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Reforming the International Investment Law System

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I. INTRODUCTION

Free trade and trade agreements have a perception problem these days: critics say they are designed for the benefit of big corporations, and that trade's negative impact on ordinary people is ignored.[1] For the most part, this perception is false. When tariffs and other protectionist trade barriers come down, companies are forced to compete. There are winners and losers in the corporate world from this competition, but the biggest winners are consumers.[2] It is ordinary people who experience the most significant economic gains from free trade.[3]

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1. *See, e.g.*, Mark Weisbrot, *Tricks of Free Trade*, SIERRA MAG., http://www.sierraclub.org/sierra/200109/weisbrot_printable.asp ("We give up our jobs and environmental safeguards for the greater glory of transnational corporations.").

2. As a leading economics textbook puts it: "[W]hen trade has opened up, and when each country concentrates on its area of comparative advantage, everyone is better off. . . When borders are opened to international trade, the national income of each and every trading country rises. . . An ill-designed tariff or quota, far from helping consumers in a country, will instead reduce their real incomes by making imports expensive and by making the whole world less productive. Countries lose from protectionism because reduced international trade eliminates the efficiency inherent in specialization and division of labor." PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 904 (13th ed. 1989).

3. *See, e.g.*, Office of the United States Trade Representative, Exec. Office of the President, *NAFTA Benefits* (October 2007), https://ustr.gov/sites/default/files/NAFTA%20Benefits.pdf.

There is one notable exception to this defense of trade agreements, however: the international investment law system, which has been incorporated into trade agreements, gives special rights to sue governments exclusively to foreign investors.[4] When you look around the world today, you see many people being treated badly by their own governments. People who are being oppressed on the basis of their religion, race or gender; people whose property has been stolen; and people who are being treated unjustly for no apparent reason at all. Do any of these ordinary people have access to enforceable international law to assert their rights against their own governments? For the most part, they do not. But foreign investors do. As a result, the criticism of trade agreements as constituting special favors for big corporations has some resonance when the investment law system is at issue.

Some might argue that even if this criticism were true, there are benefits to this system, in the form of economic welfare gains that make the system worthwhile despite any appearance of bias. In truth, such benefits have not been demonstrated.[5]

In fact, the problem the system addresses has not even been defined. What exactly is the problem that needs to be addressed by an elaborate system of investment obligations and international tribunals? It turns out we do not really have a clear answer. We are operating under assumptions from decades ago, which have not been adjusted as the world has changed.

In this paper, I offer a critique of the existing system in three parts. First, I question whether there is much of a problem with bad treatment of foreign investment by governments that needs to be addressed. If actual treatment of foreign investors is generally good, concerted international action is unnecessary. Second, I argue that the nature of capital flows today means that referring to investment as "foreign" overlooks the reality of today's interdependent economic world. Globalization has led to transnational companies that operate

4. These rights were originally found in bilateral investment treaties, but they have now spread to the investment chapters of bilateral, regional, and plurilateral trade agreements, including the North American Free Trade Agreement. North American Free Trade Agreement ch. 11, Dec. 17, 1992, 32 I.L.M. 605 (entered into force Jan. 1, 1994) [hereinafter NAFTA].

5. *See* Jason Webb Yackee, *Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?*, 42 LAW & SOC'Y REV. 805, 827–28 (2008) ("While I find some tentative evidence that privatization programs and the World Bank's investment insurance program may promote FDI, my results suggest that BITs have little or no impact on investment decisions . . .").

around the world, and are not "foreign" and "domestic" in the sense they used to be. And, third, I explore the nature of the international judicial review that the international investment law system has made available, and ask whether we have gone too far in creating international "constitutional" courts. Judicial review is well-accepted in the domestic sphere, but in the international context it is still novel and unexplored.

Finally, I consider alternative approaches to addressing any problems that do arise in relation to the treatment of investment, such as improving the domestic law protections in nations where problems exist, and encouraging private companies to take on more responsibility for their own protection. I conclude that the real issues that exist here can be dealt with in these more productive ways.

