version). The study was funded by MMG, owner of the largest mine in the country and written by Oxford Policy Management (OPM) with support from the National Economic Research Institute (NERI), economic staff from the National University of Lao People’s Democratic Republic, and Earth Systems Lao (ESL). The findings were presented at a February 2011 workshop in Vientiane hosted by the Government of Lao People’s Democratic Republic and ICMM.

Findings

The report provides a snapshot of the mining sector’s contribution to development outcomes at both local and national levels. It focuses primarily on the two biggest mines in the

⁴⁵ <http://shapingsustainablemarkets.iied.org/icmm-partnerships-development> .

country: the PBM Phu Kham copper-gold mine operated by Australian PanAust Ltd.; and the MMG Sepon gold and copper mine owned by MMG and Government of Lao People's Democratic Republic (10%), which together account for over 90% of total national mining production.

At the national level, it found that mining is responsible for 80% of FDI in the country, 45% of total exports, 12% of government revenues and 10% of national income. At the local level, it assessed the increases in incomes and employment along with other socio-economic impacts on people in villages surrounding the mines and found that while increases in income and employment were positive, many socio-economic development indicators still lagged behind. It noted the important role of local preference in hiring workers and efforts to procure goods and services from within Lao People's Democratic Republic in helping to ensure local economic benefits but suggested that the Government would need to put in place parallel policies beyond those applied to the mining sector to generate greater benefits from investments in this sector. It also assessed macroeconomic factors, and analysed the impact of mining on governance structures, institutions and policies.

The study found that benefits at the national level were complemented by those at the local level, more so than in some other countries with a large mining sector. On the policy front, it found that the clearest need was to improve the wider business environment so that local firms can respond to business opportunities to supply the mines with goods and services, and build a competitive basis to supply other firms within the country.

Discussion

An assessment of the role of mining in a country's economy and development is a valuable tool that can positively inform policy-makers and contract negotiators. The ICMM assessment model considers only the social and economic impacts of mining (in sharp contrast to other tools that include environmental factors) and thus falls short of assessing the full impact of mining. At the same time, while it outlines several policy challenges, it is not clear to what extent the findings have influenced national policies or development strategies.

The industry-driven nature of this study may be a limitation in its ability to influence policy. It would be good to see detailed assessments done systematically in all countries that are heavily dependent on natural resources, driven internally or with independent support, to ensure that they are credible and mainstreamed into policy decision making.

(c) Other industry associations

A few other industry associations have also developed standards and protocols to encourage more responsible business practices. For instance, the World Gold Council developed a conflict-free gold standard for its members that aims to establish a mechanism by which gold producers can assess and provide assurance that their gold has been extracted in a manner that does not cause, support or benefit unlawful armed conflict or contribute to serious human rights abuses or breaches of international humanitarian law. The standard establishes criteria that gold mining companies must follow in regards to conflict assessment, company assessment, commodity assessment,

externally sourced gold assessment and a management statement of conformance. Conformance with the Standard must be externally assured. The standard was developed with input from stakeholders and with reference to relevant international standards and guidance developed by the OECD, United Nations, GRI, and others. It also provides in-depth operational guidance on issues addressed by the OECD Gold Supplement intended to help the mining sector establish processes to mitigate and manage areas of conflict. Its effectiveness will rest on whether and the extent to which companies implement the standard.

Finally, the International Hydropower Association has collaborated with a number of partners, including development organizations and NGOs, to produce the “Hydropower Sustainability Assessment Protocol”. The Protocol is an assessment tool intended to measure and assess the sustainability of hydropower projects against internationally accepted criteria during the 4 main stages of a project, and provides a series of scores to the project against 19 sustainability issues. Seven assessments have been undertaken since the release of the Protocol in 2010, but only one pilot assessment is available in the public domain, the Trevallyn Hydropower Project in Australia. The impact or credibility of the Protocol is not clear. It has been criticized by the civil society organization, International Rivers, for being overly industry-driven and for the exclusion of some dam-affected people in its preparation.

5. Major achievements, limitations, constraints and policy implications

Voluntary instruments no doubt help advance responsible business practices, transparency and accountability, but they are not going far enough. They set clear expectations and standards and provide a wealth of implementation guidance that can be promoted by the United Nations and governments. A major constraint is that voluntary instruments have no enforcement power and, in most cases, only very weak tools to penalize non-compliance. As a result, all too often businesses do not follow them, especially when competitors do not either. Cases of unacceptable human rights abuses, corruption and environmental mismanagement are still commonplace and development indicators of communities located in areas with natural resource wealth still show gaps with indicators of the population at large. Voluntary instruments are the most effective with the biggest, most globalized and high visibility companies. They are particularly effective in cases where companies feel pressure and scrutiny from financial stakeholders, host governments or home governments. However, many of the smaller, lesser-known TNCs are able to fall through the cracks, facilitated in part by Asian financial institutions that are less concerned about these issues.

What does this mean for policy? Governments can build on these initiatives in a number of ways. They can raise awareness on and promote compliance with these initiatives among both foreign and local companies in their own markets. For example, they can promote local Global Compact networks. They can further disseminate the practical implementation guidance provided by the UNGC, GRI, IPIECA and ICMM, RSPO

and the World Commission on Dams among companies operating in their territories – either directly, via stock exchanges or in the investment contract negotiation process.

Setting an example sends a strong message, thus governments can take steps to ensure that the standards and guidelines are being followed by their own SOEs. However, while voluntary compliance may be effective in some countries, it may be impossible to achieve in others (for instance as is the case with EITI in China). As a result, there is a trend to incorporate international instruments into national legislation. This is particularly the case for ISO 26000. In cases where voluntary compliance is problematic, governments may want to consider this option – particularly on issues where voluntary guidance is making less headway such as human rights and corruption. The choice whether to opt for national regulation or voluntary participation in global initiatives will depend on the specific circumstances, which vary widely between countries and the types of investment. Changes in the listing requirements for natural resource companies on national stock exchange in Hong Kong, China; the United States and currently also the European Union are driving increases in transparency and accountability, drawing in many cases on the priorities set by international initiatives. Where initiatives can be joined by countries themselves – such as EITI – governments should do so!

Countries need reliable information on the impacts of FDI on their territories and populations, and should thus consider conducting detailed assessments – alone or with the support of civil society and (financial) support of key industries. Finally, governments should pressure financial institutions operating in their territories to sign on to responsible investment principles such as the Equator Principles and UNPRI.

CHAPTER 5

CASE STUDIES

A. Mongolia: efforts to enact strong mining regulation against a backdrop of challenges

1. Overview

Mongolia is one of the new great economic frontiers. It is a vast country of merely 2.8 million people, with immense barren landscapes of the Gobi desert and Mongolian steppe. However, below the surface, it has significant copper, gold and coal deposits that have attracted significant inflows of FDI. It also has an interested neighbour, China, in these deposits.

Over the last few years, Mongolia has been one of fastest growing economies in the world. Its 2011, its economic growth rate jumped from 6.5% in 2010 to 17.5% in 2011 as a result of a few major investments in mining. Indeed, major mining investments have dominated FDI in Mongolia. The largest of these is investment in the Oyu Tolgoi copper-gold mine, currently being constructed in the Gobi desert. It is expected to be one of the biggest mines in the world, and represents a total projected investment of over \$10 billion. Canadian-owned Ivanhoe Mining began investing in Oyu Tolgoi in 2001 and established a partnership with Rio Tinto in 2006, who has since taken over majority ownership of the mine. In 2009, the Government of Mongolia, Rio Tinto and Ivanhoe Mines signed the Oyu Tolgoi Investment Agreement, setting the Government's stake at 34% and fixing a royalty rate of 5% over the life of the agreement. It also specified that new laws passed subsequent to signing the agreement would not apply to Oyu Tolgoi. It was seen as a landmark agreement setting the country on a growth path driven by massive inflows of FDI.

Yet despite all this growth, Mongolia is still a largely poor country. Over a third of its population lives below the poverty line and 22% live on less than \$1.25 a day (UNDP, 2013). Roughly a third of its inhabitants are nomadic herders in the steppes who depend on their livestock. It thus faces the familiar dual challenge of attracting FDI while protecting the environment and converting the wealth obtained from FDI to development.

