Chapter 2

The Context for International Investment Agreement Negotiations

2.1 Existing IIA practice

2.1.1 Why states sign IIAs

This section explains the basic reasons states decide to enter into IIAs and how these reasons inform the negotiating positions of the parties. The basic purposes of existing IIAs can be simply stated as follows:

- To protect foreign investors from a treaty party state (the investor's *home state*) against discriminatory or unfair treatment by governments in the other party state (the *host state*);
- To ensure that the host state legal regime for foreign investors from the home state is stable, transparent, consistent and fair; and
- To promote foreign direct investment in host states by providing these protections to investors from the home state.[1]

The main way in which these purposes are achieved in existing IIAs is through provisions designed to protect foreign investors. The prospect of increased foreign investment inflows is only an incidental and, as discussed in Section 2.2 (Links between signing IIAs and attracting increased foreign investment), somewhat uncertain result of granting investors the protection that is provided for in IIAs.

In particular cases, developing countries will have a wide range of other motivations for entering into IIAs. Some may want to use investment treaties as a kind of external constraint to lock in domestic market-opening reforms, as well as to signal this intention to foreign investors from all states. Signing an international treaty makes it more difficult for the government to change its policies, laws and regulations regarding foreign investors.

Countries may negotiate an IIA as a way of keeping up with other developing countries that have signed agreements. Virtually all countries seek foreign investment, and the network of IIAs is already large and continually expanding. The competition

1 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. Some BITs concluded with the United States and Canada, and more recently with Japan, contain commitments regarding access to host state markets (UNCTAD (2007), *Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking*, UN publication, Sales No. E.06.II.D.16 at 23, United Nations, New York and Geneva).

for investment can be intense.[2] A country may seek to sign an IIA with a developed country that has already signed IIAs with neighbouring countries as a strategy to ensure that it is not discriminated against in the competition with its neighbours to attract investors from the developed country.

Countries may view signing a BIT with another country as a first step towards establishing a closer economic relationship with that country on a broader basis, possibly including entering into a comprehensive preferential trading agreement. The existence of a BIT between a developed and a developing country has been shown to increase the odds that they will enter into a preferential trading agreement. In addition, the combination of a BIT and a preferential trade agreement has been shown to attract more investment than a BIT alone.[3] Finally, a factor that often contributes to a developing country's desire to sign a BIT is pressure from the other party seeking protection for their investors.

While the desire to lock in openness to investment, keep up with the competition, build goodwill to pave the way for preferential trade agreements or respond to the pressure of other states may all play a role in some cases, the express purpose of all IIAs is the protection and promotion of foreign investment.

Box 2.1 Typical provisions in a bilateral investment treaty

1. Definitions and scope of agreement provisions
2. Basic investor protection obligations
   - National treatment
   - Most favoured nation (MFN) treatment
   - Fair and equitable treatment
   - Prohibition on expropriation without compensation
   - Prohibitions on restrictions on transfer of funds
3. Reservations and exceptions
   - General exceptions

(Continued)

2 Z Elkins, A Guzman and B Simmons (2006), 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960–2000', 60 *International Organization* 811.

3 J Tobin and M Busch (2010), 'A BIT is Better than a Lot: Bilateral Investment Treaties and Preferential Trading Agreements', *World Politics* 62, 1–42. In the past, BITs may have been signed on behalf of a government for political reasons, such as an opportunity for a government leader to demonstrate a general interest in an improved economic relationship with the other party state. Since most developed countries had a standard form of agreement, it was easy to put together a treaty to sign. Now that investor–state arbitration has made the costs of investment treaties much clearer, it seems unlikely that this practice will persist.

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- Annexes setting out reservations for existing measures and areas of regulation

4. Transparency requirements
5. Investor–state dispute settlement

The relative importance of protection and promotion, however, are typically quite different for IIA parties. This may not be obvious from the form that these agreements take. In all existing investment treaties, the obligations are stated to be mutual and reciprocal in nature. That is, subject to some reservations,[4] the same protections that Canada agrees to give to investors from Trinidad and Tobago under the foreign investment protection agreement between the two countries must be provided by Trinidad and Tobago to investors from Canada. However, capital-exporting countries such as Canada are typically interested in securing protection for their investors, whereas the dominant motive for most capital-importing countries to sign an IIA is to increase foreign investment from capital-exporting treaty partners.

In the context of an IIA negotiated between a developed country and a developing country, there will usually be few investors from the developing country party with investments in the developed country party that will benefit from protection under the IIA. In such cases, the parties rarely expect that an IIA will induce investment from the developing country into the developed country. In this situation, there is very little cost to a developed country from entering into the treaty. It will never be called on to fulfil its investor protection obligations.

Developing countries, on the other hand, are interested in foreign investment from developed countries to stimulate economic development and contribute to host state revenues, providing them with the resources needed to alleviate poverty and, more generally, to achieve their political, social and economic goals. In order to try to attract investment, they subject themselves to the obligations to protect investors set out in the IIA, even though the investor protection obligations may impose real constraints on domestic policy-making flexibility.

Where developing countries are negotiating IIAs with each other, they may have interests both as capital exporters in investor protection and as capital importers in attracting investment. In 2010, 30 per cent of outward investment originated in developing countries. Some developing countries, such as China, have significant interests as exporters of capital to developed countries. In short, while, traditionally, developing countries have negotiated IIAs as capital importers, more and more developing countries have interests as exporters too, especially in their negotiations with neighbouring developing countries.

4 Where reservations are permitted in a treaty, different reservations taken by each state result in some formal asymmetry of obligations.

2.1.2 Why investors want IIA protection

It is important to appreciate the concerns that investors from developed countries have about protecting their investments because these concerns inform the demands and expectations of developed countries during IIA negotiations. Investors from capital-exporting developing countries are likely to have the same concerns.

Investor concerns regarding the risk of arbitrary and discriminatory treatment by host states

Fundamentally, foreign investors are concerned about the risk of arbitrary and discriminatory treatment by domestic governments in host states. IIAs create standards of behaviour for the host states in which investors operate that reduce the risk of such treatment and, more generally, promote a secure and predictable legal regime for investors.[5] Investors cite several reasons for their concerns and the need to have IIA provisions to address them.

Weak protection for investors under host state domestic law and under customary international law: Investors may be concerned that customary international law[6] does not provide sufficient protection for foreign investors to guarantee them a stable investment environment. For example, virtually all IIAs prohibit expropriation without certain procedural guarantees being met and require compensation to be paid. It is argued that such treaty provisions can guarantee a higher and more certain standard of compensation than weak and contested customary international law standards.[7] Foreign investors may also be concerned that domestic law standards of treatment in a host state provide inadequate protection of their interests. IIAs can create higher, more comprehensive and more effective standards for investor protection that operate independently of domestic law in host states.

Host state incentives to treat foreign investors will diminish after the investment is made: One of the most important motivations for seeking protection against host state actions through IIAs is to overcome what has been described as the problem of 'dynamic inconsistency' or the 'obsolescing bargain'.[8] Countries seeking to attract foreign investment have an incentive to liberalise their domestic regimes and take other steps to encourage investors to locate within their borders. However, once investments have been made, host countries may be tempted to make their regimes less

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5 D L Swenson (2005), 'Why Do Developing Countries Sign BITs?', 12 *University of California Davis Journal of International Law and Policy* 131.

