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The international regime on investments:
a problematic *status quo*,
an uncertain future

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1. Introduction

In the mid-80s, international investments were, together with trade in services and intellectual property rights (DPI), one of the “new issues” on the agenda of international trade negotiations to be dealt with by the Uruguay Round of the GATT. During the same period, investments were included as a specific issue in the NAFTA negotiations, and the results of these negotiations were consolidated in a chapter of the Agreement dedicated essentially to protecting the investor’s (property) rights and defining commitments on market access for investments of the Parties.

In the 90s, the issue became increasingly relevant in trade negotiations, despite the fact that it was not yet “officially” included in the multilateral agenda. In fact, although the issue of investments is partly or indirectly dealt with in several agreements of the WTO such as the TRIMs Agreement, the GATS, the ASCD and the TRIPs Agreement (OECD, 2004a), on the multilateral sphere it has yet to be dealt with as an “autonomous” issue: in this field, the WTO norm is in essence limited to regulating the use of TRIMs that affect the trade of goods, namely the measures inconsistent with Articles III:4 and XI:1 of GATT 1994. As for investments in services, these are dealt with as a modality of trade in services and are submitted to the disciplines and methodology of liberalization conceived to deal with the four modes of provision considered in GATS.

Nevertheless, within the WTO the treatment of the issue also gained density in the second half of the 90s. Investments in financial services and telecommunications were the object of sectoral multilateral agreements as part of the negotiations on services after the Uruguay Round. Besides this, the Ministerial Conference held in Singapore in December 1996 created a working group to examine the relationships between trade and investments.

The Doha mandate established in November 2001, in addition to providing for the continuation of negotiations on services – which bears direct implications on the negotiations on investments in these sectors – determined that the beginning of negotiations on “trade and investments” should occur after the Fifth Ministerial Conference of the WTO held in Cancun in September 2003, based on modalities of negotiations that would be defined at that Conference. The refusal of the developing countries to negotiate the so-called Singapore issues (among them investments) was one of the factors at the root of the setback of the Cancun Conference. Consequently, the negotiations held in Geneva during the first semester of 2004 led to withdraw the issue of investments from the current multilateral agenda.

Difficulties to “multilateralize” the treatment of investments were also felt in the negotiations of the OECD’s Multilateral Agreement on Investments, a supposedly less complex negotiation than the one underway in the WTO, since it involved only developed countries. The MAI negotiation was “imploded” in October 1998 on account of the large number of reservations expressed by the Parties, the explicit opposition of the governments of some of these Parties, and the pressure from civil society groups in the member countries of OECD.

So far, the negotiations on investments failed to produce any concrete results in the multilateral (or even the plurilateral) sphere after the Uruguay Round – except for the conclusion of the GATS Protocols of Financial and Telecommunications Services – and the negotiating dynamic remained essentially in the bilateral sphere, that is, the same sphere where the investment agreements originated and multiplied. Accordingly, the issue is dealt with comprehensively in recent bilateral trade agreements signed by the European Union with Mexico and Chile and by the United States with Chile, Morocco, Jordan, Australia and Central American countries (CAFTA), among others.

As of the turn of the century, although bilateral investments treaties (BITs) kept multiplying, criticism grew, both in the countries of the North and the South, concerning certain provisions of this type of agreement and more generically concerning the very idea of negotiating agreements centered on protecting the rights of the investors.

This paper is organized in the following way: section 2 contains a description of the emergence of investments as an issue in the agenda of trade negotiations and the factors that lie at the root of this emergence. Section 3 presents the main characteristics of the agreements that refer to international investments on the various levels of negotiations. Detailed reference is made to the OECD Multilateral Agreement on Investments, whose negotiations failed, because this process (and its outcome) represents a key moment in the history of the treatment of the issue in the trade negotiations of the 90s: the MAI episode illustrates both the ambition of the investment agreements typical of that time and the emergence of several forms of resistance to such a model of agreement. Furthermore, the main factors that explain the difficulties as to multilateralizing treatment of the issue of investments are discussed in this same section. Finally, section 4 discusses the problems arising (i) from the adoption of a paradigm of investments agreement that is today the object of criticism from different sources, as well as (ii) from the overlapping of investment agreements created in different instances and subject to different types of conditionings factors. Thereafter, proposals are presented towards overcoming the obstacles that prevent (i) the emergence of a new generation of agreements endowed with more legitimacy; and (ii) reducing the risks and uncertainties related to the overlapping of (not always convergent) obligations derived from different agreements.

2. The investment issue in the agenda of international negotiations: a stylized evolution

The 1948 Chart of Havana aimed at creating the International Trade Organization to deal not only with trade issue but also the “national regulations regarding international firms and

restrictive business practices” (Sarafian, 1992). Article 12 of the Chart set some parameters for future negotiations on an international investment agreement: “these guidelines for negotiations were not meant to be legally binding. They nonetheless recognized the tension that existed between private rights and public goods and between the movement of capitals and the development of domestic economies which is inherent to any and every investment” (Mann and Von Moltke, 2004).

With the exception of this frustrated initiative, it can be affirmed that the late 50s and early 60s witnessed the first initiatives at negotiating agreements specifically geared towards the issue of investments.

In the scope of the relationships between developed countries, the main forum of cooperation and negotiation in the area of international investments has been the OECD. Accordingly, in 1961 the OECD countries adopted the Code of Liberalization of Capital Movements, regulating transactions between residents and non-residents. The Code was updated a number of times, having been strengthened and expanded as regards services, especially of a financial nature. The activity of the OECD in this area grew more intense in the following decades with the Declaration on International Investments and Multinational Companies signed in 1976 and updated on successive occasions since then.

Annex I of the Declaration are the Guidelines on Multinational Companies, which establishes voluntary principles and standards of “responsible” business behavior to be followed by transnational corporations¹. Within the OECD, the successive revisions of the Declaration reflected the growing concern in the industrialized countries as to the treatment accorded to transnational corporations by the governments of host countries: the issue of the national treatment for foreign investments in the countries of the OECD gained priority status and was included in the National Treatment Declaration, which bound member States to explicitly register their exceptions to this type of treatment for foreign investors.

The Declaration also included an Instrument on Incentives and Disincentives to International Investments, seeking to make the measures adopted by the signatories in this area transparent and providing for consultations, revision procedures and studies with a view to tightening the cooperation between the member States on this politically delicate issue. Also annexed to the Declaration is an Instrument on Conflicting Requirements, which recommends the member countries to avoid or minimize conflicting requirements imposed on multinational corporations by different countries.

As of the early 90s the Guidelines incorporated to their text issues of environmental protection and employment and industrial relations, signaling the emergence of a brand-

¹ The developing countries demonstrated their concern with the business practices of multinational in the 60s and 70s in the sphere of UNCTAD. In this case the main objective of the developing countries was to reach a mandatory instrument – not a voluntary one, as in the case of the OECD Guidelines – capable of overseeing the action of transnational companies and curbing possible excesses. Although practically concluded in the early 80s and incorporating - through pressure from the OECD countries - rules for treatment of ETNs by receiving countries, the UNCTAD Code was never implemented, and in 1992 the negotiations regarding this instrument were suspended.

new generation of issues in the arena of international economic negotiations (OECD, 1997a).

To date, the Guidelines have already undergone four revisions – in 1979, 1984, 1992 and 2000. The last revision, initiated by the Committee on International Investments and Multinational Companies - CIME of the OECD, in 1998 and concluded in 2000, “is held to be the most important by proposing new chapters on the struggle against corruption and consumer protection as part of the theme of corporate social responsibility”. In reality the new text of the Guidelines contains “recommendations to put an end to child labor and forced labor, and all the fundamental international norms of labor are covered in them. With regard to the environment, the recommendation is for the multinational corporations to improve their conduct from the environmental point of view by adopting measures such as better internal environmental management, stricter measures involving the publication of environment- related informations and more decisive intervention measures on the effects on the environment” (Vilmar, 2002). Besides the OECD member countries, the Guidelines were adopted by another four non-member countries: Argentina, Brazil, Chile and Slovakia².

With regard to relationships between developed and developing countries, the first bilateral instruments for protecting investments date from the late 50s and early 60s. As commented on by Mann and Von Moltke (2004), in the first bilateral agreement, signed in 1959 between a developed country (Germany) and a developing country (Pakistan), the key focus was protection of investors’ rights, and the agreement was not concerned about the rights of the country hosting the investment – in contrast with what was seen in the guidelines proposed by Article 12 of the Chart of Havana.

According to those authors, one strong reason for this evolution involved the political atmosphere prevailing in the developing countries during that period: the processes of decolonization and formation of new national States made expropriation and nationalization of foreign assets in those countries a constant and very real risk.

Even when this risk became less important, bilateral investment agreements remained within this pattern, focusing on protecting the rights of the investor and involving pairs of countries with different levels of development. The rules and disciplines set by these agreements became growingly based on principles brought from the trade regime managed by the GATT – national treatment, NMF – leaving aside consideration of the complex relations between the rights of the investor and those of the host State (Mann and Von Moltke, 2004). Beyond incorporating the GATT principles of non-discrimination, the BITs developed disciplines and rules of a new variety – *absolute standards* for treating IDE (that is, not relative like those of NT and MFN of GATT), the concept of indirect expropriation, and so on – which would later on become the center of the criticism addressed to investment agreements.

² This last country later became a member of OECD, unlike the other three non-member signatories of the Declaration.

If the main motivation for investment agreements in the 50s and 60s had to do with the perception of the risks associated with decolonization in the country where the investments originated, as of the 80s other factors contributed not only to keep the issue on the negotiation agenda but – beyond that - to focus these negotiations and the agreements they produced on the protection of investor rights.

Outstanding among these “new” factors was the exponential growth of the flows of international private investments and the simultaneous intensification of relations between production of goods and services and between international flows of trade and investments. Besides this, the countries of the OECD and several developing countries witnessed a process of unilateral revision of national investment regimes restrictive to foreign capital.

The convergence of these factors generated a new and intense demand from transnational corporations for the setting of internationally applicable stable and predictable rules to enable them to organize their activities without restrictions, combining trade and investment flows, production of goods and services and lowering transaction costs. Simultaneously, incentives grew for national States to try to attract foreign investments, and agreements on investment protection were viewed as mechanisms capable of contributing to that end.

The BITs multiplied during the 90s. In 1990 there were 470 BITs and the investments covered by these agreements represented less than 5% of the flows of FDI from OECD countries to developing countries. In 2000 there were over 2,000 BITs and half the flows of FDI from OECD countries to developing countries were covered by BITs (Hallward-Driemeier, 2003).

In the 90s the exponential growth of investment agreements was in part a result of the expansion of agreements between developing countries, but at the end of the decade agreements between developed and developing countries were still clearly the majority. Also dating from the 90s were the first initiatives in which investment agreements were included – as specific chapters – in bilateral or regional free-trade agreements.

To date, investment agreements have essentially multiplied bilaterally, since the only relevant regional agreement is NAFTA’s (the Mercosur investment agreements are not even in place). This hegemony of the “bilateral track” does not mean that the content of the BITs is homogeneous: there are important differences between them and these often relate to divergences between the templates used by the United States and the European Union to negotiate investment agreements with developing countries.

A key characteristic of the scenario resulting from this pattern of dissemination of investment agreements is the fact that, although these include GATT principles and concepts, they developed outside the institutional framework of multilateral trade regulation.

