Chapter Two

International Law on Foreign Investment

Sources of International Law on Foreign Investment

- As foreign investment (FI) rules are part of public international law, sources of international law on FI would then be the same as sources of public international law.
- These sources of international law are stipulated under Art. 38(2) of the Statute of International Court of Justice. These sources are treaties, custom, judicial precedents, general principles recognized by nations and writings of scholars.

- **Treaties:** different types; multilateral, regional, plurilateral and bilateral treaties.
- **Multilateral treaties** are those international instruments;
  - Signed by large number of countries across the world.
  - Membership is not as such limited by geographical location or level of development.
- As far as FI is concerned, there are no multilateral treaties, especially to regulate substantive issues of FI. Though limited in number there are on dispute settlement -ICSID (International Center for Settlement of Investment Dispute).
  - ICSID - established in 1966 for legal resolution and conciliation between international investors, which is part of and funded by the World Bank Group (IBRD, IDA, IFC, MIGA and ICSID. While the first two focus on public sector/government funding the rest three focus on private market interaction by providing funding, insurance and dispute resolution).

- The reason for the absence of multilateral instrument is the result of disagreements over issues of FI among countries.
  - Developed countries push for a treaty which gives broader protection for investors and a low interference of host state.
  - On the other hand, developing countries want to control investors.
- This is the main reason for the absence of multilateral treaties not lack of attempts to formulate such treaty.

- The first attempt made in the late 1940s when attempts were made to establish the International Trade Organization (ITO).
  - Under the Havana Charter the US proposed incorporation of investment issues.
- In subsequent years, different attempts have been made;
  - For instance, organizations like Organization for Economic Co-operation and Development (OECD), the World Bank Group, and the WTO attempted and failed to bring countries on consensus.
  - Among these, the serious one was the 1997 attempt to adopt a Multilateral Agreement on Investment (MAI), but failed.
    - It was a draft agreement negotiated in secret between members of OECD between 1995 and 1998. it sought to establish a new body of universal investment laws that would grant corporations unconditional right to engage in financial operations around the world, without any regard to national laws and citizens' rights; and it gave corporations the right to sue governments if national health, labour or environmental laws affect their interest.
    - When the draft became public in 1997, it faced with widespread opposition from CSOs and finally in 1998 the host nation France withdrew its support for MAI; effectively preventing its adoption due to the OECD's consensus procedures.

- **Regional and plurilateral treaties**; agreements, in which
  - Only a limited number of countries participate and often not open to the participation of all countries.
  - **Regional agreements** are reached among countries in the same geographical area.
  - **Plurilateral treaties;** a treaty between a limited number of states with a particular interest in the subject matter of the treaty, mainly among countries at similar level of economic development. They can also be made among countries in the same geographical location.
    - OECD can be example (founded in 1948 between European States but reformed in 1961 accepting non-European States, to stimulate economic progress and world trade and now has 36 members. It is a club of developed nations – 42% of the world GDP-describes themselves as committed to democracy and the market economy).
- There are several regional treaties on FI and becoming increasingly important sources in FI matters and its regulation.

- The case of the European Community-1952 (now the EU-1993), is the prime example.
  - The extensive liberalization of capital movements, the effective elimination of discriminatory measures and the adoption of common rules among its members has had far-reaching effects on FI *among member countries* and an important impact on investment in and from *third countries*.
  - Investment in developing countries has been affected by the successive agreements concluded between the EU and African, Caribbean and Pacific countries, although the arrangements foreseen in the Conventions have been slow in their realization.

- Other regional arrangements involve shallower integration, but still affect FI is the North American Free Trade Agreement (NAFTA).
  - Its members are the United States, Canada and Mexico.
  - Although NAFTA is formally only a "free trade zone" -- and not a common market or an economic union like the European Community/ EU -- the agreement covers FI. It creates a framework for the free movement of investments within the NAFTA region.
    - Free trade area vs. custom union (the d/c is regarding their approach to non-treaty nations. The latter requires member states to set identical tariffs for non-treaty nations while in the former members are free to set their own tariff on non-treaty nations).
    - Customs union vs. economic union (the former allowed member countries to move goods across border, but they do not share a currency which is the case in economic union. Plus, the latter allowed to move workers across borders freely, which is not the case in customs union).
    - Economic union is the last step in the process of integration, after free trade area, customs union and *common/single market*. It is expressed by four freedoms of movement – of goods, services, labour and capital.
  - It may in fact be considered as characteristic of a recent trend for free trade agreements to include FI in their scope.

- **In Asia;**
- Association of South East Asian Nations (**ASEAN**);
  - An intergovernmental organization established in 1967, comprising 10 Southeast Asia countries.
  - Its objective is to facilitate cooperation on economic, political, security, and related issues.
- The Asia Pacific Economic Cooperation (**APEC**);
  - An intergovernmental organization established in 1989 to promote free trade throughout Asia-Pacific Region (countries around the border of the Pacific Ocean).
  - Now 21 members including US, Canada, Australia, China, Japan and Mexico.
- In **Africa**, there are such kind of organizations, though they are infant and lags behind their goals.

