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THE TREATIFICATION OF INTERNATIONAL INVESTMENT LAW

Jeswald W. Salacuse*

I. BACKGROUND

In the immediate post-World-War II era, as international investment gained momentum, foreign investors who sought the protection of international investment law encountered an ephemeral structure consisting largely of scattered treaty provisions, a few contested customs, and some questionable general principles of law. For investors, this international legal structure was seriously deficient in at least four respects. First, it was incomplete, for it failed to take account of contemporary investment practices and to address important issues of investor concern, such as their rights to make monetary transfers from the host country. Second, the principles that did exist were often vague and subject to varying interpretations. Third, the content of international investment law was contested, particularly between industrialized countries and newly decolonized developing nations that in the 1970s began to demand a new international economic order to take account of their particular needs. Finally, existing international law offered foreign investors no effective enforcement mechanism to pursue their claims against host countries that had injured or seized their investments or refused to respect their contractual obligations.

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1. In 1970, the International Court of Justice in the Barcelona Traction case found it surprising that the evolution of international investment law had not gone further and that no generally accepted rules had yet crystallized in light of the growth of foreign investments and the expansion of international activities by corporations in the previous half-century. See Barcelona Traction, Light and Power Co., Ltd. (Belg. v. Spain), 1970 I.C.J. 3, 46-47 (Feb. 5). Even as recently as 2004, one distinguished scholar, discussing the role of customary international law applicable to international investments, found that “[t]here are few customs in this sense in the field of foreign investment.” M. Sornarajah, The International Law on Foreign Investment 89 (2nd ed. 2004).

As a result of these four deficiencies, investors had no assurance that investment contracts and arrangements made with host country governments would not be subject to unilateral change by those governments at some later time. Foreign investments, particularly in developing countries, were in the word of Raymond Vernon, “obsolescing bargain[s]” between the investor and the host country.3 Years earlier, in his exploration of the role of contract in the social order, Karl Llewellyn, a noted American legal scholar, had captured more graphically this same tension between negotiated agreements and subsequent reality when he likened it to a Greek tragedy: “Life struggling against form.”4 In the post colonial era of nationalizations and contract renegotiations, the political and economic facts of life in host countries struggled against the form of various legal commitments made to foreign investors. In that struggle, life usually triumphed over form.

II. THE MOVEMENT TOWARD TREATIFICATION

To change the dynamics of this struggle and protect the interests of their companies and investors, industrialized countries began a process of negotiating international investment treaties that, to the extent possible, would be: 1) complete, 2) clear and specific, 3) uncontestable, and 4) enforceable. These treaty efforts took place at both the bilateral and multilateral levels, which, though separate, tended to inform and reinforce each other.

The bilateral efforts particularly bore fruit. Beginning in 1959, individual industrialized countries, negotiating on the basis of predetermined models or prototypes, concluded bilateral investment treaties (BITs) with specific developing countries in order to protect their investors in those countries by: 1) subjecting host countries to a set of international legal rules that they had to respect in dealing with investors and 2) by giving investors themselves the right to bring a claim in international arbitration against host country governments who violated those rules.5 The BITs’ intent was to restrain host country action against the interests of investors—in other words, to enable the form of legal commitments made to investors to resist the forces of change often demanded by the political and economic life in host countries. By 2006, the nations of the world had concluded nearly 2,500 BITs6 affecting 170 countries and several other important investment treaties containing similar provisions, such as

5. For background on the BIT movement, see Jeswald W. Salacuse, BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries, 24 Int'l Law. 655 (1990).
NAFTA\(^7\) and the Energy Charter Treaty\(^8\). In addition, various other bilateral international treaties, such as the Free Trade Agreements advanced by the United States\(^9\) and the Economic Partnership Agreements promoted by Japan,\(^10\) contained chapters on investment that replicated the provisions of the BITs. As a result of this process, a wide spread treatification\(^11\) of international investment law had taken place in a relatively short time. An important support for this new architecture has been the International Centre for Settlement of Investment Disputes (ICSID), which was formally established in 1965 as an affiliate of the World Bank to resolve disputes between host countries and foreign private investors.\(^12\) Although ICSID did not hear its first case until 1972, it was destined to become an important institution for international investment dispute resolution.\(^13\)

