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The Emerging Global Regime for Investment: A Response

Responding to Jeswald W. Salacuse, *The Emerging Global Regime for Investment*, 51 HARV. INT'L L.J. 427 (2010).

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I. INTRODUCTION

Professor Salacuse argues that today's network of investment treaties adds up to an emerging global "regime" for international investment.[1] He defines "regime" as do international relations scholars: "principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations"[2] and adds that to qualify as a regime the network must "constrain and regularize the behavior of participants, affect which issues among

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[1] *See* Jeswald W. Salacuse, *The Emerging Global Regime for Investment*, 51 Harv. INT'L L.J. 427, 431 (2010).

[2] *Id.* at 431 (quoting STEPHEN D. KRASNER, *Structural Causes and Regime Consequences: Regimes as Intervening Variables*, *in* POWER, THE STATE, AND SOVEREIGNTY: ESSAYS ON INTERNATIONAL RELATIONS 113, 113 (2009)).

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protagonists move on and off agendas, determine which activities are legitimized or condemned, and influence whether , when, and how conflicts are resolved."[3]

Salacuse's conception of the regime does not include other arrangements that set out additional or overlapping principles, norms, and rules for international investment. Specifically, he does not incorporate the investment rules associated with the World Trade Organization (WTO). Yet, both the Agreement on Trade-Related Investment Measures (TRIMS), which restricts host countries' imposition of performance requirements on foreign investors, and national schedules under the General Agreement on Trade in Services (GATS), which ensure market access to certain investors, cover part of the agenda of home countries in earlier negotiations for a truly multilateral agreement on foreign investment. These rules now surely form part of any emerging global investment regime. Of course, the "regime" has not generated international law that is binding on non-treaty countries. As a result, it does not cover a large part of investment flows, particularly those between rich countries. In addition, it has not yet created a really common set of principles, because language differs considerably from treaty to treaty and only limited common interpretation has emerged from arbitration tribunals. Subject to these caveats, Salacuse's conclusion is reasonable: an international regime for investment is emerging through the spread of bilateral investment treaties (BITs), investment provisions in bilateral and regional trade agreements (RTAs), and dispute settlement clauses of individual investment agreements.[4] Salacuse's exploration of the emerging investment regime and its key differences from most international regimes clarifies some of the special challenges the regime faces in retaining developing countries as adherents. Its unusual origins and structure carry important consequences for those who wish to encourage developing countries to remain in the regime. One feature is the fact that the existing

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[3] *Id.* (quoting Donald J. Puchala & Raymond F. Hopkins, *International Regimes: Lessons from Inductive Analysis*, 36 INT'L ORG. 245, 246 (1982)).

[4] Political scientists who have explored the "regime nature" of current rules on foreign investment have also tended to ignore the investment rules embodied in the WTO and the GATS, although they have generally accepted the view of the system as making up a regime. Schill argues a somewhat different point, that the current regime is approaching the equivalent of a multilateral regime because of its most-favored-nation provisions and the possibilities of treaty shopping. *See* Stephan W. Schill, Investment Treaties: Instruments of Bilateralism or Elements of an Evolving Multilateral System? 9–15 (Global Admin. L. Viterbo IV Working Paper, 2008), *available at* http://www.iilj.org/GAL/documents/Schill.pdf. One might also add to Salacuse's list unambiguous consent to the International Centre for Settlement of Investment Disputes (ICSID) (or other) arbitration provided by some countries in their legislation. When such exists, a country opts into the regime without the need of BITs, RTAs, or clauses in investment agreements. In spite of the emerging international regime, unilateral actions persist. The United States still threatens to cut off aid, withdraw its generalized system of preferences (GSP), and vote against multilateral loans for countries that take U.S. property without prompt and adequate compensation. One might also consider national and multilateral political risk insurance organizations as part of any regime. The Overseas Private Investment Corporation (OPIC), for example, has insured investors against non-payment of arbitration awards.

regime makes it difficult for host countries to benefit from learning by experience. A second problematic outcome is that the scope of "investment" covered by the regime has frequently been stretched beyond what many host countries probably intended when they signed investment treaties. The third issue is the absence of significant "escape clauses," safeguards that have played crucial roles in making other international regimes politically acceptable and long-lived. Finally, the unusual structure makes it extremely difficult for concerned parties to effect constructive change.

