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An Alternative FDI Framework for More and Better Jobs in Developing Countries

A policy discussion paper

Summary

The benefits of inward Foreign Direct Investment (FDI) are not always automatic in developing countries, particularly in relation to employment. To encourage FDI, workers' rights may be eroded; domestic firms may be crowded out; mergers and acquisitions often result in job losses; and women are largely engaged in unskilled, labour intensive activities. To get the maximum out of FDI, countries impose a range of market access provisions and performance requirements on the investor such as local content obligations which increase linkages with domestic production enhancing local jobs.

However these policies are increasingly prohibited through 'investment liberalisation' as developing countries sign bilateral investment treaties (BITs) and in investment chapters of Free Trade Agreements (FTAs). These BITs and FTAs also include 'investment protection' through investor-state dispute settlement (ISDS) which give exclusive rights to companies to sue governments in private courts if for example they believe that their profits are at risk from government regulation (such as the imposition of a minimum wage). As such, current investment agreements are not conducive to sustainable development, more and better jobs, and the eradication of poverty in developing countries.

An alternative FDI framework is required, one that balances the rights of investors with obligations; does not restrict government's ability to regulate in the public interest including labour provisions or to restrict their ability to impose performance requirements and other provisions that lead to more and better jobs for both men and women. Additionally, in this alternative FDI framework Investor-State Dispute Settlement (ISDS) is removed and replaced with dispute prevention and settlement via national courts and/or state-to-state arbitration; and companies are held accountable for their actions at both a national and international level.

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Cover photo: Garment workers manufacturing security uniforms for export in a factory in Uong Bi, an industrial city in a north-eastern region of Vietnam

Cover photo: Lizzie Gerrard/ActionAid

Introduction – FDI and employment

Foreign direct investment (FDI) can bring benefits to the economies of developing nations and to some of the poorest communities in those countries. Potential benefits include new employment; capital injections where there is limited domestic investment; technology transfer; access to new export opportunities and to join global value chains; tax revenues accruing from investment; and better balance of payments. To this end, FDI will be important in achieving a number of Sustainable Development Goals, particularly SDG 8 (decent work), 5 (gender equality) and 10 (reduce inequalities). Promoting inward investment is also an integral part of bilateral development strategies with developing countries, such as the UK's Department for International Development.[1]

But inward FDI is not always beneficial to developing countries. Many companies are engaged in massive tax avoidance; in Africa, little value is added in country;[2] and in countries such as Vietnam technology and knowledge transfer is simply not happening.[3] Although FDI can create new employment opportunities, they are not necessarily decent jobs. Below are some of the concerns regarding employment.

A race to the bottom

The drive to secure foreign investment has prompted governments to offer investors the prospect of ever more 'flexible' workforces, where companies will be freed from having to respect the full range of workers' rights which they would have to guarantee in their home countries. As countries compete with one another to attract foreign investment, many have tried to provide even more attractive investment climates than their competitors by disregarding key rights enshrined in national law. In a number of cases, the erosion of workers' rights has been identified as a positive incentive through which to encourage foreign investment.[4]

This tendency has set up a 'race to the bottom' in which there is constant downward pressure on workers' rights in order to offer foreign investors the most enticing deals possible. The North American Free Trade Agreement (between the US, Canada and Mexico) has resulted in the relocation of production to Mexico to take advantage of that country's lower wages and weaker environmental standards.[5] Another comprehensive study finds that labour rights fell precipitously across 148 developing countries due to competition for foreign direct investment.[6, 7]

Hair Braiding. A member of the youth group of Colectivo Chilpancingo. Colectivo Chilpancingo was an instrumental driving force in organzing the cleanup effort of Metales y Derivados, a maquiladora that abandoned its toxic site with over 23,000 tons of contaminated waste in 1994.

Crowding Out

Foreign investment can also jeopardise the security of jobs in the domestic sector of any industry which is opened up to competition, especially when that competition comes from the world's most powerful multinational corporations. The vastly superior size and strength of these multinationals often prove too much for local competitors, who are simply forced out of the market.

