

Policy pointers

Decisions about whether to negotiate an IIT, how to word it and who to involve should fully reflect the far-reaching policy trade-offs at stake.

Emerging international practice helps show how to promote investment while preserving national 'policy space'. International best practice points to public consultation in investment policymaking.

Policy choices on IITs require a systemic approach that considers how different treaties affect each other's provisions, and that considers wider links to national and international law.

Given major disparities in negotiating capacity, sustained investment in capacity support is needed in lower-income countries: for governments to make informed policy choices and negotiate better deals, for parliamentarians and civil society to provide effective 'checks and balances', and for federations of domestic producers that stand to gain, or to lose, from proposed IITs.

Investment treaties and sustainable development: an overview

Over 3,000 international investment treaties (IITs) are in force, more are being negotiated. While informed debates on IITs are usually framed in legalistic terms, the signing and wording of these treaties imply important trade-offs between policy goals. The ramifications can be expensive (the record payout to investors for breach of an IIT is US\$1.7 billion), far-reaching (affecting issues well beyond investment policy, including public health or environmental measures), and difficult to withdraw from (because the ability to terminate a treaty or its effects may be restricted for decades). Countries considering negotiating investment treaties need proper reflection and public debate on these policy choices. This overview briefing is the first of four promoting debate on IITs and sustainable development.

Foreign investment, law and sustainable development

Many low- and middle-income countries are stepping up efforts to attract foreign investment. At the same time, these efforts are under growing scrutiny for their ability to support, or undermine, sustainable development.

Broadly speaking, sustainable development involves improving peoples' livelihoods while respecting the environment. It entails carefully balancing the social, environmental and economic aspects in any investment process. It also entails empowering people to have control over the decisions and processes that affect their lives.

Economic globalisation has been accompanied by extensive developments in the national and international law that regulates investment flows. Applicable rules include norms of international law; the national law of the country hosting the

investment ('host state') or, in some cases, of a third country; and contracts between investors and host states ('investment contracts'). These legal arrangements influence the terms and conditions of foreign investment, the way its costs and benefits are shared and, ultimately, how well it contributes to sustainable development.

International investment treaties (IITs) are an important part of these multi-layered legal frameworks, and a central pillar of the international law governing foreign investment. The content of these treaties, and who participates in developing them, can have far-reaching implications for sustainable development.

Investment treaties in outline

International investment law is the body of international law that promotes foreign investments. It is based on customary international law and international treaties. Customary law is created through state practice

accompanied by *opinio juris* — that is, states' belief that their practice reflects an international legal obligation.

International investment treaties make up most of investment law norms. IITs are concluded between two or more states. They aim to

promote investment flows between party states by establishing obligations about how investments by nationals of one state in the territory of the other state will be admitted (see the related briefing on investment

liberalisation) and protected (see the briefing on investment protection).

As well as determining substantive standards of treatment, most IITs allow investors to bring disputes against the host state to international arbitration, rather than to national courts (see the briefing on investor-state arbitration).

The number of investment treaties has increased sharply since the early 1990s, as neoliberal thinking became prevalent. But the extent to which governments have signed up to these treaties varies considerably across countries.

Most IITs are bilateral investment treaties, but regional or bilateral preferential trade agreements that contain an investment chapter are increasingly common. Because international investment law is dominated by bilateral and regional treaties, the law applicable to different investments varies depending on the host and home states.

However, treaty norms that prohibit discrimination (particularly 'most-favoured-nation' clauses, which require states to treat foreign investors or investments no less favourably than investments by nationals of other states) mean that treaties tend to 'level the playing field' upward — that is any favourable treatment available through one treaty can be claimed by investors primarily covered by another IIT.

Do IITs help promote investment?

Governments negotiate investment treaties because they want to promote investment. But empirical evidence on whether this works is mixed. Some econometric studies have found a statistical correlation between a country's involvement with IITs and foreign investment volumes, but others have found no such evidence.¹ Significant conceptual and methodological challenges affect this type of study.

There is qualitative evidence that informed investors take account of IITs, for instance when structuring investments. Indeed, several

international arbitrations of treaty disputes show how investors' corporate planning can involve choosing to channel their investment through a state that had signed a robust IIT with the host state.

But one survey of general counsels from top US companies found that many counsels had little familiarity with IITs, or did not think that the legal protection provided by IITs made a big difference.² Some authors have noted that investors from different cultures and those operating at different scales may attach diverse degrees of importance to legal protection.³

Much also depends on the host state's national legal system: effective national rules could go a long way towards reassuring investors even without IITs; conversely, IITs alone "cannot turn a bad domestic investment climate into a good one".⁴

The vast literature on what drives foreign investment shows that investment decisions are primarily shaped by business opportunities, for example valuable natural resources in a host country, or a population providing an attractive market that a firm can cater for. So IITs are at best one factor among several other determinants.⁵ These considerations may explain why Brazil, which has not ratified any IITs, nevertheless receives a significant volume of foreign investment.

