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The development dimension of international investment agreements

Note by the UNCTAD secretariat

Executive summary

The universe of international investment agreements (IIAs) is highly fragmented and has become increasingly complex. New issues have arisen that have an impact on IIA negotiations, namely the protection of strategic industries, the economic crisis and investor rights, and the fact that a growing number of emerging economies have become outward investors. These developments create both benefits and challenges for developing countries. While IIAs may be an important policy tool for enhancing a host country's attractiveness to foreign investment, there are also concerns that these treaties are not effective enough in triggering new investment inflows. Therefore, one key question for policymakers is how to strengthen the promotional character of these agreements. Another challenge is the atomization of the IIA universe and the resulting need to seek consistency in a country's IIA network and its underlying investment-related policies. Furthermore, IIA negotiators need to ask themselves how to enhance the development dimension of these treaties. This includes the issues of how to balance public and private interests in IIAs and how to deal with investor responsibilities. Overall, the increasing complexity of the IIA system creates a serious capacity challenge for many developing countries, including in the area of investor-State dispute settlement.

Introduction

1. In accordance with the decision of the Trade and Development Board, the first session of the multi-year expert meeting on investment for development will consider the development dimension of international investment agreements. In accordance with the Trade and Development Board's decision, the "expert meeting will review trends and salient features of international investment agreements (IIAs) that have been implemented, including management of investor-State dispute settlement; analyse key emerging issues; analyse benefits and challenges identified in IIAs; and assess the impact of IIAs on development" (TD/B/55/9, para. 25).

2. The expert meeting is expected to facilitate an exchange of experiences on investment and development... [and] draw lessons from such experiences, with a view to helping developing countries secure greater benefits from investment" (TD/B/55/9, para. 30). In addition, the expert meeting is expected, as part of the multi-year expert meetings, to contribute to the achievement of "practical options and actionable outcomes", as identified in paragraph 207 of the Accra Accord.

3. The secretariat has prepared the present note as background information for the expert discussion at the meeting.

I. Trends and salient features of IIAs

A. Trends

4. The universe of IIAs consists of bilateral investment treaties (BITs), double taxation treaties (DTTs) and other investment-related agreements, such as free trade agreements and economic cooperation agreements. The universe of IIAs continues to grow both in number and in complexity. There is a continued shift in treaty-making activity away from BITs and towards DTTs, and a robust trend towards the renegotiation of BITs.

1. The IIA universe continues to expand

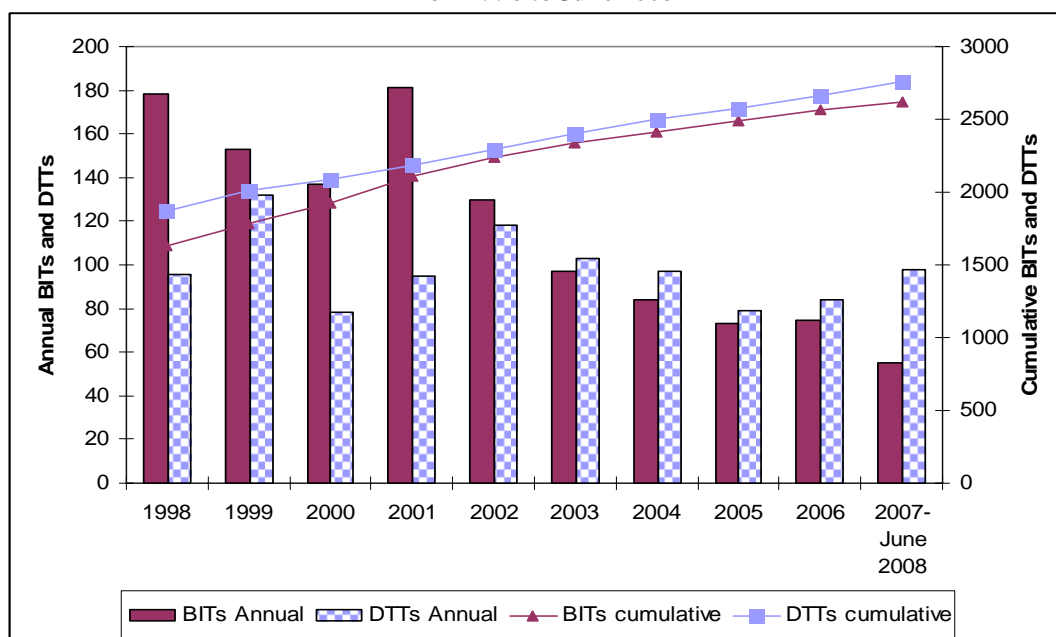
5. As of June 2008, there were 2,619 BITs, 2,759 DTTs and 259 free trade agreements or other treaties on economic cooperation containing investment provisions, making a total of nearly 5,700 IIAs (fig. 1). The majority of these treaties are in force.¹

6. The number of countries parties to BITs had reached 179 by the end of June 2008. Developed countries still dominate the global BIT network and have the largest share in the "top ten" list (fig. 2), but other country groups are increasing in importance. The treaty activity of Asian countries is particularly noteworthy, with a current share of 41 per cent (fig. 3). At the other end of the spectrum are the countries of Latin America and the Caribbean, which currently have a share of 19 per cent. This region has substantially slowed its treaty-making activity. As an example, at the time of writing this report, not one BIT had been signed during 2008, and some countries have even taken steps towards withdrawing from existing commitments.²

¹ For a discussion of the entry into force of BITs, see UNCTAD 2006.