Today, unlike the situation that prevailed in the immediate post-World War era, foreign investors in many parts of the world are protected primarily by international treaties, rather than by customary international law alone. For all practical purposes, treaties have become the fundamental source of international law in the area of foreign investment.\(^14\) This shift has been anything but theoretical. For one thing, it has imposed a discipline on host country treatment of foreign investors. In cases where host governments have failed to abide by their commitments to investors, those governments have become respondents in international arbitration proceedings (some 226 according to one recent count\(^15\)), and in many cases arbitral tribunals have held them liable to pay injured in-

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9. See generally Office of the United States Trade Representative, Free Trade Agreements, http://www.ustr.gov/Trade_Agreements/Section_Index.html
11. The word treatification, while not recognized by any standard English dictionaries, has been used on rare occasions previously. See, for example, the executive summary on missile proliferation on the web site of the Canadian Department of Foreign Affairs. Foreign Affairs and International Trade Canada, www.dfait-maeci.gc.ca/armslMTCR/page2-en.asp (last visited Dec. 20, 2006).
15. United Nations Conference on Trade and Development, supra note 6, at 27.

III. THE TREATIFICATION PUZZLE

Although the process of treatification of international investment law seems to be continuing unabated, it also presents a puzzle: why do developing countries, who usually have few national investors in need of protection abroad, sign investment treaties whose effect is to restrain governmental action in their dealings with foreign investors? Concluding and sustaining a treaty, like any agreement, requires the existence of a basic bargain between the parties, a bargain where both sides believe they derive benefits. An investment treaty between two developed states, both of whose nationals expect to invest in the territory of the other, would be based on the notion of reciprocity and mutual protection. One side promises to protect the investments of the other side's nationals in return for protection of its own national's investments in the other side's territory. But that basic bargain would not seem to apply in a BIT between a developed, capital-exporting state and a poor developing country whose nationals are unlikely to invest abroad. One may therefore ask why poor counties whose nationals have little prospect in the near future, if ever, of undertaking foreign investments would sign a BIT whose purpose is to protect the investments of foreigners. Why would it be in that developing country's interest to constrain its sovereignty by concluding a treaty whose very purpose is to limit the host government's ability to take what it may judge in the future to be necessary legislative and administrative action to advance and protect national interests?

One can identify five possible explanations to the BIT treatification puzzle: 1) foreign investment promotion; 2) relationship building; 3) economic liberalization; 4) encouragement of domestic investment; and 5) improved governance and a strengthened rule of law. Let us examine each one briefly.

A. INVESTMENT PROMOTION

The most common explanation to the BIT puzzle is that developing countries sign BITs as a means to promote foreign investment and to increase the amount of capital and associated technology flowing to their territories. The basic assumption of this explanation is that a bilateral investment treaty with clear and enforceable rules to protect and facili-
state foreign investment reduces risks that the investor would otherwise face and that a reduction in risk, all other things being equal, encourages investment.

In the 1980s and 1990s, as other forms of development finance became less available from commercial banks and official aid institutions, developing countries increasingly turned to direct foreign investment in order to foster economic development. Developing countries have seen BITs as one way of promoting investment and have therefore signed them in increasing numbers. Thus, one can say that a BIT between a developed and a developing country is founded on a grand bargain: a promise of protection of capital in return for the prospect of more capital in the future.

The dual objective of investment promotion and investment protection is clearly evident in the full title of most BITs: A Treaty Concerning the Encouragement and Protection of Investments.

