

PART I. BACKGROUND

Chapter 1

Introduction

1.1 The rationale for a guide to international investment agreement provisions for developing countries based on sustainable development

1.1.1 Exploring how international investment agreements can do a better job of promoting foreign investment and accommodating appropriate host state regulation

Whether and how to negotiate international investment agreements (IIAs) are significant policy issues for virtually all countries. Most IIAs in place today are bilateral investment treaties (BITs) between capital-exporting developed countries and capital-importing developing countries. Developed countries are interested in the protection that these treaties offer to their investors operating in host developing countries. Developing countries hope that by committing to provide protection, IIAs will improve the prospects for future inflows of foreign investment. This has been called the ‘grand bargain’ of BITs.¹

However, there is reason to doubt the value of the bargain represented by existing IIAs. Evidence of the link between entering into IIAs and increased foreign investment inflows, the main benefit sought by developing countries, is weak. In addition, investment inflows have not always contributed to sustainable development.² At the same time, critics assert that the forms of IIA typically sought by developed countries can constrain the ability of host developing countries to regulate foreign investors operating within their borders. IIAs may make it difficult for countries to achieve essential public policy objectives, including their development goals and the maintenance of environmental, human rights and labour rights standards.³

The constraints that IIAs impose on host states, combined with costly, inconsistent and sometimes surprising decisions by investor–state arbitration tribunals regarding the meaning of broadly worded IIA obligations, have led many countries to rethink what obligations an IIA should include. In some cases, countries have revised the models that they use as the basis for negotiations. A few countries, such as Ecuador, have sought to terminate their obligations altogether.

1 For example, J W Salacuse and N P Sullivan (2005), ‘Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain’, 46 *Harvard International Law Journal* 67.

2 K von Moltke and H Mann (2005), *A Southern Agenda on International Investment?: Promoting Development with Balanced Rights and Obligations for Investors, Host States and Home States*, International Institute for Sustainable Development, Winnipeg.

3 M Sornarajah (2010), *The International Law of Foreign Investment*, 3d ed., Cambridge University Press, Cambridge.

This guide (the ‘Guide’) is designed to assist developing countries to negotiate IIAs that do a better job of promoting their sustainable development. It explains how IIAs can increase foreign investment flows into developing countries and addresses how these agreements can support the efforts of host developing countries to regulate foreign investment inflows in order to ensure that they contribute to sustainable development.

The Guide achieves these goals by:

1. Identifying emerging best practices in existing agreements;
2. Suggesting new and innovative provisions;
3. Acting as a resource for developing country negotiators; and
4. Describing how states can achieve coherence among their IIAs.

1.1.2 Identifying emerging best practices

New model agreements contain innovative provisions of which developing countries should be aware. The international regime for investment, composed principally of more than 3,000 BITs and preferential trading agreements with investment provisions, has matured to the point at which there is broad consensus on many of the core categories of investor protection obligations. At the same time, the specific content of these obligations is evolving in important ways. Model agreements recently adopted by some countries in response to the growing number of investor–state arbitration cases incorporate innovations that strike a better balance between investor protection and the preservation of policy-making flexibility for party states. These models provide useful new approaches to incorporating sustainable development into IIAs.

Also, IIAs are being negotiated in increasingly diverse contexts. For instance, developing countries are negotiating more IIAs amongst themselves in bilateral and regional groupings. At the same time, a growing number of developing countries are becoming exporters of capital as well as importers. Some agreements between developing countries provide alternative approaches to the provisions that could be included in other investment agreements.

The Guide identifies emerging best practices from existing treaty models and discusses the costs and benefits of the different approaches they represent.

1.1.3 Identifying new kinds of provisions

As noted, evidence on the effects of IIAs on foreign investment flows is weak. The Guide includes examples of new, more effective ways to encourage investment flows. For instance, the traditional investor protection provisions that dominate existing IIAs could be supplemented with provisions that require technical assistance from investors’ home states to support the development of transparent and effective regulatory schemes in host states that will be more predictable and less burdensome for investors. In addition, provisions could be included in an IIA to require home states to directly facilitate investment in host states by their investors.

The Guide also discusses new sorts of provisions that are designed to preserve the ability of states to regulate investment in a manner that ensures that foreign investment is harnessed to achieve development objectives without creating strong disincentives to investment. Such provisions may be useful to host states hoping to use IIAs more effectively to achieve sustainable development.

1.1.4 Supporting developing country negotiators

In addition to suggesting new provisions that may lead to a better bargain for developing countries than existing IIAs, the Guide is intended to be directly useful for countries negotiating new IIAs. There are often significant differences in economic and political power between developed and developing countries. Negotiators from developing countries frequently lack experience with IIAs, compared with their developed country counterparts. The information and analysis provided in the Guide helps to redress these chronic inequalities of bargaining power between developed and developing countries. The Guide aims to compensate in a modest way for the inadequate resources that developing countries can devote to evaluating the effects of entering into an IIA on investment flows and on their social and economic policies.