In this way a “generation” of investment agreements developed in the 90s that translate clearly the priority accorded to the objectives of (i) providing foreign investors with extended protection and guarantees, including new institutional mechanisms and new

substantive provisions included in the agreements; and (ii) defining liberal rules of admission and establishment of foreign investors in the host countries, and if possible increasing the degree of liberalization applicable to the flows of investments between the contracting Parties at the moment the agreements are signed.

This dynamic of agreements production based on extended protection of investors' rights and on liberalization of the rules applied to investment flows remains hegemonic up to now, but the atmosphere in which this dynamic occurs began to change in 1997. In the last few years this change of atmosphere seems to have begun to affect the very design of the investment agreements.

As a matter of fact, in 1997 the scenario shaped by the success of the Uruguay Round and by the hegemony of pro-liberalization interests began to destabilize with the financial and exchange-rate crisis in several countries in Asia and the deterioration of the Japanese economy.

Moreover, at the same time, in the leading countries of the OECD, the anti-globalization movement gained political strength, feed by the evaluation that "globalization has gone too far" – to borrow an expression from Rodrik (1997) – and that the regulatory competition enabled by economic interdependence, in addition to producing unemployment in these countries, would cause a race to the bottom process in the policy sphere, thereby threatening social norms and cultural values enshrined in those countries.

The failure of the negotiations of the OECD Multilateral Agreement on Investments – MAI - in 1998 was an emblematic moment as it signaled the exhaustion of the liberalizing thrust that the new generation investment agreements expressed better and more completely than any other type of agreement. In fact, investment agreements became, in the mind of the critics of globalization, the paradigm of an international commitment responsible for generating a marked asymmetry between the rights of private investors – protected by the agreement – and those of the host national State.

While in the countries of the OECD the agreements on investments became the favorite targets for critics of globalization, in the developing countries one witnessed a critical re-evaluation of the results of the Uruguayan Round and especially of the TRIMs Agreement. In the months that led up to the frustrated meeting of the WTO in Seattle at the end of 1999, several developing countries defended revising the TRIMs Agreement as part of a set of measures meant to incorporate the "dimension of development" to the regulatory framework inherited from the Uruguay Round and to the agenda of a new Round of multilateral negotiations. This is not the appropriate place to discuss the factors that lay at the origin of this critical revisionism in relation to the results of the Uruguay Round – an attitude that spread among developing countries between the WTO Ministerial meetings at Seattle and Doha.

Although investments continued to be part of the agenda of international negotiations, the issue was removed from the Doha work program after the Ministerial Meeting of the WTO held in Cancun in November 2003. Furthermore, its treatment, on ambitious bases, was rejected by Brazil in the FTAA negotiations, leading to a commitment whose net result was

a clear reduction of what was to be the chapter of investments in the hemispheric free-trade agreement.

3. The main investment-related international agreements

3.1. The multilateral dimension

There is no specific agreement on investment protection within the sphere of the WTO. Nevertheless, the architecture of the multilateral set of agreements contains “agreements and provisions with various levels of relevance for foreign investments and foreign investors”. There are agreements that directly affect the protection to international investments and help to create a more liberal atmosphere for international investment, and there are those that do not protect foreign investments but deal with regulatory matters of immediate relevance for international investors and their investments (OECD, 2003).

a) Investments in WTO agreements

The only multilateral agreement that presents the elements of an architecture of a “traditional” investment agreement, including provisions and modalities for progressive liberalization and lowering the levels of discrimination between nationals and non-nationals, is the GATS.

This agreement is relevant to the issue of investments because it includes, among the trade services modalities, the so-called commercial presence which clearly is identified to an international investment in services sectors. In other words, the disciplines of the GATS apply multilaterally to modality 3 of service provision and the specific commitments made by the different countries to different sectors and sub-sectors in this modality define the conditions of market access and national treatment guaranteed to foreign service providers who establish themselves in the modality of commercial presence in the territories of the countries that draw up such commitments.

According to Solé (2001), the adoption of a broad agreement such as the GATS in a new area of multilateral negotiations was only possible because it was accepted that the agreement was “relatively not very demanding in relation to the obligations that it sets”, the main one being of a general nature, namely acceptance of the principle of multilateralism – the MFN clause – even if the countries can impose limits and define exceptions to the scope of this principle.

As regards the principle of national treatment and market access, the conditionalities introduced in the GATS are even more relevant. In fact, the principle of national treatment only applies to the sectors and sub-sectors included in the lists of specific commitments of the member States and to the forms of provision of services that are specifically mentioned. So there is a liberalization mechanism based on positive offer lists drawn up by each country but conditioned by restrictions that the countries intend to maintain.

In general this methodology encouraged the member States to adopt a strategy of consolidating in the GATS the status quo of the national regulations applicable to trade and service

investments, avoiding committing themselves to additional liberalization. On account of this, there are significant differences between the national lists of specific offers and exemptions from the NMF principle, which essentially reflect the degree of liberalization already admitted by national regulations.

The TRIMs Agreement does not refer specifically to companies or foreign investments, but applies its provisions to all companies. Nonetheless, “since multinational companies tend to be more trade-intensive than their domestic counterparts, the onus of trade-related investment measures tends to fall more heavily on that group” (OECD, 2003).

According to Mersserlin (1995), the Agreement on TRIMs is essentially “a simple reaffirmation of the application of the rules of the GATT to TRIMs”. Put otherwise, the Agreement “does no more than codify the existing jurisprudence of the GATT and call on countries to eliminate progressively the measures that are [already] incompatible with the GATT rules” (Graham, 1996). The GATT disciplines are considered liable to application to investment policies insofar as these affect trade flows directly (Hoekman and Kostecki, 1996). Accordingly, from the long list of TRIMs that the United States suggested eliminating at the start of negotiations³, the Agreement only retained those that violate GATT Articles III (national treatment) and XI (prohibition of the use of quantitative restrictions).

The Agreement does not specify all the measures that it aims to eliminate, it merely indicates by way of illustration measures that are held to be incompatible with GATT rules, essentially those of local content – assimilated to quantitative restrictions on imports – and the obligations of trade balance⁴ - whose effects combine those of quantitative restrictions on imports and subsidies to exports.

Although they are not strictly speaking investment agreements, the AGP (Agreement on Government Procurement) and the TRIPs Agreement also bear impacts on certain dimensions of international investment (the TRIPs Agreement, for example, protects IPRs, an increasingly important part of the assets of international investors). Both agreements include provisions on non-discrimination, national treatment and so on.

Finally, the relevance of ASCD (Agreement on Subsidies and Countervailing Duties) for the investments area involves the fact that certain types of incentives to investment may be classified as subsidies and are either prohibited or considered “liable to legal action” in the light of the disciplines of the Agreement. Nevertheless, the implications of ASCD for foreign investments are only indirect and their relevance is contingent to the use, by the governments that host such investments, of incentives that can be classified as subsidies to attract them.

c) Relationships between trade and investment

³ The list of TRIMs presented by the United States included: obligations of local content; export and trade balance performance; local production; transfer of technology, in addition to exchange restrictions and limitations to shares participation of foreign capital in local companies.

⁴ This type of obligation binds foreign companies to maintain a certain *ratio* between imports and exports.

The WTO Ministerial Conference held in Singapore on December 1996 set up a Working Group to analyze the relationships between trade and investment. From then on, the investment issue became known as one of the “Singapore issues” in the multilateral agenda. Although the issue was not supposed to be subject to negotiation, the final goal of the players pushing it within WTO was to go further beyond the TRIMs agreement scope and to extend to investment policies (as binding commitments) the basic principles of GATT – national treatment, MFN, etc.

The Doha document, besides providing for the continuation of the negotiations on services – with direct implications regarding investments for these sectors – also determined that the beginning of the negotiations on “trade and investments” would depend on the explicit consensus to be put forth in the following Ministerial Conference, which would be responsible for defining the subsequent negotiating approaches.

Until the Fifth Conference was held, the WG on Trade and Investments should focus on clarifying issues such as: “scope and definition, transparency, non-discrimination, methodologies for pre-establishment commitments based on an approach such as the GATS, of positive lists, provisions related to development, exceptions and safeguards for balance of payments, and dispute-settlement among Members”. This document suggests that it considered the possibility that discussions in this area might lead to the negotiation of an Agreement on investments *à part entière*, but with characteristics that would differentiate it from most of the agreements on investments (mainly BITs) presently in force.

The option for positive lists of (pre-establishment) commitments is one of these distinctive features, the other being the explicit reference, in the Doha document, to “long term cross-border investments, particularly FDI” as the key target of the potential multilateral agreement to be agreed upon. These features suggest that the Doha mandate pointed to pursuing an agreement more restricted than the vast majority of investment arrangements in force, as far as coverage for investments and investors are concerned⁵.

Until the failure of the Cancun Ministerial Conference, the WG on Trade and Investments held several meetings, discussing, among other things, the issue regarding provisions for development, which was included in the Doha Declaration. In this debate, the emphasis of countries such as Brazil was on the need to achieve a balance between flexibility for implementation of development policies in developing countries and the establishment of transparency disciplines for policies that affect investments and for protection to foreign

⁵ Although included in the Doha document, these views were not a consensus, as it would be observed in the discussions of the working group on trade and investments throughout 2002 and 2003. For example, in the debate on types of treatment for pre-establishment, most countries – including Brazil – defended the adoption of positive lists *à la* GATS, as a means to dealing with the issue, because, among other reasons, this architecture permits more flexibility in devising the national lists of commitments and the GATS already considers this model for investments in services (commercial presence case – mode 3). The USA, on the other hand, defended the negative list methodology, resorting to the example of its various bilateral agreements to promote and protect investments.

investments and investors. Some developing countries defended the performance requirements presently forbidden by the Agreement of TRIMs, as mechanisms to reduce trade deficits that tend to be generated by direct investments, in the relationships between the subsidiary and its headquarters, as well as between the subsidiary and the head company's traditional suppliers in the country where the investment originates.

As it is known, the Cancun Ministerial Conference did not allow any agreement regarding the treatment of the investment issue. On the contrary, together with the other "Singapore issues", investments were the source of strong polarization between developed and developing countries. After Cancún, the US and the European Union made it quite clear that these issues were no longer part of their negotiation priorities and, as a consequence, investments were excluded from the Doha Round.

3.2. The issue of investments in non-multilateral instances: the agreements on investment protection

The issue of international investments consolidated on the agenda of bilateral and regional negotiations in the 90s either through the multiplication of bilateral agreements exclusively dedicated to this issue (the BITs) or as a specific issue of broad negotiating processes – bilateral or regional – aimed at creating free-trade areas. In both cases the investment agreements have the objective of establishing rules to protect investments and foreign investors and, in an increasing number of cases, commitments on market access (or establishment).

In this process the NAFTA chapter on investments became a reference for bilateral agreements signed by the United States, but also by its partners in agreements with third Parties, and closely influenced the MAI negotiations in OECD. These two agreements, one in effect and the other whose negotiations failed, adequately illustrate the ambition and range of the treatment accorded to the issue of international investments in the 90s.

a) The NAFTA chapter on investments

The importance that the issue of investments has in NAFTA translates first and foremost the high degree of integration reached by North American productive systems in the early 80s through trade and investment flows. It also owes to the reforms introduced by Mexico in its trade and investment regimes as of the mid-80s, and to Mexico's interest in assuring the investors that they would have safe and permanent access to the United States and Canadian markets. Besides that, it reflects the strategy of the United States to use regionalism as an alternative path for negotiating and implementing disciplines and introducing issues whose treatment was resisted in the multilateral sphere.

