SEATINI
Strengthening Africa in World Trade

Policy brief, 2017

Making Investments work for people

Proposals for adoption of Performance Requirement Measures in Investment policies, laws and agreements

Performance Requirement (PR) measures are a range of policy instruments which are used by host governments as investment policy tools to maximize and achieve their economic objectives from investments, especially Foreign Direct Investments (FDIs). They are stipulations required of investors to meet certain specified goals with respect to their operations in the host country. Such provisions support the regulation of investments as well as encouraging joint ventures, technology transfer and local sourcing.

Introduction

Investments have from centuries past played an important role in fostering economic and social transformation in many economies. They come with a number of development promises. Notably, investment can contribute towards the enlargement of the production base through fostering production capacity; it can facilitate modernization of production processes thus improving cost effectiveness and potentially enhancing productivity. It allows for the production of new and improved products through incorporating international world-class innovations hence increasing value addition in production and raising quality standards. It can further bridge the gap between developing and least developed countries with more advanced countries by facilitating increased exports and an active participation to international trade. Investment can also be instrumental in creating jobs and providing a market for locally produced inputs hence increasing individual and household incomes.

It is for this reason that the EAC partner states have aggressively taken to putting in place investment friendly policies, laws and agreements to attract more investments, especially FDI. However, these legislations do not clearly balance between the rights of investors and their obligations towards delivering the development promises of investment.

This paper therefore seeks to emphasize the need for performance requirements measures as policy alternatives that host countries such as the EAC partner states i.e. Uganda, Kenya, Tanzania, Rwanda and Burundi can use to benefit from FDI.

What constitutes Performance Requirements (PR) measures?

Performance Requirement measures are a range of policy instruments which are used by host governments as investment policy tools to maximize and achieve their economic objectives from investments, especially FDIs. Such provisions support the regulation of investments as well as the regulation of capital outflows by foreign investment including encouraging joint ventures, technology transfer and local sourcing. They are stipulations imposed on investors requiring them to meet certain specified goals with respect to their operations in the host country. They are and have

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been used by developed and developing countries together with other policy instruments, such as monetary and fiscal policy, trade policy, labour policy, environment laws, screening mechanisms and incentives appraisal frameworks; and are often aligned to the host states' development strategies. Nonetheless, there are divergent views as regards the effectiveness of performance requirements. While some experts regard them as an essential instrument in a country's FDI policy package, others tend to argue that their impact on a country's attractiveness to investment inflows could at best be limited and at worst costly and counter-productive.

Forms of Performance Requirement measures

According to the International Institute for Sustainable Development, the forms of PRs vary. These could constitute Mandatory and Non-mandatory Performance Requirements. Mandatory PRs are often linked to the conditions for the entry and operation of an investment. Therefore, the investor must agree to them prior to establishing its investment or continuing to operate in the host state. Non-mandatory PRs, on the other hand, are linked to access to certain benefits. These may include tax exemptions, land concessions or subsidies by the host country.

Performance requirements can generally be imposed on the investor before the investment is made and after it has been made and is already in operation. However, the latter has often resulted into legal implications. Mandatory performance requirements imposed on investments already in operation have often been deemed to be in breach of the host state's commitments, especially in trade and investment treaties. This can especially be very problematic in scenarios where the host state is committed to an agreement/ treaty in which a provision on "Expropriation and Compensation" has been included. This can especially be problematic if the provision does not clearly stipulate or clearly distinguish between legitimate state regulatory activity in the public interest and those state measures that are deemed expropriatory or in breach of the treaty.

Performance Requirement (PRs) Measures[1]

PRs measures may range from local content requirements to export performance requirements. Below are the various performance requirement measures that a host country can adopt under various circumstances:

Local content requirements: Ensure a level of local content for products and services. This may consist of measures directly imposing a percentage or quota to be achieved or requiring the priority use of local goods and services over foreign goods and services of equal quality. These PRs are intended to foster forward and backward linkages in order to drive the creation and diversification of related economic activities i.e. agriculture, industry and services, thereby facilitating structural transformation. They are particularly crucial in the extractive industries sector, which is often an economic enclave in host countries. – Germany.

