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A Note on Large-Scale Land Acquisitions, Commitment Problems and International Law

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A Note on Large-Scale Land Acquisitions, Commitment Problems and International Law*

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Abstract

Poorly developed countries with weak institutions often face severe commitment problems. International investors are reluctant to invest in these countries because their property rights are insufficiently protected. We argue that in order to overcome the commitment problem countries may subject investors' rights protection to independent investment tribunals. These tribunals are known to strictly support property rights protection and to be reluctant to honor human rights considerations, although they might be applicable. This may explain why human rights of the local smallholders in large-scale land acquisitions are hardly protected in the Global South.

***JEL Classifications*:** F21, F53, K33, O13, Q15

***Keywords*:** large-scale land acquisitions, land grabbing, law & economics, international law, property rights, commitment problems, foreign investors, weak institutions

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1. Introduction

Recently, large-scale land acquisitions[1] (LSLA) mainly in the Global South have become the center of a heated political and academic debate. Proponents of this kind of land deals emphasize the opportunities for local economic development when foreign investors utilize arable land more efficiently (e.g., Deininger and Byerlee, 2011). Critics call the same deals “land grabs” (e.g., Cotula, 2011) because, among other things, neither governments nor international investors typically consider – possibly, because they are rent-seekers – the deals’ effects on local populations and smallholders. Behind this debate is a general conflict about the allocation of property rights in land. On the one hand, investors require target countries of land deals to provide secure investors’ property rights in line with international standards. On the other hand, there are often informal land use rights of the local population. Once international investors have acquired land titles, they may start to challenge smallholders’ informal rights thereby possibly endangering these persons’ livelihoods.

This reasoning is very much in line with one of the corner stones of the economic analysis of law: the analysis of different property rights assignments and their effects on the behavior of economic agents (including local smallholders, international investors and target-country governments). In fact, referring to the above-described conflict of interests an interesting question arises. Economic theory suggests that the government’s objective will be to maximize either total welfare of the domestic population (*welfare-theoretic perspective*) or political support in order to, e.g., get re-elected or to remain the ruling elite (*public-choice perspective*). Under both perspectives, one would not expect governments to ignore domestic smallholders’ interests in the first place (unless their number is entirely irrelevant which is unrealistic). This is, however, what allegedly happens in many countries around the world. In order to secure property rights of international investors, smallholders’ informal, sometimes customary, land use rights do not seem to play a major role in the national governments’ considerations.

Bujko et al. (forthcoming) suggest extending the public-choice argument and investigating the narrow self-interest of politicians and bureaucrats. In their analysis, they ask whether land deals become more likely when governments are corrupt and show that corruption is indeed a strong

[1] LSLA may be defined as intended, concluded or failed attempts to acquire land through purchase, lease or concession. More specifically, for a land deal to be recorded by the most comprehensive dataset on this issue, the *Land Matrix*, the deal must (i) entail a transfer of rights to use, control or ownership of land through sale, lease or concession; (ii) have been initiated since the year 2000; (iii) cover an area of 200 hectares or more; and (iv) imply the potential conversion of land from smallholder production, local community use or important ecosystem service provision to commercial use (Land Matrix Global Observatory, 2014). Here, (i) and (iv) are of particular importance for the discussion in our paper.

positive predictor of LSLA especially in the Global South. In this note, we will take on an alternative perspective on the interplay of target-country governments and international investors when it comes to concluding land deals. We will argue that governments in the Global South are often desperate in finding foreign investors to foster development. Foreign firms shy away from investing in these countries because insecure property rights cause substantial risks for their investments. Even if governments are non-corrupt and their promises to investors are sincere, they face a commitment problem caused by the Global South's bad reputation as a place to invest. In order to make commitments that are (more) credible, governments may accept external control and, possibly, enforcement even if it comes at a cost for the domestic population. We will therefore argue that governments might consider subjecting land deals to international investment tribunals a promising strategy to convince international investors. This is because these tribunals are known for their reluctance to put much emphasis on human rights, even though they might be applicable and require government intervention on behalf of the domestic population and at the expense of foreign investors.