II. ORIGINS AND STRUCTURE OF THE EMERGING REGIME

A. Multilateralism vs. Bilateralism

The origin of Salacuse's portion of the emerging investment regime lies almost entirely in bilateral negotiations or negotiations among only a very few countries.[5] Early investment treaties were overwhelmingly between rich countries, which are homes to investors that go to the developing world, and poorer countries, which are recipients of their investment.[6] There is, of course, good reason for the pattern. The treaties could be important for investors mainly because investors do not trust judicial systems in developing countries to provide them with adequate protections, as they believe they receive in their home countries.[7] Investors also seek guarantees of market access and freedom from performance requirements in rich countries; but few investment treaties guarantee broad market access, and performance requirements are covered under TRIMS as well as many investment treaties.[8]

The push by rich countries for bilateral investment treaties is the result of the failure of efforts to build a truly multilateral regime. Chapter III, Article 12, of the 1947–1948 Havana Charter for an International Trade Organization called for agreements that would encourage foreign investment while maintaining rights of recipient countries.[9] The Charter was never ratified.[10] Subsequent efforts by the Organization

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[5] See, for example, the North American Free Trade Agreement (NAFTA), U.S.-Can.-Mex., Dec. 17, 1992 107 Stat. 2057 (1993). The Energy Charter is something of an exception, but it is not global and it covers only one sector.

[6] See Zachary Elkins, Andrew Guzman & Beth Simmons , *Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000*, 60 INT'L ORG. 811, 814–819 (2006), for data on income differences between treaty partners by date of signing of BITs.

[7] U.S. officials were surprised when they found cases lodged against the United States under NAFTA. Note that the U.S.-Australia Free Trade Area Agreement does not provide for arbitration at the initiative of a private investor. This may reflect the more balanced bargaining powers of the parties or the trust that investors place in the courts of the two countries.

[8] The United States has been more insistent than European countries on including liberal market access in its treaties.

[9] More specifically, the Charter called for bilateral or multilateral agreements:

> [(i)] to assure just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another; (ii) to

for Economic Co-operation and Development (OECD) and the United Nations to conclude a binding accord for international investment similarly came to naught.[11] Attempts to cover international investment under the WTO resulted in the provisions mentioned earlier, which were important to the capital exporting countries but did not cover protection of investors' property rights.[12]

To satisfy both host and home countries, any truly multilateral agreement would have had to include rights and obligations that affected three parties—host governments, home governments, and multinational firms themselves.[13] While home countries were interested in protection of their investors' property,[14] freedom from performance requirements, and guarantees of market access, host countries insisted on rules to govern behavior and reporting by international investors, requirements for

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> avoid international double taxation in order to stimulate foreign private investments; (iii) to enlarge to the greatest possible extent the benefits to Members from the fulfilment [sic] of the obligations under this Article; (b) make recommendations and promote agreements designed to facilitate an equitable distribution of skills, arts, technology, materials and equipment, with due regard to the needs of all Members; (c) formulate and promote the adoption of a general agreement or statement of principles regarding the conduct, practices and treatment of foreign investment.

United Nations Conference on Trade and Employment, Nov. 21, 1947 – Mar. 24, 1948, Havana Charter for an International Trade Organization, art. 11, para. 2, U.N. Doc. E/Conf. 2/78 (Mar. 24, 1948), *available at* http://www.wto.org/english/docs_e/legal_e/havana_e.pdf. It ensured rights of host countries

> (i) to take any appropriate safeguards necessary to ensure that foreign investment is not used as a basis for interference in its internal affairs or national policies; (ii) to determine whether and, to what extent and upon what terms it will allow future foreign investment; (iii) to prescribe and give effect on just terms to requirements as to the ownership of existing and future investments; (iv) to prescribe and give effect to other reasonable requirements with respect to existing and future investments.

Id. at art. 12, para. 1(c).

[10] Only trade provisions were finally agreed to under the provisional General Agreement on Trade and Tariffs (GATT).

[11] For histories of various efforts, see CHARLES LIPSON, STANDING GUARD: PROTECTING FOREIGN CAPITAL IN THE NINETEENTH AND TWENTIETH CENTURIES 73–76, 107 (1985); EDWARD M. GRAHAM, GLOBAL CORPORATIONS AND NATIONAL GOVERNMENTS 101–119 (1996); Stephen Young & Ana Teresa Tavares, *Multilateral Rules on FDI: Do We Need Them? Will We Get Them? A Developing Country Perspective*, 13 TRANSNAT'L CORPS. 11–18 (2004).

[12] I use "property rights" in the sense that most economists understand it, to include not only physical property but also contractual obligations.

[13] See Louis T. Wells, *Property Rights for Foreign Capital: Sovereign Debt and Private Direct Investment in Times of Crisis*, *in* THE YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY (Karl Sauvant ed., forthcoming Oct. 2010), for a more complete "catalog" of issues supported by governments in multilateral negotiations.

[14] To keep investors' pressures for support from interfering with foreign policy, in the case of the United States. This motivation is being documented by Noel Maurer.

the transfer of technology, and restrictions on intervention by investors' home countries in support of their investors abroad. Negotiations might also have resulted in mechanisms to ensure that investors, as well as host countries, would live up to their contractual obligations—most likely an administrative body in which both host and home countries would participate.

