

International Trade Committee

Oral evidence: UK investment policy, HC 998

Wednesday 1 May 2019

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Members present: Angus Brendan MacNeil (Chair); Mr Nigel Evans; Mr Marcus Fysh; Sir Mark Hendrick; Mr Ranil Jayawardena; Julia Lopez; Faisal Rashid; Owen Smith; Matt Western.

Questions 132-201

Witnesses

[I](#): Professor David Collins, Professor of International Economic Law, City, University of London, Ruth Bergan, Co-ordinator, Trade Justice Movement, and Pia Eberhardt, Researcher and Campaigner, Corporate Europe Observatory.

[II](#): Stephen Adams, Senior Director, Global Counsel, Jack Knight, Deputy Chief Executive, Investment Association, and Jonathan Geldart, Regional Chair for Yorkshire and Humber, Institute of Directors.

Written evidence from witnesses:

– Ruth Bergan – [evidence submitted by Trade Justice Movement \(UIP0004\)](#)

Examination of witnesses

Witnesses: Dr David Collins, Ruth Bergan and Pia Eberhardt.

Q132 **Chair:** This morning we are taking evidence for our inquiry into UK investment policy. May I thank the panel for their presence here this morning, and make an apology? Something is wrong with my right ear this morning, and I am not hearing very well. I am not sure what it is.

May I ask the panel to introduce themselves—name, rank and serial number, as you choose?

Ruth Bergan: I'm Ruth Bergan. I am a senior adviser at the Trade Justice Movement.

Pia Eberhardt: My name is Pia Eberhardt. I work for an NGO that is based in Brussels called Corporate Europe Observatory, and I am their trade expert.

Chair: We need those in the UK.

Dr Collins: My name is David Collins. I am a professor of international economic law at City, University of London.

Q133 **Chair:** Dr Collins, I will start with you. What are the investor or investment protection provisions, and why do they feature in international investment agreements?

Prof Collins: There are a number of them, and they are designed to guard against political risks faced by companies investing in other countries. The nature of the provisions include national treatment and most favoured nation, which are non-discrimination standards that essentially mean that the foreign company cannot be treated differently than the equivalent domestic company, or treated differently from companies from third countries with which there is also a treaty.

There is the fair and equitable treatment standard, which guards against procedural unfairness in various aspects of administration in the host state. There are guarantees against expropriation without compensation—expropriation obviously meaning when the state takes the asset belonging to the foreign investor. This now includes indirect expropriation, which is when the investor actually gets to keep their asset but the value of it has been diminished because of excessive interference.

There are also provisions such as full protection security, which guards against physical harm suffered by the investor, such as damage that may ensue in a riot or civil unrest. There are guarantees that allow for the conversion of currency, meaning that the profits that the investor makes can be sent back to their home country in their own currency, and not frozen in the banks of the host state, subject to various restrictions.



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There are guarantees against the imposition of performance requirements, which are extra conditions placed on foreign investors—for example, to use local products in conjunction with their activities. There are also the procedural aspects, which typically include the investor-state dispute settlement mechanism. I think that is about it.

Q134 **Chair:** That is quite an impressive list. Couldn't it be argued that all that limits the sovereignty of a state?

Prof Collins: Yes, that is absolutely correct. That is pretty common in international treaties. That is really what is involved with an international treaty; it involves a degree of surrendering sovereignty.

Q135 **Chair:** Would that not be an unpalatable message in a UK that has staked itself on regaining sovereignty?

Prof Collins: I doubt it. I think the UK is quite used to signing many international treaties. You cannot have a role in international law, period, unless you are prepared to surrender sovereignty. As with any legally binding commitment, you bind yourself. It is just binding to a different authority.

Q136 **Chair:** Thank you very much. Ruth, what is the significance for the purpose of investor protection provisions of how investments and investors are defined?

Ruth Bergan: In investment treaties, both investor and investment tend to be defined quite broadly and often quite vaguely. If you look at the UK model, bilateral investment treaty investment covers every kind of asset owned or controlled directly or indirectly, moveable and immoveable property, any other property rights, shares in a company, any other form of participation in a company, intellectual property rights, goodwill, technical processes and know-how.

That is about as broad a definition of investment as you are likely to find, and the sheer breadth of that definition has allowed for a really broad range of cases brought by various different kinds of investors. For example, the Children's Investment Fund here in the UK took India to court based on a 1% shareholding in a company called Coal India.

In terms of the definition of investor within UK bilateral investment treaties, again, companies can take almost any form, and can be constituted in, for example, any part of the UK. That has led to a case brought by Yukos Universal, based on registration in the Isle of Man. They sued Russia and were awarded \$50 billion, despite having no substantive presence in the UK. One of the characteristics of UK treaties is that they do not require businesses to have substantive operations within the UK in order to access the benefits of treaties. That is actually somewhat unique; countries such as Germany require more substantive business operations.

There are also no limitations on the kind of investment that is undertaken. We do not require a company, say, to meet local regulations or laws before they can access protections under a treaty. We do not put any kind of limitations in terms of environmental or social impacts.



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Finally, in terms of the coverage of investment treaties, UK treaties also contain something called an umbrella clause, which really broadens the scope of what is covered, because it allows contract disputes to be raised to the level of a treaty dispute. That is actually quite unusual in international law. In general, violating a contract is not equivalent to violating a treaty protection, but this allows that to be circumvented.

Chair: Mr Jayawardena has given me his word, which is his bond, that he will ask a short question and not stray anywhere else.

Q137 **Mr Jayawardena:** Indeed—a short question. Dr Collins, just for the sake of balance, because you will be aware that your evidence is used in a particular way by certain politicians, you said that it is integral that sovereignty had to be ceded, but the difference, and I think you would concede this, is that normally—

Chair: It sounds like a leading question, but lead on.

Mr Jayawardena: For the sake of time! The difference is that it is also possible for a country to withdraw from such an arrangement if it wishes. Sovereignty has been ceded, but temporarily, and it can be reclaimed should that be the wish of any sovereign nation. That is correct, isn't it?

prof Collins: Yes, I agree with that.

Chair: So when you have entered into an agreement, it could be welched on at any time.

Q138 **Mr Jayawardena:** Normally we can withdraw from an agreement, but of course we can't from the backstop.

Prof Collins: Subject to notice under the Vienna convention, or subject to the termination provisions in the relevant treaty. You can't just say, "I'm quitting it tomorrow—bye."

Q139 **Mr Jayawardena:** That is separate from what we have seen to date, which is either the EU agrees on our behalf, in respect of trade, or indeed what has been proposed in terms of the backstop, which involves no exit mechanism at all.

Prof Collins: You are now asking about the Brexit withdrawal agreement.

Q140 **Mr Jayawardena:** You will be aware, Dr Collins, that your evidence will be used in a certain way by certain politicians. That is why it is important, for the sake of balance, to put both sides of the equation on the table.

Prof Collins: You are raising a nuanced issue with respect to sovereignty and being a member of a supranational organisation. Yes—as we all know, by being a member of the EU you surrender a degree of sovereignty to the EU mechanism. That is how it works. In the withdrawal agreement, as I recall, there is no termination date specified, but you still have the Vienna convention, by which you can withdraw subject to notice.

Q141 **Mr Jayawardena:** There is different legal advice on that.

Prof Collins: Yes.

Chair: Faisal Rashid—before we go down that rabbit hole any further.

Q142 **Faisal Rashid:** Coming back to Ruth, you mentioned substantive business operations, and compared the UK with Germany. Are there any criteria, and how would you define “substantive business operations”?

Ruth Bergan: I suppose it means a certain number of staff and a certain amount of operation within the country. I am not sure whether there is a legal definition of what that means, but in the case of the Children’s Investment Fund, clearly there was no substantive operation; it was just a shareholding. I suppose, from our point of view, we would look at what benefit that was bringing to people in India, or to Indian environmental concerns. The answer would be: very little. In fact, the main beneficiary from that was the Children’s Investment Fund themselves.

Q143 **Mr Evans:** A question to Pia. Could you tell me what the significance is of fair and equitable treatment standards in respect of investor protector provisions, please?

Pia Eberhardt: It is an extremely relevant provision. It is standard in international agreements. Normally, it is formulated quite shortly and vaguely. I have picked one UK investment treaty to look at how it is phrased. The UK deal with the United Arab Emirates from 1992 states: “Investors shall at all times be accorded fair and equitable treatment.” It then goes on to state that that means there should not be “unreasonable, arbitrary or discriminatory measures.” I guess we would all have signed that agreement or provision in the ‘90s because it sounds innocent and fair enough, but what is relevant is how that provision has been used by investors and interpreted by tribunals. It has become kind of the catch-all clause that companies use most often and most successfully. They use it particularly when they charge public interest regulations under the ISDS, such as public health laws and environmental protection decisions. It has become one of the most risky provisions for taxpayers and regulators.

