



The Voice of OECD Business

Freedom for Investment – Sovereign Wealth Funds and the Economics of Climate Change

BIAC Statement to the OECD Council Meeting at Ministerial Level

3 June 2008

BIAC is pleased to submit this statement to the 2008 Meeting of OECD Council at Ministerial Level (MCM) as input to the BIAC and TUAC consultation with the MCM bureau.

BIAC appreciates this opportunity to engage in discussion with OECD Ministers, Ambassadors and Leadership on this paper's two areas of focus: Sovereign Wealth Funds and the Economics of Climate Change.

OECD countries' policies towards investment from sovereign wealth funds (SWFs)

Introduction

1. BIAC strongly welcomes the discussion that OECD Ministers will have at their annual Meeting on the OECD policy initiative "*Freedom of Investment, National Security and 'Strategic Industries' – Sovereign Wealth Funds and Recipient country Policies*" (FOI Project).
2. For OECD business the FOI project including its implications on investment policies towards sovereign wealth funds (SWFs) are of high importance. In 2005 we urged the OECD, as the international organisation for investment, to take the lead in countering emerging investment protectionism. We called on the OECD to build on its investment instruments and its experience and to identify best practice policy guidance to keep markets open for cross-border investment without compromising legitimate national security objectives. Since the Organisation embarked on its FOI project in 2006, BIAC and its members have been providing continued business input and support for the initiative within the OECD context as well as in the member countries.
3. In March 2008, BIAC urged the OECD Council to prepare a political statement to be issued by the Ministers at their Meeting in June that confirmed strong commitment to open markets for investment and OECD's leading role in fostering this support. We are now very pleased to see that a draft Ministerial Declaration "Sovereign Wealth Funds and Recipient Countries' Policies" has been developed. However, in BIAC's view this Declaration must be further strengthened to restore fully investors' confidence in OECD countries' policies towards incoming foreign investment from SWFs.
4. With this submission BIAC highlights the business concerns about the reassessment of investment policies in many countries, provide our assessment of the OECD work under the FOI project so far and suggest concrete improvements concerning the text for the Ministerial Declaration.

Countries have been tightening rules on foreign investment

5. OECD business is very concerned about reassessments of investment policies that we have witnessed in several countries. In some cases this has led to a tightening of legislation and procedures applied to foreign investors while in others similar discussions are well under way.
6. Increased activity by foreign investors that are state-sponsored is one important factor that has fuelled discussions on how foreign investment may impact on governments' abilities to ensure national security is protected and how to restrict foreign investor activity in sectors perceived to be of strategic importance. BIAC members are concerned about the risk that the debates may trigger inappropriate policy responses in OECD

countries which may endanger the continuing benefits that cross border investment brings to countries and to their citizens.

7. We see this reassessment of investment policies and the tightening of investment procedures as being driven by varying motivations. In some cases the main purpose is to protect domestic industries from foreign competition or to limit the influence that foreign companies have as shareholders in domestic firms. In this context, BIAC notes with serious concern that in the past few weeks a number of OECD countries have blocked planned foreign investment by private businesses into their economies.
8. National security concerns are also an important factor which threatens to make our markets less open to foreign investment. While protecting national security must be a top priority for governments, it is also important to note that the impact of tighter investment procedures on cross-border investment, growth and job creation is usually negative regardless of the reason for the tightening. BIAC believes that in some cases where rules were tightened for national security reasons, governments had not seriously explored all possible alternative measures. In the view of OECD business, host governments should not restrict capital inflows from SWFs or any other foreign investor for purposes other than narrowly defined national security reasons.

BIAC appreciation for the OECD work

9. The preliminary OECD results concerning FOI and the development of host country policy guidance towards foreign investment including from SWFs are summarized in the OECD Investment Committee Report, 'Sovereign Wealth Funds and Recipient Country Policies', 4 April 2008. We congratulate the OECD for the good quality of this paper and the high relevance of its policy implications. In our view, the report provides a very useful background for the discussions among the Ministers outlining basic principles and pointing the way to further work.
10. We particularly support the OECD statement that SWFs have much to offer to our economies. For the recipient countries, great opportunities emerge from the additional capital that SWF investments bring and that helps our businesses to thrive, boost investment and create jobs. The benefits of capital injections have been clearly felt in the financial sector which received some US\$ 50 billion SWF investment in the past ten months. Many OECD companies from other sectors also report very positive experiences with SWFs that have shown themselves to be reliable and long-term investors.
11. BIAC believes it is important that the OECD reminds its member countries of their commitments as hosts of foreign investment under the OECD investment instruments. As the Organisation stresses, these instruments require fair treatment for all foreign investors including SWFs.
12. We also wholeheartedly support the OECD call on countries not to misuse legitimate concerns about protection of national security as cover for protectionism and to apply any investment procedures, if at all, with restraint, i.e. only for narrowly defined national security purposes.