- The Common Market for Eastern and Southern Africa (**COMESA**);
  - a free trade area established in 1994, now with 21 members.
- Economic Community of West African States (**ECOWAS**);
  - Established in 1975 with a mission to promote economic integration across the region.
  - Now it has 15 member countries.
- Sothern African Development Community (**SADC**);
  - An intergovernmental organization established in 1980, with a view to further socioeconomic cooperation and integration.
  - Now it has 16 member states.
- East African Community (**EAC**);
  - An intergovernmental organization composed of six member states (such as Burundi, Kenya, Rwanda). Established in 1967, collapsed in 1977 and revived in 2000.
- These regional blocks are an integral part or pillars of the continent wide African Economic Community (**AEC**);
  - An organization of AU States created by the Abuja Treaty signed in 1991, entered in to force in 1994.
  - Its objectives are creation of free trade areas, customs union, a single market, a central bank and a common currency; thus establishing an economic and monetary union to be completed in 2028 (its maximum transition period is 2034).

- Why regional/plurilateral agreements more successful than multilateral?
  - The number of countries involved is smaller and they tend to be relatively homogeneous.
  - Hence, the adoption of instruments that serve common interests in fairly specific fashion is more feasible.
- **Bilateral investment treaties (BITs**); are now one of the most important international instruments on FI.
  - These are treaties concluded between two countries.
- There have been proliferation of BITs as of the 1990s even though the first of its kind was concluded in 1959, between Germany and Pakistan.
  - The number of BITs has grown from about 500 in 1980 to 2, 923 in 2014.

- **Custom** - customary international law. It requires;
  - Consistent state practice and
  - Opinio juris (sense of legal obligation on the part of the states that practice)
- Concerning FI only few customs developed. The reason is;
  - Lack of uniform practice and diverging views on issues of FI among countries, especially between the Western and many developing countries.
- But it does not mean customary international law has no any role on matters of FI.
  - For instance the right to be paid fair compensation, sanctity of contract (no change of contract unitarily), and equity of states, which are accepted as customary international law are applicable to FI.

- **General Principles of Law**; it is a source for some principles of international law on FI.
  - For instance, much of the support for the payment of full compensation upon expropriation of foreign property is based on arguments relating to notions/general principles of unjust enrichment.
  - The principle that compensation must be paid is itself said to be a general principle of law.
  - The principle of fairness, proportionality. Hence, resort can be made for such principles, if there is gap.

- General principles of law have been used widely by arbitration tribunals in extracting principles applicable to investment contracts; where there is a systematic pattern in their use by the tribunals and precedents have been built.
- However, tribunals have used general principles in a manner which favor the promotion and protection of investment rather than towards the acknowledgment of norms that may favor developing states/ the principles are being applied detrimental to the interests of the host state.

- **Judicial Decisions**; the decisions of the International Court of Justice (ICJ) and its predecessor – the Permanent Court of International Justice (PCIJ)- on the area of FI. The following three decisions are considered as significant.
- **Identify the facts of the case and holding of the courts and examine the implications of the decisions/analyze the holdings**. (***Individual assignment***).
- The first, the 1***927*** Chorzow Factory Case (Germany Vs Poland) a decision of the PCIJ.
  - The court decided that if expropriations occurred, full compensation must be paid. This remains the basis for any discussion of issues of compensation for the taking of foreign property.

- Expropriation is the taking of private property by a government acting in its sovereign capacity.
- Nationalization is a form of expropriation and generally covers an entire industry or geographic region. It typically occur in the context of a major social, political or economic change.
- Confiscation is seizure of private property by a government as a punishment for breach of law.
- Requisition simply is a formal request or demand for something (by a government).

- The second, ***the 1970*** Barcelona Traction Case (Belgium Vs Spain) a decision of the ICJ.
  - It is concerned with corporate nationality and the diplomatic protection of shareholders of corporations.
  - The court decided that the right to diplomatic protection of a corporate entity belongs to the State under the laws of which it is incorporated and in whose territory it has its registered office. It rejected ownership or control as sole connecting factors entitling a state to exercise diplomatic protection.
- The third, the ***1987*** Elettronica Sicula Case/ELSI Case (US Vs Italy) a decision of the ICJ.
  - Concerned with issues as to what amounts to a taking and whether liquidation of a foreign corporation by a court could provide the basis of a claim that there was a denial of justice for which responsibility arose in the state.

- There are also several FI cases decided by Arbitral tribunals, both ad hoc and institutional (ICSID).
  - The extensive use of arbitration for settling disputes related to FI obviously confers increasing importance on this class of rules.
  - Though previous decisions are not binding, in practice, tribunals often make a reference to previous tribunal decisions. This increases the role of tribunal decisions for the construction of norms of international law on FI.
- **Writings of Scholars**; the teachings of the most highly qualified publicists of the various nations are a subsidiary means for the determination of rules of international law.
  - They help to construct conceptual framework and to develop approaches and expectations that may eventually find expression in formal binding texts.

