Karl P. Sauvant, "Reforming the International Investment Regime: Two Challenges", in Julien Chaisse, Tomoko Ishikawa and Sufian Jusoh, eds., *Asia's Changing Investment Regime: Sustainability, Regionalization, and Arbitration* (Singapore: Springer, 2017).

REFORMING THE INTERNATIONAL INVESTMENT REGIME: TWO CHALLENGES

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1. Introduction

This short contribution addresses two challenges in relation to the reform of the international investment law and policy regime, namely how to encourage the flow of substantially higher amounts of sustainable foreign direct investment (i.e., investment that makes a maximum contribution to development) and how to bring about a more widely accepted dispute-settlement approach. These challenges are part of the broader context within which governments in Asia negotiate international investment agreements, and which they may want to keep in mind in future negotiations.

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The reform of the investment law and policy regime needs to be seen against the background of intensive international discussions of the strengths and weaknesses of that regime. In fact, ideas that would have been cast away only five years ago as being unrealistic (such as a world investment court) are now firmly inscribed in the international agenda. The investment regime is in flux, and it is therefore an appropriate time to seek substantial improvements that would make that regime more widely accepted by all stakeholders.

It is not surprising that these discussions are ongoing, as the regime, in its current form, is a relative young construct. It has evolved, and continues to do so, in response to experiences, pressures and changing interests. And it has shown its impact through its investor-State dispute-settlement mechanism.

To a certain extent, some of the regime's weaknesses are a legacy issue. The regime was framed at a time of significant power asymmetries between the principal capital exporting (mostly developed) and most capital importing (mostly developing) countries, and long involved overwhelmingly unidirectional (i.e., North-South) foreign direct investment (FDI) flows. Today, however, it exists in an environment marked by the imperative to promote sustainable development, including the need to halt climate change; growing economic inequality; far greater economic and political interdependence, with FDI increasingly a two-way street; far greater public involvement in policy and rule-making; and a desire for the preservation of policy space and balanced rights and responsibilities on the part of governments and international investors.

The reformist quest for carefully balancing the regime should be welcome, as it reflects changing circumstances: it is a sign of greater maturity and fairness in international economic relations, even if it might complicate the search for consensus in rule-making.

Any discussion of the reform of the investment regime needs to begin with an identification of the regime's purpose, whether in relation to bilateral, regional or multilateral investment agreements. In a world in which all United Nations members just adopted, in September 2015 and at the highest political level, the Sustainable Development Goals, it appears logical that the purpose of the regime should be to encourage the flow of substantially higher amounts of sustainable FDI in the framework of a widely accepted enabling investment framework that regulates the relationships between governments and international investors in a balanced manner.

A good part of the international discussions about the investment regime revolve around some of the elements of the regime's purpose. This contribution focuses on two of these elements. The first one addresses the need to encourage the flow of substantially higher amounts of sustainable FDI by launching an international support program for sustainable investment facilitation, suggesting also alternative ways in which such an objective could be achieved (section 2). The second one deals with the quest for a more widely accepted enabling investment framework and, in particular, its dispute-settlement mechanism that is at its core, proposing the establishment of an independent Advisory Centre on International Investment Law (section 3).

2. Encouraging the flow of sustainable investment: the need for an international support program for sustainable investment facilitation

Why is there a need to encourage the flow of sustainable investment?

The answer is straight-forward: The world's investment needs are tremendous: to upgrade the physical infrastructure for the 21st century; to enhance skills; to build the science, technology and innovation capacity required to advance the frontier of knowledge; to transition to a low-carbon world economy to halt climate change; and,

ultimately, to create employment, advance growth and development and create better living conditions worldwide – in brief, to meet the Sustainable Development Goals. This will require, annually, trillions of dollars of new investment.

While the public purse has to provide most of the required funds, FDI can make an important contribution as well. However, world FDI inflows declined substantially from their peak of US$2 trillion in 2007 as a result of the financial crisis. Flows need not only to recover, but surpass this earlier record. There is no economic reason why FDI flows could not be substantially higher than what they were in 2007.

