

An International Investment Regime? Issues of Sustainability

Konrad von Moltke

IISD

INTERNATIONAL INSTITUTE FOR
SUSTAINABLE DEVELOPMENT
INSTITUT INTERNATIONAL DU
DÉVELOPPEMENT DURABLE

An International Investment Regime? Issues of Sustainability

Konrad von Moltke

The International Institute for Sustainable Development contributes to sustainable development by advancing policy recommendations on international trade and investment, economic instruments, climate change, measurement and indicators, and natural resource management. By using Internet communications, IISD reports on international negotiations and brokers knowledge gained through collaborative projects with global partners, resulting in more rigorous research, capacity building in developing countries and better dialogue between North and South.

IISD's vision is better living for all—sustainably; its mission is to champion innovation, enabling societies to live sustainably. IISD receives financial support from the governments of Canada and Manitoba, other national governments, UN agencies, foundations and the private sector. IISD is registered as a charitable organization in Canada and has 501(c) (3) status in the U.S.

Copyright © 2000 International Institute for Sustainable Development

Published by the International Institute for Sustainable Development

All rights reserved

Printed in Canada

Copies are available for purchase from IISD. Copies may also be ordered through IISD's on-line order form at <http://iisd.ca/about/prodcat/ordering.htm>

Canadian Cataloguing in Publication Data

Moltke, Konrad von

An international investment regime?

Includes bibliographical references.

ISBN 1-895536-27-8

1. Sustainable development. 2. Investments, Foreign—Environmental aspects.
3. Investments, Foreign (International law). I. International Institute for Sustainable Development. II. Title.

HG4521.M64 2000 338.91 C00-920191-2

International Institute for Sustainable Development

161 Portage Avenue East, 6th Floor

Winnipeg, Manitoba

Canada R3B 0Y4

Tel: +1 (204) 958-7700

Fax: +1 (204) 958-7710

E-mail: info@iisd.ca

Internet: <http://iisd.ca/>

Trade and investment site: <http://iisd.ca/trade/>

This document is printed on recycled paper.

Preface

Environmental activists are widely credited with (or condemned for) launching the opposition that finally led to the abandonment of negotiations for a Multilateral Agreement on Investment at the OECD in late 1998. It took more than environmental opposition to stop the MAI in its tracks, but since then it has been accepted wisdom that environmentalists are opposed to an international investment agreement. This study takes a hard look at that assumption. Its first conclusion is that an international investment agreement should be a priority for those interested in the environment and sustainable development. The question then is, what kind of an investment agreement?

The history of investment negotiations over the past 20 years reveals that the MAI suffered from more shortcomings than just the widely advertised environmental ones. With its focus on investor rights—certainly an essential part of any investment agreement—the MAI perpetuated a polarization of the process that consistently separated investor rights from investor obligations. The need to strike a balance between private (investor) interests and public goods must be at the heart of any international agreement, certainly when viewed from the perspective of sustainable development.

An international agreement that facilitates a balancing of private interests and public goods needs to look quite different from the MAI. Indeed, it must also look different from the GATT. It represents a challenging undertaking, in many respects as difficult as constructing a regime for the control of climate change (itself an agreement that seeks new private investment in areas of public concern). This study draws lessons from the experience in building international environmental agreements to suggest a new approach to an international investment agreement. It proposes a framework agreement on investment combined with a number of sectoral agreements (for example, on climate change, forestry, or the provision of services for that matter), in which it becomes possible to identify the public interest being served by providing private investors with additional rights.

In publishing this study, the International Institute for Sustainable Development hopes to help relaunch the debate on an appropriate international investment regime. IISD is convinced that a great deal of useful work needs to be done in this area, much of which will benefit the environment and sustainable development.

Executive summary

Investment is essential to the achievement of sustainable development. Much existing infrastructure and many existing practices are unsustainable, and investment will be needed to replace them. To promote this kind of investment an international investment regime will be needed.

Over the last few years, flows of foreign direct investment have increased dramatically so that they now dwarf bilateral and multilateral official development assistance, for many years the mainstay of international investment activities. At the same time, official development assistance has stagnated so that it is now a much smaller proportion of developed-country GDP than it was at the time of the United Nations Conference on Environment and Development. Moreover, foreign direct investment is taking up many of the economically viable infrastructure projects that have formed an important part of the portfolio of official development assistance. This leaves official development assistance the task of funding economically marginal projects, further complicating the task of justifying it to the electorates of OECD countries.

Foreign direct investment is flowing to a few favoured countries, including Argentina, Brazil, China, Chile and Mexico. Reliance on foreign direct investment to fund development leaves many countries without resources, including those that most desperately need investment for sustainable development.

We must rethink long-held assumptions about the process of development and the role of governments in it. It is essential that scarce resources—including foreign direct investment—are allocated as efficiently as possible and in a manner consistent with sustainable development. In particular, capital should be flowing to less-developed countries and regions. An appropriate international investment regime could help meet the public policy challenges that this distorted pattern of investment represents.

This book reviews the long debate about an international investment regime. It considers existing multilateral, regional and bilateral investment agreements and seeks to identify the need for a broad multilateral agreement. It also reviews the two major streams of international debate in this area, one focusing on investor rights and the other on investor obligations.

The central importance of investment to the development process has long been recognized, but attempts to form an international investment regime

have been defeated by the extreme polarization of the debate. While the United Nations Conference on Trade and Development sought to negotiate binding obligations for multinational corporations, the governments of OECD countries focused primarily on securing additional rights for investors so as to improve the security of their investments. The public-policy interest is to achieve an appropriate balance between investor rights and obligations, and between private interests and public goods, but none of the international approaches to investment has tackled this task.

Balancing conflicting policy goals is still largely beyond the capability of most international organizations, which are typically static in the sense that both the ends and means are fixed. This requires much more dynamic and innovative institutional arrangements capable of adjusting the means to changing conditions to achieve certain ends. This can only be achieved if these arrangements have the necessary legitimacy to undertake such tasks. Similarly, balancing private interests and public goods remains outside the scope of most international regimes. The international investment agenda (together with the need to move toward a more sustainable economy and the institutions required to maintain competitive markets) cannot be adequately addressed without institutions capable of undertaking such a balancing at this international level.

Drawing on experience with international environmental regimes, this book seeks to identify the structurally determining characteristics of an international investment regime. It argues that investment occurs in a long time frame and that the relationship between the investor and host country is notably different from that between exporters of goods or services and the countries of import. Investors acquire rights in the host country, and with those rights come obligations.

The time frame of investment and the legal rights of investors in host countries argue for a dynamic regime. In particular the principles underlying the process of trade liberalization—most-favoured nation and national treatment—and the WTO dispute settlement system are inappropriate for an investment regime unless they are adjusted to reflect the dynamic nature of the issues that need to be addressed and are accompanied by a substantial institutional architecture to ensure flexible yet effective implementation. This strongly suggests that an international investment regime needs to be constructed outside existing international organizations, possibly beginning with a framework convention followed by a series of protocols addressing specific issues.

Table of contents

Preface	iii
Executive summary	v
Acknowledgements	ix
1. Introduction: The need for an international investment regime	1
2. Precursors of an international investment regime	9
2.1 Multilateral approaches to an international investment regime	9
2.1.1 Trade negotiations	9
2.1.2 World Bank initiatives	11
2.1.3 UN Centre for Transnational Corporations Draft Code	14
2.1.4 Framework Convention on Climate Change	15
2.2 Bilateral investment agreements	15
2.3 Regional investment agreements	17
2.3.1 Arab investment regime	17
2.3.2 ASEAN industrial joint ventures	18
2.3.3 The North American Free Trade Agreement	18
2.3.4 APEC Non-Binding Investment Principles	25
2.3.5 The Multilateral Agreement on Investment	25
2.3.6 The European Union	31
2.4 Unilateral action	32
3. Regimes, institutions and organizations	37
3.1 Dynamic and static regimes	39
3.2 Goal conflicts	41
3.3 The effectiveness of international regimes	42

4.	The nature of an international investment regime	47
4.1	The time frame of investment	48
4.2	Economic citizenship	49
4.3	“Like” investments	50
5.	Some issues for an investment regime that promotes sustainability	53
5.1	Right of establishment	56
5.2	National treatment	56
5.3	Most-favoured nation treatment	59
5.4	Dispute settlement	61
5.5	Maintenance of competitive markets	62
5.6	Investor responsibility	63
5.7	Institutional capacity	65
5.8	Transparency	67
6.	A different approach: A framework agreement on investment	69
6.1	Is a single agreement the answer?	70
Annex 1	Excerpt from the Agreement on Trade-Related Investment Measures	73
Annex 2	Excerpt from the Draft Multilateral Agreement on Investment	75

Acknowledgements

This report has benefited from the criticism and support of the trade and investment staff at IISD, which has a remarkable willingness to entertain new ideas. Special thanks to Joe Petrik for his editorial support.

— 1 —

Introduction: The need for an international investment regime

The character of international investment has been changing. Twenty years ago, most international investment was undertaken by a few large multinational corporations that sought to secure their raw material supplies, or that were establishing a market presence with production or sales units in the early phases of globalization. Foreign investment was an important adjunct of trade rather than an independent economic activity. Today most companies listed on stock markets in OECD countries are technically multinational corporations, with investments and economic interests in more than one country.

It is now a mistake to view foreign direct investment simply as an adjunct to trade. Capital is a scarce resource, particularly in developing countries. Efficient allocation of capital is critical to the achievement of economic growth and sustainable development. Current patterns of capital allocation are counterintuitive, with the largest flows converging on the most developed countries. Other things being equal, capital should be seeking the highest returns, which should be available where capital is most urgently needed—in the developing world. High returns are available in those countries, but the risks involved in such investments still make them unattractive. One paramount task for an investment regime is to improve efficiency in the allocation of capital by reducing uncertainty.

There have been encouraging trends. By the end of the century, foreign direct investment was being undertaken by enterprises both large and small with a wide range of concerns. The option of investing in another country has become a normal part of strategic growth plans for enterprises. Individual investors are now seeking investment opportunities outside their own currency region as a matter of course. And mutual funds make these kinds of investments available to small investors.

Investment flows have increased dramatically. For many developing countries, foreign direct investment has become the most important source of capital inflows, overtaking both official development assistance and the funds made available by multilateral development banks. In developing countries, between a third and a half of private corporate investment is undertaken by affiliates of foreign corporations.¹ Investment flows from OECD to non-OECD coun-

tries have finally become positive, with large outflows from more developed to less developed markets. Between OECD countries, traditionally the recipients of the largest amounts of foreign investment, the number of enterprises that participate and the range of projects being funded have grown dramatically.

The growing significance of foreign direct investment gives greater urgency to long-standing debates about creating an international regime for investments. Investment is not an act of nature. It represents a critical economic function of great social significance. It also has major implications for the prospects of achieving greater sustainability. Mature, strong economies generate and sustain significant levels of investment, and policy intervention is necessary mainly to ensure that essential market disciplines are maintained.

Policy-makers in mature economies have grown accustomed to having their cake and eating it too. Wealth creation has reached a point where many hard choices can be avoided. In the United States alone, for example, tax receipts rose dramatically between 1992 and 1998 as the government participated in an extraordinary increase in the value of many forms of investment. With this wealth, the U.S. government could celebrate the end of budget deficits, maintain a huge defence budget, increase spending on some broadly based social programs, invest in infrastructure, increase the endowment of its universities, and invest abroad—all at the same time and without raising tax rates. Policy-makers in developing countries do not have that luxury. There, the need for investment, including investment in infrastructure and social development, is overwhelming but capital is scarce and it is difficult to ensure that investment flows meet a range of policy objectives.

An international investment regime is ultimately about efficiency and fairness. Insecure or severely distorted conditions of investment are risk factors, which are reflected in expected rates of return. Countries perceived as high risk will only attract investment for projects that offer exceptional rates of return. Under such conditions, many important projects will remain unfunded, and funds that are available will be used in ways that are not as efficient as they could be. Lack of clear rules also creates an incentive for side-payments and corruption, which again exacts an economic penalty on projects and investment flows.

Issues of fairness arise because of unequal power and conflicting goals of the various participants in investment. Investors from countries that are perceived as weaker will fear for the security of their investments in foreign countries. At the same time, some governments are significantly weaker than many major corporations and may find it difficult to impose their legitimate priorities. At the very least, the effort required to defend less-secure investments is itself a drag on investment and a source of economic inefficiency.

Investments are mostly private transactions aimed at generating positive rates of return, but they can have far-reaching implications for the welfare of coun-

tries, including prospects for sustainable development; use and protection of natural resources; and employment, income and economic security. It is the role of government to balance these sometimes conflicting public and private interests, by promoting investment, by creating incentives to direct investment to certain activities or regions, or by maintaining a system of taxes and fees that contribute to public-policy goals.

Among the many measures confirming the recent growth of foreign direct investment, those most likely to identify the interests at stake for various countries concern the “stock” of foreign direct investment relative to GDP and the ratio of trade to GDP (See Tables 1–3).

*Table 1. FDI to GDP ratio (stock).
(Inward + outward investment, divided by twice the GDP)*

	1980	1993
1. Netherlands	18.3	35.8
2. Belgium/Luxembourg	5.2	27.4
3. Switzerland	18.1	27.1
4. Malaysia	13.5	24.4
5. United Kingdom	13.6	24.4
6. Australia	4.9	20.1
7. Canada	14.4	17.9
8. Sweden	3.6	15.4
9. Spain	2.8	13.7
10. France	3.2	11.4
10. Norway	1.2	11.4
11. Chile	1.7	10.6
12. Germany	5.5	9.1
13. South Africa	13.4	8.3
14. Finland	1.2	8.2
15. United States	5.8	7.9
16. Venezuela	1.3	7.4
17. Hungary	n.a.	7.0
18. Italy	2.0	6.4
19. Thailand	1.5	5.9
20. Austria	2.6	4.8

Source: John H. Dunning, “The advent of alliance capitalism,” in John H. Dunning and Khalil A. Hamdani, eds., *The new globalism and developing countries*, Tokyo: United Nations Press, 1997, p. 21.

*Table 2. Trade to GDP ratio.
(Exports + imports, divided by twice the GDP)*

	1980	1992
1. Hong Kong	104.1	126.6
2. Singapore	206.9	123.4
3. Malaysia	44.9	62.7
4. Belgium/Luxembourg	58.0	54.1
5. Ireland	55.2	54.1
6. Netherlands	42.8	44.9
7. Taiwan, Province of China	n.a.	35.3
8. Thailand	23.5	29.7
9. Portugal	32.0	28.7
10. Hungary	n.a.	28.6
11. Switzerland	32.5	27.3
12. Austria	27.3	26.6
13. Denmark	27.0	26.0
14. Norway	30.9	24.9
15. Indonesia	23.4	24.2
16. Chile	n.a.	24.0
17. Korea, Republic of	34.2	23.9
18. Canada	24.2	23.7
19. Germany	23.2	23.4
20. New Zealand	23.3	22.9
21. Sweden	26.2	21.4
22. Venezuela	25.5	21.0
22. Greece	22.0	21.0
23. Finland	29.8	20.9
24. United Kingdom	22.5	19.8
25. France	18.9	17.8
....		
33. United States	9.1	8.3
34. Japan	12.7	7.8

Source: John H. Dunning, "The advent of alliance capitalism," in John H. Dunning and Khalil A. Hamdani, eds., *The new globalism and developing countries*, Tokyo: United Nations Press, 1997, p. 20.

*Table 3. Stocks of outward foreign direct investment, by major home country and regions.
(billions of U.S. dollars)*

Countries/Regions	1967			1973			1980			1990		
	Value	% of Total	% of GDP	Value	% of Total	% of GDP	Value	% of Total	% of GDP	Value	% of Total	% of GDP
Developed Countries	109.3	97.3	4.8	205.0	97.1	5.1	503.6	97.2	6.2	2,012.0	96.2	10.8
United States	56.6	50.4	7.1	101.3	48.0	7.7	220.2	40.0	8.2	559.7	26.8	8.8
United Kingdom	56.6	50.4	7.1	101.3	48.0	7.7	220.2	40.0	8.2	253.4	12.1	27.0
Japan	1.5	1.3	0.9	10.3	4.9	2.5	19.6	6.6	3.4	259.8	12.4	6.2
West Germany	3.0	2.7	1.6	11.9	5.6	3.4	43.1	7.8	5.3	185.0	8.8	10.8
Switzerland	2.5	2.2	10.0	7.1	3.4	16.2	22.4	7.0	37.9	89.1	4.3	38.4
Netherlands	11.0	9.8	33.1	15.8	7.5	25.8	42.4	7.6	24.7	134.0	6.4	43.4
Canada	3.7	3.3	5.3	7.8	3.7	6.1	21.6	3.9	8.2	86.3	4.1	16.1
France	6.0	5.3	7.0	8.8	4.2	3.8	20.8	3.8	3.2	160.5	7.7	12.8
Italy	2.1	1.9	2.8	3.2	1.5	2.4	7.0	1.3	1.8	73.8	3.5	7.5
Sweden	1.7	1.5	5.7	3.0	1.4	6.1	7.2	1.3	5.8	44.6	2.1	24.0
Other	5.4	4.8	0.8	20.0	9.5	1.7	15.4	3.2	1.9	162.5	7.8	12.0
Least Developed Countries	3.0	2.7	0.6	6.1	2.9	0.6	13.3	2.8	0.7	78.2	3.7	1.5
TOTAL	112.3	100.0	4.0	211.1	100.0	4.2	516.9	100.0	4.9	2,090.4	100.0	8.7

Source: John H. Dunning, "The advent of alliance capitalism," in John H. Dunning and Khalil A. Hamdani, eds., *The new globalism and developing countries*, Tokyo: United Nations Press, 1997, p. 21.

