

Baldi, Marino

Research Report

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Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)

Managing Editor: Shawn Lim (shawnlwk@gmail.com)

Are trade-law inspired investment rules desirable?

by

Marino Baldi*

Traditional bilateral investment treaties (BITs) focus on investment protection, i.e., regulate post-establishment aspects of foreign investment. In recent times, investment agreements have increasingly been supplemented with liberalization rules and also clauses on, e.g., key personnel, labor rights and sustainable development. Such integrated investment accords have notably become part of preferential trade agreements (PTAs). This trend started with NAFTA, continued with the negotiations on a Multilateral Agreement on Investment (MAI),¹ and has in the course of the past ten years increasingly characterized PTAs throughout the world. The rapid proliferation of PTAs has, in the investment field, unfortunately led to lower quality provisions. Many of these treaties contain such wide-ranging exceptions and vaguely formulated safeguard clauses that their regulatory value as regards the protection of foreign investments in their post-establishment phase is called into question.

There is no doubt that the world would benefit from more comprehensive investment rules. But the question is how best to achieve them through treaty design. Is it advisable to have all the elements under discussion in one instrument (the NAFTA approach), or would it be preferable to have separate instruments for different subject matters (the traditional OECD approach)? From the viewpoint of negotiating tactics, the single-treaty approach may have certain advantages. However, experience shows that a multiple-instruments solution (where protection is separated from the other elements) helps to avoid problems that are extremely difficult to overcome in a single-treaty approach. Based on my experience with the MAI negotiations and many PTA negotiations with investment chapters, I am convinced that the single-treaty approach, which closely connects investment liberalization and protection issues, ultimately has negative effects on both areas. This has to do with the different legal and economic characteristics of the two areas.

Investment protection rules as they relate to post-establishment present clear characteristics of property law. As a matter of principle, provisions of this kind ought to have a broad scope since basically all kinds of assets are worth protecting. Traditional BITs therefore usually feature comprehensive, asset-based definitions of the term "investment". Extensive exceptions to the broad coverage of investment

protection are neither necessary nor desirable. Contrary to the property-oriented provisions on protection, investment liberalization rules have a trade-policy character. In the trade field, sector exceptions to the basic disciplines of an agreement are a normal feature. Also, from a trade-policy perspective, free market access is mainly, if not exclusively, of importance for direct investment as opposed to short-term capital movements.

If one aims for a single instrument combining protection and liberalization elements and providing only for one set of definitions (which is normally the case), one almost inevitably runs into virtually insurmountable problems. Take the case of portfolio investment: from a protection point of view, it may be desirable to use an asset-based definition of investment that also covers portfolio investment; from a liberalization angle, one might, however, wish to restrict the definition to direct investment. In practical treaty terms, the most frequently chosen way out of this dilemma is to have a broad investment definition together with some kind of a safeguard clause allowing the host country to intervene more or less at its own discretion in the free flow of capital. This solution, however, undermines legal security -- whereas the main purpose of investment agreements is to enhance such security. Similar problems occur in respect of national treatment if exceptions to the basic rule -- as is usually the case -- do not differentiate between pre- and post-establishment (reservations that seem reasonable regarding market access may be problematic regarding post-establishment).

The problems are by no means theoretical. In the MAI discussions, e.g., negotiators were grappling with the investment definition throughout the negotiating process without arriving at a satisfactory solution, as they were never able to decide on a concept supported by all sides. While I would not say that this was *the* reason for the breakdown of the negotiations, I contend that the combination of investment protection elements with liberalization and other regulatory features in one treaty, together with the intended generally and unavoidably applicable investor-state dispute-settlement (broad "prior consent"), were the real reasons behind the failure of the negotiations -- rather than any one or more of the somewhat superficial reasons that are often put forward.

What, then, is the proper context for addressing issues concerning investment and development, which include aspects of sustainability, employment and human rights? It should be clear from the above that these issues are much closer to the liberalization aspects of investment-treaty-making than to the -- not really negotiable -- protection aspects. Moreover, liberalization and development issues are mainly relevant in the context of direct investment. This should be kept in mind when discussing the need to rebalance investors' rights and the sovereign interests of host countries. It also seems obvious that, given their political and systemic nature, rebalancing efforts should essentially take place on a multilateral level.

* Marino Baldi (marino.baldi@prager-dreifuss.com) is Senior Counsel at Prager Dreifuss, Attorneys at Law, Bern/Zurich/Brussels and was previously a Swiss Ambassador and Government Representative for Trade and Investment Agreements. The author is grateful to Roberto Ehandi, Rainer Geiger, Anna Joubin-Bret, and Pierre Sauvé for their helpful peer reviews. **The views expressed by the author of this *Perspective* do not necessarily reflect the opinions of Columbia University or its partners and supporters. *Columbia FDI Perspectives* (ISSN 2158-3579) is a peer-reviewed series.**

¹ The MAI negotiations were an attempt to negotiate a comprehensive multilateral investment agreement, led by the OECD members, but also encompassing a number of other countries. The negotiations began in 1995 and were abandoned in 1998, essentially because of overly ambitious goals.

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For further information, including information regarding submission to the *Perspectives*, please contact: Vale Columbia Center on Sustainable International Investment, Shawn Lim, shawnlw@gmail.com or shawn.lim@law.columbia.edu.

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