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ENCOURAGING CAPITAL FLOWS AND VIALE DISPUTE SETTLEMENT FRAMEWORKS UNDER THE MONTERREY CONSENSUS

Joseph J. Norton[†]

I. INTRODUCTION

THIS article will focus on the interplay between an appropriate legal infrastructure (with particular emphasis on an effective bank regulatory/supervisory framework, and viable domestic judicial systems and competent, non-corrupt judiciaries) and effective dispute resolution mechanisms to resolve successfully investment disputes for the broader purpose of facilitating greater foreign capital flows. It will be argued that the two methods of investment dispute resolution (judicial and alternate dispute resolution (ADR)) are not conflicting; rather, they can be reconcilable, or even seen as complementary in many respects. Further, recommendation for a suitable foreign direct investment (FDI)-dispute resolution “environment” will be made, including enhanced bilateral investment treaties (BITs) and the development of suitable “public private” partnerships.” These various issues will be treated in light of recent international developmental efforts such as the UN’s 2000 Millennium Developmental Goals¹ and the “consensus” reached at the UN’s 2002 International Conference on Financing for Development.²

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1. Heads of State and/or Government of the Member States of the United Nations gathered at the Headquarters of the United Nations in New York to participate in the Millennium Summit from 6 to 8 September 2000. The Summit was a historic opportunity to agree on a process for the fundamental review of the role of, and challenges facing, the United Nations in the new century. During the roundtable discussions of the subsequent 2002 Monterrey Consensus, several speakers noted that such goals have “imposed fundamental responsibilities on governments.” Investing in people – including education, health, basic social infrastructure, and social security programs – is vital for overcoming poverty.
2. This United Nations-hosted conference on key financial and development issues attracted fifty Heads of State or Government, over 200 ministers, as well as leaders

The International Conference on Financing for Development was held under the auspices of the United Nations in Monterrey, Mexico on March 21 and 22, 2002. This conference led to the adoption of the so-called Monterrey Consensus, which proposes a “holistic” approach to financing for development³ and defines long-term objectives to promote financial and economic growth. Further, the Monterrey Consensus identifies measures to be adopted, and infrastructures to be reinforced and cooperation efforts to be made between developing and developed countries. Among the measures necessary to promote financial and economic growth, this consensus emphasizes the importance of FDI and its contribution “toward financing sustained economic growth over the long-term.”⁴

Indeed, FDI is thought to be the dominant form of resource flows and the primary source of private capital for low-income countries.⁵ Therefore, it is important to identify how legal intervention can affect investors’ choices and encourage financial flows in association with FDI. It should also be noted that a weak financial and related legal infrastructure could affect the investments made by contributing to their volatility. In other words, a good level of “financing for development” through the creation of a favorable climate for FDI requires that developing countries attract foreign investors by designing appealing laws and a legal infrastructure that also protects legitimate national social interests. Additionally, developing countries are encouraged to strengthen their financial sector infrastructure to capture and maintain capital flows resulting from these investments.

This article considers the possible impact of the Monterrey Consensus on the creation of a conducive climate to FDI, with a special emphasis on both a robust and stable banking law infrastructure and an effective domestic judicial system in developing countries to resolve investment disputes and to attract, from an *ex-ante* perspective, foreign investors. Part II of this article analyzes the mobilization of domestic and international resources necessary to foster economic growth and development. This mobilization can only be achieved if developing countries enhance their banking and financial infrastructures, thus increasing the availability of credit through effective yet sound lending transactions. Indeed, a deficient banking system along with obsolete or non-existing lending instruments can limit capital flows resulting from FDI. As a result, developing countries will not fully benefit from the reforms they may have un-

from the private sector, civil society and all the major intergovernmental financial, trade, economic, and monetary organizations.

3. “Our goal is to eradicate poverty, achieve sustained economic growth and promote sustainable development as we advance to a fully inclusive and equitable global economic system.” *Report of International Conference on Financing for Development – Monterrey Consensus*, ¶ 1, U.N. Doc. A/CONF.198/3 (2002), available at www.un.org/esa/ffd/aconf198-11.pdf [hereinafter *Monterrey Consensus*].
4. *Monterrey Consensus*, *supra* note 3, ¶ 20.
5. See Ewe-Ghee Lim, *Determinants of, and the Relation Between, Foreign Direct Investment and Growth: A Summary of the Recent Literature* 12-15 (IMF, Working Paper No. 01/175, 2001).

dertaken to attract foreign investors. On the other hand, the Monterrey Consensus highlights the role of the financial infrastructure and banking system to promote not only needed capital flow, but also the development of ancillary capital markets. Therefore, Part III of this article will analyze the dispositions relating to the creation of an “effective supervisory mechanism, supported by a solid central bank,”⁶ as these may relate to the issue of capital flow and broader capital market development.⁷

The study of these various issues leads us to the focal point of this article in Part IV: effective dispute resolution. Indeed, mobilizing resources, both domestic and international, and strengthening the financial infrastructure through the enhancement of the banking system brings forth the issue of effective investment dispute settlement mechanisms. In this respect, it is important to understand that arbitration is not functional unless it is associated with a suitable legal infrastructure, which would include (among other components)⁸ a competent, predictable, and unbiased domestic judiciary system. On this latter point, arbitration is not a substitute for an operational judiciary system; rather, it is a complement to and is significantly dependent on the efficacy of such a system. For example, not only would foreign investors avoid referring their disputes to a faulty domestic judicial system, but would also be reluctant to use such a structure to enforce arbitral awards. As a result, ADR mechanisms, particularly arbitration, cannot survive without sound judicial reforms in developing countries. Where the domestic court system fails to address foreign investors’ concerns, arbitration would prove of little use in supplying sufficient procedural assurance to investors. A second key point in Part IV relates to the necessity, from a developmental perspective, to adopt more effective measures regarding dispute settlement procedures between firms and governments. These include more comprehensive BITs prescribing convenient locations for international arbitration and significant reductions in the cost of arbitration, which have so far deterred developing countries from more fully using this recourse.

