**Do Developing Countries Really Benefit from Investment Treaties? The impact of international investment law on national governance**

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Who benefits from international investment law? Contemporary international rules on investment protection have their historical roots in a system that was designed to protect interests of foreigners abroad—to ensure that foreign business actors in host states benefited from governance as good as that they enjoyed in their home states, even if a host state’ legal system fell below the acceptable standard.[[1]](#footnote-2) Although met with strong opposition from a wider international community,[[2]](#footnote-3) the idea of special treatment—or good governance—for foreign investors has entered the corpus of international law through IIAs. Supported by its own bespoke dispute settlement mechanism (ISDS), the modern IIA regime effectively reaffirms the historically contested rules on special treatment of foreign investors.

In its recent strides, however, the investment treaty regime has moved far beyond its original mission of safeguarding foreign investors against serious breaches of international law, such as outright takings of property and denial of justice. Special treatment of foreign investors now means that international business actors may claim redress even for governmental actions displaying “a relatively lower degree of inappropriateness.”[[3]](#footnote-4) Lack of transparency, stability and predictability of state actions as well as the lack of effective remedies and enforcement mechanisms at a national level can now lead to a host state’s liability in damages.

## The rise of good governance justification in arbitral awards and the literature

To support the expansion of the scope of state responsibility under investment treaties, new justifications have been proffered claiming that the regime fulfils a useful societal function. Some of the emerging narratives argue that investment treaties and ISDS benefit not only foreign investors but also a broader range of stakeholders in host states, from businesses to ordinary citizens. Even if investment treaties might be unsuccessful in achieving their economic objectives, it is argued, their existence would still be justified by good governance norms enshrined in substantive standards of treatment such treaties impose on state parties.[[4]](#footnote-5) Although designed to benefit foreign investors, these good governance standards may arguably “spill over into domestic law and set new standards also for the domestic legal system.”[[5]](#footnote-6) The key premise of the good governance narrative is that the remedy of damages would pressure host states into complying with and incorporating the good governance standards in their domestic legal order and wider bureaucratic practices.[[6]](#footnote-7) By acting as *catalysts* of governance reforms in host states, investment treaties allegedly improve domestic governance not only for foreign investors but also for host communities.

In a rather worrying turn, the language of good governance has been embraced not only by academics but also by arbitral tribunals. In a string of awards, including the seminal *Metalclad*, *Tecmed* and *Occidental* cases[[7]](#footnote-8), arbitral tribunals held that transparency, stability, predictability and consistency of state behaviour ought to be seen as constitutive elements of the FET standard. Recent efforts to reform investment treaties have done little to reverse such interpretative practices, although construing FET as a host state’s obligation to abide by good governance has never been adequately supported by historical and doctrinal evidence. The interpretations of other good governance standards, such as an investment treaty obligation to provide an effective means of asserting claims and enforcing rights are similarly questionable both for their insufficient legal underpinnings and their normative implications.[[8]](#footnote-9) Harnessing the language of good governance to justify the expansive interpretation of investment treaty rules is unlikely to divert attention from the shortcomings of the legal and normative reasoning underpinning the relevant arbitral awards. Rather, it may further heighten concerns over the regime’s legitimacy and credibility.

## Does empirical evidence support the good governance argument?

The claim that investment treaties improve governance at a national level is yet to be supported with empirical evidence. Instead, the good governance narrative of international investment law is premised on a set of assumptions about how host states *should* respond to investment treaty norms. The proponents of the good governance narrative presume that the imposition of monetary liability on host states for a breach of good governance standards will (1) deter host states from mistreating foreign investors and (2) encourage them to proactively reform legal and bureaucratic practices.[[9]](#footnote-10)

For such deterrent and transformative effects to exist, however, government officials in host states need to be aware of the existence and meaning of investment treaty norms. Furthermore, national legal and regulatory frameworks should be in place to effectively discourage government officials from acting in breach of those investment treaty norms. The crucial question is: to what extent are government officials actually aware of and influenced by investment treaty disciplines in making their decisions vis-à-vis foreign investors? Does the imposition of monetary sanctions on host states prompt them to address the governance failures lying at the roots of investor–state disputes and to enhance accountability of relevant government agencies and officials?

