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**TRAINING PACKAGE  
ON ECONOMIC AND LEGAL ASPECTS  
OF INTERNATIONAL INVESTMENT AGREEMENTS (IIAs)**

**MODULE 2  
POLICY ASPECTS OF FDI IN DEVELOPING COUNTRIES**

**THEME 2  
INTERNATIONAL RULES ON FDI**

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## A OVERVIEW

The past decades have seen a proliferation of international investment agreements (IIAs), especially at the bilateral, regional, and inter-regional levels. The number of bilateral investment treaties (BITs) and bilateral double taxation treaties (DTTs) has increased continuously. Added to that, economic integration agreements within and between regions nowadays encompass a broad range of issues, including investment as well as trade in goods and services and international factor movements. At the multilateral level, although efforts to create comprehensive rules for FDI through a multilateral agreement have failed, a number of agreements dealing with specific aspects of investment have been concluded.

Along with the growth in their number, IIAs are becoming increasingly sophisticated and complex in content. Their geographic scope is expanding, with an increase in cooperation among developing countries in the area of investment policy. The increasing activity in international treaty-making has been paralleled by a rise in investor-state disputes. As a result of the proliferation of IIAs with differing geographic scope and coverage, countries - and firms - have to operate within an increasingly complicated framework of multi-layered and multi-faceted investment rules with overlapping obligations and commitments as well as gaps in its coverage. Maintaining national policy space in the face of those commitments and incorporating the development dimension into IIAs are major considerations for developing countries in ensuring coherence between national and international policies with respect to FDI.

## B LEARNING OBJECTIVES

Upon completion of this theme, the students should be able to:

- ❑ Understand the nature of IIAs and the main types of IIAs;
- ❑ Understand the evolution of and recent trends in IIAs;
- ❑ Understand the concept of policy space within the context of ensuring coherence between development objectives, national policies and international commitments.

## C HANDBOOK

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### 1 TYPES OF INTERNATIONAL INVESTMENT AGREEMENTS (IIAS)

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#### 1.1 Nature, purpose and typology of IIAs

In pursuing their economic policies and development strategies, most countries have entered into one or more international investment agreements (IIAs). IIAs are agreements between states that address various issues related to international investment and regulate such investment, including FDI.

IIAs typically apply to investment in the territory of one country by investors of another country. Consequently, the rules they establish affect:

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- ❑ The investor making an investment in a country other than his/her country of origin;
- ❑ The home country of the investor;
- ❑ The host country where the investment is made by the investor.

The terms “agreement” and “treaty” generally denote binding international instruments and in what follows the two terms are used interchangeably. The term “instrument” covers both binding and non-binding arrangements. Besides IIAs, which are legally binding, there are a number of non-binding international instruments that concern international investment, such as declarations of principles and guidelines.

IIAs usually focus on the treatment, promotion and protection of international investment, especially FDI, although different agreements may vary in this respect, depending on the type and the purpose of the agreement. For example, bilateral investment treaties (BITs) focus mainly on protection, treatment and dispute settlement, while regional trade and investment agreements generally aim at creating more favourable conditions for FDI through liberalization of rules regarding entry and operations.

### Question 1

**What is an international investment agreement?**

**What are the main objectives of IIAs?**

**Who are the main actors involved in and affected by IIAs?**

According to the number of countries involved, as well as the form of participation, IIAs may be:

- ❑ **Bilateral** (between two countries; or between an organization of countries<sup>1</sup> and a third country);
- ❑ **Plurilateral** (between a limited number of parties): this is the case, for instance, with regional agreements; however, not all plurilateral agreements are regional (see below the case of WTO agreements);
- ❑ **Multilateral**: not limited to certain countries/regions and with the possibility of inclusion, provided the rules of the agreement are accepted, of all parties.

In the context of the World Trade Organization (WTO), a multilateral agreement is one that is agreed by all WTO members, for example the General Agreement on Trade in Services (GATS). A plurilateral agreement is one to which only some WTO members have agreed, and which only applies among those members. Examples are the Government Procurement Agreement and the Agreement on Trade in Civil Aircraft.

From the point of view of the substantive issues covered, IIAs can be classified as follows:

- ❑ International agreements dedicated exclusively/mainly to investment

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<sup>1</sup> See subsection 1.4 for a brief discussion of regional economic integration organizations (REIOs).

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- **Bilateral investment treaties (BITs):** investment agreements between two states - practically all countries nowadays have concluded such agreements;
  - **Regional agreements on investment:** investment agreements between several states from the same region - for example, the Framework Agreement on the ASEAN Investment Area;
  - At the **multilateral** level, there is no agreement in force that deals exclusively with investment, although there were several initiatives in this regard, such as OECD's draft Multilateral Agreement on Investment (MAI).
- Other international agreements that concern investment
- Bilateral agreements in fields related to investment, such as **double taxation treaties (DTTs)**, which aim at avoiding having the same income taxed by two or more states;
  - Bilateral or regional agreements dedicated to a broader range of issues among which investment is one, such as **economic integration agreements (EIAs)**;
  - **Multilateral agreements in certain sectors**, which also cover investment, such as WTO's General Agreement on Trade in Services (GATS) or the Energy Charter.
- Contracts between a State and a foreign investor (State contract)
- A common mode of entry for foreign investors, especially into developing countries, is through the making of a foreign investment contract with the State or a State entity. A "State contract" can be defined as a contract made between the State, or an entity of the State, which, for present purposes, may be defined as any organization created by statute within a State that is given control over an economic activity, and a foreign national or a legal person of foreign nationality. State contracts can cover a wide range of issues, including loan agreements, purchase contracts for supplies or services, contracts of employment, or large infrastructure projects.

The various types of IIAs negotiated between countries provide international investment rules that are multifaceted and differ in geographical scope and coverage, forming a spaghetti bowl of international investment relationships (figure 1). Some of them address only certain aspects of FDI policies. Others address investment policies in general, including policies that affect both domestic and foreign investors (competition rules or anticorruption measures). Still others cover most or all important elements of an FDI framework, ranging from admission and establishment to standards of treatment to dispute settlement mechanisms. Rising in number, they have created an intricate web of commitments that partly overlap and partly supplement one another, creating a complex set of investment rules.

What follows is a discussion of the most relevant types of IIAs at the bilateral, regional and multilateral levels and other international instruments that deal with FDI.

### Question 3

**What is the difference between an international investment instrument and an international agreement on investment?**

**What is the difference between a plurilateral and a multilateral agreement in the WTO?**  
**Name the main types of international agreements dedicated exclusively or mainly to investment.**  
**Name other types of agreements that concern investment.**

**Figure 1. IIAs between countries and regions, 2005: “spaghetti bowl”**



Source: UNCTAD web, based on World Bank 2005, figure 2.2.

## 1.2 Bilateral investment treaties (BITs)

Since the late 1950s, bilateral treaties for the promotion and protection of investment have become the most widely used type of treaty in the field of foreign investment, their total number reaching over 2,600 at the end of 2007 (UNCTAD 2008, forthcoming). Such treaties have replaced an earlier type of bilateral treaty, the treaty of friendship, commerce and navigation, which included provisions on rights of foreign nationals and companies among rules on a broad range of aspects of bilateral economic and political cooperation. By contrast, the distinguishing feature of the modern BIT is that it deals exclusively with issues concerning the admission, treatment and protection of foreign investment (box 1).

### Box 1. Common features of BITs

BITs exhibit a certain pattern of uniformity in their structure and content. Elements common to virtually all such treaties are the use of a broad definition of the term “investment”, the inclusion of certain general standards of treatment of foreign investment, such as fair and equitable treatment and full protection and security, and more specific standards of protection regarding expropriation and compensation, transfer of funds, and the protection of foreign investment in case of civil strife. Most such treaties also provide for national and most-favoured-nation treatment, although this is frequently limited to the treatment of foreign investment after admission. Many such treaties provide for the ability of States as well as foreign investors to resort to international arbitration.

Source: UNCTAD 2004.

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A large number of BITs are between a developed country, on the one hand, and a developing country or economy in transition, on the other, but the proportion of BITs concluded between developing countries and between developing countries and countries in transition is increasing.

BITs have rarely been concluded between developed countries. However, top sources as well as top recipients of FDI flows are mostly developed countries (see module 1, theme 2). This may suggest that, from the point of view of a home developed country, BITs are more related to the need to ensure investment protection as a complement to a host country's regulatory framework than to the size of potential FDI outflows to a particular economy.

From the point of view of a host country, the international investment framework can contribute to attracting FDI. Although (as noted in module 1, theme3), statistical analysis does not reveal a significant impact of BITs in determining FDI flows to host countries, they can play a role in specific countries and situations. For example, they could signal that a host country's attitude towards FDI has changed and its investment climate is improving. Indeed, investors seem to regard BITs as part of a good investment framework (UNCTAD 2003, p. 91).

### **Question 4**

**Using box 1, name the main provisions usually found in BITs.  
Give reasons why countries conclude BITs with one another.**

### **1.3 Double taxation treaties (DTTs)**

International double taxation occurs when two different states impose the same type of tax on the same taxpayer and on the same taxable item (e.g. income). This can discourage trade and investment. Bilateral tax treaties, known as double taxation treaties (DTTs) are the primary means of eliminating such tax barriers, and thus promoting trade and investment.