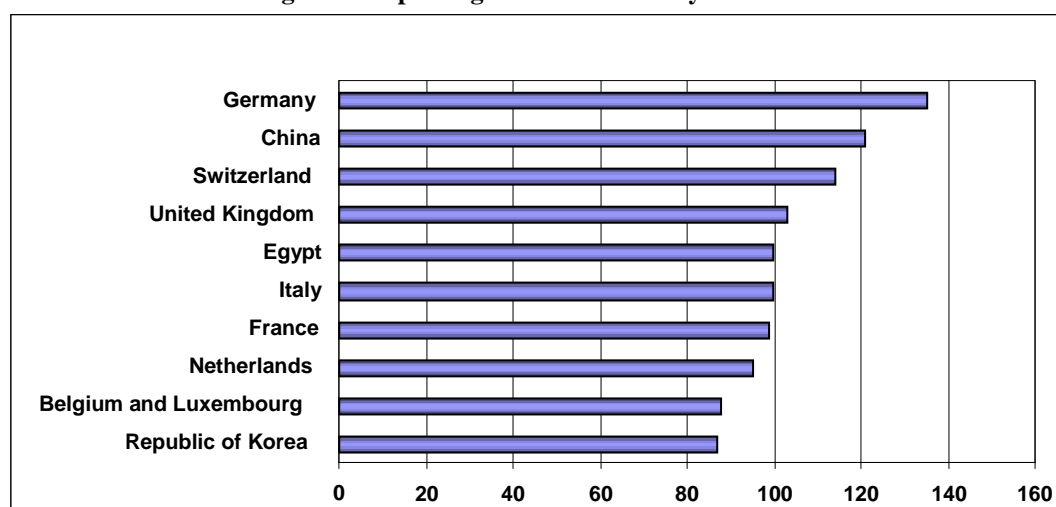
² For example with effect from November 2008, Bolivia will withdraw from the World Bank's International Centre for Settlement of Investment Disputes (ICSID). In December 2007, Ecuador announced that its consent to ICSID arbitration is no longer available for any disputes arising from mining and oil contracts. The Bolivarian Republic of Venezuela has made public similar concerns. Ecuador has also denounced nine of its 25 BITs, and in a similar move, the Bolivarian Republic of Venezuela has denounced its BITs with the Netherlands in April 2008.

Figure 1. Number of BITs and DTTs concluded, annual and cumulative from 1998 to June 2008



Source: UNCTAD (www.unctad.org/iia).

Figure 2. Top 10 signatories of BITs by June 2008



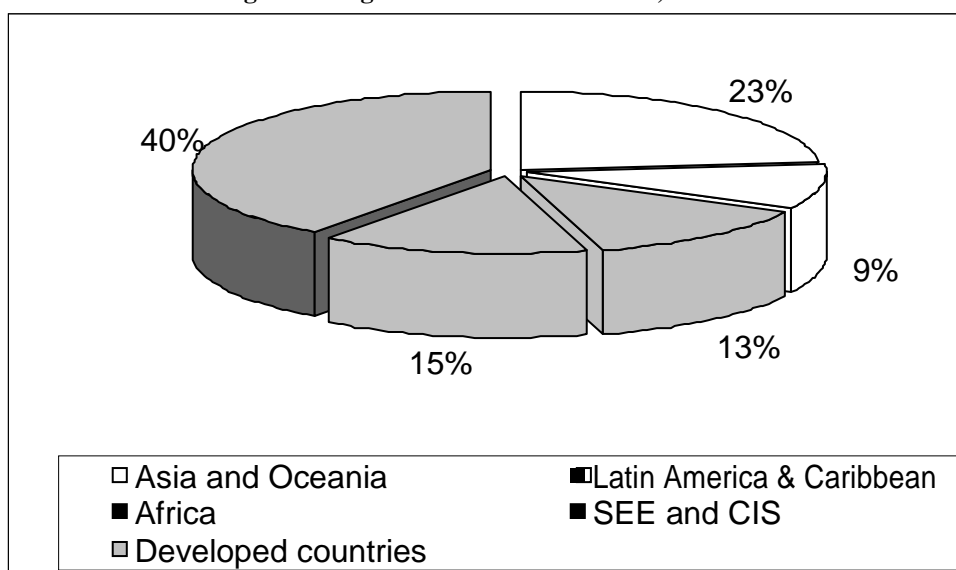
Source: UNCTAD (www.unctad.org/iia).

7. It is also noteworthy that more BITs are being renegotiated. At the end of June 2008, the total number of renegotiated BITs stood at 121. Therefore, at the present time, less than 5 per cent of all BITs have been renegotiated.³ However, this number may rise, as many BITs are becoming relatively old, and more countries are revising their model BITs in order to reflect new concerns, for example, the right of the host country to regulate as well as environmental and social issues.⁴

³ To date, Germany has renegotiated the most BITs (16), followed by China (15), Morocco (12) and Egypt (11).

⁴ Norway, for example, is finalizing a new model BIT that includes, *inter alia*, the promotion of transparency in economic cooperation between the parties, and emphasizes the protection of health, safety, the environment and

Figure 3. Regional distribution of IIAs, June 2008



Source: UNCTAD.

Notes: The above figures reflect multiple counting. (For example, BITs concluded between countries from Asia and Africa are included in *both* regions.)

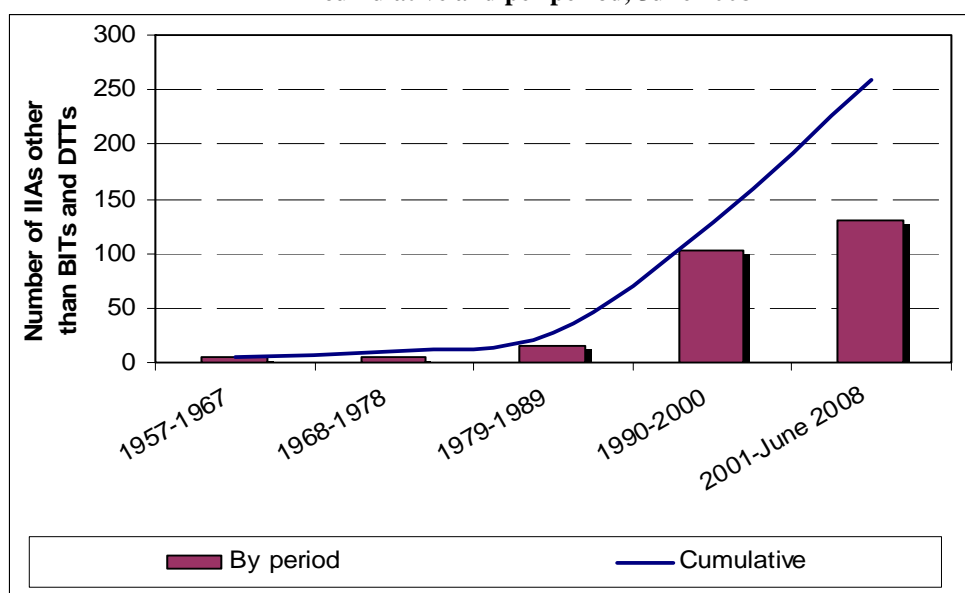
SEE and CIS = South-East Europe and the Commonwealth of Independent States.

