Protecting Foreign Investors

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Bilateral investment treaties (BITs) are among the better kept secrets of the internal economic regime in the recent past. Increasingly, other international agreements signed by governments are subject to much discussion and public debate both at the negotiation stage and during implementation. In India, for example, we are now much more concerned about the positions taken by government negotiators at the WTO, and there is active debate about the various clauses in the agreements.

Yet BITs, which have been expanding dramatically both in number and in coverage and protection provided to investors, remain largely outside the domain of public discussion. The Indian government has signed more than fifty such treaties, yet these are hardly known, and the precise contents of such treaties are not disseminated or discussed at all, even though they can have all sorts of implications and also carry a number of dangers which are only now becoming obvious in several countries.

BITs are agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each other's territories by companies based in either country. In addition to providing for basic rights of admission and establishment, such treaties typically cover issues which are various forms of protection to foreign investors, such as compensation in the event of expropriation, war and civil unrest or other damage to the investment and guarantees of free transfers of funds and the recuperation of capital gains.

In addition, there are usually specified dispute settlement mechanisms, both for state vs. state and investor vs. state. In fact, the experience so far is mainly with investor-state disputes, since multinational companies have been more than willing to use the provisions of such treaties to extract concessions or compensation for public actions.

Thus, the main provisions of such treaties tend to be broadly similar to those in the abandoned OECD Multilateral Agreement on Investment (MAI), and sometimes they are even more stringent. This is of special significance given the previous failure to impose investment rules in the WTO, and the persistence of hopes for the renewal of this issue. There is no doubt that once a substantial number of countries have signed or accepted even more sweeping provisions with respect to investment in bilateral or regional deals, they will find it much harder to resist MAI-type agreements at the WTO, and may even prefer a situation in which they are all in the same adverse situation together, rather than being individually "picked out".

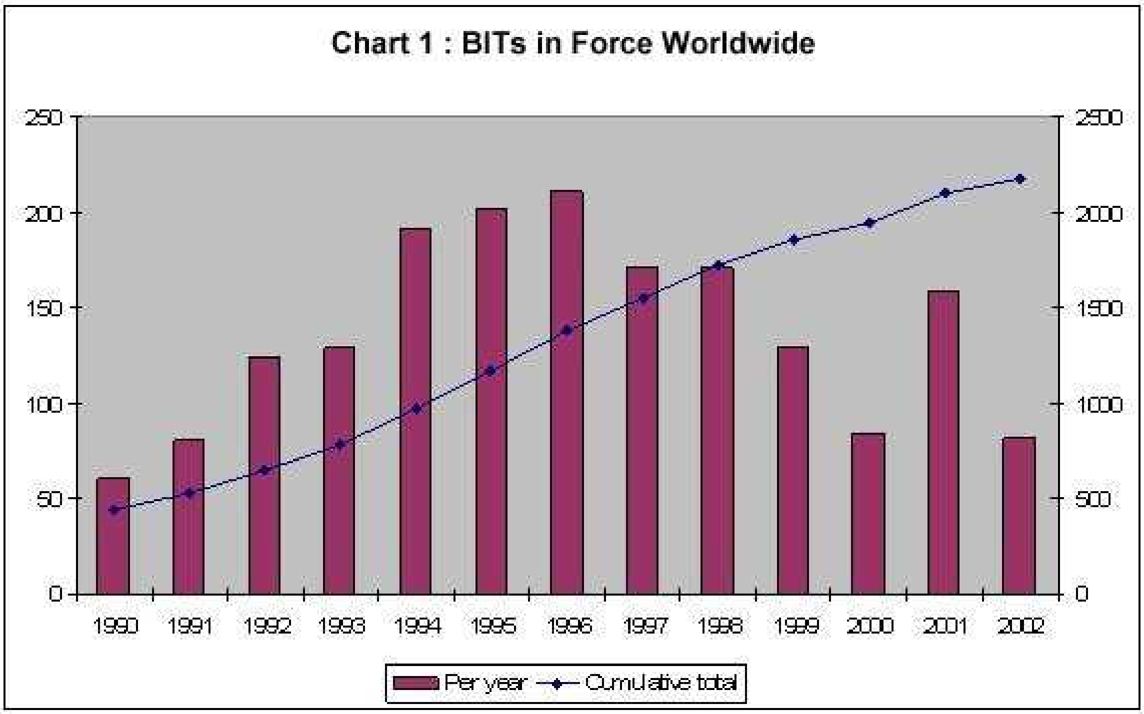
Earlier, NAFTA was widely believed to be the most stringent application of such investment rules. Chapter 11, NAFTA's powerful investment chapter, provides foreign corporations with rights to sue governments for enacting public policies or laws which they claim to affect their profitability. There is no provision for exception even for such goals as safeguarding the environment, protecting the health and safety of citizens, supporting small businesses or maintaining and increasing employment.