II. IS THERE A PROBLEM WITH BAD TREATMENT OF FOREIGN INVESTMENT?

If you look back at the situation of 100 years ago, or even 60 years ago, foreign investors were often treated badly. The world that existed at that time was much less democratic, with many authoritarian governments having shifting views on foreign investment, alternately encouraging it and then expropriating it.[6] In the post-colonial world of the 1950s, 1960s, and 1970s, economic nationalism was on the rise, and newly empowered developing nations began to take back what they believed was theirs.[7] In many cases, this was accomplished through expropriation of physical assets.[8] This era was a challenging one for Western multinationals who had invested in the developing world.

To deal with this situation, these companies lobbied their own governments for international treaties that would give them recourse in neutral international courts, which could handle any disputes that arose.[9] This approach appealed to the governments themselves,

6. One prominent example is the Mexican expropriation of foreign oil companies' assets. *See* Office of the Historian, U.S. Department of State, *Mexican Expropriation of Foreign Oil* (last visited Mar. 13, 2015), https://history.state.gov/milestones/1937-1945/mexican-oil/.

7. Stephen J. Kobrin, *Expropriation as an Attempt to Control Foreign Firms in LDCs: Trends from 1960-1979*, 28 INT'L STUD. Q. 329, 344 (1984).

8. *Id.*; *See al*so J. Frederick Truitt, *Expropriation of Foreign Investment: Summary of the Post World War II Experience of American and British Investors in the Less Developed Countries*, 1 J. INT'L BUS. STUD. 21, 23–30 (1970) (detailing expropriation and nationalization by sector).

9. An early effort in this regard was the 1965 Convention on the Settlement of

which did not like having to engage in the diplomacy of defending their companies' rights.[10] In the 1960s and 1970s, templates for such treaties were developed and applied, and soon proliferated. By 2012, there were nearly 3,200 agreements on foreign investment, either as free-standing treaties or chapters of trade agreements.[11]

While this process was taking place, however, attitudes towards foreign investment changed in most of the world. Economic nationalism faded and governments began to court investors. Today, a typical story about large foreign investments will note the subsidies offered by the government to attract that investment.[12]

To a great extent, then, bad treatment of foreign investment is a problem of an earlier era. While there are a small number of nations which threaten expropriation or actually expropriate foreign investors' property, the frequency of such acts is down considerably.[13] According to one economist, the number of direct expropriation acts was 136 in the 1960s and 423 in the 1970s, but has since declined to only 17 in the 1980s, 22 in the 1990s, and 27 instances in the 2000s, through 2006.[14]

In the face of this empirical data, it is not completely clear what the problem is that the investment law system seeks to address. If

Investment Disputes between States and Nationals of Other States. *See* Convention on the Settlement of Investment Disputes between States and Nationals of Other States, ch. 1, § 1, art. 1, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 ("The purpose of the Centre shall be to provide facilities for conciliation and arbitration of investment disputes between Contracting States and nationals of other Contracting States in accordance with the provisions of this Convention.") [hereinafter ICSID Convention].

10. Prior to the ICSID Convention, the traditional view was that States alone had jurisdiction to approach an international tribunal. P. F. Sutherland, *The World Bank Convention on the Settlement of Investment Disputes*, 28 INT'L & COMP. L.Q., 367, 372 (1979).

11. U.N. Conference on Trade and Development, *Investor-State Dispute Settlement: UNCTAD Series on Issues in International Investment Agreements II*, 18, U.N. Doc. UNCTAD/DIAE/IA/2013/2 (2014) [hereinafter UNCTAD].

12. As a recent example, Alabama provided $158 million in financial and logistical support to attract an Airbus manufacturing plant. Jon Ostrower, *Alabama Puts Airbus Incentives at $158 Million*, WALL ST. J., Jul. 9, 2012, http://www.wsj.com/articles/SB10001424052702304022004577516922037292712. Overall, U.S. state and local government subsidies have increased from $26.4 billion in 1996 to $46.8 billion in 2005. Emerging countries such as Brazil, China, Vietnam, and India also provide significant investment subsidies. KENNETH P. THOMAS, INVESTMENT INCENTIVES AND THE GLOBAL COMPETITION FOR CAPITAL 2 (2011).

