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The Governance of Foreign Investment at a Crossroad: Is an Overlapping Consensus the Way Forward?

Abstract: This article makes the claim that the present efforts to reform the international investment regime (IIR) will not save this field from the existing criticisms. Given the plural values at issue, it is unlikely that states – let alone local populations – will ever reach a consensus on the substantive questions surrounding foreign investment. Historically, the main characteristic of foreign investment governance has been the lack of multilateral consensus. This field remained dominated by diplomacy and customary international law until bilateral treaties and investment arbitration became the leading mechanism to resolve investment disputes in the 1990s. This highly legalized regime, however, has been subject to criticisms from developing and increasingly from developed countries. Most reform proposals fail to go beyond alternatives that have been unsuccessful in the past, such as a multilateral investment agreement (MIA) or state-to-state arbitration. This article takes a different approach to foreign investment governance, starting from its political economy. It claims that the IIR does not depoliticize foreign investment relations but rather promotes the politics of foreign investors' property rights protection. Relying on property theory and pluralism as heuristic tools, this article analyses the resistance to investment arbitration, the obstacles to multilateral cooperation, and the possibility of an overlapping consensus on the institutions for foreign investment governance.

Keywords: international investment law, investment arbitration, governance

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> What is at issue is the degree of freedom that should be allowed the multinational corporation or the nature and extent of regulation that should be imposed on its present operations and future growth in order to make it better serve divergent national interests.
> U.S. Department of Commerce (1973, 42)

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1 Introduction

The mismatch between the global corporate reality and national political authorities is a central issue in economic regulation. Multinational corporations (MNCs) are active in different countries and view the world as a single market to do business. They are involved in the production of natural resources, outsource many of their activities, and sell final products globally. National political authorities may attempt to regulate any of these activities for a public purpose. But they often fail to tackle the entire business structure or the global value chain. This can create two kinds of political tension. On the one hand, there is the potential problem of distribution of benefits between MNCs and the different host states. An area where this is clear is international taxation, where MNCs can rely on different tax planning tools such as transfer pricing (Avi-Yonah 2000). On the other hand, there is a constant tension between the global corporate and the domestic perspectives. What local communities expect of foreign economic activities may be quite different from the maximum effective utilization of economic resources.

This mismatch between economic activity and political authority has attracted much attention from governments as well as the literature in international relations, international law, and international economics (Rehbinder 1969; Vagts 1970). In 1969, the U.S. Assistant Secretary of State for Economic Affairs predicted that the "problems of conflicting jurisdictions and of regulation in the public interest will [...] lead inevitably to international agreement and perhaps to international machinery for administration" (Solomon 1969, 125). But despite the large academic and governmental interest, there has been a systemic lack of multilateral consensus on the governance of foreign investment. Most governance initiatives of MNC activity today are based on voluntary corporate social responsibility initiatives.[1]

The situation of MNCs, paradoxically, has attracted much less attention. State activity nonetheless can hinder foreign investment if each country follows a particular regulatory philosophy aimed at materializing social goals as different as economic growth and community welfare. Interestingly, while there is little international regulation of MNC activities, there are several international legal tools in place that these corporations can use to supervise state activity. The international business lobby demanded and obtained the establishment of international mechanisms for the protection of foreign investment, while

1 The most important of these initiatives is the U.N. Global Compact. See www.unglobalcompact.org/.

convincing states that social and environmental issues should remain regulated at a domestic level (Stiglitz 2007; Levy and Prakash 2003).

The paradigm of these mechanisms is investment arbitration, a dispute resolution mechanism for foreign investment disputes based on international treaties for the protection of foreign investment. Most of these treaties are bilateral (BITs) and deal only with protection, although this tendency is changing and foreign investment liberalization is being introduced in recent free trade agreements. Presently, the network of investment treaties includes more than 3,000 treaties (UNCTAD 2013a, xix). The literature concurs that these treaties, despite some differences between them, constitute a regime with common "principles, norms, rules and decision making procedures" (Salacuse 2010; Schneiderman 2008, 26). The relevance acquired by the international investment regime (IIR) in the last two decades is mainly a result of investment arbitration. Investment treaties empower foreign investors to sue host states directly before international arbitral tribunals, without requesting the espousal of their home states. These tribunals are empowered to review host state measures according to the standards of protection incorporated in the applicable treaty.

It is possible to characterize the IIR within the trend of private international empowerment *vis-à-vis* national states. Investment treaties impose obligations on every signatory country, and these obligations only refer to standards of foreign investment protection. Since the inception of the IIR, however, developed countries only identified themselves with the role of home states (Miles 2013; Sornarajah 1997). Large corporations based on their territories and owned by national individuals were competing for raw materials and markets in the new postcolonial world. These investors needed security against the political authority of newly independent countries. Signing investment treaties was a way to facilitate the calculability of western business in foreign countries. Since developing countries were not expecting a sudden outflow of capital towards the developed world, investment treaties represented an asymmetric consensus that was "one-sidedly extended to developing countries" (Andersson 1991, 11).

The asymmetric structure of the IIR began to change only recently when developed states had to appear before investment tribunals as *respondents*. According to the United Nations Conference on Trade and Development (UNCTAD), 27% of the investment arbitrations in 2013 were initiated against developed states (UNCTAD 2014a, 7). This is a result of two central developments. First, there are increasing outflows of foreign investment from countries such as China, Brazil, India, and Russia to developed and developing countries. This new political economy breaks the *de facto* asymmetry of the regime, as China for instance has rapidly developed a new investment treaty programme (Gallagher and Shan 2009). Second, the international business lobby has pushed the IIR structure beyond its original postcolonial geography, i.e. beyond the original asymmetric character. After the creation of North American Free Trade Agreement, it became clear that investment arbitration not only served for Canadian and U.S. American corporations to sue Mexico but also for these foreign investors to sue the United States and Canada.[2]

As the asymmetric structure of the IIR fades, this article argues that the original consensus for the proliferation of investment treaties may come to an end too. While the international business and legal lobby continues to push for investment arbitration in every economic deal, governments and civil societies no longer only from Ecuador, Venezuela, or Bolivia but now also from Australia, France, and Germany begin to reconsider this regime, or at least, to reconsider whether they want to continue moving towards a universal model of investment protection (see Jandhyala, Henisz, and Mansfield 2011). Many actors in developed states did not worry about investment arbitration until very recently because this mechanism was meant to facilitate corporate control of resources in other latitudes; it was a problem of others. But as the *North vs South* dynamic of foreign investment changes, actors in the developed world are beginning to think about the IIR in *Private vs Public* terms: a side of the struggle that has concerned developing countries for many years.

