The Role and Implications of Bilateral Investment Treaties

By Dr A Rohan Perera, Legal Adviser, Ministry of Foreign Affairs, Sri Lanka, being a Paper presented at a sub-regional workshop for South Asia on "Recent Developments in International Investment Agreements", held in Colombo, Sri Lanka, on 15 and 16 December 1999 under the auspices of UNCTAD

Introduction

The Bilateral Investment Treaty (BIT) creates the legal environment for the promotion and protection of foreign investment. The primary objective of the BIT is to generate investor confidence that the regulatory framework which exists within the host state guarantees the element of stability and predictability, which from the investor's point of view are essential pre-requisites to prudent investment. These treaties also recognise the right of the host state to approve and admit foreign capital into their territory and to channel such investment in a manner that contributes to the economic growth and development of the host state. In other words, the role of the BIT is to function as an instrument which strikes a balance between the interest of the investor seeking protection of the investment from arbitrary legislative or administrative action of the host state and the interest of the host state in the creation of favourable conditions for the flow of foreign investment into its territory in a manner which accords with the development priorities and objectives of that state.

The principal pillars of the bilateral investment treaty regime, which collectively contribute to a stable investment climate are the clauses dealing with

(i) The guarantee of full protection and security for foreign investment;
(ii) The grant of most-favoured-nation and national treatment;
(iii) Prohibition against nationalisation and expropriation of a foreign investment; except on the limited ground of a "public purpose" and against the payment of "prompt, adequate and effective" compensation;
(iv) Right of an investor to freely transfer capital and returns;
(v) Compensation for losses suffered owing to war or other armed conflict;
(vi) Right of subrogation in respect of the claims of an investor; and
(vii) Binding international dispute settlement procedures.

Regional Initiatives in South Asia

From the regional perspective, one of the early initiatives at formulating a multilateral legal instrument to regulate the investor-host country relationship, paying particular attention to the issue of encouraging the flow of investments from one developing country to another, was the initiative taken by the Asian–African Legal Consultative Committee (AALCC) at its annual session in Colombo in 1981, at a time when Sri Lanka herself had commenced the negotiation of bilateral investment treaties, in the aftermath of the liberalisation of its economy. The AALCC initiative resulted in the formulation of a draft model investment protection for consideration by the member governments, for purposes of BIT negotiations.

An issue that was addressed during the AALCC study was the question whether investments, made by one developing country in another, should receive some kind of special or preferential treatment in order to promote regional cooperation, as also to ensure greater flow of investment from one developing country to another, in the context of South–South cooperation. The study acknowledged that some difficulties would arise by the fact that a number of Asian/African states have concluded BITs with the capital-exporting industrialised countries which contain the Most Favoured Nation (MFN) clause, which constitutes a cornerstone of any BIT. The effect of the MFN clause is that the industrialised country to whom such agreement applies, could claim the same benefits that may be accorded under an investment protection agreement concluded between the developing countries themselves. One of the possible alternatives that was suggested in this regard was a multilateral convention between a group of developing countries, creating thereby a multilateral preferential regime, perhaps on the lines of the Lome Convention, which would exclude the operation of the MFN clause in regard to the special regime created in terms of such an international agreement, as a well-recognized exception to MFN treatment.

Another multilateral initiative of direct relevance to South Asia was the one undertaken by the South Asian Association for Regional Cooperation (SAARC) for the conclusion of an agreement between the Governments of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka for the encouragement and reciprocal protection of investments, under a multilateral legal framework within countries of the SAARC region. This initiative which was taken at the First SAARC Meeting on the Promotion and Protection Investment held in New Delhi in September 1997 is yet pending within the SAARC forum.

Both the AALCC model and the SAARC draft have relied considerably on the number of bilateral treaties that have been concluded by the countries of the region. However, this is not to deny the fact that there are some significant points of departure in both texts, in comparison to BITs concluded by developing states with capital exporting industrialised states. A clear illustration is the reference to the payment of "fair and equitable" compensation upon nationalisation or expropriation of a foreign investment in the former texts, whereas the BITs concluded by developing states with industrialised states provide for "full market value" as compensation. This again raises the issue of according MFN treatment in respect of investments by one developing country in another, if more favourable treatment is granted under a BIT with a developed country.

Sri Lanka has concluded 24 bilateral treaties since the conclusion of the first BIT with the United Kingdom in January 1981. From the South Asian and the BIMST-EC regions, Sri Lanka has BITs with India, Pakistan (to be ratified) and Thailand. This Paper will therefore seek to highlight some of the fundamental implications of BITs for South Asian countries in the context of our own experience of the BIT regime.

A discussion of the role and implications of BITs in the current context would not be complete, however, without referring at least in passing to the issue of the requirement of approval of the host state for admission of foreign investments into its territory, an issue acquiring increasing relevance in the context of current developments.