DTTs concluded between two countries aim to eliminate the double taxation of income or gains arising in one country and paid by residents of the other country. The number of DTTs worldwide at the end of 2007 was over 2,700 (UNCTAD 2008, forthcoming).

Although DTTs focus on taxation and not on investment, they are included among investment-related international agreements because of their important role in facilitating investment flows. However, BITs and the investment chapters in regional and multilateral agreements remain the main IIAs with respect to regulating international investment.

### **Question 5**

**What are DTTs?  
Explain their importance for foreign investment.**

#### 1.4 Economic integration agreements (EIAs)<sup>2</sup>

There are a significant number of agreements that encompass a broader range of issues than investment (including notably trade in goods and services, and other factors of production). Agreements that aim at economic integration of a limited number of states (EIAs), typically from the same region, are prominent among them. As with DTTs, some regional agreements, although not explicitly mentioning investment, still affect it: for instance those containing provisions on free establishment of service providers or free movement of capital.

The degree of economic integration sought by member countries of EIAs varies, depending on the type of integration agreement. It can involve trade liberalization limited to selected products or sectors (sectoral trade agreements providing for lower tariffs or duty-free treatment among member countries in certain sectors) or preferential trade areas (that give preferential access to certain products from certain countries, by reducing tariffs). More advanced types of economic integration agreements include the following:

- ❑ **A Free-trade area (FTA)** eliminates tariffs and non-tariff barriers, notably quotas, on trade in goods and services between member countries. Unlike a customs union, each member country in an FTA retains its own tariffs and quotas on trade with third countries.
- ❑ **A Customs union (CU)** removes, as an FTA does, restrictions on mutual trade. It also adopts a common system of external tariffs and quotas with respect to trade with third countries. In other words, it is a free trade zone with a common external tariff.
- ❑ **A common market**, in addition to being a customs union, involves the freedom of movement of production factors: capital and labour. Harmonization of policies or common policies among member countries vis-à-vis third countries are possible.
- ❑ An **economic and monetary union** is a common market with a common currency and common economic policies. It implies a high degree of coordination or even unification of the most important areas of economic policy, as well as common institutions with supranational powers.
- ❑ **Complete economic integration** is the final stage of economic integration. All economic policy areas are harmonized or replaced by common policies, and a supranational state develops, making decisions on behalf of member governments.

EIAs can be:

- ❑ (Intra) **regional agreements**: in fact, most of EIAs are between countries from the same region, and EIAs with various degrees of economic integration cover almost all regions; or

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<sup>2</sup> Additional useful information on this can be found in the Vi training package on Regional Trade Agreements, also available from the Vi website (<http://vi.unctad.org>).

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- **Inter-regional agreements:** some EIAs are between two or more countries or organizations of countries from different regions of the world.

Countries that wish to liberalize trade engage themselves in FTAs either at the bilateral or at the regional level. Because trade in some products, notably services that are not tradable at arm's length, requires the presence of the supplier in the customer's country through FDI (called, in the GATS, "commercial presence"), FTAs covering such services can also facilitate FDI. Mexico, a country with many FTAs (a total of 12 ratified, including the North American Free Trade Agreement - NAFTA - as well as FTAs signed with the European Union and with the European Free Trade Association) is an example of a country helped by FTAs to become attractive to foreign investment.

In general, trade liberalization, to have effects on FDI, should be possibly full and irreversible, and should be accompanied by additional measures such as the liberalization of capital flows as well as free movement of services in all modes of delivery. Initially FTAs tended to focus on the liberalization of trade in goods. With growing interest in FDI, countries have tended to create international instruments to promote and protect investment flows in addition to an international legal framework to promote export and import of goods and services. This has been done increasingly within FTAs which nowadays typically have investment chapters, including, in addition to liberalization, investment-related provisions similar to those found in BITs.

In more advanced phases of economic integration, some agreements provide for the creation of regional institutions, with specific attributes. Organizations of sovereign states which have committed themselves to economic integration, and to which the member states have transferred competence on a range of matters, are called Regional Economic Integration Organizations (REIOs). These regional institutions can conclude various agreements, in the name of the member countries, with third countries. They may also have the authority to make binding decisions and/or to adopt legislation. However, these attributes are not always associated with an advanced degree of economic integration, such as customs unions or common markets. An example in this respect is the Organisation for the Economic Co-operation and Development (OECD). In other cases, member countries establish a forum of regional cooperation but do not create binding documents. This is the case with the Asia-Pacific Economic Cooperation (APEC).

Countries and REIOs sign a variety of agreements that have a variety of names such as regional trade agreement, economic partnership agreement, new-age partnership agreement, economic complementation agreement, agreement for establishing a free trade area or closer economic partnership arrangement. Agreements that contain, beside trade liberalization, a commitment to liberalize, protect and promote investment, as well as provisions that indirectly concern investment, are sometimes designated as preferential trade and investment agreements (PTIAs).

Thus, the universe of international agreements that deal with, or concern, directly or indirectly, foreign investment, is not only very complex, but also dynamic, both in terms of form and substance. Some examples of regional and interregional EIAs<sup>3</sup> include the North-American Free Trade Agreement (NAFTA), the Association of South-East Asian Countries (ASEAN), the Common Market of the South (MERCOSUR), the European Union (EU) or the Common Market for Eastern and Southern Africa (COMESA) (see annex).

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<sup>3</sup> For a detailed analysis, see UNCTAD 2006.

**Question 6**

**What are EIAs and what is their main purpose?**

**Name the different types of EIAs and discuss their main features.**

**Question 7**

**What is a REIO? What powers can it have?**

**Are FTAs also PTIAs?**

**Give an example of EIA from your region. Is your country party to an EIA?**

## 1.5 Multilateral agreements

The most important multilateral effort to create international rules for investment was undertaken in the early years after World War II within the framework of the **Havana Charter**, but it failed. Other efforts to create comprehensive multilateral rules for FDI, even non-binding ones, undertaken occasionally in the postwar period, have shared the fate of the first effort. Most prominent among them were the United Nations Code of Conduct on Transnational Corporations, in the late 1970s and 1980s, and the Multilateral Agreement on Investment (MAI) by the **OECD**, in the late 1990s (box 2). The exception was, the non-binding World Bank Guidelines on the Treatment of Foreign Direct Investment, adopted in 1992. They set down certain standards of treatment of investors on which a degree of international consensus existed.

Some multilateral agreements dealing with specific aspects of investment were adopted as well. The Convention on the Settlement of Investment Disputes between States and the Nationals of other States (signed in Washington, in 1965) provides a framework for the settlement of investment disputes, creating the International Centre for Management of Investment Disputes (ICSID) based in Washington, DC. The ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy deals with a range of labour-related issues. The Convention Establishing the Multilateral Investment Guarantee Agency (MIGA), signed in 1985 in Seoul, enhances the legal security of FDI by supplementing national and regional investment guarantee schemes with a multilateral one. However, efforts by members of the **World Trade Organization** (WTO), to create an investment framework at the multilateral level did not reach a consensus at the latest WTO Ministerial Conference that was held in Cancun in 2003 (box 3).

### Box 2. The Multilateral Agreement on Investment (MAI)

Efforts to create in negotiating international investment rules were carried out in the context of the Multilateral Agreement on Investment (MAI) that the OECD members sought to negotiate, until their discontinuation in December 1998 (OECD 1998; UNCTAD 1998). At the OECD Council meeting on 28 April 1998 it became clear that the MAI negotiations were encountering significant difficulties. France, for example, announced that it would no longer send its delegation to participate in the negotiations.

The MAI negotiations set out to provide high standards for the liberalization of investment regimes and investment protection between the OECD member countries and, eventually, other interested non-member States. While the negotiations resulted in a convergence of views on a number of substantive areas, too many unresolved issues remained to conclude the negotiations successfully. They related to the definition of investment, exceptions to national and most-favoured-nation treatment, intellectual property, cultural exception, performance requirements, labour and environmental issues, regulatory takings, and settlement of disputes.

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In addition other factors that contributed to the failure of the negotiation on the MAI are first, the opposition of non-governmental organizations (NGOs) to the underlying philosophy, objectives and some of the substantive provisions under discussion, as well as the process of negotiations, which in their view was too closed and opaque. Secondly, the initial strong support of the business community for the MAI negotiations waned after it became clear that no significant liberalization was in sight, and that the issue of taxation would be excluded from the rules. Thirdly, the aftermath of the election of centre/left governments in a number of OECD countries ushered in new political priorities which, given that no compelling problems of investment protection existed in the OECD area, left little incentive for political leaders to push the negotiations forward. Thus, the opposition of NGOs, the limited interest of the business community, and the negative outcome of an overall political cost-benefit analysis combined with the complex substantive issues sealed the fate of the MAI negotiations.

Source: UNCTAD 1999a.

### Box 3. Trade and investment at the WTO

The first WTO Ministerial Conference in Singapore in 1996 established the Working Group on the Relationship between Trade and Investment, along with three other working groups dealing with the so-called "Singapore issues".

At the Fourth WTO Ministerial Conference in **Doha** in November 2001, members of the WTO recognized "the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade" It was also agreed "that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations".