History of International Law on Foreign Investment

- Seeing **International Law on Foreign Investment, in terms of period**;
- **The period before 1950s**; despite foreign investment dates back early, there was no well-developed international law that would govern foreign investment, in this period. There are different reasons
- First, **colonialization**.
  - Investment was largely made in the context of colonial expansion.
  - The investors were foreign nationals from colonial powers.
  - Investing in territories colonized by the imperialist powers.
  - If there were any risks against their investment, the imperialist powers would provide protection either by use of force or any other means, which makes the need for an international law on foreign investment minimal.

- Secondly, even in the territories that were not colonized, to protect investment;
  - They would first try to resolve the dispute by way of diplomacy and if agreement failed the home state would send its war ships or other forces to the border of the host state (a mix of diplomacy and power).
- Third, if the investment could not be protected by the above means;
  - Resort was made to international law on the treatment of aliens. The principle of treatment of aliens under international law, impose state responsibility to protect foreign nationals, would then be applicable to treatment of foreign investors by adapting the rules to situations of foreign investment/as foreign investors are aliens(foreign nationals).
- Hence, international law to resolve foreign investment issues was a last resort. This hindered the development of international law on foreign investment.

- **In the 1920s**, there were some sort of move, especially in Latin America.
- The relations between the US and its Latin American neighbors indicated the need for the development of an international law relating foreign investment.
- The two had difference on the kind of protection to foreign investors (which is typically the argument between developing and developed countries).
  - The difference was between the idea that a foreign investor should be confined to the remedies available in the local law (national/internal standard) and the idea that he must be accorded the treatment according to an international standard (external standards).

- The clash was mainly prevalent between the US and Mexico when Mexico in 1917 nationalized the properties that belonged to US nationals.
- Cordell Hull, the US Secretary of State, since 1938 engaged in a series of diplomatic exchanges with the government of Mexico;
  - He argued for the respect of the right to prompt, adequate and effective payment of compensation for expropriated property - the Hull Formula doctrine.
  - He further argued there is an obligation on states to pay compensation by standards set by international law- the law on the treatment of aliens.
- Mexico responded that;
  - The country is under obligation to pay compensation in adequate manner but the time and manner of such payment would be determined by Mexico's own laws.
  - It asserted that there is no external standard for treatment of foreign investors under international law.

- The position of Mexico was based on **the Calvo doctrine** (developed by the Argentine jurist Carlos Calvo);
  - He argued that under international law foreign nationals had no rights greater than citizens of the host country.
  - It argued that provision of equal treatment to foreign investors satisfied the requirement of international law and
  - Also foreign investment would be protected only in accordance with domestic law.

- **The period after liberation**; Many countries were liberated especially in the period immediately after WWII and 1960s.
- Now, the imperialist powers lost their direct control and protection. Use of force started to be condemned internationally especially after bloody wars of WWI and WWII
- The former colonies became hostile to foreign investment and took over or nationalized the property of foreigners in some cases without compensation.
- After political independence, developing countries also want economic independence.

- Accordingly, they put a pressure on UN in this regard.
  - The UN in 1962, passed a resolution which sets the principle of permanent sovereignty over natural resources. States are entitled over their natural resources, including the right to confiscate/nationalize, provided they provide compensation.
  - In the late 1960s, there was an attempt to enact regulations to put restrictions on the conduct of TNCs. But it failed.
- Thus, the developed countries felt the need to develop explicit international law/rules on foreign investment. There are attempts (as highlighted above).

- However the attempt to formulate the law failed. Because;
  - Countries have diverging views on laws governing foreign investment due to the sensitive nature of the issues involved.
  - It involves a wide-ranging issues such as economics, politics and other issues of special significance that make concluding agreements among countries difficult.
- As a result, there has not been a well-developed international law on foreign investment.
- **In 1980s onwards**- period of rationalization. In fact, since 1980's there have been a time of investment liberalization, promotion and protection.
  - But these recent policy changes are reflected at the national level and BITs, not yet extensively reflected in multilateral instruments.

WTO and Foreign Investment

- The aim of WTO to liberalize trade, yet, it has also investment aspect since certain trades are connected with investment. Most notably TRIMs and GATS.
- Trade Related Investment Measures (**TRIMs**); it has a connection with FI, even if not directly.
- It is concerned with performance requirements or measures which the host state may impose on investors such as;
  - Local content requirement
  - Export requirement/trade balancing
  - Job creation requirement
  - Duty to make research

- Such measures on investors/investment affects trade and this is why TRIMs agreed, for instance, if we take local content requirement it adversely affects importation of goods; in export requirement mostly governments determine the destination of the produces without the lead of the market.
- **GATS** (General Agreement on Trade in Services); cross border service delivery. Four models;
  - **Model 1**; cross border supply/only the service cross borders.
  - **Model 2;** consumption abroad/the consumer go abroad for the service.

- **Model 3**; commercial presence.
- **Model 4**; movement of natural persons who deliver service.

- Not all trade in services are foreign investments, but Model 3.
- It is this model which relates trade with investment. Take a foreign bank operated in Ethiopia, as example.
- Whether to include investment issues under WTO or not is a controversial issue and still under negotiation, especially since 2001/3, the Doha round.