*Table 4. Stocks of inward foreign direct investment, by major host country and regions.
(billions of U.S. dollars)*

Countries/Regions	1967			1973			1980			1990		
	Value	% of Total	% of GDP	Value	% of Total	% of GDP	Value	% of Total	% of GDP	Value	% of Total	% of GDP
Developed Countries	73.2	69.4	3.2	153.7	74.0	3.8	394.1	78.0	4.7	1,561.0	75.3	8.4
West Europe	31.4	29.8	4.2	79.9	38.4	5.6	211.6	42.0	4.8	880.2	42.4	12.5
United Kingdom	7.9	7.5	7.2	24.1	11.6	13.9	63.0	12.5	12.0	197.1	9.5	21.0
Germany	3.6	3.4	1.9	13.1	6.3	3.8	47.9	9.5	5.8	128.0	6.2	7.5
Switzerland	2.1	2.0	8.4	4.3	2.1	9.8	14.3	2.8	14.1	36.5	1.8	15.7
United States	9.9	9.3	1.2	20.6	9.9	1.6	83.0	16.4	3.2	445.3	21.5	7.0
Other	31.9	30.2	4.2	53.2	25.6	4.2	99.5	19.7	6.5	251.8	12.1	7.0
Japan	0.6	0.6	0.3	1.6	0.8	0.4	3.3	0.7	0.3	16.9	0.8	0.4
Least Developed Countries	32.3	30.6	6.4	54.4	26.1	5.4	111.2	22.0	5.4	299.8	24.0	9.9
Africa	5.6	5.3	9.0	10.2	4.9	8.7	13.1	2.6	4.1	50.1	2.4	14.1
Asia	8.3	7.8	3.9	15.3	7.4	3.6	35.8	7.1	5.0	278.6	13.4	8.7
Latin America	18.5	17.5	15.8	28.9	13.9	12.3	62.3	12.3	8.4	167.6	8.1	11.4
TOTAL	112.3	100.0	4.0	211.1	100.0	4.2	516.9	100.0	4.9	2,090.4	100.0	8.7

Source: John H. Dunning, "The advent of alliance capitalism," in John H. Dunning and Khalil A. Hamdani, eds., *The new globalism and developing countries*. Tokyo: United Nations Press, 1997, p. 21.

These tables clearly identify the range of interests governments may have in an international investment regime. Small countries with a large involvement in foreign investment—the Netherlands, Belgium and Switzerland in particular—and medium-sized countries whose prosperity depends on international trade and investment—France, the United Kingdom and Canada—all have an urgent interest in protecting their investors. The United States has an interest in an investment regime mainly because the total amount of investment by its citizens is large, even though it is relatively much smaller than those of most other OECD countries. The United States is also more readily able to protect investments made in other countries by its citizens.

Those concerned with sustainable development have a particular interest in an investment regime. Many current economic activities, in developed and developing countries alike, are known to be unsustainable. Often, alternatives are available but they require investment. In other words, without investment sustainability is unattainable. With such an urgent need for investment, the move toward sustainability requires that scarce resources be used efficiently—and that the imperatives of sustainability are respected in the investment process. Indeed, it can be argued that an investment regime, which does not actively promote sustainable development, represents an important step back from the widely endorsed principles of sustainable development.

Despite these fairly clear reasons for developing an international investment regime, this goal has proven surprisingly elusive.

1 E.V.K. Fitzgerald, *et al.*, “The development implications of the Multilateral Agreement on Investment,” a report commissioned by the Department for International Development (UK), Finance and Trade Policy Research Centre, University of Oxford (manuscript, March 1998).

–2–

Precursors of an international investment regime

2.1 Multilateral approaches to an international investment regime

It is possible to distinguish two fundamentally different approaches to developing a multilateral agreement on international investment.² A series of initiatives dating to the origins of the trade regime have sought to define rules governing the treatment of foreign investment by states, generally by the “host” state in which the investment is made. These initiatives focus on the rights of investors and a dispute settlement procedure to ensure that these rights are respected. An alternative approach, based largely on the United Nations Conference on Trade and Development and its United Nations Centre on Transnational Corporations, sought to define the obligations of corporations that invest in foreign countries. Both approaches have attracted strong opposition, in the first instance mainly from developing countries, in the latter from certain OECD countries and from the United States in particular, leading ultimately to the closing of the UNCTC.

The controversies surrounding these attempts to address the issues relating to international investment have led to a situation where not even the questions have been properly framed. To date, no attempt has been undertaken to draw both approaches together and develop an agreement that encompasses both the rights and the obligations of foreign investors. The most comprehensive study of the law of international investment concluded that the, “multilateral instruments, whether binding or non-binding, are difficult to construct in the area of foreign investment.... A satisfactory code must address both the issue of how foreign investors conduct themselves in host states as well as the treatment of foreign investors by the host states. For historical reasons, the two bodies that have produced recent instruments are identified with different camps in the debate. If a code is to be produced it is better that the attempt is made by other institutions or a new institution.”³

2.1.1 Trade negotiations. The United Nations Conference on Trade and Employment, held in Havana in 1948, included encouraging the international

flow of capital for productive investment as one of the objectives of the proposed International Trade Organization.⁴ The assumption implicit in this approach—that trade and investment regimes are essentially congruent—has never been seriously challenged. Nevertheless, the negotiating history on international investment measures demonstrates the complexity of the issue and indirectly confirms that an international investment regime needs to take into account many factors that go far beyond the concerns of trade in goods or services.

After the failure of the Havana Charter to attract significant ratifications, the General Agreement on Tariffs and Trade became the forum for multilateral trade negotiations. Not until after the conclusion of the Tokyo Round in 1978 were serious efforts made to include investment matters in the GATT. In 1982 the GATT Council agreed to establish a panel to deal with a dispute between the United States and Canada concerning the Canadian Foreign Investment Review Act. The panel developed an initial approach to identifying what has later become known as “trade-related investment measures” or TRIMs—in other words, those investment measures that have an impact on trade.

The Punta del Este Declaration that defined the negotiating mandate for the Uruguay Round stated that “following an examination of the operation of GATT Articles related to the trade-restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade.”⁵ This mandate was linked tightly to the trade-related aspects of investment, and the resulting Agreement is correspondingly modest in scope.⁶ Article 1 specifies that it applies to investment measures related to trade in goods *only* (italics added) and Article 9, which sets up a review of the Agreement no later than five years after entry into force (2001), states that “in the course of this review, the Council for Trade in Goods shall consider whether the Agreement should be complemented with provisions on *investment policy and competition policy*” (italics added).

The TRIMs Agreement extends the protections of Article III (national treatment) and Article XI (quantitative restrictions) of GATT 1994 to trade-related investment measures. In an annex, it includes five measures, which are “inconsistent with the obligations of national treatment,” as an “illustrative list” (in practice a limitative list).⁷ These are largely what are known as “performance requirements” in the OECD context. The distinction between TRIMs and “investment policy” as well as the inclusion of “competition policy” in Article 9 provide important guidelines on the limits of the Agreement and the essential differences between the TRIMs Agreement and a multilateral investment regime.⁸ By distinguishing between TRIMs and “investment policy,” the Agreement clearly implies that the two are different and may require entirely different international disciplines.

The Uruguay Round also revealed deep and abiding differences of opinion between major participants in the negotiations. The United States and Japan had the most expansive view of trade-related investment measures. The European Union had a somewhat more restricted perspective. The Nordic countries took a position that was even more restrictive. Key developing countries argued that investment measures are legitimate instruments in the context of their economic situation and advocated a case-by-case approach to TRIMs.

As well as the TRIMs Agreement, the General Agreement on Trade in Services—which was part of the Uruguay Round Agreements—contains an embedded agreement on investment. In a sense this represents the counterpart to investments related to trade in goods covered by the TRIMs Agreement. But investment is so central to trade in services that the GATS needed to address this issue as an integral part of the Agreement itself, rather than through a plurilateral add-on.

The GATS is a complex structure revolving around both positive and negative schedules. That is, countries can exempt certain service sectors (in principle only temporarily) from certain general obligations, and can make a positive commitment to apply the rules of the GATS to sectors that have been identified in a list. The GATS does not include productive investments or portfolio investments, which are the predominant portion of all foreign direct investment, and does not create open-ended rights for investors. It foresees a two-tiered dispute settlement process: the classic WTO procedure for complaints between members about the fulfillment of their obligations under the Agreement, and a purely domestic arbitration process open to individual service providers concerned about the implementation of these obligations in practice. While this represents a significant opening of the WTO toward investment, the GATS, like the TRIMs Agreement, is carefully hedged so as not to create new rights in international law and to focus on the specific investment needs of service providers.

Over the past few years, however, attitudes of some developing countries to a comprehensive multilateral investment agreement, within the WTO or elsewhere, have changed. In part the countries that have been most successful in attracting foreign direct investment have shown a much greater willingness to embrace a regime based on the principles espoused by OECD countries.

2.1.2 World Bank initiatives. The World Bank has a long-standing interest in international investment flows other than those it supports. In addition to various forms of co-operation with other multilateral development banks and with bilateral development agencies, the World Bank has sought to promote private investment flows to strengthen the impact of its own resources and to support activities it may consider valuable but outside its own remit. To this

end, it promoted the negotiation of the Convention Establishing the Multilateral Investment Guarantee Agency.⁹ Upon the Convention's entry into force in October 1985, MIGA became part of the World Bank Group.

The objectives of MIGA are “to encourage the flow of investments *for productive purposes* among member countries, and in particular to developing member countries, thus supplementing the activities of” the World Bank, the International Finance Corporation and other international development finance institutions (*italics added*).¹⁰ It is not concerned with portfolio investment or the sale and purchase of other instruments derivative from “productive investment.” To achieve its objectives, MIGA issues guarantees against non-commercial risks for investments in a member country, which flow from other member countries. It also carries out “appropriate complementary activities to promote the flow of investments to and among developing member countries.” Article 23 provides for a research function with respect to investment activities in developing countries and authorizes MIGA to “promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investments.”

MIGA has limited programmatic means, involving the insurance of investments or guarantees for insurance (reinsurance) of investment and a technical assistance program, which assists developing member countries in attracting foreign direct investment. With a capital stock of 1 billion special drawing rights,¹¹ MIGA's capacities are circumscribed.¹² “A review of MIGA's existing portfolio indicates that about 30 percent of MIGA's current contracts are not project related, i.e., they are for investments in the financial sector. The remaining 60 percent [*sic*] of MIGA's contracts are for various types of investors in projects.... In MIGA's case, the “typical client” may be best characterized as a financial institution or a minority owner in a project” (*italics deleted*).¹³

In 1965, before the creation of MIGA, the World Bank had already established the International Centre for Settlement of Investment Disputes (ICSID). The relevant convention entered into force in October 1966 and has attracted 139 signatures.¹⁴ At the request of parties to the Convention, the Centre establishes Conciliation Commissions or Arbitration Tribunals, drawing upon two panels to which each member country may name four persons, with the Chairman of the Centre's Administrative Council adding a further ten. Commissions and Panels consist of one or more members, provided the number is uneven. The Tribunal shall decide a dispute “in accordance with such rules of law as may be agreed by the parties.”¹⁵ In other words, the Tribunals do not apply multilateral rules of law defined by the Centre, nor do they create a body of precedents that can be binding upon the parties, except insofar as they accept them at the time of the dispute.

ICSID has created the “ICSID Additional Facility,” which is available to countries not party to the ICSID Convention. The effect has been to make uni-

versal the coverage of the Centre, located at the World Bank headquarters. The Vice President and legal counsel of the World Bank is the Secretary General of ICSID, so ICSID is in practice a multilateral facility of the World Bank without the membership limitations of the Bank itself.

Over the years, ICSID has become widely accepted. At first the countries of Latin America were skeptical about arbitration in investment disputes in general and the Centre in particular.¹⁶ Recent bilateral agreements in Latin America have, however, also incorporated ICSID as a settlement mechanism, as have the Mercosur investment protocols.

“To date, 41 cases have been registered by the Centre, 3 involving conciliation, the remaining 38 arbitration. Ten of the arbitrations are currently pending before the Centre. The majority of the other cases have concluded with settlements by the parties coming to terms before the rendition of an award.”¹⁷ It is generally assumed that the existence of ICSID, its inclusion in many bilateral and regional investment agreements, and the fact that its arbitration awards are not subject to judicial review have provided a powerful incentive for dispute avoidance. That the Convention contains no rules of substantive law and no rules of conduct has presumably contributed to the willingness of parties to accept its jurisdiction.¹⁸

In July 1990 the Development Committee of the International Monetary Fund and the World Bank published guidelines on the treatment of foreign direct investment, specifying that “these guidelines are not ultimate standards but an important step in the evolution of generally acceptable international standards which complement, but do not substitute for, bilateral investment treaties.”¹⁹ The guidelines articulate what may be deemed an interim consensus, albeit not a negotiated one, on a number of critical issues that will inform any broadly based multilateral investment regime. On the issue of “performance requirements,” in effect obligations of investors, the guidelines state that “states will note that experience suggests that certain performance requirements introduced as conditions of admission (of investments) are often counterproductive and that open admission, possibly subject to a restricted list of investments (which are either prohibited or require screening and licensing), is a more effective approach.” It clearly recognizes the need for exceptions based on certain “sectors reserved by law of the State to its nationals on account of the State’s economic development objectives or the strict exigencies of its national interest.” Restrictions that apply to national investment on account of public policy (*ordre public*), public health and the protection of the environment will also apply to foreign investment.

The fundamental issue of most-favoured nation and national treatment is addressed with caution, reflecting the range of practice to be observed in bilateral investment agreements. The key obligation is for each state to “extend to

investments established in its territory by nationals of any other State fair and equitable treatment according to the standards recommended by these guidelines.” Rather than further developing the principles to be applied, the guidelines proceed to cover a number of key issues, such as issuance of licences, transfer of funds and access of personnel. An entire section deals with expropriation and unilateral alterations or termination of contracts, with a focus mainly on the issue of compensation.

2.1.3 UN Centre for Transnational Corporations Draft Code. The UNCTC Code is a defensive document. Its purpose has been defined as “to maximize the contributions of transnational corporations to economic development and growth and to minimise the negative effects of the activities of these corporations.”²⁰ The Code is a reaffirmation of the sovereignty of the receiving country. As so often, when a general principle such as sovereignty needs reaffirmation in this form, the underlying reality is that it no longer has the universal application that is being claimed. The Code attempts to strengthen the position of (weak) developing countries with large multinational corporations by defining a range of obligations, which would effectively transfer control over the investments to the receiving state. No investor is likely to undertake investment under such a regime.

The draft Code does not include the principle of most-favoured nation. It articulates as a basic principle that “transnational corporations should receive [fair and] equitable [and non-discriminatory] treatment [under] [in accordance with] the laws, regulations and administrative practices of the countries in which they operate [as well as intergovernmental obligations to which the governments of these countries have freely subscribed] [consistent with the international obligations] [consistent with international law].” The principle of national treatment is severely hedged by an introductory statement: “Consistent with [national constitutional systems and] national needs to [protect essential/national economic interests,] maintain public order and to protect national security, [and with due regard to provisions of agreements among countries, particularly developing countries,] entities of transnational corporations should be given by the countries in which they operate [the treatment] [treatment no less favourable than that] [appropriate treatment (end of sentence)] accorded to domestic enterprises under their laws, regulations and administrative practices [when the circumstances in which they operate are similar/identical] [in like situations].... [Such treatment should not necessarily include extension to entities of transnational corporations of incentives and concessions granted to domestic enterprises in order to promote self-reliant development or protect essential economic interests].” The proliferation of square brackets in this text—some on minor points—is an indication of the distance that remained to be covered when the effort was broken off.

The UNCTC Code addresses a number of important issues, including the long-term nature of investments, the obligations of investors, the need to respect national laws, and several issues relating to environmental management. Nevertheless, it has addressed these issues in a fashion that has served to further polarize the relationship between investors and the receiving countries. It does not adequately reflect the obligations already accepted by many developing countries in bilateral investment agreements. Moreover, its focus on multinational corporations no longer corresponds to the complex reality of foreign direct investment.²¹ It cannot be viewed as the basis for a multilateral regime, or even as setting the agenda for negotiations leading to such a regime.

2.1.4 Framework Convention on Climate Change. The FCCC is in fact a multilateral regime on structural economic change and investment. How this affects the application of WTO principles, such as most-favoured nation, will be discussed later. It is, however, essential to keep in mind that the FCCC is establishing a complex set of rules governing international investments that reduce greenhouse gas emissions. These rules can be viewed as the nucleus of a specialized international investment regime, organized according to principles that are very different from those which govern trade regimes.

The FCCC is currently in a state of development. The Clean Development Mechanism, introduced through the Kyoto Protocol, establishes a new set of rules that are applicable to international investments. It is premature to speculate on the full extent of the FCCC's development. Should indications of serious climate change on a global scale prove well founded, the FCCC may yet become a comprehensive regime for screening investments to ensure that their impact on global climate change remains as limited as possible.²²

2.2 Bilateral investment agreements

The number of bilateral investment treaties is remarkable. By one count, more than 900 such agreements had been concluded by July 1995.²³ No bilateral agreements have been concluded, however, between members of the OECD, with the exception of developing countries and those that have recently joined the organization (Korea, Turkey, Yugoslavia and Mexico in particular). In other words, bilateral investment agreements have typically been concluded between an OECD country and a developing country, or between developing countries. It is reasonable to assume that the motivation of one party is generally to attract investment, while the other is seeking to gain some additional protection for that investment.

The bilateral agreements are generally concluded based on "prototype" bilateral investment treaties, which have been elaborated by a number of countries. A complete list of these prototypes is not available, but it must be presumed that the instrument that is ultimately used will reflect the relative power and interests of the two parties.²⁴

The prototypes elaborated by OECD countries (France, Germany, Switzerland, the United Kingdom and United States) base the agreement on the principles of most-favoured nation and national treatment. The prototypes from Chile and China enunciate a more general principle of “fair and equitable” treatment, which is subsequently embedded in what might be termed a most-favoured nation framework. Chile includes a reference to national treatment whereas China does not. These differences suggest that some significant differences remain between countries, even at the level of the underlying principles. “Fair and equitable” treatment is a relative standard, which not only requires interpretation but can also clearly involve different treatment in different situations. Most-favoured nation and national treatment imply an absolute standard, particularly in light of their significance in the trade regime. In practice the remaining need for interpretation and adjustment is to be found in the phrase “under like circumstances” which applies to both most-favoured nation and national treatment.