I just want to give a couple of examples. One example is a recent ruling in a case filed by a British investor, Eiser, against Spain. Spain lost that case because it enacted certain changes to its renewable energy policy. The tribunal said, “Spain, you violated this provision for fair and equitable treatment because you radically altered a regime that was there before and put in place a completely new regime.” It was radical change and the tribunal considered that to be arbitrary towards the investor. This shows that tribunals have already come to interpret the standard as a legal standstill guarantee for investors. That makes it very difficult for Governments not to pay as they soon as they change the law.

Another example is a case against Mexico that Mexico lost. It was about a hazardous waste landfill. The authorities on the ground did not reissue a licence and the region was also declared a nature protection zone. Again, the tribunal ruled, “Mexico, you did not treat the investor fairly and equitably, because different state authorities at the local and national level did not act consistently.” When you look at UK politics, or German politics, which I am more acquainted with, you have a lot of inconsistencies and



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back and forth in politics and democracy. It shows how powerful the provision has become and how it has been used by tribunals to limit what Governments can do.

Q144 **Mr Evans:** You gave the example of Mexico. What sort of investor are you talking about and what sort of compensation was it paid in the end?

Pia Eberhardt: In this case, it was a US investor, Metalclad. I would need to look up the compensation. It was an early case, and back then the compensation did not go into the billions. It was a couple of million dollars in compensation.

Q145 **Mr Evans:** Still substantial, then.

Pia Eberhardt: It is interesting. I regularly look at what law firms are advising investors to do. There are a couple of law firms that are thinking, "How will Brexit impact investors in the UK? How will a potential cap on energy prices in the UK impact investors? How would a renationalisation of the railways and energy systems impact investors?" You have a lot of recommendations by law firms saying, "Dear investors, the UK has signed a number of treaties that contain this very powerful provision that will give you a lot of rights to sue the UK under the agreements and get much more compensation than you would ever get under UK law." It is a really powerful clause.

Q146 **Mr Evans:** Sounds like litigation nirvana.

Pia Eberhardt: Yes. There is a lot of ambulance chasing by law firms in this field because it is a money-making machine for the legal industry. They have an interest in encouraging claims, which obviously increases the risk of states all over the world being sued.

Prof Collins: I just wanted to add to that. I think I agree with most of those statements and share those opinions but for the fact that the fair and equitable treatment standard is not an easy claim to make. You have to show an egregious treatment by the host state. We see language like, "Regulations that shock or offend". It is not just any time that you do not like what the Government are doing or think, "I don't like that tax. I'm upset that you are making me pay a licence charge"; it is about the Government substantively interfering with you. It is not easy to succeed with those claims. I should tell you—you may know this—that the host states usually successfully defend themselves.

Q147 **Chair:** There are a couple of examples there of successful claims. What is the ratio of successful to unsuccessful claims?

Prof Collins: If you pass the jurisdictional phase, which is more along the lines of what Ruth was referring to, in terms of whether the business entity counts as an investment or not, which is not always easy to pass either—a lot of the time they are thrown out for not being an investment; although the definitions are wide, there are many things that are not covered, such as one-off contracts—and if it is then established that you can indeed use the treaty and its protections, the win-loss ratio is slightly in favour of the investors.



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If you include the jurisdictional stage, however, it is slightly in favour of the states, which is what you would expect from any system of litigation—50:50 win-loss. It is called the 50:50 rule, which basically means that no legal dispute settlement mechanism of any kind will survive if it deviates much beyond 50:50, because people will settle otherwise.

Pia Eberhardt: May I quickly respond? I really disagree that it has to be egregious behaviour. I mentioned a case that Spain lost. The case also went to the Spanish courts, up to the Constitutional Court and the Supreme Court of Spain. Maybe you think those courts are a bit lunatic, but they approved the measures taken by the Spanish state and said that they were in line with the constitution, while at the same time the investor won the investment arbitration case about exactly the same issue. I do not agree that it has to be extremely egregious behaviour by the state for an investor to win on the basis of FET. Actually, a couple of written testimonials that you received make exactly that point—that this is the winning clause for investors.

Q148 Sir Mark Hendrick: The Committee visited Japan last year and we spoke to investors there who have major investments in the UK, particularly in the water industry. They were concerned about the impact of the nationalisation of water, as well as possibly the railways and other industries, should we have a change of Government. Are you saying that if there was a nationalisation, either with or without the compensation of shareholders, there could be severe legal cases brought against the Government potentially?

Ruth Bergan: As I understand it, a lot depends on what compensation is offered. At the moment, there are some law firms suggesting that companies would do better to look to international treaties, because they would receive a higher level of compensation in the case of renationalisations.

The expectation of the UK and UK law already says that there should be compensation in the case of expropriation. Where the treaties come in, and where they can be problematic, is that they push much further the extent of compensation that can be available.

For example, you see cases where, under investment treaties, you are allowed to claim for loss of future profits. There was a case against Libya where the investor had spent about £5 million and was compensated £935 million—£900 million of which was for loss of future profits. It is not so much that it requires us to do things differently; it is that it pushes much further the level of compensation and the ways in which investors ought to be compensated.

Chair: Briefly, Owen Jones—Owen Smith—sorry!

Owen Smith: It happens to me all the time.

Chair: That is a terrible Welshism. I apologise.

Q149 Owen Smith: Thank you, Brendan. Are there any examples that you can



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cite of investors successfully suing states for any nationalisation of their assets—recent ones using international treaties?

Ruth Bergan: There was the case of *Rurelec v. Bolivia*, where they renationalised the gas industry. It is a complicated case. Bolivia had valued the assets at zero, which entailed no compensation. I am not making the case that states are always behaving entirely as one might wish them to, and investors are always—but in that case, the investor was successful. It was another case that was brought by a company investing through tax havens. Bolivia argued that this was in response to structural adjustment programmes that had been imposed by the IMF and World Bank years before, and that they were just unpicking some of the things they had done reluctantly on the basis of such programmes.

Q150 **Julia Lopez:** This is a question for Dr Collins. What are indirect expropriation provisions and how do they work?

Prof Collins: Indirect expropriation means that the investor can keep their asset—they keep the title to the asset in law—but they lose the functional utility of it. They have lost the benefit and enjoyment of the asset, which in the commercial context means that it is no longer commercially viable for them. It would cover a range of measures that would impinge on the profitability of the investment project, and it is potentially very sweeping in its scope.

Q151 **Julia Lopez:** Can you give some examples of that?

Dr Collins: Of the exact wording?

Julia Lopez: Yes.

Prof Collins: It would be something along the lines of, "The host state is required to pay compensation in the event of compensation, be it direct or indirect." The answer I am giving you is not going to help you very much, because the treaties are very slim. Perhaps one of my colleagues has a treaty in front of them. It would simply include the word "indirect" in front of expropriation.

Ruth Bergan: From the UK, it is defined as "measures that have effect equivalent to a nationalisation or expropriation."

Q152 **Julia Lopez:** I have a question for Ms Eberhardt. What evidence is there to show the effect that investor protection provisions have on the flow of FDI, particularly regarding developing countries that have signed bilateral investment treaties?

Pia Eberhardt: It is really good that you asked this question. Until today, one of the most important justifications for these agreements is that they would bring investment. Unfortunately, the evidence to back up this claim is not there or is very inconclusive. You have a couple of econometric studies that show either an effect, no effect or maybe even a negative effect. You have researchers who have done qualitative studies; they have actually spoken to people working in companies: how does a treaty affect your investment decision? Again, there is no big correlation. You have a



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couple of countries' experiences, which also show that investment treaties do not bring the promised investment.

South Africa is one of the countries that in the past year have started terminating treaties, and they said, "Well, we looked at the issue very closely, and we see that we have a lot of investment from countries with which we have no treaties. On the other side, we have hardly investment from countries with which we have signed treaties." You have Brazil as an example: it has never signed an agreement with ISDS for that direct right for the investor to sue, and it is the biggest recipient of foreign direct investment in Latin America. The promise that signing an agreement brings investment is an empty promise, because other factors, such as market size and education of the labour force, are much more relevant.

Q153 Julia Lopez: What about a developed country like the UK? How strongly do you think we require investor protection provisions to attract investment? Do you think it is a key part, or is it actually quite irrelevant, given the stability of our system?

Ruth Bergan: None of our bilateral investment treaties are with countries that are exporting capital. Our major sources of investment are EU countries and particularly the US, and we have never had an investment treaty with them. In fact, our treaties were initially all about external investments and protecting our investors.