Inequalities between developed and developing countries are more easily exploited when negotiations are based on a pre-existing IIA model drafted by developed countries with only their interests in mind. When such a model is used, it can be difficult for developing countries to deviate from it. The Guide will make it easier for developing countries to negotiate IIAs consistent with their sustainable development objectives. The provisions that are discussed provide alternatives to existing IIA models that may be a new starting point for negotiations. In addition, the Guide will be a useful reference tool during negotiations to evaluate the costs and benefits of different approaches.

In addition to IIA negotiators, the Guide aims to support those implementing investment treaties and those involved in activities that may be subject to treaty obligations, including investment promotion agencies, domestic policy-makers and legislative drafters. Officials in government legal departments and others who may be called on in the event of a claim made under an IIA may also find the Guide helpful.

1.1.5 Enhancing policy coherence

Almost every country is a party to at least one IIA, and states continue to negotiate new agreements. The more IIAs that a country enters into, the more likely it is that conflicting obligations will arise. To avoid such conflicts, IIAs must be compatible. It is impossible to achieve perfect compatibility. Every agreement will reflect the unique result of negotiations between states. However, the Guide is intended to support consistency in investment treaties and will encourage greater policy coherence by improving understanding of the nature and effect of obligations, both in existing treaties and those being negotiated, and of how IIA obligations interact with each other. The Guide also discusses how to ensure coherence between IIAs and domestic policy on investment with a view to ensuring that IIA commitments support domestic policy goals.

1.2 What is in the Guide?

The first few sections of the Guide provide an overview of the context for IIA negotiations. They discuss:

- The basic purposes of international investment agreements;
- Links between IIAs and inward investment flows; and
- Links between investment inflows and sustainable development.

This overview will assist users of the Guide by identifying some of the objectives of both developed and developing countries in negotiating IIAs and explaining the need for new kinds of IIA provisions. In addition, the ways in which the Guide addresses this need are introduced.

The remainder of the Guide discusses options for IIA provisions, including samples of specific provisions, along with a discussion of their costs and benefits. These examples are not intended to be prescriptive. Each state must determine what bundle of commitments is appropriate given its unique circumstances, including its policies regarding openness to foreign investment and its capacity to regulate investment. The sample provisions are included primarily to illustrate how sustainable development policies, such as the protection of the environment or the promotion of human rights, could be better achieved through the innovative drafting of IIA provisions.

The provisions discussed in the Guide fall into three general categories:

- **Core investor protection obligations:** These are the obligations found in most existing IIAs. They include for example, national treatment, most favoured nation (MFN) treatment, fair and equitable treatment, compensation for expropriation and limits on restrictions on the transfer of funds by investors. Provisions in this category are the traditional host state obligations to investors. Like most international obligations, these provisions do impose some constraints on host state freedom to regulate. The Guide discusses more nuanced, sophisticated and balanced versions of these core obligations that increasingly have been adopted in national IIA models and that provide greater and more certain freedom for host state regulation to achieve domestic policy goals. The Guide also discusses the prospects for qualifying and limiting investor protection commitments through reservations and exceptions.
- **Investor protection obligations not found in most treaties:** These include provisions such as prohibitions on performance requirements that are found only in some IIAs. While these may have a positive impact on investment flows, they raise other policy issues for host countries, including concerns about their impact on a state's flexibility to adopt measures to obtain its development objectives.
- **New obligations to promote sustainable development:** The Guide provides examples of new kinds of obligations, such as obligations on home states and investors, that depart substantially from provisions in traditional IIAs, and are designed to better ensure that states can achieve their development goals, including attracting increased foreign investment. However, in some cases these

innovative provisions may discourage foreign investment in seeking to promote sustainable development.

1.3 What is not in the Guide?

The Guide does not compare IIAs with investment contract commitments or insurance that may be used as substitutes for, or complements to, IIA obligations as ways to encourage investment. The Guide's focus on IIAs does not suggest, however, that IIAs constitute the best or only approach to attracting and retaining foreign investment. Other forms of commitment may be preferable in some circumstances. For example, investment contracts have some advantages over IIAs. Unlike investment treaties, investment contracts can be used to bind the investor to specific commitments to the host state. In addition, it is easier for a state to assess the costs and benefits of specific transactions than to make this kind of assessment for the wide range of investments typically covered by an IIA. In an IIA, a state accepts broad commitments in relation to an unlimited number of future investments of various kinds by foreign investors for a long period of time, subject only to any limitations in the treaty. Even though they may be better in some cases, contract commitments and other strategies to attract investment are simply outside the scope of the Guide.

The goal of the Guide is modest. Rather than surveying all possible approaches to attracting investment, it aims to help developing countries with existing IIAs and the negotiation of new ones. In this regard, the Guide tries to address a significant practical challenge. Despite the potential utility of contracts and other alternatives to IIAs, developing countries will continue to be confronted with opportunities, and in some cases pressure, to negotiate IIAs. The Guide does not suggest that all countries will be better off negotiating IIAs. Some countries may determine that the costs of IIA commitments exceed the benefits and decide not to enter into these agreements. The discussion in the Guide should assist countries considering that option. The main purpose of the Guide, however, is to provide a source of useful information and analysis for countries that have negotiated, or are considering negotiating, IIAs.