Bilateral investment agreements include dispute settlement provisions, in accordance with generally accepted international legal practice. Most of these provisions draw, in one way or another, on the International Centre for Settlement of Investment Disputes. Alternatively, they incorporate the UNCITRAL arbitration rules.²⁵

The common characteristic of these bilateral agreements is that they do not “internationalize” the investment process. The agreements seek to use existing national law in a framework accessible to nationals of the other country. The international regimes created are minimalist, lacking individuality or any institutional or organizational capabilities. They generally rely on ICSID for dispute settlement. ICSID in turn remains embedded within the World Bank, sharing facilities and, to a certain extent, personnel.

It is tempting to view multilateral efforts to establish an international investment regime as little more than extending bilateral agreements to the multilateral level. Such a view misses the essential institutional differences between a regime that draws on existing national law and one that seeks to create new international law. In practice, these are entirely different regimes. The difference between bilateral and multilateral investment regimes is even more dramatic than the transformation brought about through the Uruguay Round Agreements, which took the General Agreement on Tariffs and Trade—an international institution without organizational existence—and transformed it into the World Trade Organization, an international organization which incorporates the GATT.

It is generally difficult to predict the impact of institutional changes when most other factors are kept constant. Thus the transformation of the GATT into the WTO could appear as a relatively modest fix to a practical problem.

Yet the results have transformed the trade regime and placed it at the centre of the debate about globalization. Certainly, the new agreements signed at the conclusion of the Uruguay Round contributed to the emergence of the WTO. But it is now also recognized that the change in organizational character changed perceptions in subtle ways, resulting in an increasing misfit between the organization's traditional practices and the expectations it faced.

The tendency is to assume that the same words will always produce the same results, but it has often been shown that this assumption is false. In international society, the struggle of the European Union to achieve proper implementation of its directives, particularly its environmental directives, is perhaps the most enduring example. In international investment regimes, the use of commercial arbitration procedures to review regulatory measures provides a recent example.

The difficulties in actually predicting the impact of institutional changes induce many observers to discount their significance. Sometimes dramatic changes can have subtle impacts; at others times apparently minor adjustments have major consequences. Much more needs to be known about these processes in international society.²⁶

2.3 Regional investment agreements

A 1996 compendium lists 31 regional instruments dealing with investment and eight free trade and regional economic integration instruments that contain investment-related provisions.²⁷ The variety of instruments is large, ranging from the Treaties establishing the European Union to OECD instruments, and from the Community Investment Code of the Economic Community of the Great Lakes Countries (1982) to the APEC Non-Binding Investment Principles. Their common characteristic is that they rely on an existing organization to provide the means of implementation, rather than attempting to create an institutional framework of their own. A number of examples may serve to illustrate the approaches that have been chosen.

2.3.1 Arab investment regime. A series of agreements have been concluded that seek to promote investment between Arab (or Islamic) states, beginning with the Agreement on Arabic Economic Unity in 1957, which guaranteed free movement of persons and capital in Article 1.1 and free exchange of goods in Article 1.2.²⁸ They are an outgrowth of the Organisation of the Islamic Conference. These agreements contain many of the provisions on security of investment and investor rights that are found in other international investment agreements. Their principal purpose is, however, to give preference to investors from Arabic (or Islamic) countries. No information is available on the effectiveness of these agreements.

2.3.2 ASEAN industrial joint ventures. The Association of South East Asian Nations is a loose multilateral grouping. Its approach to investment is singular, focusing on the concept of joint ventures and “Industrial Joint Venture Products.”²⁹ This agreement is not intended to create a comprehensive investment regime but rather creates tariff preference for certain kinds of enterprises, comparable to the *maquiladora* principle in Mexico. There are several indications that the agreement actually benefits a number of specific regionally operating enterprises, for example the extension of the deadline for raising minimum ASEAN equity ownership in a joint venture from 40 to 51 per cent. First limited to projects that applied for joint-venture status by the end of 1990, two subsequent protocols extended this deadline to the end of 1993 and then to the end of 1996.

2.3.3 The North American Free Trade Agreement. NAFTA has gone further than any other regional trade agreement in developing a set of specific rules for investment.³⁰ It is based on the bilateral agreements developed by both Canada and the United States. Chapter 11 of NAFTA applies to foreign investors and investments (i.e., those from the other Parties) and its prohibitions on performance requirements and the injunction against encouraging investment by relaxing “domestic health, safety or environmental measures” apply to all investments, both foreign and domestic.³¹ The investment chapter articulates three principles: national treatment, most-favoured nation and a “minimum standard of treatment.” National treatment and most-favoured nation require that a country’s treatment of NAFTA partner investors be “no less favorable than that it accords, in like circumstances,” to domestic investors, or to investors of any other country. The minimum standard is defined as “treatment in accordance with international law, including fair and equitable treatment and full protection and security.” This language effectively incorporates two standards of treatment that are used as alternatives in some bilateral investment agreements, thereby circumventing the need to choose. It suggests that the combination of MFN and national treatment represents a stronger standard although this need not be the case. “Fair and equitable” introduces the need for interpretation, which can ultimately lead to much more significant and balanced conclusions.

Dispute settlement between Parties under the chapter on investment falls under the general provisions of NAFTA governing the settlement of disputes between the Parties. The chapter on investment contains a further set of rules governing the settlement of disputes between a Party and an investor of another Party.³² These proceedings are based on the ICSID Convention (and the UNCITRAL Arbitration Rules).³³ In this regard, NAFTA explores new territory.

NAFTA, completed in 1992 by Canada, Mexico and the United States, was the first regional or multilateral investment agreement to grapple with these

issues. The focus in those negotiations was on enhancing investor security. Where the environment was considered, the focus was mainly on the enforcement of environmental laws and assuring that NAFTA would not lead to the creation of so-called pollution havens or a general “race to the bottom” for environmental standards.

In contrast, during the negotiations and over NAFTA’s first two years, little attention was given to the scope and interpretation of the investment protection provisions contained in NAFTA’s Chapter 11, and how they relate to environmental protection by the host state. The past few years’ experience demonstrates, however, that this is a critical area to consider. The investor protections provided in Chapter 11 have been used repeatedly to challenge the host country’s environmental laws and administrative decisions. As a consequence the provisions designed to ensure security and predictability for investors have now created uncertainty and unpredictability for regulators. This in turn has impacts on a broad range of public values and threatens to colour the public’s perception of the entire agreement.

Table 5 sets out the known Chapter 11 cases initiated to date. The absence of any transparency requirements means this list may be incomplete. The bolded cases are those with a known environmental angle.

Table 5. NAFTA Chapter 11 cases to date.

<i>Company</i>	<i>Party</i>	<i>Issue</i>
Halchette Distribution Services	Mexico	Unknown
Signa S.A. de C.V.	Canada	Impact of administrative drug approval process on an investor
Ethyl Corp.	Canada	Import ban on gasoline additive MMT for environmental purposes
Metalclad Corp.	Mexico	State and municipal actions allegedly preventing the location of a hazardous waste facility
Desona de C.V.	Mexico	Alleged breach of contract to operate a landfill
Marvin Feldman	Mexico	Unknown
USA Waste (“Acaverde”)	Mexico	Believed related to landfill activities
S.D. Myers	Canada	Temporary ban on PCB waste exports
Loewen Group Inc.	United States	Award against company following allegedly biased civil court proceeding

<i>Company</i>	<i>Party</i>	<i>Issue</i>
Sun Belt Water Inc.	Canada	Allegedly biased treatment by provincial government of U.S. partner in a joint water export venture
Pope & Talbot	Canada	Allegedly discriminatory export quotas to implement the U.S.-Canada Softwood Lumber Agreement
Methanex Corporation	United States	Claim for \$970 million for breaches arising from California's adoption of a ban of the fuel additive MBTE
Mondev International	United States	Real estate in Boston

NAFTA has an extensive investor–state dispute resolution process, which gives foreign investors the right to directly challenge host governments on their compliance with the Agreement. This mechanism was sought by the U.S. and Canada to protect their investors in what was then a suspect Mexican system, and was welcomed by Mexico as a tangible guarantee, sure to increase the flow of investment from the North. As a result of this confluence of economic interests, Chapter 11 contains the most extensive set of rights and remedies ever provided to foreign investors in a multilateral investment agreement.

Although much of the cause for environmental concern derives from the way the provisions have been argued in the cases to date, two characteristics of the dispute resolution process compound the substantive concerns.

First, the process allows foreign investors to sidestep procedural or public-interest safeguards in favour of a non-transparent, secretive system of arbitration with no right of appeal. Although common in purely commercial areas where money is the only issue, Chapter 11 is unprecedented in its reach into critical areas of public policy-making as the cases to date demonstrate. The Ethyl case involved the ban of a fuel additive (a suspected carcinogen), a decision that had been controversial between the Canadian federal government and the provinces. The Methanex case deals with a comparable decision by California, but it also seeks to deter other states from following California's lead. The Sun Belt case is concerned with unequal treatment of Canadian and American companies, but on an issue of great political saliency in Canada, the possibility of initiating bulk water exports.

Second, the right to initiate cases is unfettered by any need for consent from the Parties. The result is a growing and alarming strategic use of the provisions by investors to further private interests, often threatening environmental protection and other public-policy goals. It is clear from the history of Chapter

11's use to date that this strategic tool will be employed both before and after regulations have been adopted. This has changed the investor–state provisions, from their intended role as a defensive investor protection mechanism to an offensive strategic tool.

Initiating such suits is virtually cost-free for major companies, costing literally just a few thousand dollars to prepare a notice of intent to arbitrate that starts the process and produces privileged access. Without clarity on how to interpret the provisions (what constitutes expropriation? what is meant by national treatment?), this is a modest cost to business but a large potential cost to government.

There might be less cause for concern about the dispute resolution mechanism if there were greater certainty about the scope and interpretation of the provisions on which it rules. The scope of the provisions is alarmingly broad; the definition of “measures” subject to review includes both legally binding and non-binding acts, and even such things as court decisions. This leaves a wide range of measures open to potential challenge, certainly including environmental and other public welfare laws, regulations, policies or administrative actions. The Ethyl case, settled out of court, argued that government statements about the dangers of the investor's product constituted actionable “measures.” The government reversed these statements in the settlement.

The definitions of investor and investment are equally broad, including virtually any form of equity participation, debt security, any loans to an enterprise, property acquired in the expectation of an economic benefit, other interests arising from a commitment of capital, and so on. Minority shareholders in a company, certain bond holders, and other “passive” investors can exercise the rights of an investor under Chapter 11, in some cases without having the consent of the company itself. It is foreseeable that a foreign component might be strategically added to an otherwise domestic investment simply to have access to the extraordinary rights and remedies found in Chapter 11, since they go far beyond the rights available to purely domestic investors.

The Parties must adhere to five disciplines:

- national treatment;
- most-favoured nation treatment;
- minimum international standard of treatment;
- prohibitions against certain performance requirements on investors; and
- provisions governing expropriation.

The best known of these in the environmental community are the provisions on expropriation. But the other provisions are also troubling from a sustain-

able development perspective. The existing Chapter 11 challenges against Canada alone have already raised all five of these disciplines in seeking damages for Canadian environmental measures. As will be argued below, each discipline is fraught with uncertainties that have significant detrimental effects on sustainable development.

Articles 1102, 1103: National Treatment and Most-Favoured Nation. These are comparative standards that require a host country to treat a foreign investor in a manner that is “no less favourable” than the way in which they treat their own investors or investors from any other country. This seems straightforward, but its actual application raises a number of questions. First, what does “no less favourable” mean to an environmental regulator? Does it mean that a foreign investor must receive the best treatment of any other company? Does it require average treatment, if this can be measured? Can the comparison be against a domestic company receiving the least favourable treatment of all domestic companies? A pending case argues that the investor has received less favourable treatment than some domestic firms, since it is subject to softwood lumber export quotas in its province of operation (as are domestic firms in that province), but such restrictions are not present in some other provinces. In another case, an investor argued that even though no domestic firms were producing its product (MMT, a gasoline additive), an import ban violated its rights since it amounted to treatment less favourable than a domestic producer *would* have received.

Second, it is unclear whether there may be some legitimate reasons for treating a foreign investor differently. The “no less favourable” treatment to be accorded to foreign investors is to occur “in like circumstances,” a phrase which has been defined in laws covering trade in goods. But defining it in the context of long-term investments is altogether different. If a foreign investor is denied permission to build a polluting plant because emissions from the existing plants in that area have already reached regulatory thresholds, are the potential investor and the existing firms in “like” circumstances? And, while “like circumstances” for goods producers has come to be judged by the commercial substitutability of the goods, such a test may be too limited for environmental regulators, who will also need to consider the environmental impacts of production, consumption and disposal of the goods.

Article 1105: Minimum standard of treatment in accordance with international law. This discipline requires minimum standards of “international law, including fair and equitable treatment and full protection and security,” to be met. The existing cases that cite this provision argue a fairly consistent theme of lack of due process or a denial of justice, or both. From a sustainable development perspective, this is the least worrisome of the five Chapter 11 provisions.

Article 1106: Performance requirements. This discipline prohibits certain types of requirements that governments might try to impose on investors. For example, governments may not demand that firms source their inputs domestically, or export a certain percentage of their output. Nor may they demand that investors transfer a particular technology or proprietary knowledge as a condition of investment. There is an environmental exception, for measures “necessary” to “protect human, animal or plant life or health” or for the conservation of natural resources, but the traditional interpretation of “necessary” in trade law exceptions suggests this may be a tough hurdle to clear.

It is not certain whether this provision might be used against *any* measure that restricts the import or export of goods, or imposes any quotas or tariffs, whether or not related to a specific firm or as a condition of investment. With Canada’s import ban on MMT, for example, the complainant argued that the ban had the effect of a performance requirement, since it effectively forced the firm to produce the product domestically rather than import it. Canada protested that this argument would make *every* border measure a performance requirement, but conceded that the issue could be decided on the merits. The case was settled out of court in the complainant’s favour, perpetuating the uncertainty.

Article 1110: Expropriations. The provisions on expropriation have received the most public attention, given their significant potential impacts on environmental regulation. Article 1110 states in part:

“No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”), except: (a) for a public purpose; (b) on a nondiscriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation...”

This article serves a valuable purpose: foreign investors need protection from unfair expropriation of their physical property. They also need protection from less extreme or obvious actions with the same intent, such as the removal of directors or excessive taxation. Most of the disputes brought to arbitration under this article will be of the latter type, complaining that some government measure, by constraining the commercial activity of the investor, constitutes *indirect* nationalization or expropriation, or is *tantamount* to it. The concern is that this article may be interpreted to prevent governments from regulating commercial activity to protect the environment, or human health and safety—exercising the “police powers” that are not traditionally considered expropriation under international law.

In the United States, this question has become a heated issue under the title of “regulatory takings.” This is a constitutional issue arising from the protec-

tion of private property, and one that has particular significance for environmental laws because of their impact on land and property use. If Article 1110 (1) is successfully used to challenge government actions, it will amount to a short-circuiting of the ongoing U.S. process for resolving this still controversial issue.

In the NAFTA context there are no clear guidelines to help distinguish between regulatory takings that are subject to compensation and regulation that is not. Analysts of the present state of international law generally hedge their bets on the distinction, even for measures of general application and without any discriminatory or abusive factors. This is in part because increasingly, even where the *intent* or *purpose* of a measure is laudable, the measure's actual *effect* is the test used in determining liability. This "effects test" creates even more uncertainty given the changing nature of environmental regulation, which necessarily involves targeted measures, based on site-specific activity. Such regulations, permits or administrative decisions are bound to be uneven in their economic effects across the regulated sector.

The uncertainty that prevails in general international law on this question is compounded in the NAFTA context by a number of provisions unique to the Agreement. These include the expansive definition of "measures," discussed earlier, and a specific exception for certain measures of general application (implying a willingness to contemplate a broader range of application than normally prevails). The Agreement also breaks new ground in applying the Chapter 11 provisions to general measures of taxation, and in including three separate threshold tests for compensability: expropriation, indirect expropriation, and measures tantamount to expropriation.

It is difficult to predict which of the broad range of existing or proposed environmental measures in the NAFTA countries might be found to amount to expropriation. This has troubling implications for environmental policy. Foreign direct investment, unlike trade in goods, is a long-term process, often extending over several decades. The prospect of paying compensation for changes in environmental regulation over the life span of a foreign investment has the potential to create a "regulatory freeze."

The initiation and conduct of investor–state disputes is carried out in private. There are few requirements to provide the public with information at various stages of the process—and such requirements as exist have been rendered inoperative by the Parties' failure to establish the Trade Secretariat provided for under NAFTA. The secrecy has begun to be reversed by at least two of the three governments, but the process of change remains *ad hoc*.

This lack of transparency is aggravated by at least two key factors in the NAFTA case. First, the scope of the measures covered by NAFTA and the

uncertainties of interpretation of the provisions, mean that many cases will go beyond narrow commercial disputes to core issues of public policy. Second, Chapter 11 allows negotiations on such issues to take place solely between the government and foreign investors in a privileged and secret context.

2.3.4 APEC Non-Binding Investment Principles. In 1994 the Sixth Ministerial Meeting of APEC endorsed the APEC Non-Binding Investment Principles.³⁴ As is often the case with APEC declarations, this statement of principles clearly defined the boundaries of current consensus within the broader trade context. APEC includes many major countries, both members and non-members of the WTO, in particular Canada, China, Indonesia, Japan, Mexico and the United States. Without a culture of negotiation comparable to that of the WTO, APEC can articulate consensus positions on issues that have proven intractable in other fora, yet leave scope for necessary negotiation.

