8

Investment Treaties and Good Governance: Norm and Institutional Design, Internalisation and Domestic Rule-making

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# I. Introduction

This contribution forms part of the author’s ongoing project which examines the role of international investment law in fostering good governance and rule of law at a national level. What role does international investment law play in generating national law? Can investment treaty remedies induce governments into compliance with the rule of law and good governance standards? To what extent and how do investment treaty norms influence government decision-making in host states? To answer these questions, the project examines the evolving objectives of international investment law and undertakes socio-legal and interdisciplinary analysis of the impact, both *ex ante* and *ex post*, of international investment law on governmental conduct. The aim of this contribution is to introduce the key strands of the argument developed in the project and to discuss some of the preliminary findings stemming from the empirical case studies and interviews conducted to date.

While much has already been written on why states sign international investment agreements (IIAs), there is a dearth of studies on the connection between such agreements and state actions in both the domestic and international arenas. What effect do international investment law and its dispute settlement mechanism have on state behaviour? With the exception of some recent scholarly contributions, the existing literature makes little effort to engage with causal assumptions about how the investment treaty regime influences host state behaviour. One such assumption is readily discernible in the arguments which justify both the existence of the regime and its increasingly expanding reach. The proliferation of voices criticising IIAs and investment arbitration coincided with a rapid uptake of the good governance narrative among the regime’s supporters as though it was felt that international investment law ‘must fulfill *some* useful societal function’.[[2]](#footnote-2) International investment law and investor-state arbitration, it has been claimed, are necessary and desirable not just to ensure effective protection of foreign investors but also to promote host state compliance with the rule of law and good governance precepts. Thus, one of the investment treaty regime’s broader objectives, as well as one of its projected collective benefits, is the transformation of governance institutions and practices in host states. It has been argued that ‘investment treaties aim at binding States into a legal framework that gives them an incentive and a yardstick for transforming their legal systems into ones that are conducive to market-based investment activities and provide the institutions necessary for the functioning of such markets’.[[3]](#footnote-3) ‘Indirect collective benefits’ of international investment law for host societies comprise not only the ability of host states to attract investment but also the potential for change in ‘the political dynamic of reform of domestic dispute resolution and policy making institutions’.[[4]](#footnote-4)

The increasing frequency of such claims in legal discourse compels one to question their conceptual and juridical underpinnings. ‘Good governance has a very powerful and apparently universal appeal: all peoples and societies would surely seek good governance – in much the same way that all peoples and societies were seen as desiring development.’[[5]](#footnote-5) Just as is the case with economic development, which has long been regarded as one of the primary objectives of IIAs, it is barely questioned by either proponents or critics of the investment treaty regime that fostering good governance (and the rule of law) is a desirable end. However, what remains under-explored is the capacity of international investment rules to bring about change in domestic governance institutions and practices. This contribution questions the good governance narratives in the investment treaty context from conceptual, doctrinal and empirical angles. First, it will critically examine the regime’s internal capacity to influence host state behaviour by analysing its existing make-up through the eyes of political science scholarship on state compliance with international law. Does international investment law possess the necessary tools to influence domestic governance? Is it inherently compliant with rule-of-law and good governance precepts to be able to export them successfully into national legal environments? The focus will then shift to findings emerging from empirical investigations, including the small-scale interviews and case studies conducted by the author in two developing countries. Finally, the contribution will draw attention to the variety of forms in which investment treaty law can influence government behaviour, highlighting the importance of peering behind the state and identifying domestic actors and factors that shape the ways in which host states respond to investment treaty disciplines.

# II. Investment Treaty Law and its Capacity to Foster Good Governance in Host States

## A. Norm-embedding and Compliance with Good Governance Standards

At the heart of the good governance narrative in investment law scholarship lies the claim that, although legally enforceable only by foreign investors, strict investment protection standards create a ‘spillover’ effect that benefits national citizens and residents as the host country gradually develops better administrative practices to comply with international investment best practices.[[6]](#footnote-6) The need to comply effectively with the rule of law and principles of due process imposed by investment treaties may arguably entail legal reforms and foster more legalistic and rule-oriented governance practices.[[7]](#footnote-7) An inquiry into the capacity of international investment law to bring about a positive change in domestic governance may provide new and useful insights into the currently largely unexplored question of compliance in the investment treaty context. One can distinguish three layers of compliance: pre-dispute compliance with good governance standards, post-dispute compliance with concrete arbitral prescriptions, and post-dispute adjustment of domestic governance norms and practices. The rate of compliance with the concrete arbitral prescriptions stage may well be high, which is not surprising given the strength of the enforcement mechanism undergirding the investment treaty regime. In an effort to enforce arbitral awards, investors can go as far as resorting to judicial proceedings and discovery subpoenas seeking information about the respondent host state’s banking assets and transactions.[[8]](#footnote-8) Compliance with arbitral awards may be involuntary and is frequently carried out against the respondent state’s will. Moreover, arbitral awards rarely if ever prescribe concrete changes in governance practices. What is more interesting for the purposes of this project, however, is *ex ante* and *ex post* compliance by host states with investment treaty obligations which explicitly or implicitly compel states to maintain good governance standards in daily practices of domestic bureaucratic and legal institutions. Can international investment law, with its strategy of substituting domestic governance mechanisms by international structures, effectively induce states into compliance with the rule of law and good governance standards at a national level?[[9]](#footnote-9)