All bilateral treaties concluded by Sri Lanka provide for the applicability of the agreement to investments which are approved in accordance with the rules and regulations in force in Sri Lanka and are accepted in accordance with its general economic policy. This requirement is not only designed to facilitate the identification of investment that are entitled to the protection in terms of the agreement, but also addresses the vital national interests of the host government, particularly in the case of developing countries, to ensure that foreign investments conform to the general economic policies and national development priorities of the host state and that they are channelled into fields where they are most needed. For instance, conditions of admission could relate to investments which are to be located in underdeveloped areas of the host country, investment that generate maximum employment opportunities, investment which facilitate the capacity to transfer of technology and know-how etc.[1]

This issue, no doubt, is likely to generate considerable discussion in the context of the on-going WTO debate on the relationship between trade and investment and the proposal on the formulation of a Multilateral Investment Agreement (MIA). The proposal to confer a right of establishment on the part of a foreign investor would, certainly, reverse the existing position by taking away the discretion of the host state to approve and admit investment and conferring on the investor the right of establishment of investment irrespective of the development priorities of the host country.

This, would have a critical bearing on the development imperatives of the developing countries and would be perceived as impairing the ability of host states to adopt their own development strategies. It is bound to be a complex negotiating issue within the WTO. Apart from the economic implications, it also involves the fundamental issue of the sovereignty of the host state which will underpin the approach of the developing host states to this critical issue.

Implications of Bilateral Investment Treaties

In assessing the implications arising from the BIT regime for the host state, this Paper seeks to address the scope and content of two fundamental clauses imposing international legal obligations *vis-a-vis* foreign investment, having particular regard to Sri Lanka's own experience as a host state. These are:

(1) the obligation and international responsibility devolving on a host state by virtue of a clause which guarantees that investments of nationals or companies of one contracting party "shall enjoy full protection and security" in the territory of the other contracting party; and

(2) the nature of the legal consequences arising from the "compensation for losses" clause dealing with losses suffered by a foreign investor in situations of war or other armed conflict.

It would be pertinent to note in this context, that these clauses were the subject of arbitral proceedings before the International Centre for the Settlement of Investment Disputes (ICSID) (established under the International Convention on the Settlement of Investment Disputes) which were instituted by a foreign investor against the Government of Sri Lanka in terms of the BIT between Sri Lanka and the United Kingdom. The claimant alleged that the investment, a prawn farm situated in the Eastern Province of Sri Lanka, suffered damage as a result of operations carried out by the Security Forces.[2]

(i) *Nature of liability of the host state arising from the "full protection and security" clause*

A central issue which arose in the ICSID Arbitration under the UK/Sri Lanka BIT was whether the "full protection and security" provision of Article 2(2) of the Treaty created a "strict liability" regime which renders the host state liable for any loss arising from destruction of the investment, even if caused by a person whose acts are not attributable to the state and under circumstances beyond the state's control.

The claimant in pursing the position that the clause created a strict liability regime "without fault" on the part of the state, contended that the term "enjoy full protection" sustained the construction that the parties intended to provide the investor with a guarantee against all losses suffered due to the destruction of the investment, for whatever reason and without any need to establish the person responsible for the cause of the damage. The implication of this construction was that the "full protection and security" clause had the effect of providing a foreign investor with an insurance by the host state against the risk of having his investment destroyed under whatever circumstances.

On the other hand, the contention of the Government was that the standard set by the "full protection and security" clause was the same standard of protection for the exercise of "due diligence" based on fault, which was the minimum standard under customary international law.

In determining this issue, the Tribunal had the opportunity of examining similar expressions used both in BITs and in precedent treaties such as Treaties of Friendship, Commerce and Navigation. It was observed by the Tribunal that similar expressions or even stronger terms like "most constant protection" had in fact been used in bilateral treaties over a century.

The argument that the term "full protection and security" should be construed as an absolute obligation which guarantees that no damage will be suffered by a foreign investor within a host state, had not met with success in one of the earliest instances before the Italy-Venezula Mixed Claims Commission in which the interpretation of this term in the 1861 Treaty between Italy and Venezula had been the central issue.[3]

In a more recent case concerning Elettronica Sicula SPA (ELSI) between the USA and Italy[4] adjudicated by a Chamber of the International Court of Justice, the US Government had invoked Article V(1) of the BIT which imposed an obligation to provide "most constant protection and security" without however seeking to place an interpretation that this obligation constituted a guarantee by the host state involving strict liability of that state.

In its judgement of 20 July 1989 the Chamber of the International Court of Justice had clearly stated that "The reference in Article (v) to the provision of "constant protection and security" cannot be construed as giving of a warranty that property shall never in any circumstances be occupied or destroyed".