6 Customary international law is international law that exists independent of treaty law and is composed of 'rules of law derived from the consistent conduct of States acting out of the belief that the law required them to act that way' (Shabtai Rosenne (1984), *Practice and Methods of International Law*, Oceana, New York, at 55).

7 UNCTAD (1998), *Bilateral Treaties in the Mid-1990s*, United Nations, New York and Geneva.

8 M Hallward-Driemeier (2003), 'Do Bilateral Investment Treaties Attract FDI? Only a Bit … and They Could Bite', World Bank Policy Research Paper, WPS 3121, World Bank, Washington, DC, at 2; R Vernon (1971), *Sovereignty at Bay: The Multinational Spread of US Enterprises*, Basic Books, New York.

favourable to foreign investors or even to expropriate foreign investments. They may be pressured by domestic investors or civil society groups to give preferential treatment to local investors, or they may wish to acquire a profitable foreign investment and operate it as a state-owned enterprise or put it under the control of domestic investors.

One reason foreign investment is subject to the risk of this kind of government action is that foreign investment is often not very mobile. Once investors incur non-recoverable or 'sunk' costs that would be lost if the investor withdrew its investment before it generated significant returns, a state has some freedom to modify its rules to make the domestic environment less favourable to the foreign investor without causing the investor to leave. An investor that has partially constructed a mine in a country may not be able to recover its costs by selling the mine property if the local government changes the rules in ways that make the mine financially less feasible. In such situations, the host state has greater freedom to change its regime for foreign investors in order to extract greater benefits from them.[9] Concern about this dynamic inconsistency problem is one of the primary reasons that investors lobby their governments to negotiate IIAs. To some extent, commitments in IIAs restrain host countries from changing the rules in ways that are inconsistent with the basic expectations of foreign investors.

Some have questioned the significance of the dynamic inconsistency problem and the need to resort to IIAs to address it.[10] In almost every case, a country will be concerned about attracting investment, not just today, but also on a continuing basis in the future. Any country that wishes to be an attractive destination for foreign investment would be unwise to engage in the kinds of changes to its investment policy and practice that the problem of dynamic inconsistency would predict. On the other hand, states do make these kinds of changes from time to time.

Another reason to doubt the seriousness of the dynamic inconsistency problem is that there are a number of alternative ways for foreign investors to obtain protection against risks associated with state behaviour, including investment insurance and guarantees in investment contracts. Insurance for foreign investors against political risks associated with contracts with host states may be available from the World Bank's Multilateral Investment Guarantee Agency (MIGA) or national agencies in the investor's home state. In some cases, agencies in the host state may provide insurance. Political risk insurance may cover a variety of

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9 E Neumayer and L Spess (2005), 'Do Bilateral Investment Treaties Increase Foreign Direct Investment in Developing Countries?', 33 *World Development* 1567 at 1570.

10 J W Yackee (2007), 'Do BITs Really Work? Revisiting the Empirical Link between Investment Treaties and Foreign Direct Investment', Legal Studies Research Paper No. 1054, University of Wisconsin Law School. See also UNCTAD (2009), *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries*, United Nations, New York and Geneva, discussing the methodological problems with the empirical studies, at 56–8); K P Sauvant and L E Sachs (2009), 'BITs, DTTs, and FDI Flows: An Overview', in K P Sauvant, and L E Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows*, Oxford University Press, Oxford.

risks associated with state action, including expropriation of land, confiscation of assets and revocation of permits. Contractual protection can be tailored to address specific investor concerns about host state conduct. For example, an investor may be able to negotiate a promise by the host state not to change the rules that govern the investment.[11] This commitment may be backed up by an undertaking by the state to submit to arbitration if the investor claims that the state has not fulfilled its obligations.

An IIA may not be important for particular investors who can take advantage of these alternative forms of protection. However, these alternatives can result in additional costs for investors and states because they must be negotiated each time an investment transaction occurs. Once a treaty is negotiated, IIA protection operates to protect all investments by investors of a party state against actions of the other party state over a long period of time. Alternative arrangements are also less transparent than an IIA. Protections for investors negotiated in individual contracts may be known only to the parties, and their lack of transparency may increase the risk of corruption involving the government officials who negotiate them. In addition, if contracts are hidden from the public, democratic checks on government agreements with investors will be undermined.

It is hard to evaluate the extent to which IIAs are really necessary to attract foreign investment. As discussed, there are alternative mechanisms for protecting investors. In addition, reputational considerations may deter a government from changing policies in ways that are harmful to investors after they have made their investment. In practice, however, there is some evidence that investors view the investor protections in IIAs as important. The most obvious evidence is the large and continually expanding network of IIAs. MIGA and many national investment insurance providers, including those in France and Germany, require the existence of an IIA between the investor's state and the host state as a condition of their agreement to insure an investment, apparently because of their perception that IIAs play a role in mitigating the risk of state behaviour that will negatively affect investments. Some major transnational corporations, such as Dow Chemical, that have the sophistication and resources to negotiate protection directly with host states nevertheless view the presence of an IIA with a country as an important consideration when deciding whether to invest in the country.[12]

Investor concerns regarding the effectiveness, fairness and independence of host state courts and administrative tribunals and other remedies

Foreign investors are often sceptical about their ability to obtain relief from domestic courts and administrative tribunals when they complain about host state conduct. They may view domestic institutions in a host state as corrupt,

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11 This kind of clause is referred to as a 'stabilisation clause'.

12 Tobin and Busch, op. cit. More discussion of the evidence regarding the links between signing an IIA and attracting investment is provided in Section 2.2 (Links between signing an IIA and attracting increased foreign investment) and Appendix 1 to the Guide.

incompetent or not sufficiently independent of the state. Local civil procedures may not provide relief in a timely way or, if relief is obtained, the procedures for collecting compensation or other remedies may not be effective against the state and state agencies.

Traditionally, the only alternative to pursuing relief through domestic procedures for a foreign investor was to lobby its government to pursue the claim on its behalf. This is called 'state espousal' because obtaining relief was dependent on the investor's home state 'espousing' the investor's claim and raising it with the host state government. Relying on 'state espousal' has several disadvantages from an investor's point of view. The home state's interest in pursuing a claim on behalf of one of its investors against another state will depend on a number of factors, such as the economic and political importance of the investor and its investment, as well as a complex matrix of political considerations related to the relationship between the investor's state and the host state. Regardless of the merits of an investor's claim, these kinds of considerations may discourage a state from pursuing the claim.

As a consequence of concerns about the effectiveness of domestic procedures in the host state and the alternative of state espousal, investors urged their governments to negotiate for the inclusion of investor–state arbitration in IIAs. This dispute settlement mechanism allows a foreign investor from one party state to submit to binding arbitration a claim that another party state has breached its obligations under the agreement. Unlike state espousal, it is solely up to the investor to decide whether to initiate a claim, how to argue its case and whether to settle its claim. If the arbitral tribunal finds that the state complained against has breached its IIA obligations, it can make an award of financial compensation in favour of the investor against the state to compensate the investor for any loss that it suffered as a result. In addition to providing a process for investors to seek compensation in particular cases, the host state's agreement to submit to investor–state arbitration demonstrates a strong and credible commitment to comply with the obligations set out in the IIA for the benefit of investors from the other party state.