13. Further, BIAC fully endorses the OECD principles for recipient country policy guidance. Non-discrimination, transparency/predictability, regulatory proportionality, and accountability are cornerstones of sound investment policies. Any investment screening and authorisation procedures applied by OECD countries must fully respect these basic principles in practice.
14. We support the OECD's call on SWFs to apply high standards of governance and transparency. The application by SWFs of best practices to be identified by the IMF will facilitate keeping markets open for foreign investment.

Business expectations for the Ministerial Meeting

15. In our view, the main purpose of a discussion at the highest OECD level should be to confirm that the OECD will play the leading role in the international debate on freedom of cross-border investment. The Organisation must provide the leadership to shape further understanding about the real issues at stake. The preliminary policy guidance on how to keep our markets open for foreign investment without putting national security at risk must be further clarified to ensure effective implementation in practice.
16. In our letter to the OECD Council dated 20 March 2008, we made it clear that in view of the ongoing policy discussions and actions concerning approaches to foreign investment, BIAC finds it imperative for the OECD Ministerial Meeting to not only discuss but to issue a clear, concise political message in support of open markets for investment and the existing OECD investment instruments. We stressed that we are convinced that such a statement will have a profound, positive effect on markets and policy makers. It would be timely as it would help to restore business confidence by making it clear that the current investment policy debates and actions do not represent a shift towards investment protectionism.
17. We are now delighted to see that the Council and Ministers seem to share BIAC's view concerning the importance of a high-level political statement and that a draft has been issued. We welcome that the draft Declaration includes the Minister's endorsement of the principles: (a) not to erect protectionist barriers to foreign investment; (b) not to discriminate among investors in like circumstances and to limit any additional investment restrictions to cases where there are legitimate national security; and (c) where such national security concerns arise, to apply only investment safeguards that are transparent, predictable, proportional and accountable in their application.
18. However, in BIAC's view the Declaration needs to be strengthened further to reflect fully the level of commitment by OECD Ministers that would be necessary to restore investors' confidence in OECD countries' policies towards incoming foreign investment from SWFs. In our view, some issues alluded to in the Declaration should be addressed in a clearer way to ensure that markets and policy makers can fully understand the message. Further, we suggest raising additional important issues that are not yet mentioned in the draft text. We urge the Ministers to send a stronger political signal by addressing in their Declaration the following additional points:

- A. **Scope and timeline for future OECD work.** The OECD has agreed on the guiding principles (transparency, predictability, accountability, and proportionality) for foreign investment safeguards that countries may consider in cases where legitimated national security concerns arise. Yet, how these principles should be practically implemented is still unclear. We believe that the Ministers should inform markets and policy makers that the Organisation will address these questions in detail and present the results **by mid-2009 at latest.**
- B. **Implementation and monitoring.** The draft Declaration includes a brief reference to future “peer monitoring of policy developments”. However, given the critical importance of implementing future OECD policy guidance, we would expect a clearer commitment to this activity. We believe that the Ministers should **commit to full implementation** of the OECD policy guidance on the country level. This commitment should be accompanied by full endorsement of the concept of **country-specific peer monitoring reviews** aimed at benchmarking Members’ policies and actions against the agreed OECD policy guidance.
- C. **OECD-IMF co-operation.** The draft Declaration mentions “continuing co-ordination between the OECD and the IMF”. We believe the Ministers should be more specific about their objectives. We therefore suggest clarifying the Declaration stating that in pursuing their respective mandates on establishing policy guidance for recipient countries and for transparency and governance of SWFs, the OECD and the IMF will closely co-ordinate their activities to make sure that the results of their work will be **fully complementary and consistent.**
- D. **Involvement of SWFs and their home countries.** In the draft Declaration the Ministers welcome “international discussions involving SWFs, their governments and recipient countries”. We believe the Ministers should go a step further and **pro-actively invite** SWFs and their home governments **from non-OECD countries** to a constructive dialogue and active participation in the OECD work. The OECD should be fully aware of the expectations that SWFs have concerning the policies and procedures applied to their cross-border investment in OECD countries.
19. BIAC calls on the Ministers to issue a Declaration at their Meeting on 4-5 June 2008 which adequately reflects our suggestions.