What appears to be problematic in the investment treaty context is that the institution of investor-state arbitration, with its predominantly externalised, decentralised and frequently ad hoc nature does not provide the necessary bedrock of support to facilitate effective and consistent embedding of good governance and rule of law values in the legal and bureaucratic practices of host states. When compared with other international regimes, the investment treaty regime appears to lack some of the vital characteristics necessary for the fulfilment of its promise to transform domestic governance in host states. One considerable impediment to the effective embedding of good governance standards in the legal and bureaucratic practices of host states is the lack of national judicial involvement, precipitated by the waiver of the local remedies exhaustion – a unique feature and cornerstone of the investment treaty regime. Political science scholarship has long stressed the role of embeddedness in promoting compliance with international rules. As observed by proponents of liberal institutionalist theory, when international legal commitments are embedded in domestic legal systems it is no longer necessary for governments, and in particular national executives, to take positive action to ensure enforcement of international judgments.[[10]](#footnote-10) ‘Instead, enforcement occurs through domestic courts and executive agents who are responsive to judicial decisions.’[[11]](#footnote-11) Thus, ‘other things being equal, the more firmly embedded an international commitment is in domestic law, the more likely is compliance with judgments to enforce it’.[[12]](#footnote-12)

Other theories of compliance, among them notably the theory of transnational legal process, have also stressed the importance of embedding and norm internalisation as a precondition of compliance. Koh has argued, for example, that ‘self-enforcing patterns of compliance’ are generated through internalisation of international norms in domestic structures through executive, legislative and judicial action. It is through repeated participation in the transnational legal process – the interaction between transnational legal actors and national epistemic communities – that states comply with international law. In Koh’s view: ‘True compliance is not so much the result of externally imposed sanctions ... as internally felt norms.’[[13]](#footnote-13)

Social science theories of governance also point in the direction of iterative interaction between external and internal actors; after all, governance is defined as ‘the creation of a structure or an order which *cannot be externally imposed* but is the result of the interaction of a multiplicity of governing and each other influencing actors’.[[14]](#footnote-14) Since international investment law is largely premised on the transfer of adjudicatory powers from national courts to international tribunals, the former are removed from ‘the transnational iterative process’. Lack of vertical interaction between international tribunals and national courts prevents the latter from exercising a key role in embedding good governance standards in domestic legal orders.[[15]](#footnote-15) Three notable dimensions of this problem are: (1) the absence of mandatory recourse to domestic remedies prevents national judicial involvement in embedding rule of law norms and practices; (2) the fact that lack of domestic remedies in the national legal order in itself can constitute a breach and form a basis of a host state’s liability; and (3) as evidenced by recent arbitral practice, judicial attempts to enforce good governance standards and thus to provide effective remedies also can lead to host state liability.

To provide an example of how the lack of consistent interaction between the external agency and domestic actors currently impedes the fulfilment of the good governance agenda of investment treaty law, one could take a look at recent arbitral practice. A number of investment protection instruments, including certain US IIAs and Article 10 of the Energy Charter Treaty, expressly require that states provide investors with ‘effective means of asserting claims and enforcing rights’.[[16]](#footnote-16) This ‘effective means’ provision has been invoked in a number of investment disputes, including *AMTO v Ukraine*, where the claimants went as far as contending that the host state should be held to monetary responsibility for failing to create and maintain effective bankruptcy legislation.[[17]](#footnote-17) The desirability and fairness of sanctioning developing states for their lack of legal and institutional capacity provides yet another ground for contesting the investment treaty regime’s promise of good governance for host communities. To echo Harlow’s criticism of global administrative law, there is ‘a measure of hypocrisy in seeking to impose external standards on the poor and under-privileged, which the self-styled “good countries” are unwilling and sometimes unable to meet’.[[18]](#footnote-18) That is, however, a separate question which falls outside the scope of this contribution. What is more troubling and relevant for the discussion at hand is the fact that attempts by national courts to restore the rule of law in domestic settings and to rectify wrongs committed by administrative bodies may lead to a host state’s liability under the relevant IIA.

