The Law and Economics of FDI
30 hours

Course Convenors:
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Syllabus Contents

Course aims 2
Course units 2
Introduction to the law part 3
  Detailed description 3
  Bibliography 3
  Questions 4
An introduction to the seminar economics part 5
  Detailed description 5
  Bibliography 5
  Questions 8
Assessment 9
Exam questions examples 9
Specialized websites 9
Course aims

The course addresses key issues in the law, economics and institutional dimensions of international investment activity and of ongoing efforts at regulating such activity. The main objective is to enable students to discover how legal issues and economic issues are interrelated as determinants of Foreign Direct Investment (FDI) which influence the location and investment decisions of Multinational Enterprises (MNEs) and ultimately their effects on home and host countries, although these latter aspects are not the subject of the course. This way, students will be able to “uncover” misconceptions about Foreign Direct Investment / Multinational Enterprises / International Investment Law and thus understand better some of the driving forces of globalization.

How is Foreign Direct Investment shaped by International Investment Law (i.e. the legal environment) is a central question in this course. We will examine the substantive law governing international investment, the enforcement of rights and obligations in investment disputes and the proper role of investment law in the international legal system. To answer these questions, the course tackles a number of theoretical, policy and legal issues stemming from the increasing importance of cross-border investment activity, situates key actors (the multinational enterprise, home and host country governments), and discusses the incipient and still very disparate nature of investment regulation, particularly at the global level. This type of knowledge is essential to decision makers in firms and the policy arena alike. Besides economic factors, corporate investment decisions depend on the legal framework governing international capital flows as well as on proactive policy measures which influence the locational quality. Further, such knowledge helps a lot in making sense of the debate on the relationship of MNEs and National Governments!

Course units

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<th>Law Part</th>
<th>Economics Part</th>
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| A. Architecture and Dynamics of International Investment Law (2 units)  
Contents: Overview, bilateral investment treaties, preferential trade agreements, multilateral, recent patterns and innovations | A. Overview on Determinants of FDI (1 unit)  
Contents: Four groups of determinants; definition and types of FDI. |
| B. Principles of International Investment Law and Treaty Interpretation (2 units)  
Contents: Scope of IIAs, investor and investment, admission, right of establishment, standards of treatment, expropriation, does the system work? | B. Interpreting regression results (2 units)  
Contents: Interpreting regression results, size of coefficients, statistical (in)significance; measurement of variables; logarithm and elasticity; exercises and problems |
| C. Dispute Settlement (2 units)  
Contents: Legal aspects of arbitration, policy aspects, how to spot a BIT claim, structuring transactions in order to take advantage of IIAs, general conclusion | C. Empirical Evidence on “FDI Treaties” (FTAs, DTT and BITs) (3 units)  
Contents: Theoretical expectations; interpreting empirical results of selected studies; summary and open questions |
Introduction to the law part

Detailed description
The recent development of international investment protection law is remarkable and international Investment Law is emerging as a distinct and important field of international law. As countries increasingly opened their doors to FDI in the 1980s and 1990s, they simultaneously entered into numerous international investment agreements, leading especially to an explosion in the number of investment treaties. BITs are spreading at a breathtaking pace and they bind the contracting parties’ governments toward foreign investors who may bring suit in international arbitration tribunals in case of any violation of the rules of the respective treaty. Such arbitrated cases raise important questions about the rights and obligations of international investors and the appropriate mechanisms for resolving investment disputes. Arbitration proceedings have alleged treaty violations in response to a range of state measures, including, for instance, emergency laws enacted during a financial crisis and the re-zoning of land for specific uses, and in a broad range of sectors such as construction, water and sewage services, telecommunications, financial services, mining, gas and oil production. Even more importantly, governments will, in the case of defeat, normally comply with an adverse arbitral award. Throughout the course, students are invited to reflect on the economic activity of foreign direct investment in its political and social context.

- Emphasis is also placed on assessing the effectiveness and legitimacy of public/private and hard/soft law forms of investment regulation.
- This course provides an overview of the principal substantive and procedural provisions of BITs. The substantive rights typically include a guarantee of prompt, adequate, and effective compensation for expropriation, freedom from unreasonable or discriminatory measures, a promise of “fair and equitable treatment” for foreign investments, guaranteed national and most-favored-nation treatment for investments, and assured full protection and security of investments. Together, these provisions are meant to boost investor confidence and the transparency of the policy environment.

Bibliography
Core text:

Other books and articles
Unit A:

Unit B:
Unit C:

- Todd Weiler (Ed), International investment law and arbitration: leading cases from the ICSID, NAFTA, bilateral treaties and customary international law London (London: Cameron May, 2005) 850.

