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# Challenges posed by BITs to developing countries

**Bilateral investment treaties pose many challenges to developing countries, and initiatives are underway to move towards a new framework. This message is contained in a closing speech by Mariama Williams on behalf of the South Centre at the 6th Annual Investment Forum for Developing Country Negotiators, Port of Spain, Trinidad and Tobago, 29-31 October 2012, which was co-organised by the South Centre..**

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**By Mariama Williams**

On behalf of the South Centre I would like to acknowledge the co-sponsors, the International Institute for Sustainable Development and the Ministry of Trade and Industry of the Government of Trinidad and Tobago for hosting this 6th Annual Investment Forum for Developing Countries Negotiators which focuses on *Understanding and Harnessing New Models for Investment and Sustainable Development.*

Undeniably this 6th forum is quite timely and a great success. The attendance by 75 participants from 36 countries from Asia, Africa and Latin America, as well as international organizations, including the Commonwealth Secretariat, the United Nations Economic Commission for Africa (UNECA), the CARICOM Secretariat, the Caribbean Export Development Agency (CEDA), the Southern African Development Community (SADC), the United Nations Conference on Trade and Development (UNCTAD) is a testimony to the importance of the subject matter under discussion.

The previous two days of this forum have been focused on the urgent need for reform of the institutional architecture for investment agreements both in the bilateral investment treaties and in international investment agreement within Free trade agreements. In this regard it is important to take a step back and explore the contextual framing for the reform of the institutional architecture, instruments and processes of international investment. Ultimately, a broader more political nuanced approach is critical for the uploading at all levels of the decision-making chain. As beyond the technical issues, there is a also the imperative to change the mind frame and demystify some of the strangleholds about foreign direct investment (FDI) that still control the thinking about FDI as at many levels in developing countries.

**Context: Challenges posed by Bilateral Investment Treaties (BITs) & International Investment Agreements (IIAs)**

According to Oxfam more than 170 countries are involved in BITs and investment agreements that allow foreign direct investors access to international investor-state arbitration to settle disputes before using national courts. As noted by Oxfam 'such arbitration fails to consider the public interest, basing decisions exclusively on commercial laws.' Now however, there is a growing backlash against the overly, and, in some cases, egregious interpretations of key provisions of international investment agreements by arbitration tribunals that are increasingly making BITs/IIAs a mercenary exploit having not much to do with investor protection but rather allowing legal raids on developing countries' treasuries.

Mechanisms for enforcing BITs and IIAs such as arbitration clauses, tribunal processes and specific legal instruments such as host government agreements within mining and extractive sectors, provide companies with effective control and coercive power over legislation and regulation that may apply to their investment activities and which ultimately may lead to states compensating them with monetary awards for any new laws that affect corporate priorities. Researchers such as Hildyard and Muttitt note that this is a deliberate strategy that law firms and some corporations have created. In the words of one such law firm: "*Without having to amend local laws, we went above or around them by using a treaty*" (George Goolsby Baker Botts).

As a result of these types of actions, developing countries face:

· Costly and far reaching implications of BITs and IIAs;

· Claims for compensation by firms, which in some cases vitiate ODA (see for example ,the case of El Salvador and PacRim which sued it for $100 million, a claim which is double the amount of US foreign aid to El Salvador, which has 34.6% of population living on less than $2 per day ( at the same time the economic benefit of mining in the country is only about 0.4% of its GDP) (The Guardian, February 2010);

· Claims for loss of expected future profits related to non-discriminatory environment, health, safety, land use and zoning policies;

· An unethical so-called judicial review process that is riddled with conflict of interest: In some cases, 3 lawyers rotate between suing government on behalf of corporation and being judges; law firms are incentivized to troll for cases and engage in lengthy proceeding;

· Investor-state dispute resolution used as threats and coercion against governments' ability and right to regulate in the public interest and for developmental and social priorities;

·Threat of charges of 'Expropriation', particularly indirect expropriation—raised against any governmental action that firms deem to 'reduce the value (and potential value) of their investments'.

These outcomes, as noted by legal experts and researchers, undermine the rules of law in the South and circumvent national legal systems as well as set double standards since national investors often do not have similar such recourse. Ultimately, they create a systematic bias and engender a system that is structurally loaded against the public interests (Oxfam, 2007).

There is thus a clear need to stop private firms exploiting poor states. It is also important to work to shift the understanding of policy makers from the old paradigm that promoted the ultimate freedom of investment at all costs and to help to shift towards a new sustainable development approach.

## Foreign Investment, Trade and Economic Development—Myths and Realities

The old paradigm, the freedom of investment model, 'assumed all investment is good and all investment promotes development.' So proponents prescribe that 'governments should liberalise investment regimes, reduce or limit regulations and conditions on investors in order to realize the benefits of FDI.' This is the intellectual, political and ideological approach behind the first generation of BITs and which continues to dominate the thinking of developed country partners that governments negotiate with. Unfortunately, it is also the thinking that many developing countries still operate under.

But, the experiences of many countries show no clear relationship between signing BITs and seeing increased flows of FDI. South Africa, for example, reports that it has not received significant inflows of FDI from partners with whom it has BITs. But it received investments from jurisdictions with which it has no BITs. This reality leads to the conclusion that BITs are not decisive in attracting investment (TWN Update 2012). Conventional wisdom would argue that FDI is a potent ingredient in development because it allows for the transfer of technology and capital and is hence a catalyst for development. But while, FDI may be associated with increased trade volumes, it may also have undesirable impacts on poverty eradication and gender equality strategies, the environment, labor laws, working conditions and overall economic and social development.