The generalization of the resistance and discontent about the IIR is a recent phenomenon and may be indicating the decay of this regime or, at least, an increasing space for contestation and change (UNCTAD 2014b). Back are the days of the alleged *de facto* multilateral consensus. The IIR thus faces three potential scenarios: (a) It can overcome the legitimacy crisis, continuing the path envisioned by Wälde towards a universal regime applicable to every investor; (b) it can gradually recover its asymmetric structure; and (c) it can evolve into a broader institutional framework for the governance of foreign investment. The opportunity to reconsider foreign investment governance should not be taken lightly. This is one of the few international economic fields where multilateral consensus has remained impossible, and it is difficult to think of MNCs as regulated citizens of the world without such a multilateral consensus.

Rather than engaging in futurology, the objective of this article is to contribute to understanding the resistance to the IIR, the obstacles to multilateral cooperation in foreign investment, and the realistic space for an overlapping consensus for the governance of MNCs. Presently, there are new calls for a multilateral investment regime or for increasing the engagement of states in investment litigation. These initiatives focus on the consolidation of the present structure of the IIR, proposing

2 For the cases filed against the United States, see http://www.state.gov/s/l/c3741.htm. For the cases filed against Canada, see http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gov.aspx?lang = eng.

some minor reforms to improve this regime (Åslund 2013; Graugnard 2013; Hufbauer and Stephenson 2013; Roberts 2014). None of them, however, begins the analysis with the political economy of foreign investment or the purpose that an international regime should pursue. The objective of this article is to start exactly at this point, emphasizing the relational implications of foreign investment (Kennedy 2009, 77). My main argument is that the IIR empties foreign investment governance from most political content and purpose except for one particular goal: the facilitation of multinational corporate use and benefit of resources. Defenders of the IIR claim that the advantage of investment arbitration is the depoliticization of foreign investment relations (Broches 1995; Shihata 1986). By this they mean the reduction of home and host state political interference in the enforcement of allegedly clear government commitments (Elkins, Guzman, and Simmons 2006). As I will argue, however, the IIR does not eliminate politics but rather consolidates a particular kind of politics: the politics of foreign investors' property rights protection. This can affect any competing local view on the use of resources.

Section 2 describes the conundrum of foreign investment governance. It shows that the activity of MNCs brings about very delicate issues for host countries and populations and that these issues have most in common with the problems that private property rights create at the domestic level in terms of both state authority and democracy. Section 3 makes a historical analysis of the long record of multilateral disagreements on foreign investment negotiations. This serves as the starting point to consider the structure and politics of the IIR in Section 4. Section 5 relies on the late Rawls to consider the possibility of reaching an overlapping consensus on the basic political institutions to govern the problems created by MNCs. This approach can coexist with a plurality of equally valid ideas on property and the use of resources. This section illustrates some of the challenges for this strategy looking at the World Trade Organization (WTO). The article concludes by stressing that the IIR puts local populations in a state of vulnerability *vis-à-vis* foreign investors, promoting anxiety and distrust among states and civil society. It suggests that a broader institutional structure can help politics recover its necessary place in the governance of foreign investment.

2 The political economy of foreign investment: a question of private property and foreign ownership

Most of the contentious issues that foreign investment creates relate to the control of resources in host countries, including natural resources, infrastructure, and means of production. Many countries have natural resources and the social conditions to develop their economies. They also need, however, the capital and technology to use those resources. Historically, this need has put developing countries in a relatively weak position *vis-à-vis* nations with abundant capital (Ogle 2014). When the issue is framed in terms of scarcity and abundance, the solution may seem quite straightforward: bring the capital and the technology from abroad. But this solution does come with a cost: "Private investors invest to make profits and not for reasons of benevolence" (Akinsanya 1987, 58). MNCs are only likely to invest in a country when there is a prospect of profitability, and they can ensure the control of the key resources comprising the investments. Private property rights are essential for any business plan because they legally transfer the control of the resources from host states or local individuals to foreign investors. A private property system is – as Lipson remarks – a necessary step to tap foreign investors' energies (Lipson 1985, 8–19). In this regard, if the expansion of foreign private investment is to be equated with the development of capitalism beyond national borders, institutional economics anticipates the centrality of the internationalization of private property rights (see North 1981; Olstrom and Schlager 1996, 137).

The problems that foreign investment can produce in host countries are analytically similar to those created by the private ownership of resources. The conflict between foreign investors, host states, and local population is not considerably different when the investors are domestic (Stiglitz 2007, 463–70). This does not mean that the foreign character of an investor can be ignored because, in fact, it often tends to exacerbate the problems created by private property (Stiglitz 2007, 470). But the bases to consider the political economy of foreign investment should be those of private property, properly complemented with the relevance of the foreign elements, including the role of home states.