However, the issue is not only more FDI, but better FDI. “Better” FDI is investment that has certain “sustainability characteristics” in terms of contributing as much as possible to the economic, social and environmental development of host countries and take place in the framework of fair governance mechanisms while remaining commercially viable – in brief: sustainable FDI for sustainable development.

There is of course the challenge of defining FDI’s “sustainability characteristics”. (Note that the focus here is on the characteristics of individual FDI projects, as opposed to the overall behavior of international investors as capture, e.g., in the “responsible business conduct” instruments of the OECD.) An international organization or a non-governmental organization could establish a working group to prepare, in a multi-stakeholder process, an indicative list of FDI sustainability characteristics. Individual governments seeking to attract sustainable FDI could draw on that list for guidance purposes. A “sustainable FDI” definition is also needed for investor-state disputes, as arbitral tribunals consider, as they should, an investment’s development impact when adjudicating claims and, therefore, need evaluation criteria. The same applies as more international investment agreements make reference to “sustainable development” or “sustainable investments”. Such a working group could also identify mechanisms to encourage specifically sustainable investment flows.

To obtain considerably higher sustainable FDI flows requires that the FDI determinants at the country level are right. And that means that countries themselves have to be at the forefront of improving the FDI determinants: they need to strengthen the crucial economic determinants of their economies (e.g., the quality of human resources, of the science, technology and innovation capacity, of the physical infrastructure), their regulatory frameworks for FDI and their investment promotion capacities.

Many countries, however, and especially the 48 least developed countries, can do only so much on their own. They simply lack the capacity to compete successfully in the highly competitive FDI world market to attract the required funds. Hence, they need assistance, not only to strengthen their economic FDI determinants (including through official development assistance), but also their FDI regulatory frameworks and investment promotion capacities.

Accordingly, future international investment agreements should incorporate binding commitments that aim at encouraging higher sustainable investment flows. Some investment agreements already contain commitments by the treaty partners that seek to further this objective, for instance by requiring consultations on the promotion of investment flows between them. But few contain binding commitments in this respect. Notable exceptions are the 2015 Brazilian investment treaties with Angola and Mozambique: among other things, they mandate the establishment of “thematic agendas” for cooperation and investment facilitation. This is an approach that should be emulated in other international investment agreements.

But one should also consider going further and launch an international support program for sustainable investment facilitation, with national investment promotion agencies as the focal points. A sustainable FDI support program would complement the World Trade

Organization (WTO)-led Aid-for-Trade Initiative and the WTO Trade Facilitation Agreement, which focus on trade. In a world of global value chains, these two instruments address one side of the equation, namely trade, while a sustainable FDI support program would address the other side of the equation, namely investment. Analogue to the WTO efforts, a sustainable FDI support program would be entirely technical in nature, focusing on practical actions to encourage sustainable investment flows to developing countries.

One option to create such a program is to extend the Aid-for-Trade Initiative to cover investment. The initial emphasis could be on investment in services, given the WTO's General Agreement on Trade in Services and that services account for nearly two-thirds of the world's FDI stock. Alternatively, the Aid-for-Trade Initiative could be complemented with a separate Aid-for-Investment Initiative.

Another option is to expand the Trade Facilitation Agreement to cover sustainable investment. A subsidiary body of the Committee on Trade Facilitation could provide the platform to consult on the operation of what would be a sustainable investment module within the Trade Facilitation Agreement.

A third option is for all governments to launch a Sustainable Investment Facilitation Understanding. The WTO could work on such an Understanding as part of a post-Doha agenda, but work could also begin in another international organization with experience in FDI matters, especially UNCTAD, the OECD or the World Bank. Or leading outward FDI countries could launch a plurilateral initiative, initiated by the G20. (The top ten outward FDI economies, which include four emerging markets, accounted for four-fifths of world FDI outflows in 2014.)