Q154 Julia Lopez: In the event that we signed a bilateral FDI with the US, do you think that we would actually not require such a dispute settlement mechanism?

Prof Collins: May I go back to the question of FDI flows? I disagree with my colleague. There are many studies on this issue, and some of them have recently shown that there is an increase in FDI. There was a study done by the United States International Trade Commission very recently, which shows an increase of about 4% in FDI following the conclusion of bilateral investment treaties. Many of the studies on which the claim that the treaties do not lead to FDI flows is based came out of an era in which world FDI flows were in decline, and it was an easy trick to make it look as though they do not work. That is not to say that they categorically work. They do more so in some circumstances than in others. The strongest evidence of where they work is in countries that are transition economies, and again they are modest gains. It depends on what kind of treaty it is and what kind of provisions there are in it—whether there is a pre-establishment guarantee, and so on.

It is a complex question, and it is an oversimplification to say that they categorically do not work or that they categorically do work. It is very much an ongoing study, and it has been misrepresented. The United States International Trade Commission did this study in the run-up to the conclusion of the USMCA—the new NAFTA. There are a number of studies that show an increase.

Q155 Julia Lopez: Could it be put the other way—that investor-state dispute provisions are often not sufficient to override a lot of concerns that



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companies have when they invest in particular jurisdictions where there is an uncertain legal system?

Prof Collins: Yes, I am not going to disagree with you. That is especially the case if there is an exhaustion of the local remedies requirement, which would compel the investor to use the domestic system, and only when that is not forthcoming are they able to use the investor-state system. No, it's not going to solve every problem.

Pia Eberhardt: May I respond to the accusation that I am misrepresenting the evidence? That was a bit harsh. There are excellent written contributions from people who have looked at all the studies that have been done over the past 20 years, and the evidence is inconclusive. That is why even the UN Conference on Trade and Development says that the promise that it brings investment is misleading.

Q156 **Julia Lopez:** May I just go back to Dr Collins about the idea of a US-UK deal? A lot of the arguments against such an agreement are focused very heavily on the NHS and the potential for private US companies to sue it. Do you believe that we would require a very robust investor-state dispute settlement procedure in such an agreement with the US?

Prof Collins: "Require" meaning that it would be a red line for the US?

Q157 **Julia Lopez:** Do you think we could do a worthwhile agreement with the US without including those kinds of things?

Prof Collins: Yes, you could. Canada just did one with the US that excludes ISDS. You could do it. I suspect the US would want it, but I suspect you could do one without it.

Q158 **Sir Mark Hendrick:** Just on that point about investment agreements, there is obviously a bit of a dispute between two of the panellists. To clarify, nobody is saying that an agreement isn't a good idea; it is just a question of how effective an investment agreement would be. Is that possibly characterising it in a more favourable way, or are you saying that investment agreements are negative? I seemed to get the point that investment into the UK isn't affected by it, but investment into a developing country might be more seriously affected by it. Is that the way to put it?

Ruth Bergan: Something to bear in mind about the UK is that, so far, we have mainly had deals with capital-importing countries. We have had one case against us. If we go into deals with countries like the US, I think the chances are that we will see an increase in cases. A study ahead of the transatlantic trade and investment partnership commissioned by the Government suggested that that would be the case, and that the compensation offered under it would be more than we would normally offer under our own agreements. Given that the treaties have not brought the promised investment that they have been offering, and given that they offer significant additional privileges to international investors, compared with domestic companies or individuals, I don't think they are an appropriate mechanism for dealing with the kinds of things they claim to deal with.



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Pia Eberhardt: I agree. I would say that there are no clear proven benefits of investment treaties to society at large. Obviously, you always have a couple of investors that benefit. On the other hand, there are serious risks for taxpayers, the regulatory space and the rule of law, because this system also contradicts a couple of other legal regimes, including domestic legal regimes.

Q159 **Chair:** Let us hear David Collins on that point.

Prof Collins: I would just like to add this. I guess the obvious question is, why do you feel you need a treaty with somewhere like the US, which we understand to have the rule of law, and so on? You might expect that the UK would want one with a developing country, because you might not trust the court system and you might be worried about corruption and those kinds of things, but you might not be worried about that in the US. Sadly, you can't expect that all of the courts in the US will be as efficient or as non-arbitrary as we might wish them to be. This is being recorded and I am concerned that I will say something that sounds insulting, but I am not sure that I would trust the court of Louisiana or Kentucky or something like that. A number of Canadian investors have struggled with this in the past in NAFTA. So you cannot assume that, because it is a developed country that commits to the rule of law, all its institutions across all its many governments, regional and municipal, will be the same, and that is what the treaties are there for. So you have to think of the UK as a capital importer, but also as a capital exporter. Are British companies going to be safeguarded when they go into Louisiana against some Louisiana judge who might impose an arbitrary interpretation of regulations? That is what ISDS is there for.

Q160 **Faisal Rashid:** Very quickly because I don't want to keep going on about that topic. I understand where Dr David is coming from and I also understand where Ms Eberhardt is coming from, but the most fundamental point is what is in the treaty. It depends. That is when it will or will not work. It is exactly what both countries agreed goes into the treaty and what was negotiated.

Pia Eberhardt: I would say you can also look at it from a more principled question, which is what, for example, judges do. What this regime does is take one group of actors, the foreign investors, out of the existing legal order and allows them to bypass domestic courts, which is very unique in international law, without exhausting local remedies, and file a claim in their own parallel justice system. You could say this is what we want to do, but this is where I would say the question of the benefits for society at large is really important, because it is quite a legal privilege you grant to foreign investors. If you are a foreign investor, you usually are not on unemployment benefits, so this is the more wealthy part of society to which you grant extra special rights. If you want to do that, that's fine, but it is quite a legal privilege.

So it is not only about what exactly is written under fair and equitable treatment. It is about this basic question: why do you grant them greater rights than anyone else in your society, including here in the UK and also



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in the US? The German judges association has been quite strong on this point. They do not deny that there are problems in legal systems around the world. Of course they exist, but they have to be addressed for everyone; for normal citizens in the US and not just for foreign investors coming to the US and the other way round, and I think that is quite a strong argument.

Ruth Bergan: Another thing to add to what Pia has said is that effectively what this provides is a kind of risk insurance to investors. It makes public a private risk. I am not sure that that is the right approach to this. There is evidence from the Cato Institute that this can be market-distorting. My sense is that the risk should be borne by the investor, because, after all, that is where the profit is taken.

Q161 **Faisal Rashid:** Ruth, why has investor protection and in particular investor-state dispute settlement proved to be so controversial?

Ruth Bergan: I think you have heard some of the reasons why we think it is controversial. It is this basic point that it sets up an unfair system where international investors have a different and quite privileged legal system that nobody else can access. That also then means that they have a greater and a particular way of influencing national regulation that I think people are very surprised and very concerned about when they learn what is happening. When they learn that Germany lowered environmental standards in the face of a case brought by Vattenfall, there is a sense that that is not how regulations and democracy should work. That is what drives the concerns about it.

To expand on that, in the UK we certainly do not offer these kinds of privileges to UK citizens. You have the Wednesbury convention, which suggests that administrative decisions by the Government should not be subjected to the kinds of things that investment treaties offer unless a decision was so outrageous in its defiance of logic or accepted moral standards that no sensible person could have arrived at it. It is a much higher bar than is ever offered to international investors under these treaties. I think that sense of unfairness is really acute.

Added to that, there is the fact that there are no responsibilities and nothing required of investors within the treaties. They get the privileges no matter what the kind of investment, with no particular requirement to have behaved in an environmentally or socially responsible fashion.

It is also, as Pia was saying, limited to companies that can afford the legal costs to access the system, so again it is not small businesses that are using the system. On the whole, it is bigger businesses.

Q162 **Faisal Rashid:** What is regulatory chill?

Pia Eberhardt: Regulatory chill refers to a situation where a Government or a Parliament does not proceed with, for example, an environmental law, because it is afraid of being sued or because a lawsuit has already been threatened and that is potentially so expensive that the measure is not taken forward. We have evidence that this happens in the world of ISDS.



Ruth already mentioned one case against Germany. It was the first case by Vattenfall, a Swedish energy company, over €1.4 billion. It was about environmental restrictions on a coal-fired power plant that the local governments had in place. More specifically, the question was how much water could be taken out of the local river to cool the plant and then put back into the river. The restrictions were tightened. That led to an ISDS claim against Germany over €1.4 billion and that put so much pressure on the local government to settle the case. As part of the settlement, they relaxed the restrictions, so Vattenfall actually got what it wanted.