In the following section 2, we will lay out our economic argument. First, we will show the nature of the commitment problem, and then we will briefly discuss how it could be resolved in theory. In section 3, we will turn to land deals and their treatment in different branches of international law. In section 4, we will combine economic and legal aspects of LSLA. We will show that accepting investment tribunal decisions without hesitation might be a strong signal to international investors, but that this comes at a high price for (especially the vulnerable) parts of the local population at least in the short run. Section 5 briefly concludes.

2. The Nature of the Commitment Problem

Governments of less developed countries often face difficulties in making policy commitments to the domestic private sector as well as to foreign investors. One of these difficulties is to guarantee credibly and permanently private property rights, including property rights in land. Formally, one may explain the problem as a game between a government and an investor from abroad in which the government offers an attractive package deal for the acquisition of property in land consisting of, e.g., tax breaks, subsidies and preferred access to natural resources or land (e.g., Cotula and Vermeulen, 2009). That is, the government seeks to influence the location decision of the foreign firm. Ideally, the private investor will buy or lease the land and make some production or investment decisions that ultimately raise national welfare.

In this game, however, a credibility problem may arise because the government is free to revise the offered package after investment and production decisions are made. For instance, it could raise taxes, shorten the time of a long-term lease contract or even expropriate the investor. The government may in fact have an incentive to surprise the investor with a policy that it would not choose ex ante, when investor' decisions are still unsettled (Bagwell and Staiger, 2002: 32). Ex post, after the decision to enter the country and after, e.g., a production facility has been set up, the investor has become "locked-in" and can no longer evade changes of government policy. Then, government choices affect only domestic consumer decisions (Bagwell and Staiger, 2002: 32), implying that the government can pursue new distributional objectives directed more towards consumers (or corrupt politicians).

Hardly surprisingly, if investors understand the government's incentives, then they alter their investment behavior in anticipation of the government's actions.[2] On a global scale, this distorts the international allocation of (investment) capital, and global welfare will be sub-optimally low. This is because investors do not choose the most attractive investment opportunity but a less profitable one elsewhere. Potential target countries will experience substantial welfare losses because of the absence of investments, which could otherwise complement abundant local factors of production.[3] These national and global distortions can only be avoided if a mechanism can be found that helps to align ex ante and ex post incentives of the target-country government.

Bond and Samuelson (1989) point out that it can be in the best interest of a government to eschew seemingly profitable deviations from commitments (in the short run) in order to induce investors to believe future commitments (in the long run). For instance, governments may grant tax holidays to foreign investors as this will help them to recoup investment costs more quickly (e.g., Doyle and van Wijnbergen, 1994). This tends to reduce the anticipated future risks. Similarly, it may be helpful to introduce self-bindings through, e.g., becoming a member of an international organization (such as the NAFTA or the WTO) with an already existing set of rules that aims at impeding harmful actions against foreign firms' property rights abroad (Bagwell and Staiger, 2002: 69). More specifically, from an investor's perspective a government appears more credible when it commits to a rules-based system in the international

[2] Note, however, that governments may also have long-term interests in good relations with potential investors (Thomas and Worrall, 1994).

[3] Typically, countries in the Global South are land- and labor rich, but lack capital (both real and human). With a standard neoclassical production function, one would expect output to rise if additional units of the scarce factor complement the abundant resources. In this respect, land may be seen as "under-utilized" due to a lack of, e.g., modern agricultural machinery.

arena with elaborate enforcement and retaliation mechanisms. We will return to this point later and show that subjecting one's country to the decisions of investment tribunals under international investment law may indeed increase credibility.

Before doing so, let us briefly discuss some economic implications of commitment problems in the context of LSLA. First, several authors consider LSLA a part of a global "land rush" of investors from more affluent parts of the world (e.g., Arezki et al., forthcoming). Arguably, this is at odds with the impression that land prices are too low (Cotula and Vermeulen, 2009), because low prices are not indicative of an actual "rush" for a scarce resource. If there were really a land rush, i.e., a substantial (excess) demand for land, why do governments not auction off the land? One possible answer would be that corrupt governments are not interested in maximizing revenues from land deals, but in maximizing bribes (as suggested by Bujko et al., forthcoming). Another argument, more in line with our reasoning, is that demand is in fact much lower than anticipated[4] (especially when compared to actual land supply) because potential investors believe in too high risks in the Global South. With a low demand, however, land prices will remain at very low levels, despite an existing general interest in acquiring land. Commitment problems may convincingly explain this development.