The case of *Arif v Moldova* provides a curious example of the internally contradictory set of obligations imposed by international investment law on host states, thus highlighting problems with the feasibility of the good governance promise (and mandate) of investment treaty law. The dispute arose after Moldovan courts had found illegality in actions of Moldovan airport authorities. The Moldovan judiciary held that the airport authorities failed to follow the competitive tender process required by the law, thereby preventing the foreign investor’s competitors from participating in a tender for the right to operate duty-free shops at the Chisinau Airport. Disgruntled by this judicial ruling, the investor initiated investor-state arbitration. The investment tribunal acknowledged that the courts of Moldova had acted in what was an exemplary manner by transition economy standards. Yet the courts’ effort to restore the rule of law by pronouncing on the illegality of the administrative action was found to be in violation of Moldova’s IIA commitments, simply because the court rulings discouraged Arif’s investment, while the executive branch encouraged the same.[[19]](#footnote-19) This inconsistent treatment of the investor by the two branches of the Moldovan government was found to constitute a breach of the fair and equitable treatment standard. The executive branch committed a further treaty breach when it enforced the national court’s orders against the investor, so as to restore legality and compliance with national laws.[[20]](#footnote-20) The case of Arif is unsettling because it shows that, on the one hand, the lack of domestic remedies could itself lead to state liability, including under the effective means standard. On the other hand, the availability of such remedies and their utilisation by national courts could also be a problem, as attempts to restore legality in domestic law by national courts could be regarded as a breach of investment treaty law. This leaves host states in a situation when any attempt to rectify the original wrongfulness in executive conduct by judicial organs may be seen not only as superfluous but also in violation of IIAs. Can suppressing domestic judicial oversight of domestic executive action promote the rule of law? How can IIA prescriptions of good governance be embedded and implemented in domestic legal orders if restoring the rule of law by judicial bodies can itself be condemned and sanctioned as an investment treaty breach? ‘If States cannot simultaneously respect arbitral norms and facilitate the integrity of institutions that support development, one of the key justifications for IIAs – their contribution to economic development – can be brought into question.’[[21]](#footnote-21) If states cannot simultaneously respect the rule of law prescriptions of IIAs and maintain legality and integrity in the functioning of national institutions, the contribution of IIAs to the creation of rule-orientated governance practices is just as questionable.

## B. Does the Investment Treaty Regime Comply with Good Governance Standards?

When analysing state compliance with good governance standards through the lens of liberal institutionalist theory, one is pushed to question what role the existing design of international investment arbitration institutions plays in determining the regime’s capacity to affect state behaviour. ‘Institutions ... need to be consistent with the basic normative commitments of their members, so that having a reputation for supporting the institution has intrinsic, as well as instrumental, value.’[[22]](#footnote-22) Does the investment treaty regime possess the necessary institutional consistency that would enable it to have a transformative impact on domestic governance? To be able to foster good governance and compliance with the rule of law in host states, international investment law must be guided by the same governance precepts, including transparency, predictability, consistency and accountability. There is a considerable body of scholarly contributions that have criticised both the institutional framework and the procedural mechanisms of investment treaty law for falling short of these benchmarks.[[23]](#footnote-23) In this contribution, mention should be made of another shortcoming of the existing investment treaty regime, which detracts from its capacity to foster *ex ante* compliance and can discourage rather than encourage positive change in host states: its lop-sided nature and the resulting ambiguity of normative values that it stands for and is able to export into domestic regimes. Of particular interest here is the much-criticized failure of international investment law to balance investment rights with investment responsibilities, particularly in the context of corruption. Well-evidenced and much-discussed cases of misconduct by foreign investors and their complicity in illegal acts committed by governmental agencies in host states is an illustration of how investments can affect local communities not by eliminating inadequate governance practices but rather by entrenching them. Cases such as *World Duty Free v Kenya*, *Inceysa v Ecuador* and *Fraport v Philippines* have divided academics and practitioners as to how international investment law should tackle the incidence of corruption.[[24]](#footnote-24) At one end of the spectrum are those who advocate a zero-tolerance approach to investor participation in corruption, and in particular bribery. Others argue that ‘a zero-tolerance approach undermines the general welfare of non-parties to the arbitration, who may be, as described by the *World Duty Free* tribunal with reference to the peoples in Kenya, “the mass of tax-payers and other citizens making up one of the poorest countries in the world.”’[[25]](#footnote-25) Furthermore, commentators have even suggested that ‘upholding corrupt investors’ claims in appropriate circumstances, such as where the state has condoned or demanded bribes from investors, is a more effective method of combating corruption and *enhancing the rule of law*’.[[26]](#footnote-26) The claim that the rule of law could be strengthened through condoning investors’ complicity in bribery and corruption appears to be dubious at best. It is true that countries which suffer from endemic government corruption usually lack a *culture* of legitimate and transparent business practices and the political will to encourage such practices by enforcing anti-corruption laws.[[27]](#footnote-27) Should tribunals grant investors compensation even despite their claims being tainted by corruption, the host communities would not benefit from such awards but would rather be taxed twice: once through the perpetuation of corrupt practices by foreign companies, and then by having to shoulder the financial burden of the monetary award rendered against the host state. If IIL continues to allow corrupt investors to recover their losses despite their participation in corrupt practices, the function of IIAs as instruments of good governance can be legitimately doubted.

