HOW FAR ARE NEW GENERATION INVESTMENT AGREEMENTS CAPABLE OF PROTECTING THE HOST STATE'S INTERESTS? - AN EVALUATION

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ABSTRACT

International Investment Agreements (IIAs) are at the centre of the international investment law regime, emergence of which had started from early 1950s. These earlier IIAs (known as first generation IIAs) were entered into by the states, particularly, the capital importing developing countries for stimulating the flows of foreign direct investment (FDI) from the capital exporting nations. But, in practice, the IIAs have failed to fulfil this aim, instead these first generation IIAs are persistently being criticised for being detrimental to the interests of the host states due to their unilateral focus on protecting the investors and their investments in the hands of arbitral tribunals. These growing discontents coupled with the changing patterns of foreign investments of early 2000s have paved the way for reform initiatives in this area through the emergence of new generation of IIAs. This new generation IIAs are aimed at addressing the gaps and criticisms of the first generation IIAs. Accordingly, it is expected that this new generation IIAs will safeguard the interests of the host state by bringing about a balance between investor's protection and host state's right to regulate in the public interest. However, the effectiveness of such changes remains unexplored. As such, this paper aims at examining the effectiveness of the new generation IIAs in protecting the interests of the host states. The paper finds that due to certain concerns raised in this study regarding the reforms brought in, the efficacy of the new generation IIAs in safeguarding the host state's interests remains doubtful.

I. INTRODUCTION

IIAs have become an integral part of the legal and policy mechanisms of economic processes in today's world. These IIAs comprise two types of investment agreements: 'Bilateral Investment Treaties' (BITs) and 'Treaties with Investment Provisions' (TIPs).[1] A Bilateral Investment Treaty (BIT) is an investment agreement between two countries containing the terms and

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1 UNCTAD, "International Investment Agreement Navigator: Terminology", available at <https://investmentpolicy.unctad.org/international-investment-agreements> (Last visited on May 11, 2021).

conditions of prospective investments by investors of both parties.[2] TIPs are mainly regional and multilateral economic treaties containing investment provisions. This can be of three types: treaties containing broad investment sections (e.g. a free trade agreements with investment section); treaties with limited investment-related provisions (e.g. trade treaties having few provisions on establishment of investment or investment-related fund transfer); and treaties containing investment framework clauses (e.g. trade treaties having a mandate for cooperation in areas of future investment).[3]

Starting from 1950s,[4] countries have entered into these IIAs hoping to increase FDI flows in exchange for restricted policy space. However, the practical scenario is the opposite. These first generation IIAs are relentlessly criticised for protecting the interests of the investors only who are mostly the large multinational corporations, often in detriment to the interests of the host states where the investments are made. Facing bitter experience under these first generation IIAs,[5] countries are now reconsidering their position and embracing new regime of IIAs known as new generation IIAs to remedy the mischiefs caused by the first generation IIA practices. Such move is greeted with the hope that host states' interests will be better protected under these new generation IIAs as these IIAs are aimed at balancing the rights and duties of investors and preserving the host state's right to regulate in the public interest.[6] However, the real efficacy of these changes remains mostly untested.

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[2] Cornell Law School Legal Information Institute, "Bilateral investment treaty", available at <https://www.law.cornell.edu/wex/bilateral_investment_treaty> (Last visited on May 12, 2021).

[3] Muchlinski, P. T., *Multinational Enterprises and the Law*, 2nd ed., Oxford, 2021, p. 652-53.

[4] The first BIT was signed between Germany and Pakistan in 1959.

[5] Often countries have to face investment claims brought by the investors before international forums (mostly arbitral tribunals) for violations of treaty obligations, which sometimes result in state liability for payment of large amount of compensation. For example, in *Hulley vs. Russia* (2014), USD 50 billion was awarded as compensation to the respondent state; in *Tethyan Copper vs. Pakistan* (2019), USD 4 billion (excluding interest) was awarded as compensation which was almost as large as the International Monetary Fund's (IMF) bailout that had been agreed two months earlier with the intention of saving the Pakistani economy from collapse. See, Bonnitcha, J. and Brewin, S., "Compensation under Investment Treaties", *IISD Best Practices Series*, November 2020, at <https://www.iisd.org/system/files/publications/compensation-treaties-best-practicies -en.pdf> (Last visited on July 23, 2021). Also, the cost of defending a case before arbitral tribunal is huge. For example, a 2017 study found that the average cost for defending an ICSID case is USD 1.45 million for a respondent state. See, Bottini, G., "Excessive Costs and Insufficient Recoverability of Cost Awards", *EJIL:Talk*, April 03, 2019, available at <https://www. ejiltalk.org/excessive-costs-and-insufficient-recoverability-of-cost-awards/> (Last visited on August 05, 2021).

[6] Muchlinski, P., "Negotiating New Generation International Investment Agreements: New Sustainable Development Oriented Initiatives", in Hindelang, S. and Krajewski, M., (ed.), *Shifting Paradigms in International Investment Law, More Balanced, Less Isolated, Increasingly Diversified*, Oxford, 2016, pp. 41-64, at p. 41.

Accordingly, the objective of this paper is to examine the effectiveness of these new generation IIAs in protecting the interests of the host state. The paper relies on two research questions: *firstly*, what reasons stimulate the emergence of new generation IIAs and what are the reforms brought in under these IIAs? And *secondly*, how far are these changes under new generation IIAs adept in protecting the host state's interests? In order to reach a conclusion, the paper is divided into five sections. After the introductory section, the second section highlights the present scenario of the first generation IIAs and the backlashes levelled against them. This is followed by the third section which depicts the context of emerging new generation IIAs and the reforms undertaken therein in comparison to the first generation IIAs. The fourth section examines the effectiveness of the changes under new generation IIAs in safeguarding the interests of the host states. This is done by examining two particular areas of reform: host state's right to regulate and investor's obligation. The fifth section concludes by summarising the findings of the paper.

II. FIRST GENERATION IIAs AND THE CRITICISMS

2.1 First Generation IIAs and the Context of their Emergence

The prevailing model of first generation IIAs emerged in the political context of 1950s and 1960s, the periods categorised by concerns of the former colonies as to impact of the then decolonialisation process and the emergence of newly independent developing states.[7] Given this background, the first generation IIAs focus on only one aspect of investment process i.e. protection of foreign capital and investment.[8] Consequently, the regulatory burden is always on the host states who are mostly the developing countries.[9] Alschner describes the nature of these IIAs, particularly the BITs by saying that "BITs were designed to cover an asymmetrical relationship between developed, capital exporting countries and developing, capital importing countries".[10]

In spite of its slow pace in the first three decades from 1959 to 1989 only with 386 IIAs, IIAs increased manifold during 1990s with 1600 treaties in this decade.[11] Craving for FDI in the wake of debt crises faced by the developing countries coupled with persuasion for structural adjustment programmes, trade

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7 Mann, H., Moltke, K. V., Peterson, L. E. and Cosbey, A., *IISD Model International Agreement on Investment for Sustainable Development: Negotiators' Handbook*, Manitoba, 2006, at p. X.

8 *ibid.*

9 Traidcraft, "International Investment Agreements Under Scrutiny: Bilateral Investment Treaties, EU Investment Policy and International Development", Traidcraft report, 2015, at p. 10.

10 Alschner, W., "Americanization of the BIT Universe: The Influence of Friendship, Commerce and Navigation (FCN) Treaties on Modern Investment Treaty Law", 5(2) (2013) *Goettingen Journal of International Law*, pp. 455-486, at p. 465.

11 *supra* note 9.