Critics of these procedures argue that the threat of investor–state arbitration has a chilling effect on domestic legislators, discouraging them from acting or implementing policies which, though they may promote legitimate policy goals, are, or even might be, contrary to IIA obligations. For instance, legislators might hesitate to terminate a concession granted to a foreign investor to provide some service, such as waste collection, with the goal of returning to the public delivery of the service, out of concern that the investor might claim that the termination is a breach of the fair and equitable treatment obligation in an IIA. This chilling effect is exacerbated by uncertainty regarding the standards for investor protection found in IIAs that has resulted from inconsistent and surprising decisions by investor–state tribunals. Another concern for states is the cost of investor–state cases. Damage awards in investor–state suits can be very costly. The expense of defending an investor–state claim can be considerable, even if the state is successful. For all these reasons, a state may try to manage its risk of claims being made by refraining from some kinds of regulatory initiatives. Nevertheless, despite these and other concerns about investor–state arbitration,

provisions for such a procedure are found in the vast majority of treaties currently in place and under negotiation.[13]

2.2 Links between signing IIAs and attracting increased foreign investment

Developing countries compete for foreign investment and many governments consider IIAs to be a necessary component of a strategy to attract it. But is this a good strategy? Do IIAs attract investment? It may seem surprising, but academics and others have only recently tried to determine whether signing a foreign investment treaty actually leads to increased foreign investment inflows. Proponents of IIAs have had to confront the brute fact that some developing countries, of which Brazil is the best example, have been extremely successful in attracting foreign investment from countries with which they do not have IIAs.[14] Other countries have signed IIAs and attracted little investment.

The success of some countries in attracting investment without having IIAs in place, and the failure of those that have signed them to attract investment, simply reflect the fact that there are a large number of variables that affect the decisions of foreign investors regarding whether to invest in a particular country. IIAs will never be more than one factor in investor decision-making.[15] There is no doubt that the domestic policy environment in a state, including its openness to investment and trade, efforts at investment promotion and involvement in preferential trading arrangements, as well as its transparency, are also significant factors. Market variables unique to each state are also important, such as:

- The size of and rate of growth of the domestic market;
- *Per capita* income;
- Geographical proximity to investors' home states; and
- The ease of investing in a market, including the availability, cost, reliability and quality of inputs into production, such as labour, electricity, telecommunications and the transportation infrastructure.

The relative importance of these factors will vary depending on the nature of the investor's investment. For example, an investor planning to set up a chain of retail stores to sell to the local market in a country will be more interested in the number of consumers and their *per capita* income than a mining company that intends to

13 A more detailed discussion of the costs and benefits of investor–state arbitration is set out in Section 7.1 (Investor–state dispute settlement) of the Guide. The consensus among developed countries on the desirability of investor–state arbitration was broken in 2011, when the Australian government announced it would no longer seek to have investor–state arbitration included in the IIAs it negotiates. Government of Australia (2011), 'Trading Our Way to More Jobs and Prosperity', Gillard Government Trade Policy Statement, Department of Foreign Affairs and Trade, at 14.

14 Hallward-Driemeier, op. cit.; Salacuse and Sullivan, op. cit.

15 A review of the studies of the effects of IIAs on investment flows is provided in Appendix 1 to the Guide.

export all of its production. The mining company will be more concerned about efficiency considerations, such as the cost and reliability of local power, and the quality and quantity of local mineral resources. Many global businesses try to allocate specific portions of their production process to countries in which that portion can be most efficiently carried out. This kind of business might allocate its research and development to one country, its component manufacturing to another country and final assembly to a third country. In each case, its investment decision will be based on distinct locational advantages in each country.

2.2.1 Empirical evidence

Researchers have recently tried to determine whether IIAs actually achieve one of their main goals: increased foreign investment flows into signatory countries. Studies have looked at two main expected effects on investment flows:

- **Commitment effect**: Signing an IIA creates an international commitment by a host country to comply with investor protection obligations in the treaty in relation to investors from the other party state. The expected effect is increased investment by investors from the other party state.
- **Signalling effect**: Signing an IIA sends a signal generally to foreign investors that a country is serious about protecting the rights and interests of foreign investors. The expected effect is increased investment from all countries.

To determine whether there is a commitment effect, studies have looked at investment flows between pairs of countries that have signed a BIT. Some of these studies show a significant positive correlation between a developing country signing a BIT with a developed country and increased foreign investment from that country. Other studies have found little or no evidence of such an effect. A similar inconsistency exists in studies seeking to determine if a signalling effect exists. Some studies have found a positive effect on total investment inflows into a country from all countries as a result of the country signing a BIT, while others have not. Most studies have found the other forms of treaties with investment provisions, such as preferential trade and investment agreements (PTIAs), have had a positive effect on investment inflows.

In some of the studies that found a positive relationship between signing an IIA and investment inflows, the results varied depending on particular circumstances. For example, several studies have found that the relationship between IIAs signed by a country and investment inflows to that country varied with the number of agreements entered into. At some point, signing an additional agreement was found to have little marginal effect.

Commentators have suggested that the inconsistency in the results of studies looking at the relationship between signing an IIA and investment inflows is due to problems with data and econometric modelling techniques.

2.2.2 Problems with empirical models

Most studies have looked simply at the correlation between IIAs and investment inflows and assumed that if the relationship was positive over time, meaning that

signing an IIA was associated with increased investment either from the IIA partner or generally from all countries, then it was the IIA that caused the increased investment. It is possible, however, that the reverse is true: higher levels of bilateral investment could encourage countries to negotiate IIAs rather than the other way around. This might occur, for example, where investors in a host state sought the protection of an IIA between their home state and the host state after making their investment, and their government then negotiated an IIA with the host state.

Alternatively, investment flows may be affected by variables that models have not taken into account. Most significantly, few studies to date have tried to control for the effect of investment-liberalising changes made by a host state to its domestic regime. Often such changes are made contemporaneously with entering into a BIT.[16] Where a study shows a positive relationship between signing a BIT and investment inflows, but does not try to eliminate the effects of pro-investment domestic reform, it may overstate the investment-inducing effect. Some of the new investment might be attributable to the changes to the domestic regime. While the impact of the changes to the domestic regime is uncertain, the failure to control for such an impact in an empirical study makes conclusions regarding the investment inducing effects of BITs unreliable.

In one of the few studies that have rigorously examined these kinds of problems, Aisbett concluded that it is impossible to say that IIAs caused increased investment flows.[17] In her view, the results found by some earlier studies are unreliable because they do not deal adequately with the possibility of reverse causation or other potential causes for the results observed.[18]

2.2.3 Problems with data

There are a number of problems with using existing data to explain the relationship between investment flows and signing investment treaties. The data on investment flows for certain sectors, such as services, and for some countries, particularly least developed countries, are not always comparable or reliable.[19] This is particularly true for data on bilateral flows.[20] Investment flow data are also plagued by problems associated with the complex organisation of transnational businesses. Sometimes investments may be identified as coming from a particular foreign country in which the entity making the investment is organised, but the real source of capital is another country. For example, an investment by an investor of one state may be identified as

16 J W Yackee (2007), op. cit. Studies have tried to address trade openness in their models. One study that tried to control for this found a positive correlation between IIAs and investment inflows (P Busse *et al.* (February 2008), 'FDI Promotion through Bilateral Investment Treaties: More than a BIT?', Kiel Working Paper No. 1403, Kiel Institute for the World Economy, Kiel).