After the Doha Conference, the Working Group focused on clarifying the seven issues mentioned in the Declaration: scope and definition; transparency; non-discrimination; modalities for pre-establishment commitments based on a GATS-type, positive list approach; development provisions; exceptions and balance-of-payments safeguards; consultation and the settlement of disputes between members. Its work was also guided by a number of principles spelled out in the Doha declaration such as the need to balance the interests of countries where foreign investment originates and where it is invested, countries' right to regulate investment, development, public interest and individual countries' specific circumstances. Support and technical cooperation for developing and least-developed countries, and coordination with other international organizations such as UNCTAD were also emphasized.

During the Ministerial Conference in September 2003 in **Cancún**, ministers were supposed to decide whether there is an "explicit consensus" on modalities that would allow negotiations to go ahead, leading to new WTO rules on trade and investment. However, the discussions collapsed in Cancún and, in July 2004, the General Council decided to discontinue the negotiations on the relationship between trade and investment.

The main concern expressed by some developing countries was that a multilateral agreement would add obligations on them, while limiting their ability to align investment inflows with national development objectives.

Source: UNCTAD 2003, p. 93 and WTO, Cancún WTO Ministerial 2003: briefing notes.

Even though the efforts to create a multilateral investment framework have failed, there is still a number of multilateral agreements that address, through related issues, foreign investment (see also module 3 for detailed examples).

- The WTO General Agreement on Trade in Services (GATS), concluded as part of the Uruguay Round, offers a comprehensive set of rules covering all types of international services delivery, including "commercial presence". The commercial presence of the service providers involves FDI. The GATS leaves member countries considerable flexibility on the scope and speed of liberalizing

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services activities. It allows them to inscribe, within their schedules of commitments, activities that they wish to open and the conditions and limitations for doing this - the positive list approach.

- ❑ The WTO Agreement on Trade-Related Investment Measures (TRIMs) prohibits certain trade-related investment measures (also adopted as part of the Uruguay Round).
- ❑ The Convention on the Recognition and Enforcement of Foreign Arbitral Awards signed in New York in 1958, is applicable also to investment awards.
- ❑ The Energy Charter Treaty, a multilateral agreement in the sector of energy, contains provisions on energy sector investment between the 51 signatory countries.

### Question 8

**What were the main attempts to create a multilateral framework for investment?**

**What were their results?**

**Give examples of multilateral agreements with investment-related provisions.**

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## 2 EVOLUTION OF AND RECENT TRENDS IN IIAS

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There have been significant changes in national and international FDI policies in the past two decades (box 4), related to the ongoing integration of the world economy and the changing role of FDI in it (for the changes at the national level, see module 2, theme 1). At the international level, these changes have found their expression in a variety of instruments, bilateral, regional and multilateral.

### Box 4. FDI rules: a historical view

While in earlier times indirect foreign investment was far more important than direct, FDI acquired increasing importance as the twentieth century advanced, and it began gradually to assume the forms prevalent today. In international legal terms, however, FDI long remained a matter of national concern, moving onto the international plane, where rules and principles of customary law applied, only in exceptional cases, when arbitrary government measures affected it.

After the end of World War II, attitudes towards FDI were shaped by the prevalence of political support for State control over the economy and the beginnings of decolonization. Socialist countries for a long time excluded FDI from their territories, while developing countries endeavored to regain control of their natural resources from foreign interests. At the same time, controls and restrictions over the entry and operation of foreign firms were imposed in many countries, and no international consensus on the pertinent legal norms could be reached.

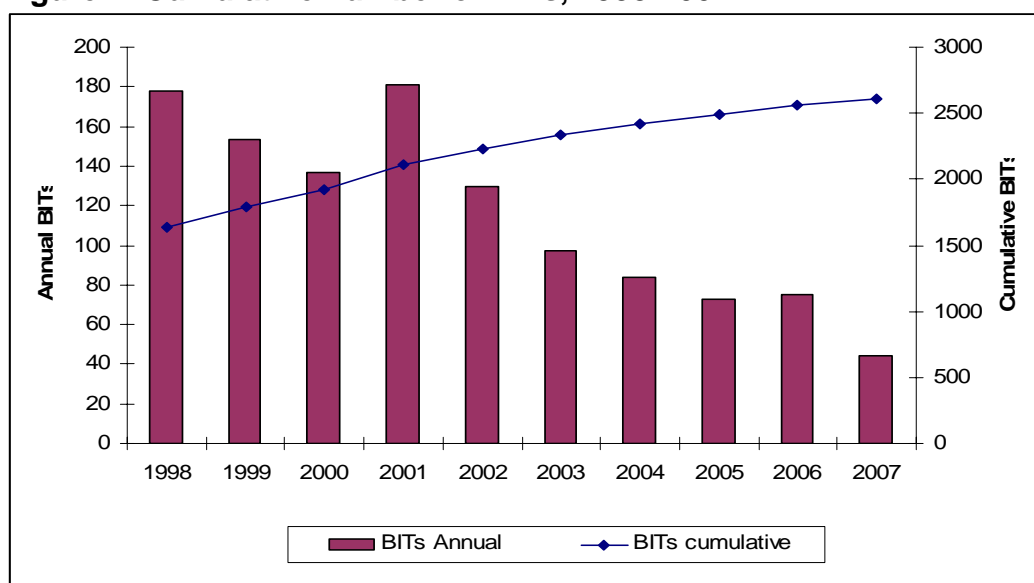
In the 1980s, a series of national and international developments in the context of the globalization process, mainly related to the increasing concern to attract FDI and create stable conditions for it, radically reversed the policy trends prevailing until then, with a significant impact on the regional and worldwide efforts of establishing international rules on the subject. By the end of the 1990s, host countries were seeking to attract FDI, by dismantling restrictions on its entry and operations and by offering strict guarantees against measures seriously damaging foreign investors. An international legal framework for FDI began to emerge. It is based on customary international law as well as on national laws and regulations, and it is composed of a multitude of international investment agreements and other legal instruments.

Source: UNCTAD 1999.

## 2.1 Trends and developments in BITs

The number of BITs worldwide has increased rapidly, most of them being concluded during the 1990s. From 388 in 1990, their number has grown continuously (figure 2). In 2007, 44 BITs were signed and *Asian countries* were the most active in concluding 29 new BITs in 2007. There has been a slowdown in the conclusion of BITs between 2001 and 2004, however, since then, the average increase has been stable (approximately 75 BITs per annum) for the last four years. The total number of BITs in 2007 has reached the figure of 2,608 agreements.

**Figure 2. Cumulative number of BITs, 1998-2007**



Source: UNCTAD 2008.

BITs traditionally cover the following key issues: scope and definition of investment, admission and establishment, national treatment, most-favoured-nation treatment, fair and equitable treatment, compensation in the event of expropriation or damage to the investment, guarantees of free transfers of funds, and dispute settlement mechanisms, both state-state and investor-state (these topics are discussed in module 3). Most recently, a new generation of BITs is gradually emerging that expands their content and scope. This new generation of BITs follows the trend set by some of the recent EIAs that include investment chapters and is exemplified by the new model BITs of the United States, Canada and – to a lesser degree – Japan, all of which include important new features. Several Latin American countries have also embarked on this new generation of treaties in their negotiations with other countries.

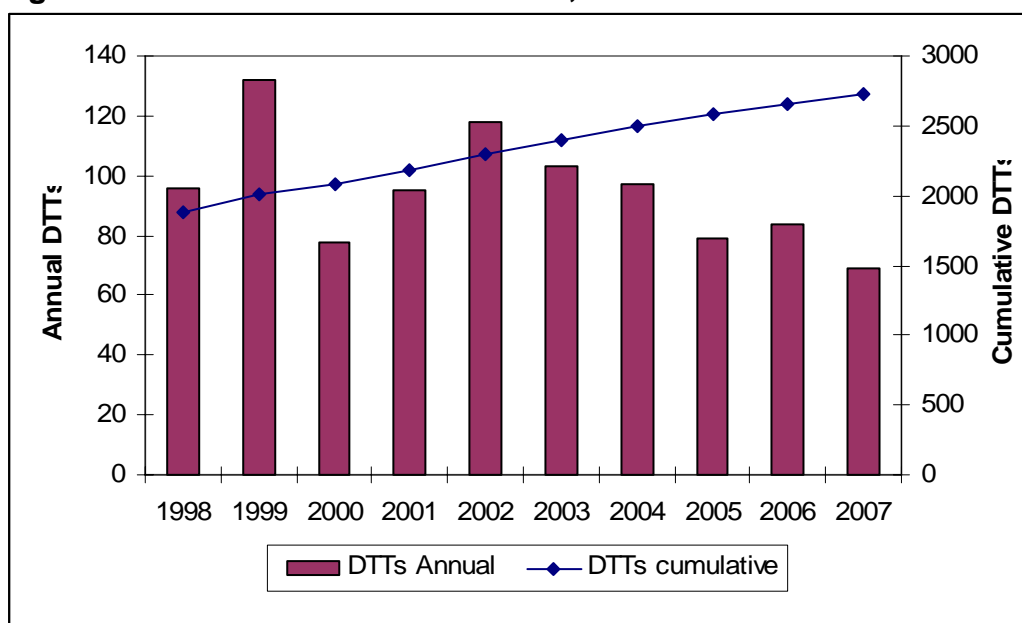
Among other changes, the new generation of BITs addresses a broader set of issues including not only specific economic aspects, such as those relating to investment in financial services, but also other issues where more room for host country regulation is sought. The protection of health, safety, the environment, and the promotion of internationally recognized labor rights are areas on which the new generation of BITs includes specific language generally aimed at clarifying that the investment protection and liberalization objectives of investment agreements cannot be pursued at the expense of these other key public policy objectives.