A troubling illustration of the impact of foreign investment – and of international rules on foreign investment protection – can also be found in the much-publicised instances of environmental neglect by foreign companies. Hirsch observes that ‘existing literature consistently emphasises the importance of foreign investment as a channel for the diffusion of knowledge, technology and management practices’.[[28]](#footnote-28) What role do foreign investments *and* investment protection rules play in entrenching, rather than eliminating, weaknesses in governance practices in host states, in particular environmental governance? One cannot but agree with Miles’s observation that ‘sourced from a purely instrumentalist conceptualisation of the environment, [international investment law] is indifferent to the effects of investor activity on the local communities and environments of host states’.[[29]](#footnote-29) The negative impact of international investment law on domestic governance, and in particular environmental governance, is considered as one of the legacies of imperialism which lies at the roots of the modern IIL. It finds its reflection in the historical ‘commodification of the environment of host state for the use of the foreign investor’[[30]](#footnote-30) and the entrenchment of such commodification in host states’ neglect of the environment. Just as with corporate complicity in corruption, both integrity and feasibility of the good governance promise of the investment treaty regime hinges on the stance investment treaties and arbitration take on environmental misconduct of foreign investors.

# III. Some Insights into Emerging Empirical Evidence on the Patterns of Internalisation of Investment Treaty Prescriptions in Host Governments

At the heart of the argument that posits a transformative impact of investment treaty law on governance in host states is an assumption that investment treaty rules act as ‘a deterrent mechanism against short-term policy reversals and assist developing countries in promoting greater effectiveness of the rule of law at the domestic level’.[[31]](#footnote-31) ‘While tribunals cannot quash domestic acts or compel States to bring their domestic legal order into line with investment treaty obligations, the monetary sanctions they can impose exert considerable pressure on states to bring their domestic legal orders into conformity with their investment treaty obligations.’[[32]](#footnote-32) However, just as with many areas of international law and policy, the claims regarding effectiveness of international investment law, including in the context of fostering good governance and the rule of law in host states, remain by and large empirically and theoretically untested.[[33]](#footnote-33)

The project intends to fill this gap and examine the interplay between investment treaty disciplines and governmental conduct by focusing on the so-called incentive effects of investment treaty rules on bureaucratic behaviour. If host states are expected to respond to investment treaty norms by adjusting their legal orders and ensuring *ex ante* compliance with the prescribed standards of governmental conduct, government officials ought to understand the scope and meaning of investment protection guarantees under existing bilateral and multilateral agreements. To what extent are government officials actually aware of and influenced by investment treaty disciplines in making their decisions? In empirically evaluating the interplay between investment treaty rules and host state behaviour it is important to disentangle two distinct but interrelated issues: (1) the extent of awareness of investment treaty law; and (2) the ways in which investment treaty law is internalised leading to changes in government behaviour.

Recent empirical studies provide useful insights into the extent to which government officials are aware of investment treaty prescriptions. For instance, Poulsen and Aisbett’s survey of government officials in 13 developing countries has shown that ‘all officials, including stakeholders, noted that they had been unaware of the far-reaching scope and implications of bilateral investment treaties (BITs) during the 1990s, when the treaties proliferated’.[[34]](#footnote-34) Although the primary focus of their survey was on the making of BITs rather than the impact of BITs on host state behaviour, it nevertheless elucidates the extent to which government officials, including those who were directly involved in signing BITs, were and are aware of investment treaty law.

Of course, the question can be raised as to whether the historically low levels of awareness have changed after the number of investment treaties and investment arbitrations proliferated. Poulsen and Aisbett’s study also reveals that: ‘In twelve out of 13 countries where officials were interviewed, respondents thus noted that it was not until the first claim was filed against their country that stakeholders realized that BITs exposed them to serious liabilities.’[[35]](#footnote-35) This finding resonates with those made by this author in the course of case studies conducted in two developing states. The case studies comprised interviews with government officials and analysis of national legislative material relating to investment policy-making and dispute settlement, as well as rules on the enforcement of judgments against government agencies and officials in two developing countries which (1) have a number of investment treaties; and (2) have been exposed to investment arbitration on a number of occasions. The interviews (21 respondents in total) were conducted among government officials working in ministries and agencies that have had involvement in investment treaty making and dispute settlement, as well as government officers who interact with foreign investors outside the context of investment treaty law and dispute settlement, that is, in making, implementing and otherwise applying national laws in domestic, not international, settings. The interviews showed that the first exposure to investment arbitration claims entailed a spike in the level of awareness of investment treaty law among government officials who were directly involved in regulating and implementing foreign investment projects (for example, ministries of energy, economic development, justice and foreign affairs).