Private property is always in tension with sovereignty and democracy. This tension is caused by the authority that states vest on some individuals through the creation of private property rights (Cohen 1927, 11–14). Property rules govern the relation between individuals regarding the use and benefit of resources, and these rules are good against the entire world. Private property grants the owner the authority not only to use and benefit from the resources, i.e. to control them, but also to exclude other individuals and the state from interfering with this use. According to legal realism, the right to exclude represents the coercion that property rules impose on the rest of the social actors, whether private or public (Hale 1923, 471). In this line of argument, granting property rights to a foreign investor implies a passive obligation for the state not to interfere with the foreign investor's use of the resources, and an active obligation to police any individual who interferes with that use without the consent of the foreign investor. As Cohen observes, the character of property as power may be obscured by the premise that economic transactions are based on consent, e.g. the acquisition of land in the market; however, once control over a resource is transferred, any owner – including a foreign investor – can dictate its use (Cohen 1927, 12). This can create a wide range of conflicts, which are governed by the applicable property laws. The central principle of these laws is that private property and the private use of the resources are not absolute. States create private property rights, granting some individuals control over certain resources, but this control cannot be absolute because otherwise property could destroy social life and the environment.

The environmental and social consequences of the use of resources are closely connected. Very often, the environment needs to be severely altered to make economic activities like mining or large-scale agriculture possible. Such changes can have important social repercussions. The capital-intensive production of crops, for instance, will affect a local and independent group of peasants, who may be pushed to begin working as employees for the large undertakings. This project may create some well-paid jobs locally but it can also exacerbate overall poverty and inequality, worsening the living standards of the majority (Perrone 2013).

The dominion granted by property can be consequently equated in many ways to the notion of sovereignty. The transfer of control over resources to foreign investors necessarily implies a cession of authority that goes beyond the mere development of particular projects. Barnet and Muller note that "in the course of their daily business [MNCs] make decisions with more impact on the lives of ordinary people than most generals and politicians" (Barnet and Muller 1974, 214). Local populations will predictably react when these decisions have negative consequences for them, urging host states to protect their interests and alternative views on the use of resources.[3]

What follows is that for domestic democracy to be consistent with foreign investors' property rights, the principles of political determination and security of private property need to be balanced. There is no such thing as absolute property rights and absolute democracy, as Montesquieu and Madison already noted in the eighteenth century. The tension between private property and democracy is a fundamental topic in any constitutional property debate. For property defenders, private property promotes democracy as it allows individuals to exercise their autonomy, facilitating economic transactions. This view is defended by the World Bank, for instance, that consistently relates private

3 See *TECMED vs Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003; and *Aguas del Tunari vs Bolivia*, ICSID Case No. ARB/02/3.

property with democracy and the rule of law (Waldron 2012). This position, however, is in the best of the cases shortsighted. Realist and progressive scholars have demonstrated that states and communities maintain an inherent interest in the use of resources and the distribution of benefits, not because they do not want to respect individual property, but because the use of resources can affect the individual autonomy of non-owners and community life (Alexander 2006, 1–7). Property is a political and relational concept that incorporates "ideas about ethics, justice, morality, or any other values and goals" (Lehavi 2010, 469).

When describing the problems that private property in the hands of foreign investors create for sovereignty, democracy, and ultimately for local populations, it is necessary to consider the importance of the foreignness of the investor. This includes examining both foreign investors and home states. Historically, foreign investors have been identified with the national interest of their home states. In 1935, Staley described a world where "diplomacy serve[d] investments" and "investments serve[d] diplomacy" (Staley 1935, chapters 3, 6). During the post-colonial context, MNCs were still considered agents of their home countries that served to maintain the economic dependency of the former colonies (Gilpin 2001, 286–8). These corporations were a tool to consolidate a distribution of labour where developing countries produced natural resources and developed countries manufactured industrial goods. In reaction to this dominant view, many developing states decided to limit foreign investment in natural resources. A number of other countries implemented similar or even more stringent policies. During this period, Japan, South Korea, and Finland remained quite closed to foreign investment, while France and Canada adopted measures concerned with the superiority of U.S. MNCs (Chang 2004; Servan-Schreiber 1969; Globerman and Shapiro 1999).

Based on the policy changes in Canada, Bergsten in 1974 predicted "coming investment wars" (Bergsten 1974). In the following years, countries certainly struggled in relation to foreign investment, but the struggle was not so much for or against liberalization but for the attraction of MNCs. In few years, foreign investment became very welcome and desired. The main reason for this shift was a rapid change of perception regarding multinational corporate activity. What in the 1960s and 1970s was considered problematic for development became by the end of the 1980s – hand in hand with neoliberalism – one of the essential recipes for the very same goal (Dunning and Lundan 2008, 675).

Part of this change arguably responded to the increasing detachment of MNCs from their home states. The world of global value chains and economic globalization that Reich, and Stopford and Strange describe as a consolidated trend in the 1990s effectively contrasts with the picture provided by Staley back in 1935 (Reich 1992; Stopford and Strange 1991). The relation of MNCs with home states, host states, and local populations represents today "a complex and by no means one-directional nexus between internationalization and multinational corporate embeddedness in nations and regions" (Sally 1994, 181). What is indisputable is that the interests of these firms can presently diverge substantially from those of the home state. Today, multinational corporate plans transcend the nation-state and its interests, constituting "the first institution in human history dedicated to central planning on a world scale" (Kobrin 2005, 224).

This change of perception on MNCs had implications for the regulation of foreign investment at the private property level. The fierce competition for foreign investment triggered a large number of regulatory changes. Most governments around the world unilaterally reversed many of the restrictive measures adopted in previous decades. UNCTAD data show that 94% of the changes in foreign investment policies between 1992 and 2003 (1,771 out of 1,885) were liberalizing and protective rather than restrictive (UNCTAD 2004, 8). The signature of BITs expanded at a rapid pace during this period, under the auspices of a "Grand Bargain" by which host states granted foreign investors international protection in exchange for the possibility to increase the inflow of capital (Salacuse and Sullivan 2005). As these neoliberal reforms were implemented, few governments paid attention to the warnings regarding the social and environmental risks involved with foreign investment (see Lall 1991; Reich 1989). The extensive authority granted to foreign investors according to the treaties – much of it in the form of strong property rights – was going to have profound effects for states and local populations, announcing the long series of disputes that 20 years later investment arbitrators are presently adjudicating.