Another significant trend regarding BITs is that countries are increasingly embarking on the renegotiation of their existing treaties, as these reach their expiration date, or due to a change in economic and/or political circumstances. While BITs generally provide for tacit renewal after their expiration, in some cases countries embark on their re-negotiation, usually agreeing to stronger commitments.

## 2.2 Trends in DTTs

The network of DTTs is also expanding (figure 3). In 2007, for instance, 69 new DTTs were concluded. This represents a sustained growth of DTTs albeit at a slightly slower pace since the year 2003. The total number of DTTs reached 2,730 by the end of 2007 (UNCTAD 2008).

**Figure 3. Cumulative number of DTTs, 1998-2007**



Source: UNCTAD 2008.

### Question 9

**Discuss the main trends in the number and features of BITs since 1990.**

## 2.3 Evolution of other IIAs<sup>4</sup>

As mentioned, besides BITs and DTTs, international investment rules are increasingly being adopted as part of bilateral, regional, inter-regional and plurilateral agreements that address, and seek to facilitate, trade and investment transactions, such as bilateral free-trade agreements or regional economic integration agreements.

The number of such agreements has been growing steadily (figure 4) and, by the end of 2007, it had reached 252; with 11 new agreements concluded during 2007. In addition, at least 70 agreements involving 108 countries were under negotiation at the end of

<sup>4</sup> Also referred to as *Preferential Trade and Investment Agreement*.

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2007..The large majority of the agreements, about 87 per cent, were concluded since the 1990s (figure 4). Until the late 1980s, investment facilitation through these agreements remained confined mainly to intra-regional processes, albeit with some exceptions (e.g. early agreements between the European Community and developing countries). Since 1990, however, countries and groups located in different regions began to conclude trade and investment agreements with one another, with the result that interregional agreements now account for more than a half of the total, and for about 49 per cent of the 182 concluded since 1990.

The growth of IIAs other than BITs and DTTs is partly the result of two important qualitative changes that took place during the 1990s.

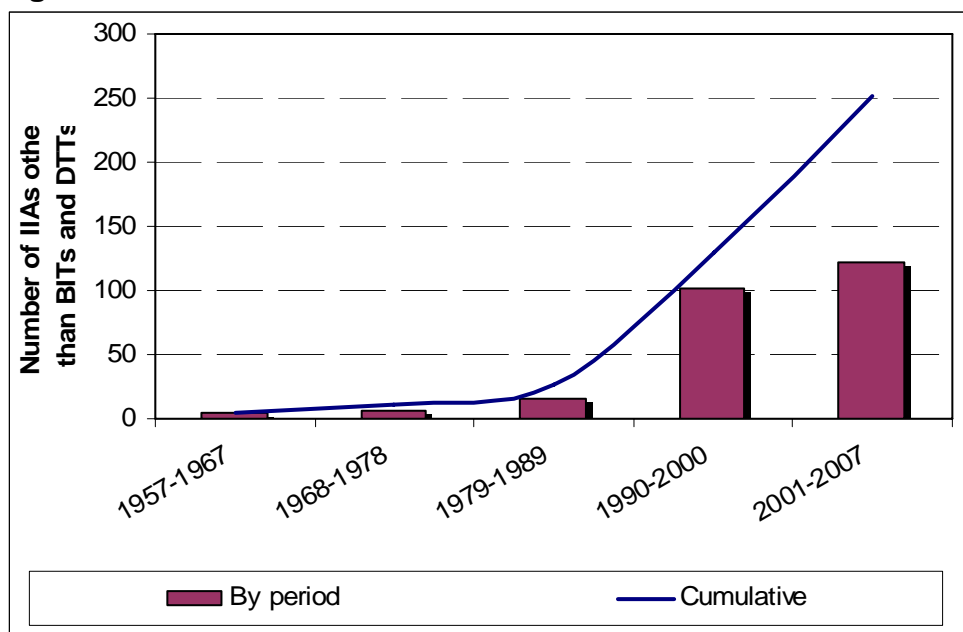
- First, these agreements, which previously had been used mainly by countries at similar levels of development, started to be concluded between developed and developing countries: By end of 2007, 85 had been signed (77 since 1990).
- Second, there has also been a dramatic increase in such agreements among developing countries since the 1990s. By end of 2007, over 90 of them had been signed (59 since 1990).

The more frequent use of these agreements demonstrates a trend towards a more integrated approach when dealing with interrelated issues in international investment rule-making. Among the treaties of this kind concluded in 2006 were the FTAs between the United States and Colombia, Oman, Panama, and Peru, and the Economic Partnership Agreement between Japan and the Philippines. These agreements establish, inter alia, binding obligations for the contracting parties concerning the admission and protection of foreign investment. The scope of the protection commitments in these FTAs is comparable to that found in BITs, including with regard to dispute settlement. 2006 also saw the conclusion of the new Central European Free Trade Agreement (CEFTA) consolidating more than 30 bilateral FTAs.

The proliferation of these agreements is one of the key developments in international economic relations in recent years in response to the increasing global competition facing national economies for resources and markets. The choice of partners within and between regions responds not only to a variety of economic and political motivations but also to the characteristics of the countries involved.

Compared to BITs, these other IIAs show far more variation in their scope, approach and content. Moreover, they increasingly encompass a broader range of economic transactions, including, notably, trade in goods and services, investment and capital flows, as well as movement of labour. The more issues are addressed, the more complex the agreement, and the greater the likelihood of overlaps and inconsistencies between provisions. At the same time, their greater variation presents an opportunity for experimenting with different approaches to promoting international investment flows that better reflect the special circumstances of countries at different levels of economic development and in different regions.

**Figure 4. Growth of IIAs other than BITs and DTTs from 1957 to 2007**



Source: UNCTAD 2008, forthcoming.

### Question 10

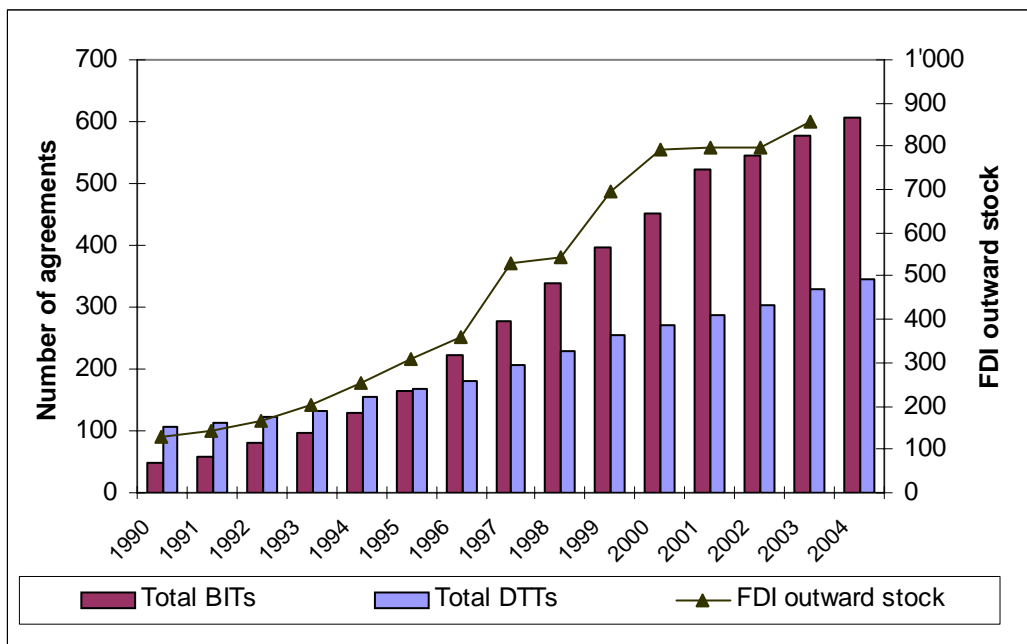
**What are the main reasons for the growth of IIAs other than BITs and DTTs?**

#### 2.4 South-South cooperation

Developing countries have intensified their efforts to conclude IIAs among themselves. Indeed, agreements on investment between developing countries have increased substantially in both number and geographical coverage over the past decade, according to UNCTAD data (figure 5).

- By the end of 2007 South-South IIAs included 693 BITs. South-South agreements now represent more than a quarter of the total number of BITs.
- During the 1990s, 156 new DTTs were signed between 69 developing countries, bringing the total number of treaties to 256 by the end of 1999. Growth persisted until 2004, with the number of South-South DTTs reaching 345 treaties between 90 countries. In 2007 Developing countries were involved in 36 of the new DTTs. Eight of the DTTs signed in 2007 were among developing countries only.
- Other IIAs between developing countries also experienced a dramatic increase since the 1990s. 59 such agreements between developing countries were signed since 1990. This suggests that developing countries are increasingly pursuing development strategies based on cooperation among themselves on trade and investment. Some developing countries - such as Brazil, China, Republic of Korea, India, Mexico - have become important investors abroad, and mainly in other developing countries.