The result of this set of interests and incentives is a chapter on investments that marks a rupture in the history of investment agreements. The chapter defines high-level and broad standards of disciplines (applying to goods and services) and is part of an Agreement whose general view is designed to express "the interconnection between investment, trade,

competition policy, protection of intellectual property and services” (Gestrin and Rugman, 1996).

The scope of application of the NAFTA chapter is comprehensive in the sense that it is based on the concept of “assets” rather than “activities of the company” to characterize the investments covered by the Agreement. The concept of “asset” is broader and includes not only property and securities but also shares and various forms of participation in companies, credit securities, intellectual property rights and so on. In addition, NAFTA considers as investors covered by the Agreement both citizens or permanent residents of countries of origin of the investment and corporations established in that country. As a result, companies from non-member countries established under the laws of one of the member countries and exercising “important commercial activity” there are benefited by the provisions of the Agreement in their investments in NAFTA.

The touchstone of the NAFTA provisions with regard to investments is the national treatment obligation (including sub-national instances) mentioned in the Articles that deal with investments, services and financial services. NAFTA, however, goes beyond the simple obligation of national treatment among member countries by setting down common norms for dealing with international investments, irrespective of their origin.

The reserves presented by each signatory country to the principle of national treatment may remain in place as long as they are made explicit in the “negative list” that is part of the Agreement and that expressly indicates the principles or provisions of the Agreement affected by each measure. In compensation, unlisted measures that should restrict national treatment are to be eliminated, and negative lists cannot be added to while the Agreement is in effect.

The restrictions imposed by NAFTA on the use, by signatory countries, of performance requirements as the criterion to authorize setting up foreign companies are considered to be broader and more detailed than those defined by the Agreement on TRIMs of the WTO, especially as regards mandatory requirements (that is, not bound to a concession of a benefit accorded to the investor). The so-called mandatory performance requirements are prohibited by NAFTA for a clearly broader list of measures than those prohibited in the TRIMs Agreement. On the other hand, NAFTA permits offering an incentive to a Party in exchange for fulfillment by the investor of a certain requirement as to the location of production, provision of a service, performance of R&D activities and training and contracting of workers, among other items.

With regard to expropriation, NAFTA only admits this for reasons of “public utility”, with compensation through payment of a “quick, adequate and effective” indemnity. Furthermore, the agreement introduces the concept of “measures equivalent to expropriation” or “indirect expropriation”, which was to become one of the most controversial aspects of the implementation of NAFTA and - in a more general way - in the debate on investment agreements. The freedom to make payments and investment-related transborder transfers is affirmed in the NAFTA text, which sets forth that transfers can be made in a “currency of free use”. Restrictions to payments and transfers are connected to

one of the parties applying their laws on bankruptcy and protecting creditors' rights, criminal and penal infractions, and so on.

The NAFTA mechanisms for settling disputes were conceived to deal with contentions between member States and between an investor and a member State. In the latter case, when "an investor understands that a State has failed in its obligations provided for in the Agreement on investment", he can ask to install a procedure of consultation and friendly negotiation between the parties involved. Should these not enable a solution to be reached, the investor can submit the matter to the arbitration of international institutions such as the World Bank's International Center for Settlement of Investment Disputes or the United Nations Commission on International Trade Law. The arbitral instance may order provisional measures to protect the rights of the investor and monetary compensation and/or restitution of goods. However, it is not admitted for the arbitration court to order the government of a member State to annul or revoke a measure that is understood to constitute a violation of the obligations provided for in NAFTA (Graham, 1996).

NAFTA also contemplates another issue related to investments (and services) and whose treatment on the multilateral level faces difficulties, namely the question of transborder movement of "key personnel" used by companies of member States that have activities in other contracting parties.

NAFTA consolidated a paradigmatic position as far as international investment agreements are concerned, influencing directly the design of different bilateral agreements signed in the American Continent during the 90s and establishing the "basic standards" for treating the issue within the scope of OECD. Free-trade agreements signed between Chile and Canada and between Chile and Mexico, both in the second half of the 90s, contain investment provisions that are practically identical to those in Chapter 11 of NAFTA. This is likewise the case of the bilateral free-trade agreements signed by the United States with Chile, the Central American countries and the Dominican Republic, as well as those signed by Mexico with Japan, Bolivia, Costa Rica and Nicaragua.

b) The OECD *Multilateral Agreement on Investment*

In the OECD countries, despite an unquestionable tendency towards liberalizing national investment regimes since the 80s, there still persisted a series of restrictions and reservations concerning national treatment of FDI, which were the object of intense negotiations within the scope of the Organization.

According to Graham (1996), the main policy mechanisms in effect in the OECD countries when MAI was being negotiated and that violated the principle of national treatment of foreign investment were the following:

- Screening of foreign investments on account of economic considerations and public interest: this practice is still authorized by legal texts in countries such as France, Canada, Mexico and Belgium, but its concrete effects on the rights of establishment and the operation of foreign investors became increasingly less important;

- Exceptions justified by reasons of national security. There has always been consensus in OECD as to the legitimacy of this type of exception, but there have also been divergences as to its scope;
- Exception to national treatment for cultural industries. Justified by concerns about the “cultural identity” of countries and regions, this exception is applied by some countries that reserve time, for example, for diffusion of national productions;
- Access to public programs of technological development. Several OECD countries, including the United States, have important programs of technological development organized and/or financed by their governments. In some of these countries, participation in these programs is restricted to national companies or conditioned, for foreign companies, to criteria of bilateral reciprocity in similar programs; and
- Monopolies recognized by the State and other specific sectoral reserves. In some OECD countries these sectoral reserves include some of the most dynamic sectors of the economy. Refusing foreign investors the right to establish themselves and to enjoy national treatment in these sectors was, at the time of the MAI negotiations, one of the major obstacles to a broad liberalization of investment flows between OECD countries.

Besides these reservations and exceptions to the principle of national treatment, investments within the “OECD zone” were also affected by public policies related to performance requirements and by governmental incentives to investment.

Therefore the scenario in which the OECD countries began to negotiate, in 1995, a sweeping and ambitious investment agreement – the MAI – was dominated by national investment regimes that included policies and mechanisms limiting national treatment to foreign investments. But it was also marked by the conclusion of the NAFTA negotiations – whose investments chapter was presented as a model of investment agreement to be pursued by OECD countries – and by the multiplication of BITS, systematically involving, on the one hand a developed country and on the other hand a developing country or former socialist economy.

The MAI was negotiated in OECD by a specific negotiating group after 1995, and the negotiating mandate defined by the ministers of the OECD member States predicted the conclusion of negotiations for April 1998. However, especially after 1997, the negotiations evolved differently from what was expected: the definition of the national lists of exceptions and the very concept of reserve produced a serious impasse in negotiations. Furthermore, in many countries, the pressures from non-governmental organizations and trade unions against signing the MAI also contributed to complicate the conclusion of the negotiations.

Once approved by the Ministerial Council of the OECD, the MAI seemed ready for signing, including by non-member States. Given the composition of the OECD and the set

of non-member States that attended the negotiations of the Agreement⁶ as observers, one was led to believe that the MAI would be signed by the great majority of countries that accounted for international investment flows, either as poles of origin or as receiving poles.

In this sense, the MAI was considered to represent an important step on the path of “multilateralization” of the network of existing bilateral and regional investment agreements, influencing directly and intensely the discussions on the issue being developed in multilateral forums, especially the WTO, which could not ignore the standards and disciplines defined by the MAI.

The general objectives of the negotiations underway in OECD involved: (i) establishing high-level standards of treatment and protection of investments; (ii) deepening the existing commitments to liberalization applicable to the phases of pre- and post-establishment of the investment, with broad obligations on national treatment, stand-still of reserves, gradual dismantling of exceptions, MFN rules, and transparency; and (iii) establishing disciplines in areas not satisfactorily covered by the OECD instruments in place up to then.

Moreover, unlike various other OECD instruments, the MAI would be “legally binding” and would have a provision make effective its enforcement, besides taking into account the multilateral obligations signed in the WTO, both in the TRIMs agreement and the GATS and in the TRIPs Agreement (OEA, 1997).

The scope of the MAI was extremely wide-ranging: it was to cover all forms of investment (rights, portfolio, financial and intangible property) at all stages and in all sectors of economic activity.

In principle, all sectors would fall within the scope of the Agreement and only the introduction of a specific reserve would authorize one of the contracting parties to suspend the application of the Agreement to a particular sector. The reserves would all be listed in the Agreement, forming a negative or exceptions list that could not be expanded afterwards. Besides this, the degree of restriction to foreign investments defined for each reserve could not be extended either, thereby constituting the minimum limit of liberalization (*standstill*). During the negotiations the setting of a second list of reserves was discussed, the so-called “B list”, in which there would not even exist the standstill commitment, meaning that restrictions to foreign investments could be expanded in the policy sectors and areas included in this list. The idea of establishing a “B list” of exceptions was defended by the NAFTA countries and rejected by the majority of the MAI-negotiating countries.

The MAI was to cover all the types of measures that a contracting party can adopt to restrict the freedom to invest, that is, all the different normative instruments (laws, regulations, legal decisions, etc) to which a member State can eventually appeal.

The explicit limits of the Agreement referred to: (i) the inclusion of general exceptions to its provisions, related to questions of national security and public order; (ii) the definition

⁶ Argentina, Brazil, Chile, Hong Kong and the Slovakian Republic were the five non-member countries admitted as observers to the Negotiating Group in September of 1997.

of a temporary safeguard clause to enable the contracting parties to suspend the application of certain disciplines of the Agreement on account of the occurrence of serious difficulties faced by one of the signatories concerning balance of payments or foreign financing. Resorting to this clause, however, would be liable to supervision by the IMF and the Group of Contracting Parties entrusted with the implementation of the Agreement; (iii) exclusion of the tax issues from its scope, for the benefit of maintaining bilateral agreements to avoid double taxation⁷; and (iv) a relative flexibilization of the applicable rules and disciplines when it comes to financial services, a sector that received differentiated treatment in a specific chapter of the Agreement. With regard to these services, the Agreement admitted restrictions to the freedom of investment for prudential reasons and qualified the obligation of transparency so that this would not interfere in the confidentiality required for certain financial information (OECD, 1997a).

The “special topics” of Chapter III on treatment of investors and investments refer to obligations that complement the basic principle of non-discrimination, going beyond the rule of national treatment and treatment of MFN.

As regards performance requirements, MAI prohibited the use of twelve modalities of measures, a prohibition that was to apply to the treatment of investments coming from other countries signatory to the Agreement, but also – as happens in NAFTA – from non-signatory countries. The prohibited measures included those already contemplated by the Agreement on TRIMs, but several others were added to these in order to differentiate between:

- the requisites related to export and maintaining a certain *ratio* between imports and exports (or entry of foreign currencies related to investments), reaching certain (policy-set) levels of national content, the obligation of purchasing goods and services produced in the territory of the host country and the restriction of domestic sales and/or conditioning of these sales to the fulfillment of a certain exports target (or generating foreign currencies). These requisites were prohibited under any circumstances (whether related or not to the investor’s obtaining some advantage (tax incentive, credit, subsidies, etc); and
- the requisites related to the obligations to transfer technology, to attain certain levels of production, sales, employment, R&D in the territory of the host country, to employ a certain proportion of local personnel, to set up joint ventures and to ensure a minimum level of local participation in investment capital. These requisites were not prohibited when linked to advantages but were not admitted if presented as straight performance requirements, that is, as non-conditioned requirements.