Second, while countries sell off property in land permanently or lease it to investors for long periods (in some contracts for up to 99 years), the political risk in many countries of the Global South is an immediate one. Local institutions are weak and detrimental government policies may occur soon after the investment decision. Therefore, investors strive for achieving a positive return on investment already in the very short run. It certainly helps if land is cheap, but also when production costs are low. In other words, firms may resort to depriving the local population from accustomed land uses without offering adequate alternative jobs. This will help investors recovering the costs of investment before they expect economic conditions to worsen. While both low land prices (Cotula, 2011) and a disadvantageous treatment of workers (e.g., Colchester, 2011) rightly have been criticized on humanitarian grounds, they may ultimately have resulted from the above-mentioned commitment problem.

[4] This is reflected also by prior estimations on the topic. A 2010 World Bank study e.g. spoke of 56.6 million hectares of land that had allegedly been subject to LSLA from October 2008 to August 2009 alone (Deininger and Byerlee, 2011). Similarly, a 2012 report published by International Land Coalition estimated that there had been LSLA of 203 million hectares between 2000 and November 2011, citing the *Land Matrix* database as its source (Anseeuw et al., 2012). By contrast, current *Land Matrix* figures indicate a mere total of 37.8 million hectares since the year 2000, showing that there were overestimations in the past owing to a lack of reliable data.

3. International Investment Law, Human Rights Law and LSLA

Our previous discussion has indicated that property rights issues are at the heart of the discussion about large-scale land acquisitions. Two potential problems stand out. First, in countries with a weak rule of law international investors and their property rights may not be sufficiently protected (i.e., they face a positive probability of being expropriated or harmed in some other way). Second, formal and informal (e.g., customary) land rights of the local population may not be honored by investors and/or the national government. In the following, we will first consider investors' rights and then turn to human rights issues.

Different branches of international law recognize an asymmetric legal relationship between sovereign states and individuals, where states are in the superior position (Hirsch, 2010). For one, human rights law aims at protecting individuals (this includes, as legal persons, also international investors) against all kinds of detrimental actions by sovereign states. In order to do so, it assigns different rights, freedoms, authorities and obligations to individuals and states (Hirsch, 2010: 108). For another, international investment law deals specifically with the asymmetric relation between host governments and international investors. Interestingly, this branch of international law focuses almost exclusively on private law aspects of the aforementioned relation. This includes a considerable weight on reciprocal promise-based and reliance-based obligations that both parties form during their negotiations (Hirsch, 2010: 108). While the asymmetry between parties appears to be rather small in the early stages, it may become larger in later stages when investors are locked-in and can no longer evade legal changes, as our previous section explained. In order to reduce the ex post risks of investors, international investment law uses investment arbitration through investment tribunals as a means of dispute resolution (Hirsch, 2010; Simma, 2011).

Since LSLA have to be considered as a specific kind of international investment (FDI), international investment law applies to them as well. At the heart of this legal regime, there are regional trade agreements (such as NAFTA and, possibly in the future, TTIP) as well as bilateral investment agreements between sovereign states (so called "international investment agreements" or IIAs).[5] Until today, approximately 3,000 IIAs have been signed not only between developed and less developed countries, but increasingly also between developing and less developed countries (e.g., between China and some African countries).

[5] Direct agreements between host governments and international investors are usually termed "international investment contracts".

Typically, IIAs include several measures to protect foreign investors against discretionary actions by the host-country government. Among them, there are minimum standards for treating investors, a ban on expropriation, on discriminatory treatment relative to domestic competitors and on performance requirements irrespective of the investment's success (cf., e.g., United Nations, 2010). In case of a breach of obligations of the host country, legal recourse is possible at an international investment tribunal (such as ICSID in Washington, DC). Freeman (2013) shows that the number of investment treaty arbitrations is indeed particularly high in institutionally weak countries.

Importantly, the ruling of the tribunals is independent of the host country's (possibly home-biased) judicial system, thereby reducing the investor's risk.[6] At the same time, the independence of these tribunals has put them under criticism (Smaller and Mann, 2009) because tribunals may overemphasize protection of investors' property rights relative to the local population's customary property rights (in land) in the host country.