The APEC investment principles set out, with remarkable clarity, the agenda for an international investment regime: transparency, non-discrimination (most-favoured nation and national treatment), investment incentives, performance requirements, expropriation and compensation, repatriation and convertibility, settlement of disputes, entry or sojourn of personnel, double taxation, investor behaviour and the removal of capital exports. On the central issues, the APEC principles introduce significant qualifications. Thus, most-favoured nation treatment is promised “in like situations, without prejudice to relevant international obligations and principles.” National treatment is accorded “with exceptions as provided for in domestic laws and policies.” Signatories will “minimize the use of performance requirements that distort or limit expansion of trade and investment.” The principles include a clear statement that “member economies will not relax health, safety, and environmental regulations as an incentive to encourage foreign investment,” a statement presumably more assertive for being non-binding. They include the observation that “acceptance of foreign investment is facilitated when foreign investors abide by the host economy’s laws, regulations, administrative guidelines and policies, just as domestic investors should,” identifying the need to address investor obligations along with investor rights.

2.3.5 The Multilateral Agreement on Investment. The Organisation for Economic Co-operation and Development has a long-standing interest in foreign direct investment. This is readily understandable since the preponderance of such investment has occurred between member states of the OECD, and foreign direct investment that has occurred in developing countries tends to have originated from OECD countries.³⁵ Despite this fact, there are few bilateral investment agreements between OECD countries, nor, until very recently, has the OECD itself sought to develop a multilateral agreement on this issue.

The OECD is not normally a negotiating forum. Its principal activities concern compiling and exchanging of information between its member states. The OECD is the source of much information on foreign direct investment, some of which is further incorporated into the relevant UN documentation. As well, the OECD has published a number of analytical studies on the issue.

The OECD Council can adopt decisions and declarations, whose binding force remains a matter of debate. Certainly, decisions must be viewed as significant, even though they are not subject to a ratification procedure and even though there is no tradition of enforcement. Over the years, the OECD has adopted a declaration and a number of decisions on international investment and multinational enterprises.³⁶ The 1976 Declaration ties together all other OECD activities related to investment.³⁷ It is addressed to “multinational enterprises” and member countries and covers just six issues:

- It recommends to multinational corporations that they observe the OECD Guidelines for Multinational Enterprises;
- It defines national treatment and states that member countries “should” accord this to enterprises operating in their territories; it also develops a process to make exceptions to national treatment more transparent;
- It seeks to establish a procedure to avoid imposing conflicting requirements on multinational corporations (a section added after the 1991 review of the Declaration);
- It identifies investment incentives and disincentives as a matter of concern;
- It establishes a consultation process for the Guidelines, national treatment and incentives and disincentives; and
- It creates an obligation to review the functioning of the Declaration every three years.³⁸

In essence the Declaration represents a framework agreement for a joint program on international investment.

Directly linked to the Declaration are Guidelines for Multinational Enterprises, which define OECD member states’ expectations of multinational corporations.³⁹ They are a unilateral declaration on the part of governments, although they have presumably been reviewed with representatives of industry before being adopted. Adopted first in connection with the Declaration in 1976, the Guidelines have been amended several times. The most significant change was the 1991 addition of a paragraph on the environment. A further revision of the Guidelines was adopted in June 2000.⁴⁰

The Guidelines must be seen in relation to efforts within the United Nations to develop a Code of Conduct on Transnational Organisations. The UN launched this effort in 1974 by establishing the Commission on Transnational Corporations.⁴¹ The OECD Declaration and Guidelines can be seen as an attempt to establish the boundaries for the UN effort. A comparison of the two instruments shows how differently they address a single agenda.⁴² The differences begin with form and process, which necessarily lead to differences of substance. The UNCTC sought to draft a “code,” thus conveying the notion that the document would be binding in some way. The OECD speaks only of “guidelines,” conveying clearly that the instrument was not to be binding. The UNCTC process was one of negotiation, with an elaborate apparatus and a series of negotiating sessions involving all member states. The OECD document is drafted by the Secretariat under the auspices of one of the committees. Presumably, the original Guidelines were promulgated after consultation with industry representatives. The current process of revision includes a public comment phase. The UNCTC draft had to be abandoned before it was agreed to, and contained some strong affirmative language that was heavily bracketed. The OECD Guidelines have been available for almost 25 years without any indication that they have had an impact—beyond sidetracking the UNCTC process. In recent years the OECD approach is the only one that has survived. Although the UNCTC approach clearly was incapable of gathering sufficient support, the issues it identifies still deserve serious consideration in any investment agreement that reaches beyond the OECD.

The revised version of the OECD Guidelines is the result of a lengthy process that included opportunity for public comment. They suffer from their hortatory nature, which precludes the kind of specific detail that might be required to render them useful in practice. It is interesting to compare them with the requirements for certification under the ISO 14000 series of standards. They are more specific in a number of areas and incorporate the ISO requirement for a system of environmental management that aims at continuous improvement. They avoid the difficult issue of developing company-wide standards and adhering to the highest standards in all jurisdictions, regardless of legal requirements. The OECD Guidelines lack any mechanism for reporting or review of performance, so it is reasonable to assume that the ISO standard will be more effective in the medium term, even if it is less ambitious to begin with. The central dilemma of the OECD Guidelines remains that they deal with putative obligations without reference to the rights of enterprises. This is as problematic as defining rights without obligations, an approach attempted in the negotiation of the MAI.

After the conclusion of the Uruguay Round, the OECD economics ministers launched negotiations for an MAI, for which the OECD provided the forum even though the negotiations were considered an independent enterprise. The

decision to begin negotiations did not attract much attention. Their purpose was to create a single multilateral framework for investment to fill gaps left by bilateral agreements.

To assess the MAI initiative in the OECD it is important to understand the role that the OECD has played in the evolving trade regime. It has traditionally been a forum in which the governments of developed countries could articulate an agenda and explore agreements and disagreements before taking the issues to the wider forum of the GATT. In this manner, the OECD has acted as an informal preparatory forum for recent GATT Rounds—certainly since developing countries formed a majority in the GATT/WTO—including the Uruguay Round. Presumably, this tradition provides an important background to the Ministerial Council's decision to launch the MAI negotiations.

Given the difficulties that had been encountered in addressing the issue of investment in the GATT/WTO, clearly the intention was to develop an instrument that would become the basis of a broader, global investment regime. In recent years the OECD has extended its reviews of foreign direct investment to countries outside the organization, for example Ukraine, Chile, Argentina and Brazil.⁴³ A number of these countries sat in on the MAI negotiations. In addition, a series of meetings was organized parallel to the MAI negotiations to consult with the governments of the “dynamic economies of Asia and Latin America.”⁴⁴ In essence this was a form of lobbying of governments by other governments, seeking to create a favourable basis for action on an international investment regime.

In light of the OECD experience in analyzing foreign investment, its publications on the topic, successful conclusion of the Uruguay Round, and the significant effort to include key developing countries, the MAI negotiations were perceived as the end of a long process. Given the existence of numerous bilateral and regional agreements and the broad consensus on the underlying principles, at least among the participants in the negotiations, framing the MAI was seen by many as largely a technical task, which could be completed fairly expeditiously.

The negotiations were conducted by a group of senior civil servants and were largely isolated from the regular business of the OECD, and from public debate. In March 1998, after an unprecedented international campaign, triggered by environmental interests but supported by a wide range of groups that are skeptical about the processes of globalization and the distribution of its benefits, the MAI negotiations were put on a slower track with no deadline. In October 1998 the process was abandoned entirely after France withdrew, mainly because it could not shield its cultural industries from the MAI rules. The newly installed German government also decided to press for “social and

ecological compatibility,” which could not have been accommodated in the technical draft under consideration. The result was a lengthy, much-bracketed text that did not do much more than articulate the principles of most-favoured nation and national treatment, proscribe performance requirements, and provide for dispute resolution. In this regard, the text of the MAI mirrors quite closely the typical bilateral agreements on investment concluded by many OECD countries. It also reflects many of the investment provisions of NAFTA.

The MAI was institutionally stunted. Trying not to pre-empt a later transfer to the WTO, or the creation of a separate entity for investment, the negotiators produced an institutional structure like the original GATT, without a strong organizational base and with the narrowest of institutional resources. It is difficult to understand how the MAI negotiators could have failed to perceive the problems created for the GATT by its strange institutional structure, imposed by the need to circumvent the consent of the U.S. Senate. Apart from the difficulties encountered in any attempt to amend the Agreement, without legal identity or a proper secretariat, the GATT remained a pawn of the member states to an extraordinary extent, even by the standards of weak international organizations. Although this offered the advantage of avoiding conflicts with powerful member states, it entailed the drawback that broader international interests were never properly articulated. An investment agreement, with its inherent need to balance different policy priorities, can hardly be expected to survive without a strong advocate for the common interest underlying the regime.

Although the MAI text is lengthy and appears complex, it is a relatively straightforward document. It is certainly much less complex than most environmental agreements, and the FCCC in particular. It codifies the principles and institutions of the GATT and of bilateral investment agreements—most-favoured nation treatment, national treatment, some transparency, dispute settlement and a ban on performance requirements—in the context of investment. In doing so it perpetuates the view that the international policy priority is to liberalize the flow of investment—that is, to create new markets for investment. In fact these markets already exist. The real need is to ensure that they function in a manner that reflects a balanced understanding of the individual rights and public needs.

In retrospect, launching the MAI negotiations as a technical process in the OECD without a clear political mandate can be seen to have been an error. By creating a negotiating process that was not integrated with the organizational structure of the OECD, the negotiators failed to perceive early-warning signs. For example, an attempt by the OECD Environment Committee to engage the negotiators in debate was waved off. No thought was given to the

problems that are likely to arise when bilateral agreements, which leave the parties in full control of the process, are turned into a multilateral agreement, which creates new international law and initiates a dynamic that must ultimately lead to new organizational structures.

The dangers of this process are illustrated by experience with the NAFTA Chapter 11 investment provisions, which reflect many of the assumptions underlying the MAI.⁴⁵ The difficulties that have arisen in NAFTA with the investor–state dispute settlement process illustrate the dangers inherent in relying on an inappropriate institutional structure to balance private rights and public needs. Similar problems might have been expected under the MAI. For example, shortly after the termination of the MAI negotiations, the newly installed German government took a political decision to end its country’s use of nuclear energy. Among the key determinations leading to this policy was a decision to put all accumulated waste from nuclear power generation in Germany into interim storage and thence into long-term storage, implying the end of all reprocessing operations. Reprocessing for waste from German nuclear power plants occurred in two locations: in France and the United Kingdom. In practice reprocessing nuclear waste had become meaningless since the fast-breeder reactors it was intended to fuel had proven inoperable everywhere. But reprocessing of nuclear waste from German power plants—essentially the transformation of one form of nuclear waste into another form—had continued because a previous government had accepted this as equivalent to final disposal (implying the existence of fast-breeder reactors). The new German government announced a decision to withdraw this recognition as part of the transition out of nuclear energy. It is interesting to speculate on the impact an agreement such as the MAI could have had on the German government’s decision had it been in effect. Only facilities (and hence investments) in France and the United Kingdom were affected. Presumably, the MAI would have provided the reprocessing facilities with rights to pursue the German government for an action equivalent to expropriation. Even if such a complaint were not to succeed, it boggles the mind to consider a situation in which an “MAI dispute panel” would decide, without public accountability or debate, the relative position of the German government and the reprocessors in the inevitable dispute over compensation. This could create a situation where an unaccountable panel of trade law experts would review and second guess one of the most contentious public and political decisions in German politics at the end of the 20th century.

The assumption that the principles underlying the GATT/WTO system are also appropriate for an investment regime has never been questioned.⁴⁶ Even more seriously, the lessons from 50 years of struggling with the institutionally inadequate GATT appear not to have been learned. While the initial resistance to the MAI originated in environmental circles, it ultimately encountered a

roadblock because no major party endorsed it enthusiastically. Once countries began to focus on its implications the number of reservations grew so large as to nullify the effectiveness of the agreement. In other words, the negotiations collapsed because the original approach was flawed.

In retrospect, the opposition to the MAI appears increasingly as the first event in a gathering movement to resist globalization. Followed quickly by the inability of the U.S. Administration to obtain fast-track authority from Congress, an enormously damaging public dispute about the appointment of a new head of the WTO and the collapse of negotiations in Seattle, the failure of the MAI demonstrated the vulnerability of the institutions that have been created to guide the emergence of international markets. A common theme of each of these events is the attempt to continue down a well-trodden path at a time when the reality of international economic relations has changed beyond all recognition. Although markets have been innovating at an extraordinary pace, governments appear to believe that the remedies from 50 years ago still provide answers to the challenges of international markets.

2.3.6 *The European Union.* The approach to foreign direct investment taken in the original treaty establishing the European Economic Community was entirely different from that in other international investment agreements, reflecting the special character of the EU.⁴⁷ Article 3(c) of the EEC Treaty specified that among the purposes of the Community is “the abolition, as between Member States, of obstacles to freedom of movement for persons, services and capital.” This objective was developed in Title III, which covered freedom of movement for workers, the right of establishment, the freedom to provide services, and the free movement of capital. Together with the subsequent revisions of the Treaties through the Single European Act, the Treaty of Maastricht, and the Treaty of Amsterdam, these provisions secure unlimited foreign direct investment between countries of the EU, subject only to the Rules on Competition (Title 1, Chapter 1) and certain issues dealing with agriculture.

This difference in approach has implications for the EU’s participation in international negotiations on investment. The Treaties create obligations for the Member States to permit the free movement of people, services and capital, without the need for further legislative action by the EU. In contrast with commercial policy, which requires continuous regulatory action by and assigns exclusive competence to the EU, the approach taken by the Treaties does not establish a specific EU competence, outside competition policy. On the other hand, as the EU legislates in ancillary areas, it also acquires the related external competence. As a result the EU and Member States need to participate together in comprehensive multilateral negotiations on investment, whereas the Member States can and do act alone in the bilateral context.⁴⁸

2.4 Unilateral action

A particular issue related to foreign direct investment is continuing “home state” control; that is, the extent to which the country in which an investor is based retains a measure of control over that investor’s investments in another country. This is an issue even where investment insurance—which introduces the home state directly into the relationship between investor and host state—does not come into play. “The home state continues to have an interest in the foreign investment after it leaves its shores, over and above its interest in the protection of the foreign investment through the principles of state responsibility and diplomatic intervention.”⁴⁹ This fact alone should warn negotiators that investments are different in character from trade in goods and will give rise to a range of issues beyond those encountered in multilateral trade regimes.

For most regional and multilateral investment agreements, however, unilateral action represents a particular problem that needs to be kept within strict limits. Historically, European countries continued to exercise extensive unilateral control over the investments of their nationals in former colonies that had become newly independent. Indeed, protection of nationals and their investments has repeatedly been given as a reason for using force, mainly in the countries of Africa, by European countries.

The United States, on the other hand, has sought to exercise control over investments of its nationals, and even over investments of nationals of other countries, relative to its foreign policy. The examples are many and include embargoes against the People’s Republic of China, pressure on U.S. corporations and European subsidiaries of U.S. corporations seeking to undermine the construction of the Siberian gas pipeline to Western Europe, an attempt to freeze Iranian assets in banks outside the jurisdiction of the U. S. during the Iran hostage crisis, and U.S. efforts to punish foreign corporations that do business in Cuba by threatening their position on the U.S. market.⁵⁰

A special instance, situated between trade in goods and foreign direct investments, were the rules that evolved during the Cold War in an attempt to keep certain advanced technologies from becoming available to countries in the Soviet bloc. This led to the establishment of the Coordinating Committee on Export Controls (CoCom), a body linked to the OECD in much the same way as the MAI negotiations.⁵¹ CoCom was recently disbanded.

As with trade in goods, unilateral action is typically taken by a more powerful country against a less powerful one (although the United States has taken such action against a number of other major OECD countries). One purpose of a well-framed international agreement on investment must be to develop clear rules on the extent of home state interest in foreign investments, even when these are not subject to investment insurance schemes.

- 2 M. Sornarajah, *The international law on foreign investment*, Cambridge: Cambridge University Press, 1994, pp. 187–223.
- 3 *Ibid.*, p. 223.
- 4 United Nations Conference on Trade and Employment held at Havana, Cuba from November 21, 1947 to March 24, 1948, *Final Act and Related Documents*, Lake Success, N.Y.: Interim Commission for the International Trade Organization, 1948, p. 5 (quoted in United Nations Centre on Transnational Corporations, United Nations Conference on Trade and Development, *The impact of trade-related investment measures on trade and development*, New York: United Nations, 1991, p. 79).
- 5 “Ministerial declaration on the Uruguay Round,” in United Nations Conference on Trade and Development (UNCTAD), *Uruguay Round: Papers on selected issues*, New York: United Nations, 1987, p. 369.
- 6 World Trade Organization, *The results of the Uruguay Round of multilateral trade negotiation: The legal texts*, Geneva: WTO, 1995, pp. 163–167.
- 7 See Annex 1 in this book for the “illustrative list” of TRIMs.
- 8 Article 9 reads: “Not later than five years after the date of entry into force of the WTO Agreement, the Council for Trade in Goods shall review the operation of this Agreement and, as appropriate, propose to the Ministerial Conference amendments to its text. In the course of this review, the Council for Trade in Goods shall consider whether the Agreement should be complemented with provisions on investment policy and competition policy.”
- 9 United Nations Conference on Trade and Development, *International investment instruments: A compendium, vol. I: Multilateral instruments*, New York: United Nations, 1996, pp. 213–243.
- 10 Article 2.
- 11 “Special drawing rights” is an accounting unit used by the International Monetary Fund. Based on a weighted basket of currencies, SDRs are the closest equivalent of a global currency. As of 20 April 2000, 1 SDR = \$1.34 US. (See <http://www.imf.org/external/np/tre/sdr/drates/0701.htm>.)
- 12 Multilateral Investment Guarantee Agency, “MIGA: The mission and the mandate.” See <http://www.miga.org/welcome> (Jan. 2, 1999).
- 13 The Multilateral Investment Guarantee Agency, “Draft environmental assessment and disclosure policies and environmental review procedures,” <http://www.miga.org/welcome.htm> (Jan. 2, 1999), p. 2.
- 14 The World Bank, “An overview of ICSID,” www.worldbank.org/html/extdr/icsid/html (Jan. 2, 1999), p. 1.
- 15 Article 42 (1).
- 16 Aron Broches, “The experience of the International Centre for Settlement of Investment Disputes,” in Seymour J. Rubin and Richard W. Nelson, eds., *International investment disputes: Avoidance and settlement (Studies in Transnational Legal Policy No. 20)*, St. Paul, MN: West Publishing Co., 1985, pp. 79–80.