3 From multilateral disagreement to the BITs rush: is there a consensus on foreign investment governance?

Historically, foreign investment has not been a peaceful domain. Investment disputes have led to expropriations, coup d'états and military interventions (Maurer 2013). Although only some foreign investment ends in turmoil, tensions between global corporate and local interests are latent and when the issues do escalate, they normally become political and difficult to resolve. No government wants to be seen accepting demands by foreign investors, in particular when a large land reform or the cultural industry are at stake, and they may rely on their sovereign powers to turn the situation in their favour. Foreign investors reasonably demand protection against this political risk, and in the event of a dispute would not hesitate to employ their economic power or to recur to their home states.

The large record of foreign investment disputes contrasts, interestingly, with the lack of international institutions in this field. If foreign investment disputes have been a concern for both developed and developing countries, the persistent multilateral disagreement and the inexistence of an international institution indicate how difficult it is to organize the governance of foreign investment. While developing countries have resisted some of the initiatives, which essentially aimed to protect foreign investment, other attempts in favour of a broader institutionalization – such as the U.N. Code of Conduct on MNCs – were blocked by developed countries. On other occasions, developed countries at the Organization of Economic Cooperation and Development (OECD) were unable to reach a consensus on their own terms (Correa and Kumar 2003, chapter 3).

The list of disagreements begins in the nineteenth century with the Calvo Doctrine, according to which developing countries asserted that domestic laws govern foreign investments and eventual disputes should be decided before domestic courts. This position opposed the views of developed countries based on a doctrine firstly enunciated by Grotius and Vattel during the sixteenth and seventeenth centuries. In essence, the doctrine of diplomatic protection recognizes an interest of home states over the property rights of their citizens in foreign countries, and this interest authorizes home states to initiate legal proceedings at the international level and according to international law.

In the wake of the twentieth century, the only international consensus was that countries should resolve foreign investment disputes peacefully. Home states were precluded to use force as long as host countries accepted to submit the dispute to international litigation (Drago-Porter Convention of 1907). The creation of the League of Nations did not imply any progress in this area. The only outcome of the conferences held at The Hague in 1930 was the confirmation of the lack of consensus between developed and developing countries on most substantive issues (Borchard 1930). Like most international economic topics, the matter was back on the agenda at the end of the Second World War. These negotiations were shaped by a positive view – mainly among developed nations – on the creation of international institutions to govern international trade, investment, finance, and development. Trade and investment negotiations concluded with a draft of the Havana Treaty, whose main purpose was to create the International Trade Organization. But as developed nations reached a consensus on trade with the conclusion of the General Agreement on Trade and Tariffs (GATT), foreign investment proved to be again controversial. The GATT had no disciplines on this area, and the United States rejected the Havana Treaty due to the opposition of the business lobby to the foreign investment chapter. The regulation of foreign investment was the only part of the Bretton Woods project that came to nothing (Dattu 2000, 286–8).

The negotiations for a multilateral understanding on foreign investment did continue but only to suffer one failure after the other. Developing countries persisted in opposing most initiatives, while developed countries blocked any alternative project, and could not reach a consensus among themselves. In the 1960s, the OECD negotiated and approved the Draft Convention on the Protection of Foreign Property. Despite the common views of developed countries, some differences among OECD members impeded the signature of a multinational convention based on this draft (Newcombe and Paradell 2009, 30). In the meanwhile, developing countries pushed for an alternative model for foreign investment governance. Their objective was a regime that focused less on protection and more on the problems that MNC activity can create for host countries and local populations. Developing countries channelled their voice through the United Nations, passing the resolutions on the Permanent Sovereignty over Natural Resources in 1962, and the Charter of Economic Rights and Duties of States in 1974. These resolutions were not binding – as every General Assembly resolution – and developed countries strongly objected to their content, in particular, to the Charter of Economic Rights (Newcombe and Paradell 2009, 31–33).

Foreign investment reappeared on the multilateral agenda during the Uruguay Round of the GATT. Again, despite the substantial consensus that led to the creation of the WTO, states did not reach any major consensus on foreign investment. The only exception was a relatively minor agreement on trade measures related to investments. After 1995, foreign investment remained on the agenda of the WTO only for a short period. It was discussed during the Doha Development Road, but abandoned at the Cancun Ministerial Meeting in 2003 (Smythe 2003). In the meantime, developed countries tried to reach a consensus of their own within the framework of the OECD. This strategy followed the premise that the disagreement on foreign investment is a *North vs South* debate. Yet, as had already happened in the 1960s, some developed countries opposed to the conclusion of the MIA in a scenario of rising civil society pressure due to the potential risks that this initiative posed to environmental protection (Dattu 2000, 299–300).

The systematic lack of consensus, despite the importance of the problem, is explicable when foreign investment rules have focused on facilitating multinational corporate activity and hindering change in host countries. The resistance of Latin American countries was not simply a question of reaffirming sovereignty in the abstract. In 1968, Metzger noted that the views of Mexico during the land reform of the early twentieth century were understandable given that foreign investment rules constituted an obstacle to change, which amounted to a total barrier "if foreign investors were dominant" (Metzger 1968, 291). The situation of developed countries is not different. French and Canadian resistance to the application of the MIA to their cultural industry was based on a similar concern. These domestic industries follow a business model that is quite different from the dominant multinational corporate strategy in the entertainment sector (Meunier 2000, 110). Reasonably, French and Canadian authorities were concerned that by facilitating the activity of MNCs they could have seriously affected the viability of their domestic cultural industry (Bubba and Rose-Ackerman 2007, 298). Once MNCs became dominant, there would be little space for change. As Schneiderman has recently put it, "[any] pluralistic understanding of civilisations would be buried beneath the weight of [this] international law project" (Schneiderman 2014, 62).

