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## Do Bilateral and Regional Investment Treaties Facilitate Development?



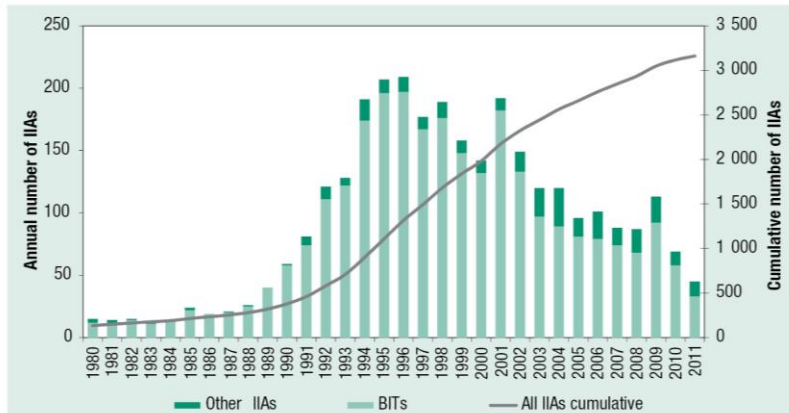
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### Overview

- Approximately 3000 bilateral Investment Treaties (BITs) in operation:
  - Vietnam has 60 BITs (as of 1 June 2013)
- Classically, structured between developed and developing states:
  - Example: Germany-Philippines BIT
  - However, some BITs are “intra-ASEAN”
- Treaty provisions tend to reflect strategic interests of developed state as capital exporter.



Figure III.2. Trends of BITs and “other IIAs”, 1980–2011



Source: UNCTAD.



- Strategic orientation:
  - BITs are protection instruments (except for U.S treaties):
    - Treaty obligations apply after the investor is established in the host state:
      - Host state retains full sovereignty to decide whether to admit the foreign investor and on what conditions
  - For the U.S and few other states:
    - BITs are also economic liberalization instruments:
      - Require host state to liberalize (open) their economy to foreign investment



- Key provisions:
  - Scope of operation:
    - Broad definition of “investment” and “investor”:
      - Beyond FDI to portfolio/loan capital
  - Relative standards of treatment:
    - National treatment
    - Most-favored-nation treatment
  - Absolute standards of treatment:
    - Guarantee of compensation in the event of direct and indirect expropriation
    - Fair and equitable treatment



- Absolute standards (cont.):
  - Transfer of funds
    - *Gruslin v Malaysia*
  - “Umbrella” clause
    - *SGS v Philippines*
- Exceptions?
  - Limited (compare with WTO)
- Dispute settlement:
  - Investor-state arbitration



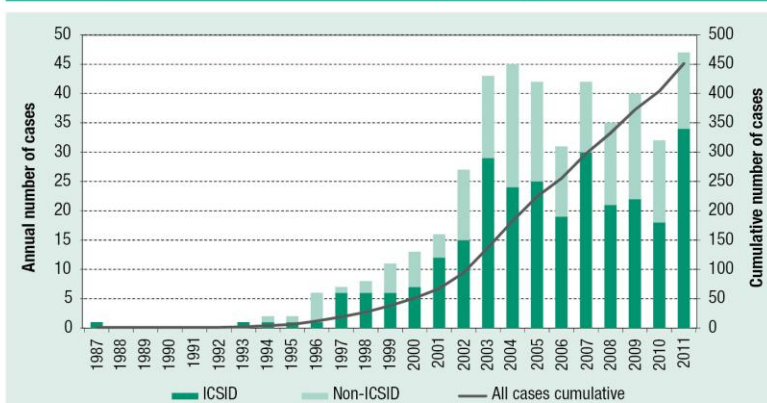
- Foreign investors are able to bring action directly against (host) state party for breach of a treaty standard:
- What are the critical features of arbitration?
- Contrast:
  - Commercial arbitration (under a contract)
  - Investor-state arbitration (under a treaty)



- Monetary compensation is usually awarded rather than restitution.
- Damages awards can be significant (see UNCTAD Issues Note, 9-10):
  - On 5 October 2012, an arbitral tribunal rendered the largest ever damages award (of US\$1,769,625,000) against Ecuador due to Ecuador's termination of an oil production investment held by a U.S company (*Occidental v Ecuador*, Award (ICSID Case No. ARB/06/11, Oct. 5, 2011))
- Costs of bringing and defending actions are also significant:
  - Do "costs follow the event" in investor-state arbitration?



Figure III.4. Known investor-State treaty-based disputes, 1987–2011



Source: UNCTAD.



- Does entry into BITs lead to increased foreign investment into states?
- Empirical reports are mixed:
  - Most report negative findings.
  - But one recent study (Berger et al) has found causation between extending market access (pre-establishment national treatment) and increased foreign investment.



- Before extending market access, developing states should carefully audit their domestic economies to assess ability to take the benefit of foreign competition in key sectors:
  - This includes communication between the central government and any regional/local instrumentalities.



- There is also the question of how best to schedule reservations (exceptions) to market access:
  - Positive list (as in the WTO General Agreement on Trade in Services)
  - Negative list (typically used by the U.S and other developed states).



- What impact do investment treaties have on policy mechanisms designed to maximize developmental benefits from foreign investment?
  - Performance requirements
    - Typically required to be extended on a non-discriminatory basis
  - Subsidies
    - Softer regulation (especially in ASEAN)



- How can developing states minimize their risk profile to initiation of investor-state arbitral claims?
  - Definition of “investment”:
    - Tie scope of operation to some express condition of legality under domestic law.
  - Umbrella clause:
    - Impact on contracts entered into by the state as they are brought under the “umbrella” of the treaty: prospect of multiple claims
    - Omitted in ASEAN (*SGS v Philippines*)



- Recalibrate protective obligations:
  - Fair and equitable treatment:
    - Tie to customary international law
  - Indirect expropriation:
    - Ensure impact does not alone determine breach
  - Transfer of funds:
    - Create flexibility to allow intervention to limit unstable capital flows including capital controls
  - General exceptions (using the WTO)