The MAI provisions in relation to privatization – not found in other investment agreements – referred to the principle of non-discrimination applicable to all the phases of privatization and contained rules on transparency specifically designed for this type of process.

⁷ The OECD deals with this issue based on its model tax convention on income and capital, which served as a model for over 1,400 double-taxation agreements all over the world

The rules relating to monopolies concentrated on the principle of non-discrimination, whereas the main concern as to State companies was to prevent such entities from acting against the provisions of the Agreement in performing regulatory functions.

Incentives to investments were one issue that concentrated some of the biggest difficulties in the negotiations, as Graham (1996) had forecast. Some countries were against including in the MAI specific provisions applicable to incentives, while those defending the inclusion of this theme were divided as to the treatment to be granted to incentives in the scope of the agreement.

Among the “special topics” was the inclusion of an Article that would prohibit (or at least discourage) host countries from reducing norms related to health, security, the environment and labor as a way of attracting or retaining foreign investments in their territory.

As regards protecting investments, MAI revived the typical guidelines of the new paradigm of agreements in the area: restrictions on expropriation, precise and detailed rights to compensation, free transfer of resources linked to investments and dispute-settlement mechanisms between States and between an investor and a State. For inter-State disputes not settled amicably, the provision was for the establishment of “arbitration panels” whose decisions would be definitive and mandatory.

Although MAI provided a mechanism for settling disputes between investors and the State, when negotiations were interrupted it was not clear whether this mechanism should cover all the disciplines of the Agreement, or what were the responses admitted for countries faced with non-fulfillment by another signatory of an arbitral decision taken in the framework of the Agreement’s mechanism for settling disputes.

The initially temporary and then definitive paralysis of the MAI negotiations in October of 1998 was directly related to the exhaustion of the dynamic of liberalization that enabled, among other things, the successful conclusion of the Uruguayan Round and the implementation of liberalizing reforms to national investment regimes in developed and developing countries. It is interesting to analyze why the MAI negotiations lent themselves so adequately to playing the pioneer role of scapegoat of globalization.

For Glimet (2001), the option for a *state of the art agreement*, an agreement that would put together and enhance all the most “advanced” features of the regional agreements and bilateral BITs, turned the MAI into a hardly “amendable” project, transforming it, as a whole, into an object of criticism and of rejection in various OECD⁸ countries.

Among the characteristics that became increasingly controversial in the MAI negotiations, the following are included:

- a wide-ranging investment definition (*asset-based*);

⁸ Curiously, a similar observation could be made in relation to the proposals presented by the USA in the investment negotiation group in the FTAA, ruled by the objective to achieve a state of the art agreement in this area. Also in this case, such an objective will certainly not be achieved, at least in a hemispheric level.

- a *top-down* methodology (negative lists) for commitment undertaking, strengthened by a *ratchet* clause that would automatically consolidate any new liberalization measure unilaterally adopted by member countries in the future. This methodology ended up stimulating member countries to devise long reserve lists;
- broad provisions regarding investment protection, inspired on provisions of the bilateral treaties. As observed by Solé (2001), “the content of the BITs goes way beyond the sheer promotion and protection of investments. They generate very encompassing obligations (in fact, almost unlimited) in relation to ‘investment treatment’: national treatment and of MFN, obligations that become even more encompassing if they are also extended to the pre-establishment stage;
- the double dispute-settlement mechanism and, in particular, the investor-State mechanism.

As per Glimet (2001), this combination triggered the challenging of the bases upon which the MAI negotiation was organized, an agreement that became increasingly perceived as a codification of a new power relation between transnational companies and national States, supposedly benefiting the first ones⁹.

c) The bilateral investment agreements

As mentioned, the investments’ issue treatment at the WTO has so far been characterized by the adoption of limited scope agreements, such as TRIMs, or of broad scope, but implying, for signatories, few general obligations and commitments. On the contrary, agreements specifically geared towards the investments’ issue have been signed in bilateral ambits (more than 2,000 Bilateral Investment Agreements exist currently) and have portrayed a much greater ambition, translated into provisions and disciplines which apply to external investment protection and, in many cases, also to liberalization of international investment flows among signatories. As a result of this evolution, there is a strong disparity between, on the one hand, obligations and commitments which come from the multilateral level and, on the other hand, disciplines deriving from non-multilateral agreements.

As to these last ones, the trend of the international agreements on investments - and especially BITs - defines a clear trajectory whereby these agreements broaden their scopes and become all-embracing. In this process, the concept of covered investments was redefined: in general, the adopted investment concept is ample, covering a wide range of assets (*asset-based* definition), and goes beyond the FDI concept or even the “long term investment” concept.

Also the patterns of investment protection has been considerably expanded in these agreements: the new generation BITs go well beyond the NT and MFN treatment principles, which are comparative or relative patterns (as they refer to treatment granted to

⁹ Solé (2001) makes an interesting observation regarding imports, for the MAI, of typical provisions of bilateral BITs, systematically involving developed countries, on one side, and developing ones, on the other. According to the author, these agreements were made to be complied on by the developing countries and, therefore, “the problem of compliance (of its provisions) by the developed countries was never posed”. Thus, the MAI negotiations would have made it explicit that “developed countries (particularly the European) systematically violated the bilateral agreements they had signed” with developing countries.

foreign investors in comparison with the one granted to domestic investors and/or from third Parties), trying to define “absolute” treatment patterns: “in relation to expropriations, for example, national treatment is not enough; foreign investors want absolute guarantees, and not just to be treated as nationals” (Torrent, 2001).

Additionally, new generation agreements on investments introduced an important – and increasingly controversial – institutional innovation in the history of international regulatory instruments: it involves the establishment of the mechanism for settling disputes between a private party (the investor) and a national State. Nonexistent in the multilateral tradition and in the WTO dispute-settlement mechanism, this system is included in the NAFTA and in the vast majority of BITs (in both US and EU countries’ BITs) , besides being included in the MAI text.

The impacts of the inclusion of this mechanism in the Agreements’ text have been enhanced by the strengthening of the provisions related to expropriation – whose reach has been extended, in some Agreements, thanks to the concept of “measures equivalent (or similar) to expropriation”.

As far as indirect expropriation is concerned, the introduction of this broad concept in the BITs gives the investor affected by regulatory measures that allegedly hurt its interests the right to ask for compensation. This provision has generated much uncertainty on “how to treat individual exercises of regulatory oversight which may deprive an investment of some of its value but which do not amount to a complete deprivation or where a deprivation is total” (Peterson, 2004). The burden of this juridical uncertainty is put on the host State as the “regulatory risk” usually faced by foreign investors is transferred to the regulatory agencies in that country.

As Peterson (2004) puts it, although “there is no settled approach to cases where investors allege that certain regulatory measures constitute a compensable form of expropriation”, what can be stated with authority – drawing on the experience of international arbitration of disputes on investment and BIT-related issues – “is that tribunals can, and will, assume the jurisdiction to review the treatment of foreign investors by the host State’s regulatory and administrative authorities, and to assess whether this treatment may be deemed to constitute a form of compensable expropriation”.

In relation to performance requirements and TRIMs, recent evolution of the agreements on investments in the Americas and the very MAI negotiation confirm a trend to increase restrictions on the use of such instruments, although, in particular agreements, the link of such requirements to the concession of benefits from the receiving state can make it admissible.

In addition, mainly in the US-backed BITs, the broadening trend led to the extension of the coverage to the so-called pre-establishment phase of the investment. The NAFTA, the failed MAI/OECD and many other bilateral BITs pushed by the US during the 90s regulate admission conditions and establishment of foreign investments, ruling over existing and future investments. The principle of national treatment and the MFN clause become key elements in defining market access conditions guaranteed to foreign investors and, although restrictions

deriving from national laws and regulations may lead to horizontal and sectoral reserves and exceptions, such agreements tend to, at least, “freeze” the range of these restrictions and, further, to reduce them in the long run.

In other words, such agreements not only protect already established foreign investors’ rights, but also regulate the right of access for new outside investors – as per national treatment and MFN principles – and aim at a growing liberalization of market access conditions applied to foreign investments. In these agreements, domestic legislation restricting foreign investments is no longer an absolute restriction, becoming a “target” for the liberalization mechanisms embedded in it. Moreover, in these agreements, domestic legislation is subjected to a transparency obligation, materialized in certain institutional commitments.

In spite of this evolution towards a broader scope and stricter disciplines, even the new generation agreements have hardly advanced in the regulation of incentives to attract investments, mainly due to the resistance offered by developed countries. Not by chance, MAI negotiations were marked by intense controversies intra-OECD relating to how this issue should be addressed in the Agreement’s text. In fact, until today, only one deep regional integration project, the European Union, was able to determine and implement rules to discipline policy competition – mainly incentives-based competition - to attract investments.

In sum, “the typical modern BIT” (Peterson, 2004) includes a preamble which sets the protection of investments and the enhancement of the investment climate as its main objectives and purpose; a broad definition of investment and investors; provisions designed to offer certain absolute (“fair and equitable treatment”) as well as relative (National Treatment or MFN) standards of treatment; protections against direct and indirect expropriation; and a double dispute-settlement mechanism (State-State and Investor-State).

Although the broadening of scope and coverage and the introduction of new mechanisms for dispute settlement between the investors and host States are central features of many “new generation” BITs, some important differences exist between them.

Referring to Torrent and Molinuevo (2004b), at least three broad models of BITs have multiplied during the last fifteen years:

- the US model, based on NAFTA architecture, includes as major elements: broad asset-based definition of investment, covering both FDI and portfolio investment; liberalization of access and obligation of national treatment for post-establishment, subject to a list of exceptions (“negative list” approach); TRIMs-plus disciplines on performance requirements; rules on expropriation and compensation, including indirect expropriation provisions; and Investor – State dispute settlement mechanism;
- the bilateral agreements signed by EU countries, which concentrate on protection after access and do not create obligations on market access (establishment);

- the “EC-led” agreements, which focus on market access and do not include obligations on treatment after the establishment of the European investors. After the Uruguay Round, these agreements have a GATS-like chapter on services, which includes FDI in services sectors (as mode 3 of trade in services), and an investment chapter dealing exclusively with FDI in goods. These agreements “continue to exclude provisions on expropriation or investment protection, which is unsurprising since EC law has no rules in such areas and each member retains its full competence on these issues”.

The Table 1 below compares some of the main elements of the three models of investment agreements.

Table 1

Bilateral/regional investment agreements: comparing coverage and key provisions

Provisions Type of agreement	Coverage	Main objectives	Treatment to investments in goods & services	Sectorial exceptions and reservations	Investor – State dispute settlement
NAFTA	Includes establishment / access	Market access + investors rights protection	Same treatment in the investment chapter	Yes	Yes
US model BITs	Includes establishment / access	Market access + investors rights protection	Same treatment in the investment chapter	Yes	Yes
EU countries model BITs	Excludes establishment / access	Investors rights protection	Same treatment in the investment chapter	No	Yes
EC Bilateral / regional agreements	Includes establishment / access	Market access	Separated treatment: FDI in services part of services chapter (GATS model)	Yes	No

3.3. The difficulties in the path of multilateralization of bilateral and regional agreements

The fact that a paradigm of investment agreements consolidated in the 90s, mainly through bilateral negotiations and with the architecture described above, does not mean that the “multilateralization” of the commitments signed in these agreements became a simple task. The idea that bilateral and regional agreements following the same pattern would work as building blocks for the emergence of a multilateral regime in the area of investments never materialized. Recent experience suggests that the efforts to multilateralize the debate and negotiations on investments, both in OECD and WTO, faced obstacles that are still insurmountable.

