Towards a Repository of Policy Options for IIA Reform

Research Project
Reforming the Present International Legal Framework for Foreign Direct Investment (FDI): Basic Elements for an Analytical and Policy Framework[1i]

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1. It must be recognized that the "architecture" of the present **international legal framework is chaotic and flawed with too many contradictions** between: a) General International law and International Economic law; b) Bilateral Investment Treaties (BITs) and the WTO's General Agreement on Trade in Services (GATS; c) EU Member States' BITs and European Union law.

2. It must be recognized, once and for all, that the **argument on the economic relevance of traditional "mainstream" BITs, mainly in order to attract Foreign Direct Investment (FDI), is inconclusive**. On the other side, there is a considerable lack of clarity on what are the real objectives to be pursued with the signature of IIAs.

3. It must be recognized that, from a legal, economic and political perspective, **FDI** (or, in other words, the establishment of foreign firms) **and international capital movements raise two very different sets of problems**, while mainstream BITs, on the contrary, merge the two by using a very broad, and quite ambiguous, definition of "investment".

4. It must be recognized that a **reasonable international legal framework for FDI would make sense and be welcomed**, in particular because some former "recipients" of FDI are becoming very significant "exporters" of it, and because international disputes on FDI are beginning to change their direction: countries attacked are not only developing countries but also developed ones. However, it must also be recognized that, when designing this international legal framework, one **cannot apply the same logic to the multilateral and the regional levels (**for the bilateral level some answer should be offered, once and for all, to the contradiction between BITs and GATS art. II).

5. It must be recognized that the **substance of IIAs has to be reviewed thoroughly** in order to make it **acceptable by <u>all</u> countries**. In order to do so, we suggest radically changing the prevailing approach (methodological and even "psychological") of trying to **define exceptions to a very broad list of general and undefined obligations** (a sort of "top down"/"negative list" approach). One should begin by the foundations, building up a well-balanced agreement that really makes sense (**a new IIA model**). Once we have conceived it, the political discussion should address how to move from the present situation towards this new model, an evolution for which, admittedly, many concessions, equilibriums and compromises would be needed. The main axes of the revision could be:

   <u>a. **Redefinition of its scope**</u>: IIAs should only cover FDI, and, of course, movements of capital directly linked to it, leaving the issue of international capital movements (the immense majority of which, as said, have nothing to do with FDI) to other fora and institutional frameworks).

[1] The opinions expressed in this paper are those of the author and do not necessarily reflect the views of the UNCTAD Secretariat or its Member States.

b. **Approach to be followed in the "first establishment/access" and "post-establishment" phases**: Concerning access or first establishment, development, social, or security national policies may provide national governments with legitimate grounds to restrict foreign ownership or participation in enterprises in certain economic sectors (a "positive list approach makes sense). To the contrary, for already-established firms (which are not "smugglers" who have entered the country illegally…), national firms under foreign membership should only very exceptionally be discriminated against (a "negative list" approach).

c. **Essential obligations to be kept (or to be added)**:

- National Treatment
- Rights to repatriation of profits and to capital increases
- Specific "more favorable than NT" or "NT plus" provisions on expropriation, with or without adequate compensation (this is an essential point to be developed)

d. **Provisions to be dropped or very substantially modified** - The main ones concern:

- **"Indirect" expropriation**, a notion whose inherent "anti-regulatory" bias cannot be overcome and whose undefined scope seems unacceptable (as it seemed, in the selected club of developed countries, during the OECD/MAI negotiations, and continues to seem now).
- Concerning **"fair and equitable treatment"**, the approach should be that of transforming this unqualified and limitless standard in a set of relatively well identified rules (including in particular rules on access to justice).

e. **And the set on international rules should be completed by a set of domestic rules** allowing companies that have invested in foreign countries to have speedy access to their home governments and guaranteeing that home governments will expeditiously respond to them on whether they envisage to support their claims. This is an essential aspect in order to articulate private and State action in International Investment disputes (we return to this in the next point).

6. **In the review of dispute settlement mechanisms**, experience in the last two decades (and in the very recent past), combined with common sense, seems to justify the thesis that current mainstream BITs have crossed a real "red line" by allowing foreign investors to initiate an international litigation against a State without having first consulted and received some sort of an authorization from its home government. Investor-to-State and State-to-State dispute settlement mechanisms shouldn't be two parallel tracks that never meet. It is argued that some sort of international investor-to-State dispute settlement is required because host countries, and their domestic jurisdictions, are "unreliable. But it shouldn't be accepted that home countries are also unreliable: a foreign investor should first seek at least the opinion of its home government, and preferably its assent, before engendering an international conflict that can grow well beyond the economic dispute that originated it.

   Furthermore, the relative lack of practical effect of many investor-to-State disputes leaves open the question whether following the way of State-to-State dispute settlement would have been more fruitful and less costly.

7. Finally, and only for the sake of some completeness, we only mention two issues that are very polemic (we know this) but which, at least at the academic level, could or should be addressed. The first is that of the **possibility of annexing at IIAs an annex combining two sections, one on performance requirements and the other on investment incentives**. The second is whether within the IIA (or in parallel to it) there shouldn't be some obligations for the foreign investor (for example on core labour rights or other sensitive matters) to be implemented by and in its country of origin.

[i] This is the summary of a collective work that has its roots in one of the panels of the 2012 Singapore Biennial Conference of SIEL as well as in previous UNCTAD publications by the authors. A slightly longer version of this summary (six pages) can be downloaded from: http://ssrn.com/abstract=2568686. Paragraphs 1 to 4 are analytical; paragraphs 5 to 7 suggest, as a policy recommendation, an overall framework for reform.