Considering the prevailing case law, it appears that investor protection clearly dominates other standards of protection.[7] What is more, international legal experts (e.g., Osgoode Hall, 2010) and NGOs (e.g., Corporate Europe Observatory, 2014) have particularly criticized that investment tribunals have the tendency to cut back regulatory autonomy of sovereign states by granting compensation for damages in cases where governments changed, e.g., social or environmental protection measures. A prominent example is *Aguas del Tunari v. Bolivia*, where the local population of the town of Cochabamba violently protested against a major increase of water prices and forced the national government to revoke a contract with an international investor owning the local water supplier. The investor then filed a case with ICSID, claiming damages of USD 50 Million, which was only dropped due to long-lasting international protests.

In the case of LSLA, investment tribunals could rule that, e.g., host-country policies aiming at providing secure access to food and water qualify as investment contract violations. This would be the case if investors were required (ex post[8]) to supply a share of their harvest or water

[6] Next to the more indirect effect of deterring problematic policy changes of target countries in the future, the rulings of the investment tribunals will provide a legal basis for private claims against the country in the case of non-fulfillment of obligations. Courts in the home countries of investors may decide to have target-country wealth assets in their country confiscated. This works as a strong enforcement mechanism and was the case, e.g., when Argentina did no longer repay its debt with US investors.

[7] For instance, *Biloune v. Ghana*; *Tecmed v. Mexico*; *Azurix v. Argentina*; *Siemens v. Argentina*; *Channel Tunnel v. France and the United Kingdom*; *Sempra v. Argentina*. One small exception is *Mondev v. USA*, which investigated (but ultimately dismissed) the potential relevance of Art. 6(1) of the European Convention on Human Rights.

[8] From an economic perspective, a lower land price should reflect ex ante requirements of this kind. Complaints of contract violation would not be justified. This is, however, different from the perspective of international investment law.

resources to the local population rather than being free to, e.g., exporting it to their home countries. From the tribunals' purely legal perspective, existing contracts legitimize these rulings. Tribunals are likely to judge such requirements as unlawful due to their effect of expropriating – at least indirectly – investors of parts of their property rights. Legally, this would constitute a claim for damage. While a number of IIAs feature exception clauses, these are usually restricted to situations where public order or national security is threatened, thus stipulating high thresholds for interference with the investor's legal position.

At the same time, however, one should be aware of the fact that such rulings by investment tribunals might be incompatible with another branch of international law. In their legal practice, the tribunals usually give little regard to existing rights of the local population resulting from international human rights law. For instance, the International Covenant on Economic, Social and Cultural Rights (ICESCR) secures the "right to an adequate standard of living" including a right to food, water, housing and clothing. If LSLA threatens the livelihood of local populations, they could potentially be challenged with reference to these human rights. For instance, in case of a transfer of a complete set of property rights in land, an international investor would have the right (referring to *ius fruendi*) to export all of his harvest to his home country. At the same time, the local population may suffer from hunger under these conditions, unless the investor is forced to sell parts of his harvest to the local population. This requirement would dilute the acquired property right, but confirm to the human right to food. In fact, states might be obliged to impose such policies in order to comply with their obligations under international human rights law.

In order to soften this potential conflict between these two branches of international law, a number of suggestions have been proposed which try to bring the local population's and international investors' interests in line. Typically, these proposals include soft-law measures such as defining best practices or minimum standards. For instance, the UN Special Rapporteur on the Right to Food, Olivier de Schutter, proposed "*Minimum human rights principles applicable to large-scale land acquisitions or leases*" (United Nations 2009) while the Food and Agriculture Organization of the UN (FAO) suggested „*Voluntary Guidelines on the Responsible Tenure of Land, Fisheries and Forests in the Context of National Food Security*" (FAO 2012). With these instruments, the international community tries to avoid disputes caused by LSLA at an early, i.e. pre-investment, stage. Investors receive the signal that both conflicts with the local population as well as with the global public, which may start protest campaigns against the investors, may be avoided by behaving according to certain (human rights) standards. In more recent IIAs, one also observes the inclusion of broader exceptions to avoid

a “regulatory chill”,[9] i.e., a situation in which governments of poorer countries shy away from introducing welfare-enhancing regulatory policies (e.g., increased social or environmental protection measures) due to fear of legal disputes and the potential payment of damages.