Until the 1990s, in view of this systemic disagreement, foreign investment disputes remained governed by general international law and contracts. A review of the literature between the 1960s and 1980s demonstrates that most of these disputes were resolved through either diplomatic protection – with the active participation of home states – or contractual arbitration. Customary international law was fundamental for these decisions and awards (Yackee 2008, 1569–96). This does not mean that during this period there were no international developments in the governance of foreign investment. Beginning in 1959, many European countries signed BITs with former colonies, inaugurating a trend that continued throughout the 1960s and 1970s. In addition, the World Bank sponsored the negotiation of the Convention for the creation of the International Centre for the Settlement of Investment Disputes in (ICSID), which was finally approved by the minimum number of countries in 1966, despite the opposition of Latin American countries.

But both BITs and the ICSID remained dormant for 30 years. At the beginning of the 1980s, there were less than 250 BITs and only 9 disputes registered at the ICSID. The main foreign investment disputes of that time, involving countries such as Libya, Kuwait and Iran, were resolved outside of ICSID and according to general international law. This picture completely changed during the 1990s. In the period 1994–1996, states were signing an average of 4 BITs per week. Today, the amount of bilateral, regional, and sector-specific investment treaties exceeds 3,000. The caseload of the ICSID reflects this boom. In 1997, the number of cases registered per year had reached 10, and since 2000, the annual average has remained well above 20 (50 in 2012). Most controversial disputes of this period, involving countries such as Argentina, Ecuador, and Venezuela, have been resolved within the IIR, i.e. through investment arbitration and according to investment treaties.[4]

This scenario led some authors in the mid-2000s to argue that most states had reached a kind of *de facto* multilateral consensus on foreign investment (Schill 2009). It is indisputable that during a brief period many states literally rushed to sign treaties with as many countries as possible. There is some evidence, however, that many states were not fully aware of the legal consequences of those treaties (Poulsen 2011). Rather than a consensus on the content of the IIR, then, the signature of the treaties reflects the foreign investment rush of the 1990s and the dominance of neoliberal ideas: states were competing for capital (Guzman 1998; Elkins, Guzman, and Simmons 2006). The Grand Bargain of protection for foreign investment was highly embedded in the Washington consensus, which promoted private property protection as a central part of a one-size-fits-all development approach. But the Washington consensus did not do very well in the field of foreign investment. Many studies have shown that BITs do not increase foreign investment flows or have at best only limited effects, while the relationship between these flows and development is unclear (UNCTAD 2009; Sumner 2005, 281). If there ever was a *de facto* multilateral consensus, it was a very brief one.

In addition, as some scholars had warned, the retreat of the state in the regulation of foreign investment quickly translated into increasing disputes and discontent in host countries and local populations (Kaushal 2009). The rise of neoliberalism brought about growing criticism against international economic institutions across the board. The WTO, the IMF, and the World Bank were under strong pressure in the late 1990s and early 2000s, although they have managed to overcome much of the legitimacy crisis by now. The situation of the IIR is slightly different because this regime has been by far and large the most criticized in the recent years, and there remains considerable resistance to its present structure and expansion.

The denunciation of ICSID by Venezuela, Bolivia, and Ecuador are important indicators of the relevance of this criticism, as are the decisions of Australia, the Czech Republic, South Africa, and recently Indonesia to modify, denounce, or stop signing investment treaties (UNCTAD 2013b; Bland and Donnan 2014). This criticism does not indicate a decay of the IIR, however, because some level of resistance is inherent to the political game. But what is different about the current crisis in the IIR is the increasing criticism in developed countries after these states

4 According to UNCTAD and ICSID statistics.

have become subject to a few investment arbitrations. In other words, it was to be expected to see Ecuador or Venezuela criticizing the effects of investment treaties, after all they are the others, but it is certainly different to see Europe and particularly Germany resisting to the inclusion of an investment chapter in the Transatlantic Trade and Investment Partnership (TTIP) (Donnan and Wagstyl 2014). This attitude of developed countries could be a signal of a large change of circumstances because investment treaties allegedly incorporate the preferences of these countries.

In this regard, current developments in investment treaty making show some of the main proponents of investment treaties and arbitration slightly shifting their discourse towards the IIR, trying to reconstitute its original asymmetric structure. This strategy aims to reverse the universalization of the IIR in a move that would equal to making the GATT applicable to *other* countries only.

There is substantial evidence of this strategy. First, the only FTA the United States have signed in recent years without an investment chapter was with Australia. The explicit reason for this decision was that countries with developed and trustworthy legal systems do not need investment arbitration (Dodge 2006). Second, the existing debate in the European Union (EU) shows that according to the Commission and some member states such a regime is not needed within Europe. The incorporation of the Eastern European countries implies their adherence to acceptable principles of law (Tietje 2013). Third, the inclusion of an investment chapter in the negotiation of the TTIP is gaining new detractors. These are not the usual suspects only, such as environmental nongovernmental organizations (NGOs) or the government of France. They include, for instance, the libertarian CATO Institute (Ikenson 2014). The philosophy behind this change of mind is summarized well in one of the latest document issues by UNCTAD:

> In that context, questions arise about the rationale for including ISDS [investment arbitration] into IIAs – or other agreements – between developed countries with sophisticated regulatory and legal systems, and with generally open investment environments. Originally, the primary purpose of IIAs was the provision of legal protection to foreign investors, including through ISDS [investment arbitration], hence addressing concerns that host countries' domestic legal systems may not be advanced enough to ensure due process, fair and non-discriminatory treatment and adequate compensation for expropriation. (UNCTAD 2014a, 25)

The position of the EU and some key U.S. actors carry a great deal of either inconsistency or hypocrisy.[5] If these countries want the IIR to consolidate as a

5 See the presentation of Lord Goldsmith at the European Union Committee of the House of Lords, 14th Report of Session 2013–14, para. 159.

way to favour their MNCs, why do they resist the incorporation of investment arbitration in their own economic treaties? In theory, they should have nothing to fear. A leading arbitrator affirmed in a lecture at Georgetown in 2005 that the only objective of the IIR is to discipline host governments that do not comply with their commitments and the rule of law.[6] To a great extent, this message has been repeated in most investment awards. No tribunal claims to be affecting host state legitimate authority to regulate.[7] Assuming that the EU is aware of the negative consequences their position may have on the future of the IIR, it is worth reflecting about the reasons behind the opposition of some of its members to investment arbitration in the negotiations of the TTIP.

