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The Evolving International Investment Regime: Expectations, Realities, Options

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Edited by José E. Alvarez and Karl P. Sauvant with Kamil Gérard Ahmed and Gabriela P. Vizcaíno (New York: Oxford University Press, 2011).

The transboundary flow of capital directed at establishing businesses is the engine of the world economy. Approximately 3000 bilateral and regional investment protection treaties worldwide govern this driver of economic globalization. As might be expected, the international investment regime now competes with the World Trade Organization for global praise and criticism. This volume looks at how these treaties and investor-state arbitrations that apply them accommodate the different expectations of various stockholders, including governments, foreign investors and civil society. The volume's diverse authors focus especially on the views of developing countries and international civil society. They address the extent to which the regime is satisfying the expectations of those who originally drafted the treaties as well as the states now at the losing end of investor-state awards. They review critiques of the regime that help explain sovereign and political backlash, identify avenues for accommodating various interests, and make specific proposals to address concrete challenges. The volume should interest academics, practitioners, negotiators of international investment agreements, and others who want to know more about the rules that govern foreign direct investment, the activities of multinational enterprises, and those who seek to advance sustainable economic development through both.

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Contents

Detailed Contents

PART III Report of the Rapporteur

Foreword

Some might argue that the system for the protection of international investment has reached an impasse. Since the first modern investment treaty claim was referred to arbitration just over two decades ago, the ad hoc tribunals deciding these claims have produced at times conflicting decisions, sometimes with little regard for the regulatory interests of host states. The ensuing problems are not unique to the investment treaty regime; more broadly the proliferation of international dispute settlement mechanisms and the broadening of international law has increased the possibility that the same conduct of a state may be scrutinized in relation to different, sometimes disparate treaty regimes, applied by distinct dispute settlement fora, each operating in the absence of a binding system of precedents. But these more general characteristics of the international legal "system"—not themselves new—have risen to the surface in investment treaty arbitration, in part because of the increasing number of cases.

This book is a contribution to the debate on what can be done to address the deficiencies of the investment treaty regime. But in fresh contrast to a mass of literature on the so-called "crisis" of international investment law, it approaches the question by first considering the interests and expectations of the relevant stakeholders: capital-exporting and capital-importing states, investors, and host states. An examination of these interests and expectations provides the basis for constructive and realistic suggestions for reform, bearing in mind ever-present political concerns and realities.

Part I sets out the expectations of the most significant categories of stakeholders in the international investment regime, dealing primarily with developing states, and also with civil society, concentrating on nonbusiness groups aimed at social and developmental justice. Additionally, the question whether international investment agreements meet the concerns and expectations of these stakeholders is addressed. In this part, some of the common critiques of the investment treaty regime are examined anew: whether and to what extent there is a bias in favor of developed states; whether the emphasis on host state obligations could be recalibrated with a view to the imposition of responsibilities on investors and home states; and whether apparent inconsistencies in the case law can be explained by the specific facts and provisions at issue.

Part II is forward-looking as it sets out possible avenues for reform (including institutional options) and reflects on the way forward for law and policy with emphasis on multilateralism, the responsibilities of investors, and the need for balancing of interests. Part III concludes with praise and pleas: the former for the flexibility so far demonstrated in the short life-span of investment treaty arbitration; the latter for the redress of imbalances, real or perceived. For those lawyers, arbitrators and diplomats who will have to confront those imbalances, this volume provides concrete and informed ideas, for which the editors and contributors are to be commended.

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April 2010

Preface

To make investments, business must have some conviction that governments will not unreasonably take property and that contracts will generally be enforced. In turn, governments expect taxes from business but also impose regulations and accountability standards to direct business activities toward the public interest. Regulations are viewed as particularly important when business activities might generate externalities, positive or negative; exploit monopolistic powers or otherwise imperfect markets; or affect income distribution in undesired ways. In domestic settings, countries and their firms have arrived at somewhat different balances between rights and controls over business and quite different views of administrative practices with regard to them. Once investors cross national borders, they operate under more than one regime, often under quite different concepts of rights and obligations. Moreover, when they do business in developing countries, investors from rich countries may face systems that not only differ from those of their home countries but which are evolving and not as clearly specified as what investors know from their experience. Understandably, such investors seek a degree of certainty about the security of their investments and contracts in environments that appear to be less secure than their home countries. And they prefer not to be caught up in conflicting demands between home and host governments.