Another example is the infamous cases that Philip Morris launched against Australia and Uruguay. They were about plain packaging and other tobacco regulations. In the end, Philip Morris lost, but the case still had the intended effect. A couple of countries—New Zealand, for example—are on the record as saying, “We wanted to do the same thing as Australia but we want to wait until the case is concluded.” So the case had the effect of delaying anti-smoking legislation in New Zealand and a couple of other countries for years. You might say, “We are strong UK MPs; we would never back down,” but I would say that when you face a €1.4 billion threat, it would be foolish not to take that seriously. It is the money and the regime and a strong enforcement mechanism that makes that threat so powerful when compared with other lawsuit threats that you are probably all familiar with.

Q163 Faisal Rashid: So ISDS is working for some large corporations, but it can also undermine the Government and their policies as well. In that example, of course the investor is there with the investment, but the local government changed or relaxed the policy, which they should not have done, because of that investor who is investing in that country. So it is working in some ways but is also putting pressure on Governments and local government.

Prof Collins: Can I just add to that? The other side of the coin to regulatory chill is good governance. Maybe there are a number of laws that developing countries shouldn’t be imposing because they are anti-business or they are corrupt or they are arbitrary. The threat and pressure of ISDS acts as an agent of reform in favour of rule of law and good governance.

Pia Eberhardt: May I come back to this quickly? In your written evidence, there is a statement that the evidence on the good governance claim is next to zero. It is plausible, but the evidence is not there.

Dr Collins: I don’t know how you would measure it. I would be interested to see the nature of that. Other than anecdotes, I don’t know what the evidence would be.

Q164 Faisal Rashid: Okay. Let us move on to the EU’s investment court system. Can you explain how the EU’s investment court system and the multilateral investment court that it is proposing are intended to address the perceived deficiencies in ISDS?



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Pia Eberhardt: I follow EU policy a lot, so that is probably a question to me. In response to the massive criticism of investor state dispute settlement across the EU, the European Commission changed the toxic acronym from ISDS to ICS—investment court system. It was a relabelling exercise, but the investment court system also includes some important changes from the old ISDS. For example, ISDS proceedings under the new EU regime must be transparent and open to the public, while under the old regime sometimes even the fact that a claim exists is hidden from public view.

The arbitrators who decide the cases are also chosen differently. Under today's regime they are hand-picked by the parties, which it is a bit like you going to your courts and 50% of the judges being your friends or neighbours. *[Laughter.]* No, I am not kidding—that is how ISDS works today. Under the new regime, the EU says "No, this has to stop." The EU and its trading partners will put together a list of arbitrators. They will be state-appointed, and the three people who will decide a future dispute will be picked from that list. It makes the system a bit more independent.

These are really important reforms, I would say, but the egregious cases that we have been seeing and the threat of regulatory chill really will not be addressed that much by these changes. They are more about improving the dispute settlement process and judicialising it a bit more.

Q165 **Faisal Rashid:** Do you think that this transparency will work, or is there more that the European Union should do?

Pia Eberhardt: Transparency is already an existing trend that we see in this field. It comes from many corners, so I think we will see more transparency initiatives in the future. I come from Germany, which is currently battling a €6.1 billion case that is completely untransparent, and as a German taxpayer I would love to see more details of that case. Parliamentarians would also love to see more of the documents. But would that make everything fine? No, of course not. As I said, it does not change the risk for taxpayers, for regulations or for democracy; by and large, those problems remain unaddressed by the new EU approach.

Q166 **Faisal Rashid:** Do you have any views from a Trade Justice Movement perspective?

Ruth Bergan: I think we would agree: it addresses some of the procedural issues, but not the substantive issues that we have been talking about. From our perspective, the onus should be on the companies to do their due diligence and risk assessments on whether it is really a good idea to invest in a particular country. They should then think about how an investment is structured. If you want to avoid difficulties, you might want to go into a joint venture with a local company, or you might want to make sure that your impact assessments are public and that you have engaged with local communities.

If you do face issues, you might want to look at mediation. That is contained within the new Brazilian model of an investment agreement, which does not include ISDS. We think that investors should be using local



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courts, which is a really good way of helping them to improve how they deal with these kinds of disputes. Political risk insurance is available commercially, as well as through the World Bank and from the UK Government; it covers most of the issues that are covered by investment treaties. Finally, you can turn to state-to-state dispute settlement. You therefore do not really need a separate treaty, because you are using many of the same mechanisms that are available to everyone else, and you are using commercial risk insurance.

Q167 Chair: Dr Collins, would you like to come in—particularly on the point about the judges being friends and neighbours?

Prof Collins: I agree that the investment court system is about the process. It is a procedural change; it is not changing the substantive rules of the investment treaties. What it might do is improve the public's perception of the system, which is a big deal because all this anxiety arose when the public started hearing about it and getting upset about secret courts and evil corporations.

Maybe the ICS will help to deal with that, but I am concerned that it will make the process longer and more expensive. It has an appeal system, which—if the WTO experience is any guide—will probably be used 70% to 80% of the time, so the process will take twice as long and probably cost twice as much. We are hearing quite legitimate suggestions that it is an expensive procedure that is not accessible to ordinary companies or ordinary people, and being that much more expensive will make it that much less accessible. The people who like it—if you want hear somebody defend the ICS system—are the investment lawyers, because they get twice as much fees to do twice as much stuff. I am probably in agreement with the other panellists: I am not really convinced that it will fundamentally do much with the system.

Q168 Chair: Before we move to Owen Smith, I have a quick point that has come up from actions yesterday on CETA and Wallonia—the Belgian Government brought the case to the ECJ, which yesterday issued an opinion in which it found the EU's Investment Court System compatible with EU law. A quick question: do you agree with the ECJ's assessment that the ICS will not call into question the level of protection of public interest determined by the EU following a democratic process? Are we happy with that?

Pia Eberhardt: I was actually quite shocked to read that specific paragraph in the ruling where the ECJ basically says that the formulations in the treaty are enough of a safeguard to protect regulations in the public interest, because there is a lot of analysis about the very weak formulations in the CETA by people who know this regime—it sounds nice, providing easy comfort, but it will not stop investors from challenging public interest regulations or from winning cases, because the legal base has not changed as much. So no, I am not happy with the ruling. I know that a couple of people who have been following this field were hoping for a different ruling. Reading the text, it sounds a bit naive—wishful thinking, without taking the reality of investment arbitration into account.

Q169 **Chair:** I will do the Harry Truman here—but on the other hand?

Prof Collins: I have not read the case, although I know it came out yesterday. I am not remotely surprised that the ECJ issued the judgment that it did, because the EU obviously drafted the Investment Court System of the CETA, along with Canada. They would not have done it without advice from the lawyers that it was probably compliant with EU law, so I think that it would have been a big shock to everybody if the ECJ had suddenly said, “Oh, actually, no, it’s not compliant.” I am not surprised at the outcome in the sense of looking at the whole treaty negotiation cohesively.

Q170 **Owen Smith:** Ruth, to take you back briefly to one of the issues that you were talking about a moment ago—alternatives that could be employed by investors to protect themselves—is there any evidence that there is a lesser volume of, for example, political risk insurance being taken out by companies as a result of ISDS in treaties?

Ruth Bergan: I do not know. That is not a question that I could answer.

Prof Collins: I could try to answer. The data on political risk insurance is very sketchy. We have a very poor picture of what the uptake is. My understanding is that the uptake is low and, strangely enough, particularly low by companies from developing countries. It is mostly taken up by developed country investors. The suggestion is that one of the reasons why developing country investors do not use it is that they are already comfortable with political risk in their home jurisdictions.

One of the problems with political risk insurance as an alternative to the ISDS system is that it is very expensive. The MIGA—the insurance that is available from the Multilateral Investment Guarantee Agency of the World Bank—is conditional on satisfying a number of requirements in relation to having a developmental purpose, so it will not be broadly available. My understanding is that MIGA will only offer political risk insurance if the investment is going into a country for which a bilateral investment treaty is in place as a back-up. They sort of go hand in hand.

It is suggested that there is a moral hazard issue in political risk insurance, in as much as if you feel that you are covered by insurance, you are more likely to behave in an egregious manner that might lead to the host state being unhappy with you. On the other hand, some people have said that having political risk insurance—especially from the World Bank—contributes a halo effect, which makes the host state less likely to interfere with the investor, because it does not want to upset the World Bank. But we need more studies on this to see it as a potential alternative. As it stands, I would say that it is not an alternative on its own.

Q171 **Owen Smith:** David, do you buy the notion that there is any risk under these ISDS mechanisms that, as I think Ruth was hinting earlier on, we are effectively nationalising private risk that ought rightly to be borne by the companies?