While some argue that the evidence of crowding out in developing countries is inconclusive,[8] ActionAid would disagree. Overwhelming competition of this kind has had devastating effects on local employment, as domestic enterprises are 'crowded-

out', shed jobs and ultimately have to close down altogether. For example "[t]he impact of FDI in the South African economy – particularly in the dairy, pharmaceuticals, steel, and electric and electronics sectors – has not always been positive and has had a crowding-out effect on some local producers".[9] Research has found similar situations in China, the Middle East, in ECOWAS (West African) nations and North African countries.[10, 11, 12]

'Green field' v 'Brown field' investment?

A further issue with inward FDI is whether it is green field (i.e. new) investment or brown field investment (i.e. mergers and acquisitions). The former tends to bring new employment opportunities whilst the latter is often associated with restructuring and loss of jobs. In 2014, 36% of all investment was M&As (prior to the 2008 financial crisis, M&As had become the preferred option for overseas investment, then fell back but is now growing again).[13]

The pharmaceutical sector in India is a good example. Since 2001, there have been at least a dozen notable acquisitions of national firms by foreign companies. The Sun Pharma (US)-Ranbaxy (Indian) merger will create the world's fifth biggest generic drug maker, but it will also result in job redundancies. Sun Pharma has estimated that it will save $250 million in the third year of the merger; at least 40% of these savings are expected from a cut in the work force at various locations (possibly as high as 5,000 people).[14, 15]

Women and low-skilled jobs

Employment opportunities for women from FDI remain largely in the low-skilled sectors, i.e. the labour intensive, largely export-oriented industries such as textiles, garments, electronics and selected agricultural subsectors; in call centres, hospitality and tourism.[16] Increasingly, FDI is providing higher skilled jobs; but there is mounting evidence that as FDI upgrades or becomes more skilled, women lose jobs to men or get pushed down the production chain into less skilled, subcontracted work. Consequently the gender wage gap does not narrow.[17] Even in Taiwan and South Korea, FDI in the post-war era only created low skilled jobs for women; and while these countries developed technologically more advanced manufacturing, this didn't translate into better opportunities or wages for women.[18]

Photo: Lizzie Gerrard/ActionAid

Garment workers joined by their factory manager and Women's Union representative outside their factory on the outskirts of Hai Phong, a major port city in north-eastern Vietnam. The factory specialises in manufacturing garments for a growing Vietnamese-owned fashion brand.

How are developing countries trying to get the best out of FDI?

Host governments are therefore attempting to implement a range of policies (commonly known as 'policy space') that will get the best out of FDI. These 'performance requirements' or 'market access' provisions imposed on the investing company include:

- **The closure of certain sectors to inward FDI (and services);**
- **The screening and licensing of FDI;**
- **Restrictions on the number of enterprises (or service providers);**
- **Measures which restrict or require specific types of legal entity or joint ventures;**
- **Export a given level or percentage of goods or services;**
- **Achieve a given level or percentage ofdomestic (i.e. local) content;**
- **Transfer technology or a production process; or**
- **Hire and train a given number of nationals of the host country.**

The rationale for introducing these policies is not only to protect domestic sectors but to strengthen the industrial base, 'crowd-in' local domestic investment, add value, and to generate employment and exports.[19]

For example, local content requirements have been used by developing countries to link local content with various industries to stimulate domestic employment. In 1999, up to 42 percent of motorcycle components were produced in Vietnam. The Vietnamese government implemented policies to encourage local production of components between 2000 and 2004; by 2005 more than 70 percent of components were sourced in Vietnam. Unusually, Vietnamese companies managed to meet foreign investors' higher quality standards as well as supplying parts to domestic firms.[20]

Brazil's national agency for oil, gas and biofuels (ANP) uses local content as one of its requirements when allocating petroleum rights and these have increased over the years from 25% local content when the programme started to 80% ten years later. Petrobras, the state run oil and gas company has championed local content for many years. This scheme has forced interested international suppliers to establish Brazilian subsidiaries and/or build up local manufacturing and operational capabilities to be able to participate in the biding process.[21]