8. Developed countries also dominate the DTT universe, which takes in 195 countries. Only 38 per cent of DTTs have been concluded between developed and developing countries, and only 16 per cent have been concluded between two developing countries. Twenty-four per cent of DTTs have been concluded between developed countries, which is significantly higher than the share of BITs concluded by these countries. This may be explained by the fact that double taxation poses a greater threat in developed countries than political risk. Countries in Asia and Oceania have been the most active, having concluded 1,024 DTTs by the middle of 2008, followed by Africa, which had concluded 462, and Latin America and the Caribbean, which had concluded 324. At the national level, the highest number of treaties had been signed by the United States of America (154), the United Kingdom (152) and France (134). Among developing countries, China (99), the Republic of Korea (83) and India (80) were the front-runners, as of the middle of 2008.

9. International investment agreements other than BITs and DTTs are continuing to become more important, such as free trade agreements and economic cooperation agreements containing investment provisions (fig. 4). In addition to the 254 agreements already in existence, at least 70 such IIAs were under negotiation by the end of June 2008, involving 108 countries. Their total number – less than 10 per cent – is still small compared to the number of BITs, but it has nearly doubled over the past five years. Many of these agreements establish binding obligations on the contracting parties concerning the admission and protection of foreign investment, in addition to a framework on investment promotion and cooperation. The scope of the protection commitments is comparable to that found in BITs, including with regard to investor–State dispute settlement.

international labour rights. It also stresses the importance of corporate social responsibility and reaffirms the parties' commitment to democracy, the rule of law, human rights and fundamental freedoms.

Figure 4. Number of IIAs other than BITs and DTTs concluded, cumulative and per period, June 2008



Source: UNCTAD.

2. The increasing complexity of the IIA universe

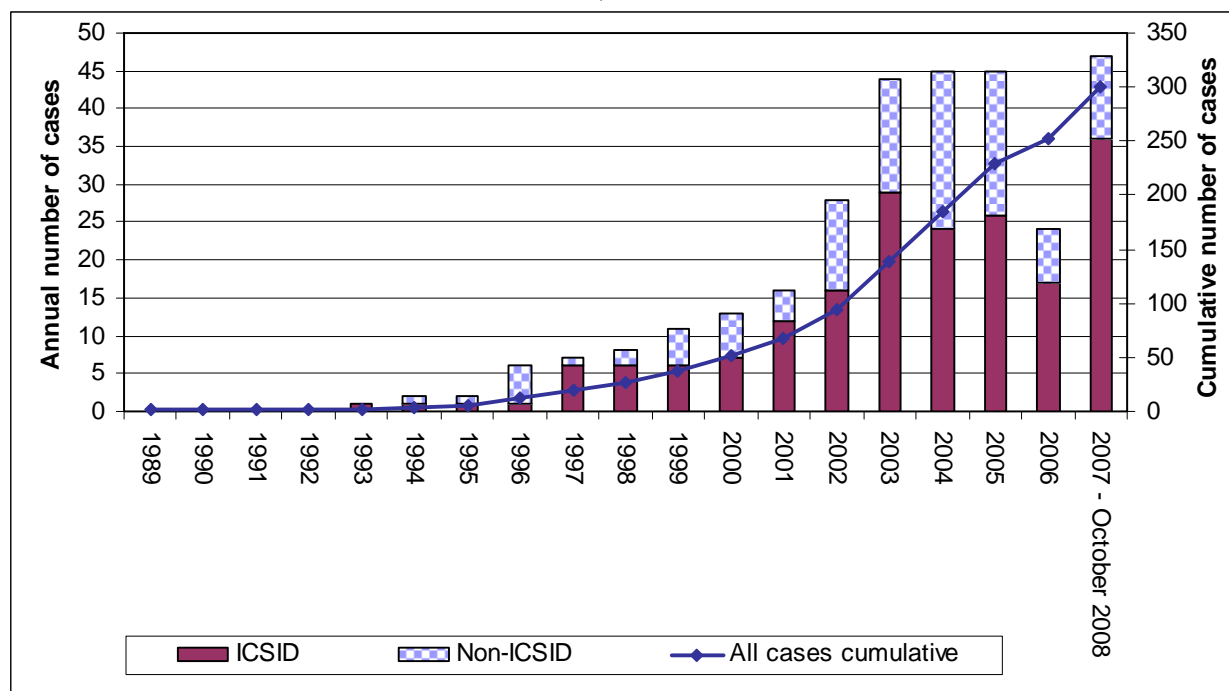
10. The IIA universe is not only growing numerically, but also in complexity. In fact, each new treaty adds to the complexity of the system as a whole. For example, a number of IIAs include significant revisions to the wording of various substantive treaty obligations, such as the meaning of “fair and equitable treatment” and the concept of indirect expropriation. Some recent BITs place stronger emphasis on public policy concerns associated with foreign investment through exception clauses, covering – among other things – national security and public order, protection of health and the environment, respect for core labour rights, cultural diversity, and prudential measures for financial services. Significant innovations also continue to take place in investor–State dispute settlement procedures, in order to increase transparency, promote judicial economy, and foster sound and consistent results. Complexity is also increasing as a result of the rapid growth of atypical forms of IIAs, namely free trade agreements and economic partnership agreements. Consequently, the previous relatively homogeneous structure of IIAs has given way to a more diversified texture (see section 2 below). In addition, even “traditional” IIAs are showing an increasing variety of content, with regard both to the number of substantive issues covered and to the manner in which individual provisions are drafted.