Recognizing the need to address these challenges, President Tsakhiagiin Elbegdorj suspended the issuance and processing of both mining and exploration licenses in 2010, until comprehensive revisions could be made to the existing mining law. The decision was endorsed by the National Security Council and by Parliament, which resolved to extend the suspension in 2010, 2011 and 2012. The working group on the revision was expanded to include parliamentarians, government officials and

experts and began to work under the auspices of the presidential office starting in 2011 (Jargalsaikhany, 2013). This process is ongoing and current progress is discussed below.

2. Challenges hindering development

Whether or not the mining law can address all of these challenges, it needs to address several weaknesses such as tightening environmental and social safeguards, establishing a more participatory process and fostering local content. Meanwhile, corruption and politicization of the law-making process threaten to undermine progress. Some of these challenges are discussed in greater detail below.

(a) *Environmental protection and resettlement*

Water availability and the livelihoods of herders are among the country's top concerns. Local civil society claims that the environment and human rights have not been properly safeguarded. The day after the Oyu Tolgoi Investment Agreement was signed, MiningWatch Canada and Britain's Rights and Accountability in Development (RAID) helped the Mongolian organization OT Watch file complaints to the OECD Guidelines NCPs in Canada and the United Kingdom. They claimed the companies had not carried out a sufficient EIA and water study and feared that the mine would reduce the quality and availability of water, threaten wildlife and biodiversity in the area, and decrease pastures which provide the livelihoods for country's traditional nomadic population (MiningWatch Canada, 2010). Amid protests, Mongolian NGOs also appealed to John Ruggie, the United Nations Special Representative on Business and Human Rights at the time, asking him to urge the Government to require Rio Tinto to complete a more thorough EIA and water study and review the benefits sharing aspects of the Investment Agreement. They claimed that the technical and economic feasibility study had not been passed by the Mineral Expert Council, the body responsible for approving mining projects (Mines and Communities, 2010).

Both Ivanhoe and Rio Tinto responded in writing to the NCPs asserting that the claims against them were unfounded. After reviewing the evidence, the NCPs decided that the environmental assessments were complete and of high quality, and dropped the case. This spurred criticism by civil society about shortcomings and inconsistencies in the NCPs' response.

In 2012, a group of herders filed a complaint with the World Bank Group's Compliance Advisory and Ombudsman (CAO) just as the IFC and MIGA were considering a financing package of \$900 million in loans and up to \$1 billion in political risk insurance. Representing the herders, OT Watch claimed that they had not granted free prior and informed consent, had been forced to resettle and had not been sufficiently compensated. It urged the World Bank Group to withhold financial support unless herders were properly compensated (Mines and Communities, 2012).

Whether or not the EIA, water assessment and resettlement practices were up to international standards, it was the perception of local communities that they were

not. This led them to protest and reach out for support which put Ivanhoe's and Rio Tinto's reputation and international financing and insurance at risk. At a minimum, a more participatory process with greater efforts to keep communities informed could have helped prevent the protest.

(b) *Enhancing local content*

One of the most effective ways of linking FDI to the rest of the economy is by ensuring that local value chains around mining are developed. Domestic businesses have appealed to the Government of Mongolia to help them take on a bigger role in the mining sector. In 2010, a consortium of Mongolian companies was established to participate in mining projects such as the Tavan Tolgoi coal deposit. The business community is also demanding legal mandates that would require foreign investors to contract with local businesses (Jargalsaikhany, 2013).⁴⁶ There is certainly a case that strong policies are needed to establish strong linkages between FDI and local firms.

With regard to employment, the salary gap between expatriate workers and local workers is very large. Narrowing this gap, especially in cases where local workers are skilled professionals, would benefit the local workforce tremendously. Housing is another related issue. Whereas the local workforce, in some cases, welcomes the construction of permanent housing near worksites, this could have negative repercussions by creating dependencies on the fortunes of the mine that will increase vulnerability. A better strategy might be to develop corporate community investment plans aligned with longer-term economic development plans.

(c) *Addressing corruption*

As perceived by both investors and local business, corruption is a serious issue in Mongolia. In Transparency International's 2012 Corruption Perception Index, Mongolia was ranked 94 out of 176 countries, placing it right in the middle among Asian and Pacific countries. Despite the fact that there have been some improvements over previous years, the situation is reportedly still bad. In a report published recently by the Asia Foundation (2013) called the Study of Private Perceptions of Corruption, which surveyed 330 members of the business community, the overwhelming response was that significant steps are still needed to curb corruption in Mongolia. In response to one question, 75% of businesses reported they "always" or "often" encountered corruption in public tenders and contracting.

High profile arrests of a former president on corruption charges and the arrest of SouthGobi Resources' legal counsel as a corruption suspect, have heightened public attention to the matter. Unfortunately, the corruption trial of the former president may not be indicative of real efforts to curb corruption. According to some accounts, the

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⁴⁶http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=40552&tx_ttnews%5BbackgroundPid%5D=7&cHash=a6544697c99685d5ab7140449758672e.

former president and his supporters in the Mongolian People's Revolutionary Party (MPRP) argue that his arrest was entirely politically motivated and designed to remove him from the political scene before the legislative elections in 2012.⁴⁷

(d) *Enhancing clarity and transparency in lawmaking*

A 2005 report submitted to USAID by a United States consultancy firm assessing corruption in Mongolia stated that “with very few exceptions, politics in Mongolia is a domain for seeking economic advantage and accumulating wealth. For the most part, political parties are increasingly similar to one another in terms of platform or program, a hallmark of personalistic political systems, where distribution of state resources is the main basis for political loyalty”.⁴⁸ While not unique to Mongolia, these dynamics seem to be still at play. This has led to troubled outcomes in several pieces of recent legislation.

One example is the new Strategic Foreign Investment Law restricting FDI in strategic sectors such as mining as Parliament must approve foreign takeovers of assets in these sectors.⁴⁹ The Law, passed in May 2012, prior to national elections, is seen as a politically motivated attempt to block China's largest state-owned mining company, Chalco, from purchasing a controlling stake in SouthGobi Resources, a copper mine that is a subsidiary of Rio Tinto. The attempt sparked sharp criticism from nationalist political groups, who were concerned of too much Chinese ownership of Mongolian resources, and attracted a lot of domestic attention.

According to investors the Law has brought about regulatory uncertainty that weakens Mongolia's position in attracting FDI. There is a lack of clarity about how the law will work in practice and there is a potential for regulatory delays due to interventions by politicians in deal negotiations which may lead to corruption. In September 2012 following the passage of the Law, FDI was down 44% with respect to the same month the previous year, though part of this drop can also be attributed to a slump in commodity markets.

(e) *Renegotiating the investment agreement*

The Government is also attempting to renegotiate the Oyu Tolgoi Investment Agreement. The drop in foreign inflows, commodity prices, and spending promised during the election left the Government with a budget deficit of \$643 million in 2012. The budget for 2013 proposes a renegotiation of the Oyo Tolgoi Investment Agreement that would increase tax and royalty payments from the project by \$319 million in 2013 and seeks to increase the Government's ownership share in the mine. At the time of writing this study, the Government and Rio Tinto were caught in a deadlock on the

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⁴⁷ <http://blogs.the-american-interest.com/fukuyama/2012/09/02/mongolia-mining-and-malfeasance>.

⁴⁸ http://pdf.usaid.gov/pdf_docs/PNADE136.pdf.

⁴⁹ <http://dealbook.nytimes.com/2012/12/10/boom-in-mongolia-deflates-after-deal-that-started-it-is-threatened-2>.

matter. This could hinder future investments, or worse, prompt Rio Tinto to start international arbitration.

3. Government actions

(a) *Revising mining and investment laws*

Mongolia seems to be taking the revision of the Mining Law very seriously and attempting to shelter it from politicization. Since 1994, it has revised mining regulations several times to attract FDI and reduce corruption or irresponsible mining activities. These revisions introduced stricter environmental requirements (in particular relating to mine closures and rehabilitation), increased local participation by giving local communities a certain level of approval authority, improved control and enforcement by the Government in issuing licences, and increased requirements for local development and local sourcing. Points of contention still revolve around license classifications, the increased role of the Government and the issue of wider local community participation.