Addressing the climate change challenge

A contribution to the OECD project on the economics of climate change

Introduction

20. There is broad-based agreement within the business community that climate change is a challenge to which all parts of society, including business, need to respond. In view of the magnitude of this challenge and the important repercussions on economies that policies to address climate change can have, it is vital that policy makers can base their decisions on a clear understanding of how climate change economics can inform the development of efficient, national, regional and global response strategies.
21. We are at a crucial point in time. The United Nations Climate Change Conference in Bali last December opened the door to broadening cooperation on climate change and paved the way for post-2012 discussions, calling for a new decision at the United Nations Climate Change Conference in Copenhagen in 2009. In view of this short timeframe, it is more urgent than ever to give the necessary attention to the economic aspects of climate change and assess the economic implications of different policy scenarios.
22. Thanks to the OECD's strong economic expertise as well as its evidence-based and multi-disciplinary approach, the Organisation is, in BIAC's view, ideally placed to advance the understanding about the economics of climate change, thus providing an important contribution to international climate change debates. We therefore welcome the launch of the OECD project on the economics of climate change and call upon Ministers to support further work in this area, which should receive the necessary attention both within national governments and at the international level. This paper puts forward key considerations for OECD analysis and policy recommendations in this area. BIAC looks forward to contributing constructively to these discussions.

Considering the complexities of climate change analysis

23. The analysis of climate change economics is a complex task, which requires attention to the long-term time scale, the extent and nature of uncertainties concerning climate change impacts and the character of future technology options, the international scope of the issue and the uneven distribution of policy costs and benefits across space and time, as well as consideration of the effective timing of policy measures. Costs and opportunities need to be considered in a balanced manner. When analysing climate action, a wide range of factors need to be taken into account as they will undoubtedly have implications for climate change policies, including the enormous investment requirements in both energy and energy-intensive sectors that will be necessary to ensure access to reliable energy and its efficient use. The IEA has carried out quantitative analysis on the investment requirements in the energy sector, which can be usefully drawn upon.

24. The question of the effective timing of mitigation or adaptation and consideration of what is possible and when, should be given due attention. In particular, low income countries may prefer to adopt policies aimed at achieving high growth rates in the nearer term followed by higher abatement in the future when they are able to afford such measures. Developing countries are facing particular challenges. The combined effort to pull millions out of poverty and give them access to basic resources, such as clean water and reliable energy, illustrates the enormous task at hand. Challenges exist in the areas of managing urbanisation and tackling deforestation. Mitigation policies should therefore be considered within the framework of policies that are necessary for enhancing living conditions for the poor of the world. While efforts often focus on mitigation, the economics of mitigation, adaptation and impacts need to be considered. Given that global temperatures are forecasted to rise even in a low growth scenario, adaptation policies will inevitably need to be considered as an additional policy option. We strongly recommend giving the necessary attention to the economics of impacts and adaptation to ensure that potential adaptation measures are based on a clear understanding of the costs and benefits to the extent possible.
25. While economic assessment of climate policy options is vital, we strongly recommend taking into account the complexities and linkages to other important policy areas that have direct implications for climate change discussions. The ability to respond to climate change will be affected, for example, by policies aimed to address energy supply and use, energy security and economic development. Climate policy will have impacts on other key areas for economic development, environmental protection and trade. For example, if policies encourage low greenhouse gas (GHG)-emitting, but land and water-intensive energy sources, such as biofuels, what would this imply for access to water, another major and increasingly important challenge the world is facing? Such consequences are important factors in determining the best course of action regarding climate change and need to be part of the discussions.

Seeking cost-effective responses to tackling climate change

26. The overarching aim of market-based climate policy is that those who generate GHG emissions should face the marginal cost of the impact of their emissions. Market-based policies that allow for sufficient flexibility and include provisions for broad international cooperation will be important in effectively reducing GHG emissions globally over many decades with minimum disruption of economic activity. To deliver reductions at least cost, economic analysis often underlines that a common price signal is required across different sectors and countries as might be achieved in an ideal system by taxing emissions or by capping them and allowing emission permits to be traded among emitters. While a price signal is important, there are political and practical challenges to enable and enforce a single price on GHG emissions. To minimise costs and regional competitiveness impacts, all sectors and countries would have to be included, and the requirements to implement such a universal tax system would be far-reaching.
27. Both taxes and emissions trading have their pros and cons. Competitiveness impacts in sectors and regions that are trade-exposed need to be given careful attention. Overall tax neutrality is important, and using taxes or revenues from selling or auctioning CO₂

allowances in trading systems purely as revenue raising mechanisms should be avoided. Full auctioning would represent an additional cost burden and would remove money required for investment to address mitigation or adaptation at the enterprise level. The global dimension and potential competitiveness impacts on energy intensive industries must be given due attention in discussions on regional trading schemes, e.g. through free allocation of allowances based on benchmarks. At the same time, the potential of flexible mechanisms involving the developing world should be investigated.