**Figure 5. South-South cooperation: BITs and DTTs**



Source: UNCTAD 2005. "Recent trends in IIAs", research note, Geneva: UNCTAD.

**Question 11**

**Briefly describe the evolution of South-South cooperation regarding investment.**

**2.5 Conclusion**

The main recent trends in IIAs include the following:

- ❑ First, the number of bilateral investment treaties (BITs) and bilateral double taxation treaties (DTTs) continued to expand.
- ❑ Second, international investment rules are increasingly being formulated as part of agreements that encompass a broader range of issues (including notably trade in goods and services, and other factors of production), other than BITs and DTTs.
- ❑ Third, the investment provisions in the new agreements tend to be increasingly sophisticated and complex in content, clarifying in greater detail the meaning of certain standard clauses.
- ❑ Fourth, among the new BITs some are newly re-negotiated treaties that replace earlier BITs between the same partners, either because the original treaty has reached its expiry date or because of changed circumstances.
- ❑ Fifth, cooperation among developing countries on international investment policy is intensifying.

International investment rule making is likely to further intensify between developing countries in the years to come. Indeed, a large number of IIAs are currently under negotiation and/or re-negotiation, suggesting an even more pronounced increase in the

coming years. Hence, the international framework of investment rules continues to expand at the bilateral, sub-regional, regional and inter-regional levels. This suggests that the present system of investment agreements will become even more complex in the future, raising the likelihood of conflicting rules and investment disputes, as well as costs of compliance for both governments and business of the parties to the agreements.

**Question 12**

**Name the main recent trends in IIAs. Discuss in groups possible explanations for these trends.**

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### **3 INTERNATIONAL INVESTMENT DISPUTES**

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Although investor-state dispute settlement provisions have been included in IIAs since the 1960s, the use of these provisions to institute arbitral proceedings has been rare until recently. Up to April 1998, only 14 cases had been brought to the International Centre for Settlement of Investment Disputes (ICSID) involving BITs, and only two awards and two settlements had been issued. However, since the end of 1990s, the number of cases has grown dramatically - in 2007, at least 35 new investor-State cases were filed under IIAs, 27 of which were filed with ICSID.<sup>5</sup> This is a marked increase over 2006, where only 26 new cases were reported.

The cumulative number of known treaty-based cases reached 290 by 2007 (figure 6).<sup>6</sup> This development poses a particular challenge for developing countries. At least 73 governments – 44 of them in the developing world, 15 in developed countries and 14 in Southeast Europe and the CIS – have faced investment treaty arbitration. The Argentine Republic still tops the list with 46 claims lodged against it, 44 of which relate at least in part to that country's financial crisis early in this decade. Four new arbitration cases were launched against the Argentine Republic in 2007. Mexico continues to have the second highest number of known claims (18), with no new cases in 2007. The Czech Republic has the third highest number of claims filed against it, with 14 (with two new cases filed in 2007). Canada and the United States come next, with 12 cases each. Ecuador, India and Poland (with 9 cases each), Egypt, Romania, and the Russian Federation (with 8 cases each), Ukraine and Venezuela (7 cases each), Turkey (6 cases), Hungary, Kazakhstan and Moldova (with 5 cases each) also figure prominently. Six countries faced arbitration proceedings for the first time in 2007, all from the developing world or economies in transition (Armenia, Bosnia and Herzegovina, Costa Rica, Guatemala, Nigeria, and South Africa).

Under several arbitration systems, the existence of a dispute and its final decisions are never made public. Even under the ICSID arbitration system, the decisions of the tribunals have not all been made public. While this situation is gradually changing, the new ICSID rules applicable from 10<sup>th</sup> April 2006 Rule 48 requires the tribunal to make the legal reasoning of the award publicly available. Apart from that, the ICSID arbitration facility is the only facility that maintains a public registry of claims. A number of claims are known to be

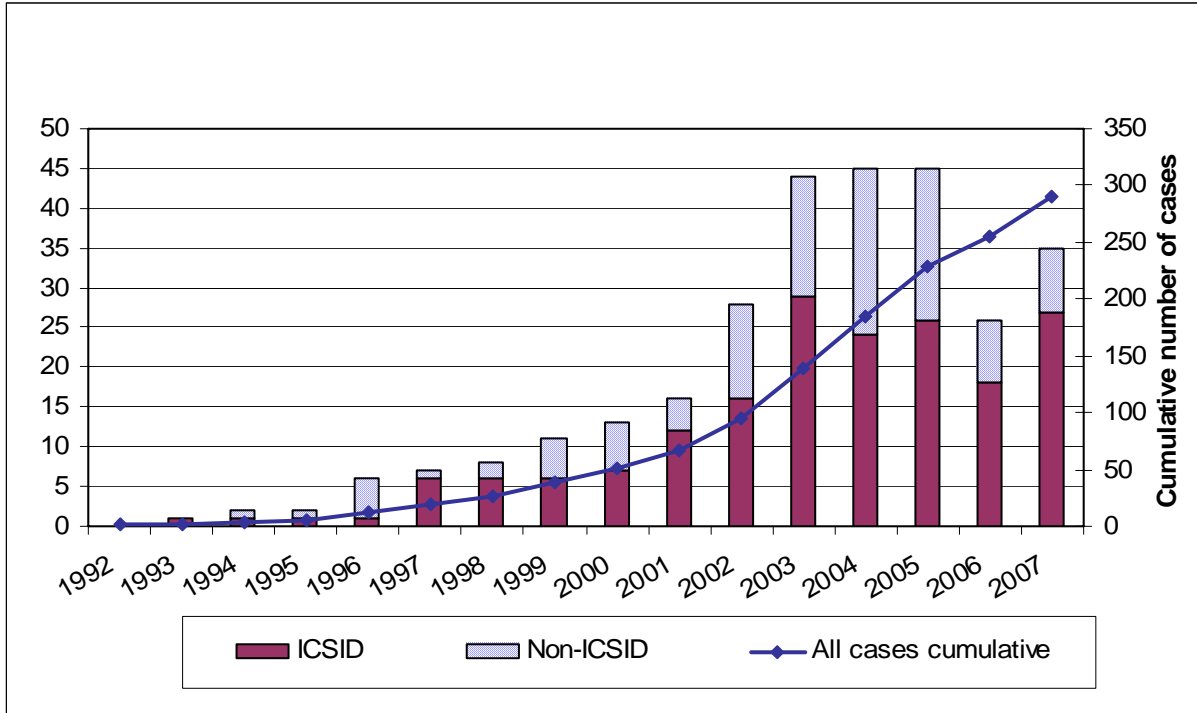
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<sup>5</sup> This number does not include cases that are exclusively based on investment contracts (State contracts) and cases where a party has so far only signalled its intention to submit a claim to arbitration, but has not yet commenced the arbitration (notice of intent); if these latter cases are submitted to arbitration, the number of pending cases will increase.

<sup>6</sup> These disputes were filed with ICSID (or the ICSID Additional Facility) (182), under the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL) (80), the Stockholm Chamber of Commerce (14), the International Chamber of Commerce (5), and ad-hoc arbitrations.

proceeding outside of ICSID, and their number was 8 in 2007, in comparison to 2005, where the number was 56, of which 39 were UNCITRAL and 4 ad-hoc arbitrations. The UNCITRAL is also in the process of revising its arbitration rules to make them more transparent and investment treaty friendly.

**Figure 6. Known investment treaty arbitrations, end 2007**



Source: UNCTAD 2008.

Investment dispute cases cover the whole range of investment activities. They relate to all kinds of investments, including privatization contracts and state concessions. They apply to a diversity of industries and activities, including construction, water and sewage services, brewing, telecommunications concessions, banking and financial services, hotel management, television and radio broadcasting, hazardous waste management, textile production, gas and oil production, and various forms of mining.

The financial implications of the investor-state dispute settlement process can be substantial, both from the point-of-view of the costs of the arbitration proceedings and of the awards rendered (box 5). The number of dispute cases solved in favour of states is similar to the number of cases in which the decision was favourable to the investor.

**Box 5. Financial implications of international dispute-settlement cases**

Although precise information about the level of damages sought by investors and the awards rendered is scarce and difficult to obtain, it is clear that some claims involved large amounts. For example, the Czech Republic's award of some \$270 million plus substantial interest in the Lauder case; the award in CSOB vs. Slovakia (29 December 2004) of \$824 million plus an additional \$10 million as partial contribution to CSOB's costs; or Occidental's 2002 award against Ecuador of \$71 million plus interest). But not all claims lead to the requested awards being granted. The amount awarded for a claim is not necessarily an indication of the real financial magnitude of a case, since there are no penalties for claimants filing particularly high claims. Very large claims often end up yielding very small awards. The Metalclad vs. Mexico claim for \$43 million, for example, led to an award of less than \$17 million, and S.D. Myers, in its \$70-to-\$80 million claim against Canada, was awarded \$6 million, i.e. less than 10 per cent of the amount sought. Nor do all claims brought by businesses succeed. Indeed, a number of cases are won by states.