17 E Aisbett (2009), 'Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation', in Sauvant and Sachs, op. cit.

18 Ibid.

19 J W Yackee (2010–2011), 'Do Bilateral Investment Treaties Promote Foreign Direct Investment?: Some Hints from Alternative Evidence', 51 *Virginia Journal of International Law* 397 at 410.

20 Ibid. at 410–11.

originating in another state if it has been flowed by the investor through a subsidiary organised under the laws of that other state that the investor controls. Such a structure might be adopted for various reasons, including seeking to take advantage of a low tax rate in the state in which the subsidiary is incorporated. Similarly, a national of a state may make an investment in their own state but flow the investment funds through a wholly owned subsidiary corporation organised under the laws of another state. This kind of 'round-tripping' investment may be recorded as a foreign investment from the other state, even though it is really a domestic investment. In connection with these kinds of investments, investment flow statistics may not accurately reflect the true source of an investment.

Also, the use of aggregate investment data may mask possible variations in the investment flow effects of IIAs from sector to sector. Different kinds of investments are likely to be affected by IIA commitments in different ways, though it is not clear what the effect will be. For example, investments in sectors where the international movement of capital is relatively easy, such as financial services, might be greatly affected by IIAs, while investments in sectors such as natural resources might not be affected by IIAs signed by a country that does not possess resources available for exploitation.[21] An alternative and opposite analysis is also possible. Investments with more sunk costs benefit more from the protections in an IIA. Thus investments in sectors such as natural resources, where sunk costs are higher, might be more affected by IIAs. Other sectors, such as financial services that involve significantly lower sunk costs that cannot be recovered if the investment is terminated, might be little affected by IIA protection. Also, it may be that small and medium-sized businesses value IIA protection more highly since large transnational corporations are often in a position to negotiate for commitments directly from the state.[22] None of these kinds of considerations have been accounted for in the models used to date, even though it seems likely that the impact of an IIA will vary depending on the type of investment.

2.2.4 IIAs with different strengths

Studies that use long-term data lump together treaties with varying provisions that may provide quite different levels of protection for investors.[23] In particular, many early

21 This is suggested by Swenson, op. cit. Busse et al., op. cit., came to the opposite conclusion in their study (at 23).

22 UNCTAD (2009), *Role of International Investment Treaties*, op. cit., at 52–3.

23 Swenson, op. cit. Swenson developed a model that looked at the investment effects of signing a BIT, including effects occurring not only just after the BIT was signed, but also for a period prior to signing during which investment might be stimulated by the anticipated signing of the agreement. She also attached more weight to lag effects than do some other models. She found that new BIT signings in the early 1990s were not positively related to increased FDI, but that signings of BITs in the late 1990s were positively related. In contrast, T Siegmann (2007), 'The Impact of Bilateral Investment Treaties and Double Taxation Treaties on Foreign Direct Investment,' University of St Gallen Law and Economics Research Paper Series, Working Paper No. 2008–22, found that BITs from 1985 to 1995 had a significant effect on investment flows, which treaties signed after 1995 did not.

treaties did not provide for investor–state arbitration, which significantly reduces the value of the investor-protection provisions in these treaties.[24] Few empirical studies control for the relative strength of IIA obligations. It may be that a more significant positive effect on investment inflows is associated with IIAs incorporating stronger commitments. However, studies that have looked at the effects of strong US BITs have come to conflicting conclusions.[25]

2.2.5 Alternative evidence

In an attempt to address some of the methodological and data problems associated with the empirical studies discussed above, some researchers have surveyed investors to try to get a sense of the relative importance of the presence of an IIA for their decisions about where to invest. In a 2007 survey of transnational corporations for UNCTAD, more than 70 per cent of the respondents reported that the existence of an IIA with a country from which they would benefit did play a role in their decision about whether to invest in that country. Just fewer than 25 per cent of the respondents said that IIAs were relevant 'to a very great extent'. Only 23 per cent did not consider them 'at all.' Nine per cent of respondents answered 'don't know'.[26] Of 33 factors, the existence of an investment treaty ranked about in the middle in terms of its relative importance. It ranked higher in relation to investments in transition economies. Other surveys of the factors that corporate decision-makers take into account in deciding whether to invest in a country, however, have concluded that there is no evidence that IIAs are a significant factor in investors' decisions on where to invest.[27]

2.2.6 Conclusion

While a majority of studies to date have found a positive relationship between a country signing an IIA and increased investment into that country, other studies dispute those results on a variety of grounds related to problems with methodology and data. This does not necessarily mean that IIAs do not help to attract investment. Nevertheless, the conflicting evidence suggests that that if there is a role it is relatively small. Also, the impact of IIAs is likely to be complementary to other policies and circumstances that make a host country more attractive to foreign investors. The effect of signing an IIA may also vary depending on the nature of the investment.

In addition, whatever the evidence of benefits associated with concluding IIAs in the form of increased foreign direct investment (FDI) inflows, it is not clear that they are higher than the substantial costs developing countries incur in negotiating, signing,

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24 Yackee (2007), op. cit., at 413.

25 See Salacuse and Sullivan, op. cit. Salacuse and Sullivan found a strong positive effect associated with signing strong US BITs. See also K P Gallagher and M B L Birch (2006), 'Do Investment Agreements Attract Investment? Evidence from Latin America', *Journal of World Investment Law and Trade 7 at* 961. Gallagher and Birch find no evidence that signing a US BIT affected investment flows.

26 L Kekic and K P Sauvant (2007), *World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk*, Economist Intelligence Unit and the Columbia Program on International Investment, London and New York, at 96.

27 E.g. Yackee (2007), op. cit.

ratifying and complying with the obligations typically contained in such treaties. This caution is even expressed by some of those researchers who found that FDI inflows did result from IIAs.[28]

2.2.7 Guide features promoting investment

In response to the relatively weak evidence of the investment-inducing effects of existing IIA models, the Guide describes two features that are designed to stimulate more foreign investment than existing agreements in a more direct way. First, it discusses ways in which developed country parties can support the creation and implementation of a robust and transparent domestic regime for foreign investment in developing country parties. Such a regime should help to attract foreign investors by ensuring that their investments are subject to clear and predictable rules, as well as being more effective to obtain host country public policy goals. Second, the Guide discusses various obligations that can be placed on the investors' home states to promote investment in host states.

2.3 Links between foreign investment and sustainable development

In July 2008, the UN Secretary-General released a report that reviewed the implementation of the 2002 UN Monterrey Consensus on Financing for Development.[29] It concluded that action was needed to encourage larger and more consistent foreign investment flows to a broader group of developing countries and to ensure that investment activity led to development.[30] The need was described as particularly pressing for many small economies, which have seen growth rates decline compared with larger low- and middle-income states. How can the goal of increasing investment flows be linked to sustainable development? The Guide suggests various ways of achieving this.

To link foreign investment and sustainable development, the first task is to determine how investment and development are related, or how they ought to be related. Attracting foreign investment is an essential part of the development strategy of most developing countries. Important international instruments relating to sustainable development recognise that attracting foreign investment is crucial for developing countries to achieve economic growth that will translate into increased welfare for their citizens.[31] In addition, citizens naturally want to participate in the economic activities in their country, such as markets for goods, financial services and capital.