Current investment treaties and agreements

But it is these very policies that are being eliminated as part of International Investment Agreements (IIAs), either as part of Bilateral Investment Treaties (BITs) or in more comprehensive investment chapters in Free Trade Agreements (FTAs). By the end of 2015, there were 2,928 BITs and 358 other IIAs. Governments often feel compelled to agree IIAs, because they perceive (usually mistakenly) that they are a necessary condition to attract much-needed FDI.[22]

FTAs and a number of recent BITs are liberalising inward investment by eroding the policy space available to developing countries to regulate inward investment (those exporting FDI argue that to attract investment, restrictions and regulatory burdens on investing companies should be minimized). For example, these same FTAs and recent BITs now prohibit the use of local content policies.

IIAs, via BITs and FTAs, also provide for investment protection once the investment has been established. They do so through controversial Investor-state Dispute Settlement (ISDS) procedures. ISDS grants companies exclusive rights to sue governments in secretive and one-sided 'corporate courts', for example if the company deems that government regulations could affect its operations or profits. Most ISDS cases are brought under the problematic clause of 'fair and equitable treatment' (FET) which requires governments to treat investors fairly and not upset their 'legitimate expectations'.[23]

ISDS has already been used by companies to tackle worker's rights. Veolia is reportedly seeking €82 million from Egypt because the company believes that the government's new labour legislation – including the introduction of a minimum wage – contravened the contract between the two parties and is attempting to sue Egypt based on the BIT between France and Egypt.[24]

An alernative FDI framework – for more and better jobs (MBJs)

Many developing countries have become disillusioned with current investment policy as defined by IIAs. They are not conducive to sustainable development, creation of more and better jobs and the eradication of poverty. Countries such as Ecuador, India, Indonesia and South Africa are conducting their own reviews and audits with a view towards alternative investment policies. In many cases, governments are now terminating BITs.

Part of this disillusionment is aimed, not just at the problematic clauses in IIAs, but the size of claims being sought under ISDS. In 2013, the Ecuadorian government began an audit of existing BITs and their arbitration rulings, not least because of the $1.77 billion award against the country in favour of Occidental Petroleum Corporation. But developing countries are also now aware that IIAs do not increase inward flows of FDI;[25] that signing an IIA is not a necessary condition to attract much-needed FDI.[26] Brazil has never ratified any IIA yet this has not deterred inward FDI. The country is one of the largest recipients of inward investment in the world.

ActionAid believes that current IIAs should be terminated and a new FDI framework (including investment agreements, treaties, contracts and/or policies) should adhere to the following principles:[27]

- The inclusion of binding investors' obligations, for example substantive and binding provisions on labour and other human rights, including the requirement for human rights due diligence and environmental protection;
- More precise but restrictive language regarding investors' rights (this should exclude the FET principle);
- The abolition of ISDS mechanisms (and current variants of ISDS such as the EU's proposed Multilateral Investment Court or the International Court System); a new mechanism should be based around a dispute prevention policy, domestic dispute settlement – and the exhaustion of local remedies – and/or state-to-state arbitration (this may well require the strengthening of the domestic legal system);
- Exclude or restrict the scope of the national treatment (NT) and the most favoured nation (MFN) principles;
- Nothing in the new FDI framework should restrict the ability of governments to regulate in the public interest – for example in terms of jobs, gender equality, the environment, and human and workers' rights – and this should be explicitly incorporated into the relevant parts of any new investment policy and agreements (i.e. not just in the preamble);
- Nothing in the new FDI framework should restrict the ability of governments to establish entry and operational requirements on FDI in the interest of the public good and to get the maximum benefits – i.e. more and better jobs, particularly for women and young people – from market access provisions, performance requirements and other policies;
- Governments must protect their people, communities and workers from exploitation or other injury as a result of foreign investors' actions in the host country. As well as extending national legal provisions for sanctions against companies for breach of national laws, governments should also guarantee legal redress for people, workers and communities affected by corporate activities, and extend legal liability to directors for any breach of national laws by their company.

This would also entail amendment to the Trade-related Investment Measures (TRIMs) Agreement at the World Trade Organisation which also prohibits local content requirements.