What is perhaps even more interesting for the purposes of this project is that the case studies show a remarkable lack of awareness of investment treaty law among officials in lower tiers of government. Even before the emergence of empirical scholarship on international investment law and policy-making, it was argued that decision-makers – particularly those in administrative agencies of developing states – who do not have direct or regular dealings with foreign investors are unlikely to be aware of international investment agreements and their prescriptions.[[36]](#footnote-36) As a consequence, such decision-makers are unlikely ‘to internalise the constraints of investment treaty protections’ [[37]](#footnote-37) not only when evaluating the adoption of new governmental measures but also in exercising their day-to-day decision-making powers vis-à-vis foreign investors. The case studies suggest that, even after the respective governments became exposed to a number of investment treaty arbitrations, government officials in the executive and judicial organs have remained unaware of both the very existence of investment treaty law and of the fact that their acts or omissions affecting foreign investors may lead to investment arbitration claims. This preliminary finding is noteworthy, not least because recent statistical analyses of the International Centre for the Settlement of Investment Disputes (ICSID) case load show that the majority of government decisions that lead to investor-state arbitrations are associated with actions taken by the executive branch and that, beyond ministries, it was the conduct of subnational actors such as provincial, state and municipal authorities and agencies that eventually led to investment disputes.[[38]](#footnote-38) If government officials involved in making executive and judicial decisions vis-à-vis investors are unaware of investment treaty law and its prescriptions, even after the country has had to defend itself in a number of investment arbitration cases, it becomes very difficult to agree with the argument that such arbitration would lead to changes in governmental practices and culture within these agencies.

Another noteworthy aspect that emerges from the case studies is that investment treaty law can be internalised by government officials but not necessarily in the way predicted by the proponents of the good governance narrative. Although anecdotal, evidence from the interviews reveals that, in some cases, despite the previous exposure of the host state to investment treaty arbitration claims, government officials chose to ignore the risk of a new claim which their action could entail. One interviewee, for instance, referred to an incident where a high-ranking official disregarded legal advice about the potential risk of investment arbitration on the ground that the governmental action at issue was economically significant and thus more important. It appears that even though, as some scholars have suggested, the country may scale back its IIA policy after experiencing their bite,[[39]](#footnote-39) the existence of IIAs may not necessarily influence government decision-making vis-à-vis a concrete foreign investment project even after the country had been exposed to investment arbitration. This suggests that, due to various factors, the awareness of IIAs and of their implications does not necessarily lead to internalisation in the sense of engendering more risk-averse and IIA-compliant patterns of behaviour on the part of government officials.

Governments’ failure to learn from their previous experience may also be reflected in their failure to adjust both their investment treaty policies and domestic legal frameworks. Since many cases of compliance or non-compliance with international law are ultimately made by individuals,[[40]](#footnote-40) it can be questioned whether holding a host government to monetary liability would have a subsequent deterrent effect and promote *ex ante* compliance with investment treaty rules, thus arguably leading to improved governance at a national level. In theory, the imposition of monetary liability on the state should compel a governmental agency to assume responsibility for detecting, identifying and controlling risk-increasing activities in which its departments and employees engage.[[41]](#footnote-41) Governments are expected to put in place risk management measures to identify potential exposure to, and reduce the probability and magnitude of, monetary liability.[[42]](#footnote-42) Such measures may include employee training programmes and remuneration policies that link the cost of governmental responsibility to salaries and promotions. The capacity of an external governance regime to induce government officials to act in a certain manner and to refrain from certain types of behaviour will hinge on the targeted government’s ‘monitoring ability’.[[43]](#footnote-43) A lack of proper incentive to avoid harm arises where neither the government nor its employees bear the costs of the harms that they cause.[[44]](#footnote-44) Thus, in order for investment treaty law to have an incentivising and transformative effect on national governance practices in a host state, an internal loss-allocation regime should be in place to ensure that monetary losses incurred as a result of damages awards are shifted to a governmental agency which has managerial, supervisory and budgetary authority, and political power over bureaucrats whose activities lead to state liability.[[45]](#footnote-45)

However, in practice, imposing liability on host governments does not necessarily lead to risk-averse bureaucratic behaviour. This preliminary conclusion draws on interviews as well as sample case studies of national legal rules governing the payment of damages in connection with claims against state organs and government officials. It transpires that governments often fail to respond to liability rules in the expected manner, that is, they fail to take measures aimed at identifying the causes of investment disputes and preventing officials from engaging in the forms of conduct that may lead to a dispute and host state liability. It has emerged from one case study, for example, that the only monitoring mechanism the government introduced after its exposure to investment arbitration was a new agency tasked with dealing with investment claims. No attempt was made to identify the potential causes of investment disputes and to put in place measures to change governance practices that fell short of investment treaty prescriptions.