- 17 The World Bank, (Jan. 2, 1999), p. 2. See fn. 14.
- 18 Aron Broches, pp. 83 and 77.
- 19 United Nations Conference on Trade and Development, *International investment instruments: A compendium, vol. I: Multilateral instrument*, New York: United Nations, 1996, pp. 247–255.
- 20 Cited in Sornarajah (see fn. 2), p. 195, as part of the Preamble. This text is, however, not reproduced in Draft United Nations Code of Conduct on Transnational Corporations, in United Nations Conference on Trade and Development, *International investment instruments: A compendium, vol. I: Multilateral instruments*, New York: United Nations, 1996, pp. 161–180, which reflects the status of negotiations as at 1986.
- 21 *Ibid.*
- 22 See <http://www.unfccc.de> for materials on the development of the Framework Convention on Climate Change, which contains all the relevant documents.
- 23 United Nations Conference on Trade and Development, *International investment instruments: A compendium, vol. I: Multilateral instruments*, New York: United Nations, 1996, p. iv.
Fitzgerald et al., (see fn. 1), p. 28, speak of 1,600 bilateral treaties, without providing additional sources.
- 24 United Nations Conference on Trade and Development, *International investment instruments: A compendium, vol. III: Regional integration, bilateral and nongovernmental instruments*, New York: United Nations, 1996, pp. 115–258.
- 25 The United Nations Commission on International Trade Law (UNCITRAL) is an organ of the UN General Assembly. Established in 1966, UNCITRAL's goal is to promote harmonization and unification of commercial law. It developed the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which entered into force June 7, 1959 (<http://www.un.or.at/uncitral/english/texts/arbconc/58conv.htm>—Jan. 3, 1999). UNCITRAL has, by resolution of the General Assembly, established Arbitration Rules (<http://www.un.or.at/uncitral/english/texts/arbconc/arbitrul.htm>—Jan. 3, 1999) and Conciliation Rules (<http://www.un.or.at/uncitral/english/texts/arbconc/concirul.htm>—Jan. 3, 1999).
- 26 See Oran Young, *Institutional dimensions of global environmental change, IDGEC Science Plan*, Bonn: IHDP, 1999.
- 27 United Nations Conference on Trade and Development, *International investment instruments: A compendium, vol. II: Regional instruments*, New York: United Nations, 1996.
- 28 Agreement on Arabic Economic Unity, in UNCTAD 1996, vol. 3, pp. 25–26; Agreement on Investment and Free Movement of Arab Capital among Arab Countries (1970); Convention Establishing the Inter-Arab Investment Guarantee Corporation (1971); Unified Agreement for the Investment of Arab Capital in the Arab States (1981); Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organisation of the Islamic Conference (1981), in UNCTAD 1996, vol. 2, pp. 121–126, 211–228, 241–250.

- 29 Revised Basic Agreement on ASEAN industrial joint ventures, in UNCTAD 1996, vol. 2, pp. 281–291.
- 30 This section is drawn from Howard Mann and Konrad von Moltke, “NAFTA’s Chapter 11 and the environment: Addressing the impacts of the investor-state process,” Winnipeg: International Institute for Sustainable Development, 1999. Available at <http://www.iisd.ca/trade/chapter11.htm/>.
- 31 Article 1114.1: Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.
- Article 1114.2: The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.
- 32 Mann and von Moltke, 1999.
- 33 *Ibid.*
- 34 APEC, “APEC Non-Binding Investment Principles,” Jakarta: APEC, November 1999.
- 35 See Tables 1–4 in this book.
- 36 OECD, “The OECD declaration and decisions on international investment and multinational enterprises: Basic texts” (OECD Working Papers, vol. 5, no. 7) Paris: OECD, 1997.
- 37 “Declaration on international investment and multinational enterprises,” (21 June 1976), in OECD 1997, pp. 101–102.
- 38 Review has occurred in 1979, 1984 and 1991.
- 39 OECD, “Guidelines for multinational enterprises,” 1997, pp. 103–110.
- 40 See <http://www.oecd.org/daf/investment/guidelines/mnetext.htm>.
- 41 Economic and Social Council, Resolution 1913 (LVII) of 5 December 1974.
- 42 CUTS Centre for International Trade, Economics & Environment, *Multilateralisation of sovereignty: Proposals for multilateral frameworks for investment* (Discussion Paper #9807), Jaipur: CUTS, July 1998, Annex 2. This useful paper does not use the latest version of the OECD Guidelines.
- 43 Reviews of foreign investment are published by the OECD: Brazil (1998), Ukraine (1997), Chile (1997) and Argentina (1997).
- 44 See, for example, OECD, *Foreign direct investment: OECD countries and dynamic economies of Asia and Latin America*, Paris: OECD, 1995.
- 45 Mann and von Moltke, 1999.
- 46 See chapters 4 and 5 in this book.

- 47 In accordance with widespread practice, this book will refer to the European Union when discussing the EU, its constituent parts or its predecessor organizations. Technically precise nomenclature will only be used where strictly appropriate.
- 48 The European Commission has recently proposed amending the Treaties to include investment among the issues that fall within the exclusive competence of the European Community, joining trade and trade-related intellectual property rights.
- 49 Sornarajah, p. 145
- 50 For comprehensive analysis of U.S. sanctions until 1984 see Gary Clyde Hufbauer and Jeffrey Schott, *Economic sanctions reconsidered: History and current policy*, Washington, D.C.: Institute for International Economics, 1985.
- 51 Michael Mastanduno, *Economic containment: Co-Com and the politics of East-West trade*, Ithaca, N.Y.: Cornell University Press, 1992.

—3—

Regimes, institutions and organizations

Until quite recently the structure of international relations was stable, revolving around sovereign states, which created international organizations to achieve the limited goals they felt incapable of addressing alone. The transformation of “international society”—the individuals and organizations that work at the international level, whether they are organized internationally or not—has been dramatic. Several forces have been driving this process: the internationalization of economic activities, now known as “globalization,” the emergence of new information technologies that cannot be limited nationally, the pursuit of human rights, and the increasingly evident inability to manage conflicts between and within society with the traditional, sovereignty-based instruments. It is not generally recognized that the need to protect the environment, with its inescapable international dimension, is itself a major force promoting the process of “globalization,” understood to mean the progressive transfer to the international level of decisions previously reserved to sovereign states.

It has become increasingly difficult to describe these developments in the terms of traditional international relations: sovereign states pursuing their own interests, their agreements and the international organizations they have created, all determined in large measure by the arithmetic of power. The idea of the international common good, defined largely as the outcome of the actions of self-interested sovereign states, appears increasingly like the notion of domestic society as the result of the self-interested actions of individuals: a powerful idea but insufficient to explain all the phenomena being encountered in international society.

The rapid expansion of international investment fits into this stream of change. The focus is on an individual project, wherever located, undertaken by a single investor, a small group of investors, partnership or open funds, or by combinations of these. The notion of nationality of an investor is rapidly being elided, leaving only the host state with the responsibility of ensuring that the investment is undertaken appropriately—economically, socially and environmentally.

It is difficult to assimilate the emerging language of international relations, since this involves giving up a structure that appeared to be a powerful tool for

understanding what was occurring. Nevertheless, it is now becoming increasingly common to speak of international “regimes,” groupings of actors, whether states, public or private organizations, or individuals, acting at the international level to address jointly defined problems or to achieve jointly defined goals based on mutually agreed rules of behaviour. Traditional international organizations are “regimes.” International private (“non-governmental”) organizations are also “regimes.” The “Francophonie”—that is, the group of French-speaking countries—is a regime. Conceivably, all German speakers form a regime in Central Europe—currently roiled by a dispute about the role of private and public institutions in making the rules of orthography—which one hopes will not coalesce into a state. In addition, a large number of public/private regimes—for example the international banana supply chain or the international regime for settling payments between banks—have emerged for the simple reason that traditional, state-centred regimes have proven inadequate for the tasks at hand.

In addition to regimes, attention is increasingly focusing on “institutions”: the rules of the game. “Institutions” are important social conventions, which are in fact the most important building blocks of international regimes. For example, “property” is an institution that is widely recognized as essential to the development of international economic regimes. “Research,” or “scientific research,” is an institution without which no environmental regime can exist, since it takes research to identify and categorize environmental issues. “Contracts” are institutions governing relations between individual actors, public or private. “Markets” are institutions that have come to dominate thinking about economic affairs. “Participation” is an institution that resonates in democratic societies but has little or no meaning in authoritarian ones. It is remarkable how many institutions are receiving widespread international recognition as enjoying general validity. By focusing on the institutions of international regimes, rather than on sovereign states, it becomes possible to link the operation of these regimes to the substantive concerns they are designed to address.

An unfortunate ambiguity surrounds the word “institution.” It is frequently used as a synonym for “organization,” as in “International Financial Institutions.” Organizations are regimes with staff and a physical location. They generally have some form of charter or formal governance agreement, setting out objectives and identifying institutional means to achieve them. Organizations can be small, occupying one room and with part-time staff only, or very large. Frequently, organizations are needed to operationalize desired institutions.

The manner in which organizations and regimes incorporate institutions into their structure, and the range of institutions that are involved, are indicators

of the complexity of the respective organization or regime. It may also be an indicator of the ability of the organization or regime to address issues dynamically. The relationship between institutional richness and the effectiveness of international regimes remains one of the most important current issues of international relations research.⁵²

3.1 Dynamic and static regimes

The past decades have seen an extraordinary growth in international governance. Countless regimes have been created to address issues ranging from the management of cross-border wastewater treatment, to the movement of bananas in international commerce, to regimes for financial transactions, to human rights, sustainable development and nuclear proliferation. As the number of regimes has grown and the issues requiring international attention have proliferated there has been an understandable desire to use existing regimes to the maximum extent possible, adapting them to new tasks.⁵³ That is only possible, however, if the regime in question is sufficiently flexible and dynamic.

Traditionally, once a problem requiring international policy action is identified, the appropriate governments meet as legislators to create an international regime. The process is based on principles that date back more than three centuries and were largely fixed in the major wars of the 19th and 20th centuries. These principles were never designed to address a wide range of dynamic and potentially conflicting issues and, inevitably, the results are mixed at best.

State-based regimes reflect the reluctance of states, particularly powerful ones, to reduce their sovereign ability to control events that affect them. States are always grudging in granting authority to international regimes. Indeed, when international public regimes wield significant power, it is almost always the representatives of states who end up exercising that power, as they do within the WTO structure. As a rule of thumb, public international regimes with significant powers are tightly controlled by states and are limited in their ability to extend this authority to other areas. On the other hand, international regimes that are not as tightly controlled have but limited powers. Clearly, the WTO falls into the first category while organizations such as the World Health Organization and the Food and Agriculture Organization fall into the second.

Organizations that pursue a single goal can be described as “static.” They may modify the means for achieving that goal but the ends are considered unchanging. To describe such organizations as static is not to claim that they do not evolve. It identifies the essential one-dimensionality of their activities. Often their static nature permits them to focus sharply and is thus closely related to their organizational strengths and effectiveness in pursuing their goals. It is virtually impossible to transform a static organization into a dynamic one.

According to this definition, the WTO is a static organization. This is perhaps its most important strength and its greatest limitation.

In an era when the creation of the WTO appears as one of the major successes of recent policy, it is tempting to assign additional responsibilities to the WTO, particularly in the areas of investment and competition. Alternatively, policy-makers may be tempted to apply the principles that characterize the WTO to create new organizations. Both approaches entail risks. Issues requiring a dynamic response are not appropriate for a static organization.

The WTO is built around two principles that together achieve non-discrimination in trade—most-favoured nation and national treatment—with transparency requirements and the dispute settlement process to support them. These principles, enunciated in Articles I and III of the GATT, are viewed as absolute obligations of member states of the WTO, modified mainly by the exceptions of Article XX.⁵⁴ Their application is not a matter of judging whether they have been properly balanced against other policy priorities but is largely the assessment of government actions against standards that are considered absolute—because without them the threat of protectionism is constant.

The dispute resolution process of the WTO is unique in international society. Nowhere else do states submit to comparable systematic arbitration of disputes. In particular, respondents cannot choose whether they will participate in a WTO dispute settlement procedure. To be acceptable to the member states, however, the dispute process needs to remain sharply focused on the specific agenda of the trade regime. The result is a remarkable organization, which is, however, static. It is put at risk when overburdened.

Some international regimes have been created because a problem was recognized but the solution was still unknown or uncertain. It is highly intuitive that such organizations are structured differently from regimes that apply known remedies to identifiable problems. They will also need to employ different institutions. Such regimes are designed to be dynamic in the sense that they can adopt new approaches and develop innovative institutions as more becomes known about the underlying issue. They may even need to redefine the issue itself as more becomes known about it. Perhaps the most characteristic institution of such regimes is the “framework agreement,” which identifies a problem, establishes a range of institutions but does little to promote a solution to the issue. Such dynamic regimes may appear weak and ineffectual relative to static regimes. In particular, they are unlikely to have binding principles or institutions of enforcement. Nevertheless, they have sometimes proven capable of developing effective policy approaches and achieving a remarkable degree of compliance. It is almost impossible to understand the operation of dynamic regimes from the perspective of static ones, and vice versa.

The most important area for the development of dynamic organizations is that of environment and sustainable development, with its built-in tensions between policy priorities. Our knowledge about environmental phenomena derives in large measure from natural science research and entails considerable uncertainty about the issues and their remedies. International environmental regimes necessarily reflect these uncertainties and are typically designed to evolve over time. They derive their effectiveness from sources that are quite different from those that promote the effectiveness of static regimes.

An analogy to competition policy can illustrate the distinction between static and dynamic regimes. In competition policy, it is possible to distinguish between static and dynamic efficiency. Although the theoretical basis for this distinction is different from the one developed above for international regimes, the conclusions are remarkably similar: “If society includes only those people currently living, and the relevant time frame is short (days, months or even a few years), then that society pursues static efficiency. But if it includes future generations, and the relevant time frame is longer (five years, a decade, a new generation), it pursues dynamic efficiency. Practices that are statically efficient may not be dynamically efficient; the converse is also true. Thus the simultaneous pursuit of static and dynamic efficiency involves trade-offs.”⁵⁵ This statement also clearly identifies the differences between trade policy and investment policy.

3.2 Goal conflicts

As the number of international regimes has grown, goal conflicts have arisen. Given the preponderance of static regimes, these conflicts have typically presented themselves as conflicts between regimes, even though they should often be viewed as inherent in the workings of each of the regimes. The relationship between trade and sustainable development is but one such conflict. The issues in conflict are rarely starkly defined and require the exercise of fine political judgment. Yet the very existence of international regimes suggests that the necessary weighing of alternatives and the implementation of responses must occur at the international level. Individual countries will weigh such conflicts differently, and allowing countries too much discretion in such areas will quickly defeat the very purposes the regimes were set up to address. Countries have a right to choose the level of environmental protection they desire—as long as such choices do not have an impact on other countries or the global commons, as they almost always do. In the latter cases, the necessary decisions are international in nature. Similarly, the GATT recognizes some exceptions, such as those articulated in Article XX, but it submits each country’s decisions—the balancing of obligations under the GATT against other equally legitimate objectives—to international review through the regime’s institutions of transparency and dispute settlement. The central dilemma is that

international regimes, with few exceptions, are incapable of balancing conflicting goals.⁵⁶ Outside the European Union no institutions exist that can undertake the kind of balancing of conflicting priorities this implies. The result is, almost inevitably, conflict with no resolution.

Organizations that need to balance conflicting goals are necessarily dynamic, as not only the means to achieve certain ends can change but also the balance between those ends. Conversely, static regimes are poor at confronting goal conflicts. Most domestic governance structures are dynamic, since they are designed to endure and to address any issues that may arise in their jurisdiction. As issues arise, evolve and sometimes disappear again, the balance between them changes as do the strategies to address them.

There are no international institutions designed to achieve a balance between conflicting policy goals, or to promote the integrative co-operation of organizations with conflicting goals. There is a great deal of talk about the need for co-operation and integration, but in practice it is difficult to achieve because each organization has its own charter and its own governing body, and because success has generally been linked to single-minded pursuit of the central concerns of the regime. States have proven incapable of coordinating their approach to different organizations, presumably because this involves angering some domestic constituency without any assured benefit as a result. Balancing conflicting priorities always implies less effort in some areas than might otherwise occur, and the affected constituency will make itself loudly heard in domestic politics while each state is only one voice among many in the international regime. Moreover, some issues are truly international in nature—including many environmental issues—and no state can reflect the appropriate balance of interests.

Perhaps no task is more urgent than the development of international institutions capable of balancing conflicting policy goals in a legitimate manner.

3.3 The effectiveness of international regimes

Opinions differ widely on whether the plethora of emerging international regimes are “effective” (defined as capable of achieving the objectives they were established to pursue). In general, static regimes have tended to be more successful than dynamic ones. The WTO is generally considered to be effective. The World Bank is viewed as powerful, even as doubts exist about its effectiveness in promoting economic development, let alone sustainable development. The organs of the United Nations system enjoy uneven reputations: the Security Council is considered reasonably effective, while ECOSOC is widely viewed as ineffective. The World Health Organization enjoys a better reputation for effectiveness than the Food and Agriculture Organization, or the International Labour Organization.

These assessments are impressionistic. Determining the effectiveness of international regimes—environmental regimes in particular—poses a number of vexing analytical problems.⁵⁷ Environmental regimes are created to protect or improve the environment. The environment, however, does not obey social or economic regulations; it responds only to the laws of nature. Consequently, all environmental regimes, whether domestic or international, act indirectly: they seek to modify human behaviour with the goal of protecting or improving the environment. Modifying human behaviour is not achieved by decree alone. Some regulations are respected more than others, particularly if they have appropriate incentives to promote their respect, either through social coercion or through the judicious use of institutions to create incentives, and if they enjoy the consent of those who are being regulated. Finally, most international regimes—and certainly all international environmental regimes—are implemented through the action of other jurisdictions. These are often states but in environmental affairs they are frequently regional or local jurisdictions, leading to the institution of “subsidiarity” and introducing yet another layer of uncertainty into the effort to assess their “effectiveness.”