In conclusion, Part V of this article will provide an overview of the necessity to encourage “public/private partnership(s)” so as to foster development and poverty alleviation in the South. These various efforts may be instigated by the main international financial institutions (IFIs) and/or regional financial institutions (RFIs) through actual co-financing and cooperation programs. This may also be done at the initiative of developing countries, through technical assistance, and by creating an at-

6. See *Monterrey Consensus*, *supra* note 3, ¶ 17.

7. Financial sector legal reforms over the past decade by IFIs and RFIs have revealed that a sound and viable banking sector needs to be in place to support the development of longer-term capital (such as securities investment) markets.

8. The other components would include modern commercially-oriented laws conducive to encouraging and supporting FDI, transparent and fair administrative processes (with judicial review), and effective, but fair enforcement mechanisms – all within a competent, non-corrupt overall “rule of law”-based governmental system.

tractive atmosphere to foreign private and public sectors. From a general developmental perspective, one should mention that a successful monitoring of the Monterrey Consensus would most probably encourage developing countries to strengthen their judiciary systems, thus encouraging more foreign capital flows. Additionally, in the follow-up process⁹ of the "Bretton Woods Institutions," the United Nations and other stakeholders are likely to facilitate the overall process of development while underscoring the decisions taken by the UN's Development Committee and resolutions of the UN General Assembly adopted in 2002. It is also noteworthy that there was active involvement by the Director-General of the World Trade Organization (WTO), a number of ministers of trade, and several ministers of development cooperation from donor countries. The ongoing monitoring of the Monterrey Consensus is viewed as the novel element that will treat many issues simultaneously, such as those issues surrounding official financial flows, the external debt of developing countries, the role of the International Monetary Fund (IMF),¹⁰ the international financial architecture, and the coherence and consistency of the international trading system in support of development.

II. MOBILIZATION OF RESOURCES

A. NEW COMMITMENTS

In order to implement effectively the Monterrey Consensus, it is important to mobilize domestic and international resources.¹¹ Domestic resources are deemed a vital prerequisite for development and may not be substituted by external assistance. In this respect, the Monterrey Consensus identifies several actions that should be undertaken by developing countries to allow a positive impact of foreign capital flows, *a fortiori* foreign direct investment. Among these measures, one can cite the "coherence and consistency of macro-economic policies, increasing productivity, reducing capital flight, encouraging the capital sector and attracting while making effective use of international investment and assistance; building good governance, and fighting corruption."¹² Such efforts are likely to

9. See *Global Development Finance, Striving for Stability in Development Finance*, World Bank (2003), available at http://www.worldbank.org/prospects/gdf2003/GDF_vol_1_web.pdf.

10. For further insights on the IMF's involvement in Market Development, see *WORLD ECONOMIC AND FINANCIAL SURVEYS, GLOBAL FINANCIAL STABILITY REPORT: MARKET DEVELOPMENTS AND ISSUES* (International Monetary Fund, Sept. 2003).

11. On the theme of coherence for development, some speakers noted that "although FDI is important for development, simply attracting FDI does not automatically imply faster growth. There is a need for complementary domestic policies to link the operations of foreign firms to the domestic economy and thereby increase its benefits for the country concerned." See *Summaries of Multi-Stakeholder Round Tables*, U.N. International Conference on Financing for Development, U.N. Doc. A/CONF.198/8/Add.4 (2002) [hereinafter *Conference*].

12. Creating an environment favorable to investment also entails other elements prescribed within the Consensus. These prerequisites may be ranked in a broader category encompassing fundamental rights such as freedom, peace and security,

create a considerable burden on developing countries, but also may reiterate their commitment to participate actively in the developmental process.¹³ Indeed, much multilateral aid aimed at reducing poverty and fostering development without any substantial requirements imposed upon the recipient has proven to be of limited effect due to a lack of host country commitment and “ownership.”

Historically, the underprivileged position of many countries justified the unconditional aid, resulting in a considerable waste of resources, with little impact on foreign capital flows to development. With the endorsement of the Monterrey Consensus, developing countries become as committed as developed nations to their own developmental process. This new approach considerably shifts the objectives of developmental efforts, along with the results to be expected. The mobilization of domestic resources should serve as the barometer whereby the commitment of a developing country will be measured. Henceforth, multilateral aid will be provided to developing countries that make a considerable effort to mobilize their own domestic resources. These efforts may consist of improved domestic laws and legal infrastructures with respect to commercial activities better operational bilateral investment treaties with effective “stabilization clauses” and political risk insurance for foreign investors.