Three factors seem to be at the root of this fact: in the first place there is a qualitative change when one passes from the sphere of bilateral agreements to the multilateral dimension. This change has to do with the fact that “a multilateral agreement will create obligations among developed countries, whereas BITs generally associate an OECD member country with a non-member of this organization (...). The MAI negotiations generated a surprisingly high number of requests for exception on the part of countries that tried to protect themselves against foreign investment in certain sectors” (Mann and Von Moltke, 2004). A similar argument is presented by Torrent and Molinuevo (2004a). For these authors, it was the MAI negotiations that brought to the fore the question of fulfillment by developed countries of the provisions of the BITs signed with developing countries: “the MAI negotiations showed pure and simply that the developed countries (Europe in particular) generally violated the bilateral agreements they had signed.”

Secondly, although one may refer to one specific pattern of protection for foreign investments that is provided by bilateral agreements, as well as to the regularity with which many agreements contain certain specific regulatory provisions that materialize a high level of investment protection, this does not mean that there are no significant discrepancies between the bilateral agreements in place: “quite a large number of investment agreements, notably the BITs, while promoting closely related concepts (NT, MFN treatment, fair and equitable treatment, full protection and security) contain legal and/or textual variations, sometimes of a subtle nature” (OECD, 2004a).

These discrepancies involve different aspects of the agreements, some of which are mentioned below:

some agreements provide not only for protection of investments but also the rights of (pre)-establishment, that is they also define conditions of access to markets in the investments area. Other agreements limit themselves to the protection of already established investments (the so-called post-establishment phase of the investment);

some agreements provide for exceptions to the principles of national treatment and MFN, while others only admit the traditional general exceptions related to public order, national security, etc;

some agreements restrict the use of performance requirements applicable to foreign investments not prohibited by the TRIMs Agreement, while others do not even mention this type of policy instrument;

the scope of the concept of investor and foreign investment varies from one agreement to the other, although a persistent tendency has been noticed to broaden the scope of this concept; and

with regard to disputes between the investor and the host State, some agreements mandate foreign investors to first submit their complaints to the domestic courts, as a necessary step to have access to international arbitration. Another group of agreements open from the start-out a choice between the local courts and an international arbitration mechanism, the choice being irrevocable.

As observed earlier, many of the divergences pointed out above are related to the fact that the United States and countries of the European Union – the chief promoters and signatories of bilateral agreements on investment – adopt different agreement models. The bilateral agreements of the United States include commitments of establishment (access to market), whereas those signed by individual EU countries in general do not. The agreements pushed ahead by the United States provide for exceptions and reserves to the application of the NT and MFN principles, while in those signed by individual EU countries these obligations apply to all the sectors of the national economy. The agreements of the United States provide for lists of sectoral reservations and exceptions, in addition to TRIMs-plus disciplines applicable to the use of performance requirements by the host countries, in contrast with those signed by the EU countries.

The differences are obvious not only when the bilateral agreements signed by the United States are compared with those signed by the European countries, but also between these two models of agreement and the investment treaties signed by the European Community after the Uruguay Round. In fact, these agreements adopted the GATS model, which deals with foreign investments in services as mode 3 of trade in services, whereas the bilateral agreements of the United States following the Uruguay Round, as well as the BITs signed by individual EU countries, grant investments uniform treatment and protection, whether they are made in services or goods sectors.

On the other hand, whereas the BITs signed by individual EU countries do not provide for obligations of NT and MFN for establishment, the bilateral agreements of the European Community “focus mainly (...) on market opening obligations and access rights for European investors and disregard investment protection disciplines” (Torrent and Molinuevo, 2004b) and do so through the GATS model of scheduling commitments. According to such agreements, the chapter of investments includes only rules and disciplines applicable to FDI in goods, while the services chapter includes investments and trans-border trade of services.

Generally speaking, the agreements signed by the United States are more comprehensive in scope and their regulatory effective content, according to Torrent and Molinuevo, 2004b, tends to be greater than that of the agreements signed by individual countries of the European Union and the bilateral agreements signed by the European Community.

A third reason for the difficulties faced in the road to multilateralize the network of investment agreements has to do with the fact that the introduction of the debate on the relations between trade and investment into the WTO agenda – a step forward with regard to the agenda of the Uruguay Round, which in this area was limited to the treatment of TRIMs – happened almost at the same time as the failure of the first initiative to negotiate an investments agreement involving a large number of participants (MAI/OECD). As stated before, this failure signals a significant change in the policy and political environment in which the trade negotiations take place: the North-South consensus in favor of trade liberalization and regulatory harmonization became weaker and gave way to a new scenario in which the main players both in the North and the South condition proposals of liberalization and harmonization to their “non-trade concerns”.

In this new environment, the process of expanding the agenda of trade negotiations in order to include an increasingly large number of non-border themes – a process that began with the Uruguay Round - was interrupted and later inverted, as made evident throughout the Doha Round. In the current Round, the agenda of negotiations mandated in November 2001 was gradually reduced, mainly due to resistance from numerous groups of developing countries. The negotiations on investments in the WTO became a favorite target of this movement and the issue was excluded from the multilateral agenda following the Ministerial Conference held in Cancun in 2003.

An additional problem for the process of multilateralization involves the fact that a broader treatment of investment policies within the WTO might demand an extensive reordering of the structure of texts generated by the Uruguay Round – as suggested by Messerlin (1996). The structure of the GATT 1994 is directly based on the negotiating options made and the different results obtained in the many issues negotiated. Messerlin proposes that when including the issue of investments to the structure of GATT 1994, a clear distinction be made between the agreement referring to the trade of goods, the GATS – which would only refer to the trans-border trade of services, excluding investments in services – and a text exclusively dedicated to international investments in goods and services.

A less radical option would be to seek less ambitious paths for the issue in the sphere of the WTO, opting for a definition of investments more restricted than those which appears in the great majority of the BITs and then extending the GATS methodology to negotiating investments in goods. This was the direction pointed to by the Doha mandate for negotiations on trade and investments, as well as by some proposals presented during the Round.

Indeed, in the Doha negotiations a document of the European Community presented at the Working Group on Trade and Investments proposed adopting the GATS model – positive lists, obligation of pre-establishment (market access) defined only for the sectors and sub-sectors chosen by the offering countries, a scheme for progressive liberalization, etc – with the argument that such a structure is more flexible to accommodate interests of a large number of countries, besides already being applied to investments in services (mode 3 of GATS). As a matter of fact, the Doha mandate already established the principle of positive lists for any future negotiations on investments and, besides that, it refers only to direct investments. The proposal of the European Union aimed at setting a broad coalition in favor of making the GATS the paradigm of a less ambitious (as compared to BITs and the NAFTA) multilateral agreement on investments, as regards the protection of investments.

These characteristics help to understand the difficulties in multilateralizing the international investment regime, based on the existing agreements (in the bilateral, regional and multilateral spheres), thus suggesting that there is significant likelihood that the present scenario will continue to prevail. If this is true, the problems created by the regulatory *status quo* in this area become more relevant for the analysis.

3.4. The current regime and its problems

Of course, the current situation is very complex, marked as it is by characteristics and tendencies such as (i) multiplication of bilateral (and some regional) agreements with provisions that do not always converge but often have a high regulatory content; (ii) application of principles of non-discrimination typical of the multilateral trade regime to these agreements; (iii) partial and unequal treatment¹⁰ of investment-related issues in the multilateral sphere; and (iv) accumulation of cases of litigation between investors and host States, under the dispute-settlement mechanisms provided for in the bilateral and regional agreements.

This situation raises concerns not only of a legal and juridical nature, but also policy-related ones. In the first place it should be noted that the multiplication of investment agreements takes place practically without any debate on their effectiveness to attract new flows of FDI and to compensate for the regulatory and institutional weaknesses of developing countries. If we add to the costs of signing ambitious agreements the idea that the benefits generated by such agreements for the host countries do not exist or are marginal, it becomes very hard to argue in favor of the BITs.

It is surprising that over 2,000 BITs are in place without there being any clarity with regard to the benefits potentially produced – for the signatory countries – by signing this type of treaty. Attention to this type of evaluation only became manifest when it turned clear that the content of these agreements granted foreign investors “rights (...) more substantial than many had anticipated” and created a “potential prospect of large scale litigation” (Hallward-Driemeier, 2003). This author engages in an “empirical investigation of whether the benefits (of BITs) are being realized, whether a BIT can substitute for weak domestic property rights and whether ratifying it results in a significant increase in FDI”.

The study focuses on the importance of BITs for FDI outflows from OECD countries to developing country hosts, “testing the hypothesis that the strengthening of property rights significantly affects FDI flows”. The results of the econometric exercise which analyze twenty years of bilateral FDI flows from the OECD to developing countries are quite clear: (i) BITs do not appear to help attracting additional FDI and (ii) BITs complement rather than substitute for strong domestic institutions and do not provide for host countries “a short-cut from the need to implement broader reforms of domestic institutions”.

One potential benefit of the BITs relates to their contribution to developing countries “migrating” from incentives-based competition to attract foreign investments to a rules-based pattern of competition. There seems to be no evidence in this respect: countries that signed many BITs in the 90s did not stop implementing sectoral policies to attract investments based on granting tax and credit incentives.

In the second place, the overlapping of commitments and provisions between different agreements raises significant juridical questions. If on the one hand this overlapping may suggest that between provisions and commitments of different agreements there is a “common denominator” and a reasonable degree of consistency – which would facilitate

¹⁰ In the sense that the regulation applicable to investments in services is more comprehensive and detailed in the WTO agreements (that is, GATS) than the one involving investments in goods (the TRIMS Agreement).

both non-conflictive coexistence of such agreements and eventual efforts to multilateralize the commitments. On the other hand, however, the overlapping can also generate problems of dynamic inconsistency: (i) divergence of rules and commitments assumed by a country or bloc of countries in different agreements, which can lead to discrimination among countries on account of negotiated rules; and (ii) undesired extension of commitments established on the bilateral level that come to benefit, via a MFN clause, countries that are not signatories to the bilateral agreement in question.

Moreover, the multiplication of bilateral agreements poses the question of consistency of the resulting situation with the functioning of the multilateral system. This also suggests the importance of discussing mechanisms to organize the relationships between the multilateral norms and agreements and the rules and disciplines set up in non-multilateral instances (Torrent and Molinuevo, 2004b) in the hypothesis that the current international regulatory situation continues to prevail.

The overlapping of commitments signed in different agreements entails both the relation between different models of BITs and the relations between the BITs, on the one side, and regional and multilateral agreements – in this case, essentially the GATS – on the other.

As regards the overlapping between different BITs and their provisions, the concepts presented in these agreements and the patterns of protection that they promote are quite similar, although, as observed earlier, there are clear differences between them concerning their scope – covering only the phase of post-establishment, or also pre-establishment – the existence or not of sectoral exceptions, disciplines applicable to performance requirements and so on.

Torrent and Molinuevo (2004a) analyze in detail the “spaghetti bowl” generated by the proliferation of BITs that follow different models – the model of the United States and the European countries model – and discuss some of the legal consequences of two of these differences: extending or not the obligations of MFN to the phase of establishment of investment (market access) and the existence or not of lists of sectoral exceptions in the BITs.