Employment requirements: Achieve a specific level of local jobs. These measures may also take the form of a quota to be filled or be subject to the condition that jobs be made available in equal quality and quantity over the territory. They may relate to both skilled and unskilled posts, and aim to increase and diversify the number of jobs

[1] Performance requirement measures in Investment Treaties: Best practices series, 2014 by IIDS

created by the investments and contribute to reduce unemployment. For example, countries like South Africa have put in place specific policies such as the Black Empowerment Program where investors are required to employ a certain number of African black citizens to ensure inclusiveness[2].

Skills transfer requirements: Engage the workforce (local) in training programs or build the capacities of suppliers of goods and services. These requirements are often a response to demands for the location of the workforce and suppliers of goods and services in order to overcome the critical problem of a lack of appropriate skills or abilities. An example in Ethiopia during the development of the Railway, the Ethiopian Railway Corporation required that the China Railway Group takes time off to transfer skills and technology to the Ethiopian citizens. Part of the agreement involved a technology swap that saw 10 Ethiopians head to China for training. Some of the train masters and project engineers spent between 10 and 15 months in China on training before coming back to take charge of the project under the supervision of the Chinese engineers[3].

Transfer of technology to the host country: The investor brings a certain level of a predetermined type of technology, which it often owns, applying the highest industrial standards. These requirements aim at enabling local enterprises to access the best technologies and preparing them to better compete on the world market.

Maintain specified environmental and social standards: These PRs should not be confused with requirements for the internationally recognized and required practices of environmental and social impact assessments nor should they be confused with Corporate Social Responsibility. These requirements help ensure that the investor is conscious and therefore provides means to avert possible adverse impacts of the investment on environmental and social conditions in the communities where the investment is located.

Joint venture and equity venture requirements: Form a joint venture with national partners in the investment. These requirements are intended to ensure that certain key sectors of the economy do not fall under foreign control. Joint ventures may also foster the transfer of skills, technology and know-how to local companies. Furthermore, they may also be a means of creating national champions in a sector by enabling them to benefit from the Experience and strengths of a foreign company. In addition, equity venture requirements require that a minimum level of domestic shares in the company's capital is maintained. These requirements help ensure that certain sectors remain under the control of nationals, or generate income to the benefit of nationals. In India, domestic equity requirements have helped to promote the formation of joint ventures that in some cases generated externalities in the form of local learning and quick absorption of knowledge brought in by the foreign partners. The South African experience suggests that mandatory domestic equity requirements in selected service industries and in mining helped to ensure new opportunities for black South African-owned businesses.

Export performance requirements: Requirements to export a certain level of locally produced goods

[2] Analysis of the Uganda-Netherlands Agreement on Encouragement and Reciprocal promotion and protection of investment: Policy recommendations for its review

[3] East Africa: Kenya, Ethiopia Bet on Technology Transfer in their Railway Projects http://allafrica.com/stories/201606150857.html

and to limit a certain volume or quantity of sales of goods or services to the national market. The aim of this requirement is to balance or achieve a surplus in the country's terms of trade as well as increase the amount of foreign exchange inflows into the country hence contributing towards addressing a country's balance of payment deficits.

Location requirements: A requirement that certain investments should only be established within specific areas and not in others. The aim of these requirements is to accelerate development in disadvantaged areas of the country. It may also be aimed at protecting certain natural resources. For example, a requirement that an industry engaged in manufacturing of certain products should not be located along the banks of a water resource.

The role of Performance Requirement measures in Making Investments work for people

Although the inclusion of performance requirement measures in investment laws, policies and agreements has recently been contested, its relevance cannot be overlooked. Notably:

1) Provisions on Performance requirements measures can amidst the paradigm of liberalization; deregulation; and private sector led development help to reinforce and reinvigorate the role of the state in development. At the moment, many LDC governments struggle with the task of ensuring that their countries reap from the increasing amount of resource seeking FDI flowing into their different countries. While countries like Uganda, Kenya and Tanzania currently boast of a variety of mineral resources (renewable and non-renewable), the extent to which the indigenous people, especially marginalised groups of women and youth can benefit from these resources; and the subsequent returns from investment can at the moment only be influenced by the active role of the state.