B. DOMESTIC EFFORTS

Despite the surge in foreign direct investment in the last decade,¹⁴ an effective international regulatory regime for FDI has yet to be created. As a result, domestic laws and legal infrastructures continue to play a paramount role in attracting FDI and in fostering the ability of developing countries to regulate effectively their internal financial and commercial activities for translation into increasing foreign capital flows. In this context, developing countries should enact flexible rules with respect to the different types of business enterprises, regulations of capital markets and capacity (especially of foreign joint-ventures) to engage in business. The recommendations of the Monterrey Consensus were not limited to the identification of these key legislative efforts. The Consensus presents a novel approach to attracting FDI by presenting parties with a more “goal-oriented” approach to development. This approach recommends striking a balance between achieving economic growth (and all the ele-

domestic stability, respect for human rights, rule of law, gender equity, market-oriented policies, and commitment to just and democratic societies.

13. An effective follow-up process should pursue this very approach, which captures the spirit of the Consensus. It has also been argued during the roundtable discussions that a “common interest in that regard is to turn the concept of mutual accountability into concrete practice at the international as well as at the national level.” *Conference, supra* note 11.
14. Farhad Noorbakhsh et al., *Human Capital and FDI Inflows to Developing Countries: New Empirical Evidence*, *WORLD DEVELOPMENT* 29 (9), 1593-1610 (2001).

ments that contribute to development, including FDI) and providing social protection to the economically disadvantaged.

C. BILATERAL INVESTMENT TREATIES

Parallel to improving the domestic legislative framework in host countries, the Monterrey Consensus emphasizes the importance of BITs in attracting foreign investors.¹⁵ The increasing use of BITs during the last decade¹⁶ demonstrates that the gap left by the absence of a multilateral investment instrument should be filled. BITs are primarily created to build an atmosphere of trust between host countries and foreign investors by defining their rights and duties. More importantly, BITs form the basis for resolving investment disputes between the host country and the investor's home country. In doing so, they create a binding obligation (more so for the host country) whose breach, not only constitutes a breach of treaty with the investor's home country, but also a violation of international law with ensuing consequences and negative effects on the host country's reputation.¹⁷

D. INSURANCE AGAINST RISKS

In addition to their traditional functions, BITs seek to protect against unexpected prejudicial change. Although commitments made by the host country would probably insure investors against only foreseeable risks and changes at the time such pledges are made, this trust building process is essential to attract foreign capital flows. In practice, developing countries give assurances in their legal and financial systems against substantial changes that may harm foreign investors' business.¹⁸ In addition, international arbitration and "stabilization clauses" may insure foreign investors against the partiality or inefficiency of developing countries' domestic judicial systems, respectively, while ensuring that current legal provisions regulating foreign investments will either stay in force, or at least be amended in a way that will not harm investors' interests. The Monterrey Consensus addresses some of the most common concerns of foreign investors and stresses the importance of finding effective remedies to address these anxieties.¹⁹

Beyond the scope of BITs, developing countries may seem more attractive to foreign investors if they can provide political risk insurance. Such

15. "Other mechanisms, such as public/private partnerships and investment agreements, can be important." See *Monterrey Consensus*, *supra* note 3, ¶ 21.

16. See L. Eric Peterson, *Emerging Bilateral Investment Treaty Arbitration and Sustainable Development*, International Institute for Sustainable Development 3 (2003).

17. See *id.* at 19.

18. PAUL E. COMEAUX & N. STEPHAN KINSELLA, *PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW: LEGAL ASPECTS OF POLITICAL RISK* 144-46 (Oceana Publications, Inc. 1997).

19. "To this end, it is important to provide export credits, co-financing, venture capital and other lending instruments, *risk guarantees*, leveraging aid resources, information on investment opportunities. . ." *Monterrey Consensus*, *supra* note 3, ¶ 22.

insurance would protect foreign investments against the broader risks associated with the political life of the host country, including a change of government or political orientations, expropriation, loss of assets, cancellation of agreements with the government (or forced re-negotiations), nationalization, repossession of equipment, capital controls, currency inconvertibility, and the like. Although political risk can be insured against,²⁰ insurance has its limits. Premiums may be high and some risks may be completely uninsurable. In addition, insurability requires a clear and verifiable event that causes a payout. Governments rarely engage in explicit nationalization of the property of a foreign firm. Rather, they may take a series of actions that have the cumulative effect of destroying the value of the firm's investment. This is referred to as "creeping expropriation."²¹ The Monterrey Consensus tries to foresee and to prevent such actions that are irreconcilable with developmental objectives. The commitment of developing countries to engage in productive economic policy should be sufficient to prevent these actions from taking place.

E. DEVELOPMENT AND EQUAL TREATMENT

Domestic efforts are important so long as international resources are being equally mobilized, especially private capital flows. Compared with other sources of financing, private capital flows seem to have the greatest impact on poverty alleviation in developing countries. Statistics show that private capital flows to developing countries are as much as ten times greater than official development assistance flows during the period 1995 to 2000.²² In addition to increasing the rate of investment that usually accompanies such capital flows, domestic savings are also subject to a considerable rise. These benefits would help in poverty reduction, while promoting a sound approach in financing the development of many low-income countries. The Monterrey Consensus specifically stresses the importance of international private and public resources in order to achieve the Millennium Development Goals.