Governments have struggled to manage these problems associated with foreign direct investment. To the consternation of many foreign investors, a number of host countries long asserted their belief that investors must be subject to local laws, regulations, and other demands, and that disputes should be settled in local justice systems; they also insisted that investors' home countries do not intervene on behalf of their nationals who had chosen to invest abroad.[1] The policies did not reassure investors, who believed that they would not be treated fairly in local courts, at least in developing countries.

In response to problems, business abroad has urged home governments to help them defend their property rights, and governments have often obliged, in spite of the wishes of many host countries. The ways that home governments intervene have

[1] Commonly called the Calvo Doctrine, after Argentinean Carlos Calvo, particularly noted for his *Derecho Internacional Teórico y Práctico de Europa y América* (Paris: A. D'Amyot, Durand et Pedone-Lauriel 1868).

changed. In the rather distant past, the United States and other rich countries would occasionally act militarily or insist on state-state arbitrations when their investors claimed mistreatment abroad. Later, the United States would threaten (and occasionally act) to cut off aid, vote against loans by multilateral financial institutions to offending countries, and cancel trade preferences under the Generalized System of Preference (GSP). Other home countries had similar ways to protect their investors. Such actions were, however, erratic, and constrained by broader foreign policy goals. By 1990, the United States, for example, had acted only twice under the Hickenlooper Amendment to cut off aid to a host country for taking property of U.S. investors. State Department arguments on broader foreign policy grounds—mainly that such actions would push the host toward the Communist camp—rather consistently trumped other departments' and congressional interest in protecting U.S. investors abroad.

Home countries have also attempted to regulate some of the activities of their firms abroad. The United States and other countries have, for example, attempted to keep foreign affiliates of their multinational enterprises from exporting to unfriendly countries and to discipline at home investors who engage in certain corrupt practices abroad. They have reached out extraterritorially to control restrictive business practices, and domestic groups have supported cases in the courts of home countries against investors when their affiliates abroad have allegedly violated human rights.[2]

Perhaps ideally, both home and host governments would accept restrictions on their behavior, and investors would be subject to globally-agreed rules that cover their property rights and their responsibilities. That such a rules-based multilateral regime does not exist is not for lack of efforts to build it. The International Trade Organization (ITO), proposed in the 1948 ITO Charter, would have covered foreign direct investment, along with antitrust and commodity agreements. Yet, the ITO Charter was never approved by the United States. Only the trade provisions survived, as the General Agreement on Tariffs and Trade (GATT) and eventually the World Trade Organization (WTO). Both the United Nations and the Organisation for Economic Co-operation and Development (OECD) attempted at various times to negotiate multilateral agreements on investment, and efforts were made to bring direct investment under the WTO. Yet, the efforts came to naught, with the exception of small steps at the WTO. There, only the Agreement on Trade-Related Investment Measures (TRIMs) and the General Agreement on Trade in Services (GATS) have been successfully negotiated. These impose restrictions on host country policies, but provide no protection of property, behavioral requirements for investors, or restrictions on home country actions.

Absent a true multilateral investment agreement, a complex network of arrangements and understandings has emerged. Providing at least partial reassurance to investors of the safety of their property, host countries have included clauses for

[2] Most prominent among these have been cases brought in the United States under the Alien Tort Claims Act.

international arbitration in some investment agreements, occasionally promised international arbitration in their own investment laws and, more significantly, signed a network of bilateral investment treaties and regional trade agreements with investment provisions. They call for similar mechanisms of dispute settlement, by international arbitration. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) and members' commitments to the International Centre for Settlement of Investment Disputes (ICSID) increased investors' hopes of collecting awards made to them by arbitrators.