4 The IIR: a means to depoliticization or the promotion of foreign investor rights politics?

More than a question of paying compensation to a particular investor, I claim that what populations in developed and developing countries fear is that MNCs can use investment arbitration to impose their views on the use of resources, defeating their democracies and any possibility of pluralism. They fear the depoliticization of private property. Many authors have emphasized that the main strength of the IIR is precisely its depoliticization. Before, the field of foreign investment disputes was the domain of diplomatic relations, political intervention, and state-to-state dispute settlement. This position is not without merit. A problem faced by MNCs in the 1960s and 1970s was the allegation that they were agents of home states, and obviously the fact that any dispute with host states could end in diplomatic intervention only validated this allegation. The IIR resolves this problem by giving foreign investors direct standing at the international level. Furthermore, investment arbitration has been defended by small countries on similar grounds, because it helps these countries to prevent foreign interference in domestic affairs. After the establishment of an investment arbitration, domestic authorities can always answer a powerful country as the United States that the issue has been deferred to an allegedly independent and impartial international tribunal (see Paparinskis 2010).

6 Paulsson (2010). See also http://legal.un.org/avl/ls/Paulsson_IEL.html.

7 See among others *TECMED vs Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 119; *MTD vs Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004, at 98; *Suez and others vs Argentina*, ICSID Case No. ARB/03/17, Decision on Liability, 30 July 2010, at 139.

The problem of this argument is not that investment arbitration has not reduced state intervention in foreign investment protection – to this extent, the depoliticization argument is not inaccurate. The problem is that this definition of politics and depoliticization is very unsatisfactory and it does not capture the essential political character of any regime that governs the use of resources. Needless to say, the relational implications of property extend well beyond the participation of the state in the protection of private property.

Against this background, I propose to analyse the governance implications of the IIR using the lens of privatization. By privatization of foreign investment governance, I refer to something broader than foreign investors' international standing and the lower participation of home states. Privatization implies the emergence of a regime that privileges the position of MNCs and relies on their expectations on the uses and benefits of resources to supervise host states. Three characteristics of the IIR support this claim of privatization. First, the IIR is a highly legalized regime where political representation and cooperation are absent. In institutional terms, the only solution that this regime provides is litigation, and this litigation has remained thus far limited to claims initiated by foreign investors – state counterclaims, for instance, have been unsuccessful at the jurisdiction stage (Kryvoi 2012). This means that the initial and main input of the legal proceedings always comes from MNCs. This governance model shares most in common with a new medieval type of governance because the role of states is quite modest, being limited to its legal defence in *ad hoc* arbitrations and the potential renegotiation of treaties (Slaughter 1997, 183–4, 195–7).

Second, investment arbitrations operate as transnational tribunals, as opposed to inter-state tribunals (Keohane, Moravcsik, and Slaughter 2000). Arbitrators are more autonomous from governments and more dependent on foreign investors precisely because they rely on the latter to exercise their jurisdiction. This leads Tai Cheng to conclude that investment arbitration implies a strong redistribution of power from states to foreign investors and investment arbitrators (Cheng 2005, 481, 492). Such redistribution is significant because investment treaties deal with incomplete foreign investor rights and mainly incorporate vague and ambiguous protective standards, increasing the scope of arbitral interpretation.

Third, the IIR focuses essentially on the protection of foreign investor rights, whereas the impact of MNC activity on the community has been left to domestic legal orders. This comes with the problem that foreign investors can always challenge a domestic judicial decision because it constitutes a violation of a treaty standard and international law. The recent dispute between Chevron and Ecuador is a clear example.[8] This situation gives a general prevalence of

8 See *Chevron vs Ecuador*, UNCITRAL, PCA Case No. 2009–23.

international over domestic law, benefiting foreign investors' perspective on the conflict. This private perspective is strengthened, in addition, by the inter-parties adjudication followed by most investment arbitrations, which they borrow from commercial arbitration.[9]

It could be argued that investment arbitration is a positive development for the fair decision of foreign investment disputes. Arbitrators are in theory appointed because of their independence and impartiality. There are rules in the ICSID that prevent nationals to sit in cases where an investor or a state of her nationality is involved. However, a closer look at the situation of investment arbitrators shows that there are significant problems with the independence and impartiality of arbitrators. Investment arbitrators have a group interest in the future of investment arbitration, and an individual interest in their prospect of future appointments. The outcome of the arbitrations, to this extent, is not neutral to their interests particularly at the jurisdictional stage (McArthur, Kathleen, and Pablo Ormachea 2008; Van Harten 2007). They also belong to an international community that has been historically involved with the business side of this struggle. International lawyers have promoted investment treaties both in the 1960s and in the 1990s (Van Harten 2007; Schwarzenberger 1960, 148). More importantly, the main problem of investment arbitrators is that their discourse of technical correctness is not consistent with their function of resolving property disputes. Decisions regarding private property protection, especially in relation to state intervention, are not the outcome of independent technical assessments but of normative preferences. Arbitrators cannot be technically correct only because the meaning of property is plural and depends on their normative preferences (Waldron 1988, 433; Ackerman 1977, 29).

All in all, the alleged depoliticization of the IIR in reality hides a political message in favour of the protection of foreign investors' property rights. In normative terms, the IIR is justified because foreign investment protection can lead to the most efficient use of resources, and this would eventually improve the living standards of the population.[10] But this causal relationship is far from clear, and investment arbitration ends up being solely an instrument that MNCs can use to supervise host state behaviour. Foreign investors can rely on investment arbitration to punish any "irrational nationalism" affecting global planning and the expected profits (Kobrin 2005, 225). On the losing side of this regime, inexorably, we find local populations and alternative views on the use of

9 DiMascio and Pauwelyn (2008, 54–56); Hirsch (2014, 143–67); *Glamis Gold vs United States*, NAFTA – UNCITRAL, Award, 8 June 2009, at 3, 7.