3. Investor–State dispute settlement on the rise

11. The number of investor–State disputes has surged in recent years. In 2007, at least 35 new investor–State cases were filed in connection with IIAs. Twenty-seven of these were filed with the International Centre for Settlement of Investment Disputes (ICSID). In the first ten months of 2008, another 12 cases were registered – nine of these with ICSID. By October 2008, the cumulative number of known treaty-based cases had reached at least 300 (fig. 5).⁵ Since ICSID is the only arbitration facility to maintain a public registry, the real number of treaty-based cases is likely to be higher.

⁵ These disputes were filed with ICSID (or the ICSID Additional Facility) (182), under the United Nations Commission on International Trade Law (UNCITRAL) (80), the Stockholm Chamber of Commerce (14), the International Chamber of Commerce

Figure 5. Number of known investor–State arbitrations, annual and cumulative, from 1995 to October 2008



Source: UNCTAD (www.unctad.org/ia).

12. Countries from all regions have been involved in arbitrations based on IIAs.⁶ Argentina tops the list, with 46 claims lodged against it. 44 of these disputes relate at least in part to that country's financial crisis in the early part of this decade. Mexico continues to have the second highest number of known claims (18), followed by the Czech Republic (14), Canada (13), the United States (12), Ecuador (11), India, Poland and Ukraine (9 cases each), and Egypt, Romania, the Russian Federation and the Bolivarian Republic of Venezuela (8 cases each). Seven countries faced arbitration proceedings for the first time in the period from the beginning of 2007 to October 2008. These were all countries from the developing world, or countries with transition economies, namely Armenia, Bosnia and Herzegovina, Costa Rica, Guatemala, the Islamic Republic of Iran, Nigeria and South Africa. As many as 90 per cent of known disputes were initiated by firms headquartered in developed countries.

13. A large majority of cases was initiated on the grounds of violation of a BIT provision (78 per cent), followed by provisions under the North American Free Trade Agreement (NAFTA) (14 per cent) and the Energy Charter Treaty (6 per cent). In 2007, the first two cases were initiated on the grounds of alleged violations of the Central America–Dominican Republic–United States Free Trade Agreement (CAFTA-DR).

14. Awards rendered cover a broad range of issues, including the definition of "investment", the standards of fair and equitable treatment and full protection and security, the principles of national treatment and most favoured nation (MFN) treatment, the expropriation article and the umbrella clause. This means that most of the substantive provisions usually contained in IIAs have become the subject of investor–State dispute

(5), and *ad hoc* arbitration (5). Another case was filed with the Cairo Regional Centre for International Commercial Arbitration, one was administered by the Permanent Court of Arbitration, and for two cases the exact venue was unknown at the time of writing.

⁶ As of June 2008, 74 governments – 46 of them in the developing world, 16 in developed countries and 12 in Southeast Europe and the CIS – have been involved in investment treaty arbitration.

settlement procedures (UNCTAD, 2008a). Thus, no country can be sure that its IIAs remain unchallenged before international tribunals.

15. In all, the decisions rendered resulted in a balance between awards in favour and against the investor. Forty-two cases were decided in favour of the State, 40 cases in favour of the investor, 37 cases were settled amicably, and 154 cases were pending. For 17 cases that were decided, the decision is not in the public domain.

16. While international arbitration is an important and integrated component of the rule of law and a crucial means to increase legal stability, in 2007 a number of conflicting awards also led to new uncertainties concerning the interpretation of some core investment protection provisions. Such inconsistency relates, for instance, to the definition of “investment”, the scope of the umbrella clause and the MFN principle, and the issue of “like circumstances” in connection with the national treatment principle.⁷ In addition to these diverging awards is the substantial number of dissenting opinions that individual arbitrators expressed in awards. All this demonstrates that the development of case law on international investment issues is still very much in flux and far from being consolidated.

4. Stronger role of developing countries

17. The role of developing countries in international investment rulemaking continues to grow. By June 2008, developing countries were parties to 76 per cent of all BITs, 61 per cent of all DTTs, and 81 per cent of all other IIAs. There are now three developing countries amongst the “top” signatories of BITs worldwide, namely China, Egypt and the Republic of Korea.

18. There is also more South–South cooperation in international investment rulemaking; 695 BITs had been concluded between developing countries as of June 2008, constituting 27 per cent of all BITs. The total number of South–South IIAs other than BITs and DTTs exceeded 90 at the end of 2007. China alone accounted for a large share of these South–South agreements. About 60 per cent of the Chinese BITs concluded from 2003 to mid-2008 were with other developing countries, mainly in Africa.⁸

19. The growing role of developing countries in IIA treaty-making also reflects that these countries are increasingly becoming home countries for FDI flows and that their companies start to figure more prominently among the world’s major transnational corporations (TNCs). In fact, the outward FDI stock of developing countries has grown considerably since 1990, from \$144 billion to \$2.288 trillion in 2007. In addition, since the late 1990s, FDI flows originating from developing countries have grown faster than those from developed countries (UNCTAD, 2008b).

B. Salient features

20. The IIA universe as it has developed over the past decades is characterized by the following features:

21. The system is *universal*, in that nearly every country has signed at least one BIT and the majority of them are members to several, if not numerous, IIAs. The structure of

⁷ On the different approaches followed by arbitral tribunals, see for example, on the definition of “investment”, *Saipem S.P.A. v. The People’s Republic of Bangladesh*, ICSID Case No. ARB/05/07; and *M.C.I. Power Group L.C. and New Turbine, Inc. v. Ecuador*, ICSID Case No. ARB/03/6. On the “umbrella clause”, see the awards in *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13; *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3; and *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16. On the most favoured nation treatment, see *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB/05/8; and *RosInvestCo UK Ltd. v. The Russian Federation*, SCC Case No. Arb. V079/2005. On fair and equitable treatment, see *Siemens A.G. v. Argentine Republic*, ICSID Case No. ARB/02/08; *PSEG Global et al. v. Republic of Turkey*, ICSID Case No. ARB/02/5; *M.C.I. Power Group L.C. and New Turbine, Inc. v. Ecuador*, ICSID Case No. ARB/03/6; *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB/05/8. For more information on the substantive details of the 2007 awards, see UNCTAD 2008a, available at (www.unctad.org/ia).