Thus the oldest reported arbitral precedent and the more recent ICJ ruling both lent support for the finding of the ICSID Tribunal that Article 2(2) of the Sri Lanka/UK BIT on the grant of "full protection and security" to a foreign investor was a reflection of the intention of the parties to require, within their treaty relationship, nothing more than the customary international law standard of "due diligence" and that these words were not in themselves sufficient to establish that the parties intended to transform their mutual obligations into one of strict liability.[5]

Accordingly, a reasonable construction of the term "enjoy full protection and security" denotes the obligation to exercise due diligence to protect foreign nationals or companies from investment losses. The mere occurrence of investment losses by a foreign investor does not render a host state responsible to compensate the foreign investor for the losses. The host state would be obliged to compensate the investor only in the event that the latter is able to demonstrate that the host state has failed to act reasonably under the circumstances. The obligation on the host state is to act with due diligence and as expressed by Prof. Freeman "due diligence is nothing more nor less than the reasonable measure of prevention which a well-administered government could be expected to exercise under similar circumstances".[6] The requirement of 'due diligence' would thus be determined having regard to objective criteria.

(ii) *Legal consequences arising from compensation for losses clause*

The scope and content of Article 4 of the Sri Lanka/UK BIT dealing with compensation for losses for the purpose of determining the host state's responsibility for investment losses suffered as a result of property destruction was also the subject of determination by the ICSID Arbitral Tribunal. In dealing with this issue the Tribunal had occasion to pronounce itself on the inter-relationship of Article 4(1) and 4(2) in the context of the general obligation imposed by Article 2 to provide full protection and security.[7]

In the view of the Tribunal, Article 4(1) of the Treaty constituted a "special provision" which envisaged the legal consequences of losses suffered by a foreign investor "owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory of the host state. The Tribunal observed that Article 4(2) introduced a "more specific rule" particularly to cover two types of losses in any of the situations enumerated in Article 4(1), without prejudice to the rules applicable thereunder. The two categories covered under Article 4(2) are:

(i) requisitioning of property by forces or by authorities of the host state; or
(ii) destruction of property by its forces or authorities which was not caused by combat action or was not required by the necessity of the situation.

In the dispute before the Tribunal, neither party was able to provide "reliable evidence explaining with precision the conditions under which the destruction and other losses took place" and consequently the Tribunal reached the conclusion that in such instances it would be extremely difficult to determine whether the destruction and losses were caused as an inevitable result of the necessity of the situation, or on the contrary, were avoidable, if the security forces had acted with due diligence. In these circumstances, the Tribunal deemed it appropriate to rely on the well established principle of state responsibility that "the international responsibility of the State is not to be presumed".

In reaching this conclusion the Tribunal followed a pattern of long established precedents as reflected in a number of arbitral decisions which refused to allocate compensation for destruction that took place during hostilities on the assumption that these destructions "were compelled by the imperious necessity of war". In the words of the Tribunal: "The doctrinal authorities approved that reasoning, justified by the extreme difficulty described as 'next to impossible' of obtaining the reconstruction in front of the arbitral tribunal of all the conditions under which the 'combat action' took place with an adequate reporting of all the accompanying circumstances".

Consequently, the Tribunal took the view that Article 4(1) of the Treaty provided the only basis for a remedy that will be available to the claimant to base his claim. In reaching this conclusion, the Tribunal placed the following interpretation on the scope of the operation of Article 4(1) of the BIT:

(a) For the applicability of Article 4(1), the only condition required is the presence of the "losses suffered". The mere fact that such "losses suffered" do exist, is by itself sufficient to render the provision of Article 4(1) applicable, without any need to prove which side was responsible for the destruction or to question whether the destruction was necessary or not;

(b) The term "losses suffered" includes all property destruction which materialises due to any type of hostilities enumerated in the text, ie. "owing to war or other armed conflict, revolution, a state of national emergency;

In essence, the reasoning of the Tribunal was that the scope of application of Article 4(1) is not subject to any legal restrictions. Hence in the view of the Tribunal, it extended as *lex generalis* to all situations not covered by the special rule of Article 4(2), including cases where no proof has been established to determine who was responsible for the property destruction. This, the Tribunal viewed as providing "an indirect rule" whose function is to effect "a reference" (renvoi) towards other sources which indicate a solution to the issue.

The Tribunal, however, appears to have overlooked the fact that Article 4(1) did not constitute a substantive source of liability. It only provided for the according of MFN and national treatment ie the same standard of treatment as accorded to investors of third states or local investors placed in similar circumstances, as regards restitution, indemnification, compensation or other settlement ie specific standards for compensation etc.

Apparently the Tribunal based liability for failure to protect the investment, both on the due diligence standard/full protection and security clause under Article 2(2) and on the due diligence standard of customary international law which, in the view of the Tribunal, is said to be imported into the Treaty by virtue of Article 4(1). This approach, however, does not answer the contention as raised in the minority opinion[8] of the Tribunal, that an investor is not entitled to protection under Article 4(1) dealing with MFN and national treatment in the matter of compensation for losses suffered owing to war or other armed conflict, unless it can prove either that the host state has entered into a treaty which specifically provided for compensation in the case of civil disturbance or has adopted national measures to the same effect.