13. *See* Christopher Hajzler, *Expropriation of Foreign Direct Investments: Sectoral Patterns from 1993 to 2006*, 148 REV. WORLD ECON. 119, 127–28 (2012).

14. *Id.*

expropriation is rare today, what exactly is the problem? And where is it a problem? This issue has simply not been studied. With no data on the nature and extent of the problems faced by foreign investors, it is hard to craft appropriate rules to address such problems. What we do know is that, a few outliers aside, direct expropriation has greatly diminished as an issue faced by investors. Beyond expropriation, investment rules also require fair and equitable treatment. But to what degree do investors face treatment that is not "fair" or "equitable"? And what kind of treatment is this exactly? These terms are so broad and vague that is hard to say with any certainty what government behavior is at issue here.[15]

Staying with the world of data, despite arguments that investment obligations help "promote" foreign investment, the evidence on this point is mixed. Examinations of the impact of such rules on investment flows are not supportive of the claimed benefits.[16] And some countries, such as Brazil, which is famously resistant to investment treaties,[17] have had no problem attracting investment.[18]

In reality, the biggest problem in the world of foreign investment may not be *bad* treatment, but treatment that is *too good* to these investors: subsidies. As noted, subsidies to attract foreign investors have proliferated.[19] If there is a problem with foreign

15. *See, e.g.*, UNCTAD, *Fair and Equitable Treatment*: *UNCTAD Series on Issues in International Investment Agreements II*, 1–12, U.N. Doc. UNCTAD/DIA/IA/2011/5 (2012) ("the vague and broad wording of the obligation carries a risk of an overreach in its application"; "The vagueness of the FET standard is at the core of the problem"; "the legal building blocks for the analysis of the international minimum standard and its role in international investment law are precarious and often incomplete, vague and contested"; "It has even been suggested that due to its extreme vagueness the FET obligation lacks legitimacy as a legal norm").

16. *See* Yackee, *supra* note 5; Jason Webb Yackee, *Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*, 51 VA. J. INT'L L. 397, 399 (2010). ("[S]cholars have not yet been able to provide anything close to a definitive answer of whether BITs indeed achieve their central purpose: increased flows of investment.").

17. *See* Zachary Elkins et al., *Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960–2000*, 2008 U. ILL. L. REV. 265, 269 n.19 (2008) ("Brazil did not sign a BIT until 1994, and none of its ten bilateral agreements had entered into force as of the late 1990s.").

18. Brazil is ranked number twelve worldwide in "stock of direct foreign investment – at home." Cent. Intelligence Agency, *The World Factbook*, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2198rank.html?countryname=Brazil&countrycode=br&regionCode=soa&rank=12#br.

19. *See* Kenneth Thomas, Commentary, *Investment Incentives and the Global Competition for Capital*, COLUMBIA FDI PERSPECTIVES, No. 54, Dec. 30, 2011, *available at* http://ccsi.columbia.edu/files/2014/01/FDI_54.pdf ("Investment

investment that needs to be addressed, it is this one. When governments use subsidies to compete for investment, no new investment is created. The only impact is to shift investment around from location to location, in a way that benefits the large corporations who receive these subsidies.

III. IN A GLOBALIZED WORLD, WHAT IS "FOREIGN" INVESTMENT?

A hundred years ago, the global economy could much more easily be divided along national lines. Many companies had a clear nationality, and when they invested their money abroad, they maintained that nationality to a great extent.[20] Foreign investment typically meant big Western companies investing in developing countries, often in the natural resource sector (and this is where problems with bad treatment typically arose).[21]

The modern economy looks different from this older period. Today's foreign investment flows in much more varied ways. It is not just Western companies investing in the developing world. It is a wide range of companies of many nationalities, investing all over the world and creating global supply chains and operations.[22] Companies might have their headquarters in one country, develop technology in another, raise capital around the world, and produce their goods in multiple countries. And the nationality of the owners might not match up with any of these countries.

In this light, the notions of "foreign" and "domestic" investment have much less meaning than they once did. It is thus misleading to think about investors as having a particular nationality, e.g., as "American" or "Korean" or "Mexican." While particular companies

incentives (subsidies designed to affect the location of investment) are a pervasive feature of global competition for foreign direct investment (FDI). They are used by the vast majority of countries, at multiple levels of government, in a broad range of industries.").