The process of revision itself has also undergone changes. The presidential office announced that it would rely increasingly on national experts compared to previous revisions and that the Government had increased its law making capacity and experience dealing with foreign and domestic investors. In doing so, it had studied the practices of other resource-based economies. The process is now more inclusive and efforts have been made to avoid politicizing the revisions. The draft of a new mining law was debated at the National Security Council, parliamentary standing committee and the Citizens' Hall, a forum established by the presidential office in 2009 specifically to facilitate public deliberations on the Law's revision. The first public hearing took place on 18 January 2013. In efforts to address public concerns about mining, the working group has engaged civil society activists, local governments, government agencies and various professional organizations (Jargalsaikhany, 2013).

With declining FDI inflows, Mongolia is also seeking to offer greater assurances to foreign investors by making changes to the Investment Law. The revisions to this Law will make investments subject to regulation rather than bilateral deals. This is intended to provide greater clarity and stability to investors by making investment contracts subject to but also protected by legislation that can only be amended by a two-thirds parliamentary majority while future changes in legislation would not affect the current rules for investment (Reuters, 2013).

(b) *Other regulatory and voluntary improvements*

Mongolia has adopted several other laws which appear designed to help achieve greater levels of development. In the area of environment, a more restrictive water usage law (2009) prohibits minerals exploration in water basins and forested areas and cancelled over 200 mining and exploration licenses for operations deemed too close to

water basins and forests (Jargalsaikhany, 2013). Several other efforts also target corruption through transparency. Since 2007, an Independent Authority Against Corruption has been operational. The Freedom of Information Law (2011) enables the public to seek information from government institutions and authorities about their activities, human resources, budget, finance and procurement of goods and services with state funds (IFEX, 2011). The Conflict of Interest Law (2012) is intended to prevent conflicts of interest arising between the official duties and private interests of those working in public service, and to regulate and monitor conflicts of interest in order to ensure that public service activities serve the public interest and that transparency and faith in public services is maintained (Hogan Lovells, 2012).⁵⁰

Mongolia is also an active participant in EITI. It has filed annual reports since 2006 and was declared an EITI compliant country in 2010. The process seems to be helping. In 2006, the reconciliation committee found a final discrepancy of \$83.08 million (against total corporate claims of payments totally \$430.83 million), while for 2011, the final discrepancy had come down to \$59,000. The accountants and auditors responsible for completing the report made a number of recommendations for improvement (Mongolia Extractive Industries Transparency Initiative, 2012).⁵¹

4. Policy implications and transferability

Mongolia is clearly making efforts to improve its investment climate and draft a sound investment law. In these efforts, it should draw on international best practices and use the advice and recommendations from both domestic and international experts on laws, regulations, contracting negotiations, and other related issues.

In addition, Mongolia has managed to attract relatively responsible investment firms, such as Rio Tinto, that seem to be considering the environmental and social impacts of their operations. However, efforts should be made to strengthen the NCPs and ensure their uniform interpretation of the OECD Guidelines on Multinational Enterprises. Separately, if domestic firms are increasing their mining activities, they should also conform to the same strict social and environmental regulations and conditions. In this regard, they will require significant support to help them comply with international regulatory frameworks.

In the meantime, as long as licensing and law making practices are seen to be driven by rent seeking behaviour and political motivations, this will remain a serious concern. One area where corruption is more difficult is in securing financing from IFIs. Institutions such as the IFC, World Bank Group, European Bank for Reconstruction and Development and other financial institutions funding large-scale projects can thus have a significant impact on the community level by ensuring that the Performance Standards or Equator Principles are strictly respected.

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⁵⁰ <http://www.hoganlovells.com/mongolias-conflict-of-interest-law-09-28-2012/>

⁵¹ For more information, see: <http://eiti.org/files/Mongolia-2011-EITI-Report-PartI.pdf>

Finally, companies need to engage communities and civil society in a participatory way. Though first and foremost they are expected to abide by national laws and international standards, communicating with local communities on their planned and actual operations will protect their social license to operate.

B. Myanmar: incident at the Letpadaung mine

1. Overview of the mine and of the incident

The Letpadaung copper mine near Monywa in northern Myanmar has attracted significant national and international attention. The mine has faced ongoing opposition from local communities, but the controversy flared recently around the mine's expansion, which required the resettlement of many local villagers.

The mine is a joint venture between Wanbao Mining Company, a subsidiary of China North Industries Corporation (NORINCO), a company in the defense sector, , and the military-owned conglomerate Union of Myanmar Economic Holdings Limited (UMEHL).

In late November 2012, hundreds of people, including monks, gathered to protest the mine demanding that it should be closed down. They opposed the land appropriation that was required for its expansion, and also believed that the mine was causing environmental, social and health problems. After 11 days of protests near the mine site, police fired water cannons and phosphorous gas at hundreds of protestors, including villagers and monks in the early hours of the morning. The attack could be seen as a violation of human rights.

2. Investigation of the incident

In response to the incident, the President of Myanmar, Thein Sein commissioned an investigation. Aung San Suu Kyi, the popular opposition leader, was asked to chair the investigative commission.

Separately, an independent investigation was conducted by the Burmese Lawyers Network and United States based Justice Trust. Their investigation found that coercion and fraudulent misrepresentation had been used by local authorities to force villagers to sign contracts with the Wanbao-UMEHL joint venture and relinquish their land. It also found that excessive use of force was used against the protesters, including the use of oxidized phosphorous, an incendiary agent that is generally used in war to make smoke screens. Specifically, their report criticizes local officials for (a) representing the interest of the company in breach of their duties as civil servants mandated to represent the public interest; (b) abusing their power to punish those people who refused to sell their land and resettle; (c) shutting down the local monastery and primary school, and refusing to register children in a nearby school unless their

parents signed the contract to sell their land; (d) coercing villagers into signing the contract without allowing them to first read its contents; and (e) misrepresenting the essential terms of the contract promising villagers the land would be returned to them undamaged within three years.⁵²

When Aung San Suu Kyi's report was published, it acknowledged that smoke bombs containing phosphorous were used against the protestors and recommended police reform and anti-riot training of officers.⁵³ It also found that a lack of transparency was the main reason for the events leading up to the violence. Addressing broader development goals, it found that the mine lacked strong environmental protection measures and would result in job creation for local people, conceding that it only brought "slight" benefits to the nation.⁵⁴ ⁵⁵ The commission also recognized that land compensation was below market price. In order to address this issue, it recommended greater compensation to villagers and returning 1,900 acres of farmland for which the original compensation was considered insufficient.⁵⁶ It did not recommend unilaterally halting the project, because of the tension this could create with China, and the negative effect it may have on attracting future foreign investment.

Aung San Suu Kyi's report has caused criticism and hostility among local residents who expected her to recommend halting the mine's operations. As a result, the social accountability issue was not resolved. As many as 3,000 protesters marched on Wanbao's headquarters following the report's publication in early March 2013, and additional protest camps were set up in the villages nearby.

The Government investigation into the incident represents an important step forward and a clear effort to provide increased transparency and accountability. However, no specific officials were held accountable for the incident and the details on who ordered the attacks on protestors remain unclear.

Following the March protests, the contract between the Government and the mining company was revised, dramatically changing the way profits are shared. The revised contract leaves Wanbao Mining with a 30% portion of profits (down from 51%), the Government with 51%, (up from 4% under the old contract). The Union of Myanmar Economic Holdings Ltd., will have its slice reduced to 19% from 45% once the mine is back to producing copper. "Such a dramatic change of profit-sharing, unfavorable to the

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⁵² <http://democracyforburma.wordpress.com/2013/03/02/myanmar-burmareport-justice-trust-lawyers-network-ladpadaung-crackdown-english>.

⁵³ <http://www.bangkokpost.com/breakingnews/340106/myanmar-mine-must-pay-compensation>.

⁵⁴ <http://www.bangkokpost.com/breakingnews/340513/myanmar-suu-kyi-faces-protests-over-copper-mine-backing>.

⁵⁵ http://www.washingtonpost.com/business/report-myanmar-police-used-phosphorus-during-crackdown-at-mine-protest-that-burned-108-people/2013/03/11/c75367f0-8aaf-11e2-a88e-461ffa2e34e4_story.html.

⁵⁶ <http://www.bangkokpost.com/breakingnews/340106/myanmar-mine-must-pay-compensation>.

foreign investor, is highly unusual, especially for China," said Yun Sun, a fellow at the Washington-based Stimson Center, in a recent report (Mahtani, 2013).