B. RELATIONSHIP-BUILDING

A second explanation to the BIT puzzle is that developing countries sign bilateral investment treaties with developed countries in order to strengthen their relationship with those countries so as to obtain other benefits and favors, such as those in the domain of trade or foreign aid, which such a strengthened relationship may yield. Thus, even though a developing country may not be certain of increased investment flows from its developed country treaty partner as a result of signing a BIT, it has strong expectations that the BIT will result in closer ties with that country that in turn will lead to increased trade, foreign aid, security assistance, technology transfers, or other benefits that an improved relationship may yield. For example, when a left-of-center government came to power in Uruguay in 2005 after a previous government had signed but not yet ratified a BIT with the United States, the new government renegotiated but ultimately ratified the BIT, justifying its action on the grounds that it would protect and strengthen its important export markets in the United States.
C. Economic Liberalization

A third explanation for the BIT movement is that developing countries have signed BITs as part of their efforts to liberalize their economies and thereby promote economic growth. Beginning in the late 1980s, many developing countries that had previously built their economies on state planning, state enterprises, heavy regulation of the private sector, and restricted economic interactions with other countries began to abandon those policies in favor of the neo-liberal economic model, known as the Washington Consensus. 

The Washington Consensus looks to markets rather than state plans to allocate resources, to the private sector rather than state corporations as the primary engines of economic activity, to deregulation of their economies, and to openness to international economic transactions, including direct foreign investment. Developing countries have viewed BITs as one instrument among many others to achieve a more liberal economy.

Some developed countries, the United States in particular, also saw BITs as a means to facilitate liberalization of the economies of developing countries. Thus, they have sought to encourage or induce investment and market liberalization within their negotiating partners. In their view, BITs will have the effect of liberalizing the developing country's economy as a whole by facilitating the entry of a treaty partners' investments and creating conditions favoring their operations. As developing countries have reformed their economies to foster private enterprise, favorable conditions for foreign investment have been seen as very important part of that process. Although the goal of investment and market liberalization is not specifically stated in the BITs themselves, that goal has clearly been in the minds of developed country negotiators and is sometimes reflected in background documents.

22. Id.
23. The Deputy U.S. Trade Representative stated U.S. goals in negotiating BITs as follows:

The BIT program's basic aims are to: 1) protect U.S. investment abroad in those countries where U.S. investors' rights are not protected through existing agreements; 2) encourage adoption in foreign countries of market-oriented domestic policies that treat private investment fairly; and 3) support the development of international law standards consistent with these objectives.

D. Domestic Investment Encouragement

Closely related to the objective of economic liberalization is the goal of encouraging domestic entrepreneurs, who might be skeptical of their government’s intentions toward private capital, to undertake productive investments. A BIT therefore serves as a signaling device to the domestic private sector that the government’s intentions toward private capital, both foreign and domestic, are benign because of the international commitment it has made in BITs to protect the capital of foreigners.

E. Improved Governance and A Strengthened Rule of Law

Finally, a fifth explanation of the BIT puzzle is that developing countries have signed BITs to remedy the deficiencies in their own governance institutions and in their own enforcement of the rule of law. BITs thus become international substitutes for domestic institutions.25 The basis of this explanation is that developing country authorities and institutions that by virtue of a BIT have prevented themselves from acting in arbitrary and abusive fashion toward foreign investors will also be led to avoid arbitrary and abusive actions toward their own nationals and that over time those authorities and institutions will experience improved governance and a heightened respect for the rule of law. Thus, as the Minister of Finance of Uruguay explained in a private conversation at the time his country ratified its BIT with the United States, “We are not signing this treaty for them [the United States], we are signing it for us.”26

IV. SOLVING THE BIT PUZZLE

Given the diversity of their political and economic situations, individual developing countries among the 170 BIT signatories have no doubt done so for one or more of the reasons advanced above. Some countries have probably been more influenced by some goals than others. While individual scholars have imputed one reason or another to explain developing countries’ participation in the BIT movement, they have usually done so without undertaking specific empirical research into the particular motives that drove individual developing countries to sign particular BITs.

As important as their original reasons for entering into BITs is whether or not developing countries have in fact achieved the goals they were seeking. Evidence demonstrating that investment treaties have in fact achieved any or all of the above five goals is not overwhelmingly convincing and has been the subject of much debate. Various studies have concluded that BITs with some developed countries but not others do result
in increased capital flows, that BITs as a whole do not result in increased investment flows, that they have had only a very limited impact on economic liberalization, and that they may actually have led to reductions in governance quality.