FDI, like trade and development, is a complex issue which is linked to the stage of foreign investment. The literature shows an initial complementary relationship between outward FDI and exports; but it could eventually turn into a substitute type relationship.

So the FDI development inter-relationship is a complex issue requiring more dis-aggregative analysis in specific industries and service sectors (WIDER, 2005). One must look at the impacts of FDI on economic development, employment, social development and social equity issues.

FDI impacts development via tangible and intangible aspects such as technology innovation, organization, managerial practices and skills, human resource development, access to markets, forward and backward linkages with domestic enterprises.

Foreign Investment impacts many development dimensions including: trade, employment, domestic savings, consumption pattern, capital formation, the ownership of productive and financial assets and resources, technology (Transfer of technology), competition and economic growth.

Foreign direct investment therefore can have critical impacts on economic development and economic growth. The most widely known positive impacts include: Conduit for transfer of technology and human skills; New ideas and innovation; Sources of capital; and Catalyst for development (when the right linkages are present in sufficient amounts).

At the same time, the most widely known negative impacts of FDI include:

- Restrictive business practices of TNCs such as the parent company subjecting affiliates to be subjected to export restrictions and adverse (for the host country) transfer of technology agreement between affiliates and parent company;
- The distortive effect of transfer pricing (to avoid tax obligations) on government budgeting;
- Instability in trade balance and Balance of Payments due to high import contents and profit repatriation;
- Exercise of undue political influence;
- Negative impact of foreign affiliates on domestically available financing and SMEs.

Due to these issues, there is no necessary automatic and unambiguous beneficial predisposition of FDI to development. Because of this, governments need the policy space to be able to regulate the flows of investments and the types of investments into their countries.

Therefore governments must proactively work to ensure balance between domestic and foreign investment in the context of national strategies at sectors level and macro level policies to promote the sustainability of the development process.

The ability of developing countries' governments to ensure economic development depends on their ability to maximize technological transfer through such measures as performance requirements and technology transfer requirements.

A major concern is that investment treaties of the traditional type can constrain the ability of governments to regulate investments, or to formulate other policies.

## Shifting from the Freedom of Investment Model (FIM) towards an Investment for Sustainable Development Model (ISDM)

As noted by Xavier Carim, Deputy Director General, Department of Trade, South Africa, the need for an alternative approach to FDI and the work towards a sustainable framework for international investment agreements arises from recognition of the above reality and the acknowledgement that FDI can make positive contribution to sustainable development; but benefits to host countries are not automatic; so regulations are need to balance the requirements of investors with the need to make a positive contribution to sustainable development in the host state.

Clearly a sustainable investment framework must be premised on at least the following key pillars:

· Right to regulate;

· Enhancement of the development dimensions: Governments should seek to preserve aspects of trade related measures, which promote development. These include option for and around local content requirements, trade balancing requirements, employment requirements, transfer of technology, balance of payments safeguards (emergency safeguard measures are available in GATS and could be a model for goods) and protection for infant industries and SMEs. There must also be policy space for prudential measures, such as the central banks' intervention to limit potential and actual harmful impacts of FDI. (This is currently undefined in the financial annex of the WTO.);

· No mechanical application of national treatment. This could be harmful to development. This is particularly sensitive due in part to the fact that FDI are increasingly resorting to merges and acquisitions and in part to the size of TNCs, which is generally out of proportion to small and medium sized firms in the receiving economy. The issue of national treatment could pose serious drawbacks for women's and minority groups' empowerment in terms of the cooling effect on subsidies, grants or set aside for affirmative type actions for such groups as well as women-owned businesses.

· Human rights and the social and gender dimensions;

· Corporate social responsibility.

Already many developing and a few developed countries are raising challenges to the deeply flawed and corrosive practices that arise from the current approach to BITs and IIAs. These include a moratorium on new BITs, a re-negotiation of existing BITs, and withdrawal from investor-state arbitration dispute processes.

However, there is the difficult and unresolved question of what to do about BITs' self-defense mechanism: MFN and tacit renewal-survival clauses that block effective exit strategy of these countries.

In the meantime, international organisations are seeking alternative and sometimes, complementary way to move forward on the Investment for Sustainable Development Model.

These actors are motivated by the imperative to develop a common standard of protection for all developing countries including, when necessary for those who cannot avoid investor-state provision, a mechanism or process for ensuring ethical, fair and consistent interpretation by arbitration panels, especially on similar matters. There is also the search for some 'coordinating system (with input from developing countries) on the growingly complex evolving jurisprudence especially vis a vis investor state dispute provisions'.

Actors such as UNCTAD, the Commonwealth Secretariat and the Southern African Development Community (SADC) are developing new sustainable investment model prototypes that pre-suppose an ethical and equitable framework for the relationship between investors and governments based on human rights, rule of law, due process, and sustainable development as well as the security of tenure and property rights.

Other organisations are offering support to protect governments against vulture fund litigation and to build the capacity of developing countries to negotiate better contracts both with multinational corporations as well as within the framework of investment agreements.

Ultimately, if successful these processes and actions could help developing countries maximize the full benefits of foreign direct investment for sustainable development.

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