Although the mobilization of international resources was the focal point of the conference, and certainly the foundation of many developmental projects, the Monterrey Consensus also addresses the important issue of equality of treatment in developing countries. Despite significant amounts of development assistance spent every year to fight poverty, there is a large disparity in flows of international aid between recipients. It has been demonstrated that 80 percent of foreign capital flows are re-

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20. American firms can obtain insurance from the Overseas Private Investment Corporation (OPIC). Firms from other countries can seek insurance from Lloyds. The World Bank also offers insurance against events like expropriation, revolution, war, and terrorism through its Multilateral Investment Guarantee Agency (MIGA).
 21. *ECONOMIC DEVELOPMENT, FOREIGN INVESTMENT AND THE LAW* 204 (Robert Pritchard ed., 1996).
 22. MORAN THEODORE, *FOREIGN DIRECT INVESTMENT AND DEVELOPMENT: THE NEW POLICY AGENDA FOR DEVELOPING COUNTRIES AND ECONOMIES IN TRANSITION* 24-27 (1998).

currently destined to only a handful of countries.²³ These countries could successfully insure foreign investors against eventual risks to their investments due to their 'reasonably' stable political and social infrastructure. This uneven flow can lead to even greater developmental gaps between low-income countries. Through its consensual character, the Monterrey Consensus seeks to reach a new equilibrium in terms of assistance and support to developing countries. A country's credit rating, a rather rigid and formulaic assessment, would play a less determinative role in assessing the assistance needed. The more objective approach put forward by the Monterrey Consensus could encourage developing countries to undertake positive reforms, leading to the enhancement of their social, financial, and political infrastructures and thereby appearing more attractive to foreign investors.

Under broader terms, the Monterrey Consensus urges the design of a more sensitive and constructive mode of delivering international aid. These requirements seem even more consequential considering the inadequacy of current BITs²⁴ and investment constraints imposed by foreign investors during the negotiation process. Current investment practices do little to truly improve developing countries' social and financial infrastructures. Their legitimate interests ought to be prioritized in the future where both developing countries and foreign investors can benefit from the wealth they jointly create.

III. REGULATION AND SUPERVISION OF THE BANKING SYSTEM

A. BANKING INFRASTRUCTURE AND ECONOMIC GROWTH

Given the rapid expansion of capital markets and foreign capital flows the Monterrey Consensus rightfully suggests the adoption of "transparent regulatory frameworks and effective supervisory mechanisms" of the banking system in developing countries. The Monterrey Consensus adds that such a model shall be supported by "solid central banking." Due to the rather broad language of the Monterrey Consensus, details regarding previous experience references to best practices are not specified. Yet, where most economic and financial activities are driven by fierce domestic and international competition and left to market forces, the banking sector has always been heavily regulated. In developing countries, effective banking regulation is necessary to ensure a robust and efficient banking sector, which can in turn enable further economic growth. Furthermore, effective banking regulation and supervision are primary elements in attracting foreign investors. The objectives of the Monterrey Consensus will be explored in light of international efforts to stabilize the global financial infrastructure and the promotion of sound banking prac-

23. FINANCING FOR DEVELOPMENT: PROPOSALS FROM BUSINESS AND CIVIL SOCIETY 32-33 (Barry Herman et al. eds., 2002).

24. Few BITs address sensitive issues such as market failure nor include transparency provisions.

tices in developing countries. It will also highlight the role of international financial institutions (IFIs) and the possible expansion of their competence in the area of banking regulation.

B. BANKING REGULATION

In general, banking regulations determine the range of products and services in which banks may engage. Banking regulations govern banks' assets and liabilities, forms and organizational structures, minimum capital requirements, legal reserves, and the like. The rationale behind such regulations is twofold. First, protecting foreign and local investors against eventual fraud or abuse is of paramount importance. In the context of the Monterrey Consensus, these concerns may relate to the efforts made by developing countries to protect investors' rights and subsequently to create an overall environment of trust. A second reason stems from the desire to prevent, or at least limit, the effects of banking crises—either individual or systemic. These crises usually provoke waves of financial instability that can be detrimental by way of “contagion effect” to other nations, especially developing countries.²⁵ The Monterrey Consensus encourages more effective regulation of the banking sector given its relation to economic growth and development.²⁶ Additionally, a robust regulatory framework should encourage banks in the host country to assume greater economic and financial responsibilities commensurate with increases in capital. With extended operational competence, foreign investors can use valuable lending instruments and investment techniques. This process would transform domestic markets in developing countries into appealing venues for capital flows and provide the foundational support for a country to develop ancillary capital markets.

C. BANKING SUPERVISION

Having set the broader context and meaning of banking regulation as referenced in the Monterrey Consensus, it is now appropriate to envisage the dynamic between banking regulation and banking supervision. Most significantly, to realize the objectives of the Consensus, it is important to understand the interplay between successful financial sector reforms and how the intervention of IFIs can attract foreign investors. While effective banking regulations are a pre-requisite to achieving stability in domestic and international financial markets, banking supervision is an important enforcement mechanism. Although the Monterrey Consensus does not

25. Developing countries would be better prepared to face, and find timely remedies against, financial crisis if their banking systems were appropriately designed and included coherent preventive measures. These measures would translate into empowering the regulatory and supervisory authority (whether a central bank or independent agency). Furthermore, the occurrence of the Asian crisis in 1997-1998 has emphasized the importance of the banking system to the economy and its importance in generating economic growth, especially in emerging economies.