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28 Neumayer and Spess, op. cit., at 1583; T Büthe and H V Milner, 'Bilateral Investment Treaties and Foreign Direct Investment: A Political Analysis', in Sauvant and Sachs, op. cit., at 214.

29 UN Secretary General (2008), *The Latest Developments Related to the Review Process on Financing for Development and the Implementation of the* Monterrey *Consensus*, UN Doc. A/63/179.

30 Ibid. at para. 18.

31 Principle 12 of the *Rio Declaration on Environment and Development*, UN Doc. A/CONF/151/26 (Vol. 1).

Such access is an important aspect of the freedom that citizens of developing countries seek to achieve through their development policies.[32]

However, investment inflows alone cannot produce sustainable development. How can these inflows be directed towards promoting sustainable development policies? The answer depends in part on each state's development goals. Traditionally, IIAs have focused exclusively on investor protection as a way of encouraging investment, but they did not otherwise address development. In this section, we discuss alternatives to the traditional IIA model that adopt a different approach to sustainable development, and we demonstrate how IIAs can be used to achieve sustainable development goals.

2.3.1 Defining sustainable development and the right to development

To make the link between foreign investment and development, we first have to be clear on the meaning of a highly contested term 'sustainable development'.

'Sustainable development' can mean different things in different contexts. In *international environmental law,* it relates to the protection of the natural environment in order that future generations can continue to enjoy it as present generations do.[33] In *development and human rights* circles, its meaning is broader, encompassing environmental sustainability, but also equitable development to reduce poverty, improve the health of people throughout the world, promote peace, protect human rights and pursue gender equality.[34] From an *economic* point of view, achieving sustainable development entails liberalising trade and investment policy in order to facilitate the access of goods to markets and to stimulate foreign investment flows.

The United Nations has articulated a *right to development*. It incorporates many aspects of the definitions of sustainable development current in the environmental, human rights and economics literature. The UN approach has many facets that suggest different ways in which IIAs and investment link to sustainable development.

Box 2.2 The right to development

The various elements of the right to development are articulated in many international declarations and documents.

(Continued)

32 Amartya Sen (1999), *Development as Freedom*, Anchor, New York, at 6, 38–39 and 111–145. The five dimensions of freedom identified by Sen are: (a) political freedoms; (b) economic facilities; (c) social opportunities; (d) transparency guarantees; and (e) protective security (at 10).

33 World Commission on Environment and Development (1987), *Our Common Future*, UN Doc. GA/42/427, at 43.

34 UN Millennium Project (2005), *Investing in Development: A Practical Plan to Achieve the Millennium Development Goals*, Routledge, London, at 3. Arjun Sengupta defines the right to development as follows: 'The Right to Development, which is an inalienable human right, is the right to a particular process of development in which all human rights and fundamental freedoms can be fully and progressively realized' (A Sengupta, 'The Human Right to Development', in B A Andreassen and S P Marks (eds) (2006), *Development as a Human Right*, Harvard University Press, Cambridge, MA, 9, at 11.

(Continued)

Declaration on the Right to Development, Art. 1

UN Doc. A/Res/41/128 Annex (1987)

The Right to Development is an inalienable human right by virtue of which every human person and all peoples are entitled to participate in, contribute to, and enjoy economic, social, cultural and political development, in which all human rights and fundamental freedoms can be fully realized.

Vienna Declaration and Programme of Action

UN Doc. A/CONF/157.23 (1993)

[T]he right to development, as established in the Declaration [on the Right to Development], [is] a universal and inalienable right and integral part of fundamental human rights.

Report of the Independent Expert on the Right to Development, Dr Arjun Sengupta

UN Doc. E/CN.4/2000/WG.18/CRP.1 (11 September 2000) at para. 64.

The right to development 'is the right to a particular process of development that allows the realization of economic, social, and cultural rights as well as civil and political rights and all fundamental freedoms by expanding the capabilities and choices of the individual'.

2.3.2 Current IIAs do not link development and foreign investment

Existing IIAs focus on guaranteeing investor protection in order to stimulate foreign investment; few contain provisions designed to ensure that investment leads to development. Indeed, many have criticised IIAs as imposing constraints on the ability of host country governments to adopt the policies needed to promote sustainable development.[35]

IIAs can constrain the ability of host country governments to regulate foreign investors in a number of ways. First, an IIA contains international legal rules that in many cases trump the application of the domestic law of the host state to a foreign investor. For instance, the constitutional law of the host state may allow a government to expropriate the property of an investor without paying compensation if this property will be used for a public purpose such as to build a road or create a national wildlife preserve. However, most IIAs require the state to compensate the investor fully for the economic value of any property that the government takes regardless of the importance of the public purpose of the expropriation.

Second, because they create a separate regime of international legal rules that apply to foreign investors but do not apply to domestic investors, and because they create a

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

mechanism for foreign investors to seek compensation for the adverse effects of laws and regulations of the host state that does not exist in domestic law, traditional IIAs can make it difficult for developing countries to implement sustainable development policies if they impose losses on foreign investors.

To illustrate this point, recall that most IIAs create a mechanism for foreign investors of one treaty party to complain about laws and regulations that the government of the other treaty party has passed if they cause a loss to the investor by breaching an obligation in the agreement. The complaint mechanisms in the IIA are separate from the recourse available to a foreign investor in domestic law. For instance, a country may place a cap on the price of water in order to ensure that poor people can have access to a clean and safe source of drinking water. It may be possible for an enterprise, whether foreign or domestic, that owns a water utility to challenge this cap by using the domestic law of the host state, such as administrative law, contract law, property law or even constitutional law. However, a *foreign* investor protected by the IIA will have an additional option to challenge the cap: it may bypass the domestic law remedies and invoke the IIA to complain that the investor protections provided in the investment treaty have been violated. Such a claim will be accompanied by a demand for compensation from the host state. In consequence, the bases for seeking relief that are open to a foreign investor under an IIA are far broader than those open to a domestic investor, and pursuing these remedies might undermine the government's sustainable development policy.

Designing an IIA that does a better job of promoting sustainable development than traditional agreements is challenging. In part, this is because the relationship between foreign investment and sustainable development is not straightforward.

2.3.3 The costs and benefits of foreign investment for sustainable development

Studies of the link between foreign investment and economic development have so far been inconclusive; increasing foreign investment does not necessarily result in economic growth. These studies have found that the nature of the relationship between foreign investment and economic growth depends on a variety of factors that vary from one host country to the next.[36]

In part, variability in the impact of foreign investment is due to the fact that foreign investment can have both costs and benefits (see Box 2.3).[37] Foreign investment can

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36 Gallagher and Zarsky, for example, reviewed 11 studies and found that only two found a positive relationship between foreign investment and economic growth; one found a negative relationship; and the others concluded that the nature of the relationship depends on a variety of situation-specific factors (K P Gallagher and L Zarsky (2005), 'No Miracle Drug: Foreign Direct Investment and Sustainable Development' in L Zarsky (ed.) *International Investment for Sustainable Development: Balancing Rights and Rewards*, Earthscan, London; Sterling, VA, at 13). See also E S Prasad, R G Rajan and A Subramanian (November 2007), 'Foreign Capital and Economic Growth', NBER Working Paper, No. W13619, National Bureau of Economic Research, Cambridge, Massachusetts.