Lacking a multilaterally negotiated regime, home countries have managed to address protection of investors' property rights (in treaties), limits on performance requirements (in treaties and in the WTO), and limited assurances on market access (in some treaties and, in certain industries, in the GATS). The resulting regime, however, addressed none of the concerns of host countries; especially important, it imposed no behavioral and reporting rules on investors themselves, provided no international mechanism to ensure that investors lived up to their contractual commitments, and instituted no formal role for host countries in the continuing development of the regime.

B. Bilateralism and Host Countries

One must wonder why poor countries, weak or not, sign treaties that contain few if any of the provisions they sought in a multilateral regime. This puzzle led to an article with the provocative title, "Why LDCs Sign Treaties that Hurt Them."[15]

The times mattered. In the 1980s, the Washington Consensus ruled, as Salacuse points out.[16] Developing countries' new-found desire to attract foreign direct investment made even one-sided treaties seem attractive. This was especially the case as countries saw competing countries agreeing to treaties; they feared that they would lose out on foreign investment if they failed to go along with the capital-exporting countries' demands.[17] Moreover, slow economic growth made poor countries more eager for foreign investment. Desperation led to more treaties and, it seems, to treaties unfavorable to host countries.[18] For countries facing stagnation, the underlying bargain sounded reasonable, even if less than ideal: give guarantees to investors and they will come and also not demand high profits to cover risks. Although, as Salacuse explores, there are additional motivations behind treaty agreements (relationship building, economic liberalization, encouraging domestic investment, remedying governance problems, and strengthening the rule of law),[19] it is likely that these motives were dwarfed by the desire to attract investment and by pressures from rich countries, including withholding preferences in trade agreements

[15] Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA J. INT'L L. 639 (1998).

[16] *See* Salacuse, *supra* note 1, at 470.

[17] For evidence of the role of competition among countries for investment, see Elkins, Guzman & Simmons, *supra* note 6, at 822–24.

[18] For evidence that countries are more likely to agree to BITs when they are in economic crises, as measured by their facing IMF conditionality, see *id.* at 840.

[19] *See* Salacuse, *supra* note 1, at 436–44.

unless countries agreed to investment protections and warnings that their investors would go to neighboring countries that had agreed to treaties if the particular host countries failed to provide similar protections.

Poor preparation for negotiations on the part of developing countries exacerbated the problems. Rich countries came to bilateral negotiations equipped with model agreements and little willingness to depart from their terms in discussions with weak host countries.[20] On the developing country side, negotiations were often led by officials from the country's foreign office or commerce ministry, officials who had little knowledge about and experience with foreign investment and the types of serious risks involved.[21] Additionally, officials from investment promotion agencies probably played a growing role in pushing for and negotiating BITs. On one hand, such officials knew more about foreign investment than those from foreign offices. However, because the central task of these agencies was to attract investment, they were more likely to concentrate on the potential benefits of investment agreements and ignore the potential costs, as any costs would fall on other parts of the government.[22]

Moreover, in most developing countries, skills in negotiating international agreement are scarce. The task of negotiating multiple individual bilateral investment treaties has placed a huge burden on the available skills, especially since negotiators from rich countries brought varying model agreements.

In contrast to bilateral negotiations, multilateral negotiations create opportunities for skill-scarce developing countries to benefit from each other. In multilateral negotiations, countries have been able to pool skills and increase their bargaining power. Blocs of countries have taken common positions in negotiating trade agreements, for example. Although their alliances sometimes proved fragile, the attempts to build the alliances served to educate national negotiators. This stands in

[20] Initiation of treaties by the capital exporting countries (evidenced by clustering in time by home, not host countries) and their "take-it-or-leave it" stances with respect to their model treaties (evidenced by the similarity of terms across agreements with a home country) is supported. *See id.* at 822.

[21] There is no documentation of who led negotiating teams in various countries, to my knowledge. This statement is based only on my limited experience and discussions with officials in developing countries.

[22] The phenomenon is similar to that which governs promotion officials' enthusiasm for tax incentives. After all, if incentives attract even one additional investor, the agency looks better. The costs, in terms of foregone taxes from investors who would have come anyway, would be carried by another agency. Of course, finance ministers generally stand in opposition to such measures.

sharp contrast to the bilateral negotiations for the investment regime where developing countries could be "picked off" one by one.[23]

In the end, it appears that few host country negotiators fully understood the implications of the treaties they were signing. They agreed to definitions of investment that were far more inclusive than more knowledgeable and experienced negotiators would have sought.[24] While host countries generally wanted to encourage foreign direct investment, the treaties they signed rarely mentioned "direct" in the sense that economists use the term.[25] As a result, the broad definitions in treaties would later be interpreted by potential claimants to include other kinds of investment, as well as sovereign debt and even trade issues.[26] Moreover, many treaties failed to define "foreign" in ways that more knowledgeable and experienced host country officials would, or should, have intended.[27] The result was that nationals of the host

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[23] For an argument that multilateral negotiations benefit developing countries by allowing "collective bargaining," attracting more interest from civil society, and offering more opportunity for regular review, see Hilda Fridh & Olivia Jensen, *Multilateral or Bilateral Investment Negotiations: Where Can Developing Countries Make Themselves Heard?*, BRIEFING PAPER (CUTS Ctr. for Int'l Trade, Econ. & Env't, Jaipur, India), Oct.–Dec. 2002.