26. Manuel Gutian, *Dealing with Banks in Distress*, in *CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS* 176-78 (Robert Effros ed., 1998).

outline the elements that contribute to establishing a sound regulatory and supervisory mechanism, a suitable legal framework is essential to achieve such a result. This would provide the endowment of financial institutions in the host country with the necessary flexibility to accommodate foreign investors, protect their legitimate interests, and allow them to collect the financial returns they have earned from their investments. For this mechanism to function properly supervisors should be experienced and independent, yet accountable before the executive, judicial, and legislative authorities of the country. This requires an infrastructure built on transparency and good governance, with effective involvement of legitimate and competent institutions in the decision making process.

These pre-conditions, however, seem rather difficult to fulfill in developing countries, which are traditionally impeded by their weak institutional environment,²⁷ poor governance, and limited powers of banking supervisors. In this respect, it would be reasonable to infer that the Monterrey Consensus operates a "renvoi"²⁸ to the most common and internationally recognized sources of banking regulation and supervision: the "Bretton Woods" sisters, and to a greater extent, the Basel Core Principles for Effective Banking Supervision and related Basel Committee pronouncement respecting international bank supervisory standards.

D. BASEL CORE PRINCIPLES

The financial crises in many European, Latin American and Asian countries initiated extensive bank reform programs. The G-10, in collaboration with other countries, launched a series of reform programs that endeavored to draft international standards and guidelines on banking supervision to be implemented on a global level. This work resulted in what is now called the Basel Principles for Effective Banking Supervision.

27. A weak institutional environment exists where at least one of the following elements is present: (a) there is no clear differentiation of powers/roles/jurisdictions among the three branches of government and the system of checks and balances is ineffective, or (b) there is no well-established tradition or effective framework for appropriate enforcement of the law.

28. World Bank, Core Principles for Effective Banking Supervision – Basic Committee on Banking Supervision (Sept. 1997), *available at* www.worldbank.org/wbi/banking/finsecpolicy/finseccissues/pdf/basic-core.pdf [hereinafter Basic Core Principles]. The Consensus is written under rather generic terms, because it would have been more difficult to reach a consensus on detailed provisions. It is therefore reasonable to believe that for each section it contains the Consensus systemically refers to external sources of international law. With respect to banking regulation/supervision, the Basle Core Principles may be perceived as the authority source. Furthermore, Principle 1 of the Basle Principles reads *inter alia* "... It is suggested that the IMF, the World Bank and other interested organizations use the Principles in assisting individual countries to strengthen their supervisory arrangements in connection with work aimed at promoting overall macroeconomic and financial stability." Press Release, Bank for International Settlements, Core Principles for Effective Banking Supervision (Apr. 9, 1997). This disposition invites the study of the involvement of these institutions in the process of standard setting with respect to banking regulation/supervision.

Although these Principles are only recommendations²⁹ and serve as a “basic reference”³⁰ on banking regulation and supervision, they have certainly gained recognition on a global level. However, their non-binding character hinders implementation and enforcement, especially in developing countries. Developing countries typically argue for the incompatibility between their financial systems and the Basel Accord. While it is true that developing countries encounter more difficulties than developed countries in complying with the Basel Principles, such difficulties are an inherent part of the developmental process to which developing countries have committed themselves. In light of this reluctant approach in adopting globally recognized banking standards, other alternatives may be necessary to foster reforms in developing countries.

E. IMF AND WORLD BANK INTERVENTION

Many developing countries and emerging economies recognize the importance of the work of the Basel Committee on Banking Supervision, yet they remain reluctant to implement the Basel Core Principles and related pronouncements. In response, in 1997 the G-10 countries sought to design approaches that would improve the rate of implementation among low-income countries. The first approach actively engaged the IMF and the World Bank in requiring the implementation of the Basel Principles as part of their conditionality and technical assistance programs. Although the “Bretton Wood sisters” relied heavily on the Basel Core Principles in designing aid packages, compliance through conditionality was quickly abandoned. This compulsory approach threatened the ultimate goal of both the World Bank and the IMF, which covers broader developmental issues than simply enhancing banking supervision. Furthermore, the long-term viability of these institutions depends on the borrowing of developing countries: a viability that could be threatened by compulsion.³¹ The second alternative was to develop assessment programs to measure compliance with the Basel Accords. Functioning as more than just a compliance indicator, this methodology of assessment would be useful to supervisors in developing countries to detect weakness or gaps in their regulatory and supervisory frameworks. These assessments expanded in scope and are now known as the IMF and World Bank “Financial Sector Assessment Programs” (FSAP).³²

On a final note, a newly proposed Basel Accord (Basle II) was to be ratified in 2004. However, due to its complexity and the substantial revi-

29. In this respect, Principle 25 divides the content of the Basle Core Principles into two categories. The first is the minimum standards to which countries are urged to abide. The second category includes complementary measures that countries may freely adopt in light of their developmental pace. *Id.* at 41-42.

30. See JOSEPH NORTON, FINANCIAL SECTOR LAW REFORM IN EMERGING ECONOMIES 100 (2000).

31. WILLIAM LOVETT, BANKING AND FINANCIAL INSTITUTIONS LAW 78-82 (1997).

32. FSAP traditionally include five areas of study. These areas are Banking Supervision, Payment System, Insolvency and creditor's rights, Anti-Money Laundering, and Corporate Governance.

sions since made, its ratification has been delayed until 2006. Basel II includes additional areas of control³³ so as to efficiently handle a growing and complex international financial infrastructure. This new capital adequacy framework for banking institutions will face great resistance by developing countries due to its increasing complexity in implementation. In reality, Basel II will most probably prove itself inapplicable to the more basic environment found in developing countries.