However, even defending oneself against claims costs money. Investment treaty arbitration proceedings are not inexpensive to mount. The Metalclad Corporation is reported to have spent some \$4 million on lawyers' and arbitrators' fees in an arbitration against Mexico. The Czech Republic reportedly spent \$10 million on its defense against two major claims brought by a European-based broadcasting firm and one of its major shareholders. More recently, the Czech government announced expected legal fees of \$3.3 million in 2004, and \$13.8 million next year, to fight off similar claims. A cursory review of cost decisions in recent awards suggests that the average legal costs incurred by governments are \$1-to-\$2 million, including lawyers' fees; the costs for the tribunal, about \$400,000 or more; and the costs for the claimant about the same as for the defendant.

Source: UNCTAD 2005. "Recent developments in IIAs" research note, Geneva: UNCTAD.

### **Question 13**

**Describe the recent evolution of international investment disputes. What are the possible financial implications for a host country? Discuss them in groups.**

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## **4 THE CONCEPT OF NATIONAL POLICY SPACE**

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The common goal shared by all parties to IIAs, is to increase the flows of FDI. In addition, home countries (and their investors) seek transparency, stability, predictability and security - and greater market access. Host developing countries, for their part, want to advance their development by increasing the benefits from FDI. To do so, they need to have enough flexibility to use a range of development-oriented policies.

IIAs therefore need to strike a mutually advantageous balance of rights and obligations between the diverging interests and priorities of various groups of countries.

The concept of "national policy space" refers to flexibility for governments to pursue development-oriented FDI policies; it is the operational bridge between the differing perspectives of host countries, home countries and investors. Its foundation is the right to regulate, a sovereign prerogative that arises out of a state's control over its own territory and that is a fundamental element in the international legal regime of state sovereignty.

Although host countries already limit their regulatory autonomy as a result of liberalization policies, IIAs create distinctive issues in this connection. Such international agreements, like other legal texts, contain legal obligations that limit the sovereign autonomy of the parties. Given that international legal obligations generally prevail over domestic rules, tension can arise between the will to cooperate at the international level through binding rules and the need for governments to discharge their domestic regulatory functions. That is why there is a need to ensure coherence between the international commitments of a country, on one hand, and its national policies and measures for pursuing development objectives, on the other hand.

### **Question 14**

**Define the concept of national policy space.**

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## 5 THE DEVELOPMENT DIMENSION IN IIAS

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Ensuring sufficient flexibility for pursuing development objectives and related policies is a difficult balancing act. In IIAs, the development dimension is the result of negotiations in the light of overlapping – but not identical – objectives between home and host countries. It finds expression in the objectives, structure, content, and implementation of IIAs, including the use of various exceptions for development goals.

### Objectives

Many IIAs incorporate the objective of development among their basic aims, purposes or principles, as a part of their introductory statements or as specific declaratory clauses articulating general principles (see box 6 for an example).

#### Box 6. The Preamble of GATS

The Preamble to the GATS Agreement (which covers FDI in services) includes among its objectives “the expansion of [services] trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries”. It also expresses a desire for the “early achievement of progressively higher levels of liberalization of trade in services through successive rounds of multilateral negotiations aimed at promoting the interests of all participants on a mutually advantageous basis and at securing an overall balance of rights and obligations, while giving due respect to national policy objectives”. It continues, by expressing a further desire, “to facilitate the increasing participation of developing countries in trade in services and the expansion of their service exports including, *inter alia*, through the strengthening of their domestic services capacity and its efficiency and competitiveness”.

Source: UNCTAD 2000.

The main advantage of such provisions is that they may assist in the interpretation of other substantive obligations, permitting adoption of the most development-friendly interpretation.

### Structure

The structure of agreements may reflect development concerns through the application of special and differential treatment for developing country parties. This entails differences in the extent of obligations undertaken by developed and developing country parties, with the latter assuming less onerous obligations, either on a temporary or permanent basis, that are also non-reciprocal. This may be achieved in a number of ways:

- ❑ Agreements can distinguish between developed and developing countries, with different obligations for both. The Multilateral Investment Guarantee Agency (MIGA), for example, restricts its investment insurance to investment in developing countries only, listed in an annex to the MIGA Convention.
- ❑ Differences may be introduced for stages and degrees of participation by developing country parties, with accession less onerous for them or allowing for association rather than full commitment to treaty obligations.

## Content

For every key substantive issue, more development-friendly or less development-friendly solutions exist. And given their importance, they require the full attention of negotiators.

When negotiating content, flexibility can be introduced through various means:

- ❑ **Excluding some issues** altogether. For example, excluding provisions on incentives from the draft MAI would have allowed countries to have maximum policy flexibility in this area (consistent with other international obligations). Most IIAs exclude taxation issues (covered in double taxation treaties).
- ❑ **Circumscribing the scope** of key provisions - for instance, by limiting the definition of investment to FDI only.
- ❑ **Including provisions of special interest to developing countries**, such as those pertaining to transfer of technology or home country measures.
- ❑ **Using various kinds of exceptions**, reservations, derogations and waivers to transition arrangements that aim to ensure that signatories retain their prerogative to apply nonconforming domestic regulations in certain areas. Examples include exclusions from the non-discrimination principle; safeguards aimed at preserving the right to regulate, as in balance-of-payments difficulties; and general exceptions for reasons of public security and order, public health and morality.

It has to be kept in mind, however, that the provisions of IIAs interact with one another to complement, clarify, expand, limit or elaborate on the rights and obligations of parties. For example, general exclusion or exception clauses have the effect of limiting the scope of an agreement or modifying the application of its provisions. Similarly, general standards of treatment, such as national treatment or fair and equitable treatment, affect and complement the substance of more specific standards dealing with, for example, operational conditions or expropriation. These interactions offer multiple possibilities for structuring and combining provisions in IIAs to achieve the desired overall balance of rights and obligations, and accommodate diverging country interests (for more details, see module 3).

## Implementation

The implementation of IIAs can also be designed with flexibility for development as its organizing principle. Two approaches are particularly relevant here:

- ❑ Whether an agreement is **legally binding** or not affects the intensity of particular obligations. Indeed, it is possible to have a mix of binding commitments and non-binding “best effort” provisions in one agreement. Thus, development - oriented provisions could be either legally binding or non-binding (hortatory), depending on the extent to which the parties are willing to undertake commitments in this area.
- ❑ The asymmetries between developed and developing country parties to IIAs can be tackled by commitments addressed to the developed country parties to undertake

measures of assistance to the developing and especially Least Developed Countries (LDCs) parties. A leading example, as noted (module 2, theme 1) is the technology transfer commitment by developed country parties to the TRIPS Agreement towards LDCs. Such developed country commitments can be complemented by provisions for technical assistance through relevant international organizations. These are particularly important, given the complexity of the subject matter and the limited capacity of many developing countries, and especially the LDCs, to undertake FDI-related policy analysis and development, as well as human and institutional development.

**Question 15**

**What are the main ways in which a country can preserve flexibility for development when negotiating an IIA? Discuss.**

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**6 ENSURING COHERENCE OF NATIONAL AND INTERNATIONAL INVESTMENT POLICIES**

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It is for each government to evaluate the trade-off between the benefits of accepting international rules and commitments and the constraints posed by the loss of policy space. As mentioned above, flexibility can be ensured when designing and negotiating an IIA. But once international commitments are undertaken, the need for coherence and compatibility applies also for the implementation phase.

Indeed, IIAs are usually in force for many years (in the case of BITs, for instance, for 10 years or more). During this time, some of the host country's policies and measures, not existing at the time of the negotiation, might interfere with its obligations in certain IIAs. Once a policy choice has been made and it is reflected in an international agreement, significant policy changes that intervene in the time frame of an agreement and turn out to be contrary to the initial commitment would thus violate certain provisions of this agreement. For example, if the host country wishes to open certain sectors to FDI and to preserve its full control for other sectors, there is a need for careful identification of the sensitive sectors, preferably in the framework of strategic planning: once a liberalization commitment has been made at the international level, for a certain sector, it could be difficult for the respective country to withdraw from such commitments.

In other words, taking on international commitments in IIAs also requires sustainable policy orientations: clear and stable policy objectives, sectoral strategies correlated with these objectives and between themselves, and realistic implementation plans and measures. The coherence of policy positions at the national and international levels would avoid possible contradictions, in time, between host country's national policies and the IIAs it ratified. Such contradictions might lead to international dispute settlement with the foreign investors.

It has to be kept in mind that coherence must also be ensured between different international agreements signed by a country. Indeed, each IIA is part of a larger set of investment agreements at bilateral, regional, inter-regional or plurilateral levels - and addresses a broad range of issues related to investment and the operations of TNCs. When the same parties participate in various agreements, their respective provisions also interact, to complement, elaborate, expand or limit these parties' obligations. It is therefore important, when designing IIAs, to bear in mind this broader context, and ensure that the

## MODULE 2 - THEME 2 - FDI INTERNATIONAL RULES

standards, exceptions and the like that the parties seek to negotiate in agreements would not be modified or otherwise affected by other agreements in ways that were not intended. One example is the question of how investor protection standards interact with the environmental obligations of countries in multilateral environmental agreements.