⁸ Nine of the 16 BITs China signed from 2003 to mid-2008 were concluded with African countries: Benin, Djibouti, Equatorial Guinea, Guinea, Madagascar, Namibia, Seychelles, Tunisia and Uganda.

agreements is *atomized*, that is, it consists of thousands of individual agreements that lack any system-wide coordination and coherence. The IIA universe is *multi-layered* – as IIAs now exist at the bilateral, regional, intraregional, interregional, sectoral, plurilateral and multilateral level – and IIAs at different levels may overlap. The system is also *multi-faceted*, meaning that IIAs include not only provisions that are specific to investment, but also rules that address other related matters, such as trade in goods, trade in services, intellectual property, labour issues or environmental protection.

22. In substance, the agreements reflect a *considerable degree of homogeneity* with respect to the core elements of investment protection. Provisions on national treatment and MFN treatment, fair and equitable treatment, compensation for expropriation, the right to free transfers, and consent to investor–State and State–State dispute resolution appear in a very large majority of agreements. However, the actual wording of these provisions shows considerable diversity. Other provisions, however – such as guarantees of national treatment and MFN treatment with respect to the right to establish investment and prohibitions on performance requirements – appear in only a minority of agreements, sometimes with considerable variation among treaties.

23. The majority of IIAs are *primarily protective, but only moderately liberalizing*. Most IIAs are still modeled after the European BITs originating from the 1960s. However, after the entry into force of the World Trade Organization’s General Agreement on Trade in Services (GATS), more recent free trade agreements also include liberalization commitments, as do recent BITs concluded by Canada, Japan and the United States.

24. The IIA system is also *dynamic and innovative*. As stated before, a small but growing number of IIAs include revisions to the wording of various substantive treaty obligations, such as the meaning of “fair and equitable treatment” and the concept of indirect expropriation. Other examples of innovative approaches relate to the inclusion of exception clauses and new provisions on investor–State dispute settlement (see above).

25. Furthermore, most IIAs are typically *only indirectly promotional*. This means that they seek to attract foreign investment through the granting of investment protection rather than through specific promotion measures by home and host countries.

26. In addition, IIAs only establish *investor rights*, but remain silent with regard to their *obligations*. This means that host countries continue regulating foreign investment through their domestic legislation and not by directly imposing commitments on foreign investors in IIAs, for instance with regard to their corporate social responsibilities. How to ensure adequate corporate contributions to development remains a key challenge for many developing countries.

27. As instruments of protection, most agreements *contribute only slightly to transparency*. Many IIAs further the goal of transparency only insofar as the provisions of the agreements themselves are transparent. However, they do not require host countries to make their domestic laws transparent.

28. Most existing IIAs do not specifically address *development concerns*, or do so only in a marginal manner, mainly through a reference in the preamble. The development objective of these treaties is therefore a political goal and is not specifically aimed at the developing country treaty partner, but at the economic development of all contracting partners, irrespective of their status (see below).

29. It follows from this analysis that the current IIA system is not a static structure of agreements, but a dynamic framework that continues to evolve. On the one hand, the progression of the IIA system and the consolidation of core investment protection principles contribute to clarity and stability of the investment climate. Moreover, the increasing variety and complexity of IIAs with regard to individual aspects of investment promotion and protection offer countries more options than ever before in terms of treaty-making and using IIAs as instruments to further their development policies. On the other hand, the latter aspect also poses unprecedented challenges, in particular for developing

countries, concerning the negotiation of the “right” agreement, the proper implementation of IIA obligations, and for keeping the IIA patchwork transparent and coherent.

II. Key emerging issues

30. In addition to the above-mentioned trends and salient features of the IIA universe, a number of new policy issues have arisen that have an impact on IIA negotiations. They include the protection of strategic industries, economic crisis, and the role of emerging economies as outward investors.

A. Protection of strategic industries

31. Many countries have recently started to re-evaluate their liberal investment policies and some have introduced adjustments, exercising their right to regulate foreign investment to pursue domestic policy objectives. One of the main areas where a more restrictive approach towards foreign investment has become manifest relates to the protection of strategic industries and critical infrastructure.⁹ Restrictions for foreign investors in this field have been justified by host countries by referring to their national security interests.

32. Several factors contributed to this development. As long as strategic industries – such as energy, telecommunication, transportation or water – were in State ownership, Governments did not have to worry that they could fall under foreign influence. With considerable parts of these industries privatized in many countries, the option of foreign takeovers has become real. Also, numerous countries see a need to exercise a stronger control over their natural resources. In addition, countries may be of the opinion that domestic ownership or control of strategic industries is important for their competitiveness. Finally, the spread and more active role of State-owned enterprises and sovereign wealth funds (SWFs) have further accentuated national security concerns in relation to foreign investment. Concerns have been expressed that their considerable financial power could put them in a position to buy up any industry they like. In addition, in view of the State ownership of these firms and funds, it has been argued that they would not only pursue economic goals but also political objectives.

33. There is a potential conflict between the objective of investment protection in IIAs on the one hand, and the safeguarding of the contracting parties’ security concerns on the other hand. Thus, the challenge for Governments is to find a proper balance between a sufficient level of protecting its national security interests, while at the same time ensuring that investment protection is still strong enough to keep the country attractive for foreign investors.

34. Many IIAs contain a so-called “national security exception” that dispenses contracting parties from all or parts of the treaty obligations in case an investment poses a threat to national security. However, while this exception was originally perceived as targeting military threats and related matters, it has received a new dimension with regard to the protection of strategic industries.

35. This may have important implications for international investment rulemaking. First, those countries that concluded an IIA without a national security exception may feel a need for it in order to safeguard their regulatory freedom with regard to strategic industries. Second, those countries that agreed upon a national security exception in the IIA may ask themselves whether it is broad enough to cover restrictions on foreign investment in order to protect strategic industries. On the other hand, foreign investors and

⁹ A distinction can be made between “strategic industries” and “critical infrastructure”. Whereas the former term relates to *all* industries that a Government considers as crucial for its economic development, the latter term is limited to the infrastructure sector, and is not only relevant for economic reasons, but for the well-being of the society as such (e.g. access to water and sanitation). While the two terms are therefore not identical, this note nevertheless uses the idiom “strategic industries” for both alternatives.

their home countries might have exactly the opposite concern. They may have thought that the coverage of a national security exception would be limited to defence-related matters, whereas they may now be confronted with a situation where the clause has much larger and unexpected effects. Third, there is the question as to whether these new developments require adjustments in IIAs as regards the conditions under which the exception may be invoked. One could argue that contracting parties need to retain a higher degree of discretion in reacting to a national security threat if a military menace or another kind of emergency situation is at stake than in cases involving a mixture of political, economic and competitive interests in connection with the protection of strategic industries, where there is no actual crisis situation.