[24] For a paper criticizing ICSID tribunals for limiting the definition of covered investment even when consent in treaties is broad, see Julian Davis Mortenson, *The Meaning of "Investment": ICSID's* Travaux *and the Domain of International Investment Law*, 51 HARV. INT'L L.J., 257, 316–317 (2010). Mortenson recognizes that many developing countries wanted narrow definitions of investment at the time the ICSID convention was being negotiated, but they had difficulty in agreeing among themselves how to define covered investment. A broad meaning was adopted in the convention while host countries had the right to "opt out" of broad interpretations in their consents to arbitration, as in BITs. Mortenson assumes, contrary to what is argued here, that host countries understood and could exercise without pressure those rights in bilateral negotiations.

[25] Foreign direct investment is understood to mean investment in which a foreign national holds enough equity that it can exercise a degree of management control. ORGANIZATION OF ECONOMIC CO-OPERATION AND DEVELOPMENT [OECD], OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT 7–8 (3d ed., 1999), *available at* http://www.oecd.org/dataoecd/10/16/2090148.pdf. For reporting purposes, most countries consider holdings of 10% of the equity to be enough to suggest a degree of control. In contrast, "direct" in treaties often refers to the chain of ownership. Thus, a Dutch treaty might require that a protected investment be held by a Dutch entity without intermediate holding companies.

[26] Under RTAs, claimants have used what appear to be arbitration provisions for investment disputes to bring claims concerning government purchasing policies and trade restrictions. For examples under NAFTA Chapter 11, see Mariano Gomezperalta C., *How States Can Cope with the Growing Threat of Arbitration,* POL. RISK INS. NEWSL. , 1, 4–5 (Robert Wray PLLC, Washington, D.C.), May 2010, at 1, 4–5.

[27] Treaties have frequently provided that an investor is a national of the treaty country simply by its being incorporated there. *See, e.g.*, Treaty Between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Arg., Nov. 14, 1991, S. Treaty Doc. 103–2 [hereinafter U.S.-Arg. BIT]. Other treaties, however, have required that the entity have significant business activities or

country could simply set up a holding company abroad and, as "round trippers," claim the benefits provided to "foreign" investors.[28]

Broad definitions of "nationals" caused another and more serious consequence. With no requirements of a real "seat" or even significant business presence in the rich party country, treaties left foreign investors free to "treaty shop," locating a holding company—sometimes little more than a post office box—in the country that could negotiate terms most favorable to investors. Treaties concluded early in a host country's experience typically incorporated such broad definitions of "nationals," but offered especially little to the host country in terms of rights and protections. The lack of constraint by tribunals on treaty shopping, and their willingness to extend jurisdiction to investments made before the establishment of a post box holding company,[29] stymied possible improvements by countries "learning" to negotiate more favorable treaties over time, as an investor could always take advantage of less favorable treaties the host country had signed in an earlier period by merely establishing a holding company.

This constraint on host countries' abilities to learn from experience was also a result of broad most-favored-nation provisions in treaties. Unless treaties are carefully worded to exclude benefits from other treaties, they give investors the opportunity to claim all the benefits of other investment treaties. If the investor's "true" home country had a relevant treaty with broad most-favored-nation provisions, the investor could skip the post box step entirely.

In theory then, most developing countries need to sign only one treaty, if it has sufficiently broad definitions of eligible investors and broad most-favored-nation provisions.[30] If that treaty were with the Netherlands, for example, investors from the United States or elsewhere could set up a holding company in the Netherlands to take advantage of the treaty's benefits.[31] This has ensured something like a "race to the bottom" for developing countries. More accurately, one might say it ensured that host countries were "stuck in the mud" of their most unfavorable agreements.

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even its seat of control in the country before it would be considered a national for purposes of protection.

[28] By establishing a subsidiary abroad, even nationals of the host country have been able to claim the benefits of the international regime. *See*, *e.g.*, Tokios Tokelés v. Ukrain*e*, ICSID Case No. ARB/02/19 (April 29, 2004) (Decision on Jurisdiction) ¶¶ 24–34.

[29] Forum shopping, seeking coverage after a dispute has emerged, has been viewed with more concern.

[30] *See* Schill, *supra* note 4, at 9. Schill does not, however, explicitly recognize the resulting constraint on a host country's ability to improve its position through experience.

[31] For example, in the absence of a BIT between the United States and Venezuela, the American oil company ConocoPhillips filed an ICSID case against Venezuela through holding companies it established in the Netherlands, which did have a treaty with Venezuela. ConocoPhillips Company v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/30 (pending).