In case of possible conflict between provisions in different agreements, it is also important to consider how IIAs can ensure their compatibility with conflicting obligations arising from these agreements. In principle, questions of compatibility between agreements are resolved in accordance with the principles set out by Article 30 of the Vienna Convention on the Law of Treaties (see box 7).

### **Box 7. Vienna Convention on the Law of Treaties, 1969, Article 30**

#### **Application of successive treaties relating to the same subject-matter**

1. Subject to Article 103 of the Charter of the United Nations, the rights and obligations of States parties to successive treaties relating to the same subject-matter shall be determined in accordance with the following paragraphs.
2. When a treaty specifies that it is subject to, or that it is not to be considered as incompatible with, an earlier or later treaty, the provisions of that other treaty prevail.
3. When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the latter treaty.
4. When the parties to the later treaty do not include all the parties to the earlier one:
  - (a) as between States parties to both treaties the same rule applies as in paragraph 3;
  - (b) as between a State party to both treaties and a State party to only one of the treaties, the treaty to which both States are parties governs their mutual rights and obligations.
5. Paragraph 4 is without prejudice to article 41, or to any question of the termination or suspension of the operation of a treaty under article 60 or to any question of responsibility which may arise for a State from the conclusion or application of a treaty the provisions of which are incompatible with its obligations towards another State under another treaty.

Source: for example, <http://www.admiraltylawguide.com/conven/lawoftreaties1969.html>.

When the parties desire to ensure that no conflict of compatibility arises between an IIA and other treaties to which the signatory States may be a party, they can do so by inserting specific clauses into the agreement expressing this intent. Examples of such clauses include the “regional economic integration organization” (REIO) clause, which ensures that the benefits of membership of such an organization are not extended to non-member countries that are also partners to the IIA on the basis of the Most Favoured Nation (MFN) clause, and the preservation of rights clause found in BITs (for more details, see module 3).

Finally, ensuring coherence is also a challenge for the future national policies and future international negotiations. Countries can use the lessons learned from the implementation of various IIAs to further clarify and improve their policy positions for new treaties, including through enhancing, where necessary, the development dimension discussed in the previous section. Countries can also learn from the experiences of other countries, through monitoring the developments in the international regulatory framework for investment. For instance, the concerned departments in trade and investment ministries

could monitor the evolution of dispute settlement cases through consulting the documents made public in this respect by ICSID or various international publications in this field; or they can, in a broader view, engage in capacity building programmes through participating in various international expert meetings, workshops or conferences on international investment law.

**Question 16**

**Name the main policy aspects to be taken into consideration by a host country at the implementation of an IIA.**

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**7 CONCLUSION**

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In the past decades, international rules for FDI have changed significantly, based mainly on the change of perception regarding FDI. It is now generally agreed that the many facets of the legal regulation of FDI are a matter of international concern.

The international legal framework for FDI is fluid, mainly because, despite recent developments, there is no established general policy consensus. As a result, there is no comprehensive global instrument. In compensation, for example, bilateral and regional agreements have in the recent past taken the lead in creating international rules for investment and in adapting them to new conditions. Their number has progressively increased, and their provisions are becoming more and more complex. The exact relationship among legal actions and measures at various levels is unclear, since many developments are relatively new and there is little actual practice to crystallize them. Consequently, international dispute settlement cases between foreign investors and host States have also multiplied.

In this context, developing countries have to keep a balance between the diverging interests and priorities of the countries that negotiate with them and their development objectives in the national policy framework. In other words, they must address the challenge of preserving their right to regulate and at the same time create favourable conditions to attract FDI. The national policy space can be preserved through various means, when designing, negotiating and implementing IIAs, but it has to be kept in mind that an attractive economic climate requires policies and measures in a wide range of sectors and issues. Such policies and measures can have a significant impact on foreign investment and must be coherent with the international commitments undertaken.

## D PRACTICAL EXERCISE

### **Balancing national interests and international commitments: The experience of Argentina after the financial crisis**

At the beginning of the 1990s, a programme to privatize public utility firms was launched in Argentina, which set bidding conditions that made it necessary for interested local firms to associate with foreign ones and offered incentives such as a debt-to-equity swap mechanism. Further incentives were added shortly after privatization: some taxes were reduced or eliminated and new clauses were introduced to the contracts in which utility rates were denominated in dollars and indexed to the United States' inflation index. During the same decade, Argentina signed 54 BITs to provide security and guarantees for investors.

Problems began to surface when economic conditions in the country deteriorated. Economic contraction, massive withdrawals of banking deposits and a rapid decline in international reserves forced the Government in January 2002 to abrogate the convertibility law that fixed the peso's exchange rate at par with the United States dollar. The tripling of the value of the dollar in local currency that resulted, in the context of deep economic recession, led the Government to transform all the dollar-denominated contracts into national-currency-denominated contracts, including those signed with public utility firms. The periodic adjustments of public utility tariffs based on foreign inflation indices were also eliminated.

In the following months a number of foreign investors resorted to arbitration by the International Centre for Settlement of Investment Disputes (ICSID) and other fora. Indeed, 37 out of the 40 arbitration cases to which the Argentine Government is party (as of June 2005) were registered after the 2002 emergency measures were introduced, and are related, at least in part, to the financial crisis.

Argentina has stated that "it has not offered any guarantee concerning the maintenance of the convertibility system and in case of devaluation of its currency, because the Government could not have assumed an obligation to follow any specific economic or exchange policy since it can freely modify those policies." In Argentina's view, its actions had been rendered necessary by an imminent economic, financial and social crisis in the country, and it thus referred to a state of necessity. Argentina has also contended that "the emergency measures adopted by the Government are to be considered as economic policy regulatory measures that do not give right to compensation. They were instrumented through legislative acts of general scope, non-discriminatory, and therefore applicable to both Argentine and foreign nationals without any distinction. They are temporary in nature and oriented at the protection of public welfare interests, with a view to normalize the life of the country, to guarantee the continuity of public utilities and to keep rates for customers at an affordable level."

At the same time, the Government has been negotiating gradual tariff increases with privately owned public utilities provided that international claims are withdrawn. At least one complainant withdrew its complaint in April 2005, and negotiations with other energy firms are reported to be at an advanced stage.

An ICSID tribunal rendered a first award in the long list of pending cases on 12 May 2005. The tribunal ordered Argentina to pay \$133.5 million plus interest in compensation to a

United States company, on the grounds of breach of contract and violation of the BIT between Argentina and the United States. The tribunal rejected Argentina's arguments based on a state of necessity as well as the investor's contention that it had suffered an indirect or regulatory expropriation of its investment.

Source: Adapted from UNCTAD 2005, p. 71.

**Questions:**

- 1. Name the main policy aspects to be taken into consideration by a host country at the implementation of an IIA. What were the measures taken by the Argentinean government to attract FDI in its public utility sector? How did the economic crisis affect the government's ability to continue implementing the measures?**
- 2. Role-play: discuss in two groups, on one hand, the arguments brought by the Argentinean authorities regarding investors' concerns, and on the other hand, the possible arguments from the point of view of a foreign investor.**
- 3. Discuss Argentina's experience from the point of view of the host country's policy space.**

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## F ANNEX

### EXAMPLES OF EIAs

#### 1 NORTH-AMERICAN AGREEMENTS

##### **North-American Free-Trade Agreement (NAFTA)**

In January 1994, Canada, the United States and Mexico launched the North American Free Trade Agreement (NAFTA) and formed a free trade area where trade and investment barriers among these three countries were to be eliminated.

NAFTA was an expansion of the earlier Canada-U.S. Free Trade Agreement of 1989. Unlike the European Union, NAFTA does not create a set of supranational governmental bodies, nor does it create a body of law which is superior to national law.

With regard to investment, NAFTA's chapter 11 contains complex provisions that define the conditions of establishment, treatment and protection of foreign investment, as well as lists of exceptions and reservations of each country to certain commitments, in annex, including future non-conforming measures.

##### **Free Trade Area of the Americas (FTAA)**

The effort to unite the economies of the American continent into a single free trade agreement began at the Summit of the Americas, held in December 1994 in Miami, United States. Heads of State and Governments of the 34 democracies in the region agreed to negotiate the FTAA, in which barriers to trade and investment will be progressively eliminated.

Nine FTAA Negotiating Groups were created in the following areas: market access; investment; services; government procurement; dispute settlement; agriculture; intellectual property rights; subsidies, antidumping and countervailing duties; and competition policy. These negotiating groups have specific mandates to negotiate text in their subject areas and meet regularly.

The Negotiating Group on Investment (NGIN), is mandated to develop a comprehensive framework that incorporates the rights and obligations on investment.

#### 2 ASIAN AGREEMENTS

##### **Asia – Pacific Economic Co-operation (APEC)**

Established in 1989, APEC, with its 21 member economies, is the first forum for facilitating economic growth, cooperation, trade and investment in the Asia-Pacific region.

Known as APEC's 'Three Pillars', APEC focuses on: trade and investment liberalization; business facilitation; economic and technical cooperation.

APEC operates on the basis of non-binding commitments and open dialogue. Norms of a non-binding nature relating to foreign investment have been adopted in the 1994 APEC Non-Binding Investment Principles.