Finally, existing international law provides at the same time a means for alleviating the tensions between international investment law and human rights. According to the *Vienna Convention on the Law of Treaties*, there is a systematic correlation between the contents of any bilateral international agreement (such as an IIA) and all other relevant legal norms contained in other treaties signed by the countries involved, even if these norms are not part of the initial agreement. While human rights are not superior to other branches of international law, this implies that investment tribunals may also apply international human rights legislation in their rulings, provided that both the investor’s home and its host state are bound by the relevant human rights norm in question. Hence, one could indeed make a case for state policies requiring international investors – even ex post – to provide support to the local population at the expense of the investor himself.

4. The Commitment Problem in LSLA and International Law

The central question is, however, whether less developed countries in the Global South will indeed benefit from taking on a human rights-based perspective on international investments in land. Assuming that the target-country government aims at protecting its local population (and not at receiving large bribes), there is an important trade-off. The expected costs of investments increase when investors’ property rights may become diluted in case of public (ex post) regulation, e.g., by newly introduced requirements to consider the specific interests of the local population. If investments become riskier and more expensive, they also become less likely. This is a problem in particular for poor and institutionally weak countries as very often only the inflow of investments from abroad can foster their development. Analogously, an ex-ante announcement of human rights protection in an IIA will lead to either a lower price of land or investors deciding to locate in a neighbor country. In these cases, the target country will lose out any potential welfare gains from LSLA, including those received by local smallholders.

[9] Since 2012, the US use a new *Model BIT* (bilateral investment treaty) which gives greater leeway to states for imposing measures to protect social and environmental standards. For instance, Art. 12(2) sets out a prohibition on waiving or derogating from domestic environmental laws in order to attract investment, while Art. 12(3) explicitly acknowledges the parties’ right to regulate in matters concerning the environment.

At the same time, not taking steps to protect the local population from potential harm through LSLA challenges the accountability and legitimacy of target-country governments. This would especially be the case if the distribution of welfare gains from LSLA were highly unequal. For instance, international land investors will start to pay taxes on their profits at some point in time. If tax revenues are spend mostly in urban centers, the rural population may hardly benefit at all. In fact, job losses or restricted access to land and water resources may make them worse off, despite an overall welfare gain for the entire country. Governments that strive for (democratic) legitimacy will have to consider these distributional aspects when deciding whether to allow international investors into the country or not.[10]

In an ideal world, it appears possible to have both international investments and human rights protection. The FAO's and Olivier de Schutter's proposals for human rights-based LSLA point into this direction. They call upon a responsible investor behavior that will consider the local population's interests, and argue that this behavior is in fact in the interest of investors themselves as it helps to avoid costly conflicts with the population.

While these proposals might work through successfully appealing to at least some investors' morale, it does not resolve the above stated credibility or commitment problem from which target countries in the Global South suffer. Investors often do not trust into the ex-ante offered investment packages, as they fear detrimental policy changes ex post. This implies, however, that the relevant trade-off for target countries is not so much between more or less human rights protection in the case of LSLA, but between investments and no investments. Hence, countries have to do their best not only to make attractive offers to international investors but also to make them as credible as possible. One way of doing so is, as discussed above, to subject IIAs and contracts on foreign direct investment and, specifically, land investments to international legislation that is enforceable by external institutions. The stricter these institutions control the target country's actions and the more they are sympathetic with a strict property rights interpretation of contracts, the more credibility may the target country gain.

International and independent investment tribunals ruling over IIAs are particularly unattractive to target countries and may indeed result in a regulatory chill (Cotula 2014; Tienhaara, 2011), including a low level of human rights protection. This is, on the one hand, because of structural characteristics of the tribunals. At the tribunal, only investors and governments, but not other affected groups in the population, have legal standing. Human rights violations in the context

[10] With a utilitarian welfare criterion, the government could however weigh urban benefits against rural losses and conclude to allow LSLA when there is a positive net utility gain.

of LSLA are not a cause of action in itself. Furthermore, investment tribunals are not permanent judicial bodies, but are established *ad hoc* whenever there is a case to be ruled upon. In addition, tribunals make their decisions *in camera*, i.e., in closed sessions excluding the public. That is, tribunals are very independent of target-country interests also from an organizational perspective. This is added to by the demographics of the arbitration community, which is predominantly characterized by "grand old men" and "arbitration technocrats" from the industrialized world (Dezalay and Garth, 1996; Puig, 2014), pointing towards an institutional bias in investment arbitration to the detriment of developing countries.