For a developing country, the commitments generated by two BITs, one signed with the United States and the other one with an individual country of the European Union, are different: the first will provide for the right of establishment, the second will not; the first will prevent the host country from resorting to certain performance requirements that are not prohibited by the TRIMs Agreement, the second will impose no such restriction on the host country. The agreement will ensure access to the market of the host country for the new investors of the United States – with due observance by that country of the reserves included in the agreement – but not for the new investors of the EU country concerned.

On the other hand, Torrent and Molinuevo (2004a) present cases in which the provisions relating to the NMF clause of the BITs can produce involuntary extension, for non-signatory countries, of bilaterally negotiated preferences of market access.

Furthermore, the difference observed between the United States and EU countries models concerning sectoral exceptions can also generate discrimination between investors of these countries in the markets of developing countries and between investors of the two countries signatory to the BIT.

According to these authors, “since the developing country has undertaken unrestricted NT obligations in its European BITs model, the American investor acting in an economic sector that the country has included in its exception lists may claim MFN treatment by reference to European investors and thus override such exceptions. Contrary wise, developing country investors may be discriminated against in the sectors included in the other country’s exception list”.

The relationships between investments agreements appear even more complex when attention is paid to the overlapping between on the one hand the BITs and certain regional agreements like NAFTA, and on the other hand the WTO rules that apply directly to investments, especially the GATS (in its mode 3 of trade in services)¹¹.

In fact, since the GATS refers only to investments in services, the overlap with the BITs – which deal with investments in goods and services – will always be partial¹². Nonetheless, despite only referring to investments in services, the GATS contains obligations of immediate and unconditional treatment of NMF¹³ and rules of market access, in addition to providing a process of deepening commitments to consolidate opening and liberalizing domestic markets. It should be remembered that some of these aspects are not contemplated by the provisions of certain BITs (this is the case of rules of market access and progressive liberalization, in the EU countries bilateral agreements), while others are treated with considerable reservations and conditionalities in the bilateral sphere (MFN treatment).

This has led some analysts to discuss to what extent the commitments assumed by WTO members in the GATS imply the automatic extension to all the signatories to this agreement of the standard of protection and the rights assured to investors of certain countries through bilateral or non-multilateral agreements¹⁴.

This could produce a problem of free-riding which would become even more expressive if this extension of rights derived from non-multilateral agreements to all the signatories of the GATS involved not only the substantive obligations but also those of procedure. This extension would grant access to the mechanisms of settlement of disputes between investor and State in the non-multilateral agreement to non-signatories of this treaty.

¹¹ According to OECD (2004a), the provisions of the BITs and those of the TRIPs, TRIMs and Subsidies and Countervailing Measures Agreements – WTO agreements with some at least potential impact on investment flows and governmental policies on foreign investments – are usually compatible.

¹² For Torrent and Molinuevo (2004a), it was also the MAI negotiations in OECD that showed clearly that the GATS is also and above all an agreement on investments.

¹³ Although GATS allows members to list exceptions to MFN treatment (Article II), which in principle should be eliminated in ten years at most.

¹⁴ Regarding, obviously, investments in the services sectors.

Some BIT-signatory countries listed all the commitments assumed by them in these agreements in the exceptions to the MFN obligation of the GATS, while others made no reference to the BITs in their exceptions list. A third group of countries that signed BITs excluded from the MFN obligations of the GATS the provisions of the mechanism for settling disputes between investor and State included in the BITs that they signed.

Torrent and Molinuevo (2004a) have analyzed such negotiating strategies under the light of GATS provisions and they reached the conclusion that “within the GATS framework, bilateral investment agreements’ provisions are covered by the MFN obligation imposed by its Article II, since they do have an effect on trade in services. Thus, benefits and privileges on investment granted in BITs are to be extended to all WTO members when they relate to the provision of a service”. According to these authors, “what can sensibly be discussed is to what extent the various substantial (protection, liberalization) and procedural (dispute-settlement) provisions included in BITs are covered by the GATS, i.e., whether the MFN discipline requires absolutely all obligations undertaken bilaterally to be extended multilaterally”.

For those countries that follow the model of BITs of the EU individual countries, the combination of a bilaterally negotiated coverage that does not exclude any sector with the MFN obligation of the GATS can lead to a situation where the limits imposed on the commitments signed in the multilateral sphere – concerning national treatment – would lose all validity as a result of the application of the MFN clause (of the same GATS) to the limitless obligations accepted in bilateral agreements (Torrent and Molinuevo, 2004a).

The question of compatibility between “successive agreements” is normally addressed, in the case of investment agreements, by means of a specific provision, the clause on “preservation of rights”: this clause “seeks to preserve the rights of an investor in cases where the provisions of other international agreements are more favorable than the provisions of the BIT” (OECD, 2004a). In the NAFTA, for example, it is established that if any inconsistency is detected between this agreement and other agreements that members of NAFTA participate in, the provisions of this treaty will prevail as for the inconsistency, except if there is another specific provision in the NAFTA itself.

The rights-preservation clause of the European Energy Charter Treaty includes an innovating provision in this area, on establishing that “nothing less favorable in other agreements is to be construed as derogating from the ECT” obligations (OECD, 2004a).

A third kind of problem that emerge from the prevailing scenario as far as the investment negotiations and the agreements are concerned relate to the fact that the scope of these agreements, together with certain innovating provisions (such as the concept of indirect expropriation) and the availability of a dispute-settlement mechanism to which foreign investors have direct access, triggered a myriad of political and juridical criticisms to the investment agreements. These criticisms insisted that, under these agreements, the protection of investors’ rights was being assured to the detriment of the preservation of the State’s right to regulate and in a discriminatory manner in relation to domestic investors.

If the (implicit) intention of the investment agreements that multiplied in the golden age of liberalization (the 90s) was to test the limit of resistance of the concept of regulatory sovereignty of the national States, the output of this experience left no room for doubt: these agreements were increasingly perceived as illegitimate interferences in the State's regulating power and as instruments that hinder the adoption of development policies, in frontal opposition to the developmentalist mood of the first years of the century.

As mentioned earlier, the turn of the century was marked by an important change in the environment of trade negotiations: the objectives of liberalization and regulatory harmonization lost prominence to considerations and conditionalities related to domestic political factors both in the North and the South. In this process, the idea that trade negotiations, especially beyond-trade issues – including investments – restrict the capacity of governments to pursue legitimate political objectives gained considerable strength.

As Torrent and Molinuevo (2004b) remind us, the political sensitiveness of the negotiations on investments relates to the fact that “beyond-trade measures are, for trade in goods, a “second step” in the liberalization process. Internal regulation is of little relevance to major liberalization, but is determinant to level the playing field and avoid “cheating” between the partners. On the contrary, for all other measures (i.e. investment, services, government procurement, etc) no meaningful liberalization can be achieved without internal regulatory adjustments. In these cases, the barriers are mainly set through beyond-trade measures. In the latter areas (in particular, services and establishment), as the most traditional instrument of trade policy –i.e. tariffs- does not apply, the importance of domestic regulation applicable to internal operations (and of international obligations related to them) increases”.

In other words, in these areas of negotiation, production of what these authors call “effective regulatory content” of the agreements depends directly on their capacity to shape, eventually altering, the domestic regulatory matrix of the negotiating countries. It is not by chance, in the new environment of trade negotiations, that developing countries defend the GATS model of treating liberalization in areas different from goods, at the same time as the model of BITs of the United States and the European countries comes under increasing criticism.

The dilemma is clearly defined by Torrent and Molinuevo (2004b): the option for agreement models of low regulatory content accommodates different defensive interests but fails to generate results in terms of liberalization or protecting investors. As the authors put it, “the GATS approach (is) easy but unfruitful”. As for the option for models of greater regulatory content, this faces greater resistance precisely because they limit the autonomy of the national regulators.

However – as for Torrent and Molinuevo (2004b) – “in spite of all the relevance accorded lately to the issue of “rules beyond trade liberalization”, the regulatory content of bilateral/regional economic agreements remains relatively low. Key provisions limiting domestic regulatory capacities are either non existent or consist mainly of “treatment obligations” (either national or most favored nation – NT or MFN- treatment). Although the burden of these obligations on national legislation is not to be underestimated (nor its

political and economic significance), such obligations do not necessarily alter national policy preferences (in a traditional right-left perspective, for example) since they focus on the application of national policies on a non discriminatory basis”.

These considerations involve a key question on the effective implications of the current investment agreements if the debate is supposed to go beyond the mere generic concern about the “risks” associated to such agreements. As a matter of fact, the real implications of the commitments assumed through BITs, especially by developing countries, have just begun to be assessed after the experience of the NAFTA and the investor-State litigations that have multiplied over the last few years, in the wake of the proliferation of BITs.

The analysis of these experiences might suggest the validity of the conclusion presented by Torrent and Molinuevo (2004b) about the (limited) capacity of obligations to alter national preferences in the area of micro-economic policies. This does not prevent the recognition that certain provisions typical of the BITs deserve careful re-evaluation on account of (i) the uncertainty that they produce both in investors and the States signatory to the agreements and especially for future regulatory action of host States; and (ii) the possibility that these provisions cause problems involving moral hazard and adverse selection.

These provisions refer mainly to:

- defining excessively broad concepts of investment and investors;
- establishing absolute standards of treatment (FPS – Full Protection Standard and FET- Fair and Equitable Treatment) not based on customary international law (Faya Rodriguez, 2005);
- adopting relative standards of treatment (NT and MFN) without limits, which can cause problems of “negative overlapping” (produced by incompatibility or inconsistency) between commitments assumed in different agreements;
- adopting in the BITs of the United States TRIMs-plus disciplines applied to performance requirements, perceived as obstacles to the adoption of active industrial policies by developing countries;
- adopting the concept of indirect expropriation or a measure equivalent to expropriation that can be used by the investors “as an insurance against many risks that firms would otherwise have assumed themselves as part of normal process of establishing and running a business” (Hallward-Driemeier, 2003); and
- adopting the Investor-State dispute-settlement mechanism, which may create incentives for investors to present frivolous claims against host States: “if investors believe there is a chance for successful litigation against the host government and that then they are protected from substantial amount of risk, firms may work less hard to make their firm a success or may be attracted to locations where their legal

case could be made more strongly rather than for economic reasons” (Hallward-Driemeier, 2003).

Somehow, the vast majority of the criticism addressed to specific provisions found in the investment agreements (and especially in BITs) refers to the fact that these agreements “are crafted in vague, open-ended terms” (...) “often to cover the broadest range of investment situations”. As a result, “the full policy implications of most treaty provisions still remain unclear” and “only through actual arbitration between investors and states will the meaning of standard treaty obligations – and their implications for developing countries – be elucidated”. (Peterson, 2004).

If no correlation has been found between the signature of BITs by developing countries and the generation of additional FDI to these countries, it seems quite clear that the explosive proliferation of BITs helps to explain the sharp rise of treaty-based arbitrations on investment issues in the last ten years: “encouraged by the legal uncertainty surrounding the substantive meaning of meaning of key treaty rules, foreign investors are turning to investment treaties with increasing frequency – and in an effort to challenge an expanding range of government interference” (Peterson, 2004).

As many BITs key provisions are vaguely drafted, investors resort increasingly to the investor-state mechanism for dispute settlement of these agreements, leading to another serious problem for developing countries: as these countries lack “full information about how earlier disputes may have been resolved and in the absence of any procedural rules which would oblige subsequent disputes to be decided in a similar fashion, (they) may be confronted with considerable uncertainty about the concrete policy implications of the international treaties to which they have acceded” (Peterson, 2004).