Prof Collins: That is an interesting way of looking at it. If you want to frame it thusly, you could say, “Why isn’t the investor either getting insurance or conducting the investment under an investment contract?” That is fine, but it is very expensive to negotiate a contract one on one with the host state. The only companies that can do it are the giant extractor sector companies. If you want to privatise it, again, you are cutting out any of the smaller investors.

It has been done in the form of a treaty to extend the protections as widely as possible across the private sector investing market. That would be one of the risks, if you say that you are taking the role of the state out of it and expecting it to be done privately. Put that in conjunction with the reality that foreign investment brings benefits to the states that receive it, including development, and there is an argument that it should be publicly subsidised in some way anyway.

Q172 **Faisal Rashid:** A question to Pia. Some international investment agreements include investor obligations. What are these obligations?

Pia Eberhardt: Actually, to date, very few treaties include investor obligations. If I am well informed, UK treaties do not. At the moment, it is a lot of rights for investors without obligations, but the asymmetry is more and more criticised, and you have good proposals for investor obligations that could be included. For example, it could be very basic: the general obligation to comply with the host country’s law all throughout the process of the investment, not just in the beginning; the obligation to abstain from corruption, and to properly inform the state and the community where the investment is based about the project; a duty to respect human rights, and the ILO labour standards; et cetera.

There is a long list of good proposals that could be included in the agreements. The question then is how to make them effective. Again, there are several ideas. One way to make them effective would be to say that the investor loses the right to arbitration when these duties are violated. Another opportunity would be to enhance the state’s possibilities for counterclaims, which are very limited at the moment. There are also ideas for affected communities on the ground to take the investor to court based on these obligations in its home state.

As I said, at the moment this is very much a debate, and not at all reflected in existing treaties. At the moment, they remain very asymmetric, putting a lot of obligations on states and none on investors.

Q173 **Mr Fysh:** Just to elaborate on that a bit, I wonder whether the rest of the panel might have some comment on the counterclaim abilities that are there. To what extent do you think that they can work, how do they work, and to what extent do they counterbalance the investor protection rights?

Prof Collins: Just to add to what Pia said, counterclaims have predominantly been done through investment contracts, not through treaties. The few cases that are out there were contract-based claims, not treaty ones. Some of the new treaties are suggesting facilitating



counterclaims. That might be an interesting way of dealing with the counterbalance.

I just want to say that the treaties are absolutely one sided. They are imposing obligations on the states and not on the investors. That is unquestionable. Should obligations be imposed on investors in the treaties? That might well be a good idea, but I want to add that that is only one side of the situation, because of course the investors are the ones bearing all the risk when they go into the country. They are the ones who are subjected to the whims of the legal system in that state. They have the sunk costs for years and years. A mining company will not start to see a profit for about 25 years after it starts to build facilities in that state. There are all those years of exposure to risk.

The treaties were designed to rebalance that scenario. The treaties themselves were not internally really ever supposed to be balanced; they are meant to sit alongside the administrative procedures in the host states. Unless you consider that, I think you are getting a flawed picture of the entire system, as it were.

Q174 Mr Fysh: To what extent do you think that carve-outs from investment protection for certain sectors—such as, for example, the tobacco industry and the Trans-Pacific Partnership tobacco carve-out precedent—can mitigate some of the allegedly negative effects of ISDS?

Pia Eberhardt: There are examples of carve-outs. You mentioned the tobacco carve-out; it is a direct reaction to the Philip Morris claims. So, while tobacco legislation is being challenged, we put in a little carve-out to protect tobacco legislation in the future.

The EU has a carve-out for withdrawal of subsidies, following a wild case against Romania. So it is a very patchy approach to fix problems in the regulatory space of Governments. You also have a lot of tax carve-outs in treaties still; we see a lot of cases involving tax issues. So I would say that where there is a carve-out, there is also a way around the carve-out, if it is not drafted very carefully.

So, rather than taking this patchy approach of protecting this, and protecting that, I really wanted to make a general point again: if this regime has risks for public interest legislation, it is really worth considering whether these agreements should be there in the first place, as long as their benefits to society at large are not proven. The world does not fall apart when you do not sign investment treaties, or terminate them, as many countries in the world have shown.

Prof Collins: Maybe this is an obvious point, but I just want to be clear that somebody is making it. The fact that you can have these carve-outs, which Australia has done and under the new NAFTA ISDS has been left out of various sectors and kept in other sectors, and the Australia-China agreement has carve-outs for health and so on, I just want to underscore the point that these treaties are very much consent-based. You can design them as you want to design them, have this in them or have that in them,



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say that you do not want indirect expropriation or that you do want indirect expropriation, say you want cigarettes but you do not want alcohol, you want mining but you do not want telecommunications, you want ISDS for this but not for that—you can do what you want with them.

So I think that what we are getting to as we move into the 21st century is that the idea of there being an inflexible regime, with a cookie cutter all the same—they are not. The agreements are very fluid and very dynamic; they are bespoke; and they can be tailored to suit the particular country, as it needs. That is why I would caution against maybe reflexive wholesale responses against “the system”, as it were, in its entirety.

Q175 **Chair:** Panel, thank you for your time this morning. As ever, time is our enemy on occasions like this—three good witnesses and loads of information. Thank you very much for your time and we will try to move on speedily to the second panel.

Examination of Witnesses

Witnesses: Stephen Adams, Jack Knight and Jonathan Geldart.

Q176 **Chair:** Welcome to our second panel for this morning’s inquiry into UK investment policy. Can I again ask the panellists to introduce themselves—name, rank and serial number?

Jack Knight: I am Jack Knight. I am deputy CEO of the Investment Association. We represent 250 or so investment managers based here in the UK.

Stephen Adams: My name is Stephen Adams and I am a senior director at Global Counsel, which is a political risk consultancy. We conduct due diligence profile on inward and outward FDI for the UK. And I am an honorary fellow at UCL, where I teach on trade policy and trade politics.

Jonathan Geldart: My name is Jonathan—known as Jon—Geldart. I am the chair for the Institute of Directors for the Yorkshire, Humberside and North-East region, but for the last 10 years, I have spent time with an oversight role for Grant Thornton International in China.

Q177 **Chair:** Again, thank you for your time. Can you briefly explain—and I mean briefly—what services you and your members provide for investors, and what types of investment you support?

Jack Knight: We manage savings, pensions and investments for individuals and organisations in the UK, in Europe and across the world. In terms of scale, our industry has £7.7 trillion-worth of assets under management. Roughly half of that is for international clients, and of that, the balance is slightly more for EU27-based clients than for other international clients.

Chair: Substantial sums indeed.

Stephen Adams: We conduct due diligence for greenfield and brownfield and portfolio investors, either bringing capital into the UK or exporting

capital from the UK to Asia, south-east Asia, sub-Saharan Africa and Latin America.

Jonathan Geldart: The Institute of Directors has 33,000 members in the United Kingdom, and our job is to support better governance and produce better directors, such that they can provide a better business and therefore a better Britain—that is the general phraseology. However, within that, we provide advice, support, and indeed access to information to support investors, mainly investors from the UK, going outside, and we support trade missions and the like.

Chair: On that theme of betterment, who better to turn to than Faisal Rashid?

Q178 **Faisal Rashid:** Thank you, Chair. In making overseas investment decisions, what factors do investors consider, and in what order of priority, in your views?

Jack Knight: What our investment managers are primarily looking for is an investment return for their clients, but looked at the other way, that is about managing risks. There are a lot of risks to manage—environmental risks, governance risks, political risks, currency risks—and the skill of the management and the service they offer is in prioritising and managing those risks.

Stephen Adams: I do not think there is a simple answer to this question, and I am not sure there is a simple hierarchy. There is a set of issues that are always in play, I think. Probably chief among them is the one we would all obviously recognise, which is demand. An investment decision is a response to the need to be proximate to demand, or to build a structure for serving demand, and it is important to make that point. In some cases you will be dealing with an investor looking to locate alongside their clients, but in an increasingly globalised economy you will often be establishing points on a supply chain, where the customer is not necessarily in the same jurisdiction but you are serving them through multiple jurisdictions. That is the obvious thing.

Beyond that, essentially, you have a series of implementation risks. That might be connectivity in infrastructure; it might be planning and site development; it might be the local labour market and the productivity performance of the local labour market; and then, obviously, there is the question of regulatory stability. This is relevant, given the discussion you have just had. That does not necessarily mean status; what it tends to mean is the extent to which regulatory change is predictable, evolutionary and incremental. While I do not think there is a rigid hierarchy among those things, those are inevitably the things that will populate any strategic investment decision.