If governments wants to meet the world's future investment needs and, in particular, the Sustainable Development Goals, they need to help countries through an international effort to attract more sustainable FDI, helping in this manner also to put the world on a sustainable development path.

3. Improving dispute settlement: the need for an Advisory Centre on International Investment Law

The investor-State dispute-settlement mechanism constitutes the heart of the international investment law and policy regime. It makes the regime effective. And it is precisely for this reason that a number of its shortcomings are being criticized in various quarters. There is a pressing need to improve the investor-State dispute-settlement mechanism. The proposal of the European Commission (the Commission) to create a world investment court and appeals mechanism is laudable in this respect, and it is to be hoped that the Commission will be able to convince member States, the European Parliament and its partner countries to move forward in this direction. Institutionalizing investor-State dispute settlement in this manner would enhance the investment regime's legitimacy.

Even if a world investment court system should be established, however, it would not alleviate another shortcoming of the regime, namely that poor countries (and especially the least developed among them), including in Asia, typically do not have the human and financial resources adequately to defend themselves as respondents in international investment disputes. And a dispute-settlement mechanism that does not provide a level playing field for the disputing parties is compromised, undermining its very legitimacy and, with that, the legitimacy of the international investment regime.

This is particularly important as claims against host country governments can reach hundreds of millions of dollars, host country regulations may be challenged, law-making

may be chilled, and the reputation of a country as an investment location may be at stake. Moreover, litigating claims is expensive, especially as disputes are becoming more complex. There is also the risk that governments may have to assume the litigation costs of the claimants if they lose a case. The advent of third-party funding further accentuates the imbalance for more vulnerable countries, as such funders typically do not provide funding to (State) respondents but only to claimants.

This puts many countries in an asymmetric situation whenever disputes arise, beginning with a possible readiness to settle disputes in which they could potentially prevail, or knowing when to settle during an early stage of a dispute when they usefully could do so, simply because they do not have the required sophistication or the resources to defend themselves.

An independent Advisory Centre on International Investment Law would help to establish a level playing field by providing administrative and legal assistance to respondents that face investor claims and are not in a position to defend themselves adequately.

It is useful, in this context, to look at the experience of the Advisory Centre on WTO Law. When, after the creation of the WTO, the number of disputes brought before this institution rose, the independent WTO Advisory Centre was established in 2001. It advises its developing country members on all issues relating to WTO law. This includes assisting its members through all stages of the WTO's regular panel and Appellate Body proceedings as complainants, respondents and third parties. The WTO Advisory Centre provides its services through its own staff or through outside counsel at reduced rates.

Something similar could be envisaged in relation to the international investment regime. Naturally, establishing an Advisory Centre on International Investment Law raises a host

of issues that would need to be considered carefully. And the closer any assistance comes to actual participation in litigation, the more difficult it may become for some countries to support such an initiative – although, as in the case of the WTO Advisory Centre, a group of individual countries interested in furthering the legitimacy of the regime could go ahead on their own.

In any event, the central challenge is to identify acceptable ways that give all countries a fair chance to defend themselves adequately in disputes to which they are party. Hence, as in the case of the WTO Advisory Centre, the difficulties associated with establishing an Advisory Centre on International Investment Law should not be insurmountable. And doing so would indisputably strengthen the legitimacy of the international investment law and policy regime in its function to enable substantially higher flows of sustainable FDI.

4. Conclusion

The international investment law and policy regime is in flux, and a number of its aspects are being challenged. Improvements have been made as governments learn from their past experience, but more improvements need to be made. Governments in Asia have the opportunity to contribute significantly to the further development of the investment regime, given that they are participating in a host of bilateral and regional investment treaty negotiations. Moreover, China chairs the G20 in 2016. This gives that country the opportunity to initiate an exploratory process on how to move the reform of the regime forward, perhaps even in the direction toward a plurilateral or multilateral investment framework.