3. Implications for policy

At the end of 2012, Myanmar's parliament passed a new foreign investment law that lists natural resource extraction and exports as strategic objectives. To incentivize investments, it provides more favourable terms to foreign investors including the option of 50-year land leases extendable by 20 years, a five year tax holiday, guarantees against nationalization and against terminating approved activities without sufficient cause during the contract period, among other measures.^{57 58}

While investors seem keen to enter the country, the challenge will be for Myanmar to develop policies that effectively direct revenues from taxes and royalties towards much needed local development. The Letpadaung mine protests highlighted that the terms of the investment were initially not negotiated in a way that was seen as bringing about substantial economic benefits to the Government or to the people. It thus shows the need to ensure more favourable terms are secured for both the Government and communities in the vicinity of projects in the future. It is not yet clear, however, that the new foreign investment law will bring about greater economic or development benefits. Moreover, investors have indicated that it does not provide them with the certainty and clarity that they need either, suggesting that the law may need to be strengthened on both fronts.⁵⁹

In parallel, the new mining law (see box 6 in chapter 3), which is expected to be adopted in early 2014, is also largely aimed at attracting FDI. It will provide financial incentives to investors, including 100% ownership of many mining projects. Unfortunately, neither the mining nor investment laws are likely to contain clauses that reduce the risk of human rights violations, or increase social accountability. Myanmar could consider expanding the scope of these laws to address these issues in the future. For example, clauses that mandate increased local participation, give communities some degree of approval authority, ensure greater local development and local content requirements, and introduce stricter environmental requirements, would significantly increase the sustainability of FDI. Similar clauses are being incorporated in Mongolia's new investment law, which could provide a valuable frame of reference.

Human rights violations are a deterrent to FDI. One way to avoid these is to increase transparency and fairness in negotiations with villagers or indigenous populations that will be impacted by natural resource developments. This is especially true in the case of resettlement. A number of international standards provide guidelines

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⁵⁷ <http://www.mayerbrown.com/Details-of-Myanmars-New-Foreign-Investment-Law-11-19-2012/>

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⁵⁹ <http://www.economist.com/news/business/21565986-new-law-foreign-investment-not-entirely-reassuring-burmese-haze>.

for land acquisition and resettlement including the United Nations Comprehensive Guidelines on Development-Based Displacement, IFC's Performance Standard 5 on Land Acquisition and Involuntary Resettlement. The World Bank, Asian Development Bank and European Bank for Reconstruction and Development all have policies on involuntary resettlement as well as supplementary guidance notes on best practices and tools to support their implementation. It is up to both host governments (via investment laws/agreements) and investors (via corporate policies) to ensure that these best practices are followed. Not only do such guidelines help to ensure fair compensation to resettled people, but they also help host governments and investors maintain their social license to operate.

While historically, mining and investment laws have not paid attention to sustainability issues, the incorporation of measures to improve social and environmental accountability into new versions of such laws is increasing all over the world. A thorough review of international best practices in formulating investment laws and investment contracts will certainly help countries in redrafting these laws, and increase prospects for securing development benefits.

National participation in voluntary international initiatives such as EITI may also help improve transparency and accountability. Myanmar has declared its intention to join EITI, and countries that are not yet members should be encouraged to do so.

Finally, not all companies are alike, and some have much better track records of performance on social and environmental issues than others. The level of accountability required by their home countries can have an important role in shaping companies' policies and operating practices. Myanmar and other countries aiming to increase FDI would benefit from developing clear mechanisms to attract companies that are more likely to help achieve development goals. For example, prioritization could be given to companies that have a proven track record of commitment to social responsibility; that are listed on internationally reputable stock exchanges or sustainability indices; that have the capacity to use the most up-to-date technology in mine design, recovery techniques, remote sensing, and processing technology; and that demonstrate good transparency and disclosure, as well as participation in international initiatives such as the Global Compact.

C. United Kingdom: Holcim's use of corporate ecosystem valuation before quarry expansion⁶⁰

1. Background to the Corporate Ecosystem Valuation framework

Corporate activities in the natural resources sectors have huge impacts on the environment, but they are also dependent on the environment for many aspects of their business. Nature and the benefits it provides people and businesses are often called ecosystem services. For example, land can provide minerals, forests can provide timber and rivers can provide power. Both people and businesses rely on these services, giving them clear economic value. Some companies and environmental organizations have recognized the need to measure the economic value of corporate reliance on ecosystems and have done very innovative work on this topic.

In 2008, the World Resource Institute, in collaboration with the Meridian Foundation and WBCSD developed the Corporate Ecosystem Services Review (ESR), which proposes a methodology for companies to assess their ecosystem related risks and opportunities. Taking this work a step further, WBCSD partnered with the IUCN, World Resources Institute (WRI), and the consulting firms Environmental Resource Management (ERM) and PriceWaterhouseCoopers (PwC) to develop the Corporate Ecosystem Valuation (CEV) framework.

Released in 2011, the CEV framework enables companies to consider the actual benefits and attribute a financial value to the ecosystem services they depend on. Its purpose is to enable a quantitative, and in some cases monetary, assessment of the risks and opportunities related to ecosystem services. This type of assessment offers valuable insights for business planning and financial analysis. It operationalizes, at the company level, The Economics of Ecosystems and Biodiversity (TEEB) study, a report released in October 2010 by the G8+5 Environment Ministers at the Convention on Biological Diversity summit in Nagoya, Japan. Fourteen WBCSD member companies have piloted the framework. One of these companies is Holcim.

2. Holcim's ecosystem services review and corporate ecosystem valuation of quarry rehabilitation

Aggregate Industries UK, a subsidiary of Holcim, used the CEV tool to determine the best economic option for rehabilitating the Ripon City Quarry in the Yorkshire Dales, England. United Kingdom legislation requires companies to submit a rehabilitation plan when applying for a new or extension permit to extract resources. In this case, the

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⁶⁰ All facts and figures for this case study are available at: <http://www.wbcds.org/work-program/ecosystems/cev/roadtesters.aspx> and [http://www.wbcdcement.org/pdf/CSIForum2010/10%20IUCN%20Holcim%20EVI%20case%20study%20\(full\).pdf](http://www.wbcdcement.org/pdf/CSIForum2010/10%20IUCN%20Holcim%20EVI%20case%20study%20(full).pdf).

company sought a permit to expand the quarry, where it mines sand and gravel, to include land currently used for agriculture. Its plan for rehabilitation was to restore the land with a wetlands wildlife habitat and artificial lake for recreation. When the plan was met with disagreement by local stakeholders and conservationists, CEV was used as a tool to identify the restoration option with the greatest benefits to local communities. Holcim thus piloted the CEV tool with the aim of adding an economic dimension to the ESIA and identifying the optimal restoration plan.

IUCN supported Aggregate Industries UK to carry out the valuation study. Its objective was to measure and quantify, in monetary terms, the impacts that quarrying and the subsequent restoration of the quarry would have on biodiversity and the ecosystem services provided to local communities. The methodology was applied to three separate sites proposed for the expansion of the quarry. At the time, all three sites were used for agriculture. In the initial plan, one site would be restored for agriculture, the second would be restored to wetlands and the third turned into an artificial lake for sailing. The analysis measures the opportunity costs from loss of agricultural land, the investment costs involved in the restoration process, recurring maintenance costs of restoration, and the local and regional benefits generated by the restored sites. The benefits quantified and valued from the restoration included the following: wildlife habitat benefits generated from the wetlands, the value of the carbon sequestered in the wetlands, and the recreation and flood control benefits generated by the artificial lake. “Willingness to Pay” estimates were used to establish the monetary value on the basis of only one or two dominant ecosystem services per site.

Using a benefits transfer approach, the study used unit estimates of the value of specific ecosystem services (e.g. recreational opportunities from artificial lakes, flood control, carbon storage, etc.) taken from detailed studies of similar sites elsewhere in the United Kingdom.

3. Results and outcome of the valuation

The valuation found that benefits generated by the proposed restoration of the sites following the mining project outweighed the costs. In particular, the most significant benefits were the biodiversity benefits that would be generated by the proposed wetlands (£1.4 million), the recreational benefits of the lake (£350,000) and increased flood storage capacity of the overall area (£224,000). The biggest costs were the opportunity costs from lost agriculture. The costs of the restoration itself were marginal. The study concluded that the project would deliver net benefits to the local community of about £1.1 million (figure 14).

Source: IUCN Holcim EVI case study.