20. For example, the United Fruit Company (Chiquita) or the American Sugar Refining Company (Domino), which operated in the Caribbean and Latin America. *See* Marcelo Bucheli, *Multinational Corporations, Totalitarian Regimes and Economic Nationalism: United Fruit Company in Central America, 1899-1975*, 50 BUS. HISTORY 433, 434 (2008) (discussing the relationship between multinational corporations and dictators in Central America).

21. *Id.* at 437.

22. Ford Motor Co., *Form 10-K* (last visited Mar. 13, 2015), http://corporate.ford.com/doc/sr13-form-10-k.pdf [hereinafter Ford Motor Co.]; Toyota Motor Corp., *Form 20-F* (last visited Mar. 13, 2015), http://www.toyota-global.com/investors/ir_library/sec/pdf/20-F_201403_final.pdf [hereinafter Toyota Motor Corp.].

may have a majority of shareholders who are citizens of a given country, or may have their headquarters in a particular jurisdiction, transnational corporations are fundamentally "citizens of the world." Their owners can and do move production and other operations to wherever they perceive to be the best location.

To take some examples from the auto industry, in the practice of U.S. trade and investment policy, Ford is considered an "American" company, and the U.S. government often negotiates on its behalf in trade and investment agreements.[23] But does it make sense to think of Ford this way? Total U.S. employment for Ford in the manufacturing sector is about 43,000, but Ford employs more than 145,000 people worldwide in 55 different production facilities.[24] Along the same lines, Toyota is thought of a "Japanese" company. While there are over 140,000 employees in Japan, Toyota has overseas employment of close to 200,000. It has factories in North America, Latin America, Europe, Africa, Asia, Australia, and the Middle East.[25]

Clearly, both of these companies operate globally and are not purely "American" or "Japanese." The question thus arises: should the historical origin of a corporation or the nationality of its shareholders really play such a decisive role in the legal treatment of these corporations under international investment law? Why should the U.S. government push for protections for Ford abroad but not Toyota abroad? The nationality-based approach to the protections offered under these treaties does not reflect the way many companies operate in today's investment world.

To take an example from recent headlines, Burger King recently merged with the Canadian donut company Tim Horton's and, in the process, became part of a parent company based in Canada.[26] Now that Burger King has become an investment of a "Canadian" corporation (i.e., the parent company), can it sue the U.S. government under the NAFTA investment rules[27] if a future Mayor Bloomberg were to mandate size limits on donuts because of health concerns?

23. *See, e.g.*, CONGRESSIONAL RESEARCH SERVICE, THE U.S.-SOUTH KOREA FREE TRADE AGREEMENT (KORUS FTA): PROVISIONS AND IMPLEMENTATION 3 n.3 (Sept. 16, 2014) (discussing an automotive trade commitment reached by the U.S. and South Korea that was a priority for the Ford Motor Co.).

24. Ford Motor Co., *supra* note 22.

25. Toyota Motor Corp., *supra* note 22.

26. Liz Hoffman & Dana Mattioli, *Burger King in Talks to Buy Tim Hortons in Canada Tax Deal*, WALL ST. J., Aug. 25, 2014, http://www.wsj.com/articles/burger-king-in-talks-to-buy-tim-hortons-1408924294.

27. NAFTA, *supra* note 4, art. 1116.

This example shows that the formal nationality of companies has become increasingly arbitrary over the years and does not serve as a good basis for imposing investment obligations on governments.

IV. WHAT SCOPE FOR INTERNATIONAL JUDICIAL REVIEW?

International investment obligations provide for the judicial review of domestic laws, regulation, and other government measures. This proposition is controversial,[28] because it allows international courts to interfere with democratic decision-making. However, the extent of the controversy depends on the scope of the obligations. Such obligations can be narrowly drawn to target specific kinds of actions, such as protection of domestic industries. Or they can be more wide-ranging and open-ended, along the lines of rights-based judicial review as seen in the domestic constitutional law context.[29] I argue in this section that a focus on non-discrimination can be politically workable, but more expansive obligations such as "fair and equitable" treatment are not appropriate.