28. It is also important that subsidies be reviewed on a regular basis for both their economic and environmental effectiveness with a view to avoid market distortions. In recent years, for example, government support to biofuel production has increased drastically across the OECD, creating impacts that affect several sectors, and calls for careful life-cycle and cost-benefit analysis. We welcome fact-based OECD analysis in this area, which is essential to provide a clear picture of both environmental and economic realities.
29. Pricing mechanisms are one, but not the only way to address climate change. Price-signals alone may be insufficient to provide incentives for timely development and deployment of advanced, currently non-commercial technologies. Voluntary initiatives, industry-led global sectoral initiatives, public and private innovation and deployment of new technologies as well as the benefits of public-private partnerships need to be given increased attention. Furthermore, it is crucial that in post-2012 discussions, there is clarity on the future of mechanisms such as the clean development mechanism (CDM), which needs to be continued, but in a more inclusive and efficient manner. While standards and building codes have a role to play, their costs and continued usefulness should be carefully reviewed as standards are not cost-free and quickly become obsolete as technology evolves.
30. The economic costs of addressing climate change may be potentially large, particularly if there is no comprehensive coverage of emitters, sectors and types of gases and if policy measures are introduced without careful cost-benefit analysis. A cost-effective strategy is therefore essential for long-term progress, not only because it will enable policy makers to take action more easily, but also because it is the only way that will encourage widespread participation. Consumer preferences, ultimately, will dictate the success or failure of policy, as firms can only operate as long as their products are acceptable in the market. Education will play an important role in this area.

Considering micro-economic and regional implications

31. Impacts of climate policies will not be homogeneous across the OECD, and certain countries, regions and sectors are likely to be affected disproportionately. There is a need to consider and adapt strategies according to different economic levels as well as investment opportunities. Estimates based on economy-wide general equilibrium models often do not reflect the implications for sectors and regions and fail to include dead-weight losses associated with transitions. Such analysis should also consider how climate change policies could change the relative competitiveness of both energy-intensive industries as well as low-energy sectors and which costs and benefits would arise from the resulting sectoral changes in production and employment patterns. Furthermore, we suggest that OECD analysis support development of policy

approaches, for example, in the areas of labour market or social policies, that facilitate effective structural adjustment that climate change policies may trigger. Policies aimed at mitigation of climate change, unless well framed, are likely to create winners and losers. There will be business opportunities for some sectors, while other sectors will be negatively impacted. There is therefore a need for concerted effort at the international level to have a clear picture of the development trends in affected sectors arising from policies aimed at climate change mitigation.

Enhancing flexibility

32. Strategies to reduce GHG emissions must be achievable and be designed in a sustainable development context, taking into account economic, ecological and social factors and providing for sustainable economic growth. By maximising flexibility, the combination of voluntary industry-led initiatives and voluntary agreements and partnerships in combination with flexible instruments can contribute to cost-efficiency in the implementation of climate change policies, the positive ramifications of which will be felt globally if correctly designed and implemented. Bearing in mind that tangible results are important, voluntary initiatives can play an important role in the overall policy mix.
33. A number of companies, business organisations and sector associations have made proactive voluntary contributions, often in close dialogue with national governments. Such initiatives, of which there is a wide range, should be welcomed and encouraged. Industry-led voluntary sectoral initiatives have the potential to lead to efficiency improvements reaching beyond national borders, while at the same time fostering improved measurement and reporting, the exchange of best-practice and global dialogue. Beyond those industry-led initiatives and in the light of current discussions on sectoral approaches, more clarity is required on their nature and scope. This is especially important because the role and relative importance of sectors varies significantly depending on differing national circumstances, which need to be considered. Discussions need to proceed carefully and in close dialogue with affected sectors.