III. RESULTING INVESTMENT CHALLENGES

With time, a number of host countries have recognized the costs of their bilateral agreements. Several faced major contractual claims when they attempted to adjust investment treaties in light of financial crises. Both Indonesia and Argentina, for example, encountered international arbitration claims when the collapse of their currencies meant that they would have had to increase prices of utilities to untenable levels and pay for unneeded output to conform to their infrastructure contracts. Similarly, some countries ended up in arbitration proceedings when they responded to political pressure to capture a larger part of the windfall profits from the export of their natural resource wealth in the face of prices that were dramatically higher than anticipated. The consequence has been increasing frustration as host countries have experienced the costs of arbitration—large awards and millions of dollars in legal fees—initiated by investors who insist that their contracts were sacred, regardless of crisis or changed circumstances. While multilateral agreements, such as those of the World Trade Organization, include "escape clauses" to relieve countries of obligations under certain conditions, the emerging investment regime agreements have few such provisions.[32] This is almost certainly a result of the bilateral origins of the regime; it is doubtful that a multilateral regime would have materialized without stronger escape clauses.[33]

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[32] The "necessity" argument prevailed in two Argentine cases: LG&E Energy Corp. v. Argentine Republic, ICSID Case No. ARB/02/1 (Oct. 3, 2006) (Decision on Liability), *reprinted in* 46 I.L.M. 40 (2007) and Continental Casualty Co. v. Argentine Republic, ICSID Case No. ARB/03/9 (Sept. 5, 2008) (Award of Tribunal), *available at* http://www.investmenttreatynews.org/documents/p/24.aspx. Yet, in a similar case, Argentina was held strictly to its contractual obligations. CMS Gas Transmission Co. v. Argentine Republic, ICSID Case No. ARB/01/8 (May 12, 2005) (Award of Tribunal), *reprinted in* 44 I.L.M. 1205 (2005). The recent annulments of the Sempra and Enron decisions surprised many observers; they were based on the tribunal's inadequate consideration of the crisis, in light of what might be considered escape clauses in the governing treaties. For an analysis of the annulments, see Steven Smith & Kevin Rubino, *Investors Beware: Enron and Sempra Annulment Decisions Bolster the State Necessity Defense While Sowing New Uncertainty Regarding the Finality of ICSID Arbitral Awards*, O'MELVENY & MYERS LLP: NEWSROOM, Aug. 9, 2010, http://www.omm.com/newsroom/publication.aspx?pub=1020. When unanticipated high prices for raw materials led countries to demand more of foreign investors, some went to arbitration contending that their investment contracts should be adhered to rigidly. They would claim the windfall that states believed should go to them, as owners of the natural resources.

[33] For an argument that escape clauses make it easier to reach agreement in international negotiations, see B. Peter Rosendorff & Helen V. Milner, *The Optimal Design of International Trade Institutions: Uncertainty and Escape,* 55 INT'L ORG., 829 (2001). Another approach to encouraging agreement when the implications are uncertain is to limit the time duration of the agreement, calling for renegotiation after some period. *See* Barbara Koremenos, *Contracting around International Uncertainty,* 99 AM. POL. SCI. REV. 549 (Nov. 2005). This approach is less applicable to investment treaties because of the long-term nature of the investments that are

At the same time, bilateral negotiations led to no central administrative body, as Salacuse observes; this is unlike the principal regime for trade.[34] With no central body, host countries find themselves with no formal voice in the development of the investment regime; and it is not subject to occasional renegotiation or to the gradual evolution that the WTO has experienced.

Host countries have also slowly discovered that the hoped-for benefits of investment treaties have been, at best, fewer than anticipated. Empirical work on whether treaties have resulted in more investment remains inconclusive; the difficulty in finding robust relationships between treaties and investment is large enough to suggest that any impact on investment flows has at best been small. Moreover, the impact may well have been in the form of diversion of investment from one location to another, rather than in an increase in the total supply of direct investment.[35] If that is the case, collective action in multilateral negotiations would have led to more benefits to host countries.

Of course, the security provided by treaties could lead investors to demand smaller risk premiums, with greater benefits to host countries. However, a look at risk premiums for countries with investment treaties suggests that investors do not view them as significantly lowering risk. For the forty developing countries that have signed bilateral investment treaties with the United States, the average "cost of capital" was 25.8%, based on the country-risk model of *Institutional Investor*.[36] The fact that the cost of capital remains more than twice the equivalent figure for the United States suggests that investors doubt, or are unaware of, the supposed safety. Not even private insurers have taken much account of the existence of treaties in estimating risk; the premiums they charge for political risk insurance do not decline as a result of investment treaties.[37]

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covered. A ten-year agreement, for example, would presumably provide little security to an investment that is expected to run at least thirty years. One could, however, have a grandfathering provision, such that the terms of the agreement in force at the time of the investment would hold for, say, thirty years, even though the states negotiate new terms after ten years.