Investment disputes:

- (national treatment) Occidental Exploration v. Ecuador, LCIA Case. No. UN 3467 (Final Award) (1 July 2004) paragraphs 1-6, 25-35 (facts), 167-179.
- (FET) International Thunderbird Gaming Corp. v. United Mexican States, UNCTRAL (Final Award) (26 Jan. 2006) paragraphs 41-84 (facts); 192-200.
- (host state sovereignty and transparency) Metalclad Corp. v. Mexico, ICSID Case No. ARB(AF)/97/1 (Award) (Aug. 30, 2000) paragraphs 28-63; 70-101
- (expropriation) CMS Gas v. Argentina, ICSID Case No. ARB/01/8 (Award) (12 May 2005), paragraphs 53-82 (facts) ; 252-265.
- (MFN) Maffezini v. Spain (ICSID Case No. ARB/97/7), (Decision of the Tribunal on Objections to Jurisdiction) (25 January 2000), pages 14-25.
- (investments contracts) SGS Société Générale de Surveillance S.A. v. Philippines, Case No. ARB/02/6 (Decision on Jurisdiction (29 January 2004), paragraphs 92-97; 113-135.

Questions

Students are expected to come prepared and able to answer the following basic questions:

Unit A: What rules of international law seem to you the most important to regulate FDI? How do FTA address investment issues? It is striking that treaty regimes establishing significant protections for direct foreign investment are almost exclusively the result of bilateral negotiations. The WTO has encountered great difficulty in clarifying and expressing general rules in this area. How would describe the relation of WTO with investment matters? Why is there no multilateral agreement (in the WTO or OECD) on investment? Why did previous attempts fail? Would you agree that the reason for this may be the enhanced power of capital-exporting party in the negotiation of a bilateral treaty and the enhanced power of a large number of capital-importing states in multilateral fora? What is the role of the Multilateral Investment Guarantee Agency (MIGA)?

Unit B: What are the main features of the United States BIT model? How does it differ of other models? What is a nationalization? What are measures “tantamount to” expropriation? What is the effect of an expropriation that does not meet the conditions of an investment treaty? What is the origin of the national treatment standard? Must a government have a protectionist motive in order to find a violation of the national treatment standard? What rationale did the Maffezini Tribunal use to determine that the most favored nations clause applied to dispute settlement procedure? What are the limits in applying most favored nations clauses to dispute settlement procedures? What is the minimum standard of international law? Is FET equivalent to the minimum standard of international law?

Unit C: What is the essential character of the system of investment arbitration? Does the system of investment arbitration pose a fundamental challenge to the principle of judicial independence? Can the arbitrators award an amount of compensation greater than a party’s claim? Do investors have the right to obtain specific performance/restitution in kind or can they only obtain compensation?
An introduction to the seminar economics part

Detailed description
Bilateral Invesment Treaties (BITs) are usually thought to provide an important instrument for the attraction of Foreign Direct Investment (FDI). Besides BITs, other treaties like International Tax Treaties (ITTs) and Free Trade Agreements (FTAs) should be conducive to FDI. While there are good reasons to assume that this is indeed the case conceptually, it remains an empirical question whether this can be confirmed and whether the hypothesized effects are of a significant magnitude – not least since the number of BITs proliferated in the past decade. To answer these questions, we will first discuss determinants of FDI conceptually / theoretically. Turning to empirical studies, we will discuss the measurement and empirical evidence, including confirming as well as contradicting evidence, on determinants of Foreign Direct Investment as far as they relate to treaties, which are relevant for FDI. Why knowing the determinants of FDI is important: From a firm’s point of view, location choice is based on compromises between different sets of determinants of FDI (or location factors). From a government’s point of view, any policy measures related to FDI need to be evaluated as to their potential impact on FDI. To this end, policy trade-offs need to be understood. A precondition for both, firms and governments alike, is knowledge about the economic and statistical importance of single location factors as determinants of FDI.