International environmental regimes also enjoy different reputations. UNEP is seen as largely ineffective (although it has given rise to several regimes that are considered effective). The regime for protecting the stratospheric ozone layer is considered effective; indeed, some evidence shows that the thinning of the ozone layer is being reversed, a result that is considered the outcome of international action through this regime. The (bilateral) regime to protect the Great Lakes of North America is seen as effective, while the regimes to protect the Colorado River or the border environment of the United States and Mexico are subject to doubt. The Convention on Biodiversity and the Ramsar Convention are considered weak and largely ineffectual. Nevertheless, the CBD has given rise to one of the most important international negotiations in recent years by developing a protocol on biosafety. Assessments of the success of the Convention on International Trade in Endangered Species have varied over the years.⁵⁸

The tasks faced by a regime with a dynamic agenda are liable to be more complex and more difficult than those that can be accomplished with essentially static means. Although it is surprising that international society was able to agree on a ban of an entire class of industrial chemicals because of evidence that they might damage the stratospheric ozone layer, that is still a simpler matter than balancing the needs of wildlife and human development in the CBD, or allocating scarce emission rights for greenhouse gases. It is easier (though still difficult enough) to negotiate reductions in barriers to trade and to ensure that the underlying principles of most-favoured nation and national treatment are respected than to balance the dual goals of economic efficiency and fairness, which are entailed in competition policy, or the essential dimensions of sustainability: environmental integrity and essential human needs.

The most important exception to these general comments is the European Union, an international organization with indubitably dynamic tasks and sometimes contradictory goals. It is tempting to consider the case of the EU and argue by analogy for a broader international regime. It is, however, hazardous to draw lessons for international (environmental) regimes in general from the unique experience of the EU, precisely because it is such an unusual regime.

Despite much research effort it remains a puzzle why international environmental regimes are effective at all. From the perspective of static regimes—the WTO or the International Monetary Fund for example—there is no reason to expect international environmental regimes to be effective. Nevertheless, their impact is by now undeniable, and in some cases quite surprising. Apart from the dramatic institutional differences, the most salient characteristic of international environmental regimes is their ability to engage international civil society; that is, the myriad corporations and organizations that have emerged to articulate private interests that transcend national borders, and the manner in which they penetrate the domestic fabric of states.

An international investment regime is needed to ensure that private interests and public goods—including international private interests and international public goods—which are typically at stake in productive investment, are properly balanced. Because of its historical links to the trade regime, it is tempting to assume, as all investment agreements have done thus far, that an international investment regime needs to resemble the GATT/WTO. That assumption was presumably appropriate in an international system composed almost exclusively of states. Faced with the increasing reality of globalization, however, the tasks of an international investment regime have become more dynamic and more challenging. An effective international investment regime must be capable of balancing the rights of individuals against public goods. This is a highly dynamic task that will require significant institutional capability in the investment regime to ensure that its outcomes are viewed as legitimate.

52 See Helmut Schmidt, “Facing one world: A report by an independent group on financial flows to developing countries,” *International Environmental Affairs* vol. 2, no. 2 (spring 1990), pp. 174–181. Oran Young, *Governance in world affairs*, Ithaca, NY: Cornell University Press, 1999.

53 Konrad von Moltke and Howard Mann, “Misappropriation of institutions: Some lessons from the environmental dimensions of the NAFTA investor–state dispute process,” *International Environmental Agreements*, vol. 1, no. 1 (fall 2000), forthcoming.

- 54 The exceptions of Article XX have played only a limited role in the trade and environment debate, largely because they assume a degree of obviousness to actions protected by Article XX, which is impossible to achieve for most environmental issues. See Konrad von Moltke, “Risk assessment and precaution,” in *Bridges* (August 1999).
- 55 Edward M. Graham and J. David Robinson, eds., *Global competition policy*, Washington, DC: Institute for International Economics, 1997, p. 8.
- 56 For a further discussion see Konrad von Moltke, *International environmental management, trade regimes and sustainability*, Winnipeg: International Institute for Sustainable Development, 1995, <http://iisd.ca/pdf/envmanage.pdf>.
- 57 Oran Young, “The effectiveness of international environmental regimes: A midterm report,” *International Environmental Affairs*, vol. 4, no. 4 (fall 1998), pp. 267–289. *United Nations Environment Programme, Policy effectiveness and multilateral environmental agreements*, (Environment and Trade 17) Geneva: UNEP, 1998.
- 58 The literature on international environmental regimes is by now very extensive and growing fast. The first attempt to systematize it was by Oran Young and Konrad von Moltke: “The consequences of international environmental regimes: Report from the Barcelona Workshop,” in *International Environmental Affairs*, vol. 6, no. 4 (fall 1994), pp. 348–370. This is not the place to recapitulate it. The most recent contributions are cited in fn. 57.

—4—

The nature of an international investment regime

The rapid development of international markets poses a dramatic challenge to international policy-makers. New markets require new regimes to ensure that a proper balance is struck between individual rights and public goods, including international public goods. These regimes must reflect the structure of the problem they are designed to address; in other words, form follows function. The debate about an international investment regime has not taken this basic axiom of public policy to heart.

The MAI negotiators began with an institutional and organizational template—that of the GATT—and sought to adjust it to the needs of investment. A preferable approach is to first identify the key characteristics of foreign direct investment as well as the policy interest that requires concerted international action. The second step is choosing institutions and their placement in an organizational framework. The dilemma of international institutional design is the need to develop an appropriate institutional framework in an environment that exhibits relatively few institutional alternatives. The art of international negotiation is to be imaginatively innovative where this is essential, while adhering as closely as possible to established precedent.

The tendency to construct an international investment regime modelled after the trade regime is understandable, even if it represents a serious error. The affinities between the two activities are real, and the trade regime is widely viewed as a success. Foreign direct investment was long linked closely to trade. Over the past decades, international investment flows have become increasingly independent of trade, responding to their own rules and incentives. A significant portion of contemporary international investment seeks the best relationship between risk and return, or a diversification of risk, rather than the construction of a trading position. Before considering the characteristics of an investment regime, particularly its institutions and organizational structure, it is vital to consider the factors that determine the underlying problem structure and the public interest to be served by such a regime.

4.1 The time frame of investment

Trade in goods occurs within a limited time frame. It is neither instantaneous nor very extended. Goods transactions are typically measured in days or months. Sales of certain major capital goods, airplanes for example, may extend over several years. But as the time frame of the sale gets longer, the sale increasingly resembles an investment, involving leases, loans or even some form of ownership stake.

The significance of the temporal dimension of a sale lies in the social, economic and legal relationships established. The sale of goods creates a limited relationship expressed as a contract that specifies dates, conditions of delivery, prices and other relevant conditions. It may include warranties over an extended period that are, however, strictly tied to the goods being traded. This is a relationship that is readily standardized. Indeed, many aspects of international trade in goods are by now highly standardized, including contracts of sale, payments procedures, deadlines and jurisdictional issues in case of dispute. Sales of like products are alike. It is increasingly possible to sell goods internationally over the telephone or the Internet. Apart from warranties and possible service agreements, the legal relationship between buyer and seller is terminated upon completion of the transaction.

Frequently, the seller will seek to establish a longer-term relationship based on certain characteristics of the goods being sold, the inclusion of property rights in the sale (for example licences), sales strategies or other methods. But usually the resulting relationship is a personal one between buyer and seller and either party can terminate it without further consequence. Its aim is to continue to sell and to purchase the goods that are at its centre.

Trade in services demands a more complex relationship, extending over widely varying periods of time. Provision of services can be a one-time event or a continuing activity.

Intellectual property rights take the temporal and legal dimension one step further. The TRIPS Agreement implies the ability of innovators to acquire specific rights—namely patents, trademarks or brand names—in other countries and to hold and use these rights for an extended period of time. To achieve this goal, the TRIPS Agreement moves the trade regime into the domain of positive regulation. Instead of prohibiting certain activities by states it creates a positive obligation to act in certain ways. It is to be expected that implementing this novel obligation by the traditional means of the trade regime will prove highly contentious, possibly even fracturing the regime.

The time frame of investments is widely divergent. Purely financial transactions—particularly portfolio investment—can be extremely liquid, subject to purchase and sale almost immediately. Within certain markets there are now

specialist investors and arbitrageurs who will purchase and sell investments within seconds. The underlying social and legal relationship can only be described as ephemeral.

Other investments, particularly productive investments, are long-term, measured in years or even decades. The power plant that is built today may still be in use a century later—well beyond the time when it is fully depreciated—much modified but nevertheless in the same location and often using the same fuel. The forest that is cut down today may not regenerate in 200 years, and the farm or the plantation that replaces it will transform the landscape in which it is located. It will be the object of changing crops and evolving practices from one year to the next.

Trade, as a short-term activity, is static. Long-term investment is dynamic.

4.2 Economic citizenship

The social and legal relationship established by longer-term productive investments differs in the following ways from that established by the sale of goods and the operations of portfolio investment:

- Productive investments involve the purchase of contracts that are open-ended; that is, they are of an indeterminate duration.
- An investor acquires a range of rights and obligations in the country where the investment is located. These may include rights to real estate, emission rights to the environment, the right to contract with individuals and corporations, the right to undertake financial transactions.
- An investor must accept obligations to respect the law of the jurisdiction(s) in which the investment occurs and to contribute to the community in which the investment is located, for example by paying taxes.
- Frequently, investments require infrastructure to ensure fair administration of the law, to provide for the needs of employees, to ensure the availability of inputs and of transportation of output.

Investment creates a complex system of rights and obligations, extending into an indefinite future that can best be described as a form of economic citizenship.

From a social and political perspective, trade in goods and the making of a productive investment have little in common. An international investment regime that serves the interests of all parties concerned must reflect these differences at all levels, in the principles it applies, in the institutions it employs, and in the details of its provisions.

In the General Agreement on Trade in Services the trade regime took a major step toward addressing the kinds of issues bound to arise in an investment regime. The GATS definition of “services” is broad. In many ways, it transforms the nature of the trade regime, since it enters into a full range of issues relating to the right of establishment. It is initially limited in its effect by the existence of Schedules of Specific Commitments and a structure of exemptions from most-favoured nation treatment, which permit member states to identify those service areas to be included in the Agreement and certain limits to that inclusion. Like the TRIPS Agreement, the GATS involves a system of rights that must be safeguarded by positive regulation.

The underlying assumption of the GATS, made explicit in Part IV on Progressive Liberalization, is that its initially limited nature will be transformed step by step into a comprehensive regime. This also assumes that the institutional framework created by the WTO will be adequate to the complex tasks that need to be undertaken. That assumption has not been made explicit and is bound to be tested in the coming years. From the perspective of sustainability, which involves a much more complex set of values than the ideology of economic liberalization underlying the GATT/WTO system, it appears more than likely that the institutional structure outlined thus far in the WTO will prove inadequate to the task.

4.3 “Like” investments

Non-discrimination revolves around the word “like”—that is, the obligation to treat “like” investments equally. Interpretation of this term has already created significant tensions in the trade regime. The difficulty arises from imposing an inflexible obligation (most-favoured nation and national treatment) in connection with an indeterminate term (“like”). The interpretation of the term “like” represents in many ways the most serious conflict between the GATT/WTO regime and the requirements of sustainable development. A trade regime cannot promote sustainability unless it is possible to distinguish between products produced sustainably and those produced unsustainably (for example wood products from unsustainably versus sustainably harvested timber, or pond-reared versus wild-caught shrimp, or possibly agricultural products employing genetically modified organisms versus those not doing so). For many years, the GATT/WTO has steadfastly, and incorrectly, maintained that products may not be distinguished by their mode of production.⁵⁹ This untenable position was differentiated for the first time in the Appellate Body’s report on the shrimp/turtle case.⁶⁰

GATT negotiators clearly recognized that a more determinate word (for example “identical” or “same”) would nullify the effectiveness of the central principles on which the multilateral trade regime rests. French and Spanish do not have a comparable word, so the translation renders “like” as “equivalent.” Equally, a less determinate word (such as “similar”) would expose the regime

to all kinds of arbitrary discrimination. Unfortunately, interpreters of the GATT have tended to emphasize the determinacy of the obligation over the need to interpret the indeterminate word “like.”

If distinctions between “like” products in international trade needed for ensuring greater sustainability of production have proven difficult to introduce, determining what are “like” investments is sure to cause extraordinary difficulties. These difficulties are already reflected in the text of most existing investment agreements, which refer not to “like” investments but require most-favoured nation and national treatment “in like circumstances.”

An interpretative note proposed in March 1998 by the chairman of the MAI negotiations takes a first step toward discussing the difficulties surrounding most-favoured nation and national treatment for investments:

“National treatment and most favoured nation treatment are relative standards requiring a comparison between treatment of a foreign investor and investments and treatment of domestic or third country investors and investments. Governments may have legitimate policy reasons to accord differential treatment to *different types* of investments. Similarly governments may have legitimate policy reasons to accord differential treatment as between domestic and foreign investors and their investments in certain circumstances, for example where needed to secure compliance with certain domestic laws that are not inconsistent with national treatment and most favoured nation treatment. The fact that a measure applied by a government has a different effect on an investment or investor of another Party would not in itself render the measure inconsistent with national treatment and most favoured nation treatment. The objective of ‘in like circumstances’ is to permit consideration of all relevant circumstances, including those relating to a foreign investor and its investments, in deciding to which domestic or third country investors they should appropriately be compared”⁶¹ (emphasis added).

This text goes some of the way to identifying issues surrounding the concept of “in like circumstances” in an investment agreement. It does not, however, address the issue of the interpretative process, which is necessary to make these general observations effective. This process depends critically on the institutional capabilities of the regime. An investment regime without an effective secretariat, with a dispute settlement process that relies on a changing group of arbitrators and without adequate public accountability, is liable to find itself quickly embroiled in conflict. The experience of NAFTA—which has modest institutional capabilities—is illustrative in this regard.⁶²

The interpretative note does not, however, adequately address the temporal dimension of investment: circumstances can change over time but a produc-

tive investment will continue, and, consequently, “like circumstances” can involve a great deal of variation. One farm begins by growing corn, moves to genetically modified seed, and ends up with an intensive hog-raising operation, while another converts to organic production and builds an Internet business.

59 For example, GATT 1994 stipulates that “... any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties” (Article 1.1). “The products of the territory of any contracting party imported into the territory of any contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges in excess of those applied, directly or indirectly, to like domestic products” (Article III.2). See Robert Howse and Donald Regan, “The product/process distinction—An illusory basis for disciplining unilateralism in trade policy” (January 2000 draft, available at http://www.wto.org/english/res_e/reser_e/resem_e.htm).

60 WT/DS58/AB/R, available at http://www.wto.org/english/tratop_e/dispu_e/distab_e.htm.

61 “Environment and labour in the MAI: Chairman’s proposals—March 1998.” (Updated 15 May 1998, <http://www.oecd.org>, 25 August 1998).

62 Mann and von Moltke, 1999.

–5–

Some issues for an investment regime that promotes sustainability

“Sustainable development” remains the only universally accepted goal of international policy that links economic and social objectives. Often repeated, the (dynamic) goal of sustainable development has never been embraced by those concerned mainly with the (static) goal of economic growth. An investment regime, however, must ensure that sustainable development is more than a preambular declaration but also an essential goal of the entire regime.

Investment is central to achieving sustainability. Indeed, without new investment the prospects of replacing unsustainable infrastructure and production facilities are poor. The sustainability concern in international trade is linked to the need for economic growth and the need to avoid the promotion of unsustainable practices by providing market access to goods that are detrimental to the environment at any point in their life cycle. The sustainability concern in international investment is directly linked to the need for investment to promote sustainability. Consequently, an international investment regime must not only avoid creating obstacles to achieving a more sustainable economy but also must actively promote sustainable development. This goal can only be achieved if the incipient investment regime respects and incorporates the internationally agreed upon principles of sustainable development.

An international investment regime that does not recognize the broader social dimensions of investment will contribute to the destruction of social and environmental values. It will defeat efforts to achieve greater sustainability. This is a claim that has often been made about the entire process of “globalization” and it is not always accurate. With regard to investment, however, the stakes are real. It is a daunting task to construct an international regime sensitive to a range of social, political and environmental variables linked to sustainability.

An international regime for investments is the natural next step in the secular process of economic liberalization that was launched after the disaster of World War II and has now come to be known as “globalization.” Such an investment regime should be actively promoted for several reasons. Without such a regime, many countries will continue to pay economic penalties as the risks of investment without adequate legal protections are factored into the

expected rate of return. The efficiency gained by reducing such risks is one of the major justifications for an international investment regime. With such a regime, a range of risks affecting investments can be reduced. Such risks occur principally with investments in poorer developing countries, which consequently not only attract less investment but also are expected to provide higher rates of return than investments in developed countries. As in other economic regimes, increased efficiency can lead to greater sustainability but it does not automatically do so.⁶³ At the very least, it creates opportunities for promoting greater sustainability. In a world replete with unsustainable infrastructure, only further investment holds the promise of constructive change in favour of greater sustainability.

All things being equal, capital should flow toward countries with low levels of existing investment, since these are likely to offer the greatest opportunities for new investment. But all things are not equal. In practice, investment flows are unequally divided and tend to favour a limited number of countries, among them the most highly developed ones. There are many reasons for this situation, but the risk associated with insecurity of investments is certainly an important one.⁶⁴ Presumably, an international investment regime can contribute to reducing such disparities.

Along with efficiency gains, there is a range of critical issues relating to the broader social, political and environmental dimensions of investment: in a word, sustainability. An international investment regime must balance these different considerations, and do so in a continuing manner that responds to changing priorities over time. To perform this balancing function, the investment regime must be dynamic in nature.