37 Some of the voluminous literature on the effects of foreign investment is referred to by Neumayer and Spess, op. cit.

supplement local sources of investment capital, contributing to increased employment and local tax revenues. It can also have a variety of positive spillovers, such as improving productivity and innovation in the domestic industry, transferring new technologies and production and management techniques to domestic producers, and creating better-paid jobs for local employees.

However, there may also be costs. Domestic investment may be crowded out, and domestic competition and entrepreneurship may be suppressed. Foreign investment could worsen income inequality as traditional industries atrophy, and workers from those industries may find it difficult to enter new ones. Investment may encourage the host state to rely on the exploitation of local natural resources of interest to foreign investors instead of developing other productive sectors of the economy.[38] In some cases, the activities of foreign investors have had a negative impact on the protection of the environment.[39]

The activities of foreign investors in host countries can have a significant impact on the promotion and protection of human rights. Tragic instances of the violation of human rights by foreign investors operating in developing countries are well known. International human rights law imposes obligations on states to protect and fulfil the human rights of individuals subject to their jurisdiction and to provide remedies for violations. States have a responsibility to regulate effectively the operations of foreign investors subject to their jurisdiction to ensure that they do not violate human rights. Few human rights treaties impose duties directly on non-state actors such as investors. For the most part, existing IIAs do not do so either.

The particular mix of costs and benefits of foreign investment for each country will depend on a host of local factors, including the nature and abilities of its human

38 The Secretary-General of the United Nations points out that 'foreign investment in natural resource exploitation [does] not automatically translate into durable development gains …' (UN Secretary General, *Latest Developments*, op. cit., at para. 16).

39 The former Sub-Commission on the Prevention of Discrimination and Protection of Minorities (now the Human Rights Council Advisory Committee) noted that foreign direct investment by transnational corporations can negatively interfere with a number of human rights, including 'the right of peoples to self-determination and to permanent sovereignty over their natural wealth and resources; the right to development; the right of everyone to a standard of living adequate for the health and well-being of himself and his family and the continuous improvement of living conditions; the right of everyone to the enjoyment of the highest attainable standard of physical and mental health; the right to full and productive employment; the right of everyone to the enjoyment of just and favourable conditions of work; the right to form and join trade unions, the right to strike and the right to bargain collectively; the right of everyone to social security; the right of everyone to enjoy the benefits of scientific progress and its applications …'. ECOSOC (1995), *The Realization of Economic, Social and Cultural Rights: The Relationship between the Enjoyment of Human Rights, in particular, International Labour and Trade Union Rights, and the Working Methods and Activities of Transnational Corporations*, UN Doc. E/CN.4/Sub.2/1995/11 para. 89. See S Joseph (1999), 'Taming the Leviathans: Multinational Enterprises and Human Rights', 46 *Netherlands International Law Review* 171, where she notes that 'in view of their vast economic power and ubiquitous presence, and consequent intrusion into many aspects of peoples' lives, it is not surprising that MNE activity can and does occasionally impact detrimentally on the enjoyment of internationally recognised human rights' (at 172).

capital, the effectiveness of its environmental, labour and human rights standards, its regulatory capacity and its ability to absorb technology. As well, while it is clear that foreign direct investment has the potential to aid development in developing states, positive development outcomes are not guaranteed because the activities of foreign investors are oriented towards the maximisation of profit and not the promotion of development.[40]

Because many elements of domestic policy affect how increased foreign investment flows translate into greater economic prosperity for citizens, the Guide does not prescribe provisions to strengthen the link between foreign investment and sustainable development. Instead, it highlights the potential policy implications of adopting different approaches to integrating sustainable development into IIAs in order to help decision-makers in developing countries adopt a suitable approach to IIA commitments. In addition, it points to resources such as international treaties, non-binding 'soft law' documents and the work of the UN Special Representative on Human Rights and Transnational Corporations that can be useful to governments in determining appropriate standards for foreign investors operating in their territories. Finally, the Guide addresses various steps that policy-makers can take in order to link their domestic sustainable development policy to the promotion of foreign investment. Box 2.3 summarises some of these steps.

Box 2.3 Integrating sustainable development into domestic policy on foreign investment

Over the last 60 years, developing countries have chosen to pursue different approaches to sustainable development. The purpose of the Guide is to help governments understand the link between their development policy and IIAs in order to enable them to promote their unique concept of development.

Examples of the link between sustainable development and investment

Positive links between development and investment: Foreign investment can spur economic growth, including through increased employment and positive spill-overs such as technology transfer. The economic benefits of these investments can be used to promote the development goals of the host state by providing government revenue for funding social programmes.

Negative links between development and investment: Foreign companies operating within the host state may:

- Pollute the environment;
- Fail to provide adequate working conditions or pay adequate wages;

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40 ECOSOC (1995), ibid., para. 91.

(Continued)

- Require workers to work unacceptably long hours;
- Violate the human rights of citizens of the host state;
- Instigate conflict with local communities or social groups;
- Be involved in government corruption and bribery; and
- Fail to involve indigenous peoples in decision-making and ignore their rights and interests.

Making investment work for development

To strengthen the link between investment and development and ensure that foreign investors contribute to the well-being of citizens in a host state, governments can do several things.

1. Review their development policy and determine what aspects of sustainable development are priorities for them.
2. Try to anticipate how foreign investment may affect the achievement of these priorities. This involves considering how the kinds of foreign investments the government wishes to attract may affect:
    a. The environment;
    b. Human rights;
    c. Labour rights;
    d. The rights of indigenous peoples;
    e. The interests of local communities;
    f. Social policies (e.g. human health, employment);
    g. Domestic financial policies.
3. Consult with local communities in which investments exist or are planned and seek their participation throughout the life-cycle of the investment.
4. Consult with industry stakeholders, as they understand local conditions that can inform government policy.
5. Review their country's international obligations in the areas of human rights, labour rights, environmental protection and the rights of indigenous peoples. The international agreements ratified by the state contain standards that can be used for setting benchmarks and establishing best practices for investors.
6. Put in place effective domestic regulations for foreign investors in order to prevent future problems, mitigate existing risks, hold investors accountable

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for past harms and enhance benefits of the investment for the community and for investors.

7. Include mechanisms in IIAs to ensure that the host state has the capacity to regulate and enforce compliance with the environmental, labour and human rights standards it has put in place and the capacity to protect the rights and interests of indigenous peoples.[41]

2.4 Making choices: sustainable development in the sample provisions in the Guide

2.4.1 A comprehensive and centrist approach to sustainable development

In drafting the Guide, the primary goal has been to illustrate various ways in which a traditional IIA can be modified to contribute to sustainable development. While the general approach of the Guide is to provide options and indicate their consequences for various areas of government policy such as finance, human rights and environmental protection, the Guide also includes sample provisions. These provisions are legal text that illustrates how investment and development policy translate into legal obligations in particular ways.