B. Economic crisis

36. More recently, a tendency has emerged to invoke national security considerations in an economic context. Several arbitration awards in connection with Argentina's economic crisis in the early 2000s dealt with the issue of whether this situation constituted a threat to the country's essential security interests and therefore justified restrictions imposed on foreign investors. In order to fight this crisis, the Argentinean Government took a number of measures that restricted the operations of foreign investors. Argentina argued that these measures were required to protect its internal security interests in the face of possible domestic upheavals and extended social tensions. While some awards confirmed that Argentina had the right to invoke the national security exception in its BIT with the United States, other tribunals came to the opposite conclusion.¹⁰

37. An important difference between national security interests in respect of strategic industries on the one hand, and with regard to economic crisis on the other hand, is that host country measures usually have a precautionary character in the first case, whereas they have a reactive nature in the latter. Governments take action to protect strategic industries before any damage has occurred. By contrast, the country must already be in a state of economic crisis before measures based on national security considerations can be taken. Also, the latter measures affect *already established* investors in the country, while investment restrictions to protect strategic industries usually affect the *entry* of foreign investors. All this might have consequences concerning the preconditions that must be fulfilled before a national security exception in an IIA may be invoked.

C. Emerging economies as outward investors

38. Significant changes take place in the patterns of international investment flows. As emerging economies turn into powerful economic and political players, their companies invest more in foreign countries. Investment flows that were once basically one-way streets from developed countries to developing countries increasingly become busy two-lane roads. This marks the beginning of a new phase of globalization in which investors from emerging economies (such as Brazil, China, India, the Russian Federation and South Africa) play a much more important role.

39. These developments may have significant implications for the IIA universe. Developing countries that in the past saw their main objective in IIA negotiations as preserving a maximum of freedom in the treatment of foreign investors must now be concerned that their own investors receive high protection abroad. Balancing these two potentially conflicting interests may be a challenge.

¹⁰ The relevant cases are: *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/08, Award of 12 May 2005; *LG&E Energy Corp./LG&E Capital Corp./LG&E International Inc. v. The Republic of Argentina*, ICSID Case No. ARB/02/1, Award of 3 October 2006; *Enron Corporation Ponderosa Assets L.P. v. The Argentine Republic*, ICSID Case No. ARB/01/03, Award of 22 May 2007; *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16, Award of 28 September 2007; *Continental Casualty Company v. The Argentine Republic*, ICSID Case No. ARB/03/9A, Award of 5 September 2008.

40. Up to now, emerging economies have not substantially changed their treaty practice. However, some countries, such as China, have become more responsive to issues such as national treatment and investor–State dispute settlement as they have started to incorporate these standards into their IIA network, but this development is not necessarily linked to their evolving status as outward investing countries.

41. Another question is how developed countries will react to the fact that they are increasingly becoming hosts for investments from emerging economies. In the context of NAFTA, we have seen that developed host countries see a need for additional “safety nets” in their IIAs in order to limit their exposure to foreign investor claims. This trend might gain further momentum as more and more developing countries become outward investors, and as more investments are made by sovereign wealth funds and State-owned multinational companies, where the borderline between commercial and political interest may not always be perceived to be clear.

42. The key issue for the future development of the IIA organism will be whether this new phase of globalization will take place in a sense of cooperation or confrontation. The IIA universe as it has been evolving over the last decades has to a large extent been shaped by developed countries. They were the first that developed a BIT prototype, which ever since has been the basic model for all other kinds of investment agreements. The new phase of globalization increases the economic power of some developing countries and further enhances their political weight. It remains to be seen what consequences this relative power shift will have for future IIA negotiations.

III. Benefits and challenges of international investment rulemaking

A. Benefits and the impact of IIAs

43. Countries all over the world believe in the usefulness of IIAs as demonstrated by the huge expansion of the IIA universe over the last decades. IIAs have proliferated both geographically and with regard to the number of participants. International investment rulemaking has become a universal phenomenon covering all regions. It has shown its dynamism by being innovative concerning the types of treaties concluded and the manner in which individual provisions are drafted. And it is so dynamic as never before when it comes to enforcing IIA-related rights in international arbitration. Investor–State dispute settlement procedures are nowadays a standard feature in most IIAs and the more than 288 known arbitration cases show that foreign investors increasingly make use of it.

44. A recurrent issue in the discussions about the benefits of IIAs is to what degree these agreements *actually* fulfil their objective of encouraging more FDI. The debate on the impact of IIAs on FDI, previously perceived as a North–South issue, has recently gained new momentum. As a growing number of developing countries are becoming FDI exporters, they reconsider the role of IIAs as not only a device aimed at stimulating inward FDI from developed countries but also as a means to encourage and protect their own outward FDI in developed and other developing countries.¹¹

45. Since IIAs are a key instrument in the strategies of most countries, in particular developing countries, to attract foreign investment, policymakers need to know what role these treaties play in practice and to what extent they may contribute to receiving more investment from abroad. Equally important is the question of whether the impact of IIAs on investment inflows also depends on the specific type of investment treaty concluded. A better understanding of the influence of IIAs on foreign investment can help to avoid unrealistic illusions and prepare the ground for more effective systemic host country policies that give IIAs their proper place in an overall strategy of attracting foreign investment.

¹¹ In 2007, 138 developing countries reported outward stock of FDI; see UNCTAD, 2008b: 257–260.

