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## TPP and Foreign Investment: Does ISDS Promote FDI?

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The Trans-Pacific Partnership free trade agreement, signed on 4 February 2016 among 12 Asia-Pacific economies, faces a rocky road to ratification. In the run-up to the US presidential election in November, both Donald Trump and (for now) Hillary Clinton say they are opposed.

Yet Australian Prime Minister Turnbull urged President Obama to put the FTA to a vote in Congress during the 'lame duck' session before inauguration the new President is inaugurated, to counter the spectre of protectionism but also for broader geopolitical reasons. The Abe Government, fortified by its mid-year Upper House election victory, would surely then ensure ratification by Japan, thus bringing the TPP into force within the two-year window from its signature. (Beyond that, it can still come into force but only if all 12 countries complete ratification.)

However, back home in Australia, the Turnbull Coalition Government faces its own challenges in enacting tariff reduction legislation needed before it too can ratify. After the 7 July general election, although the Government was returned with a razor-thin majority in the lower House of Representatives, it has a reduced minority in the upper house (30 out of 76 Senators). It would therefore need votes from at least nine other Senators, yet the (nine) Greens Senators will never vote with the Government given their Party's implacable opposition to FTAs. Of the 11 other cross-bench Senators, Pauline Hanson's 'One Nation' (four) Senators are notoriously xenophobic, while the Nick Xenophon Team (three) Senators favour more support for local manufacturing.

Accordingly, the Government will more likely have to court votes from the Labor Opposition. Yet the latter has generally not been cooperative in Parliament, perhaps hoping something will happen in the lower House to trigger a new election. And in June, Labor had reiterated that if elected, it would not countenance 'new' FTAs that added the option of investor-state dispute settlement (ISDS) – in addition to inter-state arbitration provisions – to better enforce substantive commitments aimed at encouraging more foreign direct investment (FDI). The TPP provides for ISDS, like almost all FTAs nowadays, and this continues to generate broader public debate – as does FDI more generally. My recent co-authored econometric study outlined below examines more generally the links between ISDS-backed treaty commitments and FDI, which can inform ongoing policy discussions in Australia and further afield.

Like Labor did eventually for the China-Australia FTA in late 2015, it might back down from this stance to vote for TPP ratification by saying that this (already-signed FTA) is not really 'new'. Indeed, substantive provisions of the TPP were partly negotiated by the Gillard Labor Government.

However, from 2011-2013 its 'Trade Policy Statement' had declared that Australia would break from past treaty practice and never agree to ISDS, even in treaties involving developing countries with domestic courts and legal systems that did not meet international standards for protecting investors. Over those few years Australia therefore could not contribute to negotiating the TPP's ISDS provisions, although they (and indeed substantive commitments) ended up being quite similar to those found in FTAs signed by the Rudd Labor Government as well as a prior Coalition Government since 2004. It will be interesting to follow what Labor parliamentarians now say during inquiries underway into whether Australia should ratify the TPP, in the Joint Standing Committee on Treaties as well as recently in the Senate.

Labor's objections to ISDS since 2011 are partly driven by political expedience. (The Gillard Government was initially in coalition with the more leftist and protectionist Greens.) But the stance has also drawn on arguments from economists. They instead *favour* more free trade and foreign investment, albeit through unilateral or perhaps multilateral initiatives rather than bilateral or even regional FTAs.

Developing the latter perspective, a majority report of the Productivity Commission in 2010 into Australia's FTAs had argued against the common world-wide practice of offering foreign investors extra procedural rights (such as international arbitration through ISDS provisions) and possibly even some substantive rights (such as treaty-based protections against expropriation broader than those available to all investors under domestic law ). The Commission did acknowledge that such extra rights might be justified, for example if they led to greater cross-border FDI flows (which policy-makers in Australia generally have welcomed as enhancing productivity, cross-border trade and economic growth). Yet the Commission pointed to a few studies suggesting that, on an aggregate (world-wide) basis, ISDS-backed treaty provisions had not significantly increased flows. It maintained this view in 2015.

A recent econometric study doubts that observation, as part of an Australia-based academic research project since 2014 into investment dispute management. Under a model effectively addressing the problem of endogeneity in variables, there were positive and significant impacts from ISDS provisions on FDI outflows from OECD countries over 1985-2014. This was found from ISDS provisions on their own (especially in treaties signed or promptly ratified with non-OECD or less developed countries), and when combined with the Most-Favoured-Nation provision (a key and indicative substantive treaty commitment to foreign investors). Counter-intuitively, however, the FDI flow impact was even larger for weaker-form provisions – suggesting perhaps that investors have historically been impressed by a broader 'signalling' effect from states concluding investment treaties. The impact from ISDS provisions also seems to be diminishing since 2001. This could be related to more efforts from host states to unilaterally liberalise and encourage FDI, but also less pro-investor provisions contained in investment treaties (influenced by more recent US practice, partly in response to ISDS claims).

Further variables impacting on FDI (such as double-tax treaties) can be investigated, as can regional differences. Data limitations also remain. There is now considerable FDI outflow from non-OECD countries, and a lack of sector-level data – important to analyse FDI quality, not just quantity. Nonetheless, on the one hand, this baseline study suggests that it has been and still may be risky to eschew ISDS provisions altogether. In particular, results indicate a strong positive effect on FDI flows from ratified investment treaties overall even from 2001. So states will miss out on that if they insist on omitting ISDS, and this becomes a deal-breaker for counterparty states (for whatever reasons). On the other hand, the study suggests that dialed-back ISDS provisions and even substantive commitments (perhaps following recent EU preferences) may be an acceptable way forward, eg for the RCEP (ASEAN+6) FTA still being negotiated. It also indicates the importance of promptly ratifying treaties after signature, including the TPP.

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