Under the investor rights guaranteed in the agreement, investors are allowed to demand compensation for "indirect expropriation". This has been interpreted to include any government act, including those directed at public health and the environment, which can diminish the value of a foreign investment. These cases are adjudicated by special tribunals, bypassing the legal system of all three member countries. Already, suits with claims amounting to more than $13 billion have been filed by large companies. In a typical case in 2000, the Mexican government was ordered to pay nearly $17 million to a California firm that was denied a permit from a Mexican municipality to operate a hazardous waste treatment facility in an environmentally sensitive location.

However, while the regional agreements such as NAFTA have received some amount of adverse publicity, the numerous BITs that have been signed have been subject to very little public scrutiny, even though they can go much further. The first BIT was signed between Germany and Pakistan in

1959, but they did not really become important until the 1990s. Over 400 wide-ranging bilateral treaties were signed before 1995, but thereafter there has been an upsurge of such treaties.

The number of BITs increased by five times in the 1990s from 385 in 1989 to 1,857 at the end of 1999. By 2004 there were estimated to be 2,365 BITs in operation. (UNCTAD) They cover 176 countries, mostly in the developing world and Eastern and Central Europe, and cover around one-fourth of the stock of FDI in developing countries.



The purpose of BITs is usually to provide amore stable and secure environment for foreign investors, and thereby to ensure "investor confidence". The security and guarantees provided by a BIT are seen as essential to encourage the inflow of supposedly much-needed foreign investment to developing countries. Most developing country governments are constantly told that foreign investors need such assurances before they can be persuaded to enter into potentially unknown or risky markets.

However, there is little evidence that signing a BIT actually does contribute to more FDI in developing countries. Even the World Bank admits that "empirical studies have not found a strong link between the conclusion of a BIT and subsequent investment inflows". (World Development Report 2005) In fact, countries without too many BITs (such as China) have been far more successful in attracting FDI from home countries that have signed BITs with other developing countries.

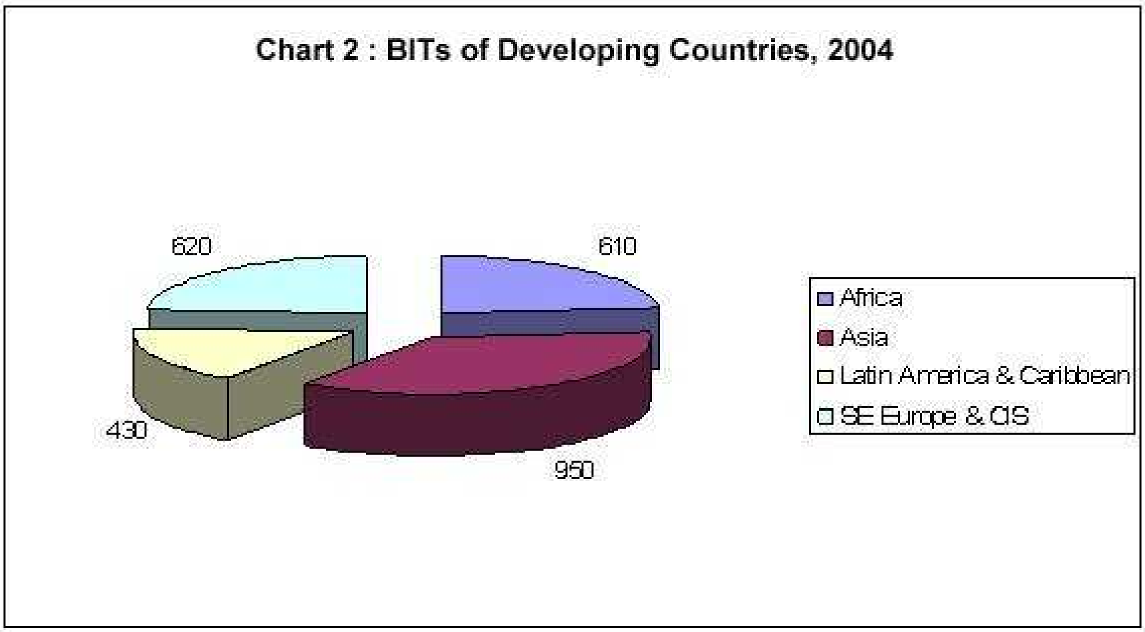


Table 1: Number of Bilateral Investment Treaties in 2002

Region	Number of BITs	Countries	Average Bits per Country
Developed Countries	1170	26	45
Developing Countireis	1745	150	12
Africa	533	53	10
Latin America and the Caribbean	413	40	10
Asia and the Pacific	1003	57	18
Central and the Eastern Europe	716	19	38