Overview of determinants of FDI
Market: Market size and market growth; market potential; etc.
Efficiency: Labour costs (not only vertical FDI, but also horizontal FDI), (labour) productivity or total factor productivity; skill; infrastructure; transport costs / distance / trade costs; etc.
Policy and Institutional Factors
- Legal environment, judicial system, International Investment Law in particular;
- Infrastructure: tangible (roads; electricity supply;) / intangible (education) / social infrastructure (governance, education etc.);
- Taxes / Thin cap rules etc.
- R&D subsidies;
- Special Economic Zones / Special Enterprise Zones / industrial clusters / agglomerations;
- Specific incentives (or targeted policies); removing specific regulatory obstacles to inward FDI; restrictions on FDI; enhancing product market competition;
- Trade barriers / capital liberalization / economic integration;
- Democratization, human rights, left-right government;
- Environmental regulations;
- Ease of doing business; corruption; economic freedom; risk, inflation; privatization;
- Labour market parameters: union bargaining power, employment protection legislation; core labour standards etc.

Bibliography
Core Texts:
Please note: all participants are required to study the key references prior to the course.

Other books and articles:
Unit A:

Unit B:
WOOLDRIDGE, J. (2001) Introductory Economics, A modern approach (Ch. 1, Ch. 4, Appendix A, Appendix C.6).

Unit C: Empirical Studies
(Note: These empirical papers are not part of the reader. Tables included in these empirical papers appear on the slides and will be used during teaching to discuss empirical results.) For interpretations of results tables in empirical studies, the following Link is useful. This page shows an example regression analysis with footnotes explaining the output:
http://www.ats.ucla.edu/stat/stata/output/reg_output.htm

- Market

- Efficiency

- Policy Factors

- Institutional Factors
Domestic

BITs


**DTTs**


**FTAs**


Questions

Students are expected to come prepared and able to answer the following basic questions:

Unit A: The determinants of FDI may be grouped into four groups: name at least three examples of important location factors included in each group. Explain, how these factors are related to FDI.

Unit B: Explain the concept of statistical significance / statistical insignificance means. Clarify the relationship between the natural logarithm and an elasticity. What is a variable? What is a coefficient? What is an elasticity? What is a semi-elasticity? Interpret the results in Table xxx in the study by xxxx.

Unit C: Describe the expected relationship of FDI and (a) BITs, (b) DTTs and (c) FTAs. Concerning BITs, describe in greater detail the range of results (Hint: Are the coefficients of different studies comparable? If not, how do they have to be transformed?) Taken these results together, how can these results be summarized, if you should answer the question how BITs affect FDI? How important are the effects of BITs compared to other location factors, DTTs in particular, which have been discussed in Unit A?
Assessment
Students are expected to attend all classes and to be punctual. Students are also expected to participate meaningfully to class discussion throughout the course. Moreover, to fully benefit this course students must:

- Read the materials and problems assigned for each class
- Be prepared to actively participate in each large and small group class
- Be willing to ask questions, raise issues and contribute to class discussions.

The grades for the course are based on three components:

- **Seminar Participation (10%)**: You will be awarded this mark for being prepared for each class and actively contributing in a positive way to the class discussions.
- **Case Presentation (30%)**: Students are encouraged to participate in classroom discussion and may choose to make a 15-20 minute presentation/discussion with the class on an arbitration case. Students are expected to complete some additional readings and research in order to prepare for the class. Students are encouraged to incorporate their research for the final assessment into the presentation and, in this regard, this assessment option will compliment and assist the research for the final exam. Please do not hesitate to contact us by phone, e-mail etc. if questions or problems turn up during the preparation of the cases. We would be happy to assist you.
- **Final Exam (60%)**: (Please note: The date for the final exam will be set during the course.)

Exam questions examples

- Recent cases suggest that the MFN obligation extends to procedural rights as well as substantive rights. Is this a reasonable determination and what are the ramifications of such a determination?
- What economic effect does FDI have on the host country and on the investor? What strategies do investors and host countries pursue in the investment process?
- It is striking that treaty regimes establishing significant protections FDI are almost exclusively the result of bilateral negotiations. Would you agree that the reason for this may be the enhanced power of capital-exporting party in the negotiation of a bilateral treaty and the enhanced power of a large number of capital-importing states in multilateral for a?

Specialized websites
They provide access to current investment treaty decisions, awards and other materials, including links to further resources:

- Digest of Investment Treaty Decisions and Awards: [http://arbitration-icca.org](http://arbitration-icca.org)
- Investment Arbitration Reporter: [http://iareporter.com](http://iareporter.com)
- Investment Claims: [http://investmentclaims.com](http://investmentclaims.com)
- Investment Treaty Arbitration: [http://ita.law.uvic.ca](http://ita.law.uvic.ca)
- NAFTA Claims: [http://naftaclaims.com](http://naftaclaims.com)
- Transnational Dispute Management: [http://transnational-dispute management.com](http://transnational-dispute management.com>
- UNCTAD international investment agreement: [http://unctad.org](http://unctad.org)