On the other hand, there are also important legal aspects making tribunals unattractive and potentially costly for the target countries. While the tribunals' ruling is not constrained by binding precedent, there is – most importantly – the tendency to exclude human rights considerations in the rulings. As discussed above, a number of important cases in the last two decades[11] have denied any relevance of these aspects and instead clearly emphasized the protection of the investors' property rights. In some of these cases, the defendants argued human rights aspects but, after the rejection of these arguments, they typically accepted the rulings of the tribunals without much complaining.

This gives rise to two possible interpretations, both of which not being favorable to human rights. Based on simple cost-benefit arithmetic, one could first argue that not accepting tribunals' rulings is a too costly venture for many poor and institutionally weak countries because of foregone inflows of FDI. Given that human rights considerations have already been taken into consideration in the cost-benefit comparison, their value must have been low. That is, target-country governments consider the protection of local smallholders as less important than the land deals themselves. This perception may again be due to a certain level of corruption in the national government or among urban elites.

The second interpretation takes up our commitment argument. By subjecting its international investment contracts or IIAs to the ruling of investment tribunals that have been reluctant to take human rights considerations into account in their decisions, the government may in fact be seen as willfully neglecting these considerations in order to send out signals to international investors. Especially for a non-corrupt, welfare-maximizing government it is difficult and costly to ignore the human rights of their local populations. The signal to international investors is, however, a strong one as it implies that in existing or future IIAs the focus is almost exclusively on the protection of property rights. This is likely to help convincing investors to

[11] See footnote 7.

choose a specific country as location. In fact, there is a pressure for institutionally weak countries to behave similarly once other countries have already accepted being subjected to investment tribunals. Too much emphasis on human rights ex ante will then only scare away potential investors, while ex post the tribunals will rule it out. Ignoring this ruling would destroy a country's reputation as a place to invest and trigger negative repercussions on the international capital markets. These negative consequences will make countries want to follow the rulings despite the costs that arise to some of the more vulnerable parts of society, all the more as current human rights supervisory mechanisms – particularly in the area of livelihood rights – are fairly underdeveloped compared to international investment law.

5. Conclusions

In this short contribution, we argued that the neglect of human rights considerations in large-scale land acquisitions may be explained by specific commitment problems of institutionally weak countries especially in the Global South. Even non-corrupt, welfare-maximizing governments have an incentive to ignore human rights of vulnerable local populations, including smallholders, if this helps to signal international investors that commitments are credible. The specific international legislation on international investments can explain this effect. International investment agreements are typically controlled and enforced by independent international investment tribunals that are known for their reluctance towards human rights arguments in investment disputes. Rather, they have a tendency to support strongly the protection of investors' property rights. When a country decides to subject its domestic legislation on land deals and the according international agreements to the ruling of these tribunals, it will be able to strengthen the credibility of its commitments. Hence, from a target-country's perspective it may make some sense to trade-off human rights of some parts of the population against aggregate economic gains from FDI. With a corrupt government, this effect may be even stronger.

Our discussion shows that target countries of LSLA may need external help to attract foreign investors without sacrificing human rights of their population, especially of those who are particularly vulnerable. Without external help, these countries have difficulties to gain credibility and thus overcome their commitment problems. Development aid should strengthen the market mechanism and those institutions that foster the functioning of the market mechanism. This includes, in particular, strengthening the rule of law and thus property rights. It is certainly not in the interest of least developed countries to question LSLA in general, rather

it will be important to provide them with the ability to negotiate on an equal footing with international investors. Of course, countries would have to pay a price for not selling a full set of property rights to an international investor or for selling them property rights that may be diluted when, e.g., in a poor macro-economic environment, governments – in line with the human right to food – force the investor to sell parts of his harvest to local communities. However, while this might lower the price ex ante, countries would not have to trade off human rights in order to get an investment contract, rather – like developed countries – they could decide without fear how strongly human rights may interfere with property rights and whether a lower price is worth it.

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