However, in adopting this innovative construction of Article 4(1) the Tribunal highlighted the inter-relationship that existed between "full protection and security" clause in Article 2(2) and the compensation for losses provisions in Article 4(1) and their cumulative effect in providing basic protection to a foreign investor:

From the above discussion of the approach of the ICSID Arbitral Tribunal to the fundamental guarantee clauses in a BIT regime, it would be a reasonable conclusion that:

(a) An Arbitral Tribunal would tend to interpret a BIT provision relating to the grant of protection and security to foreign investment in consonance with customary international law standards, unless there is a clear provision to the contrary in the Treaty; and

(2) This would however, not necessarily preclude such Tribunals from having recourse to an approach, which may even be of an innovative nature such as the renvoi doctrine in the present case, which would ensure that a foreign investor is not left without any remedy and the host state is not left totally immune from any responsibility where a foreign investor suffers loss due to destruction of the investment.

In general, it would be a safe assumption that in investment-disputes, an Arbitral Tribunal would interpret a BIT with a view to reaching a conclusion that would not leave a foreign investor without a remedy, where there is *prima facie* evidence of losses having been suffered. Perhaps, this could be viewed as an "investor friendly" approach, which would help to generate greater investor confidence. Similarly, the willingness of a host state to abide by such a finding and to honour an international arbitral award would equally contribute to the creation of investor confidence.

Endnotes

1. For instance, the 1984 Guidelines for Foreign Investment of Mexico provides for a "systematic and selective promotion of foreign investment" in those areas which will generate a positive foreign exchange balance, produce competitive exports and import substitution, contribute to national scientific and technological development, advance Mexico's further integration into the international community, involve large investments and create employment and geographical decentralization of industry. Similarly, Sri Lanka has laws and regulations providing certain incentives for nationals and companies which meet certain requirements such as those which export goods produced or contribute new technology.
2. *Asian Agricultural Products Limited (AAPL) v Republic of Sri Lanka* ARB/87/3. Award of the International Centre for the Settlement of Investment Disputes (21 June 1990).
3. *Sambiaggio case* (1903) *Mixed Claims Commission, Italy v Venezula,* UN Reports of International Arbitral Awards, Vol X. p 512.
4. ICJ Reports (1989) p 65.

5. The official commentary on Article 1 of the OECD Draft convention on the Protection of Foreign Property in its explanation on the meaning to be ascribed to the term "most constant protection and security" states: "the obligation of each party to exercise due diligence as regards actions by public authorities as well as others in relation to property" *International Legal Materials* Vol 2 (1963) 241.
   Similarly on the evaluation of British bilateral investment treaties, Denza and Brooks states that on the "politically sensitive provisions" such as expropriation and compensation for losses for damage suffered during armed conflict, the provisions "were drafted in considerable detail but not so as to go beyond what was thought to reflect international law" (1987) 36 *International and Comparative Law Quarterly* 908 at 911.
6. Freeman, *Responsibility of States for Unlawful Acts of Their Armed Forces*, Sijthoff, Leiden (1957) p 14.
7. Article 4 of the Sri Lanka-UK BIT reads:
   "(1) Nationals or companies of one Contracting Party whose investments in the territory of the other Contracting Party suffer losses owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory of the latter Contracting Party shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less favourable than that which the latter Contracting Party accords to its own nationals or companies or to nationals or companies of any third State.
   (2) Without prejudice to paragraph 1 of this Article, nationals and companies of one Contracting Party who in any of the situations referred to in that paragraph suffer losses in the territory of the other Contracting Party resulting from
   (a) requisitioning of their property by its forces or authorities, or
   (b) destruction of their property by its forces or authorities which was not caused in combat action or was not required by the necessity of the situation,
   shall be accorded restitution or adequate compensation. Resulting payments shall be freely transferable.
8. Dissenting opinion of Dr Samuel Asante dated 15 June 1999 "... the foreign investor does not derive any benefit from Article 4(1) unless the same right or privilege has been explicitly granted by the host state to its nationals or companies or to the companies or nationals of a third state in similar circumstances".

International Investment Agreements: Admission and Establishment, Legal Standards of Treatment

By M Sornarajah, Professor of Law, National University of Singapore, being a Paper presented at a sub-regional workshop for South Asia on "Recent Developments in International Investment Agreements", held in Colombo, Sri Lanka on 15 and 16 December 1999 under the auspices of UNCTAD*