Q179 **Faisal Rashid:** What factors influence decisions on where to locate greenfield investment, both globally and in the country?

Jonathan Geldart: Unfortunately, it is largely perceptual, and one of the things that we find increasingly from our members is that very large



corporates have a totally different approach to the way that a smaller investor or a medium-sized business will actually invest overseas.

I use the word “perceptual” because countries have brands; countries are brands. I spent a long time in China, and behind an investment or an opportunity in China stands brand China. Therefore, most investors start their process of thinking about investment with that in mind: “Do I feel that China is a good place to invest? Do I think it will be easy to do investment there? Do I think I will be able to have a jurisdictional environment where I can thrive? Do I believe that it is fair? Do I believe that there is probity? Do I believe that there is governance?” Those are things that affect the overall perception of the opportunity that exists, prior to them making some fiscal decisions.

Yes, they will then look at fiscal dimensions that will affect their judgment, but by and large—and this happens the other way around; it relates to the way in which DIT performs, for example—the perception of Britain stands behind us, if you like, as the stage upon which the players play. It must not be underestimated. A lot of the Chinese Government’s focus is around brand. It is not around providing a particularly financially beneficial location for you, although province by province they will do that. They know they have a brand problem and that they have to address it. That is a lot about what Xi Jinping and the Government are doing at the moment.

Q180 Faisal Rashid: But that altered perception comes with experience and highlights investor contribution and what happened in the past. It all accumulates, doesn’t it, and that builds up the perception?

Jonathan Geldart: It does and maybe colleagues could comment in addition.

Stephen Adams: There is a very concrete way of rendering that precise observation, which I think is absolutely correct. Most investment decisions are based on track record. One of the rules of thumb that I would usually apply here is that most investment is won many years before it is made, if you see what I mean. What I mean by that is that as much as a business case will be built on a view of the future, almost inevitably it will also be based on a perception of the past.

You might represent or express that as brand but, of course, it can also be expressed empirically in a country’s track record of regulation and the way it has encouraged productivity in its past behaviour towards inward investors.

As much as I think strategists are tempted to see this as a forward-looking process, inevitably they draw on both perception and a stock of empirics about a country’s track record. In many respects, that is why that is an asset it is easy for a jurisdiction to squander and, of course, hard to regain.

Jack Knight: You could even take our industry as a case study. The investment industry in the UK is an important and growing industry, and we promote our industry by saying that the UK is a stable and predictable

place in terms of business, the law, its taxation system and regulation. That is what is attractive to other businesses to come here.

Jonathan Geldart: To add to that, it should not be underestimated. I have spent the past 10 years working with Chinese businesses and within a Chinese business, and to some degree with the Chinese Government.

This is their perception of Britain. Imagine you are standing outside Britain and looking back at Britain right now. Actually, let's go back a year, before I answer the final bit. If you look at Britain for the last 10, 30, 200 years, we have a number of immensely important attributes: probity—our word is our bond; our standards; our legal procedures; our legal process. The fact that we have and apply process. Those are very reassuring, particularly to Chinese investors, where, one could argue, there is less of that within China, although it is increasing.

As you look back at Britain, it allows DIT—and I know this is something that you are particularly interested in—to say the right things in an environment where they probably do not have a long time to say things. Because they are trying to convince inward investors to come here rather than go to Saudi, or wherever it might be.

When they go out, it is an immensely beneficial part of the armoury for DIT and other institutions, such as our own, to talk about Britain in that rounded sense, which gives immense surety to investors coming in. Of course, they are going to make other decisions but it should not be underestimated the effect that brand Britain has.

I was at a conference yesterday where this was precisely discussed. Right now, there is a blip. You might think Brexit is the most important thing in our lives, as it is, but in the context of history, when you look back through history, it is a blip.

The general belief, certainly of the Chinese Government and others, though I cannot quote specifics and individuals, is, "You'll get over it, because you always have." They have immense confidence in the ability of the British Government and British institutional system to overcome what is essentially seen as a short-term blip in a longer term constitutional system that is extremely good.

Q181 **Mr Evans:** This is aimed at Jonathan and Stephen. How big is the role played by UK higher education in inward investment decisions, particularly on R&D?

Stephen Adams: Very high. The higher education sector acts as a magnet for investment in a range of ways. Obviously, there is the one that we would immediately imagine, which is commercial partnerships with universities in pursuit of R&D.

Of course, the higher education sector also supports a series of ancillary sectors: the pathway sector, for example, preparing students for university. The student housing sector has also been an attractive investment proposition in many cases over the last decade, as the

changing composition of UK students has driven a changing view of what is desirable and appropriate for student accommodation.

Obviously, all those dynamics, and of course its role in fuelling the skill level of the wider workforce, and the spillover benefits and direct benefits for partnership, depend on the continued strength of the sector, its economic robustness, its capacity to continue to attract the volume of students it currently has, and its ability to attract teaching talent. There is clearly a very positive dynamic there, as long as the sector remains healthy.

Q182 Mr Evans: Is that spread around the whole of the UK, or is it concentrated in just a few of the institutions?

Jonathan Geldart: You are back to perception and reality. The perception is that it is concentrated in a few institutions, but speaking as a good northerner, I would suggest that it is both regional and national. Indeed, as universities become known for or famous for particular skills—Leeds, Manchester or my alma mater St Andrews are examples—they find they have particular attributes and particular focal points that they are known for. Looking at Leeds as an example, they are very well known in terms of the relationship with the NHS and NHS directors there, and there are a lot of universities around medical. They have other skills as well of course. Being known for something is a critical aspect of giving surety to inward investors as well, because a lot of those inward investors, certainly going back to China, will look to invest in spin-out operations, which is a huge opportunity for us.

One other thing that the UK is known for is being inventive—not necessarily delivery, but we are seen and relied upon for our inventive nature and our creativity. Those are things—creativity being one; you have media centres in Manchester and so on—that are very powerful. I would say it is an absolutely essential element of the way we go to market externally from the UK in supporting our institutions to be known for something that is particularly special.

Q183 Mr Evans: That is part of the problem—it gets invented here and then the value-added is somewhere else.

Jonathan Geldart: That is addressable. That was an old perception, but certain universities in the UK now very much have the ability, the wherewithal and the funding to be able to deliver into markets that they were previously never able to deliver into. It has changed, but that is the perception and reality situation.

Q184 Mr Evans: Finally, how important are financial incentives by the state for inward investment?

Stephen Adams: They are an inevitable factor when they are present. When you have a competition for inward investment, you have an element of the game theory problem, which tends to mean they multiply. My instinctive view on this, though, is that they are ultimately secondary. They are subordinated to judgments about fundamentals. Most firms,



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when they are making investment decisions, are looking at fundamentals. They are aware that a subsidy is a distortion—they know that; they are not foolish. In the end, something like the capacity of the receiving state to mitigate site risk, or to guide an investor through the investment implementation process, is actually seen as fundamentally more helpful than the financial incentives.

Q185 Mr Evans: Is it critical? In many cases, would those investments not be made in any event?

Stephen Adams: Anecdotally, it is quite difficult, when you have actually had a chance to have a look at the underlying investment proposition, to make the case that they are critical. As I say, often I think these judgments are made on the basis of a perception of fundamentals, to which the incremental impact of a financial incentive is, you know—

Jonathan Geldart: To give you an example, to go the other way round, if you go to places such as Shenzhen or Guangzhou in south China, they are falling over themselves to give financial incentives to individual organisations—not individuals. Does that make a difference? Absolutely not, because everybody knows that there is a payback time and it is only temporary. You have to look at the long term, particularly if you are a mining organisation, as we have heard in the previous panel, or any other large organisation. You are not going to take a short-term palliative in terms of a long-term beneficial approach. You are not. You are just going to say, “I’ll take the money now, but that’s not the most important reason I’m making the decision.”

Q186 Julia Lopez: DIT is a fairly new Department. It is three years old. Has it made a difference in terms of making the UK a more attractive place to invest? Have you been impressed by how it has promoted and facilitated inward investment? You talk about the idea of brand. We have touched on the issue that actually there are different brands in different parts of the UK. Are there any parts of the UK that had been falling behind but have managed to turn around their position when it comes to attracting inward investment? If so, how have they done that?

Jack Knight: If I can speak, as a representative of an industry that is very active in this space, the answer is categorically yes. It has been very successful. For our industry, it is in the framework of a strategy—the investment management strategy—that has been developed with the Government. Direct work streams from that include the DIT facilitating a one-stop shop for incoming asset management firms and liaising with the regulator and the authorisations hub to facilitate and streamline applications. They worked closely with us—last week I hosted a panel at Qatar day—to receive a delegation from the governor of the central bank of Qatar. Tomorrow, I will receive a Kuwaiti delegation. This is all soft power facilitated partly by the DIT, partly by people in the UK from the DIT, and also, to a certain extent, by the Treasury and financial services.