There is, however, a real possibility that an investment regime will be constructed largely as an extension of the WTO-based trade regime, with its emphasis on removing barriers to trade. The WTO regime is already in difficulty because of its historic insensitivity to essential market disciplines, such as environment and labour standards, which it tends to view as “barriers to trade.” Over the years, it has become increasingly static, defending the fundamental trade disciplines rather than reaching out to address policy issues that may conflict with its own priorities. At the same time new issues such as intellectual property rights and services have been incorporated, using the trade dimension as a way to reach deeply into the fabric of countries’ economies. The resulting contradiction between the static institutional and organizational characteristics of the regime and its increasingly dynamic tasks lie at the heart of the current crisis of the WTO.

During the GATT era, institutional factors dictated the static nature of the regime, since the GATT itself could not be amended or otherwise modified and the accretion of related agreements tended to render the entire structure

dysfunctional. The advent of the WTO has resolved the problems of the associated agreements, but has not changed the static character of the regime. The entire GATT/WTO structure may collapse if an attempt is made to develop an investment regime that has the institutional characteristics of the trade regime. It remains open to question whether the inclusion of intellectual property rights and services has not already stretched the existing institutional framework to the breaking point.

The central question is, therefore, what are the essential characteristics of an international investment regime? Only a clear answer to this question can guide the preliminary determinations for the necessary negotiations, including the critical choice of forum. A growing consensus assumes that the WTO is the favoured forum, others having failed. The investment regime provides a necessary complement to the existing trade regime. The WTO is the most effective international forum for economic negotiations, and it already contains what may be the core of a broader investment regime in the GATS. Both TRIPS and the GATS seem to show that the WTO system can be stretched to accommodate new issues, but this consensus has never been critically examined.

Before addressing investment in the WTO, it is important to ensure that the requirements of this new element in the WTO system do not overtax its institutional and organizational capabilities. This requires carefully considering the problem structure of an investment regime to ascertain its fit with the capabilities of the trade regime.

Four principles or norms are commonly identified as governing the “extent and nature of liberalization” to be achieved in an international investment regime:

- right of establishment;
- national treatment;
- non-discrimination or most-favoured nation (MFN) treatment; and
- transparency.⁶⁵

In addition, it is widely assumed that “performance requirements,” that is, certain conditions imposed on investors by host countries, should be limited or outlawed.

This chapter will consider these four principles from the perspective of sustainable development, the only universally accepted criterion for evaluating the broader social and political significance of such a regime. It will argue that the principles of national treatment and MFN, the central principles of the GATT/WTO regime, will need to be balanced in light of two further principles: maintenance of competitive markets and investor responsibility.

Moreover, it will maintain that the GATT/WTO dispute settlement system is inappropriate to the needs of an investment regime.

The central principle underlying an investment regime is that of “non-discrimination.” In the GATT/WTO system, non-discrimination is achieved through MFN and national treatment, the central institutions of the GATT/WTO system. Although an investment regime must also achieve non-discrimination, the different nature of the issue—its problem structure—implies that it will require quite different institutions to achieve this goal.

5.1 Right of establishment

Investors must be able to invest in a jurisdiction as a right. If foreign investment is subject to some form of approval or licensing this creates costs that must ultimately be borne by the investment and will have an impact on the expected rate of return. In particular, government-licensing schemes result in opportunities for side payments that are not accounted for but still need to be covered from the investment process itself.

The right of establishment is fundamental to creating the status of economic citizenship: the right to purchase and sell goods and real property, the right to enter into contracts, the right to apply for permits and authorizations, the right to manufacture, store, ship and export. All of these rights are subject to the law of the jurisdiction as a matter of course. In particular, the ability to obtain secure property rights is an essential aspect of any investment since these rights will be needed as security for loans and other transactions. Without clear property rights it can also become difficult to obtain insurance, which in turn will tend to raise the cost of investment or at the very least the expected rate of return. What is at issue for foreign investors is that they be put on an appropriate footing compared with domestic investors.

The right of establishment can be subject to certain exceptions, for example for reasons of national security. These need to be clearly identified. Such exceptions exact an economic penalty. Protected (domestic) investors face less competition and the administration of any exceptions creates opportunities for rent formation.

Clearly defined property rights are also a necessary condition for internalizing environmental costs. Without such rights, the incentives to act responsibly toward the environment are rapidly eroded.

5.2 National treatment

International investment agreements imply a trade-off between “national treatment” and “fair and equitable treatment,” two standards that tend to be used mutually exclusively—except in the case of NAFTA. This trade-off has

never been clearly articulated. “National treatment” implies a more affirmative right than “fair and equitable treatment,” even though both require a degree of interpretation—as acknowledged by the chairman of the MAI negotiations in his proposal cited above. The difficulties inherent in defining “national treatment” for investment is illustrated by the handling of this issue in the GATS—a precedent the MAI negotiators do not appear to have followed. GATS Article XVII.2 introduces a distinction between “formally identical” and “formally different” treatment, placing the emphasis on outcomes rather than process.

In the case of environmental regulations affecting investments, interpreting national treatment is not straightforward. The inevitable characteristics of environmental management have two significant consequences: facilities are rarely “like” from an environmental perspective; and measures applied to otherwise “like” facilities at different times are liable to be significantly different.

Environmental management is a dynamic activity, responding to growing knowledge about the environment and anthropogenic threats to it, as well as to changing perceptions about the seriousness of these threats. Moreover, environmental management is typically achieved through a “package” of measures, involving standards, permits and licences on the one hand and economic incentives on the other. In addition, a complex structure of information and accountability—to management, to stockholders, to the authorities and to the public at large—represents a critical element of enforcement. Environmental management is always institutionally rich. The underlying reason for this complex approach is the difficulty in producing desired results in the natural environment—which responds to the laws of nature—through policy measures, which can only affect social behaviour. Consequently, the operation of environmental policy is always and inevitably indirect, and subject to a degree of imprecision. To compensate for this imprecision, governments have been forced to use a variety of measures—command and control, incentives and informational obligations.

An added level of complexity derives from the continuous development of technologies designed to protect the environment. As these technologies become available, policy must adjust to reflect new capabilities.

Finally, the “absorptive capacity” of the natural environment, such as it is, represents a scarce resource, to which there are no precisely delimited property rights, entailing a complex allocation process involving both public and private interests. Later “like” facilities, located in a watershed or within the distribution range of atmospheric pollutants, must take into account the prior emitters—which must in turn be subjected to new conditions to make room for new sources.

To cite one example, environmental permits for installations as basic as coal-fired power plants, one of the oldest forms of power generation, can differ widely from one facility to the next. Moreover, countries approach the problems arising from the dynamic and complex character of environmental management differently. A comparison of permits for coal-fired power plants in the Netherlands and the Federal Republic of Germany in the early 1980s showed that each facility had specific characteristics arising from the technology employed, the characteristics of the fuel, existing emissions, and shifting priorities of public policy, rendering comparisons virtually impossible. Moreover, administrative practice in the Netherlands allowed the continuous tightening of permits over many years; environmental management was in fact a continuous process of negotiation between the investor and public authorities. In the Federal Republic of Germany much more weight was placed on long-term security of permits. New permits tended to be much more stringent—and much closer to the limits of current technologies—than in the Netherlands, but after several years the requirements in the Netherlands tended to be more onerous than those in Germany.⁶⁶

There is no intrinsic reason why it should be impossible to determine what “like” treatment is under these circumstances. It is, however, a complex process, occurring continuously in all countries where equal treatment before the law is upheld. It is a demanding, continuous, dynamic process and raises questions about the institutional capabilities of an international regime. Certainly, an international agreement, which provides for investor–state dispute proceedings, needs to be developed with great caution, since it is liable to change in unpredictable ways the existing delicate balance between investors and regulatory authorities within countries.⁶⁷

Faced with the challenge of developing appropriate environmental standards, issuing permits and licences, and ensuring that all relevant measures have been complied with, environmental authorities in all countries are forced to engage in some form of selective enforcement. They must set priorities for enforcement action based on criteria such as the nature of the environmental threat, the history of a facility, or public pressure. Under these circumstances, determining what represents “national treatment” can be a challenge.

One of the paradoxes of the principle of national treatment when applied to investments is that it does not put foreign and domestic investors on equal footing—as it does when applied to goods in trade. Rather, it provides foreign investors with rights not enjoyed by their domestic counterparts, in addition to ensuring that they enjoy all “domestic” rights the latter have. In most countries the grounds on which domestic actors can take a government to court are quite circumscribed. An international investment agreement—such as NAFTA—that gives private investors the right to initiate proceedings against

host-country governments establishes a new set of legal provisions for the benefit of foreign investors, which are not available to domestic investors. Again, the NAFTA Ethyl case is instructive in this regard.⁶⁸

5.3 Most-favoured nation treatment

It would seem axiomatic that MFN treatment is a strong institution for an international investment regime. Nevertheless, a number of sustainability issues also arise in this context, essentially reflecting the need to take a static institution and apply it dynamically. The potential conflict with the climate regime is fairly straightforward, and is discussed below. Additionally, the need for selective enforcement actions makes the environmental and management practices of the investor's country of origin a matter for reasonable concern. Finally, with growing international integration of product chains, effective responsibility for certain environmental—and labour—practices rests with the home-country investor rather than with management in the host country. For example, the environmental practices of semiconductor manufacture are largely determined by the purchaser, while the labour practices of some textile manufacture are subject to review by foreign buyers.⁶⁹

The Framework Convention on Climate Change states that “the Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities. Accordingly, the developed country Parties should take the lead in combating climate change and the adverse effects thereof” (Article 4). The notion of common but differentiated responsibilities and respective capabilities has caused a good deal of discussion. The creation of a list of countries that have undertaken to limit their emissions of greenhouse gases (Annex 1 countries), and the steady development of new institutions, such as Activities Implemented Jointly and the Clean Development Mechanism launched by the Kyoto Protocol to the FCCC, introduce a range of new distinctions between countries. These are likely to result in distinctions between Annex 1 foreign investors and all other investors. Activities Implemented Jointly result in a regime in which investments from Annex 1 countries in other Annex 1 countries may receive credits for reductions in greenhouse gas emissions, while “like” investments from non-Annex 1 countries would not. Similarly, investments from Annex 1 countries in non-Annex 1 countries would be favoured under the Clean Development Mechanism, while investments between non-Annex 1 countries would not.

The climate regime has not developed to the point where these effects are predictable. Nevertheless, an international investment regime needs to respect the requirements of the climate regime.

The issue of differentiated enforcement is not so much a matter of the principle of MFN as of its interpretation in practice. As governments confront foreign investors—in particular investors from “off-shore” investment countries whose background is not or hardly known—it is reasonable to make certain distinctions based on the known requirements in the home market of the investor concerning the environment and other factors of sustainability. An investment by a major enterprise from a country with rigorous environmental controls may attract different levels of scrutiny than comparable investments from other countries, or investments from tax havens, where there is no environmental activity at all.

The last thing an international investment agreement should do is promote the investment equivalent of flags of convenience, which play such a central role in rendering international shipping—and, in particular, its environmental performance and respect for labour standards—almost impossible to control properly. For example, in the provinces of coastal China problems with foreign direct investment relating to the use of ozone-depleting substances are encountered primarily when the investors come from Hong Kong or Taiwan. It is reasonable to seek particularly close control over their actions, whether or not this contravenes the principle of MFN. Similarly, it seems reasonable to consider home-country practices when awarding concessions to manage forests. For example, companies from Malaysia with a record of damaging forest practices have been acquiring forestry concessions in countries of Africa and Latin America. A government concerned about the future of its forests could reasonably be expected to impose additional requirements on the granting of such concessions.

The question whether such practices infringe upon the principle of MFN will ultimately become a matter determined through the dispute settlement procedure. The argument made here does not obviate the need for MFN treatment; it suggests, however, that great care needs to be taken to ensure that the institutions and disciplines surrounding implementation of that treatment are properly devised and developed. An example of this concern is Article VI of the GATS, which requires the administration of measures of general application affecting trade in services to occur in “a reasonable, objective and impartial manner.” It also requires the creation of domestic institutions, in this instance “judicial, arbitral or administrative tribunals or procedures,” which can provide review and remedies.

Finally, MFN treatment assumes that investments reflect traditional relationships of individual investors in sovereign states. In integrated product chains, responsibility for certain issues, such as environmental performance or the respect of international labour standards, is distributed along the chain. In practice the relationships between investor, home country and host country

may be conditioned by many factors beyond the control of the host country—which is the only actor in the chain subject to the principle of MFN. The implications for MFN treatment are complex, particularly since investors can use environmental standards as competitive tools to exert pressure on other investors. For example, an investor with extensive experience managing the environmental aspects of power generation in his or her home country may seek more stringent environmental standards when investing in another country, expecting that MFN treatment will lead to the spread of these standards to competitors without equivalent experience. In the semiconductor industry, integrated production chains have caused the international spread of high environmental standards.⁷⁰

It is not beyond the ingenuity of international negotiators to develop solutions to these issues, but they go beyond the declaration of MFN. They go to the heart of the institutions needed to implement MFN treatment, which in an investment regime requires a balancing of individual rights and public goods.

5.4 Dispute settlement

The need for a dispute settlement process as part of any international investment regime is clear. A regime without such a process is unlikely to increase the calculability of risks to a significant degree. This dispute settlement process must, however, properly reflect the principles and the structures of the regime being created. Following the assumption that the investment regime would be based on the principles underlying the GATT/WTO regime, the obvious conclusion is that the dispute settlement process should be modelled on that of the WTO. But this book has argued the inappropriateness of adapting GATT/WTO principles to an investment regime. It follows, then, that the WTO dispute-settlement process is also not suited for an international investment regime.

Each of the factors that establish the need for a dynamic investment regime—the long-term nature of investment and the consequent need to reflect change over time, the relationship between an investor and the investing country, and the difficulty of determining “like circumstances” in an investment regime—also define characteristics of the dispute settlement process. It is not fortuitous that the issues that arise in developing a dispute settlement process for an investment regime are the same issues that have arisen in the confrontation between the (static) GATT/WTO system and the (dynamic) structures for environment and sustainability. The dispute settlement system for an investment regime must be open, accountable, capable of handling technical information and capable of balancing conflicting policy objectives. No such dispute settlement system yet exists at the international level, even though they exist at many other levels of governance, ranging from the U.S. Supreme Court to rural magistrates in Central Europe.

It is risky, even irresponsible, to impose tasks on institutions that are unable to discharge them. The results can be devastating for the institutions in question—and highly unsatisfactory in substantive terms. Under NAFTA, the attempt to use the arbitration procedures of ICSID and UNCITRAL to review regulatory measures adopted by public authorities has resulted in a process that is dysfunctional and ultimately threatens the entire regime.⁷¹

The dispute settlement system of an investment agreement will typically be called upon to adjudicate the rights of an individual investor in relation to the actions of some public authority. This is something entirely different from adjudicating disputes between countries, or disputes between two private individuals for that matter. Consequently, neither the dispute settlement system of the WTO nor the arbitration system for commercial disputes can really serve as a template. Often, the investor-state dispute settlement system will need to consider the circumstances of a specific project or investment and balance these against the broader public interest that may be affected by such a project. This represents a major institutional innovation. One solution could be to draw the courts of the host country into the process so that the international tribunal would address its conclusions to a domestic court with the appropriate competences and legitimacy, a direction at least suggested by Article VI of the GATS with its concern for domestic dispute settlement procedures. Of course this does not resolve problems created by domestic courts that act contrary to international legal obligations of the host country. A different approach is adopted by Mercosur, which gives investors the right to initiate proceedings but requires their country of origin to then represent them, effectively retaining sovereign control over all disputes.

5.5 Maintenance of competitive markets

The continuing liberalization of investment is likely to create additional concerns about maintaining competitive markets, a vital factor for many developing countries that depend on the export of a limited number of commodities. The experience of the European Union has certainly been that as trade and investment are liberalized it becomes increasingly important to ensure that measures of competition policy are adopted at a level that corresponds to the dimensions of the relevant markets. This is not an immediate need at the broader international level, but it is a need that can be anticipated with some certainty.

The debate about an international regime on competition is not as far advanced as the debate about investment. In particular, it lacks the bilateral dimension, which has been a motor for the search for multilateral responses. Competition authorities have developed a certain degree of informal co-operation, particularly between the two largest and most important markets, the

United States and the European Union. Presumably an international regime will need to grow out of this co-operation. In practice the characteristics of an international investment regime resemble a regime for competition more closely than a regime for liberalizing trade in goods.

5.6 Investor responsibility

Investor responsibility has been the most important bone of contention in various attempts to address investment issues at an international level. The debate over investor responsibility was severely polarized in the 1970s and into the 1980s. The UNCTC Code of Conduct dealt primarily with host-state rights and investor responsibility; the OECD approach focused on investor rights, outlawed performance requirements and relegated what remained in the area of investor responsibility to a separate, less binding set of guidelines. In the 1990s, the OECD approach appeared to prevail, as many countries moved toward liberalization of their capital markets.⁷² This trend was most pronounced in some countries of Latin America, particularly in Chile and Argentina.⁷³ Mercosur adopted two protocols for intra-zone and for extra-zone originated foreign direct investment, whose provisions appear to be largely consistent with the OECD Declaration and subsequent OECD instruments.⁷⁴ As a result, attitudes toward foreign direct investment have shifted in many Latin American countries and have left the OECD approach as the only one currently under active consideration.

The failure of the UN Code of Conduct process should not obscure the fact that the polarization between the two approaches resulted in a situation where both tended to focus excessively on the particular issues being raised. In practice it is hard to see how an international investment agreement can be concluded that does not address investor responsibility. A number of issues come readily to mind.

The most basic of all responsibilities is to respect the laws and regulations of the host country. Nevertheless, this simple statement requires some interpretation. Implementation of regulations is uneven in all countries, but more so in some than in others. Situations may arise where stringent regulations exist—particularly for worker health and safety and environmental protection—but where respect for these regulations is sporadic at best. Are foreign investors expected to comply with local practice—or are they to be measured by a more stringent standard?

In practice the answer may lie in the nature of the investment. Where the output from foreign investment feeds into a product chain in which the foreign investor plays a dominant role—for example in electronics, in forestry, or in mining—the foreign investor should be held to the most stringent interpretation of the law. Where the output of foreign investment is absorbed locally—for example in some food processing operations or for transport services or

power generation—the standards to be applied are essentially local in character, subject to the need of a foreign investor to protect its good reputation, or a global brand. Where obligations are international in nature—for example, those relating to stratospheric ozone depletion, climate change or biodiversity—foreign investors must meet these international obligations. Of course the interpretation of obligations, which are variable, requires a significant degree of institutional sophistication at the international level. This suggests that, as with several other aspects of an investment regime, the issues lie not in the codification so much as in the institutional mechanisms for implementation, implementation review and dispute settlement.