‘Individuals’ behaviour and normative choices are significantly affected by the social context and socio-cultural factors.’[[46]](#footnote-46) The very ability of the host government to act sensitively and thus respond to the harmful consequences of international liability by changing relevant practices can be severely circumscribed by the very weaknesses in the domestic legal and bureaucratic culture which international investment law allegedly aims to improve. Such shortcomings interfere with government ability to put in place and maintain an effective internal monitoring and loss-prevention mechanism. Governments in democratic states with high levels of institutional capacity are more likely to show sensitivity to the imposition of international liability than those with a long and pervasive record of corruption and cronyism.[[47]](#footnote-47) Liberal institutionalist theorists have long argued that ‘the domestic regime type is essential to understanding international law compliance’.[[48]](#footnote-48)

Governments based on the rule of law and, especially, the independence of the judicial branch are, in this view, much more likely to comply with international obligations than those that are not. Liberal democracies are likely to commit to rules that reflect their ideological biases and to comply with them.[[49]](#footnote-49)

Although this proposition ‘has not been put to a rigorous test’,[[50]](#footnote-50) host state compliance with international investment law may provide an interesting empirical case to support this theory, by illustrating how different countries vary in their response to the pressure of investment treaty law, that is, reform-orientated response in developed states and withdrawal and backlash in less developed states.

More to the point, the specificity of the host state regime needs to be taken into account in designing or recalibrating deterrence and incentive devices through which international investment law is to transform national governance cultures. Scholarship on law and development has made considerable advance in analysing rule of law initiatives and their impact on governance in host states. For instance, Trebilcock and Daniels highlight the role of socio-cultural values as a critical success factor in rule of law reform.[[51]](#footnote-51) The use of top-down, one-size-fits-all reform blueprints and the ensuing insensitivity to the needs and contexts of target states have caused many a reform initiative to founder.[[52]](#footnote-52) Furthermore, scholars sound a note of caution that: ‘Governments unequivocally opposed to rule of law reform will rarely be sensitive to state-level pressure mechanisms.’[[53]](#footnote-53) These observations expose the fallacy of assumptions which lie at the heart of the good governance narratives: those who advocate that investment treaty law and its monetary sanctions can act as a catalyst of governance reforms in developing states disregard the complexity of factors which shape governance practices and the diversity of incentives through which such practices could be changed.

# IV. The Varying Impact of Investment Treaty Remedies: On Forms of Impact and the Role of Domestic Actors in Shaping It

If investment treaty law is capable of producing a transformative effect on government behaviour, there is a likelihood that such an effect will not always be positive (that is, it will stimulate compliance with good governance standards) but in some cases negative (that is, it will inhibit governments from otherwise desirable action and lead to the so-called regulatory chill). The existence of a chilling effect of investment treaty law on national regulatory activity is a matter of an ongoing scholarly debate, particularly in the context of a clash between investment protection and states’ regulatory freedom to pursue environment protection, health and safety, and other public policy measures. Some scholars have argued that investment treaties ‘*should* not lead to a chill on environmental regulation nor obstruct measures that are introduced in an attempt to mitigate climate change’.[[54]](#footnote-54) This proposition, however, does not engage with empirical and theoretical studies on the effect of international rules on government conduct. Other contributions to the debate indicate that international investment treaties are likely to, and in some cases do, have a chilling effect on regulatory conduct.[[55]](#footnote-55) The aim of this project is not to record the fact that investment treaties restrict regulatory powers but rather to test this claim from various angles. In particular, attention will be drawn to the interface between good governance and regulatory chill. One aspect of this interface is the variety of ways in which international investment law can influence host state behaviour – known examples include regulatory chill, withdrawal (treaty chill), and arguably domestic governance reforms. This variety in turn gives rise to the question about the factors that determine the way in which host states respond to investment treaty disciplines.

First, we suggest that regulatory chill should be examined as a form of excessive risk-reduction strategy triggered by the imposition of monetary liability on the host state. Host states where internal risk-reduction mechanisms are in place are likely to be more susceptible to the chilling effect of investment treaty norms. This preliminary conclusion not only draws support from the liberal institutionalist and managerial theories of compliance but is also supported by a recent study on bounded rationality, which suggests that decision-making in the investment treaty context varies with the extent of expertise in the relevant government agencies, whereby developed countries with higher levels of administrative capacity may display different patterns of learning from their investment treaty experience.[[56]](#footnote-56)

Secondly, in examining the impact of investment treaty law on national governance it is important to consider the role of domestic actors in shaping a host state’s response to investment treaty disciplines. Just like many of the existing theories of compliance with international law, investment law scholarship leaves unaddressed the question of how international legal rules advance the interests of different constituencies within the target state and how those constituencies shape the way host states respond to and internalise investment treaty prescriptions.[[57]](#footnote-57) This is particularly pertinent in the context of discussing a potentially negative impact of investment treaty law on national governance whereby the imposition or threat of sanctions produces regulatory chill. To what extent, and how, is this causal relationship between investment treaty sanctions and government decision-making influenced by various domestic constituencies? As Trachtman has observed:

A theory of formation and compliance with international law that focuses on the role of domestic political coalitions achieves important theoretical advances. ... It allows for the possibility of greater explanatory and predictive power than ‘unitary state’ theories of compliance. Second, it encompasses the role of individuals in domestic politics, and therefore moves toward a more liberal and cosmopolitan understanding of the role and dynamics of international law. A domestic coalition-based theory of international law transcends the state and examines individual preferences, but takes the state as the partial mediator of individual preferences.[[58]](#footnote-58)

It seems that, with its focus on individuals and its departure from state-centric approaches, such theory would provide a suitable analytic frame for examining *ex ante* compliance with good governance prescriptions of IIAs. ‘State behaviour is the result of complex interactions between political players at the domestic level, and cannot be explained as simply resulting from power-maximizing behaviour or strategic calculation by a unitary actor.’[[59]](#footnote-59) Why despite sharing similar socio-economic and political characteristics, do states – both developed and developing – differ in the way they respond to investment treaty law? For instance, some developed states have amended their investment treaty models whilst others continue to use the traditional drafting patterns. What lies beneath this variation in the ways developed states have approached investment treaty reform? There are some instances where host states have moved towards a more participatory investment treaty policy[[60]](#footnote-60) (that is, United States, South Africa and more recently the European Union). The exposure to investment treaty claims has generated different responses among developing states too; some have reacted by withdrawing from the investment arbitration regime, others moved to adjust their treaties, yet others continued their participation in the regime by leaving investment treaty texts intact. In order to better understand the interplay between investment treaty law and governance in host states, we need to ‘[p]eer inside the state, looking for the individuals and groups that influence governments through political institutions and social practices’.[[61]](#footnote-61)

Closely linked to the place of domestic actors in the shaping of host state responses to IIAs is the position of stakeholders other than investors and host states within the emerging architecture of the global investment regime. In their recent political science perspective on government behaviour in signing IIAs, Aisbett and Poulsen question ‘whether more participants in the policy-making process reduce the aggregate impact of individual biases’.[[62]](#footnote-62) For example, the role of civil society groups in international investment law has received some attention in recent legal discourse, but what remains little explored is whether and how such actors shape the impact of investment treaty law on domestic governance. It has been pointed out that ‘host state grassroots activism remains a source of pressure to reform the unbalanced nature of international investment law, to give voice to those affected by the activities of foreign investors, and to reflect the role of resistance in shaping the regulatory network of investment protection’.[[63]](#footnote-63) Could the emerging variation in the drafting of treaty models and different patterns of response to treaty disciplines be explained by a more inclusive process in some countries and a relatively limited involvement of stakeholders other than the business community and its lobby in the treaty-making process of other countries?

# V. Conclusion

Can international investment law foster good governance in host states? This contribution has discussed some of the questions that arise when the good governance narratives in the investment treaty law context are subjected to critical scrutiny. Leaving aside the question of whether fostering good governance at a domestic level is, or ought to be, the function of investment treaty law, the chapter has instead focused on the capacity of investment treaties and the investment arbitration mechanism to bring about change in the legal and bureaucratic culture and practices of states.

In an effort to make a novel contribution to the emerging debate about the impact of investment protection instruments on host state behaviour, the chapter adopted an interdisciplinary and a socio-legal perspective. In particular, it drew on political science scholarship concerning state compliance in international law as well as on empirical case studies aimed at identifying the ways in which international investment law is perceived and internalised by national institutions and actors.

The chapter also proposed examining the impact of investment treaty law by retreating from a unitary notion of state and acknowledging the diversity of domestic epistemic communities that shape the ways in which host states respond to investment treaty disciplines. As the aim of the contribution has been to introduce some of the key arguments and empirical insights emerging from the case studies so far, the relevant findings are not conclusive and require further methodological and conceptual refinement. Rather than offering a comprehensive and detailed critique of good governance narratives in investment law scholarship, it highlights the novel doctrinal and conceptual questions that arise when examining the interplay between investment treaty law and national governance.