2) In addition, PRs can be used to regulate the amount of financial outflows in the form of profit repatriation through requiring that a certain percentage should be reinvested into the host state. This is especially important given that many LDCs as their governments are always faced with balance of payment difficulties due to capital flight, transfer mispricing, profit repatriation and other licit and illicit outflows; coupled with the burden of internal and external debts.

3) PR measures can also be used to explicitly highlight the obligations of investors. Hence providing clarity on the rights and responsibility of investors and providing a framework on which the investors can be held accountable for their actions towards employment creation, payment of their fair share of taxes, waste management to ensure environment sustainability; skills and technology, among other promises of investment.

4) PRs can also be used to protect governments from being sued by investors on vague grounds of unfair treatment or because government regulation is considered harmful to their businesses. Including a provision which highlights the performance requirements for investors establishing within a given country provides the host state with grounds to regulate an investor or revoke the license of an investor who violates people's rights or damages the environment. It also empowers the host state's community to be able to hold investors operating within their jurisdiction accountable for their obligations as spelt out in such a provision.

Shrinking policy space

Many Bilateral Investment Treaties (BITs), as well as investment provisions in Free Trade Agreements (FTAs) do not include the provision on Performance Requirements. Designed with the intention of ensuring that such bilateral agreements conform to WTO obligations, BITs and investment provisions in FTAs have been designed to conform to the WTO Trade Related Investment Measures (TRIMs) agreement which prohibits countries from adopting in their laws, certain performance requirements. However, during the 6th WTO Ministerial Conference 2005, the LDCs were allowed to maintain, on a temporary basis, existing measures that deviate from their obligations under the TRIMs Agreement until 2020.

Whilst this policy space exists for LDCs like Uganda, Tanzania, Burundi and Rwanda, it is systematically being eroded away through BITs and investment provisions included in FTAs that are being negotiated and signed by these countries. This erosion of LDCs' policy space has further been aggravated by the fact that the parties (developed countries) with which these countries (LDCs) negotiate and sign these agreements are not entitled to the existing flexibilities. For example, currently, developed countries like the U.S in their BIT model, 2012, instead, provide for a provision on prohibition of performance requirements. BITs negotiated and signed with the U.S on the basis of this model therefore prohibit the parties:

I. Exporting a given level or percentage of goods or services;
II. Achieving a given level or percentage of domestic content;
III. Purchasing, using, or according a preference to goods produced in its territory, or to purchase goods from persons in its territory;
IV. Relating in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
V. Restricting sales of goods or services in its territory that such investment produces or supplies by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
VI. Transferring a particular technology, a production process, or other proprietary knowledge to a person in its territory;
VII. Supplying exclusively from the territory of the Party the goods that such investment produces or the services that it supplies to a specific regional market or to the world market; or
VIII. Purchasing, using, or according a preference to, in its territory, technology of the Party or of persons of the Party; or
IX. Preventing the purchase or use of, or according of a preference to, in its territory, particular technology, so as to afford protection on the basis of nationality to its own investors or investments or to technology of the Party or of persons of the Party.

Recommendations

- Performance requirement measures should be included in all policies, laws and agreements of the EAC partner states in particular and the EAC in general. In addition, consideration should urgently be made to embark on the review and renegotiation of all BITs and investment provisions in FTAs to which the EAC and the individual partner states are party, to ensure that they include performance requirements.
- Countries of the EAC partner states should review and pursue the renegotiations of all

investment agreements that are currently in force to include this provision. New agreements should not be signed without the inclusion of this provision.

- The EAC secretariat in developing the EAC Investment policy and strategy, should include a provision for all forms of performance requirements. These should be identified, developed and included in the policy and strategy while taking into account the development needs to all the partner states.
- The partner states' national investment authorities should adopt performance requirement measures as part and parcel of their monitoring programs/ agendas to ensure that investors are meeting their obligations.
- Finally, civil society within the EAC should take a more effective role in demanding for inclusion in investment legislation and agreements; and subsequently monitor and hold government accountable for enforcing these requirements; and investors accountable for adhering to these performance measures.

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Acknowledgement

This policy brief was developed by SEATINI Uganda with support from Both ENDS. SEATINI would like to extend its appreciation to Both ENDS for the financial and technical support rendered in the production and publishing of this policy brief.