Expensive, far-reaching and long-lasting: how IITs can restrict 'policy space'

On the other hand, it is increasingly clear that IITs can restrict policy space for signatory states. Broadly speaking, 'policy space' refers to the ability of one country "to calibrate national policies to local conditions and needs".⁶ It can also refer to the policy options available to a country for honouring international obligations other than IITs, for example on human rights or environmental protection.

All international economic treaties limit national policy space: governments may be legally required to take some measures, and may no longer be allowed to take other measures. IITs are no different, and depending on their wording they can have far-reaching repercussions for public policy.

IIT commitments must be taken seriously because they are backed up by effective redress. If a state takes measures that violate an IIT, affected investors can usually sue that state before an international arbitral tribunal. If the investor wins, the tribunal usually orders the government to pay compensation. This can involve significant liabilities. The highest known award is for US\$1.7 billion. Even if a government

Countries should take a systemic approach in thinking through their policy choices about IITs

wins, it may have to cover its own substantial legal costs. Effective enforcement mechanisms help investors get their money (discussed in our investor-state arbitration briefing).

Recourse to arbitration has increased rapidly in recent years: cases by the start of 2013 had risen at least ten times above the 2000 level.⁷ Through these arbitrations, investors have sought compensation for losses incurred because of a wide range of public policy measures — including government action to improve public revenues, impose performance requirements, address historical injustices, or protect the environment or public health. Claims have challenged policy measures far outside what is typically considered ‘investment policy’ — including ‘plain packaging’ legislation designed to discourage smoking. And they have challenged action beyond direct government control, for example action taken by national courts to redress local complaints about investment activities.

For countries where public finances are constrained, the risk of large compensation claims can make it more difficult to take public-interest action that affects investments. In other words, concluding an IIT can restrict options in a wide range of policy areas, and in ways that may be difficult to foresee when the treaty is negotiated.

Concerns about constraints on future public policy are especially relevant because once a country has concluded an IIT, withdrawing from it may be difficult. IITs can be and often are terminated by agreement between the two (or more) state parties. But treaty clauses often restrict states’ ability to unilaterally terminate treaties, or (for treaties involving more than two parties) to withdraw from them.

In many cases, these clauses provide that the treaty can only be terminated after 10 or even 20 years. They also provide that, once the treaty has been terminated, it continues to apply to investments made while the treaty was in force for an additional 10 or 20 years. In other words, restrictions on policy space can be very long-lasting.

Because IITs can affect policy options in this way, negotiating IITs involves a delicate balancing act between entering into binding commitments on the one hand and preserving policy space on the other. It is important that decisions on whether to conclude an IIT, and on its wording, are based on informed reflection and debate.

Towards a new generation of IITs

The rise of investor-state arbitration has highlighted the policy trade-offs at stake in IITs. Some high-income countries that have usually

taken the investors’ viewpoint have now seen their own public action challenged by foreign investors — and have started rethinking their approaches to IITs. Some low- and middle-income countries have become more vocal in IIT matters — by terminating IITs, withdrawing from multilateral conventions regulating investor-state arbitration, or developing their own model treaties. Civil society scrutiny also appears to be driving change.

As a result, a ‘new generation’ of IITs is emerging that seeks to balance investment protection with other policy considerations, including in social and environmental matters, and that promotes greater transparency in investor-state arbitration. No single treaty ticks all boxes. But useful lessons can be drawn from specific provisions included in diverse treaties.

Some provisions featured in the model treaties developed by Canada and by the United States, and in some bilateral treaties concluded on the basis of these model IITs, are oft-cited examples of this trend. The Model Investment Treaty developed by the Southern African Development Community is also a good example.⁸ In addition, there is growing international guidance on how to reflect multiple policy goals in IITs, including the ‘Investment Policy Framework for Sustainable Development’ elaborated by the United Nations.⁹

And it is not just the content of IITs that has been changing. The negotiation process has also witnessed important developments. Some governments have launched public consultations to help draft their model IITs, or to feed into the negotiation of individual IITs.