Investment and MBJs for women and young people.

There continues to be a paucity of practical and concrete examples of where trade and investment policies can be targeted specifically so as to bring positive impacts on employment, women and young people. But market access conditions and performance requirement on FDI could be designed to provide more and better jobs for women and youth. Employment and training could be structured as a condition of market access; companies could be required to employ a certain number of women and young people or in more skill-intensive and non-production jobs; "[t]hey could be required to provide the types of training that women [and young people] could transfer to other sectors of the labour market, especially in more skill-intensive and highly paid sectors."[28]

These new principles are now being introduced by developing countries. South Africa has recently updated its domestic law in relation to investment. India's 2015 model BIT excludes MFN and the standard FET clauses, considerably narrows down the scope of NT, contains more restrictive clauses on investor protection (including the exhaustion of local remedies in dispute resolution) and includes general exception clauses safeguarding key policy objectives like health and the environment.[29,30,31] Brazil has recently agreed but has yet to ratify new Investment Cooperation and Facilitation Agreements with a number of countries. It again excludes FET as well as ISDS, explicitly referring first to dispute prevention and local remedies, and only then to state-to-state arbitration.[32,33,34]

Currently, investment arbitration via ISDS is non-reciprocal. Investors cannot always be sued, for example, under international law when they violate human rights. Only governments can lose in the sense that only states have to pay compensation. So we have a massive asymmetry where corporate rights are backed up by international hard law and strong enforcement (via BITs and other IIAs) but their obligations under international treaties are currently backed by soft law such as the UN Guiding Principles on Business and Human Rights.[35]

There is a need to correct this asymmetry. Multinational companies by their very nature need international oversight and regulation. Also governments and communities may be reluctant or unable (i.e. because of cost) to bring cases against companies at a national level. Countries should support the ongoing discussion at the United Nations to create a legally binding treaty on transnational corporations and other business enterprises with respect to human rights and include mechanisms of redress for people, communities and workers who have been negatively impacted by the activities of investors.[36]

In terms of domestic investment policy, active labour market policies must be used to create more and better jobs; countries need to implement laws and policies that guarantee a minimum living wage, the right to organise and collective bargaining, satisfactory working conditions, secure contracts, social protection (including parental and sick leave and unemployment benefits), ensure protection from discrimination, and ensure equal pay and job opportunities for women.

Investment and Brexit

The UK currently has 106 Bilateral Investment Treaties with other countries, of which 95 are in force (only Switzerland, France, China and Germany have more). Because these are negotiated between governments, they are not directly affected by Brexit although they are likely to be reviewed as part of UK trade and investment policy going forward.

On leaving the EU, the UK will no longer be party to the investment chapters of EU FTAs such as the EU-South Korea FTA. The UK will have to negotiate new FTAs. However, the UK has always been a cheerleader in the EU for aggressive liberalisation and deregulation in EU trade and investment agreements. There is every indication that the UK will continue to push for strong investment liberalisation and ISDS-style investment protection in new FTAs following Brexit.[37]

ActionAid believes that following the example of many developing countries that are terminating BITs, UK BITs should also be terminated and if required, renegotiated following the principles outlined in this paper (many UK BITs have reached their built-in termination date offering the opportunity of reform). New FTAs should also follow these same principles.

Conclusion

Developing countries urgently need to regulate to get the best from inward investment. But by signing BITs and investment chapters in FTAs, they are reducing the policy space that will enable them to do so. Further, these BITs and FTAs offer protection to companies to enable them to take governments to court if they disapprove of regulation which might reduce their profit margins. This is not an abstract idea: this year a French company is suing the Egyptian government over their new policy to enact a minimum wage. We need a new approach to FDI policy, one that balances the rights of companies with the rights of people, allows countries to regulate in the public interest and holds companies to account for their actions at both a national and international level.

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Front cover:
Garment workers manufacturing security uniforms for export in a factory in Uong Bi, an industrial city in a north-eastern region of Vietnam

Photo: Lizzie Gerrard/ActionAid

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