Instead, BITs have far-reaching and typically negative implications for host country governments and citizens, because of the sweeping protections afforded to investors at the cost of domestic socio-economic rights and environmental standards. A common concern about investment agreements is that they subject countries to the risk of litigation by corporations from or based in another country which is a signatory to the same agreement. This might be based on a company's objections to the host government's environmental, health, social or economic policies, if these are seen to interfere with the company's "right" to profit.

These adverse effects are already becoming evident in the increasing litigation which is facing developing country governments who seek to safeguard citizens' rights. For example, the multinational infrastructure company Bechtel (which also deals in water supply services) successfully currently sued the Bolivian government under a 1992 Holland-Bolivia BIT for loss of profits after the government's reversal of a disastrous water privatisation in Cochabamba municipality following a popular uprising in the area.

A number of other developing or formerly socialist countries are facing such disputes brought by multinational companies, ranging from Pakistan to the Czech Republic. The most striking recent examples of the adverse effects of BITs for the host country come from post-crisis Argentina.

The World Investment Report 2005 describes how the privatisation of public utilities in the early 1990s, combined with the 54 BITs that the Argentine government signed over the 1990s, had unforeseen adverse consequences after the sharp devaluation of the peso during the 2002 financial crisis. The trebling of the value of the dollar in local currency forced the government to transform all dollar-denominated contracts into peso-denominated contracts, including those signed with the utility forms that were now owned and controlled by multinational companies. In addition, the periodic adjustment of tariffs based on foreign inflation indices were also eliminated.

This has led to a spate of disputes instigated by foreign investors - as many as 37 such cases have been filed with World Bank's private arbitration body for investment disputes, the International Centre for Settlement of Investment Disputes (ICSID) since 2002. The first award of the ICSID tribunal, on 12 May 2005, ordered Argentina to pay $133.5 million plus interest in compensation to the US-based multinational CMS on grounds of violation of the BIT between Argentina and the US. ICSID rejected the Argentine government's plea that these were emergency measures based on the necessity created by the dire financial, economic and social crisis in the country.

It should be noted that the resolution of such conflicts is not subject to the standard juridical systems of the member countries - rather it is governed by tribunals or similar bodies specified in the treaty. This amounts to the privatisation of commercial justice, with no democratic accountability of the decision makers in this regard. In many bilateral agreements, the provisions state that where a dispute cannot be settled amicably and procedures for settlement have not been agreed within a specified period, the dispute can be referred to another body.

The two most important such bodies are the World Bank's private arbitration body for investment disputes, the International Centre for Settlement of Investment Disputes (ICSID) or the UN Commission on International Trade Law (UNCITRAL). Under NAFTA, complainants (usually the dissatisfied investors) are allowed to choose between these two bodies.

Domestic courts and national legal systems are completely marginalised by investors' recourse to these international arbitration panels. ICSID and UNCITRAL only allow for the investor and government parties to the dispute to have legal standing. The public has no right to listen to proceedings or to view evidence and submissions. Both bodies require only minimal disclosure of the names of the parties and a brief indication of the subject matter, which prevents public scrutiny or popular opposition. These bodies are thus given the responsibility to adjudicate virtually all investment disputes without democratic structures or transparency, despite the fact that they are not serving private goals but an international judicial function governed by treaty and international law.

These two arbitration bodies have developed rules for both conciliation and arbitration that are based completely on legal systems of the north, especially the US, and ignore much of the world's wealth of experience in settling disputes, such as Asian rules of arbitration. The record of these bodies thus far has been very investor-friendly, in awarding substantial damages and compensation to multinational corporations for "transgressions" of developing country governments.

Under these conditions, there is clearly little incentive or need for international investors to settle disputes amicably, given the highly favourable outcomes for corporations which have initiated proceedings under such agreements. So BITs have become potent weapons of multinational companies against not only governments but also the societies of countries that have signed these treaties.

Clearly, in this context, it is critical for civil society across the developing world to demand that the signing of BITs be subject to public scrutiny, and that the proceedings disputes arising from BITs be open and publicly accessible for the common good.