Opponents of the BITs have not only argued that developing countries have not attained the benefits they sought, they also contend that the costs to developing countries have been too high. Those costs lie primarily in the restrictions on actions that governments often feel a need to take to protect and strengthen their countries' environmental, labor, and other standards necessary to improve the lives of their populations. Those governments that have taken such actions affecting investor interests have found themselves involved in expensive investor-state arbitrations in growing numbers.

Despite its increasing prevalence, the uniqueness and power of investor-state arbitration should not be overlooked. For one thing, investor-state arbitrations are not simple commercial disputes that affect only the parties immediately involved. Since most investor-state arbitrations are judging the legality of governmental actions, they have significant public policy consequences relating to the ability of sovereign governments to regulate enterprises within their territories. Moreover, there are few instances in international law where a private party may compel a sovereign state to defend the legality of that state's actions in an international forum and, if it fails to defend itself successfully, pay substantial damages for the injury caused to the private party by such action.

Determining whether developing countries have actually attained at a reasonable cost the goals they sought in signing BITs is not a purely academic matter. For any treaty system to be sustainable over the long term, the parties to it must remain convinced that they are achieving the benefits they originally sought and that those benefits outweigh their costs. Based on their interpretation of available evidence, critics of the BIT movement have questioned the wisdom of the treatification process of international investment law and have argued that it needs to be slowed,
if not reversed.\textsuperscript{32} If host countries come to believe that they have not obtained the intended benefits, they may seek to weaken the treaties' ability to resist the demands of the life or to abandon them all together. BITs themselves may become obsolescing bargains.

V. THE CONSEQUENCES AND CHALLENGES OF TREATIFICATION: INVESTMENT REGIME CREATION AND ITS FUTURE

The nature and sources of international investment law have undergone a significant transformation in a relatively short time. The creation of an increasingly dense network of international investment treaties therefore represents an important milestone in the evolution of international economic law.

One important consequence of treatification is that it has increased the importance of international investment law in the economic relations among states to levels that it never enjoyed before. Prior to treatification, international investment law was basically an arcane subject that interested only a few academic international lawyers. It had little practical effect. Today, it has become of immense practical concern to a much wider audience, including the practicing bar, environmentalists, nongovernmental organizations, multinational companies, and governments, both industrialized and developing, who sometimes question the consequences of what they have created over the last four decades. As a result, unlike the situation that prevailed thirty years ago, government officials, international executives, lawyers, and financiers increasingly must take investment treaties into account in planning, negotiating, undertaking, and managing international investment transactions.

Perhaps of greater importance from the perspective of international relations, the process of treatification of international investment law has also resulted in the creation of an emerging global regime for international investment. An international regime has been defined as "principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations."\textsuperscript{33} International "[r]egimes constrain and regularize the behavior participants, affect which issues among protagonists move on and off the agendas, determine which activities are legitimized or condemned, and influence

\begin{itemize}
\item \textsuperscript{32} The International Institute for Sustainable Development has been particularly active in studying the impact of investment treaties on environmental and development problems. \textit{See, e.g.}, Konrad von Moltke, \textit{A Model International Investment Agreement for the Promotion of Sustainable Development}, \textit{International Institute for Sustainable Development} (2004), http://www.iisd.org/pdf/2004/trade_model_inv.pdf.
\item \textsuperscript{33} Stephen D. Krasner, \textit{Structural Causes and Regime Consequences: Regimes as Intervening Variables}, \textit{in International Regimes} 1, 2 (Stephen D. Krasner ed., 1983).
\end{itemize}
whether, when, and how conflicts are resolved." Taken together, the network of international investment treaties do all of these things.

Nations create international regimes in order to deal with problems in a manner that advances their interests. Since World War II, while the nations of the world have been building a global investment regime, they have also been hard at work in developing an international trade regime, primarily through the General Agreement on Tariffs and Trade and since 1995 the World Trade Organization. Whereas the international trade regime has been developed on a multilateral basis through a succession of multilateral negotiating rounds, the investment regime has been built on a bilateral basis as numerous pairs of countries have negotiated similar rules and enforcement mechanisms that apply to their nationals in each others' territory. An interesting theoretical question that is beyond the scope of this article is why the nations of the world chose a multilateral negotiating approach to trade but a bilateral approach to international investment with respect to regime creation and what the differing consequences of the two approaches are for the effectiveness and durability of the two regimes.