Non-discrimination is at the core of international economic relations.[30] It includes both national treatment, which means not discriminating *against* foreign goods, services, or capital; and most favored nation treatment, which means not discriminating *among* goods, services, or capital of different nations. Such a rule promotes good international relations and good economics; without a non-discrimination norm, protectionist measures can proliferate and economic alliances can stand in the way of peaceful trade relations.

A non-discrimination rule is narrow and bounded. Under such an obligation, a government can regulate however it likes, and based on whatever policy it chooses, as long as the measure is non-discriminatory. For example, a government could require that automobiles have a certain level of fuel efficiency, but it could not impose harsher requirements on foreign-made cars than domestic-

28. One need only look at the Australian plain packaging complaint to see the depth of the strong feelings about this issue. Cigarette maker Philip Morris International has challenged an Australian law that requires cigarette producers to sell cigarettes in plain packaging. *See* Rebecca Thurlow, *Australian Cigarette-Packaging Curbs Prompt Suit*, WALL ST. J., Nov 21, 2011, http://www.wsj.com/articles/SB10001424052970204434045770513613551548 68.

29. The fair and equitable treatment and expropriation provisions fall into this category.

30. JOHN H. JACKSON ET. AL., LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 537 (5th ed. 2008).

made ones.

By contrast, international obligations relating to subjects such as direct expropriation, indirect expropriation, and "fair and equitable treatment" are much broader. They all have parallels in domestic constitutional and administrative law, and, at least in theory, offer a form of these protections as international law. That causes a much broader intrusion into domestic, democratic decision-making, and is the source of much of the criticism of the investment law system.

"Fair and equitable" treatment in particular has been the subject of much criticism in the context of the investment system.[31] Concerns about its scope have led governments to try to put boundaries on it.[32] However, these attempts do not show much promise. A recent effort by the European Union and Canada as part of the Comprehensive Economic and Trade Agreement (CETA) leaves us with obligations that still look quite broad and undefined. The CETA includes "manifest arbitrariness" and "fundamental breach of due process" as examples of such treatment.[33] Unfortunately, such terms raise more questions about the scope of the obligations than they answer. What exactly are the limits of these obligations? What types of government actions might violate them? No doubt creative lawyers are already thinking about the possibilities, even before the CETA is signed.

International judicial review is not objectionable in and of itself, of course. Specific proposals for such review should be considered on their merits. But the nature of the obligations, the parties which have access to legal recourse under them, and how and by what means they are enforced, needs to be considered carefully as part of the debate over the scope and nature of the international legal system. Having open-ended provisions that are available only to foreign investors contributes to the perception that international economic

31. UNCTAD, *supra* note 15.

32. One example is the NAFTA parties' attempt to clarify the minimum standard of treatment in 2001. *See* International Institute For Sustainable Development, *Note on NAFTA Commission's July 31, 2001, Initiative to Clarify Chapter 11 Investment Provisions*, (last visited Mar. 13, 2015), http://www.iisd.org/pdf/2001/trade_nafta_aug2001.pdf ("This broad interpretation of minimum standards of treatment—essentially giving firms the right to litigate any international law obligation—has not been seen outside [o]f the NAFTA context. The statement puts an end to this. It brings us back to an interpretation . . .that corresponds to customary international law . . . .").

33. Comprehensive Economic and Trade Agreement, Can.-E.U., art. X.9, Oct. 18, 2013, Consolidated CETA Text, http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.

law is a corporate handout, with ordinary people ignored.[34]

V. CONCLUSION: ALTERNATIVE WAYS FORWARD

To a great extent, we have been stuck in the same debate for decades: do investment obligations, as currently written, promote and protect foreign investment, as supporters say? Or do they give corporations special rights and undermine the state's sovereign regulatory and legislative powers, as critics allege? It would be helpful to step outside this all or nothing dichotomy and think critically about some of the more specific issues that arise in this context.