Recent empirical studies seek to answer these questions through interviews with government officials and the analysis of national legislation in developing country states.[[10]](#footnote-11) The case study of five developing countries’ experience reveals that, even after states become respondents in investment arbitration, many of their government officials tend to remain unaware of investment treaty law and its implications. Even where government officials learnt about investment treaty law from their involvement in investor–state arbitration, such learning has not been translated into reforms to improve governance. The empirical data also shows that, despite having gained a certain awareness and knowledge of investment treaty law, some host governments continue to neglect the possible repercussions of their actions in breach of that law. Notwithstanding the threat of adverse financial consequences, in some cases host governments prefer to breach investment treaty norms where they find it economically and politically more expedient. Dissatisfaction with investment arbitration also appears to push host states to consider retroactive changes in national laws on investment protection and to withdraw from the investment treaty regime altogether.

*Good governance only for foreign investors?*

The emerging empirical evidence also raises the question whether, by effectively insulating foreign investors from the shortcomings of domestic regimes and by replacing the latter with the arguably stronger and more effective international alternative, the investment treaty regime reduces the incentive for host states to improve domestic governance institutions and practices.[[11]](#footnote-12) Since ISDS allows investors to escape the jurisdiction of domestic courts, national judiciaries are not merely deprived of incentives to compete with international tribunals and enhance the quality of their governance outputs, but they are also effectively barred from otherwise embedding international standards of good governance in the legal and bureaucratic practices of host states.

The empirical evidence also suggests that, due to the emphasis of the investment treaty regime on the idea of foreign investors deserving special protection, the regime contributes to a fragmentation of the national judicial and regulatory landscape and the emergence of special decision-making bodies specifically tasked with shielding foreign investors from national law and institutions. There is a discernible trend among developing country states toward creating legal enclaves for foreign investors not only at the international but also national level. The proliferation of these enclaves does not inspire belief in international law as a force for change. Instead, overvaluing foreign investors entrenches the prevailing perceptions of international law as a forum for select privileged actors. Rather than encouraging a comprehensive reform of national governance institutions and practices, developing country governments are directed toward solutions offering “good governance only for foreign investors.”

*Is the investment treaty regime itself compliant with good governance standards?*

Another crucial question is whether international investment law has the necessary characteristics to inspire changes at a national level. The investment treaty regime, in its current form, lacks some of the vital characteristics necessary for its purported mission to act as a mechanism signalling what the universally acceptable standards of good governance are.[[12]](#footnote-13) Among other things, the actual impact of investment treaty law on governance in host states hinges on the stance the regime takes on investor misconduct. If investment treaties and arbitral tribunals turn a blind eye to illegal acts perpetrated by foreign investors in host states, including bribery and corruption, the investment treaty regime could be complicit in encouraging and perpetuating inadequate and undesirable patterns of behaviour by governments and foreign investors. Regrettably, the bulk of existing investment treaties do not contain provisions to expressly address investor misconduct. Investment treaty law has long been criticized for is its asymmetric nature—for providing investor with rights, but not imposing any obligations.[[13]](#footnote-14) The failure to address the lack of investor accountability in IIAs is at odds with the investment treaty regime’s proclaimed commitment to the ideals of rule of law and good governance.

*Sanctions, top-down reforms and capacity-building*

The empirical studies of the good governance effects of investment treaty law also highlight the central role played by resource constraints in shaping the states’ capacity to internalize good governance norms. As law and development scholars have long argued, external sanctions and top–down reforms may not always carry an enabling effect on recipient countries.[[14]](#footnote-15) It seems that the emerging transnational network of influence—primarily comprising international financial and aid institutions, Western governments and those responsible for the production and diffusion of investment treaty norms—may in fact suppress rather than enable meaningful improvements in domestic governance. With their emphasis on external (foreign) expertise and external (international) law and dispute settlement mechanisms, the workings of these transnational agents may have a weakening effect on the national legal consciousness and thus hinder the emergence of new, innovative ways of interaction between developing country states and the global investment protection regime.

## Final remarks

Now that empirical evidence increasingly points to the lack of positive correlation between investment treaties and increased FDI,[[15]](#footnote-16) who stands to gain from IIAs granting foreign investors enhanced privileges? What is the overarching societal function of the contemporary investment treaty regime and to what extent is that function attainable given the existing design of investment treaty rules and associated investment arbitration procedures? Further studies are needed to explore how those who ultimately bear the costs of investment rules—developing country states and host communities—could be included in the process of redefining international investment governance and shaping the content of investment protection policies.