Aggregate Industries UK chose to pilot ecosystem valuation for several reasons. It sought to build its reputation as an environmentally responsible company, which would help it secure its license to operate in the present and gain access to additional mineral sites in the future. It also wanted to have a better idea of the actual costs and benefits of ecosystem restoration which would enable the company to better negotiate restoration and aftercare costs and programmes and save costs associated with future planning procedures. Finally, since many of its operations are in floodplains, it sought to value its contribution to flood control in the region.

The valuation demonstrates that companies can compensate for the adverse environmental impacts of extraction and deliver significant environmental benefits from restoration at a low cost. Engaging in similar exercises can be advantageous to companies seeking to obtain legal permits and maintain their social license to operate.

4. Implications for policy

Efforts to undertake ecosystem valuation have strong implications for environmental and natural resource use legislation. First, while most permits for natural resource use already require ESIA's, an important limitation of ESIA's is that they usually do not provide an economic or financial assessment of the impacts highlighted. Understanding the economic implications of ESIA's would put governments in a better position to negotiate with companies seeking to invest in natural resources. Conducting a CEV could, therefore, be a worthwhile exercise prior to contract or licensing negotiations.

In fact, ESRs and CEVs are processes that could be mainstreamed into the broader process of granting permits with analytical support from third parties, giving companies, governments and communities a better understanding of the value of the potential positive and negative environmental impacts of a proposed project.

Ecosystem services reviews and valuations also have strong implications for traditional cost-benefit analyses undertaken for project planning and finance. They show how traditional cost-benefit analyses could be expanded to include ecosystem costs and benefits, thereby providing a more complete picture of the expected impacts.

For companies, ESRs and CEVs can be a good way to show the company's commitment to responsible management of social and environmental impacts and secure legal licenses and permits. An ESR can also provide a good platform for dialogue with local stakeholders, which can help companies identify and meet community needs.

The 14 WBCSD member companies that have piloted CEV have found meaningful ways to attribute a financial value to ecosystems. Mainstreaming these efforts could fundamentally change the way companies (and governments) that rely on natural resources undertake business planning.

D. Lao People's Democratic Republic: lack of regional consensus on the Xayaburi dam

1. Background

The Xayaburi dam is a massive hydroelectric power project under implementation in Northern Lao People's Democratic Republic on the Mekong. The Mekong starts in China and runs through Lao People's Democratic Republic, Cambodia and Viet Nam. While several dams have already been built on the upper Mekong, this is the first of 11 proposed dams to be built on the slower-moving lower Mekong. The \$3.5 billion dollar dam is being constructed by a Thai firm, funded by Thai banks and will generate electricity that will be sold back to the Electricity Generating Authority of Thailand (EGAT). The project is anticipated to bring significant revenue to the Government of Lao People's Democratic Republic and to be an extremely profitable business venture.

There are a number of social and environmental issues associated with dams of this scale. The main risks are that the dam will permanently alter the geophysical conditions of the river, changing fish migration patterns and sediment flows that will impact the food security and livelihoods of populations hundreds of kilometres downstream that depend on the river's fish and agriculture along its banks.

2. Mekong River Commission

It has been long recognized that river development can have significant transnational impacts. The need for international cooperation led Cambodia, Lao People's Democratic Republic, Thailand and Viet Nam to sign the Mekong Agreement in 1995, establishing the Mekong River Commission (MRC). Their objective was to jointly manage the river's development with a focus on sustainable development and strategic natural resource management.⁶¹

The Mekong River Commission's Environment Programme works to support cooperation among MRC Member Countries to secure a balance between economic development, environmental protection and social sustainability within the Mekong region.⁶² The Programme is developing the Guideline for Transboundary Environmental Impact Assessment (TbEIA), which sets a regional standard applicable to national activities.⁶³

In accordance with the Mekong Agreement, the Government of Lao People's Democratic Republic initiated prior consultation with the Governments of Cambodia, Thailand and Viet Nam before granting approval to start construction of the Xayaburi dam.

3. Results of social and environmental impact assessments

The first environmental and social impact assessments were completed in 2010. These were met with criticism from technical experts who felt that the assessments failed to evaluate baseline data on ecosystems and carry out a proper consultation process with communities along the river, and provided an insufficient assessment of impacts on ecological resources, including fish stocks and water quality, and of the impacts on people living downstream.⁶⁴ Fears that the social and environmental impacts were not being adequately addressed led to criticism from environmentalists as well.

When the four countries met to discuss the project in 2011, Cambodia and Viet Nam expressed their concerns about the likely impacts of the dam on their countries and requested that the project be halted while further assessments were carried out before an agreement could be reached on how to proceed.

A Finnish firm, Pöyry Energy AG, was subsequently hired to review the dam's compliance with the MRC's environmental standards, but its report lacked credibility. Cambodian and Vietnamese officials and representatives of environmental NGOs argued

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⁶¹ <http://www.mrcmekong.org/about-the-mrc/history>

⁶² For a comprehensive overview of the Programme, see: <http://www.mrcmekong.org/about-the-mrc/programmes/environment-programme>

⁶³ <http://www.mrcmekong.org/about-the-mrc/programmes/environment-programme/transboundary-eia>

⁶⁴ For further information on the views of some experts, see: <http://www.internationalrivers.org/resources/technical-review-of-the-xayaburi-environmental-impact-assessment-3930>.

that the technical modifications to the dam were untested and inadequate, especially considering the number of people that depend on the Mekong for their livelihoods (Fortin, 2013).⁶⁵

At a subsequent ministerial meeting between the four countries, they agreed to conduct a more comprehensive study on the impacts of the proposed Mekong dams. There is disagreement about whether Lao People's Democratic Republic agreed to delay construction on the Xayaburi dam until these studies were complete. While Lao People's Democratic Republic did not publicly announce it would stop construction, many understood that this had been agreed and were distressed that preliminary construction on the dam site continued (Fortin, 2013).⁶⁶

In November 2012, Lao People's Democratic Republic and Thailand announced the official launch of the dam. Lao People's Democratic Republic declared that the concerns raised by the MRC had been addressed and that investments had been made to make the dam more ecologically sound. At the MRC's annual meeting in Vientiane in January 2013, Cambodia and Viet Nam objected to Lao People's Democratic Republic's interpretation of the agreements. Cambodia demanded that all construction be halted while Viet Nam insisted that no dams be constructed until an agreed upon independent study was completed.⁶⁷ In their Joint Development Partners Statement, international donors funding the MRC also expressed concerns on the social and environmental impacts of the dam and on the fact that WWF had not been invited to the consultation meetings.⁶⁸ These criticisms stirred the debate on the effectiveness of the MRC in guaranteeing a multilateral decision-making process on the use of the River.

4. Expected benefits from the dam

The Government of the Lao People's Democratic Republic has said that it expects to earn \$4 billion in revenue over 29 years, including \$135 million per year in concessions and 20% of the profits through royalties and taxes from the dam. After 29 years, it will obtain full ownership of the dam. It also hopes to have gained engineering expertise. Local benefits include a short-term influx of jobs generated by construction and a future increase in tourists expected to visit the dam. The Government has said that the roughly 2000 people displaced from their land by the project will be provided with better transport, power, education and healthcare.⁶⁹

However, the real question is how to translate government revenue into development benefits and ensure that international standards for health and safety,

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⁶⁵ <http://www.ibtimes.com/dam-conundrum-xayaburi-project-could-help-laos-thailand-hurt-cambodia-vietnam-859904>.

⁶⁶ *ibid*

⁶⁷ <http://thedi diplomat.com/asean-beat/2013/01/23/laos-finally-called-out-over-xayaburi-dam/>

⁶⁸ <http://www.nationmultimedia.com/business/Donors-raise-concerns-about-Xayaburi-dam-on-Mekong-30198142.html>

⁶⁹ Xinhua, 19 March 2013: <http://www.globaltimes.cn/content/769096.shtml#UX5HTCtNt8g>

resettlement and consultation are followed to minimize negative effects. In order to accomplish this, a concerted effort based on high social and environmental standards is required. The Nam Theun 2 dam, recently completed in the upper Mekong, is considered to be a fairly good example of adhering to these standards, particularly with regard to resettlement. It received financing from a number of international development banks that were keen on making it an example of good practices. The Xayaburi dam, however, is financed by six private Thai banks that do not have the same social and environmental criteria for their investments as development banks, and as a result represents a more challenging case.