Further, a network of bilateral treaties has been concluded for the prevention of double taxation. At the same time, less formal bilateral agreements between treasuries have added to efforts to reduce conflicting demands for tax revenue from international investors. Along with these governmental arrangements, nongovernmental organizations (NGOs) have created voluntary standards of behavior for investors.[3]

Yet, few parties are very happy with the patchwork system that has been built out of these various arrangements. Whatever the facts, developing host countries believe that decisions of arbitrators are biased against them and that arbitrators refuse to take adequate account of the need to modify bad agreements, to allow adjustments to arrangements when countries face crises, to make changes to share windfalls, or to take into account social goals. They have resented the extraterritorial application of home country laws, continuing home country "diplomatic" support for investors, and the lack of mandatory rules on the behavior of investors. They have also not always agreed with the priorities of NGOs when they push behavioral standards. On the NGOs' side, some organizations believe that arbitrators are insensitive to social and environmental needs when they rule on disputes between investors and their host countries. Both host governments and investors find the arbitration system slow, costly, and unpredictable. Even the United States, which has viewed itself principally as a home country of foreign direct investment and as having a good domestic judicial system, has been somewhat taken aback by the fact that investors have brought cases against it under the North American Free Trade Agreement (NAFTA).[4]

Observers differ somewhat on how to build a better system—or even whether substantial change is needed. Some of the authors in this volume believe it is time to try again for a global agreement on investment. Maybe an agreement is now possible, given that the divide between host and home countries and their corresponding perception of self-interest has become fuzzier. Brazil, India, and China, for example, are now homes as well as hosts to foreign investors. Mexican and Brazilian investors have seen their projects nationalized in other Latin American countries. And since the United States has had cases brought against it by investors, it might have more sympathy with host countries' arguments about interference in their domestic

[3] These are illustrated by the Extractive Industries Transparency Initiative and the Equator Principles.

[4] To date, the United States has not lost a case, but its politicians have reacted to the possibility that local or national courts might be overruled by an international tribunal.

affairs. In fact, the United States' recent model bilateral investment treaty shows more concern for host country views than did its earlier treaties.

Others, however, believe that the world has not changed that much and that old barriers to global agreement persist. Not only have the host—and home—camps not come together, as illustrated by the failed attempts to introduce more investment rules in the WTO, but multinational enterprises have not yet seen fit to support a global agreement. Without their support, a comprehensive agreement is unlikely. Moreover, the search for broadly accepted principles that could govern such an agreement has hardly been successful. For example, the most favored nation (MFN) principle for access to host country markets is unlikely to be accepted for investment, as it has been for trade. Even the United States differentiates its investment policies by country of origin.[5] Similarly, there are few viable proposals for "escape clause" provisions that are comparable to dumping rules and surge rules in the WTO, which were essential to its political acceptance by member countries. As a result, I remain pessimistic about a comprehensive global approach and thus lean toward trying to improve the current system.

The diverse authors of the chapters of this book bring some order to the criticisms of the current patchwork system and to the proposals for improving it. Although lawyers have tended to dominate discussion of the investment regime, not all of the authors in this volume are lawyers. Whatever discipline they come from, they have made their arguments accessible to a broad range of readers—corporate managers, government policymakers, economists, and others concerned with the implications of foreign investment, and the regime in which it operates, for both economic and social development. The authors delve more deeply into the concerns of these parties than has been typical of the rhetoric that has surrounded the debates. Fittingly, they start from different points of view, covering the concerns of investors, host countries, home countries, and civil society. In spite of the authors' different starting points, some themes run through a number of the chapters.

An investment regime that would be considered legitimate by the principal parties ought to eliminate the role of power in the protection of investors, but nothing in the current regime explicitly restrains home countries from using their aid, market access (under GSP, for example), or their votes in multilateral financial institutions on behalf of threatened investors. Yet, I believe that the existing regime does somewhat reduce such interventions by home governments. Home governments intervene largely because their investors use political access to demand help. Increasingly, however, home governments are able to deflect the demands of their investors, or at least to respond in lukewarm ways, because they can legitimately tell investors in

[5] The highly publicized (in 2006) proposed acquisition by Dubai World Ports of port facilities in the United States already in the hands of a British investor illustrates the sensitivity even in a rich country to the origin of foreign direct investment.

trouble that they have provided them protection already, through investment treaties.[6] That is progress.

To be completely accepted by developing countries, however, an investment regime should also impose behavioral rules on foreign investors. So far, rules have been compulsory only for those that home countries favor, such as restrictions on bribery; they have been voluntary for those sponsored by NGOs. Although some NGOs have supported behavioral rules in bilateral investment treaties, it is not so clear that their preferences match completely the preferences of developing host countries. NGOs' interests in human rights and investment have resulted in attempts to use courts in investors' home countries to counter violations abroad, but the cases have produced a mixed record that is not entirely satisfactory to the NGOs.