We discuss the issue of admission and establishment at the tail end of the high-point of globalisation as well as the Asian economic crisis. Both these phenomena which occurred as the twentieth century ends indicated that the panacea of liberalisation of the economies advanced as the solution for under-development have been subjected to considerable scepticism. The up-swell of popular reaction against the World Trade Organisation which was set up as the agency for liberalising world trade at the demonstrations attending the Seattle Ministerial Meeting demonstrated that total liberalisation will not be politically acceptable to sections even within the developed world. That was demonstrated earlier by the failure of the efforts of the Organisation of Economic Co-operation and Development to draft a Multilateral Agreement on Investment. The Asian economic crisis indicated that uncontrolled flows of capital will result in considerable disorder if there is a sudden stampede of capital out of the state precipitated by events. The successful method of dealing with such a crisis in Malaysia through exchange control, widely condemned initially by the institutional experts at the World Bank and the International Monetary Fund[1] has dented the political and economic thinking behind liberalisation considerably. Despite the visible derision of the developed country "experts", the Malaysian Prime Minister has had the satisfaction in doing it his way. One cannot assess the issue of entry and establishment of foreign investments except in the context of these events. The attitudes swing in accordance with events and are never fixed. They have been shown to have a cyclical tendency, euphoria for foreign investment prevailing at one time quickly to be dispelled by turn of events that show that such euphoria could be misplaced. In the quick span of the last decade of the twentieth century, the world has witnessed such a cycle. The twenty first century is to dawn with a balance in the attitudes as to whether foreign investment is the unqualified blessing that its advocates advance it to be or as the instrument of perpetual serfdom of the developing states which its detractors portray it to be. One cannot approach this subject with fixed attitudes. The paradigms keep shifting in accordance with prevailing trends. The identification of the paradigms is what is essential for solutions to problems of each country can then be made in accordance with the prevailing economic and political circumstances.

The Liberal Paradigm

The completely liberal paradigm does not prevail in any state. The liberal model is the product of globalisation which witnessed its heydays during the rise of Reagonomics and Thatcherism. As much as this free market philosophy stood for little control over the domestic markets, it also advocated the freeing of control over global markets. In the area of international trade, the philosophy's triumph is evidenced by the setting up of the World Trade Organisation.[2] In the sphere of foreign investment, it stood for the untrammelled movement of multinational corporations around the world. The idea was that such movement will result in development as foreign capital will supplement the resources of the cash-strapped economies of the underdeveloped world, create jobs and lead to prosperity.

The so called Asian dragons which are held out as models of the success of liberalisation do not provide examples of a complete liberal paradigm. Open entry is held out as a mirage of hope but there are wide sectors which are closed for entry by foreigners except under specified circumstances. The United States, the proponent of the liberal theory of openness as to foreign investment, does not permit entry into its markets at will. The Exon-Florio Amendment to the Omnibus Trade Act is well known. Under the legislation, the President may prevent the entry of foreign investment which he considers to be a threat to national security from entering the United States. There is a regulatory structure within the United States for reviewing incoming investments.[3] Quite apart from this, seemingly innocent laws which exist in the United States could be utilised to prevent the entry of foreign companies. Thus, the antitrust laws, which are designed to prevent abuse of dominant position, could be utilised to prevent the entry, through merger or on its own, of a large foreign multinational on the basis that its entry will lead to its acquisition of dominant position in the market.

Liberal Admission and GATS

When GATS is fully implemented, the liberal influx for foreign investment in the services sector will be assured. It mandates "commercial presence" of any service supplier in the markets of the parties to GATS.[4] This would mean that in the professional sectors, firms practising as large multinational companies or groupings will be able to spread out globally without hindrance of national laws. GATS represents an area of intrusion of the World Trade Organisation into the realm of foreign investment. The competence of the WTO in this area now must be now considered as a given factor and at least in this area, there is a possibility of a liberal regime being established. GATS permits regulation of service sectors on the basis of technical competence and qualifications but forbids discrimination against foreigners. It aims to progressively eliminate existing discrimination while purporting not to interfere with government policy objectives.

Services include many sectors such as law, health, insurance, education, banking and medicine. The inroads that foreign universities, legal firms, banks and large hospitals could make into the local markets will be significant. There is of course much grumbling with the scheme. There would be a sameness and uniformity in higher education if the leading American universities were to reproduce their campuses in different countries. The service entities with power and they all belong to the hegemonic states will be able to reproduce themselves much to the detriment of independence of thinking modes and cultural differences of people.

Whereas under GATT, treatment was in respect of the goods, the national treatment under GATS applies not only to the services provided but to the foreigner providing the services, who has necessarily to be present within the territory of the state. To that extent, GATS becomes the first multilateral instrument containing a standard of admission and treatment of foreign investors, though the instrument is limited to foreign investors who provide services. The impact it would have on immigration control and other sovereign controls that are traditionally exercised over foreign investment flows is extensive. Though initially the application of GATS will depend on negotiation with a graduated scheme possible for developing states, there will eventually come about a uniform regime in this area. When that eventuates, there will be a system of openness that is available to foreign investment in the services sector. This is a major intrusion that has been made in the area of international foreign investment through the medium of international trade. International trade which had hitherto been restricted to the area of goods has now been extended to cover investment in the wide sector of services (excluding air transport). Through this door, a whole area of foreign investment in services has been carved out of the traditional area of the international law on foreign investment and been subjected to the area of international trade. This regime will serve to remove the area out of national control and subject it to an international regime. It was a cleverly achieved objective.