The issue of “performance standards” has played an important role in the debate about international investment. These are obligations which may be linked to approval of investment and which may differ, or seem to differ, from comparable requirements imposed on domestic investors. To the extent that certain foreign investors or their investments are different from domestic ones, there would seem to be no problem with imposing performance requirements on them that reflect their special status. In practice, however, using such differences to justify imposing standards is liable to give rise to serious conflicts within any investment regime, since it effectively transfers decision-making to the dispute settlement process.

The draft MAI takes a clear position on performance requirements: it is against them. It lists 11 different requirements that are outlawed.⁷⁵ This list covers most of the issues commonly raised about performance requirements. There appear to have been few reservations about these provisions among the negotiators; the lengthy commentary, which accompanies the last negotiating text, does not discuss the issue of performance requirements. The implication of banning performance requirements is that governments will have to provide subsidies to investors if they want to impose any of the requirements listed. It is also worth noting that governments may impose performance requirements on their nationals but would be prohibited from doing so on foreign investors.

The argument for banning performance requirements has two pillars. Many performance requirements are economically inefficient and, consequently, entail the risk that they will defeat the very purpose of an investment agreement. Moreover, the ban on performance requirements assumes that governments are in a position to impose their will on investors; that is, it is designed to defend weak investors. In practice this assumption is not universally true. Often, governments are competing for investment, or at the very least feel that they must compete to attract investors. In this situation it is no longer uncommon for investors to be more powerful than governments. That situation has been exacerbated by the large but unevenly distributed increase in investment flows to developing countries.

Some difficulties arise from the hybrid character of most international investment agreements: they are agreements between states but they concern to a significant degree the actions of private parties, and sometimes create certain rights for these private parties. As agreements between states, international investment agreements can hardly impose direct obligations on private investors; yet maintaining market discipline, particularly between private actors, is an essential goal of an investment agreement. “Performance requirements” were an attempt to articulate the kinds of requirements that international investors might reasonably be expected to meet.

In practice performance requirements reflect the fact that the investor is acquiring significant rights in the jurisdiction of investment and that it is consequently normal for a negotiation to occur between the investor and the public authorities where the investment is to occur. This negotiation can cover a large range of topics, such as the provision of infrastructure, the right to use scarce natural resources such as air and water, the need to protect biodiversity and wildlife, employment, community development and other issues. The relationship between the parties can reflect a large number of different situations, ranging from dominance by the investor to dominance by the public authorities. It is essential that these negotiations be fair and equitable and that their outcome properly reflect the needs and interests of all parties concerned. Although this may sound simple, it is not easy to achieve, but prior determinations of what topics are negotiable—which is the effect of the list of outlawed performance requirements in the MAI—do not resolve the underlying dilemma.

5.7 Institutional capacity

The controversy surrounding the draft MAI demonstrates the complexity of the issues at stake in an international investment regime. This book has argued that even apparently self-evident issues, such as most-favoured nation, national treatment, or eliminating performance requirements, will require much more careful consideration in a dynamic context. The reality of foreign direct investment has changed dramatically since the post-war era, since the elimination of fixed exchange rates, and since the debt crisis of the 1980s. More changes are to be expected, with the move toward more sustainable forms of production and the huge investments that implies, with the introduction of the euro, and with recurrent crises of international markets, particularly if the Japanese banking system continues to falter. Moreover, countries with aging populations and capital surpluses will find that the only option to generate income for retirement-age people is investing their capital surpluses in countries with younger populations.

These are issues quite unlike those addressed in the trade regime over the past 50 years. The process of reducing and eliminating tariffs, developing disci-

plines for non-tariff barriers, and including further sectors such as services and agriculture in the GATT/WTO system never required a rethinking of the core principles of the regime. Only the agreement on intellectual property rights has created a new structure of rights and obligations—and it remains to be seen whether the resulting balance between monopoly for those who control intellectual property rights and the exposure of all other market participants to the commoditization of their products is one that will prove enduring. It creates new sources of polarization and results in downward pressures on prices for goods taken from the natural environment, reducing the market valuation of the environment at a time when the move toward greater sustainability demands it be increased.

The GATT system was characterized by its institutional sparseness. The GATT itself could not be amended. Since the GATT secretariat was not an international organization, its functions were strictly limited. Implementation of the agreements under the GATT was multi-unilateral; that is, it rested entirely with the countries involved, except in cases of conflict. Initially, this unusual structure served the trade regime well since it was essentially a negotiating forum and breaches of the regime's disciplines could be tolerated as long as the general direction of trade liberalization was maintained. The dispute settlement process was central to the regime's success because it provided a slightly more dynamic source of interpretation than the sparse organizational structures.

It was not until the Uruguay Round that the institutional inadequacies of the GATT became so strong that a move was made to streamline the dispute settlement process and to draw together in a single organization, the WTO, the agreements that had proliferated with changing memberships under the GATT. The ensuing organization still has many of the characteristics of the GATT, particularly the unwieldy structure of councils and committees with unrestricted membership, the tendency to view all issues in terms of negotiation, and the use of dispute settlement as a principal means of implementation. Thus far, the WTO has proven no more adept than the GATT at addressing policy issues, which require a balancing of conflicting goals, such as those relating to the environment. Ultimately, the only priority that can be recognized is the need for trade liberalization.

An international investment regime deals with a much more complex agenda. It will need to be institutionally more sophisticated than the GATT/WTO system. One of the more surprising elements of the MAI text is the lack of attention to institutional needs. There appear to be a number of unarticulated assumptions about the appropriate institutional structure, derived from the GATT/WTO, which upon closer scrutiny turn out to be questionable. The MAI provides for a "Parties Group," which resembles the GATT Council and

the Contracting Parties of the GATT even more than the General Council of the WTO. It specifies that there will be a secretariat, which has no independent functions whatsoever.⁷⁶ This makes it a more virtual organization than even ICSID, which at least has a secretary-general who has certain specified, though modest, functions under the agreement.

The MAI is the first multilateral approach to investment that did not arise from an existing organizational context, be it a regional trade agreement or the United Nations Centre on Transnational Corporations. It consequently had to create the entire institutional structure needed to address the complex, dynamic agenda of investment, since it had no implied organizational background, like the European Union, NAFTA, Mercosur, the United Nations—or the OECD for that matter. It reflected the assumption that the institutions that have served the trade regime would be adequate for an investment regime. Implicitly, the negotiators must have hoped that the two would one day be merged. It is doubtful whether that would have satisfactorily served either the needs of trade liberalization or the demands of international investment.

Reflecting the heavy reliance on the trade regime for its institutional inspiration, the draft MAI relies on dispute settlement as a means of implementation. The dispute resolution procedures of the MAI, modelled on those of the WTO and those of bilateral investment agreements, assume that the future task of the investment regime will be to apply an essentially immutable set of principles. The evolution of international investment over the past 50 years, and the necessary adjustment of public policy to go along with it, suggest that the principal tasks of the investment regime will be promoting understanding of the processes of investment, and maintaining essential market disciplines—such as rules governing competition and the environment—that are necessary to ensure that investment serves overarching goals of public policy.

The only conclusion that can be drawn from an analysis of the MAI draft is that the negotiators assumed that investment is an act of nature and that the function of government is to stay out of its way. That is not an assumption that will promote sustainable development.

5.8 Transparency

In dynamic regimes, transparency becomes a critical institution. Because of the processes of change in such regimes, and the continuing uncertainty about relevant facts and the identity of interested parties, dynamic regimes use transparency as an institution to ensure access to information and the participation of key actors, some of whom may not be known in advance. Closed regimes assume that all key parties are present or represented—and that all material information will be available through them. That assumption is inoperative in a more dynamic situation and transparency is the appropriate response.

It needs to be emphasized that “transparency” is not a process that gives rights to persons arbitrarily. Apart from the basic right to know and the obligation on members of the regime to be publicly accountable, actual participation can, and generally should, be subject to some objective criteria.

The instruments for transparency are by now well established, beginning with ensuring that all operational documents are promptly made publicly available, ensuring that meetings are public unless there are strong reasons for the respect of privacy, and providing avenues for persons outside the regime who may have an interest in outcomes to make their opinions heard for certain kinds of proceedings, particularly dispute settlement. Under no circumstances should an international investment regime be created that does not include strong provisions for transparency, together with specific rules designed to achieve this goal.

63 International Institute for Sustainable Development, *Trade and sustainable development principles*, Winnipeg: IISD, 1994.

64 See Helmut Schmidt, “Facing one world: A report by an independent group on financial flows to developing countries,” *International Environmental Affairs*, vol. 2, no. 2 (spring 1990), pp. 174–181.

65 Sylvia Ostry, *A new regime for foreign direct investment*, Washington, DC: Group of Thirty, 1997, p. 11, (reordered).

66 Konrad von Moltke, Fred Boerwinkel and Hubert Meiners, *Rechtsvergleich deutsch-niederländischer Emissionsnormen zur Vermeidung von Luftverunreinigungen Teil 1: Bundesrepublik Deutschland; Teil 2: Niederlande; Teil 3: Tabellen*. (Teil 1 also in Dutch: *Rechtsvergelijking van duits-nederlandse emissienormen ter bestrijding van luchtverontreiniging*), Bonn: Institute for European Environmental Policy, 1985.

67 Mann and von Moltke, 1999.

68 *Ibid.*

69 Konrad von Moltke, et al., *Global product chains: Northern consumers, Southern producers, and sustainability*, (Environment and Trade 15), Geneva: United Nations Environment Programme, 1998.

70 *Ibid.*

71 Mann and von Moltke, 1999.

72 The OECD Guidelines have been revised and a new version was adopted in June 2000.

73 Manuel R. Agosin, *Foreign direct investment in Latin America*, Washington, DC: Inter-American Development Bank, 1995.

74 Pedro Colombi and Javier Podrez, “Mercosur protocols for foreign investment promotion and protection,” in OECD, *Investment policies in Latin America and multilateral rules on investment*, Paris: OECD, 1997, pp. 115–125.

75 See Annex 2 in this book.

76 Article XI.7 says “the Parties Group shall be assisted by a Secretariat.”

—6—

A different approach: A framework agreement on investment

All the attempts to address investment at the international level have assumed that what is needed is a system of rules that must then be applied, much as in the trade regime, by governments and reinforced through a dispute settlement process. This is a fundamentally static view of the investment process and its function in economic and social policy. It makes no provision for the dynamic aspects of an investment regime, nor does it reflect the complex legal and contractual relationships between investor and host country that characterize foreign direct investment.

A better approach might draw some lessons from international environmental regimes, which have faced the problem of addressing issues that evolve over time and consequently demand a dynamic international regime.

The approach now well established in environmental regimes is to begin with a framework agreement, which establishes basic institutions, creates an organizational structure and defines a continuing process designed to achieve certain articulated aims. Since negotiators cannot know what measures will ultimately be needed, most international environmental agreements are quite indeterminate as to the appropriate institutions that will be required. Over time, a body of evidence accumulates and additional measures can be adopted to ensure that the regime continues to move in the desired direction.

Conceivably, a framework agreement represents a better approach to addressing international investment policies. Such an agreement would outline a set of goals for the regime—including the goal of achieving sustainable development—as well as a process to explore necessary steps toward those goals. The result would be an incremental regime, capable of responding to emerging needs and adapting to changing practices in international investment.

There is significant advantage in moving investment out of the organizations that have sought to address this issue thus far: the World Bank, the World Trade Organization, the United Nations Conference on Trade and Development, and the Organization for Economic Co-operation and Development. Several decades of effort in these organizations have resulted in stalemate. After the collapse of the MAI negotiations, every attempt to launch

a new process designed to produce an agreement on investment is liable to attract vigorous opposition. An approach that begins with modest steps and recognizes the tasks as incremental offers better chance for success.

The central challenge of any international investment regime will be to maintain a high level of predictability while retaining essential flexibility. In many ways that resembles the dilemmas of the institutions that govern the monetary system. While they need to be highly stable and predictable over long periods of time, in moments of crisis they must act decisively even if this breaks with what appeared to be well-established precedent. The challenge facing an international investment regime is not as daunting as that confronted by monetary authorities. Its purpose is, after all, to ensure the highest possible level of calculability of private economic risks in the investment process while ensuring that overriding goals of public policy—sustainability, human rights and the vitality of communities—are respected. This is not a goal beyond the reach of international society as it has evolved over the past decades, but it is a goal that can only be attained if the investments regime reflects an adequate institutional base and the capability to balance conflicting goals of policy.

6.1 Is a single agreement the answer?

Before launching a major international negotiation it is essential to identify the interest that will be served by this process and that cannot be achieved by lesser means, essentially an international interest. Given the goal of global sustainable development, there is an urgent need for an investment regime that promotes environmentally sound and sustainable foreign direct investment. The current international structure, resting largely on bilateral investment treaties, does not meet this need.

It is important to recognize that bilateral agreements serve a useful purpose, and can reasonably continue to do so. They have contributed to greater security of investment. But they have proven incapable of achieving well-distributed flows of investment, or even flows that more properly reflect potential returns. Any multilateral investment regime would need to contribute directly to this outcome if it is to provide added value beyond the current system.

A number of international goods require significant levels of investment. Among the goods not sufficiently served by current flows of foreign direct investment are certain environmental values—such as the prevention of global climate change or the promotion of more sustainable exploitation of natural resources—as well as development in the poorer countries. It makes sense to tie the availability of certain internationally guaranteed investor rights to the provision of such international goods. In other words, it may be desirable to introduce investor rights into agreements such as the UN Framework Convention on Climate Change or an international forestry agreement,

should one ever be agreed. This could be done before the creation of a global investment agreement that conveys rights to investors. In this manner it would become possible to achieve the kind of balancing between private rights and public goods that lies at the heart of any broader investment agreement.

The available options to promote investments that are desirable for sustainable development are limited. In practice, governments have chosen to provide subsidies, for example through the Global Environment Facility. Subsidies have certain undesirable characteristics: they perpetuate themselves and always entail the risk that necessary investments will not be made at all unless they are subsidized, even when they are economical without subsidy. For example, many countries found that the existence of subsidies to support the construction of wastewater treatment plants by local authorities led to a situation where no local authority would build a facility unless it was subsidized. Providing certain investor rights permits governments to improve the relationship between risk and return by lowering risk rather than increasing returns. That is an approach with few drawbacks, which does not burden the public purse, and represents a classic function of government as rule maker.

It could be argued that segmenting the international investment regime is undesirable. After all, investment is a universal activity, and in principle more investment is a broadly desirable goal of public policy. But the problems associated with an international investment regime, outlined above, suggest that it is necessary to find organizations that can provide the necessary balance between rights and obligations. By inserting new investor rights into regimes that pursue some other legitimate international policy goal—preventing global climate change or promoting sustainable forest practices for example—it becomes possible to create this balance in a more limited context.

The goal of establishing a global investment agreement is currently out of reach. On the one hand, the institutional development of international society has not progressed to the point where such a regime could be envisaged. On the other hand, public opinion in a number of key countries is strongly against a general investment agreement, making it a politically delicate undertaking. Under these circumstances a number of more modest practical steps can help to explore the real dimensions of this enterprise. A framework convention, together with investment provisions in certain sectoral agreements, is a pragmatic way to proceed.

Annex 1: Agreement on Trade-Related Investment Measures

Illustrative list

1. TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which require:
 - (a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of its local production; or
 - (b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.
2. TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, or compliance with which is necessary to obtain an advantage, and which restrict:
 - (a) the importation by an enterprise of products used in or related to its local production generally or to an amount related to the volume or value of local production that it exports;
 - (b) the importation by an enterprise of products used in or related to its local production by restricting access to foreign exchange to an amount related to the volume or value of local production that it exports;
 - (c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.

Annex 2: Excerpt from the Draft Multilateral Agreement on Investment

Performance requirements

1. “A Contracting Party shall not, in connection with the establishment, acquisition, expansion, management, operation or conduct of an investment in its territory of an investor of a Contracting Party or of a non-Contracting Party, impose, enforce or maintain any of the following requirements, or enforce any commitment or undertaking:
 - (a) to export a given level or percentage of goods and services;
 - (b) to achieve a given level or percentage of domestic content;
 - (c) to purchase, use or accord a preference to goods produced or services provided in its territory;
 - (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
 - (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales to the volume or value of its exports or foreign exchange earnings;
 - (f) to transfer technology, a production process or other proprietary knowledge to a natural or legal person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws [or to act in a manner not inconsistent with articles...of the TRIPS Agreement];
 - (g) to locate its headquarters for a specific region or the world market in the territory of that Contracting Party;
 - (h) to supply one or more of the goods it produces or the services that it provides to a specific region or the world market exclusively from the territory of that Contracting Party;

- [(i) to achieve a given level or value of production, investment, sales, employment, or research and development in its territory;]
 - (j) to hire a given level of [local personnel] [nationals];]
 - (k) to establish a joint venture; or
 - [(l) to achieve a minimum level of local equity participation.]”⁷⁷
2. A Contracting Party is not precluded by paragraph 1 from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of a Contracting Party or of a non-Contracting Party, on compliance with any of the requirements, commitments or undertakings set forth in paragraphs [1 (a) and] 1 (f) through 1 (l).”

⁷⁷ The unbracketed text is taken almost verbatim from NAFTA Article 1106, except item (g).

Investment is necessary for the kinds of innovation and change that will bring about sustainable development. And a properly crafted multilateral agreement on investment rules might increase the foreign investment going to those developing countries where it is sorely needed. But the shape of such an agreement may also have profound consequences for the environment.

What would international investment rules look like if they aimed to achieve both economic growth and environmental protection? This book surveys the many attempts to draft investment rules and takes a novel approach, first considering the nature of the problem and then asking what this means for the shape of the necessary institution. It proposes a tack radically different from any pursued to date.