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OECD WORKING PAPER FAILS TO FIND EVIDENCE OF SOCIETAL BENEFITS FROM INTERNATIONAL INVESTMENT AGREEMENTS

The debate around globalisation is no longer so much about barriers to international commerce in the form of tariff rates. With tariffs being reduced by the WTO and in rounds of specific trade agreements, the focus today is more on, so-called, non-tariff barriers, and in particular, on international agreements that protect the rights of foreign investors when locating production abroad.

Proponents of such International Investment Agreements (IIAs) claim that offering investor protection and/or non-discriminatory treatment to foreign companies would result in higher investment, thereby contributing to more jobs, production and international trade.

Trade unions, however, take a critical view of IIA's and see them as a means to strengthen corporate power, in particular when these provide corporations access to international arbitration through 'Investor-State Dispute Settlement'.

Against this background, the fifty-nine member governments of the OECD-hosted *Freedom of Investment (FOI) Roundtable* requested in 2014 the OECD Secretariat to carry out a review of the available evidence on the benefits and costs to society of investor protection. The OECD just now released the results of this research[1].

The resulting conclusions do not make for comfortable reading for the proponents of international investment protection. Summarising a host of existing studies, the OECD concludes that while IIAs almost invariably claim to result in mutually beneficial business activity, there is "surprisingly little evidence on its validity" (page 13) and that "very few of (the claims) have been empirically tested, and few of those that have been tested have been confirmed empirically".

The several dozen econometric studies reviewed in the OECD paper show diverse and at times contradictory results: some find a positive correlation between IIA's and foreign direct investment inflows; others a very weak correlation; and others still no or a negative correlation (page 29). The paper also cites a recent (2015) meta-study, which concludes that there is 'no empirical confirmation that BIT's[2] increase FDI flows or stocks' (page 30).

[1] Pohl J. (2018) "Societal benefits and costs of International Investment Agreements: A critical review of aspects and available empirical evidence", OECD Working Papers on International Investment, 2018/01, OECD Publishing Paris.

[2] Bilateral Investment Treaties (BITs).

In other words, the OECD paper finds little robust evidence of the presumed positive impacts of IIAs, despite the fact that their number has grown substantially – currently over 2200 BITs are in force.

To some extent, the OECD paper hides this conclusion by providing a number of caveats: information is not publicly available; studies often misuse concepts, including by confusing tangible investment activities with overall foreign finance flows; results concern outcomes of older types of IIAs and not the new design of more recent treaties. However, some of these caveats imply that the small or non-existing benefits of IIAs in these studies may even be overrated. For example, the OECD notes that little is known about the settlements reached in disputes, hence the ultimate costs for society are unknown and may be larger than otherwise assumed (footnote 266).

Importantly, the body of the OECD paper makes a number of interesting arguments, which strengthen the overall finding that no empirical evidence exists to make the case in favour of international investment protection:

1) Economic effects of capital inflows are not per definition beneficial as foreign direct investment can impact negatively on domestic entrepreneurship when availability of skilled workers and access to credit is reduced. Foreign takeovers may also erode the domestic tax base. Concerning the latter, a quote in a footnote (28) is illuminating: "*If you're advised that an Australian company is a major taxpayer and if it is purchased by someone overseas and therefore its tax liability would be reduced to zero, that feeds into a decision about what is contrary to the national interest*".

2) The 'hold-up' hypothesis, according to which governments shift policies and treatment towards an investor once the investment is done, is not plausible. Governments do care about the reputational risk of future investments, rather than considering just one (implemented) investment in isolation. And not all investments are as immobile as in extractive industries, so the investor still has some leverage over government by considering withdrawing.

3) One of the assumed benefits of international investment protection is that there are spill-over effects from the transfer of technology and know-how between economies. However, for this to happen, the investment needs to be truly 'foreign' and originate from abroad. The OECD paper stresses that this is not always the case. It is not unusual to find practices of 'round-tripping', where a business from the host country makes sure its investment transits through one or more other jurisdictions so that it is recorded as 'foreign' and enjoys the protection offered by the international agreement. In that case however, there is no added benefit for the local economy.

4) If IIA's are to have an impact on investment decisions, then those who make those decisions should be aware of the investment protection offered. Surveys, however, show little or no awareness – neither among decision-makers nor business. A study from 2000 shows that just over half of the surveyed companies had knowledge or awareness of BITs. A 2006 survey records that half of respondents state that the existence of an IIA influences investment decisions 'to a limited extent'. Another survey, from 2010, finds that decision-makers and legal counsels of US corporations view the presence of an IIA as a positive but un-important factor when making decisions on where to allocate investment abroad.

5) Similarly puzzling for the case in favour of IIA's is that investment promotion agencies, which would be expected to 'market' these agreements in order to attract investment, are also indifferent to IIAs. A 2013 study, based on an assessment of 155 websites of investment promotion agencies, finds that two-thirds fail to mention the existence of a BIT at all, while only 6% of the websites offer the full text of the BIT. This suggests that countries consider that BITs 'play a marginal, if any, role in attracting foreign capital".

6) Another way to test the practical impact of investment protection is to look at the premiums on insurance against political risk. It again appears that IIA's play a marginal role in the pricing of such risk.

7) The OECD is also unable to find any evidence that IIA's in some way would promote 'higher quality' investment. Indeed, the OECD paper notes that some Treaty features can be read as actually *prohibiting* host-government efforts to enhance the quality of investment by restrictive practices such as requiring research and development or education and training efforts from international investors. And even if some BITs contain language on responsible business conduct (RBC), such references are found in the preambles or in the obligations of home or host states, and are not directed to individual investments themselves.

8) A further argument is that investment protection is necessary to prevent governments from giving domestic companies preferential treatment. In reality, however, it tends to be the other way around: several World Bank studies find that the playing field is tilted in favour of foreign business, both in low and middle-income countries.

9) One of the main arguments for 'ISDS' – that it 'depoliticises' disputes – is also found not to be valid. First of all, a significant number of foreign investments, especially in dispute-prone extractive industries or utilities, involve a State or a State-owned enterprise as investor. Moreover, if the investment is protected by State-backed political risk insurance, what typically happens is that the State-sponsored insurer obtains the claim against the host State, thus bringing the dispute back into the political realm. Private investors pursuing claims against a State also often mobilise their home government to exert pressure.

10) Finally, the paper challenges the argument that IIA's would increase incentives to strive for a better legal and institutional framework. This argument is contradicted by the fact that the number of claims increased over the past decades in particular against countries with a reputation for good governance. The OECD paper also refers to anecdotal evidence on how IIAs may influence policy decisions such as, for example, on tobacco-control measures. Lastly the OECD notes that far from being used an instrument of last resort, when all other means have failed, there is evidence of the same investor introducing up to six ISDS claims, in order to pressure the government into accepting a more profitable settlement.

In conclusion, policy-makers and in particular the Freedom of Investment Roundtable, should take this evidence from the OECD seriously and stop pushing for a policy that has no shown benefits for society, but runs the risk of weakening legitimate policy decisions while at the same time strengthening corporate power.