GATS further enhances the liberal model in the sector of foreign investment in services by prohibiting the host state from specifying the vehicle used for entry. Thus, for example the host state cannot insist that entry be made through a joint venture with a local entity. Neither can it limit the percentage of shares or capital that is held by the foreigner in the entity that he establishes.[5] The liberal model provided for services by GATS will not apply to the other areas of foreign investment. The effort to include foreign investment in international trade had to stop with Trade related Investment Measures (TRIMS) which largely applies only to the prohibition of performance requirements. Though the regime will take time to be established, the chances of it being established eventually are good.

Treaty Provisions Supporting the Liberal Regime

The liberal regime is supported by treaties that established free trade areas and by some bilateral investment treaties. The OECD Multilateral Agreement would have brought about a liberal regime but was aborted at draft stage. The earlier instruments had not set themselves such an ambitious objective.

The American Model Bilateral Investment Treaty provides national treatment for establishment of the investment by nationals of each party.[6] But, the provision permits exceptions. It permits sections of the economy to be excluded from the scope of the treaty and other matters to be excluded from the scope of the provision in the annexe to the treaty.[7] In pursuance of this provision, the United States has excluded a variety of sectors from the treaty.[8] The sectors excluded by the other states that have made these treaties with the United States are longer.

Chapter 11 of the North American Free Trade Agreement which contains the provisions on foreign investment replicates the American model bilateral investment treaty.[9] But, again, parties include large sectoral exceptions virtually negating the aim of the treaty in liberalising flows of foreign investment. The Mexican list of exempted sectors is long. The conclusion that one has to draw is that while the Article states an ideal of the liberal model, it is realistic in providing wide scope for exempting the more important sectors of the economy from the scope of the liberal model. This would mean that parties retain their right of subjecting entry into sectors to regulatory regimes. It is safe to conclude that most states which advocate liberalisation merely engage in shadow-boxing. The leading proponents of a liberalised regime for foreign investment do not practise such a policy. There is a considerable amount of antiforeign sentiment which keeps surfacing within the developed states which will prevent the complete liberalisation of entry.[10] Liberalisation of foreign investment regimes remains a theoretical model that has not found meaningful acceptance yet.

The Competing Paradigm

Leaving aside a paradigm that is completely hostile to foreign investment and shuts it out altogether,[11] the paradigm that has widespread support is one which permits the host state to regulate the flow of foreign investment into it. The practice of states of many parts of the world is to admit foreign investment on the basis of their immigration power to control the entry of aliens into their state territory. The basis of this practice in international law is sound.

As a condition of their entry, aliens may be subject to whatever conditions a state may wish to impose upon them.[12] In modern times, most states have legislation on foreign investment which screens the entry of foreign investment on the basis of the benefits that the foreign investment could bring to the host economies. The potential harm, such as environmental harm, that the foreign investment entails is also assessed at this stage. The aim of the host state is to maximise the benefits that the foreign investment brings into the economy and minimise the potential it has for harm. This idea requires the harnessing of the foreign investment carefully to the objectives of the host state. It by necessity means the imposition of a careful regulatory structure on foreign investment which eliminates harm and increases benefits that the foreign investor brings. The regulatory structure achieves this by giving licenses to operate on the basis of conditions. These conditions relate to the manner of capitalisation of the foreign investment venture, the employment of local personnel and raw materials, the location of the investment in designated areas, the export of a percentage of production and such other conditions. The existence of such conditions is itself a rejection of the liberalisation model. In fact, the imposition of performance requirements which are characteristic of this model is a violation of the TRIMS discipline of the WTO.

When such a regulatory structure exists, a state cannot accept liberalisation at the international level. It must of necessity preserve that regulatory structure in the treaties it makes at the international level. There are distinct techniques which have been used in international treaties to give expression to the underlying motives behind this paradigm. Thus, the bilateral investment treaties which are entered into by South-east Asian states all of which have regulatory regimes over foreign investment[13] ensure that the protection is given only to approved investments.[14] The formula used is that the protection of the treaty is given only to "investments approved in writing". The ASEAN investment treaty also contains a similar formula. The assumption is that such approval is given only to investments which are consistent with the laws and policies of the host state that becomes a party to the treaty. It is unclear whether the approval once given can be withdrawn if a policy is changed. One would think that for the object of the approval is to be achieved, then, whenever the situation indicates that it is not being achieved the state has the right to withdraw the approval and with it the protection of the treaty. Such a view, however, would defeat the purpose of the treaty as protection then becomes subject to the unilateral manipulation of each party.