[34] *See* Salacuse, *supra* note 1, at 466–67.

[35] Although there have been several attempts to measure the impact of investment treaties to countries that sign them, the results are not very robust. This author is aware of no attempts to measure the effects of investment treaties on total flows of investment, as opposed to diversion.

[36]These calculations were done for an arbitration by Vladimir Brailovsky. They are not yet publicly available. They are based on Morningstar/Ibbotson data from INSTITUTIONAL INVESTOR, Mar. 2007.

[37] Lauge Skovgaard Poulsen, *The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence, in* THE YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 14–17, *supra* note 13. Interestingly, the largest effect on insurance premiums appears to have been with the German official insurance organization. That may well reflect the enthusiasm of the German government for bilateral investment treaties.

In light of the perception of benefits and costs from past bargains and the difficulty they face in trying to improve their situation, several countries have begun to seek annulments of or refuse to honor awards; terminate investment treaties; or withdraw, wholly or in part, from the international regime. Salacuse cites the actions of Bolivia, Ecuador, Russia, and Venezuela.[38]

IV. TACTICS FOR PRESERVING THE SYSTEM

In an ideal world, there would be no need for an international regime to provide security for foreign direct investors. All countries' judicial systems would inspire sufficient confidence that foreign investors would be willing to leave their futures in the hands of local courts. Failing that ideal world, one might wish for a truly multilateral regime that would better balance the interests of all parties. Yet, that wish is also likely to remain unfulfilled. The very existence of the current regime means that investors and home countries are unlikely to agree to new negotiations for a multilateral regime; any new regime would be seen as less advantageous to the rich countries than is the current regime. Certainly, if the current system were to collapse, interest in a grander and more stable regime might emerge. Reality is more likely to see some host countries refusing to sign bilateral investment treaties that do not address their concerns, disenchanted host countries refusing to honor awards, and even a few more countries withdrawing from the system. But all that is short of regime collapse.

One could, however, strengthen the protections for host countries in the current regime and thereby encourage more voluntary adherence by host countries and discourage defection. The following provide only sketches of some possibilities.

I and others have argued for the creation of an appeals process that would speed the development of a parallel to common law, where precedents serve to generate consistent interpretations of treaty provisions.[39] Decisions of tribunals would be more predictable and, if the appeals process were structured similarly to that of the WTO, host countries would gain a greater voice in the development of common law.[40] Similarly, I have proposed making the process symmetrical by giving host

[38] *See* Salacuse, *supra* note 1, at 471.

[39] The goal would not be to create international law that applies even in the absence of treaty provisions.

[40] *See, e.g.*, Louis T. Wells, *Property Rights for Foreign Capital: Sovereign Debt and Private Direct Investment in Times of Crisis*, *supra* note 13. A number of papers on the subject were presented at the 2004 Conference on Appeals and Challenges to Investment Treaty Agreements: Is it Time for an International Appellate System? They are available in the British Institute of International and Comparative Law's *Investment Treaty Law: Current Issues*, vol. 1, pt. 1 (Federico Ortino, Audley Sheppard & Hugo Warner eds., 2006). Also arguing for an appeals process is Nigel Blackaby of Freshfields Bruckhaus Deringer, quoted in Michael D. Goldhaber, *Wanted: A World Investment Court,* AM. LAW., FOCUS EUROPE, Summer 2004. For a similar argument

countries parallel rights to initiate international cases against investors that do not live up to their commitments.[41] I will not explore these proposals here.

Three serious problems in the current regime remain largely unaddressed in the literature: (1) the inability of host countries to benefit from their experience while still remaining in the regime; (2) the extension of jurisdiction beyond what was probably intended by host countries; and (3) the frequent lack of meaningful escape clauses in the regime.

A. Getting out of the Mud

Two barriers keep host countries from improving their position as they learn from their experiences in the investment regime: broad most-favored-nation provisions and the broad definitions of investors covered by treaties.

Although the general principle of treating nationals of different countries similarly (and no less favorably than nationals of the host country) might well be acceptable,[42] host countries could benefit from their improved negotiation skills if most-favored-nation treatment regularly excluded coverage offered under other treaties.[43]

At the same time, more care needs to be taken in defining what "nationals" are covered by treaty protections. Among other changes, investment treaties could

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supporting a "permanent tribunal for North American dispute resolution" for NAFTA, see JOHN P. MANLEY, ET AL., COUNCIL ON FOREIGN RELATIONS, BUILDING A NORTH AMERICAN COMMUNITY: REPORT OF AN INDEPENDENT TASK FORCE 22 (2005). As Salacuse points out, tribunals are not obligated to base their decisions on precedents. *See* Salacuse, *supra* note 1, at 460. Yet, as he also says, claimants, respondents, and tribunals themselves regularly cite the authority of previous decisions.