The treatification of international investment law represents an important stage in the development of international investment law. Having passed one crossroads on a journey, the evolution of international investment faces other challenges on the road ahead. At this point, one can identify at least five:

1. For the reasons discussed above, international investment treaties have come under increasing criticism from developing country governments, the international environmental community, and other elements of civil society. In the face of that criticism of treatification's constraints on national sovereignty, what steps can be taken to sustain and strengthen the bargain that under-girds the international investment treaty system?

2. Developing country governments have been subject in increasing numbers to investor-state arbitrations. In view of the costs of that process and the perceived limitations it places on national sovereignty, to what extent will host countries continue to accept the prevailing system of investor-state arbitration as a way of resolving the conflicts between life and form and what measures need to be adopted to preserve continued acceptance?

3. Since the beginning of the BIT movement, scholars have debated the extent that BITs constitute customary international law with respect to foreign investment. One argument is that BITs "establish and accept and thus enlarge the force of traditional concep-

tions” of the law of state responsibility for foreign investment.\textsuperscript{35} Others have countered that, despite their prevalence, BITs are \textit{lex specialis}, and have effect only between the parties to the BIT.\textsuperscript{36} According to this view, BIT provisions are not sufficiently uniform to establish customs accepted by the international community. Two recent arbitration awards have taken the view that BITs do indeed constitute or at least contribute to international customs.\textsuperscript{37} A question for the future evolution of international investment law therefore is to what extent have the principles and concepts of international investment treaties, because of their number, come to constitute international custom? If they have, the process of creating an international law of investment has seemingly evolved from a situation where the absence of appropriate custom prompted the creation of over 2,400 BITs, which in turn has led to the creation of custom.

4. The notion that the principles embodied in BITs could represent general principles of law\textsuperscript{38} and thus constitute a source of international law has not received extensive consideration by scholars. But as BITs proliferate, more and more countries incorporate BITs into their domestic legal systems. Thus, there is scope for arguing that BITs manifest certain concepts on the treatment of investors and investments that represent general principles of law. The argument is strengthened to the extent that individual countries have adopted foreign investment codes and laws that embody and amplify the rights accorded to investors in the BITs that host countries have signed.\textsuperscript{39} To what extent have investment treaty principles, by virtue of being incorporated into domestic legal systems, come to constitute general principles of law and thereby a source of international law?

5. The dramatic struggle of life against form that Karl Llewellyn saw as fundamental to the role of contract in the social order is played out in the foreign investment context as a struggle between the property rights of the investor and the right of the host government to regulate enterprises operating on its territory. The boundary between property rights and the right to regulate is not clear and will almost certainly be the subject of negotiations and arbitral proceedings in the years ahead. Thus the fifth and final challenge for


\textsuperscript{38} See Mann, supra note 35, at 249.

\textsuperscript{39} See Jeswald W. Salacuse, \textit{Direct Foreign Investment and the Law in Developing Countries}, 15 ICSID Rev.-Foreign Inv. L.J. 382, 382-400 (2000).
international investment law is to find ways to resolve the continuing conflict between the legal form imposed by investment treaties and host government’s legitimate right to regulate in response to the demands of life. After considerable struggle, the members of the World Trade Organization meeting at Doha in November 2001 agreed to include the subject of foreign investment on the agenda of its next round of trade talks, known commonly as the Doha Round. With respect to investment, the work plan for the round approved at the Ministerial meeting in November 2001 recognizes “the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade.” The general mandate for the negotiators, emphasizing other goals, is as follows: “Any framework should reflect in a balanced manner the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest.” World Trade Organization, Ministerial Declaration of 14 November 2001, WT/Min(01)/DEC/1, 41 I.L.M. 746, ¶ 20, 22 (2002).