5. Implications for policy

The Xayaburi Dam case highlights several issues. First, the financial incentives to build the dam seem to have outweighed pressures to slow down the process and conduct a comprehensive and credible social and environmental impact assessment first. Second, international cooperation through the MRC was not effective in requiring that high standards be met before proceeding with construction of the dam. This indicates that the accountability of individual countries to the MRC is relatively weak. If development benefits are to be maximized, however, stronger regional collaboration is needed. Water and energy planning need to be made more transparent, participatory and accountable, especially for projects with cross-border impacts. ESIAs related to the construction of dams need to be more thorough and consultative. CEVs, and other in-depth assessments of local and regional impacts should be required by both governments and banks. In order to accomplish this, incentives for social accountability would need to outweigh short-term financial gains.

Unless international mechanisms are made more effective, the resources that fund them do not achieve their development objectives. Three potential measures that may increase accountability of such mechanisms are: (a) an increase in the level of transparency of regional discussions and proceedings, (b) restructuring the type of cost-benefit analysis performed and (c) strengthening technical capacity of the MRC to conduct or oversee impact and cost-benefit assessments.

With ten more dams scheduled for construction along the mainstream Mekong, the matter is especially timely. There is a clear need for better government accountability and enhanced government capacity that would enable them to develop a strategy that would ensure the due consideration of development benefits in the application of laws and preparation of contracts. Financial institutions can play an important role in requiring that high standards are met but this will only happen if such standards are embedded in their own organizational commitments and policies.

E. Papua New Guinea: New Britain Palm Oil's support for smallholders⁷⁰

1. RSPO certification of NBPOL and smallholders

New Britain Palm Oil Limited (NBPOL) provides a good example of sustainable agriculture practices, efforts to generate benefit to smallholders, and measures to support women and youth. NBPOL is the biggest private sector employer in Papua New Guinea and the Solomon Islands. It operates 95,334 hectares of palm oil plantations and is the largest producer of palm oil in both countries.

RSPO certification is a key component of NBPOL's business strategy and sustainability efforts. It also allows the company to differentiate its product to buyers. RSPO certification emphasizes transparency, compliance, long-term economic and financial viability, the use of best practices, environmental responsibility, respect for employees and communities, responsible development of new plantings and a commitment to continuous improvement. NBPOL has also built a segregated supply chain to ensure that all of its products are RSPO certified and traceable. In order to achieve this, the company's smallholders – which supply 30% of its fresh fruit bunches – needed to be certified as well. NBPOL thus formulated a company policy to include smallholders in RSPO certification, and was one of the first companies to do so.

At its first three estates, smallholders were certified concurrently with the company's own estates. This included 7,501 smallholder blocks at West New Britain, Papua New Guinea which produce 32.6% of fresh fruit bunches; 130 smallholder blocks at Ramu Agricultural Industries, Papua New Guinea, which produce 1.5% of fresh fruit bunches; and 268 smallholder blocks at Guadalcanal Plains Palm Oil in the Solomon Islands, which produce 9.8% of fresh fruit bunches.

When NBPOL acquired three new estates in Papua New Guinea, it ensured the same process of certifying smallholders at the same time. Poliamba, where 1,410 smallholder blocks produce 14.9% of fresh fruit bunches, has already been certified. Higaturu Oil Palm, where 5,708 smallholder blocks produce 44.2% of fresh fruit bunches and Milne Bay Estates, where 795 smallholder blocks produce 5.4% of fresh fruit bunches, are in the final stages of certification.

The main benefits of certification for smallholders are the increased yields and incomes that come with better estate management. NBPOL has also committed to pass on the premium received for certified palm oil to smallholders as a way to incentivize continuous improvement. The price is based on the GreenPalm certificate price/tonne for certified palm oil. In 2010, this was \$10/tonne. In 2011, however, the premium dropped to one dollar per tonne, making the financial incentive negligible. In order to

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⁷⁰ Based on NBPOL's 2012 sustainability report that was independently assured by Aidenvironment Asia. Available from: www.nbpol.com.pg/wp-content/uploads/downloads/2012/04/New-Britain-Palm-Oil-Limited-NBPOL-Sustainability-Report-2010-11-FINAL.pdf.

maintain the incentive, NBPOL established its own floor of \$10/tonne, which it pays to smallholders for all certified fresh fruit bunches.

2. Other NBPOL support to smallholders

(a) *Technical, financial and material support*

At Higaturu, many blocks were damaged by cyclone Guba in 2007 and as a result, productivity of these smallholder blocks dropped dramatically. NBPO provided support to smallholders at Higaturu to increase productivity by restoring the blocks that were damaged and/or neglected, improving the agricultural practices and overall management of the blocks. To accomplish this, NBPOL collaborated with communities to provide credit, training, supervision in agricultural management techniques, and support for replanting of some hectares. The programme has so far succeeded in increasing average productivity from roughly 9 tonnes of fruit per hectare to roughly 14 tonnes. The aim is to increase productivity to 25 tonnes within 3 years.

(b) *Providing youth employment*

Restoring the blocks has also been an opportunity to generate jobs for youth. These jobs have benefitted youth by giving them an income, while also reducing crime and vandalism in the area.

(c) *Improving the life of women*

NBPOL has established gender committees at its operations. These committees address workplace related issues faced by women employees as well as challenges that women face in the broader community such as domestic violence and lack of educational opportunities that can hinder women's ability to participate in formal employment. NBPOL also operates programmes to enhance the livelihoods of female dependents of workers and smallholders by allowing them to collect loose fresh fruit.

(d) *Improving land access and community rights*

With estates as large as 36,000 hectares, the process used to obtain this land is a critical issue. In Papua New Guinea and the Solomon Islands, land concessions are not usually granted by the Government. Instead, most land is customary rights land, where land access is given through a lease-leaseback system and customary land owners receive royalties based on fruit production, company shares and rent for the use of their land. NBPOL's principle form of engaging with landowners is through Incorporated Landowner Groups that negotiate terms for leases and distribute and manage incomes for their communities. Close consultation with communities is essential to avoid conflict and establish good relations. Respecting communities' rights to free prior and informed consent is also essential.

3. Implications for policy

As palm oil production expands to countries like China and India, the strategies adopted by NBPOL could be applied and scaled up in those countries and others as well

to ensure greater sustainability and benefit sharing with local communities, smallholders and other contract farmers. Furthermore, technical, financial, and material support to smallholders is relevant to large tract plantation holders as well. Finally, the land rights model offers insights on building community benefits and incorporating decision-making in the land rights negotiation and contract process in palm oil and other natural resource sectors.

CHAPTER 6

ANALYSIS AND DISCUSSION

A. How are Asian companies performing compared to Western companies?

How are natural resource companies in the Asia-Pacific region performing, compared to their Western counterparts, in demonstrating responsible business practices? Indicators such as corporate participation in international initiatives, disclosure, and participation in industry associations that work to improve environmental and social impacts can provide some information.

As was shown in chapter 4, in terms of their participation in the Global Compact, Asian businesses across all sectors are more active than their United States counterparts, but less than European businesses (figure 10). Asia is the region with the second highest number of business participants following Europe with the highest number of signatories originating in China, India, Japan, and the Republic of Korea. In particular, local UNGC networks are stronger in Asia than elsewhere, but nevertheless weak in countries with large mining sectors such as China, the Russian Federation and Kazakhstan. However, given the size of Asia and total number of companies operating in the region, the number of UNGC signatories from the region is actually quite small.

In terms of public disclosure, the number of CSR reports written by companies in the natural resources sector in Asia lags behind that of Europe and North America (table 7).

Table 7
Comparison of CSR/sustainability reporting by region (number of reports)

CSR Reports	Asia	Europe	North America
Energy	215	387	160
Mining	67	98	115
Forestry and Paper products	12	136	44
Total	294	612	319

Source: GRI Sustainability Disclosure Database (accessed April 12, 2013).⁷¹

Transparency International found that compared to global oil companies, Asian national oil companies are doing a poor job of reporting on whether they have anti-corruption programmes, and half of the global companies lagging in this area are from the region. With respect to the global average, Asian companies are performing worse on organizational disclosure of partnerships and subsidiaries, with the worst performers in China (CNOOC and CNPC). Asian companies were also among the worst performers globally on disclosure of country level financial data, transfers to governments and other

⁷¹ <http://database.globalreporting.org/search>.

operational information with CNPC, CNOOC, Inpex, PetroChina and Petronas among the six worst performers globally (Transparency International, 2011).