Q187 Julia Lopez: Is that a step change from the situation before, when it was sort of a sub-department within the FCO?



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Jack Knight: It has been. We see a much deeper understanding of what a service industry is and the techniques that are required. It is about dialogue. It is about discussing regulation and innovation. They facilitate FinTech bridges between our velocity accelerator and FinTech in Switzerland and Shanghai. Yes, it has been very valuable.

Jonathan Geldart: I absolutely concur. The change to have more regionalisation in the DIT has been a real benefit. Again, speaking as someone who is involved in the northern powerhouse, that, as with the midlands engine—that coalescence around a particular part of the United Kingdom—will provide a focal point, if you like. Scotland has also been successful, dare I say it. Doing that has allowed those parts of the UK—the northern powerhouse is a good example—that were previously running behind to start to come to the forefront. We now have something in the north that, notwithstanding that I am from Yorkshire and the lads over in the west do not quite see things as we do, allows a consistent view to be delivered through DIT, not just in the UK, to inward investors coming in, but outside.

I can attest to that, particularly in Beijing, where they work very closely with the ambassador and the support staff at the embassy to do a very good job. In fact, next week—I will not be there—they will host an event in relation to WPP and the top 100 Chinese brands, which happens to be something I know about. They will absolutely be using soft power to very high effect to encourage inward investors and to encourage a change of perception among people who may want to come to the UK. I think that is a good thing.

Let me add one thing about universities. Do not underestimate the power of students. Students come here, and their parents will be supporting them. Parents are often investors. They will—I hesitate to say this—buy property for the student because they want them to have a safer environment in which to work and develop, and then they will potentially invest. One of the things that has changed in the regions of the UK is that there is now very much a focus on that—on utilising and leveraging the university connections with students on to the parents, on to investment opportunities and on to sales.

Q188 **Julia Lopez:** So these brands—the northern powerhouse, the midlands engine and so on—are a hook that really can bring people together? I look at my own region, where the Thames Gateway has not really had that but is starting to try to get it. Do you think that has made a big difference?

Jonathan Geldart: Yes. London First has done an excellent job of changing perceptions and, to a degree, moving it away from purely finance. London is seen as a financial hub, and rightly so, but nevertheless there are other things London can offer to inward investors. I think it does help make a difference. You could say a million things about the north of England, but you want to say one or two. When you get a coalescence of view—“Okay, we’re going to say these two or three things: it’s 15 million



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people, it's this sort of asset base and these are the skills"—it is a lot easier to sell it.

Stephen Adams: The convening function is absolutely key. You cannot convene effectively unless you are close to the people you are trying to convene. The one key thing is making sure that these kinds of organisations are able to help take the investor through the implementation process as well, so it is a question not just of convening but of then being able to guide them through the regulatory and practical questions they need to navigate.

If I may, on the outward function, it is important to stress that the point about convening—the Sherpa function of guiding investors into market—is very important when we think about what DIT should be doing abroad. Clearly, one of the key roles of embassies and their DIT staff is essentially to help British businesses in the same way. One of the ways that British civil servants and diplomats have perhaps struggled in the past is precisely with being well resourced to do that. In many ways, the rotational system of diplomats works against the kind of local knowledge that you need to be an effective Sherpa for outgoing British investment. Embassies that have done that well have often been quite good at drawing on local resource alongside the diplomatic corps, so that they have continuity and a depth of experience that is preserved over time and is not lost every time a diplomat comes home from her four-year tour.

Jonathan Geldart: I absolutely agree. Those institutions exist but are not utilised. If you look at Germany—we had a German here earlier—the German chamber of commerce is extraordinarily effective, particularly in China, because they speak with one voice.

Q189 **Julia Lopez:** They are compelled to join, aren't they? That is something that I am really interested in because I have seen it in practice. Would you be interested in a system in which we compelled British companies to join, or do you actually prefer our slightly more fluid system?

Jonathan Geldart: Look at the evidence for Germany and make your own decision based on that. It is quite difficult to compel anyone in Britain to do anything, as we know. Nevertheless, the principle would be to utilise other on-the-ground entities that have a single voice about Britain: the chambers of commerce; the British Council, which is obviously part of the embassy; and the Institute of Directors. I know that this is being recorded but we are absolutely considering opening an IoD in China—I signed an agreement with SASAC last year; unfortunately there have been some changes, and we would like to see the Government supporting that—to talk about governance in China and increasing the probity by putting Chinese state-owned enterprise directors through a British system to improve their knowledge.

Q190 **Matt Western:** To pick up on that and echo the points that Julia made about the levy placed on German companies to do that, at least the infrastructure is on the ground in those important markets. Looking at the map of it, what they have set up over decades is really impressive, as



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is even what the Koreans, for example, have done. If we are trying to push small and medium businesses to do and invest more, and afford them protections as well as helping to facilitate them, surely we need something like that and for people to pay for it.

Jonathan Geldart: I would be hugely in favour, but that is a personal view. I can only say what I have seen, particularly in China—others may wish to comment on other jurisdictions. The fact that you are compelled and pay money means that you want to get value. German companies want to get value out of the chamber of commerce doing things in China. Although it isn't a German example, the European Chamber of Commerce in China is incredibly effective, because they speak with one voice.

Q191 **Chair:** Can I pick up on a point that you made earlier about parents of students becoming investors? You seemed to give an example of mergers and acquisitions, particularly acquisitions of houses and flats. Mergers and acquisitions areas are not the favoured form of investment; greenfield is the favoured form of inward direct investment. Surely the buying of flats and houses adds to the already substantial housing pressure in the UK.

Jonathan Geldart: It does, but that is a direct result of pressure on university funding so that they bring in overseas students. Those overseas students, by and large, will have rich families, who want them to be secure and therefore buy housing stock. That is a direct relationship between the two.

Q192 **Chair:** Isn't that a bad thing for people who are kicked off—

Jonathan Geldart: It is, absolutely, and the issue about affordable housing in the United Kingdom is something that the Government need no doubt to address. Nevertheless, in a wider context, there are ways of doing that in terms of provision of student accommodation, and you might be likely to consider how that is actually working. We are talking about only 100,000 students—that is not going to change the world, nor would 200,000 students.

Chair: It does if you are one of the 200,000 who are kicked off the bottom of the ladder in Britain.

Jonathan Geldart: That is exactly right—you have to be very cautious. It is worthy of note and worth thinking about, but what I am particularly interested in is how it changed the perception of the parents who are investors, because their perception is generally a good one when their child comes to school or university in the United Kingdom.

Q193 **Mr Fysh:** What role do DIT staff in overseas posts play in respect of both inward and outward investment? Have you noticed any effect from cuts to those programmes?

Stephen Adams: We have been alluding to some of the strengths and weaknesses. One of the big challenges for the UK will be making sure that DIT staff abroad in some ways move on technically from the skill set that in many respects UKTI encouraged them to develop, which are



fundamentally the convening skills and the understanding of what makes an effective inward investment, to an additional and augmented set of skills. Those are the skills of being able, along with business, to recognise and tackle market entry barriers and irritants.

Converting DIT's presence abroad into a cohort of regulatory diplomats in many respects, or commercial diplomats, is one of the big challenges for the UK. The US in particular has done it, and does so very well. Apart from the cuts, which have had in many respects a material effect on morale and physical presence, part of the challenge for DIT is the question of how you take a system based on rotation, not necessarily on the chance to develop a prolonged period of exposure and experience in a jurisdiction and how it regulates and the practical challenges of navigating it, given what we need to deliver. That is supporting British businesses with precisely that kind of diplomat—someone who can be a genuine Sherpa for them in a market they are looking to enter.

Jonathan Geldart: Yes, absolutely in China you have seen a reduction in DIT's ability to perform, because they have had to cut back on where they can place people. China is a big place—that is an obvious statement—and it is very different in different places. Shenzhen, Guangdong and Chengdu are different provinces, different jurisdictions, and they operate differently. When you scale back on the availability of staff and skilled staff in particular—the great temptation is to keep the same number of people but get less cost through having new, younger people coming in, which is great for them—you do not have the age, experience and expertise to do the navigation bit. Particularly in China, you have to build the *guanxi*—the relationships—with local government so that you can help business to be supported on the ground in real ways.

Jack Knight: We have had no direct experience of cuts, but equally no evidence at all of any lavish budgets, either. Things are therefore done quite efficiently and co-operatively, as they need to be.