First, it would be a great idea for investment generally, both foreign and domestic, if we could elevate property rights and discourage expropriation. Unfortunately, current efforts in the international arena are weak and isolated. These rights are only provided to a limited group (that is, to foreign investors) and under an uncertain and unpredictable quasi-judicial framework. If we want property rights to be taken seriously, we need to promote them as a matter of domestic law, rather than offer an ad hoc system only to foreign investors. A treaty could help in this regard, if it established global minimum standards and required their adoption in domestic

34. Even domestic investors do not have the protections given to their foreign counterparts. The Economist recently reported on a Chinese hotel owner whose property was taken by local Chinese government authorities:

> Mr Qiao says he was abducted and held for 13 hours last December as the building was demolished by what he describes as a network of corrupt officials and developers. All of its contents were lost.
>
> Mr Qiao's story is far from unique. Since the mid-1990s, tens of millions of Chinese have lost their land. In many cases, only minimal compensation has been offered. Researchers believe that, of thousands of "mass incidents" of rural unrest occurring each year, the majority are about land. In one of the worst recent cases, nine people were killed in mid-October in Yunnan province in the south-west in a dispute over evictions.
>
> In their campaign for redress, Mr Qiao and his son have been stymied at every turn. Local police did not respond when thugs broke the Qiaos' windows. The electricity bureau did nothing when power to his building was cut. Planning officials scoffed at his request for adequate compensation for the loss of his business. The Qiaos informally approached a local court to assess their chances of suing the government successfully. They were given a brush-off.

"*The Law at Work: No More Rooms*," ECONOMIST, Nov. 1, 2014, http://www.economist.com/news/china/21629538-against-network-officials-and-thugs-law-no-shield-no-more-rooms.

law. For example, a treaty could set out guidelines for how and when governments should provide compensation for expropriation. Such an approach has the benefit of helping not just foreign investors, but domestic ones as well. Canada is famous for having weak protections against expropriation.[35] The solution to this problem, however, is not to grant protections to foreign investors through investment and trade agreements. Rather, it is to give such protections to *all* investors through changes in Canadian law. In this way, trade agreements would be seen as about protection of rights for everyone, including ordinary people, rather than just the rich and well-connected.

Second, foreign investors need to take responsibility for their business decisions. There is risk in any investment; there is more risk when investing in some countries than in others. Companies have a responsibility to know this and plan for it, and, in fact, it is not hard to do so. Companies that make foreign investments can buy political risk insurance; and they can demand arbitration clauses in any foreign investment contracts they sign with host governments. This approach addresses the problem without creating an overbroad international constitutional system.

Third, with respect to that international constitutional system, we need to think critically about the distinctions between different possible international legal obligations in international economic agreements. It is one thing to say that governments should promise not to discriminate against each other's foreign investments. The benefits are clear, and the scope is limited. It is quite another, however, to create a general "due process" type obligation for governments, such as "fair and equitable" treatment, that is overseen

35. *See* Mark Milke, *Stealth Confiscation: Property Takings via Regulation*, FRASER FORUM, May/June 2012, at 22, www.fraserinstitute.org/uploadedFiles/fraser-ca/Content/research-news/research/articles/stealth-confiscation-property-takings-via-regulations-ff.pdf ("Canada fares poorly in the protection of all sorts of property rights protection including, and especially in, the case of regulatory takings."); Bryan P. Schwartz & Melanie R. Bueckert, *Regulatory Takings in Canada*, 5 WASH. U. GLOBAL STUD. L. REV. 477, 491 (2006) ("The conclusion is clear: property rights are minimally protected under the Canadian Constitution. Moreover, quasi-constitutional documents such as the Canadian Bill of Rights and the Quebec Charter offer minimal protection. As a result, Canadian courts have no solid grounds to begin to develop an aggressive 'regulatory takings' doctrine. On the contrary, constitutional legal developments have signaled that the protection of property rights is ultimately left to democratically elected legislatures. Local legislators that fail to work to protect property rights are likely to lose confidence among their constituents and to lose the business of potential foreign investors. However, judges will not find protections of property rights where none are explicitly provided for.").

by international courts. Such a rule is exceedingly broad in terms of the power it shifts from the national to the international, and deserves more debate than it has seen so far.

The international investment law system is at a cross-roads, with major debates taking place in the context of the Trans Pacific Partnership and the Transatlantic Trade and Investment Partnership. These debates will help shape the future of the system and present a great opportunity to create a system that matches up with the real foreign investment issues of today.