### Author

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1. Root, E. (1910). The basis of protection to citizens residing abroad. *American Journal of International Law*, *4*(3),517–528, pp. 521–522. [↑](#footnote-ref-2)
2. See, for example, UN GA Resolutions No. 1803 (December 14, 1962) and No. 3281 (December 12, 1984). [↑](#footnote-ref-3)
3. *Saluka Investments BV v. Czech Republic*, PCA—UNCITRAL, Partial Award, March 17, 2006, para. 293. [↑](#footnote-ref-4)
4. Vandevelde, K. J. (2010). *Bilateral investment treaties: History, policy, and interpretation*. Oxford: Oxford University Press, p. 119. [↑](#footnote-ref-5)
5. Muchlinski, P., Ortino, F., and Schreuer, C. (Eds.). (2008). *The Oxford Handbook of international investment law.* Oxford: Oxford University Press, p. vi. [↑](#footnote-ref-6)
6. Schill, S. W. (2009). *The multilateralization of international investment law*. Cambridge: Cambridge University Press, p. 377. [↑](#footnote-ref-7)
7. *Metalclad Corporation v Mexico,* Award, August 25, 2000, ICSID Case No ARB (AF)/97/1; *Técnicas Medioambientales Tecmed SA v Mexico,* Award, May 29, 2003, Case ARB(AF)/00/2; *Occidental Exploration and Production Company v Ecuador,* Award, July 1, 2004, LCIA Case No UN 3467, [↑](#footnote-ref-8)
8. See, for instance, *AMTO v Ukraine*, Final Award, March 26, 2008, SCC Case No 080/2005, para. 87 (the tribunal construed the effective means standard as requiring that national laws must be not only accessible but also effective). [↑](#footnote-ref-9)
9. See Dolzer, R. (2005). The impact of international investment treaties on domestic administrative law, *New York University Journal of International Law and Policy, 37*, 972; Schill, S.W. (2009). *The multilateralization of international investment law.* Cambridge: Cambridge University Press, p. 377; and Echandi, R. (2011). What do developing countries expect from the international investment regime? In Alvarez, J. E. & Sauvant, K. P. (Eds.), *The evolving international investment Regime: Expectations, realities, options* (pp. 3–21). Oxford: Oxford University Press. [↑](#footnote-ref-10)
10. See Sattorova, M. (2018). *The impact of investment treaty law on host states: Enabling good governance?* Oxford: Hart Publishing. See also Van Harten, G. & Scott, D N. (2017). Investment treaties and the internal vetting of regulatory proposals: A case study from Canada. *Investment Treaty News*, *8*(3), 8–9.Retrieved from [https://www.iisd.org/itn/2017/09/26/investment-treaties-internal-vetting-regulatory-proposals-case-study-from-canada-gus-van-harten-dayna-nadine-scott](https://www.iisd.org/itn/2017/09/26/investment-treaties-internal-vetting-regulatory-proposals-case-study-from-canada-gus-van-harten-dayna-nadine-scott/) [↑](#footnote-ref-11)
11. Tom Ginsburg has convincingly shown that the availability of ISDS at the international level reduces incentives for host states to improve domestic governance mechanisms and practices. See Ginsburg, T. (2005). International substitutes for domestic institutions: Bilateral investment treaties and governance. *International Review of Law and Economics*, *25*(1), 107–123, pp. 119–121. [↑](#footnote-ref-12)
12. Investment treaty law’s failure to comply with rule of law ideals of clarity, coherence, and fair process has been discussed in Van Harten, G. (2010). Investment Treaty Arbitration, Procedural Fairness, and the Rule of Law. In Schill, S.W. (Ed.), *International Investment Law and Comparative Public Law* (pp. 627-657). Oxford: Oxford University Press. [↑](#footnote-ref-13)
13. UNCTAD. (2015). *World investment report 2015: Reforming international investment governance*. Geneva: UNCTAD, p. 158. Retrieved from <https://unctad.org/en/PublicationsLibrary/wir2015_en.pdf> [↑](#footnote-ref-14)
14. See e.g. Trebilcock, M.J., and Daniels, R. J. (2008). *Rule of law reform and development: Charting the fragile path of progress*. Cheltenham: Edward Elgar, 2008, p. 351. [↑](#footnote-ref-15)
15. Pohl, J. (2018, January 18). Societal benefits and costs of international investment agreements: A critical review of aspects and available empirical evidence. *OECD Working Papers on International Investment, 2018/01*. Retrieved from <http://www.oecd-ilibrary.org/finance-and-investment/societal-benefits-and-costs-of-international-investment-agreements_e5f85c3d-en>; Bonnitcha, J. (2017, September). *Assessing the Impacts of Investment Treaties: Overview of the evidence*. Geneva: IISD. Retrieved from <https://www.iisd.org/library/assessing-impacts-investment-treaties-overview-evidence>; Yackee, J. (2010–2011). Do bilateral investment treaties promote foreign direct investment? Some hints from alternative evidence, *Virginia Journal of International Law*, *51*, 397–442. [↑](#footnote-ref-16)