The other technique used in the treaties to ensure that the regulatory framework is saved from the treaty principles is more forthright. This is also increasingly coming to be adopted in the treaty practice of countries like Indonesia and Australia, both of which had screening legislation for a long period of time. The best early example is to be found in the Indonesia–Australia treaty itself. The treaty provision states that only investment "admitted by the other Party in conformity with the laws, regulations and investment policies of the latter applicable from time to time" is entitled to protection.[15]

Such a formulation effectively emasculates the content of the treaty and subjects protection to the regulatory structure of the host state for the foreign investment which does not conform to the conditions for operation imposed on it at the time of the entry loses the protection of the treaty. By ensuring that the foreign investment enters subject to the policies and laws of the host state and preserving this as a condition for protection under the treaty, the host state assures itself that no sovereign control over foreign investment is surrendered as a result of the treaty. Indonesia and Australia uniformly adopt this formula in their treaties. But, less stringent formula for the preservation of the regulatory laws are found in other treaties. Thus, the treaties made with the Eastern European socialist states contained provisions preserving the local laws on foreign investment.[16] The practice is not confined to the socialist state. The Dutch model treaty confines entry to investments "subject to the rights to exercise powers conferred by its laws and regulations". The investment treaty between Bangladesh and Thailand states that each state "shall be free to lay down appropriate conditions" on incoming investments.

The second paradigm has a wider support in international instruments. The Lome Convention (1979) specifically states that states can refuse entry to investment which does not conform to their development objectives.[17] The dent that was sought to be made to this pattern by the OECD's Multilateral Agreement on Investments has been beaten back. With dissent from globalisation so clearly visible at Seattle and civil society being active in the protection of values involved in foreign investment, it is unlikely that the liberal paradigm will make inroads into the second paradigm that has been identified. Between these paradigms, there are shades of differences that are intermediate. These variations are not studied in detail in this paper.[18]

The Standard of Treatment

Customary international law permitted a state to treat the alien according to the national standard on the basis that the alien entered the state voluntarily and must be accorded the treatment that is no different from that given to the local people. This was the standard argued for by the Latin American states in their relations with the United States. As the national standard treatment was low in these states, the United States then argued for an international minimum standard. The latter standard was the basis on which the United States constructed the basis of its claims as to the protection of the foreign investment of its nationals abroad. In the practice of the United States, there was also a resort to most favoured nation standard which was specially negotiated for in its Freedom, Commerce and Navigation treaties. The most favoured nation treatment has no meaning outside the context of treaty law and simply meant that future more advantageous treatment negotiated by a third country with a treaty partner would flow through to the other treaty partner automatically as a result of the most favoured nation clause. The clause is used widely and almost exclusively in treaties involving international trade and investments. The claim relating to the international minimum standard treatment is still maintained but has to a large extent been subsumed within the human rights standard that has developed since the Second World War. This standard however does not contain any definite principles on property protection and hence, the developed states find it necessary to still maintain the old notion of an international minimum standard for purposes of property protection.

The notion of national treatment also has undergone a change. Opposition to national treatment was maintained in the old days because of the developed states averseness to the denial of proper standards of treatment in relation to criminal trials and punishment of their nationals. That area is now taken care of by the existence of uniform and universal human rights standards. National treatment has come to be priced in the area of trade and investment as this would mean preferential access to facilities provided by the state to its nationals and equal treatment of the foreign investor with the national. The strategy of the developed states is to require national treatment both as to establishment and to the post-entry phase of operation of the foreign investment. The strategy of the instruments that favour globalisation is to require that there be right of entry and establishment coupled with national treatment after entry has been made. Thus, the OECD's aborted Multilateral Agreement on Investment (MAI) which is a document based on economic liberalism was "based on the principles of national treatment, most favoured nation treatment and transparence and will apply to both pre- and post-establishment stages of investment".[19]

It is unlikely that states that do not subscribe to the notion of freedom of entry and establishment of investments will permit national treatment for foreign investment. Since they subscribe to the second model that requires the subjection of the foreign investor to regulatory controls, the essence of the scheme would be to discriminate between the national entrepreneur and the foreign investor. The regulatory controls indicate a wide variety of restrictions on how the foreign investor is to function. They may mandate that he operates through a joint venture or that they locate in specific areas. They may be subjected to a wide variety of performance requirements. Though globalisation requires the dismantling of these restrictions on foreign investment, they are unlikely to be removed. As long as they are maintained by states it is unlikely that these states will provide national treatment to the foreign investor.

Whereas only economic liberalism justifies the model of open entry and national treatment, there are other considerations, besides economics which a state has to take into account in maintaining regulatory controls. Economics alone does not dictate the choice that is made and it is erroneous to be guided by economic bodies, whether international or otherwise, in the decision of matters relating to foreign investment. There are several factors which shape the regulatory laws of a state. Nationalism, ethnicity, protection of local entrepreneurship are political factors that have to be looked at in the making of the choice by a state. There are environmental and social considerations that have to be taken into account. Economic institutions merely address the problem from the point of view of the role of foreign investment in development. Their prescriptions have often been found to be lacking in sense.