In terms of participation in EITI, Asia is following Africa with regard to participation, but is ahead of Europe and the United States. It must be noted, however, that EITI participation is led by governments, which cascade participation to the companies operating in their territories. As of 2011, Asian countries made up 13% (4 out of 29) of EITI reports. In Europe, only Albania and Norway have prepared reports while Canada and the United States have not. According to Chinese analysts, Chinese compliance with EITI (and other voluntary standards) is unlikely, but the Government of China intends to step up mandatory requirements and is collaborating with the international community in doing so.⁷²

Another reference point is membership in industry associations like IPIECA and the International Council on Mining and Metals (ICMM) that are driving social and environmental responsibility. By joining, members make a commitment to improve on these issues. IPIECA has 29 member companies of which seven are Asian compared to 12 and eight from North America and Europe respectively. ICMM has 22 member companies with roughly equal membership from Asia, North America and Europe.

A study by Sustainalytics compared ESG risks in emerging markets to those of developed markets based on the Sustainalytics' Global Platform.⁷³ It found that disclosure of relevant ESG policies and programmes by companies in emerging markets is rather poor. But risks vary considerably from country to country. In the Russian Federation, for example, worker health and safety issues are also a concern in the mining, oil and gas industries while strict environmental standards have not yet been imposed. Chinese companies have the lowest overall scores among BRICS companies and rank consistently low across most ESG indicators. Environmental degradation and low health, labour and safety standards are the biggest sources of concern. Comparing average ESG scores in each geographic region, the Asia-Pacific region scores poorly, following Central and Eastern Europe, Latin America, and South Africa (figure 15) (Sustainalytics, 2012).

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⁷² <http://www.ukti.gov.uk/export/howwehelp/overseasbusinessrisk/item/453900.html>.

⁷³ Sustainalytics' Global Platform provides ESG ratings and profiles for more than 3,600 companies worldwide, including more than 800 emerging markets companies. The scores presented below are based on a universe of 809 emerging market companies and 1,593 developed market companies, all of which are constituents in the MSCI All Country World Index.

Figure 15
Average ESG scores by geographic region

Source: Sustainalytics, 2012.

Still, some Asian companies are doing relatively better, such as PTT PLC of Thailand, which scored quite highly in the Asian Sustainability Report (ASR™) rating on transparency across a range of ESG indicators. Thailand is also the regional leader on corporate governance, according to a World Bank report released recently, which indicated that it is approaching international best practice.⁷⁴

Another area where Asia-Pacific is lagging is responsible investing. The number of Asian banks and financial institutions that have signed on to the Equator Principles and UNPRI is extremely low compared to Western financial institutions. Nevertheless, an interest in and attention to responsible, sustainable investing in Asia is rising. In this context, most of the attention is directed towards environmental issues, and less towards social and governance issues. Disclosure of performance on human rights and corruption, for example, is much less. According to EIRIS, this relates largely to the key drivers of responsible investment – global awareness of environmental issues and risks such as climate change and resource use (EIRIS, 2011).

While Asian companies generally compare poorly, in many cases Western companies have a long way to go too. The Ceres study (2012) called “The Road to 2020 – Corporate Progress on the Roadmap to Sustainability” examined 600 Western (mainly United States based) companies and found that performance of oil and gas companies with regard to responsible business practices was generally poor. While oil and gas was the second best performing sector with regard to governance, only 19% of oil and gas companies were included in the top two tiers for overall human rights management and

⁷⁴ <http://www.worldbank.org/en/news/press-release/2013/04/25/thailand-makes-significant-improvements-in-corporate-governance-practices>.

only 15% of these companies had invested in in-depth water risk assessment and disclosure. The three oil and gas companies included in tier 1—ExxonMobil, Hess and Occidental Petroleum—had robust community consultation programmes in place. Only a quarter of the oil and gas companies disclosed community development programmes and even fewer (three companies) had policies on indigenous people and land rights.

B. Main barriers and constraints to more responsible and sustainable FDI

The following main barriers hindering the advancement of sustainable foreign investments in the natural resources sector can be identified:

1. Poor governance

Ineffective or unclear laws, regulatory uncertainty, a regulatory environment that fails to attract investment, corruption, lack of transparency and accountability all hinder more sustainable FDI.

2. Contracts that favour investors over host countries

Investment contracts do not always secure the best terms for host governments, often because of an imbalance in negotiating skills and leverage. Similarly, IIAs can constrain governments' ability to govern in a way that secures domestic growth and development.

3. Lack of comprehensive information about impacts

A clear and comprehensive understanding of the economic, social and environmental impacts of natural resource development at the local, regional and national level is rarely available. This information needs to be collected, while local and community participation can help ensure that all relevant concerns are raised and addressed.

4. Perception of costs

Investing in better natural resource management implies additional costs – for both government and business. Lack of available government funds or unwillingness of government to invest on behalf of companies can constrain efforts that aim to ensure that benefits of natural resources are equitably shared. However, evidence shows that the long term costs of *not* investing are often far greater.

5. Voluntary initiatives have no enforcement power

While voluntary initiatives are certainly pushing the sector in the right direction, they have no enforcement power and only very weak tools to penalize non-compliance. They rely primarily on companies that comply simply to meet stakeholder expectations and protect their public image but not necessarily out of conviction. Where such expectations or pressures are absent, such as in many Asia-Pacific countries, they fail miserably.

6. Investor tolerance of lax social and environmental standards

Governments and companies do not bear the sole burden of responsibility. The lingering tolerance among many institutional investors and other portfolio investors of unaddressed social and environmental risks and bad performance remains a challenge.

C. Drivers of more responsible business behaviour

What are the main drivers of more responsible business behaviour? According to CSR Asia's "CSR in 10" research of experts around the Asia-Pacific region, the top three drivers of sustainable business practices are (1) NGOs, CSOs and local communities, (2) government regulation, and (3) businesses themselves (Welford, 2011).

NGOs, CSOs and local communities have been instrumental in raising awareness on the "resource curse" as well as on other environmental and social issues and policy challenges. Their voice has become increasingly sophisticated and vocal in Asia-Pacific. Rather than opposing natural resource companies, many CSOs and local community organizations are opening up to partnering with them to pursue shared goals. Meanwhile, companies that are keen to establish a link between their brand and corporate responsibility are becoming a driving force as well. They are responding to their stakeholders, including NGOs, CSOs, local communities and governments in charting innovative modes of collaboration and benefit sharing. However, investors and businesses look primarily to governments to drive better business practices through effective regulation, especially in relation to natural resource use, social and environmental issues and disclosure.

Yet businesses drivers are also important. According to the WBCSD, some of the main drivers for its work on environment are: (1) financing and procurement (e.g. risk assessment in supply chains, B2B customers); (2) the impact of international studies (e.g. TEEB), (3) the role of NGOs and media on transparency, and (4) regulation (e.g. CBD targets and stricter national legislation).⁷⁵ Regarding risks and opportunities, it considers regulatory and legal issues such as new fines, new user fees, government regulations, lawsuits by local communities that lose ecosystem services due to corporate activities, etc., as the main environmental risks that should be driving business strategies. Meanwhile, it also highlights the need for companies to engage with governments through partnerships to develop policies and incentives to protect or restore ecosystems that provide services that companies need.⁷⁶

Taking China as an example on the topic of transparency, the British Embassy's Trade and Investment group in Beijing notes that while Chinese compliance with

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⁷⁵ <http://www.wbcsd.org/work-program/ecosystems/cev/downloads.aspx>.

⁷⁶ <http://www.wbcsd.org/pages/edocument/edocumentdetails.aspx?id=28&nosearchcontextkey=true>.

voluntary standards remains unlikely, the Government of China is making efforts to strengthen its regulatory framework and provide opportunities to enhance transparency. It recommends the following vehicles to increase transparency:

- Financing. The lobbying of major Chinese financial institutions to include tougher transparency requirements as conditions for loans for overseas projects was the most effective vehicle to promote transparency of Chinese extractive industries overseas.
- Stock exchange listing requirements. The Global Witness/Syntao report recommends that the Shanghai Stock Exchange (SSE) synchronize their disclosure standards with Hong Kong, China; New York and London, and mandate disclosure of payments prior to listing.
- Regulations in host countries. The consistent message is that Chinese companies will abide by the laws of host countries. As such, improving regulations and enforcement in host countries is the most direct path to upgrading the disclosure standards of Chinese companies overseas.
- Direct engagement with SOEs to encourage them to include EITI reports in annual financial reporting.⁷⁷

D. Possible regional cooperation mechanisms to promote sustainable investment in the natural resources sector

Natural resources are found within country borders, but the effects of their use cross national borders. Regional cooperation is thus needed to align incentives for development of these resources and the processes for their development with national, regional and global sustainability goals.