IV. INVESTMENT DISPUTES SETTLEMENT

A. OVERVIEW OF THE ISSUES

Although the Monterrey Consensus does not explicitly refer to the settlement of investment disputes, several of its recommendations make the subject relevant to the scope of this article. From its general language of providing "the necessary domestic and international conditions to facilitate direct investment flows,"³⁴ one may reasonably infer that effective dispute resolution mechanisms are an essential part of these conditions. A "stable and predictable investment climate, with proper contract enforcement" brings forth additional concerns regarding the efficiency and certainty an investment dispute resolution mechanism should offer to the parties, so as to encourage foreign capital flows. In this respect, developing countries should be able to attract greater foreign capital flows through enhanced domestic judicial systems and judiciaries, thus allowing for fair and expedient settlements of investments disputes. Although the majority of BITs contain arbitration clauses to insure foreign investors against the risks they may encounter, if the resolution of disputes is referred to a defective domestic judiciary system, then arbitration is a complement to the domestic judiciary system and can certainly not replace it. In reality, the effectiveness of the judicial system and judiciary is an important element that foreign investors always consider before undertaking their projects. Not only would the competence and impartiality of domestic courts facilitate the day-to-day operations of foreign investors, but it would also ensure that arbitral awards within the host country are enforced in an adequate and timely manner. Therefore, issues of enforcement are particularly important in understanding the interplay between the domestic judiciary system and the usefulness of arbitration.

In parallel, arbitration, although a common practice to resolve international and domestic commercial disputes,³⁵ may cause further uncertain-

33. These additional areas of control are market discipline and supervisory review. Combined with banking supervision principles the new Basel II will suggest the application of new principles in these three areas. For additional reading regarding the New International Financial Architecture (NIFA), see Joseph Norton, *Selective Bank and Environmental Developments Supervisory Trends upon Entering the Twenty-First Century*, in 2 CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW 34 (2003).

34. *Monterrey Consensus*, *supra* note 3, ¶ 20A.

35. See NON-JUDICIAL DISPUTE SETTLEMENT IN INTERNATIONAL FINANCIAL TRANSACTIONS (Norbert Horn & Joseph J. Norton eds., 2000).

ties regarding the settlement of investment disputes. The involvement of a sovereign party causes certain doubts as to the procedures that should be followed, the location of the arbitral tribunal, and the enforcement of the arbitral award. Furthermore, examining arbitration in the context of the Monterrey Consensus could unearth additional issues relative to developing countries, such as impediments they may face when resorting to this type of dispute resolution, which is still unusual to sovereign states.

B. DOMESTIC JUDICIARY SYSTEM AND ARBITRATION (AND OTHER FORMS OF ADR)

The importance of an effective judicial system and judiciary in the host country is such that it may constitute either a deterrent or a motivation to foreign investors to pursue their projects and investments. The primary concern of the latter is the possibility of facing a domestic court system that may undermine overriding legal principles such as fairness and justice. Under a deficient judiciary system, courts are likely to be prejudiced in resolving investment disputes and might systematically favor their government or locals from the host country. This quasi-irrefragable presumption of favoritism could lead to situations where foreign investors could hardly argue their cases fairly and would be far less able to collect on their claims, even when the laws protect their rights. Although considering that the host country extends procedural guarantees of fairness and due process, there will always be concerns as to effective enforcement. In addition, procedural compliance may not be sufficient to prevent politically motivated decisions that jeopardize the interests of foreign investors. There are many ways by which domestic courts can favor the host country surreptitiously, such as encouraging informal delays, purposely misconstruing the law, inflicting exaggerated fines, and the like. In reality, engaging in such practices is quite easy due to the unfamiliarity³⁶ of foreign investors with the domestic legal system of the host country.

Therefore, unless this system is reliable, competent and impartial, entrusting the domestic court system to adjudicate investment cases, where considerable amounts are often disputed, may induce foreign investors to take unnecessary risks. Such a system is necessary to address three major concerns. First, impartial and competent domestic courts may be needed to adjudicate the disputes that arise from the day-to-day operations of foreign investors. These disputes include all commercial transactions and sales of goods and services concluded between the investor and a domestic party (whether an individual or company). Granting a quick and impartial settlement of these disputes to foreign investors will give the latter sufficient "legal security" and incentive to engage in these occasional, yet

36. To mitigate their ignorance of the local legal system foreign investors will either undertake extensive studies regarding all aspects of domestic laws in the host country or assemble an impressive legal arsenal (in house legal department or professional law firms) to handle all legal matters. Either solution would result in significant costs, sometimes large enough to reverse the incentives underlying the investment at stake.

necessary, activities. Thus, the domestic court system governs the relationship between foreign investors and internal market players. This functional aspect, although not totally unrelated, should be disassociated from the second concern. That is, impartiality and competence should also be extended to the settlement of investment disputes *per se*, where there is a conflict of interest between the government or local in the host country and the foreign investors. The issues that may stem from this situation are usually different from those resolved in the context of the internal market. Yet, both interventions of the judiciary require a certain amount of fairness and expediency to attract foreign investors. The third and most important aspect of a sound judiciary system is the enforcement of either judicial decisions or arbitral awards.