10 See the preambles of US Investment treaties, available at http://www.bilaterals.org/?-us-bits-.

resources. In this respect, the evidence shows that investment arbitrators may decide disputes in ways different from domestic courts, and this includes the courts of developed legal systems (see Van Harten 2007; Schneiderman 2008).

5 A way forward: governing foreign investment through a political institutional structure

In 2003, Mann claimed that the IIR is at a crossroad: it can crystallize as a new form of colonialism or it can evolve into a new field of global cooperation on development (Mann 2003, 247). Today, many academic circles share the view that the IIR is in need of a change, with proposals ranging from the negotiation of an MIA to the recognition of a larger role for state-to-state arbitration (see Åslund 2013; Graugnard 2013; Hufbauer and Stephenson 2013; Roberts 2014). This recent literature, however, does not explain why formulas that failed in the past will work in the present. Arguably, the starting point for resolving the governance problem of foreign investment should be the political economy of MNC activity, and not the multilateralization of the existing regime or the sound interpretation of the law – something that is in itself difficult to determine. Foreign investment creates a series of challenges regarding the use of resources, and can have large social, cultural, and environmental implications. These are political issues whose resolution requires politics and cooperation. In this regard, the literature referred to overlooks that global governance in a plural world cannot be achieved through litigation only; investment arbitration is simply not enough.

Increasing the role of politics in the governance of foreign investment requires the creation of political institutions rather than the improvement of dispute resolution mechanisms. Investment arbitration cannot create consensus, it can only determine winners and losers. Tribunals, in addition, require long periods of time to adapt to new normative views about the subject in question. What the governance of foreign investment needs thus is more space for negotiation and cooperation, and less litigation, whether it is investor-state or state-to-state. The IIR shows that too much legalization and too little politics is a recipe to increase tension. Political institutions, on the other hand, can narrow down the gaps between winners and losers and can be reworked more easily to cope with emerging tensions. Political bodies can react faster because they have a macro-perspective of the situation (Freitag and Buhlmann 2009; Immergut 1998, 9).

To increase the role of politics in the governance of foreign investment, it is necessary to put the emphasis on the existing institutions along the lines argued by the late Rawls (1987). They need to be reorganized as a way to promote consensus among the different actors involved, and not as a means to favour some self- or group interests. The first step to promote politics is to open up institutions to dialogue and democratic decision making. The governance of foreign investment needs a transformation that can be briefly summarized as the opposite of the legalization of the GATT. The difficulty with the governance of international trade in the 1980s was the excessive politicization of the GATT. On the contrary, the present problem of the IIR is its excessive legalization. It has plenty of the ethos of lawyers and arbitrators but misses the ethos of diplomats and politics more in general (see Weiler 2001). This is a cornerstone for higher levels of general trust in the governance of international economic affairs (see Howse 2002, 97–98).

The creation of this international political structure obviously faces the existing difficulties to reach a multilateral consensus on foreign investment. But it is necessary to distinguish here between the obstacles to reach a substantive multilateral consensus on the use of the resources by MNCs and the difficulties to establish a political forum to discuss and decide policy approaches to the challenges posed by MNCs and foreign investment. As Rawls explains, reaching an overlapping consensus on significant normative issues is quite difficult domestically, let alone internationally. He argues, however, that an overlapping consensus on the institutional mechanisms to accommodate conflicting interests is possible (Rawls 1987, 4–5). In the case of foreign investment governance, it becomes almost an imperative. Property is a highly plural concept that enables and shapes community life (Alexander et al. 2009). Plural views about property put pressure on the institutions aimed to govern foreign investment and, the more plurality of values, the stronger the need for political institutions.

This line of reasoning could favour the inclusion of foreign investment governance in the WTO. This organization arguably represents a political consensus on the institutional structure to govern international trade. But the WTO faces its own challenges today. The difficulties of the Doha Round reveal that the members have diverging views about the purpose of this organization and the future of international trade. In this context, introducing the governance of foreign investment in the WTO may be a mistake not only because of the impracticality of negotiating such a reform, but also because of the challenges that the institutionalization of foreign investment will create.

In this regard, there are two central differences between the WTO and the IIR. First, as opposed to what happens in the WTO, MNCs have an active role in the IIR. This could change in the future but making the institutionalization of foreign investment governance conditional to such change is not necessary and perhaps not desirable. The recognition of MNCs as subjects of international law can be an initial step to ascribe international duties to these corporations. Second, the IIR may be a regime with some multilateral characteristics, but contrary to the WTO, it is composed by a large number of bilateral and regional treaties. An international organization dedicated to the governance of foreign investment will need to administer this entire network of treaties. This is arguably possible because of the enormous similarities between the text of the treaties and the operation of the most-favoured-nation clause (Schill 2009). This clause extends the highest level of protection in any of the host state's BITs to any given host state. But this is a challenge, and one unique to the governance of foreign investment.

But the main challenge posed by the institutionalization of foreign investment governance is finding the right balance between the new political bodies and investment arbitration. The inclusion of more politics does not imply the end of disputes, and thus it is necessary to consider which institutional structure would promote the best possible relation between the political and the dispute resolution bodies. First of all, the dispute resolution mechanism should aim to concentrate all foreign investment disputes. The present dispersion of arbitration forums responds more to the medieval reality of commercial arbitration than to the need to govern foreign investment. This requires some reorganization, in particular merging the ICSID into the new international organization. In itself, this would represent a salutary move in terms of legitimacy because the voting system of the World Bank is still shaped by the same power relations that determined the asymmetric structure of the IIR. The creation of an appellate body, in addition, makes more sense in this institutional context, as it would facilitate the dialogue between the political and jurisdictional bodies in charge of governing foreign investment.