The most common BITs (and NAFTA)-related disputes taken to arbitration bodies relate to the following provisions of the agreements:

- indirect (or measures tantamount to) expropriation and the “right to regulate” (OECD, 2004 b);
- standards of fair and equitable treatment (OECD, 2004c); and
- MFN clauses (OECD, 2004d).

The growing recourse to arbitration also raised the issues related to transparency and third party participation in investor–State dispute settlement procedures (OECD, 2005). Pressure for transparency has led some governments to publish arbitration proceedings and awards and, more importantly, to insert “relevant provisions in their new model investment agreements” and ICSID is proposing “to modify these rules to take into account these new developments”. Third party participation has generated a much more cautious reaction from governments, even from countries that made significant moves in the transparency issue (OECD, 2005).

As far as indirect expropriation is concerned, “there is no generally accepted and clear definition of the concept of indirect expropriation and what distinguishes it from non-compensable regulation”: most BITs include indirect expropriation without addressing non-compensable regulation, while some legal texts do address the issue of non-compensable regulation, in general listing those regulatory measures which fall under this category and thus do not give right to compensation (OECD, 2004b).

In general, BITs texts do not provide for a clear distinction between compensable indirect expropriation and non-compensable regulatory measures, an option that “may reflect reluctance to attempt to lay down simple, clear rules in a matter that is subject to so many varying and complex factual patterns and a preference to leave the development of arbitral decisions on a case-by-case basis” (OECD, 2004b). But the option for an open-ended concept which could cover the broadest range of regulatory measures and situations generates a lot of uncertainty for the host countries, especially when one takes into account the fact that there are inconsistencies among arbitral rulings on indirect expropriation, which adds to the degree of uncertainty imposed not only on the host countries but also on investors (OECD, 2004b; Peterson, 2004).

No clear textual definition of the limits between compensable and non-compensable regulatory actions and inconsistent rulings on this issue arising from the BITs investor-State dispute settlement mechanism significantly raises, for the regulatory authorities in the host countries, the level of risks linked to the adoption of new measures and policies.

However, for OECD (2004b), some criteria to distinguish compensable from non-compensable measures seem to emerge from arbitral rulings on this issue. Besides that, some of the most recently concluded US BITs limit the scope of the concept of indirect expropriation and address the issue of distinguishing between compensable and non-compensable measures. According to OECD (2004b), the criteria emerging from tribunals and the new agreements are “very similar”.

These criteria tend to set some limits to the broad concept of indirect expropriation and they relate to: (i) the degree of interference with the property right; (ii) the character of governmental measures, i.e. the purpose, the proportionality and the context of the government measure; and (iii) the interference of the measure with reasonable and investment-backed expectations (OECD, 2004b).

Standards of fair and equitable treatment are formulated in different investment agreements in very diverse ways: some make explicit reference to international law while others do not make such reference. As a result, “the proper interpretation of the FET standard depends on the specific wording of the particular treaty, its context, the object and purpose of the treaty”, etc. As in the case of the criteria set out for distinguishing indirect expropriation from non-compensable actions, the tribunals rulings on FET standard identified “a number of elements which, singly or in combination, have been treated as encompassed in the standard of treatment (...): due diligence and due process (including non-denial of justice and lack of arbitrariness)”, both elements being “well grounded in international customary law”. (OECD, 2004c).

As seen, MFN clauses in BITs and regional agreements are at the origin of complex overlapping issues among treaties. Besides, the universe of MFN clauses is “quite diverse. Some MFN clauses are narrow, others are more general” (OECD, 2004d).

The coverage of the MFN clause depends not only on its wording (reference – or not - to “like circumstances” as a criteria conditioning NMF obligation) but also on the coverage of the agreement itself (inclusion or not of the pre-establishment phase). Besides that, some MFN clauses contain specific restrictions or exceptions, excluding certain areas from the application of the obligation: regional economic integration, taxation, subsidies, etc. Some US BITs contain limitations to the MFN clauses precluding “coverage of the advantages accorded by virtue of multilateral agreements or negotiations (...) to which their BIT partners may or may not have adhered”. On the other side, “some WTO members have listed substantive provisions in their BITs as involving exemptions to the MFN obligations of the GATS with a view of protecting a higher level of treatment in such BITs in relation to GATS commitments” (OECD, 2004d).

According to this study, jurisprudence set by international tribunal and national courts indicates that the *ejusdem generis* principle has been applied, while not always in a simple and consistent way, to define the limits of the NMF obligation included in a specific agreement: according to this principle, “an MFN clause can attract the more favorable treatment available in other treaties only in regard to the same “subject matter”, the same “category matter” or the same “class of matter” (OECD, 2004b).

Besides gathering criticism for what they include, BITs have been negatively assessed for what they omit, namely duties and disciplines applicable to the investors and/or to the investment home country. This lack of obligations for one of the Parties as well as for the direct beneficiary of the protection guaranteed by the BIT, together with specific controversial provisions of these agreements, gave rise to a widespread perception that investment agreements produce and reproduce a strong asymmetry of rights and duties to the detriment of the host country.

6. Towards a new model of investment agreements ?

The failure of the MAI/OECD is often cited as the first sign of a deep change in the international trade negotiation environment. The agreement became the symbol of a globalization run by transnational enterprises and this association extended itself, in the developed and some developing countries, to the very issue of investments.

In the multilateral sphere, in spite of the limits of the Doha mandate in dealing with this issue, the resistance of a large group of developing countries led to its withdrawal from the agenda, following the Ministerial Meeting held in Cancun in 2003. Preferential negotiations as the FTAA also faced difficulties in the area of investments, where the objective of a state-of-art agreement – defended by the United States – stood in contrast to Brazil’s minimalist stance in beyond-trade issues. In this context, the investment agreements evolved principally on the bilateral level and the United States was very active in this area, including wide-sweeping chapters on investment protection in their free-trade

agreements with various small developing countries (Chile, the Central-American countries, Morocco, Jordan).

This recent evolution has only reinforced the perception that BITs – or the investment chapters of free-trade treaties that use the templates of BITs – are instruments “imposed” by developed countries on developing ones, which generate high standards of protection for their investors at the cost of restraining the right to regulate of the States that host the investments.

The fact that the environment in which trade negotiations are held has changed since the late 90s does not suffice to explain why investment agreements became the favorite target of critics of globalization and even of experts, governments and institutions that, though not critical of this process, see more costs than benefits in these agreements.

Although one must not exaggerate the real impacts, both economic and juridical, of the investments agreements¹⁵, there are certainly specific elements in BITs and in some regional agreements that make these instruments particularly targeted by critics, especially when negotiations evolve within an environment where non-trade concerns (including development concerns) have grown in importance. Among these specific features, the following deserve reference:

- the vast majority of bilateral agreements involve a developed country and a developing country and their scope is given by templates defined by the countries of the North. For many critics, this is enough to characterize these agreements and by extension the negotiating issue of investments as one that interests essentially the developed countries;
- BITs do not set obligations and duties for countries that export capital and for investors, but rather concentrate on disciplines applicable to the rights of the host State and rights granted to investors. As a corollary, the provisions of BITs are very broad and aim at covering a wide – and not *a priori* delimitable – range of situations that the investor may come to face, producing a “transfer” of uncertainty from the investor to the host State;
- BITs are in general characterized by strict reciprocity, as far as fulfillment of obligations and duties by the Parties are concerned, leaving little space for provisions relating to the development needs of the signatories and treatment of the asymmetries between them; and
- the investor-State dispute-settlement mechanisms have become *à tort ou à raison* the major expression of the asymmetry of rights between the Parties involved in BITs and are broadly perceived as a very “sword of Damocles” above the head of the regulators of developing countries. Furthermore, as the decisions of different

¹⁵ As pointed out by Torrent and Molinuevo (2004b), the obligations of many trade agreements are not broad and strong enough to alter national policy preferences (in a traditional right-left perspective, for example) since they focus on the application of national policies on a non-discriminatory basis.

processes of arbitration do not necessarily coincide, generating rules by arbitration rulings tends to bring about inconsistencies that increase the uncertainties of host States as to their rights and duties.

Hence, social criticism of investment agreements therefore points to a set of characteristics that refer to the interface between national States and international commitments and whose essential result would be to limit the rights of host States to regulate, a limitation imposed on behalf of respect for the rights of the investor.

Some recent bilateral agreements and the very jurisprudence that emanates from the arbitration panels put into action by these agreements indicate a tendency to qualify the rights of investors guaranteed by the agreements through the “indirect expropriation” clause and to recognize legitimate spaces for host States to exercise regulation.

If the limitation of the host States’ right to regulate is the prime focus of the criticism leveled at the BITs, the fact that such agreements in general involve a developed country and a developing country within a scheme of obligations characterized by strict reciprocity makes them a favorite target for “developmentalists”. For them, limiting the right to regulate is especially nefarious in the case of developing countries, whose problems would justify more sweeping and discriminatory State interventions – between sectors and companies – than those required in developed countries.

This type of criticism gives rise to proposals to reformulate the current paradigms of investment agreements by enlarging the space reserved in these agreements for the State’s right to regulate and by reducing the imbalance of rights and duties of the Parties, sanctioned by these treaties. Such proposals generally include the following elements:

- in the first place, the range and scope of some key definitions and provisions of the agreements should be limited: among these, the concept of investor and investment, the right to establishment, the clause on indirect expropriation and the mechanism to settle disputes between investor and State.

In relation to the concepts of investor and investment, certain proposals (Torrent and Molinuevo, 2004b; Motta Veiga, 2004) recommend that the North-South agreements be focused exclusively on FDI, and should not include portfolio investments. As for the proposal of a model agreement of the IISD - Mann et alii (2005) – this uses a broad concept of investor and investment (explicitly including intangible property, among other types of assets to be protected) but also excludes portfolio investments.

In the proposal presented by Mann et alii (2005), the investments agreement does not automatically cover (pre)establishment rights, but applies only to investments already established (including the investments made prior to the signing of the agreement). The signatories would present a list of sectors in which establishment rights are granted and this list could be enlarged through time. A very similar proposal is presented by Torrent and Molinuevo (2004b), who also defend, for the post-establishment phase, the possibility of adopting a negative list of exceptions to national treatment.

The idea of indirect expropriation is excluded from the model proposed by Torrent and Molinuevo (2004b), although in another paper these authors emphasize that this clause has received a very careful treatment in recent agreements such as CAFTA. The proposal presented by Mann et alli (2005) maintains the hypothesis of indirect expropriation liable to compensation, but (i) lists a series of government acts that cannot be considered as expropriation and (ii) does not consider to be expropriation measures taken to protect or enhance basic public-welfare interests, a criterion subject only to the test of *bona fide*.

The mechanism to settle disputes between investor and State is also excluded from the proposal of Torrent and Molinuevo (2004b) and in this case too this position diverges from that presented by the treaty model designed by Mann et alli (2005) in which the mechanism is adopted but its functioning is subject to some conditionalities and restrictions. First and foremost, the mechanism cannot be put into action until all the domestic solutions have been tried. Furthermore, an investor who has failed to comply with the article of the model agreement related to anti-corruption, or who has persistently proved incapable of fulfilling his/her post-establishment and corporate-governance obligations can have his/her access to the mechanism blocked. Finally, there are provisions geared to ensuring transparency and public access to arbitration procedures.

- in the second place, the prohibitions of performance requirements that go beyond those set by the TRIMs Agreement should be prevented, and in a more general manner, provisions based on the principle of special and differentiated treatment to developing countries should be included in the agreements.