In the first instance, the judicial system in the host country may be fair and expedient. Foreign investors will be able to litigate their cases before domestic courts and obtain favorable judicial decisions. Nevertheless, and despite the competence of the judges who adjudicate the cases, a given "operational" code in the host country may prevent foreign investors from enforcing judicial decisions rendered in their favor. These impediments result from a weak executive mechanism of enforcement, implicit immunities to a certain group of individuals due to their relationships with the authorities, or most commonly, a highly corrupt environment that renders all enforcement efforts futile.

With respect to arbitration, the circumstances would not differ greatly. While it is true that arbitration is often viewed as a good alternative to the domestic judiciary system, it does not supersede, far less replace, the latter. Indeed, the intervention of local authorities will still be required to enforce arbitral awards. Intervention will only take place at a later stage in contrast with the settlement of investment disputes before the judiciary system. Yet, arbitration is not sufficient to guarantee a fairer enforceable award than would the judiciary system. Both paths would require the intervention of local authorities at a certain stage so as to give full power to either judicial decisions or arbitral awards. The dependence of arbitration on the judiciary system somehow breaks the myth of arbitration as the most appropriate "independent" mechanism to resolve investment disputes. As such, arbitration would be most useful (due to its classic advantages, such as the expediency of the procedures and the expertise of the arbitrators) when associated with an effective domestic judicial system and judiciary. Arbitration may be used to circumvent disadvantages pertaining to domestic courts, other than impartiality, corruption or political motivation.

C. LEGAL AND JUDICIAL REFORM PROGRAMS

As previously mentioned, a developed, competent and non-corrupt judicial system and judiciary is not only important to enforce arbitral awards, but it is also one of the decisive general factors in attracting foreign investors. Aware of the role it fulfils, IFIs, such as the World Bank,

have developed extensive reform programs in the legal and judicial fields. These programs aim at providing the most accurate assessments and technical assistance to developing countries, and enable them to enhance their judicial infrastructure. Such programs are usually tailored to each country and do not prescribe “one-size-fits-all” steps to create the proper judicial environment to FDI. However, there do remain some recurrent themes that arise regarding developing countries and the difficulties foreign investors may encounter with their domestic judiciary systems. Without launching into a thorough analysis of the legitimacy of these reform programs, there are three remarks that ought to be made.

First, the independence of the judicial system and judiciary, where subordination to the executive is considered to be a sign of legal imperfection, has to be affirmed. To do so, it is necessary to make efforts not only in the political arena of the host country, but it also entails the formation of competent and non-corrupt judges who are able to handle cases where foreign investors are involved with a high degree of integrity and professionalism. As previously discussed, a corrupt or politically motivated judicial system is likely to reduce the rate of FDI in the long run because foreign investors would fear investing in a market where their fundamental rights are not legally guaranteed. Second, explicit mention of the private sector development is provided in the launching of the World Bank Legal and Judicial Reform program³⁷ as a *sine qua non* condition for poverty alleviation and development. The documents outlining this program dedicate substantial discussion to highlight the implications of a “transparent and efficient judicial and other dispute resolution systems, and enforcement.”³⁸ Finally, the judicial reform program would assess the level of economic integration necessary to facilitate development and sustainable growth. To achieve this, the judicial reform program should reach more developing countries and encourage them into constructive “re-modeling” of their laws, while eradicating the negative aspects of a weak judiciary system and weak institutional environment. The reform program is considered to be a novel vehicle for improvements as it enables many countries to attract more FDI and to capture the benefits created by them.

On a final note, the new commitments stipulated by the Monterrey Consensus are suitable in light of this type of reform program. Indeed, it would allow one to assess the degree of determination and commitment of developing countries that endeavor to undertake positive reforms.

37. See World Bank, LEGAL AND JUDICIAL REFORM: STRATEGIC DIRECTIONS, available at <http://www4.worldbank.org/legal/leglrf/> (last visited Nov. 24, 2003).

38. *Id.* at 52. According to the report:

Judicial independence has two functions: one is to limit government power and the other is to protect the rights of individuals. A truly independent judiciary is one that issues decisions and makes judgments that are respected and enforced by the legislative and executive branches; that receive an adequate appropriation from the legislature; and that is not compromised by political attempts to undermine its impartiality.

Id. at 26.

D. ARBITRATION (AND OTHER FORMS OF ADR)
AND DEVELOPMENTAL CONCERNS

Following the rationale underlying the Monterrey Consensus, developing countries and foreign investors should commit to the developmental process, thus transforming FDI into a fair deal for both parties. To do so, they would be compelled to make some compromises as not to prioritize their interests beyond reason and necessity. When applying this approach to arbitration, or other suitable forms of ADR, it would not be absurd to believe that the resolution of investment disputes (notwithstanding its form) should obey the same rules governing commitment and compromises to achieve development. In other words, arbitration should enable both parties to benefit from its advantages without being unlawfully burdened by its costs. To assess whether each party benefits from arbitration one has to weigh the pros and cons. The case for foreign investors gravitates towards arbitration as the preferred mode to settle investment disputes. In contrast, developing countries may be reluctant to resort to arbitration, or other forms of ADR, for two main reasons.