In order to draft these sample provisions and discuss the costs and benefits of different approaches, the Guide adopts a particular interpretation of sustainable development. It is important to be aware of this. As was explained above, countries may interpret 'sustainable development' in different ways; indeed, different interpretations will be required depending on whether a country is talking about trade policy, financial policy, environmental policy or social welfare policy. However, drafting sample text requires the definition of terms. In consequence, the Guide adopts a particular definition of 'sustainable development'. Instead of focusing purely on economic growth or environmental sustainability, it employs a holistic and comprehensive notion of development that encompasses a broad range of considerations such as environmental protection, human health and welfare, human rights and the rights of indigenous peoples.

The sample provisions reflect a comprehensive concept of sustainable development that is also centrist in its political approach and reflects the work of the United Nations Special Representative on the Right to Development. The approach to sustainable development in the Guide affirms that increasing foreign investment flows can be of benefit to developing countries, and it acknowledges that IIA investor protection provisions play a role in encouraging and promoting economic growth. However, it also acknowledges the potential negative effects of increased foreign investment

41 For a more comprehensive discussion of how to align investment policies with sustainable development see UNCTAD (2012), *Investment Policy Framework for Sustainable Development*, United Nations, New York and Geneva.

and the need to mitigate them. This approach is consistent with the international obligations that most countries have accepted by ratifying major international treaties in the area of human rights, labour rights, environmental sustainability and the rights of indigenous peoples. In taking on these obligations, countries accept part of the responsibility for regulating the negative effects of foreign investment.

2.4.2 Alternative approaches to sustainable development

The sample provisions do not adopt other interpretations of sustainable development that have been espoused by various developing countries and their advocates over the years. For instance, the Guide's use of 'sustainable development' does not reflect periodic calls for states to abandon the existing economic order despite the disadvantages that many developing countries suffer within this order.[42] Nor does it reflect any particular view about the historical origin of the inequality of the current international legal regime, which some development advocates trace to the history of colonialism and its continuing effects.[43]

At the other end of the spectrum from postcolonial approaches, the Guide does not adopt the view that every possible effort must be made to attract foreign investment to the exclusion of promoting environmental sustainability or important human rights. The sample provisions in the Guide reflect the view that foreign investment can be a means of promoting the economic growth that is necessary for citizens to pursue their goals. Economic growth can be properly managed so as to distribute its benefits and help alleviate poverty.

2.4.3 Supporting developing countries through co-operation and their integration into international decision-making

Although these alternative approaches to sustainable development are not reflected in their entirety in the sample provisions in the Guide, some of the concerns that animated the call for a 'new international economic order' and for overcoming the effects of decolonisation have been incorporated.

First, the sample provisions recognise the need to build partnerships and co-operation among IIA parties. A developing country's ability to participate effectively in IIA negotiations may be hampered by the country's lack of capacity, including inadequate information about the potential effects of the IIA, lack of expertise, lack of resources to implement the obligations set out in the IIA, and political and institutional weaknesses.[44] One way of overcoming these challenges is to promote co-operation

42 In 1974, two historic resolutions were passed by the United Nations declaring a New International Economic Order: The Declaration of a New International Economic Order (GA Res. 3201 and 3202 (S-IV), 1 May 1974 (adopted without a vote); and the Charter of Economic Rights and Duties of States (GA Res. 3281 (XXIX), 12 December 1974 (vote of 120–6, 10 abstentions).

43 See A Anghie (2005), *Imperialism, Sovereignty, and the Making of International Law*, Cambridge University Press, Cambridge, and A Escobar (1995), *Encountering Development: The Making and Unmaking of the Third World*, Princeton University Press, Princeton, NJ.

44 Ibid. at 93.

between developed and developing countries and among regional blocks of developing countries. The sample provisions in the Guide provide examples of how greater co-operation may be encouraged.

Second, the sample provisions promote full and effective participation of developing countries in global decision-making relating to investment. The cornerstone of co-operation is equality. The Brundtland Report, a classic statement of sustainable development dating from 1987, advocates that if the world is to move towards sustainable economic relations, international law should promote equality among states and eliminate inequalities in political power and influence between developing countries and large corporations.[45]

To reflect the emphasis in the Brundtland Report and other international legal documents on promoting international co-operation between developing and developed countries and between citizens and their governments, the Guide acknowledges the need for full and effective participation of developing countries in global decision-making in areas such as finance, technology transfer, debt management and trade policy. It also encourages consultation between communities and government by incorporating sample accountability mechanisms and by including examples of transparent processes for making decisions relating to investment.

2.4.4 Elements of sustainable development employed in the Guide's sample provisions

In adopting a comprehensive and centrist interpretation of sustainable development, the Guide relies on formulations of sustainable development that are broadly accepted by the international community.[46] In these formulations, economic growth is regarded as compatible with the preservation of the environment and positive social development[47] including the alleviation of poverty in developing countries.[48]

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45 One of the aspects of ensuring a fair balance between the responsibilities of investors and developing countries is to recognise the responsibilities of investors though mechanisms such as corporate accountability. This is set out in the *Johannesburg Declaration on Sustainable Development: From Our Origins to the Future: Plan of Implementation of the World Summit on Sustainable Development* (2002), UN Doc. A/CONF.199/20 [the *Johannesburg Plan*], at 15, para. 18; 38, para. 49; and 66, para. 140.

46 In particular, we have relied on the following: *Our Common Future*, op. cit.; *Rio Declaration on Environment and Development* (1992), UN Doc. A/CONF.151/26 (Vol. I); *Johannesburg Plan*, ibid.; and UN Millennium Project (2005), *Investing in Development: A Practical Plan to Achieve the Millennium Development Goals*, op. cit.

47 For instance, the *UN Declaration on the Right to Development* (1987), adopted GA Res. 41/128 UN GAOR, 41st Sess. at 3, Annex, UN Doc.A/Res.41/128 Annex, recognises that sustainable development encompasses more than just the environment. Article 1 states: 'The right to development is an inalienable human right by virtue of which every human person and all peoples are entitled to participate in, contribute to, and enjoy economic, social, cultural and political development, in which all human rights and fundamental freedoms can be fully realized'.

48 In 1998, the Commission on Human Rights, in a decision endorsed by the Economic and Social Council, established an Independent Expert on the right to development and an open-ended Working Group to monitor and report on progress in the implementation of the right to development. In his

The following is a list of some of the ways in which this concept of sustainable development is reflected in principles for regulating foreign investment. These principles have informed the drafting of the Guide:

1. Increase investment inflows through investment protection and promotion;
2. Develop transparent and effective regulation of investment;
3. Put in place effective laws and regulations in policy areas that have a nexus with investment;
4. Build partnerships and co-operation among IIA parties;
5. Promote full and effective participation of developing countries in global decision-making relating to investment;
6. Involve domestic stakeholders in developing sustainable investment policy; and
7. Facilitate the protection of the environment, human rights, labour rights and the rights of indigenous peoples.

2.4.5 Summary: the principles of sustainable development reflected in the Guide

The discussion and sample provisions in the Guide reflect the view that if foreign investment is to promote sustainable development, investment must contribute to meeting the needs of people in the host country. The Guide recognises the need to promote and protect human rights, the environment and other development priorities in a way that is consistent with both the home and host states' international obligations.