[41] *See* Louis T. Wells, *Property Rights for Foreign Capital: Sovereign Debt and Private Direct Investment in Times of Crisis*, *supra* note 13. Objections to the proposals have been that arbitration requires the "consent" of both parties. The state can grant broad consent through treaties or investment laws; when investors initiate cases, they are implicitly granting consent, but they do not grant consent automatically for the state to initiate cases. Investment treaties, however, could require that investors grant consent to arbitration when they invest, if they wish to be covered by the treaty. Although BITs and RTAs do not provide symmetry, some arbitration clauses in investment agreements do.

[42] One wonders, however, whether even the United States would agree to treat investors of all nationalities the same if market access were the issue. The country has not always treated investors from China and the Middle East the same as other investors. The attempted acquisition by DP World (a Dubai firm) of U.S. port facilities illustrates the problems of a Middle Eastern investor. The facilities were already foreign run, by a U.K. firm, but the United States resisted the Emirati acquisition. Similarly, the United States resisted China National Offshore Oil Corporation's (CNOOC's) proposed acquisition of Unocal, not wanting the resources to fall into Chinese control.

[43] This would be similar to most-favored-nation provisions in the WTO that do not apply to more favorable terms negotiated for free trade areas.

require that eligible nationals have real business in the country, and perhaps even their seat of control there. And they should exclude host nationals who go abroad to come under a treaty.[44]

B. Saying What Was Intended

It appears that in many instances, host countries signed investment treaties to encourage foreign direct investment and did not intend to apply the provisions to sovereign debt and other international portfolio flows. However, definitions of qualifying investment in BITs have been so broad that bond holders have sought to bring their disputes under their umbrella, thereby undermining the confidence of host countries in the treaties.[45] Reasonable definitions have been developed to ensure that treaty coverage was only for what was intended.[46] Their use would free host countries from current fears that investment treaties will be used to manage disputes that are outside what they originally envisaged.

C. Providing Escape Clauses

There exists a body of international relations literature that argues that escape clauses play an important role not only in making multilateral regimes possible but also in providing stability to the regime.[47] Such provisions are largely absent from the emerging investment regime.[48]

As pointed out, a large fraction of serious disputes have arisen from financial crises, particularly those in Argentina and Southeast Asia, or from sharply rising raw material

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[44] For model definitions based on "home state" *see* Part 1, Article 2(I) of Int'l Inst. for Sustainable Dev. [IISD], IISD Model International Agreement on Investment for Sustainable Development (2005), *available at* http://www.fes-globalization.org/dog_publications/Appendix%202%20IISD%20Model.pdf.

[45] *See, e.g.*, Giordano Alpi v. Argentine Republic, ICSID Case No. ARB/08/9 (pending).

[46] For a model definition of "investment," see pt. 1, art. 2(C) of Int'l Inst. for Sustainable Dev., *supra* note 44.

[47] *See* Rosendorff & Milner, *supra* note 33.

[48] There are limited exceptions, as the U.S.-Argentina bilateral investment treaty illustrates. U.S.-Arg. BIT, *supra* note 27. Its Article 11, similar to a provision in the 2004 U.S. Model Bilateral Investment Treaty, reads: "This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests." It was this provision that led to the approval of the Argentine Republic's application for annulment of the award from previous arbitration proceedings. *See* Sempra Energy Int'l v. Argentine Republic, ICSID Case No. ARB/02/16 (June 29, 2010) (Decision on Annulment), ¶ 229, *available at* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtlsRH&actionVal=ListConcluded.

prices.[49] When contracts with investors call for payments abroad that are insensitive to both exchange rates and demand, as has been the case with many infrastructure investments, host countries find themselves facing an intractable problem during currency crises. In Indonesia, for example, when the rupiah deteriorated from about 2,400 to the dollar to around 15,000 to the dollar, the state-owned power company could not honor its commitments without raising electricity prices by a factor of about six; such action would have been political suicide. At the same time, it was unable to use all the electricity it had agreed to buy under take-or-pay agreements. Government subsidies to make up the difference would have conflicted with IMF demands for a tight budget. Renegotiation of agreements was inevitable, but two groups of investors turned to arbitration rather than accepting change.[50] Similar pressures daunted governments with foreign investment in extractive industries when prices climbed sharply in the early 21st century. Political pressures to change deals with investors that were gaining "windfall" profits from the export of nations' wealth were irresistible.

Such unpredictable and politically sensitive situations are exactly what escape clauses in trade agreements are designed to address. In investment agreements, they could allow exchange controls or suspension of payment of fixed foreign exchange obligations (as in utility agreements)[51] and non-discriminatory changes in fiscal arrangements, even when fiscal stabilization clauses exist, in the face of sharply higher raw material prices. That said, if escape clauses are to be consistent with investor security, they must not to be overused; to that end, their use could impose costs on the country invoking them or be allowed for only defined periods of time. In the case of financial crises, host countries could be exempt from obligations only until the crisis has subsided. In the case of rising raw material prices, exemption might be limited to the period of high prices, after which terms might have to revert to what was originally agreed. The use of escape clauses might also be subject to other limits; taxes on windfall profits could not be confiscatory, for example.