1. \* Senior Lecturer, University of Liverpool School of Law and Social Justice. [↑](#footnote-ref-1)
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3. Stephan Schill, *The Multilateralization of International Investment Law* (Cambridge, Cambridge University Press, 2009) 377. [↑](#footnote-ref-3)
4. David Gaukrodger and Kathryn Gordon, ‘Investor-state dispute settlement: A scoping paper for the investment policy community’ (OECD Working Papers on International Investment, No 2012/3, OECD Investment Division), available at www.oecd.org/daf/investment/workingpapers,13. [↑](#footnote-ref-4)
5. Antony Anghie, ‘Civilisation and Commerce: The Concept of Governance in Historical Perspective’ (2000) 45 *Villanova Law Review* 887, 893. [↑](#footnote-ref-5)
6. Roberto Echandi, ‘What Do Developing Countries Expect from the International Investment Regime?’ in Jose E Alvarez et al, *The Evolving International Investment Regime: Expectations, Realities, Options* (Oxford, Oxford University Press, 2011) 13. [↑](#footnote-ref-6)
7. Ibid 14. [↑](#footnote-ref-7)
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9. Of note is the study conducted by Tom Ginsburg, ‘International substitutes for domestic institutions: Bilateral investment treaties and governance’ (2005) 25 *International Review of Law and Economics* 107. [↑](#footnote-ref-9)
10. Robert O Keohane, Andrew Moravcsik and Anne-Marie Slaughter, ‘Legalized dispute resolution: interstate and transnational’ (2000) 54(3) *International Organization* 457, 476. [↑](#footnote-ref-10)
11. Ibid 476. [↑](#footnote-ref-11)
12. Ibid 478. [↑](#footnote-ref-12)
13. Harold Koh, ‘How Is International Human Rights Law Enforced?’ (1998) 74 *Indiana Law Journal* 1397, 1407; see also Oona A Hathaway, ‘Do Human Rights Treaties Make a Difference? (2002) 111 *Yale Law Journal* 1935, 1961. [↑](#footnote-ref-13)
14. Gerry Stoker, ‘Governance as theory: five propositions’ (1993) 50(155) *International Social Science Journal*

    17. [↑](#footnote-ref-14)
15. See Diane A Desierto, ‘ASEAN’s Constitutionalization of International Law: Challenges to Evolution under the New ASEAN Charter’ (2011) 49 *Columbia Journal of Transnational Law* 268, 316 highlighting the importance of norm embedding in the context of ASEAN. [↑](#footnote-ref-15)
16. See eg Art II(7) of the Treaty Between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment (adopted 27 August 1993, entered into force 11 May 1997); also Art 10(12) of the Energy Charter Treaty (signed 17 December 1994, entered into force 16 April 1998) 2080 UNTS 100. [↑](#footnote-ref-16)
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18. Carol Harlow, ‘Global Administrative Law: The Quest for Principles and Values’ (2006) 17 *European Journal of International Law* 187, 211. [↑](#footnote-ref-18)
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21. Ibid 3. [↑](#footnote-ref-21)
22. Robert O Keohane, ‘International Relations and International Law: Two Optics’ (1997) 38 *Harvard International Law Journal* 487, 502. [↑](#footnote-ref-22)
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24. *World Duty Free Company Limited v Kenya*, Award 4 October 2006 (ICSID CASE NO. ARB/00/7); *Inceysa Vallisoletana S.L. v. El Salvador*, Award 2 August 2006 (ICSID Case No. ARB/03/26); *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines*, Award 16 August 2007 (ICSID Case No. ARB/03/25). [↑](#footnote-ref-24)
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26. Ibid 622. [↑](#footnote-ref-26)
27. Ibid. [↑](#footnote-ref-27)
28. Moshe Hirsch, ‘The Sociology of International Investment Law’ in Zachary Douglas, Joost Pauwelyn and Jorge E Viñuales (eds), *The Foundations of International Investment Law: Bringing Theory into Practice* (Oxford, Oxford University Press, 2014) 4–5, available at papers.ssrn.com/sol3/papers.cfm?abstract\_id=2322328. [↑](#footnote-ref-28)
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30. Ibid 134. [↑](#footnote-ref-30)
31. Echandi (n 5) 13. [↑](#footnote-ref-31)
32. Stephan W Schill, ‘System Building in Investment Treaty Arbitration and Lawmaking’ (2001) 12 *German Law Journal* 1083, 1085. [↑](#footnote-ref-32)
33. Except for a burgeoning body of research, including recent studies authored by Jonathan Bonnitcha, Emma Aisbett, Lauge Poulsen, Jason Yackee and Susan Franck. Although Bonnitcha has examined the impact of investment treaty law on government decision-making, the focus and methodology of his research are different from this project. See respectively, Jonathan Bonnitcha and Emma Aisbett, ‘An Economic Analysis of the Substantive Protections Provided by Investment Treaties’ in Sauvant et al (eds), *Yearbook on International Investment Law & Policy 2011–2012* (New York, Oxford University Press, 2013) 681–704; Lauge N Skovgaard Poulson and Emma Aisbett, ‘When the Claims Hit: Bilateral Investment Treaties and Bounded Rational Learning’ (2013) 65 *World Politics* 273–313; Jason Webb Yackee, ‘Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence’ (2010–2011) 51 *Virginia Journal of International Law* 397; Susan D Franck, ‘Development and Outcomes of Investment Treaty Arbitration’ (2009) 50 *Harvard Journal of International Law* 435. [↑](#footnote-ref-33)
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42. Ibid 246. [↑](#footnote-ref-42)
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51. Michael J Trebilcock and Ronald J Daniels, *Rule of Law Reform and Development: Charting the Fragile Path of Progress* (Cheltenham, Edward Elgar, 2008) 336. [↑](#footnote-ref-51)
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