In addition, the Guide acknowledges that developing countries should have adequate technical preparation and proper information when negotiating investment agreements. There must be due regard for the political and institutional weaknesses of developing countries, and IIA commitments should reflect an effort to overcome

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third report, the Expert stated that the right to development is composed of many elements, including: 1. economic, social and cultural rights, including: (a) the right to food; (b) the right to health; (c) the right to education; (d) the right to housing. 2. civil and political rights. 3. poverty alleviation through sustained economic growth. 4. providing financial, technical and institutional resources that enable improvement in the well-being of the entire population and the realization of the rights to be sustained. The international community's commitment to the eradication of poverty is also clear in the endorsement of the *Millennium Development Goals* and the *UN Millennium Declaration* (*UN Millennium Declaration*, A/RES/55/2, adopted 18 September 2000). It is also recognised in documents relating to sustainable development (see *UN Framework Convention on Climate Change* (1992), 1771, *United Nations Treaty Series* 107, signed 9 May 1992, in force 21 March 1992, preamble; *The UN Convention on Biological Diversity* (1992), *United Nations Treaty Series* 79, preamble; and the *Copenhagen Declaration on Social Development* (1995), UN Doc.A/CONF.166/Res./1 paras. 6–7); International Law Association (2002), *New Delhi Declaration of Principles of International Law Relating to Sustainable Development*, Res. 3/2002, 209 UN Doc. A/57/329, reprinted in International Law Association, *Report of the Seventieth Conference, New Delhi 2002*, at 211–16, para. 2.4.

these. As noted, one of the Guide's primary purposes is to support developing countries in their IIA negotiations.

To ensure that international investment rules yield outcomes consistent with sustainable development, they should be developed through wide consultation with people in the host country,[49] and decisions about the negotiation, application and interpretation of agreements should be transparent and consistent.

2.4.6 Overview of mechanisms for promoting sustainable development discussed in the Guide

The Guide provides many options to those developing countries looking to integrate concepts of sustainable development into their international investment policy. Some of the provisions discussed are not found in existing IIAs.[50]

In addition to the broad-ranging discussion of the many approaches available to host states, the sample provisions illustrate some of these specific approaches such as:

a. **Encouraging investment:** IIAs can encourage investment by providing core investor protections[51] supported by investor–state arbitration,[52] and by imposing obligations on investors' home states to promote investment in host states and to provide technical assistance for them to develop robust, transparent and effective regulatory schemes.[53]

b. **Protecting the regulatory flexibility of host states to achieve their development goals:** IIA provisions can be designed that do not prevent host states from achieving their development goals. The Guide contains the following suggestions:

   - Identifying sustainable development as the main goal of the agreement and explicitly recognising the right to regulate to achieve sustainable development in the IIA's preamble and statement of objectives;[54]
   - Drafting the substantive obligations in IIAs to provide flexibility to regulate to achieve sustainable development;[55] and

49 See *New Delhi Declaration*, op. cit., Principle 5.1; see also A Boyle and D Freestone (1999), 'Introduction', in A Boyle and D Freestone (eds), *International Law and Sustainable Development: Past Achievements and Future Challenges*, Oxford University Press, Oxford, at 15–16.

50 UNCTAD notes that there is an emerging trend for investment agreements to include provisions designed to achieve non-economic objectives such as the protection of health, safety, the environment, and human and labour rights (UNCTAD (2007), *Bilateral Investment Treaties 1995–2006*, op. cit.). The Guide discusses provisions that are part of this trend, but also those that go beyond existing agreements.

51 See Chapter 5 (Substantive Obligations of Host States Regarding Investor Protection).

52 See Section 7.1 (Investor–state dispute settlement).

53 See Section 8.2 (Technical assistance).

54 See Section 4.2 (IIA preambles).

55 See Section 5.3 (National treatment), Section 5.4 (Most favoured nation), Section 5.5 (Fair and equitable treatment and the minimum standard of treatment), Section 5.6 (Limitations on expropriation and nationalisation), Section 5.7 (Compensation for losses), Section 5.8 (Free transfer of funds), Section 5.10 (Transparency).

- Including exceptions and reservations in the IIA to ensure that legitimate state measures intended to promote development are not contrary to it.[56]

c. **Partnerships with the investors' home states to support sustainable development:** IIAs can create obligations on investors' home states to support the efforts of host states to regulate in pursuit of sustainable development. The obligation to provide technical assistance for the development and implementation of host state regulatory schemes is just one example.[57]

d. **Sustainability assessments:** IIAs provisions can be designed to require that foreign investors conduct a sustainability assessment of their investment that takes into account the environmental, social and human rights impacts of proposed investments. This assessment can be used to create a management plan designed to ensure that the investments contribute to sustainable development on an ongoing basis.[58]

e. **A grievance procedure:** An IIA can include a grievance procedure for people negatively affected by an investment.[59]

f. **Standards for investors:** IIAs can contain standards that foreign investors must meet, including requirements to comply with the domestic law of the host state,[60] to meet human rights standards[61] and core international labour standards,[62] as well as to avoid complicity in grave violations of human rights[63] and refrain from bribery and other forms of corruption.[64]

g. **Developing domestic measures and enforcement mechanisms for promoting sustainable development in the host and home states:** In order to ensure that foreign investors (who are not parties to the treaty) are accountable for their actions in the host country, IIAs can be designed to require the host state and the investor's home state to:

    - Provide in their domestic laws for appropriate levels of environmental protection and the protection of human rights, labour rights and the rights of indigenous peoples in accordance with their international obligations;[65]

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56 See Section 5.12 (Reservations and exceptions).

57 See Section 8.2 (Technical assistance).

58 See Section 6.6 (Sustainability assessments).

59 See Sections 6.6 (Sustainability assessments) and 6.13 (Enforcement of investor obligations).

60 See Section 6.7 (Investor obligation to comply with the laws of the host state).

61 See Section 6.8 (Investor obligation to respect internationally recognised human rights and undertake human rights due diligence).

62 See Section 6.10 (Investor obligation to comply with core labour standards).

63 See Section 6.9 (Investor obligation to refrain from the commission of, or complicity in, grave violations of human rights).

64 See Section 6.11 (Investor obligation to refrain from acts, or complicity in acts, of bribery and corruption).

65 See 6.12 (Other rights and obligations of party states).

- Impose criminal liability for investor complicity in grave violations of human rights and corrupt activities contrary to treaty obligations;[66] and
- Provide for investors to be held civilly liable in their domestic courts in these circumstances as well as in situations in which an investor breaches and IIA standard relating to core labour rights, fails to comply with domestic law, or fails to comply with the management plan developed in connection with a sustainability assessment.[67]

h. **Counterclaims by states in investor–state arbitration and limitations on investor access to investor–state arbitration:** IIAs can be designed to limit investor access to investor–state arbitration where the investor is not in compliance with standards set in the agreement. They can also be used to provide a counterclaim mechanism for a state against which an investor has made a claim. This would allow the state to obtain relief for injuries suffered as a result of non-compliance by the investor with obligations imposed on it under the treaty.[68]

These sample provisions reflect a comprehensive and centrist approach to sustainable development that includes the protection of the environment and the promotion and protection of human rights, labour rights and the rights of indigenous peoples. This is not the only approach to sustainable development. Each state must determine its own policy. Nevertheless, whatever approach a state elects to follow, the Guide provides options that should be of assistance.

66 See Section 6.13 (Enforcement of investor obligations).

67 See Section 6.13 (Enforcement of investor obligations).

68 See Section 6.17 (Counterclaims by states in investor–state arbitrations) and Section 7.1 (Investor–state dispute settlement).