

Echandi, Roberto

Research Report

The blind side of international investment law and policy: The need for investor-state conflict-management mechanisms fostering investment retention and expansion

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Managing Editor: Riccardo Loschi (Riccardo.Loschi@columbia.edu)

The blind side of international investment law and policy: The need for investor-state conflict-management mechanisms fostering investment retention and expansion*

by

Roberto Echandi**

Investor-state conflict-management mechanisms (CMMs) allow host countries and investors to address effectively their grievances at a very early stage, preventing conflicts from causing FDI project cancellations and reducing the incidence of full-blown legal disputes.

Investor-state disputes are framed within a continuum. Disagreement can lead to conflict, i.e., a process of “expressing dissatisfaction, disagreement, or unmet expectations with any organizational interchange.”¹ A legal dispute is an unattended conflict that has escalated and degraded into a “defined, focused disagreement framed in legal terms and with expectations of relief.”² While conflicts are usually dealt with between parties themselves through the flexible use of diverse problem-solving techniques, adjudication of legal disputes entails the application of legal frameworks by a third party.

States are multilayered and administratively complex. It is not easy for governments to identify and address investors’ grievances before they degrade into disputes. Investor-state CMMs enable a lead agency or joint body to swiftly coordinate an adequate state-wide response to a conflict while it is still in an early stage. CMMs can be contractual or institutional.³ Contractual CMMs are pre-agreed, embedded in contracts between investors and countries; they are particularly useful for public-private partnerships. Institutional CMMs exist within the administrative structure of host countries, entailing the establishment of a lead agency in charge of identifying, filtering, tracking, and attempting to resolve investor-state conflicts at an early stage—similar to the various ombudsperson offices recently established in many countries, inspired by the Korean Foreign Investment Ombudsman experience.⁴

It is important to differentiate between “conflict management” and “dispute prevention.”⁵ Although CMMs may be useful to prevent disputes, their most important role is to prevent investor-state grievances from inducing investors to give up and discontinue their investments. Indeed, only a minor fraction of investors who discontinue their FDI projects due to grievances with governments seek redress through investor-state dispute settlement (ISDS)—the overwhelming majority withdraws quietly. Thus, ISDS may be successfully prevented, and yet be too late to prevent the withdrawal or

cancellation of planned FDI expansion projects. Paradoxically, while developing countries compete in costly promotion campaigns and incentives to attract FDI, every year around one-quarter of all investors in developing countries discontinue their FDI projects due to unresolved grievances which, in the majority of the cases, arise with subnational or specialized regulatory agencies.⁶

Most conflicts leading to FDI withdrawals stem from alleged adverse regulatory changes, breaches of contract, *de facto* expropriations, transfer and convertibility restrictions, and more recently from lack of transparency and predictability in dealing with public agencies and delays in obtaining the necessary government permits to start or operate businesses.⁷

These findings entail several critical implications for investment policy makers:

- The lack of statistics and legal infrastructure in host countries to identify, track and monitor FDI lost as a result of government conduct explains why this problem has remained undetected for so long. Moreover, the cost of ISDS pales in comparison to FDI lost as a result of government conduct. Yet, it is the former, not the latter, that so far has attracted most academic and policy-maker attention.
- Thus, investor-state CMMs should become a central element of the WTO's investment facilitation agenda, as well as the discussions at UNCITRAL's Working Group III. Priority should be given not only to dispute prevention, but rather to mechanisms to prevent undesired FDI divestments resulting from government conduct. This point becomes particularly critical in an international context affected by COVID-19 and its impact on FDI flows, where FDI retention and expansion may be easier than attracting new projects.
- International investment law is a useful point of reference for lead agencies in charge of CMMs to undertake rule-based negotiations with investors and peer agencies involved in grievances. Thus, CMMs could enable international investment agreements to be implemented effectively in a non-litigious way and help fulfill their original purpose as risk-mitigation tools to foster FDI.
- Empirical evidence shows that CMMs can shift the political economy of investor-state conflicts into positive dynamics: instead of measuring the cost of investor-state conflicts, CMMs can measure the jobs and investment retained and expanded as a result of host country governments' efficient reaction in resolving conflicts and preventing FDI divestments and dispute escalation.⁸

It is time to conceive the application of international investment law as a tool to enable developing countries to retain and expand investment and jobs in a sustainable manner and provide both investors and governments with effective means to strengthen their relationship.

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** Roberto Echandi (rechandi@ifc.org) is Lead Private Sector Specialist, Trade Unit, World Bank Group (WBG), and non-resident fellow, World Trade Institute, University of Bern. The views expressed in this note do not represent the views of the WBG and are the exclusive responsibility of the author. This Perspective is based on findings referred to in Roberto Echandi and Mariana H.C. Gonstead, "Investor-state conflict management: Systemic investment response

mechanisms (SIRMS) and shared decisions system design (SDSD),” in T. Cottier and K. Nadakavukaren, eds., *Elgar Encyclopedia of International Economic Law* (Cheltenham: Edward Elgar, 2017). The author wishes to thank Mariana H.C. Gonstead for her input and Makane Moïse Mbengue, Marie Estelle Rey and Rafael Ramos Codeço for their helpful peer reviews.

¹ Cathy Costantino and Christine Sickles-Merchant, *Designing Conflict Management Systems* (San Francisco: Jossey-Bass, 1996), p. 5.

² Stephanie Smith and Janet Martinez “An analytic framework for dispute systems design,” *Harvard Negotiation Law Review*, vol. 14 (2009), p. 126.

³ Roberto Echandi, “Complementing investor-state dispute resolution: A conceptual framework for investor-state conflict management,” in Roberto Echandi and Pierre Sauvé, eds., *Prospects International Investment Law and Policy* (Cambridge: Cambridge University Press, 2013).

⁴ [Ricardo Figueiredo de Oliveira, “The useful institution of an investment ombudsperson,” *Columbia FDI Perspectives*, No. 273, Mar. 9, 2020.](#)

⁵ [WBG, *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses* \(Washington, D.C.: WBG, 2019\).](#)

⁶ *Ibid.*

⁷ *Ibid.*

⁸ *Ibid.*

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For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Riccardo Loschi, riccardo.loschi@columbia.edu.

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