### **Association of South-East Asian Countries (ASEAN)**

ASEAN was established in 1967 in Bangkok by five original Member Countries, namely, Indonesia, Malaysia, Philippines, Singapore, and Thailand. Brunei Darussalam joined in 1984, Vietnam in 1995, Laos and Myanmar in 1997, and Cambodia in 1999.

Today, ASEAN economic cooperation covers the following areas: agriculture and forestry, economics (trade), energy, environment, finance, health, information, investment, labour, law, regional haze, rural development and poverty alleviation, science and technology, social welfare, telecommunications, transnational crime, transportation, tourism, youth..

The ASEAN instruments related to investment are:

- ❑ ASEAN Agreement of 1987 (Agreement Among the Governments of Brunei Darussalam, the Republic of Indonesia, Malaysia, the Republic of the Philippines, the Republic of Singapore and the Kingdom of Thailand for the Promotion and Protection of Investments) amended in 1996;
- ❑ Framework Agreement on the ASEAN Investment Area (1998, amended by a Protocol in 2001);
- ❑ ASEAN Framework Agreement on Services (1995);
- ❑ Short-Term Measures to Enhance ASEAN Investment Climate (1999).

## **3 LATIN AMERICAN AND CARIBBEAN AGREEMENTS**

### **Andean Community (CAN)**

The Andean Community<sup>7</sup> is a sub-regional organisation endowed with an international legal status, which is made up of Bolivia, Colombia, Ecuador, Peru, and the bodies and institutions comprising the Andean Integration System (AIS). The Community provisions concerning investment are Decisions 291 and 292. The former contains the general regime governing foreign investment and the latter regulates the case of the Andean multinational enterprises.

National laws and regulations, together with bilateral arrangements or agreements to promote and protect investments, signed by member countries with third countries and even among themselves, complement these provisions.

The Andean Community is a customs union because the goods of its member countries circulate unimpeded throughout its territory free of duties of any sort, while imports from outside the sub-region pay a common tariff. The member countries have taken important steps in their commitment to establish a common market. Since meetings held in 2005 the

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<sup>7</sup> Venezuela announced its withdrawal in 2006, reducing the Andean Community to four member states.

Andean Community has adopted various measures these included greater harmonization of the customs duty and a common foreign policy.

### **Common Market of the South (MERCOSUR)**

Argentina, Brazil, Paraguay and Uruguay signed, in March 1991, the Treaty of Asuncion, creating the Common Market of the South.

In the framework of MERCOSUR, there are two relevant instruments related to investment:

- The 1994 Protocol on the Promotion and Protection of Investments coming from Non-Members (Protocol of Buenos Aires);
- The 1994 Protocol of Colonia for the Reciprocal Promotion of Investments inside MERCOSUR.

Although both Protocols encompass the same type of provisions (definitions, treatment and protection of investment, dispute settlement), they differ substantially in the sense of a higher degree of liberalization towards Members comparing to non-Members.

### **Caribbean Community (CARICOM)**

The Caribbean Community and Common Market (CARICOM) was established by the Treaty of Chaguaramas, which was signed by Barbados, Jamaica, Guyana and Trinidad & Tobago, coming into effect in 1973. Subsequently, other Caribbean territories joined CARICOM: Antigua and Barbuda, Bahamas, Belize, Dominica, Grenada, Haiti, Montserrat, St. Kitts and Nevis, Santa Lucia, St. Vincent and the Grenadines, and Suriname.

Between 1993 and 2000, the Inter-Governmental Task Force (IGTF) which was composed of representatives of all Member States, produced nine Protocols, for the purpose of amending the Treaty with a view of creating and enforcing a single market and economy. These nine Protocols were later combined to create a new version of the Treaty, called formally, the Revised Treaty of Chaguaramas Establishing the Caribbean Community, Including the CARICOM Single Market and Economy.

Protocol II, on the **Rights of Establishment, Provision of Services and Movement of Capital** includes relevant provisions on investment, such as national treatment, compensation for losses, and transfers.

## **4 AFRICAN AND WEST-ASIAN AGREEMENTS**

**African economic cooperation** includes the establishment of economic communities such as: Economic Community of West African States, ECOWAS (1975), Common Market for Eastern and Southern Africa, COMESA (1994), Southern African Development community, SADC (1980), Economic Community of the Countries of the Great Lakes, CEPGL (1976), Union Economique et Monétaire Ouest Africaine, UEMOA (1994), Communauté Economique et Monétaire de l'Afrique Centrale, CEMAC (1994). Some of

them have developed or are developing investment instruments, such as the Common Convention on Investments Customs and Economic Union of Central Africa (UDEAC, precursor of CEMAC) in 1965. In a move towards strengthening the integration process of countries members of the Common Market for Eastern and Southern Africa (COMESA), the COMESA Common Investment Area was signed, with the objective of establishing a free investment area by 1 January 2010.

In West Asia, an agreement within the Council of Arab Economic Unity established in 1964 the Arab Common Market. Relevant investment related provisions can be found in the **Agreement on investment and free movement of Arab capital among Arab countries (1970)**. Added to that, the **Convention establishing the inter-Arab Investment Guarantee Corporation**, entered into force in 1974, with membership of all Arab countries (except Comoros Islands). To achieve the aim of promoting inter-Arab investments and trade, the Corporation has developed a guarantee scheme offered to Arab investors.

## 5 EUROPEAN AGREEMENTS

### European Union (EU)

The EU Member States have set up common institutions to which they delegate some of their sovereignty so that decisions on specific matters of joint interest can be made at European level. This pooling of sovereignty is also called "European integration". Initially, the EU consisted of just six countries, then it was enlarged to 15; in 2004 the biggest enlargement took place with 10 new countries joining.

The EU single market is based on the free movement of goods, persons, services and capital. Although investment is not included specifically, provisions related to free establishment and to free movement of capital have an impact on foreign investment.

### Organisation for the Economic Co-operation and Development (OECD)

The OECD began as a group of 20 developed countries in 1960, but since then has expanded to include former transition economies and some developing countries. The OECD has a significant history in efforts to develop international rules relating to capital movements, international investment and trade in services. In this respect, OECD produces internationally agreed instruments, decisions and recommendations to promote rules of the game in areas where multilateral agreement is necessary for individual countries to make progress in a globalised economy. These instruments are regularly reviewed and updated.

- **Codes of Liberalisation:** The Code of Liberalisation of Capital Movements and the Code of Liberalisation of Current Invisible Operations constitute legally binding instruments. They aim at reducing obstacles to the current payments and maintain and extend the liberalisation of capital movements. Taken together, these two Codes serve to liberalize a broad range of transfers relating to investments. Implementation of the Codes, in particular by removal of restrictions on cross-border capital flows and trade in services and the concomitant lifting of country reservations against the Codes, involves "peer pressure" exercised through policy

reviews and country examinations to encourage unilateral rather than negotiated liberalisation. The latest update of the Codes dates from September 2004.

- **Declaration and Decisions on International Investment and Multinational Enterprises:** The 1976 Declaration on International Investment and Multinational Enterprises constitutes a policy commitment to improve the investment climate, encourage the positive contribution that multinational enterprises can make to economic and social progress, and minimise and resolve difficulties that may arise from their operations. All 30 OECD member countries, as well as nine non-member countries have subscribed to the Declaration. The Declaration consists of four elements, each one of these elements being underpinned by a Decision by the OECD Council concerning the follow-up procedures: the Guidelines for Multinational Enterprises; National Treatment; Conflicting Requirements; International Investment Incentives and Disincentives. All parts of the Declaration are subject to periodical reviews. A major review of the Guidelines for Multinational Enterprises was completed in June 2000.
- Draft Multilateral Agreement on Investment (MAI): although it has not met the consensus of the member countries, the draft MAI remains a useful reference for analysing and drafting various types of investment provisions.

## 6 INTER-REGIONAL AGREEMENTS

Besides many agreements between a REIO (namely the EU) and third countries, there are also significant agreements negotiated between two blocs of countries.

Perhaps the most important trade agreement outside the WTO agreements is the African, Caribbean and Pacific (ACP) and the European Union (EU) relation under the **Cotonou Agreement** signed in June 2000, as a successor to the Lomé Convention, which had guided these relations since 1975. The Cotonou Agreement is a global and exemplary agreement, introducing radical changes and ambitious objectives while preserving the 'acquis' of 25 years of ACP-EU cooperation. It is based on five interdependent pillars with the underlying objective of the fight against poverty: an enhanced political dimension, increased participation, a more strategic approach to cooperation focusing on poverty reduction, new economic and trade partnerships and improved financial cooperation. The Cotonou Agreement provides for a revision clause, which foresees that the Agreement is adapted, every five years. The EU is currently negotiating Economic Partnership Agreements (EPAs) with 5 blocs of ACP countries: Central Africa (namely CEMAC), South Africa (namely SADC), West Africa (namely ECOWAS), Eastern and Southern Africa (ESA), the Caribbean countries and the Pacific countries.

The EU is currently negotiating an **Association Agreement with MERCOSUR**, which aims at creating a free trade area between the two blocs. Other preferential agreements signed by the EU with third countries include the association agreements within the **Euro-Med** partnership. Liberalization of trade in services and investment, including the right of establishment, is among the key objectives in these agreements.

Source: UNCTAD 2006.