46. The host country determinants for FDI consist of (a) the general policy framework for foreign investment, including economic, political and social stability, and the legislation affecting foreign investment; (b) economic determinants, such as the market size or the availability of natural resources; and (c) business facilitation, such as incentives or infrastructure. All three determinants interact, enhancing or reducing the attractiveness of countries for foreign investment. IIAs are part of the policy framework for foreign investment, and are thus only one of the many factors that impact on a company's decision where to make an investment. As a consequence, IIAs alone can never be a sufficient policy instrument to attract FDI. Other host country determinants, in particular the economic determinants, play a more powerful role.

47. The impact of IIAs on FDI has been measured in a series of econometric studies, published between 1998 and 2008 (UNCTAD, forthcoming a). While these studies arrive at different conclusions, several – amongst them the most recent ones – concur that IIAs do have some influence on a company's decision where to invest, and that this impact is generally stronger (in terms of increased FDI flows) in the case of free trade agreements or economic cooperation agreements than with regard to BITs.

48. IIAs add a number of necessary components to the policy and institutional determinants for FDI, and thereby contribute to enhancing the attractiveness of countries. In particular, they improve investment protection and add to the security, transparency, stability and predictability of the investment framework. If IIAs liberalize market access, they also improve an important economic determinant of foreign investment. Also, the geographical expansion of integration or its deepening can and in some instances has stimulated additional investment inflows.

49. The impact of IIAs on investment flows into developing countries is confirmed by investor surveys. For the majority of reviewed companies from all sectors, IIA coverage in host developing countries and transition economies plays a role in making a final decision on where to invest. Further evidence that TNCs increasingly make use of BITs is provided by the rapidly increasing number of investment arbitration cases based on these agreements.

50. Nonetheless, developing countries in need of foreign investment may wish to further strengthen the role of IIAs as an investment promotion instrument. So far, most IIAs promote foreign investment only *indirectly* through the granting of investment protection. One could imagine that IIAs promote investment through more direct means, including home country measures (UNCTAD, 2004: vol. 3, chap. 22). Such means could include a broad range of issues, for example (a) transparency and exchange of investment-related information; (b) fostering linkages between foreign investors and domestic companies; (c) capacity-building and technical assistance; (d) granting of investment insurance; (e) encouragement of technology transfer; (f) easing of informal investment obstacles; (g) joint investment promotion activities; (h) access to capital; (i) financial and fiscal incentives; and (j) the setting up of an institutional mechanism to coordinate the investment promotion activities (UNCTAD, 2008c). However, not all Governments think that the market ought to be helped this way and economists disagree on whether such efforts are worthwhile.

B. Challenges

51. The current state of the IIA universe also poses a number of challenges. These are systemic challenges, development-oriented challenges and capacity-related challenges (UNCTAD, forthcoming b).

1. Systemic challenges

a. Atomized structure of the IIA universe

52. A first challenge has to do with the structure of the existing IIA network. As explained above, it is highly atomized and fragmented, consisting of thousands of individual agreements that lack any kind of system-wide coordination and coherence. Such a body is less stable than one consisting of a solid and homogenous structure. And it is probably also more fragile and has less resistance when it comes under pressure. However, in the absence of global investment rules, countries have no other choice but to continue concluding bilateral or regional agreements, thereby further perpetuating and accentuating the IIA micro-cosmos. As long as individual countries seek individual solutions in addressing their IIA-related concerns, the coherence of the overall system is bound to deteriorate. This runs counter to some core principles that should apply to international commercial relations – that is clarity, stability, transparency, and the existence of a common set of ground rules as it exists since decades in the trade field.

b. The interplay between IIAs and national policies

53. Coping with the interaction between IIAs on the one hand, and national investment policies on the other hand, is another challenge. In order to create a healthy investment climate conducive to economic growth and sustainable development, appropriate framework conditions need to be in place both at the national and the international level. In this respect, IIAs can set important parameters for policy reforms at the national level, while national conditions may likewise pose limits for what can be agreed upon in an IIA. National conditions become particularly important in policy areas where IIAs remain silent, as it is often the case with regard to the freedom of investment, and the social and environmental dimension of globalization. The challenge is to get this interaction “right” in the light of moving policy agendas and changing circumstances.

2. Development-related challenges

a. Balancing public and private interests

54. A basic concern for Governments has to be that private investor interests do not prevail over legitimate public concerns, for instance with regard to social and labour issues or the protection of the environment. Host countries need to ensure sufficient regulatory flexibility in IIAs to pursue their domestic policy agenda. This has led to the revision of some model BITs and also several amendments of procedural rules on arbitration (see above).

b. Strengthening the development dimension

55. Another challenge has to do with making foreign investment, through the use of IIAs, conducive for economic development. One issue at stake is how to ensure that development concerns are adequately addressed throughout an agreement, for example, through references in the preamble, the structure of the agreement, the drafting of its substantive contents, the inclusion of technical assistance provisions and adequate means of implementation, including transition periods, monitoring devices, etc. (UNCTAD, 2004: vol. 1, chap. 2).

c. Investor responsibilities

56. A related subject has to do with investor responsibilities. Many developing countries are of the view that IIAs are unbalanced in the sense that they only establish obligations for the host countries, and not for foreign investors. The question is whether one should establish investor obligations directly in IIAs, rather than merely leaving the host country with the regulatory flexibility to impose them through its domestic laws, or referring in IIAs to voluntary standards of corporate social responsibility.

d. Investment promotion

57. In addition, one could ask whether more could be done to strengthen the promotional character of IIAs, given continuous complaints that these treaties do not sufficiently contribute to attract inward investment (see below).

3. Capacity challenges

58. As explained above, countries are nowadays confronted with the task of managing an increasingly complicated IIA system. This situation may create particular problems for developing countries. Due to capacity constraints in terms of human and financial resources, limited bargaining power and lack of expertise, they might have serious difficulties negotiating the “right” IIA, translating international commitments into national law and establishing coherent economic and development policies, and reflecting them properly in their IIA network. Developing countries with frequent policy changes and weak negotiation positions also face a considerable risk of concluding inconsistent IIAs. Many developing countries also face capacity constraints concerning the management of investor–State dispute settlement cases

59. Equally important, the prevailing trend towards more regional agreements and broader economic cooperation risks having numerous developing countries being left out of this integration process, because they may not be interesting enough from the point of view of developed countries.