With regard to Stephen's point about Sherpas, you can have a really excellent level of output from that kind of thing. In Brazil, we had a tricky issue with limits on state pension funds being able to award mandates to foreign companies. This issue arose as a result of a visit facilitated by the Prosperity Fund. Subsequently, an economic and financial dialogue, with a lot of input from the personnel in country in Brazil, managed to get the UK Government to lobby the Brazilian Government to change their policy on this, with direct benefits to our member firms in the end. So there really can be some quite impressive work done at that individual level.

Q194 **Owen Smith:** There is always a debate in any generation about whether Government ought to concentrate on particular sectors to encourage FDI or provide support. Are there sectors that should be concentrated on right now that are not? How are the Government doing in comparison with previous ones?

Jonathan Geldart: I will take not a sector but a segment, to be a bit pedantic. That segment is what the Germans call the *Mittelstand*—the



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middle market—which is essentially the prime engine of growth for the UK economy, as it is for most economies in the world. Big corporates manage, by and large. Smaller businesses—those covered by the Federation of Small Businesses, for example—tend not to, although there are some exceptions who are doing export and moving into different countries. It is the middle market where, regardless of sector, they have all the same sort of needs. They need legal protection, copyright protection and IP protection and, by and large, they need to know where to go—have that navigation to support them in doing the right thing.

That is not necessarily by sector; it would depend on where you are in the world, and then within that country where you are in the country. Others can speak about other countries. In China, for example, healthcare—age care—is a great opportunity for the UK because we have immense expertise there, but it will be very patchy in terms of whereabouts in China it would be focused. That is about local GDP and changes in the economics and the age profile of particular parts of China. We could look at sectors, but a broad segment that it would be good for DIT to focus on—it is doing more of this—is the middle market, and more than 20 million businesses that want to export and go to new markets but do not quite know how to.

Q195 **Owen Smith:** Haven't we been talking about that forever?

Jonathan Geldart: We have, but it remains undelivered.

Stephen Adams: I would reinforce that. There is a huge amount of activity and latent potential in the mid-cap market, but ambition and capacity in a mid-size business do not necessarily scale up in proportion. Part of the role of effective policy is to give the tools to companies that have a lot of ambition but do not necessarily yet have the resource to manage the protocols of import or export, or outward investment.

Q196 **Owen Smith:** We have been incredibly patient in not talking about Brexit, although you did earlier, Jon, when you said that it is viewed in China as a blip that we would get over. I wonder whether the other panellists have something to say about how we are currently seen as a result of Brexit. Is Brexit squandering our longstanding reputation for certainty and stability?

Stephen Adams: I think it is impacting it. The data suggest a chilling effect, and it is difficult to disaggregate Brexit from the fact that at the moment, the ideological landscape in the UK is in flux as far as external investors are concerned, in a way that it has not necessarily been for a couple of decades. Uncertainty and the inability to price choices is poison for an investor in many cases. It has become a kind of poison bullet point at the top of the strategic planning PowerPoint presentation.

To what extent is that chilling effect a function of the uncertainty, and to what extent is a judgment on the UK's permanent prospects? It is both a judgment on structural change in the UK's supply chains and options, and an instinctive judgment about the potential impact of Brexit on underlying UK demand. It is difficult to disaggregate all those things. I do not think we know—I don't think anybody can say with certainty whether it passes



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or not. My expectation is that with choices made, and a new operational landscape made clearer, some of that activity will return. To a certain extent, the future relationship with the UK will change the way that FDI in the UK works. As firms restructure their supply chains, and in many cases as EU businesses are encouraged to locate inside the UK because they have lost cross-border—

Q197 Owen Smith: Do you think there will be some residual long-term impact from this, or something from which we will not recover, because we have all of a sudden shifted from being a country that was considered incredibly stable to one where there is—

Stephen Adams: My instinctive feeling is that the underlying view of the UK's resilience outside the UK is still comparatively strong. It will come down to the way that the UK conducts itself.

Jack Knight: It has had an effect. Our firms have had to plan for a hard Brexit, and they have had to create jobs outside the UK to get authorisations in the EU27. In certain circumstances they have had to move funds out of the UK.

Q198 Owen Smith: Can you quantify that? How many jobs? How much money?

Jack Knight: I did not say that jobs had been lost from the UK; they have been created outside. That is at the lower end of the scale of predictions, and in the lower order of things, but every job that is created is still a job. Funds in the tens of billions of pounds were moved out of the UK by certain firms—that is a matter of public record—but more than £1 trillion of funds remain in the UK. The point was the reversibility. Those are measures and steps that have been taken that are less likely to be reversed; so in terms of that, that is the case.

Jonathan Geldart: I would just add a couple of things. One is that brands take a long time to build and a short time to destroy. My earlier comment was in relation to how people I know in the Chinese Government see the UK. People in Chinese business see it as cheaper. You might not feel this is a particularly good thing, but, as a result of Brexit, the pound position in the world economic landscape is, it is good value to come to the UK right now, in terms of purchasing.

Q199 Chair: To buy stuff.

Jonathan Geldart: To buy stuff. The other thing that has happened—yesterday I was discussing with somebody who works with Alibaba and the general view there, which is not particularly a Chinese point, but a wider point, is that the uncertainty created by Brexit has actually improved the ability of British business to be agile, because they have had to be. Make no mistake: British business are way ahead of the British Government. They have already made the decisions, 12 months ago, as to whether they were going to do stuff. They have done it. You are mainly playing catch-up with what they have already decided to do. That, in a way, is the better position that Brexit has created for brand Britain, because it has allowed businesses—because they have had to—to be more agile, to be less risk-



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averse, in an environment where they do not know what is going to happen so they are going to take the risk and see. In an odd way you could argue—and I think history will look back and assert this; I hope I will be proved right—that actually this was an inflection point in British business. Because suddenly they realised—and this is happening around the world—you can't trust government, as much as you used to, to be the driver of economic change. You have to do it yourselves. To many businesses in the middle market—"Hallelujah"; because it actually gives responsibility back to businesses to do something.

Stephen Adams: I think it has crystallised the productivity question.

Jonathan Geldart: It absolutely has crystallised the productivity question, but we are now on a different issue.

Q200 **Chair:** Briefly moving on from Owen Smith's point, there, what should the key elements be of the UK's post-Brexit approach to international agreements—when there are either bilateral treaties, or trade agreements, or with investment provisions?

Jonathan Geldart: You know, it has not made a huge amount of difference.

Stephen Adams: I would agree with that.

Jack Knight: For us, we would seek to enable savers and investors to have the best choice of products and services as well as the panoply of measures for investor protection that has been discussed earlier. Also data is very important to us, and measures around data flows would be very important.

Q201 **Chair:** The final question is possibly mostly to Jonathan, but you all might want to contribute after that. The Government is considering giving Ministers new powers to block foreign investment into the UK where matters of national security are judged to be at stake. We have had a bit of that recently. What potential pitfalls do you see in these proposals, and how might they be addressed?

Jonathan Geldart: I think it is about risk management and in your previous panel there was allusion to this. Putting Huawei and China to one side—

Chair: I tried to in my question.

Jonathan Geldart: Okay; putting them to one side the question is would any Government in any part of the world want to take on inward investment that might be politically uncertain or strategically and security-wise inappropriate? That is about risk management. I have to say I am with GCHQ on this. It is about managing the risk. There is risk everywhere. We spend all our lives managing the risk, so I think that when you look forward and determine what are the right things to do, it is going to be about how the British Government can support business in managing the attendant risk to things that are going to happen. On



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matters of national security that is a matter for GCHQ, the security council and the others. I think that would be where you would certainly not be looking to have things, but again it is about managing risk. It is about not having one supplier; it is about having five.

Stephen Adams: I would make two observations. The first is—this is part of a wider trend—as long as it is predictable and transparent and as depoliticised as possible, I don't think investors are particularly worried about it. In fact, in some cases I think they actually recognise that it can perform a valuable kind of certification role, as many of these systems do in other jurisdictions, such as Germany until fairly recently. I think actually they see it as potentially helpful. The second key observation is that we do need to recognise, I think especially in this country, but more widely, it is not just a question about the rule book. In many cases it is a question about the wider playbook. I think politicians have got a lot more active in their scrutiny of inward investment. They are worried about value change. They are worried about offshoring, and for many investors, I think, what it feels like to navigate that kind of process of public scrutiny through the media, or indeed in forums like this, is as important as a change to the national security framework.

Jack Knight: I am afraid I don't have a view on that one.

Chair: That is good to hear, given the time of day. Panel, can we thank you all for the views that you did have, and the views that you didn't have, and for your honesty and clarity in both. We do appreciate it. Thank you all.