Encourage open trade and markets

34. Open trade and climate change policies should not be seen in opposition to each other, but rather how they can be mutually supportive of each other, recognising that open markets and trade will be essential for the transfer of best-available technology through private investment. BIAC is concerned about suggestions by policy makers in some OECD economies to use trade measures against “climate sinners”. These proposals range from carbon taxes on imports or border tax adjustments for imports to extensions of domestic emissions trading systems to imports. The basic aim of these measures is to level the playing field for domestic industries being subject to domestic climate change policies. BIAC believes that the proposals for trade measures are seriously misguided. Unilateral trade sanctions do not help to address the problem of climate change, but will cause considerable damage to the international trading system.
35. Trade sanctions imposed by OECD countries against countries that are exempt from reduction commitments under international law would likely lead to trade retaliation, which, in turn, could lead to an escalation of retaliatory measures. The resulting spiral of

trade protectionism would be difficult to stop and would represent a threat to the multilateral trading system, which is crucial not only to OECD, but also emerging and developing economies.

Fostering broad participation to ensure environmental and economic efficiency

36. Choosing the most effective policy tools will be essential, but of limited effect if only a handful of countries are involved. To be successful, a post-2012 international agreement needs to involve a group of countries that is as broad as possible involving in particular all the major emitters. This will require close dialogue and cooperation with these countries and an acknowledgement of their concerns and possibilities. If only selected countries commit to future emissions reductions, be they considerable, they might easily be offset by emissions in other parts of the world. Ultimately, the participation of major emitters will depend on adequate burden sharing mechanisms that are both effective and broadly acceptable. It will be essential to enhance the rate of deployment of existing efficient technologies and speed the development of innovative, currently non-commercial technologies with low emissions.
37. OECD discussions on enlargement and enhanced engagement should give room for discussions on climate change benefiting from the OECD's economic-based analysis and recommendations. We call upon the OECD to intensify such dialogues and make the analysis of incentives for non-member countries to become involved in global climate change discussions a major focus of future work.

Finding the resources for innovation

38. Besides policies to limit emissions, the key to minimising the adjustments that will accompany the shift towards lower carbon-emitting societies is to adopt emission reduction strategies that help speed up the development and deployment of energy-efficient and low-emitting technologies in the future. By identifying the possibilities and boundaries of technology, within and across industries, research and development can be applied in a targeted way. Deployment of technologies, both within OECD and non-OECD countries, is equally important and deserves the highest attention. In that regard, the vast majority of financial and investment flows will come from the private sector. Particular attention should be devoted to finding solutions that would also be practical given the realities of less developed countries and that would allow them to leap directly to the use of cleaner solutions. Therefore, providing an enabling framework for the private sector that facilitates these financial flows will be essential.
39. It is unrealistic to think that the issue of climate change can be dealt with solely via a mandatory or pricing approach. An overall enabling policy framework that takes into account the potential and complexities of environmentally beneficial innovations, as well as the flexibility, support and incentive structure that encourages firms to innovate and invest is essential. The full range of technologies that might contribute to solutions needs to be considered, including those that enable more efficient use of fossil fuels, safe nuclear energy, renewables and carbon capture and storage. An integrated policy approach to innovation is essential, taking a whole-of-government approach and

considering new dimensions in the increasingly globalised innovation process. With this in mind, business requires: Greater emphasis on international collaboration to foster R&D while avoiding wasteful duplication of efforts and maximising opportunities for international co-operation in basic research; a policy framework that provides adequate incentives to create and adopt new technologies in all areas that can bring efficiency improvements and reduce emissions; efforts to improve public acceptance of key technologies; a policy framework that encourages the private sector to invest and thus engage in technology cooperation; as well as trade and investment liberalisation to accelerate the transfer and diffusion of technology.

Concluding remarks

40. In the run-up to the United Nations Climate Change Conference in Copenhagen in 2009, BIAC recommends that the OECD consider broad-based research on the economics of climate change as one of its key priorities. Such research, which will benefit from the expertise of OECD member countries and the OECD's strength in economics, will be essential for policy decisions to be considered in the not too distant future. We call upon Ministers to support further OECD work in this area, providing a clear framework for fact-based analysis of both macro- and micro-economic policy implications to better inform future policy discussions on climate change. We encourage the OECD to provide clear descriptions not only of the results, but also of underlying modelling methodologies and assumptions regarding cost and performance of future technologies and policies.
41. According to OECD analysis, achieving ambitious climate stabilisation goals could be affordable, *provided that* the least-cost solutions are implemented. The importance of cost-effective solutions cannot be over-emphasised. We therefore urge governments to give the necessary attention to OECD analysis and call upon Ministers to:
 - Provide full support for further work on the economic implications of climate policy options;
 - Give preference to cost-effective policy options based on comprehensive cost-benefit analysis;
 - Consider effective ways of fostering innovation and deployment of climate-friendly technologies through open markets;
 - Encourage broad international dialogue and cooperation.
42. Recognising the importance of addressing climate change, BIAC looks forward to making a constructive contribution to these discussions.