Regional cooperation could be effective in several areas. One option is greater regional collaboration on regulatory matters. The exchange of information among countries on best practices in investment laws, mining laws and other regulatory steps to protect social and economic development (including enforcement mechanisms) would help raise policy and lawmakers' awareness of good/best practices and evolving concerns.

A second area for cooperation is to pursue a regional agreement on investment incentives (Thomas, 2009), which could help level the playing field and ease the burden on individual and least developed countries by offering comprehensive rules on subsidies and provisions for investment incentives. Efforts by ASEAN have touched on this area already but could be deepened.

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⁷⁷ <http://www.ukti.gov.uk/export/howwehelp/overseasbusinessrisk/item/453900.html>.

Model investment treaties help to provide guidance, but they have their limitations and should be further developed and improved. Regional collaboration on further developing these models could help refine them and ensure their applicability in different contexts.

Another option is to consider the applicability of a framework similar to the Kimberly Protocol to other commodities. The principle here would be whether countries that agree to uphold certain standards agree to trade with each other and not with countries that do not apply these standards. A functioning model would need to be developed for specific commodities. Though not perfect, the Kimberly Protocol is an impressive form of collaboration on transparency and supply chain matters that could be extended beyond diamonds.

When natural resources literally cross borders, such as in the case of rivers and pipelines, regional collaboration is no longer optional but essential. Countries reaping the economic gains from cross-border projects may be different from those countries that are negatively impacted by such projects. International cooperation is thus needed to address uneven incentive structures by ensuring more transparent, participatory and accountable decision-making processes. The recent experience of the Mekong River Commission with regard to dam building in the Mekong underscores this need.

Another opportunity for international collaboration is on measuring the real and long-term economic impacts of these investment activities in the natural resources sector. Studies that comprehensively capture the social, environmental and economic costs and benefits of natural resource use are relatively limited. Additional research leading to new information would be helpful to countries in the areas of policy making, contract negotiations, and development of sector development strategies.

CHAPTER 7

RECOMMENDATIONS

What can be done to promote sustainable and responsible business practices and investment in the natural resources sector with a view to ensuring both a satisfactory return on investment for the business or investor and an acceptable social return on investment for the host country? What can be done to reduce or eliminate barriers to sustainable development and ensure a more enabling environment for practicing responsible business and promoting sustainable FDI in the sector and region? Actually a great deal can be done.

A. What governments can do

1. Aim for clear, strong laws that are well enforced

Review national legal and regulatory framework to ensure they advance sustainable development goals.

2. Improve processes for assessing social and environmental impacts

National law should clarify and increase requirements for ESIA's for all stages of project implementation. Innovative approaches include economic valuations of ecosystems in preliminary project assessments, as well as local/regional planning.

3. Incorporate international standards in national legislation

Asia-Pacific countries should consider passing legislation that enforces high standards of social and environmental compliance, transparency and accountability. This could be by increasing disclosure requirements for listed companies to obtain extractives licenses, requiring more stringent human rights protections, etc.

4. Review tax laws and regulations

Governments may need to review fiscal regimes to ensure they get a fair share of profits generated by investments in natural resources. In this regard, governments need to enhance their negotiating skills and bargaining power.

5. Articulate sustainable development goals in regulations, contracts and agreements

Clearly articulated sustainable development goals should be written into contracts, regulations, and IIAs. Non-financial economic benefits (such as workforce development, supply chain development, community investment plans or local procurement strategies) could also be included in investment contracts and IIAs.

6. Select good investors

In competitive bidding situations, governments could prioritize companies with good track records in social and environmental protection and investment. They may also prioritize companies whose investors have signed onto the Equator Principles or UNPRI. With regard to FDI, targeting techniques exist to help investment promotion bodies identify and target TNCs with good track records.

7. Reduce corruption by increasing transparency and accountability

Governments should reduce corruption by increasing transparency and accountability in payments received, terms of investment contracts, and the granting investment incentives. They should join EITI and consider mandating the disclosure of project-level reporting.

8. Increase public participation

Public participation should be built into all stages of natural resource extraction including legal reviews, contractual processes and ESIA. This will boost transparency, accountability, and help achieve sustainable development goals.

9. Strengthen revenue management

Revenue management should aim at converting revenue to finance capital for sustainable development of local communities.

10. Increase information

Using robust methodologies for conducting ESIA, collecting baseline data on social and environmental conditions, undertake independent evaluation of impacts, etc. will ensure that the results of ESIA have credibility, especially if data to be collected extend beyond the project site and need to be collected regionally as part of a broader development planning process.

11. Implement the Guiding Principles and prepare EITI reports

Governments should adopt and apply international instruments which have a clear role for them. For example, governments should implement the policy recommendations outlined in the Guiding Principles for Human Rights related to the role of the State and prepare an EITI report.

B. What businesses and investors can do

Businesses can:

1. Join international initiatives and respect international standards on codes of conduct

Businesses investing and operating in the natural resources sector should familiarize themselves with the international guidance available for responsible and sustainable business practices and investment in this sector and make genuine efforts to comply with these standards. For this purpose they should sign on to the Global Compact and join industry associations such as IPIECA and ICMM that are leading the way towards sustainable development. Where systems of certification exist, such as RSPO, they should seek certification of compliance with international standards.

2. Follow the Guidance

Businesses should take advantage of some of the excellent guidance documents and other tools produced by IFC, GRI, IPIECA, ICMM, etc. in particular with reference to required actions practices to prevent corruption, protect human rights, protect the environment, etc.

3. Invest in local development

Companies should invest in development of communities living on or around the site of their operations, respond to issues identified in consultation with communities and contribute to local development by devising community investment plans, local procurement plans, etc.

4. Innovate and lead

Companies leading the way on sustainability issues – such as Rio Tinto’s efforts to achieve Net Positive Impact on Biodiversity Policy, or its Resource Guide on Human Rights, positioning them as leaders and help them gain greater access to natural resources, while advancing responsible business practices across the sector. Companies do not need to do this alone; there are a number of CSOs as well as industry association and international bodies that are prepared to help.

Investors can:

1. Participate in responsible investment initiatives

Portfolio and institutional investors should sign up to the Equator Principles and the Principles for Responsible Investment (PRI).

2. Ensure that high ESG standards are met in their investments

Investors need to recognize their enabling role in corporate behaviour, establish high social and environmental standards, and begin mitigating ESG risks that are not

addressed. Both investors and governments should require proper due diligence assessments, full ESIAAs, CEVs, etc.

3. Monitor performance of investments against standards and commitments

Both investors and governments should monitor and evaluate the compliance of companies against their commitments and efforts to follow implementation guidance on issues of social responsibility.

C. What ESCAP can do

1. Undertake active policy advocacy

ESCAP is in a prime position as a regional commission of the United Nations to advance the principles of responsible and sustainable business and investment, in particular the principles of the UNGC, through the ESCAP Business Advisory Council (EBAC) and its Sustainable Business Network and task forces.

2. Support governments in fulfilling their roles

ESCAP can help strengthen government capacity to incorporate international guidance and initiatives in national laws, investment contracts and IIAs. Where appropriate, ESCAP could review and give advice on strengthening national legislation and procedures.

3. Facilitate international exchange of best practices

ESCAP can provide a platform for international cooperation and exchange of information on experiences and best practices in investment policy and contract negotiation that would help disseminate important developments in this area.

4. Facilitate international cooperation around resource use and management

When local, national and regional incentives related to natural resource use conflict with each other, ESCAP can forge regional cooperation to align incentives by identifying solutions that can bring about optimal outcomes at every level whilst meeting sustainability goals.

5. Undertake research on and develop regional sustainability indicators and modalities for convergence of international instruments

ESCAP could undertake research on the development of regional sustainability indicators and instruments in the natural resources sector which are more suitable to an Asian context and differ by development level of countries. It could also identify modalities which would lead to a convergence of various international instruments on responsible business practice to enhance clarity and uptake and lessen the reporting burden for companies on their sustainability actions.

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