60. Capacity problems in developing countries have also been aggravated by the rise in investor–State disputes in recent years. Appropriately preparing for – and defending the interests of the State in – investor–State disputes often stretches the available technical and financial resources in developing countries to their limits. In addition, concerns have arisen about the potentially high awards and the huge costs of defending a case. The possibility of multiple proceedings involving the same set of events has further augmented these concerns.

61. In this context, the question of *arbitration-avoiding strategies for developing countries* has received more attention lately. Surprisingly, alternative methods of dispute resolution (ADR) seem to hardly ever be referred to in IIAs, although they are available under international instruments, such as the ICSID and UNCITRAL conciliation rules.¹² It would be worthwhile to consider giving a more prominent role to ADR – such as mediation and conciliation – in future IIAs (see UNCTAD, forthcoming c). Mediation and conciliation could have several advantages over international arbitration. If successful, they might be cheaper, faster, and more protective of the relationship between the foreign investor and the host country – all important aspects for developing countries. The significant rise in investor–State disputes in recent years could be an additional argument in favour of ADR. On the other hand, the higher degree of discretion that conciliators and mediators might have in proposing a dispute settlement could, to some extent, make it more difficult to achieve consistency.

IV. Conclusions and outlook

62. The above analysis has shown that more need than ever for capacity-building and technical assistance to assist developing countries in coping with the demands of the evolving IIA universe. Agreements become more numerous and far more complex, existing treaty provisions may have to be clarified, and “old” treaties may need to be renegotiated or denounced altogether if they have resulted in undesired outcomes. In addition, numerous developing countries have gone through the painful experience that

¹² For ICSID rules of procedure for conciliation proceedings (conciliation rules), see <http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp>. For the UNCITRAL conciliation rules, see http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1980Conciliation_rules.html.

IAs have started to “bite” and need to manage complex, lengthy and costly investor–State dispute settlement procedures.

63. Countries also have to cope with the systemic challenges deriving from the highly atomized structure of the IIA universe and the complicated interplay between IIAs and national development policies. The proper balancing of public and private interests in IIAs remains an ongoing and crucial task, as does the need to ensure that these agreements contribute to achieving the development objectives of host countries. Also, countries must think of effective means for IIAs to maximize the investment promotion goals of these treaties.

64. As if all this were not enough, countries are confronted with newly emerging issues. These include how to deal with demands to protect strategic industries in IIAs and to ensure that host countries may deviate for their treaty obligations in case of severe economic or financial crisis. Finally, emerging economies may need to review their bargaining positions in order to secure first-rate protection for their investors abroad.

65. In the absence of global investment rules, countries continue to conclude investment treaties on a bilateral and regional basis, thereby further perpetuating and accentuating the existing IIA patchwork with its inherent complexities, inconsistencies and overlaps, and its uneven consideration for development concerns. While this method may lead to suitable results in some instances, often this may not be the case. Developing countries in particular may have problems with such a “piecemeal” approach. It requires considerable expertise that might not be available. Also, many developing countries might not have sufficient bargaining power to prevail with their views in bilateral negotiations with stronger developed countries.

66. Ultimately, the existing IIA network has serious system-immanent deficiencies that result from its highly atomized and fragmented nature. They could only be overcome by changes to the system itself, namely a move towards a more coordinated multilateral approach. However, as the current global policy environment is not favourable for a renewed effort to establish binding rules in this area, other more modest resolutions need to be envisaged.

67. A more coordinated and collective approach towards international investment issues that seeks to enhance multilateral consensus-building could have several advantages, namely a gradual harmonization effect on the system, an increase in clarity and stability of investment relations, and an improvement of the consistency of rules. It could also serve as a main reference for international investment rulemaking at all levels, and ensure that all countries irrespective of their level of development can equally participate in the process.

68. A multilateral discussion forum could also enhance transparency in an important way. It would enable countries to learn more about the treaty network of their partners, their difficulties to manage it and their plans to develop it further. This would also put countries in a position to learn from each other’s experiences and to explore the potential for more coordinated approaches.

V. Questions for discussion

69. Against this background, experts may wish to elaborate on the following questions:

- (a) In relation to trends and salient features:
 - (i) What messages can be derived from the trends and salient features?
 - (ii) What are the prospects for the future development of the IIA system?
- (b) In relation to key emerging issues:
 - (i) How should IIAs address the potential conflict between investment protection on the one hand, and the protection of strategic industries on the other? Do countries, in particular developing countries, see a need to reconsider the

- content of so-called “national security exceptions” in this context to reduce the risk that their outward investors (e.g. SWFs) are unduly restricted?
- (ii) How should IIAs address the potential conflict between investment protection on the one hand, and the protection of a country’s essential security interests in times of economic crisis on the other? Is there a growing need for countries, in particular developing countries, to include a so-called “national security exception” in IIAs to address this situation?
 - (iii) What impact, if any, does the new role of emerging economies as outward investors have on their IIA negotiation position? How to solve the potential conflict between the host country interest to retain maximum discretion in the treatment of foreign investors, and the home country interest to obtain ample protection for its investors abroad?
- (c) In relation to the benefits and challenges of international investment rulemaking:
- (i) What more could be done to enhance the investment promotion objective of IIAs?
 - (ii) How relevant is the issue of coherence of the IIA universe under the development aspect? What policy areas are mostly affected by the issue of coherence or lack of it?
 - (iii) Is there a need to re-evaluate the actual balance of private and public interests in IIAs? And, if so, in what areas would it be required and how could this be achieved?
 - (iv) Are the “flexibility” mechanisms provided for in IIAs (e.g. exceptions, waivers, transition periods and safeguards) sufficient to enable host developing countries to pursue their development strategies and benefit most from foreign investment? What else could be done to enhance the development potential of IIAs?
 - (v) What could be done to ease the burden of countries, in particular developing countries, in investment dispute settlement procedures? What dispute-avoiding strategies could be envisaged?
 - (vi) What is your opinion concerning a more coordinated approach towards multilateral consensus-building on IIA matters? In what policy areas might this be feasible?

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Note by the UNCTAD secretariat

Corrigendum

Below the masthead, on the corner notation, the meeting dates *should read*
10–11 February 2009.