As the WTO literature shows, the difficult part of this institutional reform is to establish the relation between the political bodies and the dispute resolution mechanism (Roessler 2000; Bartels 2004). The political bodies should discuss issues that are of interest to all the members, remaining neutral regarding ongoing investment disputes. By now it is clear that developed and developing states face similar challenges in investment arbitration. The arbitrations faced by Argentina due to its economic crisis are now repeating again in Greece, Spain, and Cyprus (Olivet and Eberhardt 2014); and countries as different as Uruguay and Australia are defending themselves against similar claims from Philip Morris (Vadi 2012). The tension between international investment law, environmental law, and human rights law are always latent, in other words, no matter whether the dispute is against a developed or a developing country. Arguably, these issues would be better treated at a macro- and political level, rather than from a depoliticized micro-perspective angle. Drawing from the experience of the WTO, the political bodies of an international organization in charge of foreign investment governance could create committees on foreign investment and the environment, foreign investment and human rights, and foreign investment and development.

The purpose of these discussions should not be to annul the obligations assumed in investment treaties but rather to help investment arbitrators to interpret the vague and ambiguous terms of the treaties. The Appellate Body of the WTO has accepted the significance of several acts of the political bodies for the resolution of concrete disputes. They include the creation of a Committee on Trade and Environment,[11] the deliberations of the Committee on Balance of Payments,[12] and the decisions of the Committee on Phytosanitary Measures.[13] In fact, the Appellate Body has rarely ignored the opinions of the political bodies of the WTO – sometimes even to the detriment of progressive goals (Bartels 2004, 861). Following the WTO practice, a political structure for the governance of foreign investment should entitle states to make comments on investment awards, inform an eventual appellate body about their concerns, and even have the ability to overturn an award following the negative consensus formula.[14]

The introduction of politics in foreign investment governance entails both opportunities and risks for non-state actors. A political structure would benefit civil society and NGOs, facilitating their coordination and action (Tarrow 2001). Presently, NGOs can only lobby governments regarding whether to sign or reject new investment treaties. The rest of their activities are dispersed among different tribunals that are treating similar issues. For the international business lobby, this cannot be seen as a negative development because it can certainly organize itself around any new institutional structure. The outcome would therefore be more plurality of voices in a political – as opposed to a jurisdictional – environment.

The risks posed by the institutionalization of foreign investment governance are the excessive politicization of the field and the capture of investment tribunals by states. This would probably be a main concern for foreign investors.

11 WTO Appellate Body Report *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 12 October 1998, para 154–155.

12 WTO Appellate Body Report *India – Quantitative Restrictions*, WT/DS90/AB/R, adopted 22 September 1999, para. 103.

13 WTO Panel Report *United States – Certain Measures Affecting Imports of Poultry from China*, WT/DS392/R, adopted 29 September 2010, para 7.134–7.136.

14 The Dispute Settlement Body of the WTO uses a special decision voting procedure known as negative consensus that entitles its members to reject a decision of a Panel or the Appellate body if there is a consensus against its adoption.

This was a concern for the trade literature during the early 2000s, which did not materialize in practice. The risk that political bodies of a future international organization on foreign investment intervened in the deliberations of investment tribunals are, in any case, much lower in the foreign investment than in the trade field. As opposed to what happens in trade, many investment arbitrators are high-profile international lawyers and academics. These individuals will arguably be much less prone to accept institutional pressure. There is indeed evidence of the strong attitude taken by an arbitrator when he received few suggestions from the ICSID Secretariat.[15]

6 Conclusions

That the use and benefit of resources is a central issue of governance at both the domestic and the international levels does not strike anybody as contentious. What may seem controversial is that the IIR deals with the control of resources of different countries. For many decades, the literature has described the IIR as a regime solely aimed to protect foreign investor rights. But this description is incomplete. The IIR has a direct impact on foreign investors, host states, and local communities in relation to the use and benefit of resources. From this perspective, those who promoted in the 1960s and 1970s the creation of an international institution to govern foreign investment and MNCs were taking a reasonable path in light of the political economy of the problem. Relying on domestic institutions only could bring back the risk of intervention in weaker countries and of investment contracts with arbitral clauses, without solving the problems that exist today to make MNCs accountable for their actions in the global economy. Those who promoted a broader institutional structure to govern foreign investment in the past may have failed to realize some of the obstacles to reach this goal, but they were right in asserting that MNCs were only going to promote general welfare if there was an international regime in place capable to strike a balance between MNCs, states, and local populations.

The IIR is not capable of fulfilling this goal. This article has shown that rather than opening up a political space for discussing the implications of foreign investment, international arbitration only advances the protection of foreign investor rights. The IIR puts host states and local populations in a

15 See Additional Opinion of Professor Jan H. Dalhuisen in *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v Argentina*, ICSID Case No. ARB/97/3, Second Annulment Proceeding of 17 December 2007.

situation of vulnerability *vis-à-vis* foreign investors. This purpose made sense to developed countries as long as this regime was only applicable to others. But as the asymmetric character of the IIR fades, the resistance to the universalization of this regime is becoming generalized too. While developing countries want to abandon or limit the negative consequences of the IIR, developed countries want to support this regime but – as in the past – if it applies only to others.

The current resistance to investment arbitration in the TTIP opens up a space for imagining alternative regimes to govern foreign investment and MNCs: alternatives that could be fair to host states and local populations as well as foreign investors. The position of some European countries that want to promote investment arbitration with other less developed countries is hypocritical if not a form of neo-colonialism. As opposed to investment treaties, a broader institutional structure could constitute the basis for considering the plurality of interests and values involved in the use of resources by MNCs around the world. This should arguably be the purpose of any international regime in this field. The institutionalization of foreign investment governance is certainly not the panacea, and the WTO provides us with some examples of the problems that would lie ahead. The creation of political bodies should only be seen as an adequate means to promote cooperation and trust among nations and MNCs in relation to foreign investment. It is not a guarantee of success. The path to make foreign investment serve divergent national interests better is a long and difficult one, but perhaps we should not forget that the moment of highest consensus within the trade system – as Dunoff notes – was before the WTO, when the diplomatic ethos dominated the GATT (Dunoff 2009, 195–6).

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