No state, not even one among the virtuous paragons of economic liberalism, practises open entry coupled with national treatment for foreign investment. Where open and entry and post-entry national treatment are found in treaties, they are subjected to wide sectoral limitations and national security exceptions.[20] The OECD's liberalisation codes, which have only a recommendatory effect, also contain exceptions relating to national security, public order and the protection of public health, morals and safety. The OECD's draft MAI floundered, among other reasons, on the French and Canadian fear that their cultural industries would be destroyed if open entry and national treatment were to be given to American multinationals in the entertainment sphere. As long as these fears exist among the developed states, it is unlikely that a multilateral instrument based on national treatment will eventuate.

It is worth pointing out that foreign investment may receive better than national treatment in certain areas. Thus, tax incentives given to foreign investment are obviously not available to national investors even where they operate within the same industry. So too, where there is property protection and full compensation assured by a treaty, the compensation that is paid for the taking of the property to a foreign investor may be higher than that paid to a national under acquisition schemes of the state, particularly those relating to land. Constitutional problems could arise with treaties of this sort. In Columbia, the US bilateral investment treaty was successfully challenged on the ground that it violated the right to equality provision in the constitution.

Endnotes

*LLM (Yale), LLD (London).

1. Both institutions came out rather badly in this crisis. Not only had they proudly proclaimed the "Asian miracle" as the showpiece of liberalism, the solutions they advanced were looked upon with scepticism. There was also a touch of arrogance in the manner in which the solutions were advanced which triggered feelings of nationalism creating doubts as to the suitability of these institutions to deal with such problems. For a study of the objectives of the World Bank, see D Williams, "Constructing Economic Space: The World Bank and the Making of Homo Oeconomicus" (1999) 28 *Millenium: Journal of International Studies* 79.
2. J Croome, *Reshaping the World Trading System: A History of the Uruguay Round* (1999).
3. The amendment created a screening mechanism "that not only can bar but also has the power to set performance requirement for foreign investment in virtually all sectors of the US economy based on vague national security grounds" CS Eliot Kang, "US Politics and Greater Regulation of Inward Foreign Direct Investment" (1997) 51 *International Organisation* 301 at p 304.
4. Article XXVIII (d) of GATS.
5. Article XVI (2) of GATS.
6. Article II (1) reads: "With respect to the establishment, acquisition, management, conduct, operation and sale or other disposition of covered investments, each Party shall accord treatment no less favourable than it accords, in like situations, to investments in its territory of national or companies (hereinafter national treatment) of their country (hereinafter "most favoured nation treatment") whichever is most favourable (hereinafter "national and most favoured nation treatment").

7. For a study of American treaty practice, see KJ Vandevelde, *US Investment Treaties: Policy and Practice* (1992); I Shihata, "Recent Trends relating to the Entry of Foreign Investments" (1994) ICSID Rev 47. There are wide national security exceptions in the US treaties.
8. These include real estate, civil aviation, telecommunications, transport.
9. Within Mercosur, there appears to be right of entry for member nationals of Mercosur but, protection differs. The Colonia Protocol subjects investments to the national laws of each member state.
10. CS Eliot Kang, "US Politics and Greater Regulation of Inward Foreign Direct Investment" (1997) 51 *International Organisation* 301.
11. This would be favoured by theorists who belong to the extreme forms of the dependency theory.
12. Subject of course to international standards of human rights. These rights are not relevant to the situation under discussion. The argument that the right to property is relevant has not been widely accepted.
13. Singapore may be regarded as an exception but, Singapore also regulates entry into certain sectors like banking. Singapore is not an exception to the practice of providing that protection will only be granted only to approved investments alone. This indicates the existence of a system of approval that implies that there is some administrative process that decides on approval. The system that is adopted is unclear.
14. Bilateral treaties are not good instruments for selective liberalisation as liberalisation given in one treaty will multilateralise the benefits to other states which had made the treaties through the most favoured nation provisions contained in them.
15. Professor Salacuse reads this provision as restricting the existing sovereign rights of full control of the host state as the state technically can do what it pleases with the foreign investment whereas it now has to act in accordance with its laws (see his article in TW Walde (Ed) *Energy Charter Treaty* (1997) at p 336. This would be a strange reading. The proper reading is to give priority to the host states laws. The obligations of the treaty could be manipulated through the host state's laws and policies as to investments. There is no time restriction stated. The law is not limited to the law at the time of entry.
16. The France-Soviet Union treaty (1989) applied to investments "made in accordance with the legislation" of each party.
17. Fourth Lome Convention, Article 258 (a).
18. See generally for these variations, UNCTAD, Admission and Establishment: UNCTAD Series on Issues in International Investment Agreements (1999).
19. EM Burt, "Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization" (1997) 12 *Am U J Int Law and Public Policy* 1040.
20. NAFTA and the American bilateral investment treaties are the obvious examples. The United States has stated that its objective behind the treaty programme on investments is to promote economic liberalism. See Department of State, Bureau of Economic and Business Affairs, *US Bilateral Investment Treaty* (released 28 July 1997).