First, arbitration procedures, as referred to in most BITs, are prohibitive with respect to the costs they engender.³⁹ Indeed, each party to the arbitration proceeding is in charge of the cost. This includes the setting of the arbitral tribunal, the fees of the arbitrators, and often other additional expenses such as experts, traveling expenses, translations of evidentiary documents, and the like. In sum, the arbitration process may end up costing considerable amounts to developing countries. While such costs are prohibitive for the latter, foreign investors are often prosperous, large multinationals with numerous subsidiaries and branches and can afford the costs imposed by arbitration. In this respect, issues of inequality of treatment may arise since foreign investors will always have the upper hand in deciding whether to resort to arbitration and may use this option as a bargaining tool against developing countries.

Second, developing countries may have little expertise in arbitration matters and may lack highly skilled litigants with expertise in international investment and arbitration procedures. Combined with the substantial cost of arbitration this may lead to out of court settlements where developing countries are usually disadvantaged. Despite the fact that international law seeks to protect foreign investors, developing countries are the more vulnerable party in investment agreements. So far, arbitration and other ADR procedures have not been tailored to resolve investment disputes between powerful foreign investors and weaker developing countries. The procedures fail to balance the rights and duties of each party, thus creating an unequal dispute resolution mechanism. On an optimistic note, the Monterrey Consensus may restore an equilibrium to FDI and to all the issues relating to it, including arbitration and other

39. PAUL E. COMEAUX & N. STEPHAN KINSELLA, *PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW* 307-309 (1997).

dispute resolution mechanisms. It is vital to strike a balance between developing countries' rights to economically blossom and foreign investors' prospects to profit.

V. CONCLUDING OBSERVATIONS: PUBLIC-PRIVATE PARTNERSHIPS

Another developmental tool often marginalized is the use of *public-private partnerships* to foster economic growth in developing countries. Public private partnerships are schemes built on a steady structure, which involve a host party, a foreign party, and a third party, usually IFIs and/or a NGO. The host and foreign parties may be represented by either their respective public sector and/or institution having governmental authority or by a private enterprise. The extent of their involvement may stretch from passive participation in the project to an active, leading role in it. Nevertheless, the most important element that makes public-private partnerships an advantageous vehicle for development is the assurance brought by the third party to the transaction. Indeed, IFIs have long acknowledged their roles in promoting sound developmental projects by fostering the cooperation between, most commonly, host governments and foreign investors. Encouraging this type of partnership not only benefits the parties in the transaction but also attracts more investors to developing countries.

The presence of the third party may take various forms. It can diverge from a simple role of supervision to an actual financial involvement in the project at stake. In this respect, one has to mention the co-financing programs undertaken by the World Bank and its affiliate International Finance Corporation (IFC), which have so far attracted numerous investments to the most unprivileged regions such as sub-Saharan Africa. Other regional institutions have developed their own tools to promote public-private partnerships. Among these, one can cite the Asian Development Bank (ADB) and its co-financing programs, which aim at financing from sources other than the borrower or project sponsors to augment the assistance provided. Other funds may come from commercial financial institutions, official funding agencies, export credit agencies, and the like.

Although public-private partnerships have been known for well over a decade, the surge of international developmental efforts, such as the Millennium Development Goals and the Monterrey Consensus, underscore the importance of the involvement of the private sector in alleviating poverty. Nonetheless, there are several factors that should encourage public-private partnerships to better serve developmental objectives. Primarily, the public sector alone has proved incapable of providing a sustained development level to poor countries. The private sector is more able to channel capital flows and to help achieve tangible results in the short run. In light of the economic interdependence between nations, and the eco-

nomic downturn⁴⁰ after “September 11th”, the private sector should not be excluded from the arduous task of financing development.

Equally, the Monterrey Consensus appears to have revived the debate on development and international cooperation. Its novel approach invites developing countries to participate more actively in their developmental process. Yet, the real challenge the Monterrey Consensus faces is to address the channeling of private capital flows in order to serve the economic growth of developing countries. This initiative demonstrates two facts. First, official development assistance alone is not capable of fostering economic growth in developing countries. Second, encouraging developing countries to undertake positive reforms in the economic, legal and financial sectors might be better motivated by the private sector, which is driven by profits. However, there still remain significant challenges in the next decade. Having set the developmental framework to which future capital flows will be channeled, one needs now to address the more delicate issues of implementation and, most importantly, equilibrium of interests.

This equilibrium is more obvious with respect to issues such as arbitration and other forms of ADR and the mobilization of domestic resources. Developing countries and foreign investors should learn to work together towards the achievement of their respective objectives, which are not necessarily contradictory. Making compromises is the only way to strike a balance between development and making profits. This formula is not irreconcilable and will most likely be the norm if the Monterrey Consensus is effectively implemented.

It is widely accepted that IFIs and developmental organizations should be the “guardians” of implementation of the Monterrey Consensus. Furthermore, inviting private financial flows to foster economic development may require less intervention as compared to the channeling of public capital flows. The most important issue remains as to whether foreign investors will have the capacity to successfully create investment projects in developing countries while truly contributing to the developmental process of the host country. Another issue to consider is the possibility that developing countries, once committed to improvement, may move to adopt a firmer stance in confronting foreign investors who may be unscrupulous to the host country’s interests. Hopefully, the Monterrey Consensus and its follow-up monitoring and implementation will help change confrontational stances into more cooperative and productive understandings among developed and developing countries and the private sector.

40. Organization for Economic Cooperation & Development, *Sustainable Development: Making Public-Private Partnerships Work* (Apr. 28, 2003) (presented by Vivian Lowery Derryck), available at www1.oecd.org/forum2003/speeches/derryck.pdf.

Documents and Commentaries