Obtaining all parties' agreements to adequate escape clauses would likely be more difficult in the investment context than it is in trade.[52] In trade negotiations, all

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[49] Of the 128 cases pending before ICSID in April 2010, 32 were for oil, gas, or mining. SARAH ANDERSON ET AL., INST. FOR POL'Y STUD., MINING FOR PROFITS IN INTERNATIONAL TRIBUNALS 5 (2010).

[50] The two groups were owners of Karaha Bodas (mainly Caithness Energy and Florida Power & Light) and Himpurna/Patuha (MidAmerican/CalEnergy).

[51] Article XI of the U.S.-Arg. BIT was interpreted to a similar effect in the previously mentioned annulment proceedings, *see supra* note 32.

[52] For U.S. resistance to Singapore's efforts to include escape clauses allowing capital controls under certain conditions in a bilateral trade agreement, see Wayne Arnold, *Rift on Capital Controls Snags Singapore Trade Pact*, N.Y. TIMES, Jan. 9, 2003, at C3. Chile also sought a similar escape clause in its negotiations with the United States. In contrast to the United States, Canada, Japan, and the European Union have agreed to treaties that allow capital controls under certain circumstances.

parties see the possibility of the need to rely on escape clauses in the future. Conversely, in bilateral investment negotiations, it is usually only the host country that might draw on them. Home countries will likely agree to escape clauses only if the alternative is a slowly collapsing regime.[53]

D. *Effecting Change*

Changing the emerging regime in ways that will encourage continued participation by host countries is a challenging task. Although it is feasible for countries to insist on improved terms in new investment treaties, they will be of little value as long as investors can retreat to earlier treaties by locating holding companies that allow them to qualify as nationals or by drawing on most-favored-nation provisions. Old treaties have to be renegotiated or their coverage might be limited by "protocols" between the agreeing governments. Such protocols might narrow the meaning of "national" and "investment," for example. To accomplish this, host countries will probably need a coordinated effort and, perhaps, support from civil society. However, failing successful renegotiation or other mechanisms to change old agreements, host countries might well consider withdrawing from the unfavorable treaties. To be sure, most treaties specify a period during which existing investors' rights survive after a country withdraws from the treaty. As Salacuse says, they are "sticky."[54] But withdrawal limits damage to the host country.

V. CONCLUSION

Sources of instability in the emerging global regime for foreign investment lie in its origin in dispersed negotiations for bilateral treaties and in the absence of a central organizational authority. Given the lack of convincing evidence that the regime encourages more investment or lowers its cost, one might ask whether the system is worth trying to preserve. It may be, mainly because it reduces the pressure on rich countries to intervene abroad on behalf of their investors.[55] Additionally, one might hope that the regime will eventually attract more enthusiasm from managers during

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[53] If agreements were symmetrical, such that host countries could bring cases against investors, there might be broader interest in escape clauses on the part of the rich countries.

[54] *See* Salacuse, *supra* note 1, at 471–73.

[55] The current regime has not completely eliminated unilateral action by home countries. The United States, for example, occasionally exerts diplomatic pressure in support of its investors and it maintains its formal unilateral stance in successor versions of the Hickenlooper and Gonzalez Amendments and in the GSP that threaten aid, multilateral loans, and tariff preferences for countries that take steps against U.S. investors without satisfying U.S. compensation requirements. *See, e.g.*, LOUIS T. WELLS & RAFIQ AHMED, MAKING FOREIGN INVESTMENT SAFE: PROPERTY RIGHTS AND NATIONAL SOVEREIGNTY (Oxford Univ. Press, 2007) (documenting the diplomatic the support given to US electric power investors in Indonesia during the renegotiations that followed the Asian financial crisis). See also the discussion on OPIC, *supra* note 4.

the period when they are considering investments, not only after their projects are in trouble. If that happens, risk premiums may indeed fall. The case for continuing the regime, however, is not overwhelming. And Salacuse warns us of the difficulties of trying to hold the regime together.[56] A widely dispersed system makes it especially difficult to effect change. The lack of a central organization means that there are no annual meetings in which proposals might be considered. With no meetings and no rounds of negotiations to stimulate public reaction, the emerging regime faces no "streets of Seattle" for the battles that bring pressures on international bodies to evolve.[57] Moreover, there is no hegemon to push for modification. The principal levers for change probably lie with development-promoting NGOs, which can influence model treaties in investors' home countries, and with the developing countries themselves, which can elect not to sign unfavorable treaties, attempt to renegotiate those they have, and, with costs, withdraw from unfavorable treaties that they cannot renegotiate.

[56] *See* Salacuse, *supra* note 1, at 473.

[57] The reference is to the protests at the WTO ministerial meeting in Seattle on November 29–December 3, 1999.