Torrent and Molinuevo (2004b) propose that the issue of performance requirements should be treated together with that of incentives to investment, since the disciplining of the former without referring to incentives, by reducing the bargaining power of the governments of developing countries before the potential investors, would accentuate the race-to-the-bottom that the incentives auction tends to produce.

Mann et alli (2005) claim the right of the host State to pursue its own objectives and priorities for development and define “inherent State rights” that should not be restrained by the provisions of the agreement. As regards performance requirements, the proposal does not prohibit them (although it provides for respect to the restrictions established in the WTO), but establishes that this freedom to impose requirements only applies for a given investment up to the moment that the formalities and procedures to establish the project have been completed.

- in the third place, it is proposed to include in the agreements provisions that oblige capital-exporting States and investors to respect certain standards and to fulfill certain norms that would make the investments more beneficial to the host country.

The proposal presented by Mann et alli (2005) is particularly detailed in this aspect, by including a section on the obligations and duties of investors and investments, as well as the obligations of the countries of origin of the investment. Among the obligations and duties of the investors are included an evaluation of the environmental and social impacts of the investment before it is carried out, an anti-corruption pledge, post-establishment

obligations such as maintaining a system of environmental management and fulfilling the so-called core labor standards, commitments with regard to corporate governance and corporate social responsibility, etc. Some of these obligations condition investors' access to the agreement's mechanism of dispute-settlement. In addition, the host State has a series of defined obligations, but also its rights, among which those classified as "inherent" and those of applying performance requirements not prohibited by the TRIMs Agreement. Torrent and Molinuevo (2005) and Motta Veiga (2004) refer only succinctly to the advisability of including in investment agreements clauses relating to corporate conduct, without stating whether the defined obligations are binding.

Investments agreements raise another type of concern, related less to their content than to the *status quo* resulting from the multiplication of bilateral and regional agreements and the fact that the issue is only partially (and unevenly, among sectors) included in the multilateral agenda of negotiations. Two questions are particularly pertinent from this point of view: the problems resulting from the overlapping of provisions of different agreements and, related to these, the issue pertinent to the relations between multilateralism and preferential agreements and commitments.

In order "to organize a system of overlapping international trade agreements" while re-stating the primacy of multilateralism, Torrent and Molinuevo (2004b) propose that a "WTO conformity clause" be inserted in the preferential trade agreements recognizing the primacy of WTO agreements and commitments over those established by the preferential arrangements: "such a clause would establish that, in the case where (and/or in the measure in which) the WTO competent organs would determine that a specific provision of the PTA was not in conformity with WTO rules, this provision would no longer apply between the Parties of the PTA without any need to denounce the agreement or to renegotiate it"¹⁶.

The objective of the proposal is to include in the preferential agreements a clause that establishes the primacy of multilateral over preferential rules in cases where (and to the extent that) there is conflict between them. It may then be asked whether the eventual inclusion of this clause in preferential agreements on investments would be sufficient to get rid of the problems related to overlapping between their provisions.

It has been shown that in the case of investments agreements there are two types of overlapping that can cause legal but also policy-related problems: the first between preferential agreements (either BITs or regional), the second between these preferential agreements and multilateral agreements. The conformity clause proposed by Torrent and Molinuevo (2004b) potentially provides a solution to both cases by making the multilateral norm the reference to solve questions that may be related to both types of overlapping.

Nevertheless, one may legitimately question the feasibility of the hypothesis, also formulated by the authors, that the "competent bodies of the WTO" would determine conformity (or not) with the multilateral rules of a given measure included in a PTA. This

¹⁶ According to the authors, the alternatives to their proposal would be: (i) renouncing any organising mechanism; and (ii) inserting a provision in the PTA establishing its primacy over WTO agreements. Both alternatives would imply the weakening of the multilateral system as a consequence of the proliferation of PTAs.

is a strong hypothesis, one that implies the existence *ex ante* of incentives for WTO member States to decide to establish and implement this rule. The difficulties faced by the WTO debate on rules applicable to regional agreements suggest that there are few incentives for the member States of the organization to push for the adoption a conformity clause like the one suggested by the two authors.

Regardless of the qualities and insufficiencies of the alternative proposals formulated both for the content of the agreements and for the management of a complex architecture of agreements generated in different instances and with different scope, the fact is that the present situation of negotiations in the area of investment is unstable and liable to risks for the countries and for the international system of trade and investments.

The obstruction of the negotiations on investments in the multilateral sphere, the difficulties to negotiate preferential agreements between countries of the North – and between them and large countries of the South (as made evident in the FTAA) - and the multiplication of North-South bilateral agreements according to templates defined by the developed countries, are the main elements in the current situation in this area of negotiations. As a result, “countries – and firms – have to operate within an increasingly complicated framework of multi-layered and multi-faceted investment rules with overlapping obligations and commitments and also with gaps” (UNCTAD, 2005).

This situation, besides being a guarantee that the BITs will continue to enjoy low political legitimacy, tends to generate juridical uncertainty, related to the multiplication of investor-State disputes, the object of which involves the regulatory rights of national States and the problems resulting from overlapping of obligations (as seen in the disputes concerning MFN obligations included in different agreements).

Given such a scenario, some alternatives present themselves. The proposal to include in the PTAs a clause of conformity with multilateral rules reduces the uncertainties related to overlapping of obligations, but does not tackle - or even intend to do so – the core of the low legitimacy of investment agreements: the question of the balance of rights and duties between investors and host States. The reality is that this question constitutes the main obstacle on the way to including investments as a “full issue” on the agenda of trade negotiations, especially in the multilateral sphere.

The proposal made by Mann et alli (2005) to overcome this obstacle (and the current situation) is to introduce a new model of investment agreement that establishes an ambitious balance of rights and obligations between investors, host States and States of origin of the investment. In principle this model could be adopted in any instance of negotiations – multilateral or preferential – and its introduction would be accompanied by a process to harmonize the agreements in the area of investments: pre-existing agreements would be cancelled by mutual consensus or renegotiated to make them consistent with the rules of the new agreement. In other words, this proposal aims at providing a solution not only to the problem of the content of investment agreements (and hence of their legitimacy) but also to the systemic issue generated by the overlapping of the provisions of these agreements.

Another way of coping with the present difficulties is to lower the ambition of the preferential investment agreements, especially in those clauses perceived as being more restrictive as regards the regulatory right of national States. The proposals presented by Torrent and Molinuevo (2004b) and Motta Veiga (2004) go in this direction, by proposing that the agreements should be limited to FDI, concentrate on the post-establishment phase, eliminate the concept of indirect expropriation and not include the mechanism of investor-State dispute-settlement. These proposals do not contemplate the systemic issue of overlapping between the provisions of the investment agreements, although Torrent and Molinuevo (2004b) present their idea of introducing the WTO conformity clause in the preferential trade agreements as a way to organize the network of overlapping agreements.

In the Doha negotiations, before the issue was removed from the agenda, several players supported proposals to treat the theme in the multilateral sphere, combining: (i) a less ambitious definition of the issue (limited to FDI, according to the Doha mandate itself); and (ii) the adoption, for commitments to assume in investments in goods, of the GATS methodology for assuming TN and NMF commitments in services sectors.

In its two components, this proposal is politically more acceptable for developing countries but it can also be legitimately challenged in the light of the difficulties already demonstrated by the GATS methodology in generating liberalizing movements on the part of WTO members.

However, the relevance of the criticism addressed to the GATS model should not be exaggerated in this case, as restrictions to investments in goods are generally far smaller than in the services sectors in the vast majority of countries. Hence, the problems caused by the incapacity of the GATS model to generate new liberalization moves would seemingly be quite unimportant, in the case of investments in goods.

The failure of investment negotiations in the Doha Round and the consolidation of a “multi-layered and multi-faceted” regulatory status quo does not mean however that the *de facto* international regime on investment is static or that the only evolution occurring relates to the increasing number of BITs or non-multilateral agreements. Indeed, this number is still growing albeit at a slower pace in the last few years.

But *de facto* international regime on investments is undergoing important changes as some of the most recent agreements – BITs or investment chapters included in broad preferential trade and investment agreements - show substantive normative evolutions, which owe to a great extent to the experience in the enforcement of the NAFTA investment but also to the criticism addressed to some of the key substantive features of such agreements.

UNCTAD (2005) has recently summarized four main trends affecting key substantive provisions of the investment agreements. These trends are consolidating through a brand-new generation of BITs or investment chapters included in broad PTIAs.

Setting limits to the “open-ended asset-based concept of investments” seems to be the first trend emerging from this new generation investments agreements. Although these

agreements maintain a comprehensive definition of investment, they intend not to cover assets that are not really perceived as investments by the Parties.

Elaborate the language and clarifying the meaning of essential provisions of the investment agreements that expanded during the Nineties is the second trend identified by UNCTAD (2005). Two provisions are especially targeted by these efforts of clarification and limit-setting: provisions dealing with absolute standards of protection - where reference to customary international law appears increasingly - and the concept of indirect expropriation. "Some BITs models include annexes specifying guidelines and criteria to determine whether in a particular situation an indirect expropriation has in fact taken place". Besides that, it is stated that "except in rare circumstances, non-discriminatory regulatory actions by a Party aimed at protecting legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations" (UNCTAD, 2005). In relation with the "right to regulate" issue, some new agreements include specific language aimed at clarifying that its investment protection and liberalization objectives "cannot be pursued at the expense of other key public policy objectives", as health, safety, the protection of the environment and the promotion of internationally recognized labor rights.

Besides that, UNCTAD (2005) makes reference to the innovations regarding investor-State dispute settlement procedures, where new agreements are looking for greater transparency in arbitral proceedings and for "a more legally oriented, predictable and orderly conduct at different stages of the process". In some agreements, "a special procedure available at the early stage of the process aimed at discarding frivolous claim" has been included (UNCTAD, 2005).

These developments that occur in the non-multilateral instances can contribute to attenuate criticism against investment agreements and to reduce the gap of political legitimacy that they suffer from today. In fact, they all point towards incorporating some of the more common criticism against the provisions of investment agreements, in an attempt to reduce the imbalance between investor and host-State rights, as this is made explicit in the broad concept of investment, in the absolute standards of investor protection, in the indirect expropriation clause and in the mechanism for settling disputes between investor and State.

In this sense, such developments point to a maturing of the treatment of the investments issue in international negotiations, repeating a process that had already taken place in the areas of environment and labor norms. Indeed, in these two areas the debate developed towards abandoning maximalist views on the treatment of the issue - but also minimalist views that refused the inclusion of the themes in the trade debate - to define a field of discussion and negotiation acceptable to all parties. The normative evolution recently perceived by UNCTAD suggests that something similar could be occurring in the investment area, either through the signing of new agreements that are more attentive to matters whose treatment in previous agreements was considered unacceptable by some countries, or by renegotiating agreements, a process that is likely to intensify, since many current agreements will be expiring in the next few years.

Realistically, it should be stressed that this maturing of the debate still promises to be quite a conflictive process inasmuch as international disputes are multiplying between investors and host States, protected by the investment agreements in place. As recalled by UNCTAD (2005), the number of cases submitted to arbitration has grown dramatically over the last few years and these cases involve developing countries as defendants. Unlike the normative evolution registered by UNCTAD, the proliferation of these cases is a process that certainly does not contribute to consolidate an environment favorable to negotiating divergences as to the inclusion of the issue of investments in the WTO agenda.

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