The authors of chapters in this volume disagree somewhat on how inconsistent decisions under the arbitral regime are. I look not only at the frequently cited cases—for example, involving Argentina and the Czech Republic—of alleged inconsistencies, but also at the calculations of awards, where I see largely chaos.[7] Although arbitration is not supposed to be based on precedents, the fact is that decisions increasingly draw on precedents. This reflects, I believe, the search for common law, in the absence of a rich body of legislation to guide arbitrators. It ought to lead toward consistency. But until there is an appeals process to resolve conflicting decisions and to force fuller statements of panels' reasoning, the development of that law is slower than it need be. I recognize the problems of building common law in a world in which different treaties have different provisions; however, the existence of an appellate body would itself likely lead toward more common language, as parties to agreements support provisions with meanings that have been clarified. An appeals process could also increase the perception of legitimacy on the part of the developing countries, if it explicitly calls for representation of both host and home countries.[8]

In the end, the backlash from developing countries is itself sufficient justification to reexamine the system. Perceptions matter. I personally do not believe that a system that supports rigidly the freezing of terms of investment agreements for twenty-five or more years has a chance of being universally accepted by developing countries. Especially in the poorest of them, agreements are often negotiated by officials without the skills required to protect national interests. Corruption often underlies terms, corruption that is difficult to prove or which subsequent officials are reluctant to bring up. Agreements have often assigned risks to host countries that they are unable to bear, in a financial crisis for example. No government can

[6] Noel Maurer at Harvard Business School is documenting the link between the desire of U.S. officials to avoid the foreign policy costs and their support of international dispute settlement.

[7] For one example of a poorly justified and likely inappropriate award, see Louis T. Wells, *Double Dipping in Arbitration Awards? An Economist Questions Damages Awarded Karaha Bodas Company in Indonesia*, 19 Arbitration International 471–81 (2003).

[8] Although the distinction may be declining, as developing countries build their own multinational enterprises, the perception of host and home is still very important in how countries see their interests.

resist the political pressures to change long-term deals in the face of what appear to the public to be obscene profits from the country's natural resources or from low-risk public utilities. An investment regime must recognize that an agreement negotiated for this long a period is unlikely to last in the face of new governments, increased skills, changed prices for raw materials, or financial crises. Any revised regime should ensure that investors are treated reasonably, but it must also recognize that bonanzas from bad agreements or changed circumstances impose unacceptable political and economic costs on host countries.

In the best of all worlds, investors would not need international protection of their property rights or rules covering their behavior within host countries. Domestic justice systems would protect their property rights, although perhaps with different balances in different countries. Investor behavior would be responsive to adequate and reasonable domestic regulation. A multilateral agreement would have to deal only with government commitments and issues that truly spill over borders. It might, for example, parallel trade agreements in assuring a certain degree of market access. It might restrict home government support of investors abroad. And it would deal with special problems that arise because of multinationality, such as those involving reporting and taxation. But this is not the best of all worlds, and some sort of more comprehensive international regime will be needed for a long time. The one that we now have has arisen haphazardly and can surely be improved. In fact, the current backlash by some host countries and the costs, delays, and unpredictability demand change. The authors of chapters in this book not only explore in more depth problems with the existing system, but they also make various proposals for improvement.

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The core of this publication consists of original contributions prepared and presented at the Conference and subsequently finalized in light of the discussions at that event. Special recognition is due to the distinguished authors of this volume and the rapporteur of the Conference for their contribution to the international debate on some of the challenges that the international investment law and policy regime is facing and, more importantly, different ways to address these challenges. They benefited from the feedback they received from the Conference's lively participants and the active discussions chaired by Katharina Pistor and Merit E. Janow.

Michael O'Sullivan led the organization of the Conference and energetically dealt with logistical issues relating to the early stages of preparing this volume, working in particular with Maria Estenssoro and Chrysilla Bautista and supported by Jan Peter Sasse, Edward Platt, and Carlos Mauricio Mirandola. Lisa Sachs, too, helped make this publication possible.

To all of them: thank you very much!

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