One example is Norway, where public consultation on a draft model IIT in 2007–08 led to the government shelving the project. Most recently, the European Union launched a public consultation on a proposed Transatlantic Trade and Investment Partnership agreement with the United States, following public concern about an investor-state arbitration clause proposed for that treaty.¹⁰

Following an investor-state arbitration that challenged aspects of South Africa’s policies dealing with the apartheid legacy, the government of South Africa reviewed its IITs, terminated several of them and launched a public consultation on its new Investment Bill – national legislation that will govern some matters typically covered by IITs.¹¹

Elsewhere, civil society organisations have opened up spaces for public scrutiny and debate. In Thailand, for example, a coalition of national civil society organisations was instrumental in

promoting public debate on a proposed preferential trade and investment treaty with the European Union.¹²

Again, lessons can be learnt from these government and civil society efforts to promote public consultation on IITs. But it is also important to remember that not all countries have shifted approaches, and many continue to sign IITs featuring vague and unqualified standards of investor protection. Also, most treaties continue to be negotiated without much transparency and public oversight, let alone public consultation.

Well thought out capacity support and a systemic approach are needed

In thinking through their policy choices about IITs, countries should take a systemic approach. IITs cannot address all issues concerning foreign investment, and good articulation is needed between IITs and other legal instruments, such as national legislation requiring social and environmental impact assessments.

For example, providing effective safeguards for foreign investments without also strengthening the rights of people who may be affected by those investments, or without properly regulating environmental aspects, creates imbalanced legal frameworks that are unlikely to promote sustainable development.

Another important reason for a systemic approach is the 'levelling up' effect of the non-discrimination clauses included in most IITs. If investors covered by an IIT that balances investment protection with policy space can in effect rely on other treaties that are more favourable to investors, the benefits of the more balanced wording are limited. Countries negotiating IITs should always consider how the

standards included in one treaty are likely to affect, or be affected by, the provisions in others.

Given major disparities in negotiating capacity, sustained investment in capacity support is needed in lower-income countries: for governments to make informed policy choices and negotiate better deals; for parliamentarians and civil society to provide effective 'checks and balances'; and for federations of domestic producers that stand to gain, or to lose, from proposed IITs.

Capacity support may relate to the content of IITs, for example accompanying the development of model investment treaties in low-income countries. But it may also entail support to national multi-stakeholder dialogue on whether a country should conclude IITs, and under what terms.

In addition, capacity support may involve: learning from international best practice; peer-to-peer lesson sharing among low-income country governments, and among civil society organisations or parliamentarians; mechanisms that effectively harness existing capacity in the country (for instance in academia or private practice); and strategic partnerships with international centres of excellence.

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This briefing is part of a set of four aimed at promoting debate on investment treaties and sustainable development. Other briefings in the set cover the following topics:

Investment liberalisation: <http://pubs.iied.org/17239IIED>

Investment protection: <http://pubs.iied.org/17240IIED>

Investor-state arbitration: <http://pubs.iied.org/17241IIED>

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Notes

¹ See for example the studies collected in Sauvant, KP and Sachs, L (eds) (2009) *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*. Oxford University Press / ² Yackee, JW (2010) How much do US corporations know (and care) about bilateral investment treaties? Some hints from new survey evidence. *Columbia FDI Perspectives* No. 31. <https://tinyurl.com/kun4w7e> / ³ Perry, AJ (2000) The relationship between legal systems and economic development: integrating economic and cultural approaches. *Journal of Law and Society* 29(2): 282-307 / ⁴ United Nations Conference on Trade and Development (2012) *World investment report 2012: towards a new generation of investment policies*. http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/WIR2012_WebFlyer.aspx / ⁵ Sauvant, KP and Sachs, L (2012) Overview. In: Sauvant, KP and Sachs, L (eds) (2009) *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*. Oxford University Press / ⁶ Akyüz, Y (2008) *Global Rules and Markets: Constraints over policy autonomy in developing countries*. International Labour Office, Geneva. <https://tinyurl.com/pzjhuz3> / ⁷ Figures from: UNCTAD (2012) *World investment report 2012: towards a new generation of investment policies* (see note 4 above); and UNCTAD (2013) *World investment report 2013: global value chains: investment and trade for development*. http://unctad.org/en/PublicationsLibrary/wir2013_en.pdf / ⁸ Southern African Development Community Model BIT Template 2012. www.iisd.org/itn/wp-content/uploads/2012/10/SADC-Model-BIT-Template-Final.pdf / ⁹ UNCTAD (2012) *Investment policy framework for sustainable development*. http://unctad.org/en/PublicationsLibrary/webdiaepcb2012d6_en.pdf. See also Mann, H *et al.* (2005) *Model international agreement on investment for sustainable development: Negotiators' handbook*. 2nd edition. IISD. www.iisd.org/publications/pub.aspx?pno=686 / ¹⁰ See the online consultation at http://trade.ec.europa.eu/consultations/index.cfm?consul_id=179 / ¹¹ See Invitation for the public to comment on the promotion and protection of investment bill 2013. www.gov.za/documents/download.php?f=203446 / ¹² Polack, E *et al.* (2014) *Agricultural investments in Southeast Asia: Legal tools for public accountability*. IIED, London. <http://pubs.iied.org/12573IIED>