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Foreign Direct Investment for Development: the United Nations Code of Conduct and the Search for Balance in International Investment Rules

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FOREIGN DIRECT INVESTMENT FOR DEVELOPMENT: THE UNITED NATIONS CODE OF CONDUCT AND THE SEARCH FOR BALANCE IN INTERNATIONAL INVESTMENT RULES

Karl P. Sauvant[1]

I. Introduction

Thomas Wälde joined the United Nations one year before the negotiations on a Code of Conduct on Transnational Corporations[2] began, in 1977. Indeed, these negotiations accompanied his journey in the United Nations system, since they were still ongoing when he left in 1990. While not directly involved in them, he was an avid observer[3] of the process and of the discussions that took place at that time—discussions about a *problematique* that is still on the international agenda today, some 30 years after this first[4] comprehensive effort to establish a multilateral framework for foreign direct

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[1] The author is Executive Director, Vale Columbia Center on Sustainable International Investment, a joint undertaking of Columbia Law School and The Earth Institute at Columbia University, New York. This chapter partially draws on work done for a UNDP Global Governance Project. I would like to acknowledge the work of Ilze Dubava for this text and the very helpful assistance of Delphine Papaud in finalizing this chapter.

[2] When the United Nations started work in this area, the firms involved were called "multinational corporations" (see, for example, the first major report on this subject by that organization, *Multinational Corporations in World Development*, ST/ECA/190, United Nations (1973). When delegates debated the issue in the United Nations, two points were made: 1. the description "multinational" was seen to imply that the firms involved were owned or controlled by citizens of various nations, while in reality the overwhelming majority of them were in fact owned and controlled by citizens of one country, the home country, operating across boundaries; 2. at that time, the Andean Pact had adopted an agreement that foresaw the creation of "Andean multinational enterprises" owned and controlled by various members of the Andean Pact countries. See *Andean Code on Multinational Enterprises and the Regulations with regard to Subregional Capital*, 11 I.L.M. 357 (1972). To take these considerations into account and to avoid a confusion with the Andean Pact enterprises, delegates decided to change the terminology from "multinational corporation" to "transnational corporation," and this term has been used in the United Nations since then. Of course, this change in terminology did not take into account that a number of firms operating transnationally are actually not incorporated and that, therefore, a more accurate label would have been "transnational enterprise."

[3] I had the pleasure of discussing this matter with Thomas when I had the privilege to deliver the Chalfen Memorial Lecture at the British Institute of International and Comparative Law in April 2006.

[4] Arguably, the first effort was made in the context of the ITO, albeit not in as broad a manner as the United Nations Code had envisaged.

investment [FDI] had begun.[5] At the heart of these discussions (and associated negotiations) is the question of the treatment of foreign investors and, more precisely, of what rights and responsibilities foreign investors and host countries should enjoy or bear in their interaction with each other. The balance of these rights and responsibilities determines, at least to a certain extent, the impact of FDI on development, the advancement of which is of particular concern to developing countries. And this balance finds its expression in national laws governing FDI, as well as in international investment agreements [IIAs] dealing with this subject, with the latter setting the parameters within which the former can be adopted and implemented.

Apart from being an observer of the negotiations of a United Nations Code, Thomas worked "on the ground," first as a legal adviser in the United Nations Centre on Transnational Corporations and to the United Nations Industrial Development Organization and, from 1980, as an Interregional Advisor on matters related to petroleum and mineral resources in the United Nations Department of Technical Cooperation for Development. As such, he provided advisory services to developing countries in matters related to natural resources, helping them find the national regulatory framework that would maximize the developmental benefits reaped from these resources, most of which were owned or controlled by multinational enterprises [MNEs]. As Thomas defined this type of work at that time: "Advisory assistance [...] has a double function, that of assisting governments in bridging their experience gap and that of bridging the consensus gap between negotiating partners."[6] In fact, Thomas' later focus on natural resources can be traced back to his formative years at the United Nations and the discussions that took place then, and to his hands-on experience in providing practical advice to developing countries.

This chapter looks at the considerations that shaped the negotiations of a United Nations Code of Conduct on Transnational Corporations and at the search for balance in international investment rules that has since then continued to inform efforts to establish an international framework for FDI and MNEs.

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[5] Although the focus of the negotiations was on FDI, it was not clear whether, in the end, other investment should be covered as well.

[6] Wälde, T., "Third World minerals development in crisis: the impact of the worldwide recession on legal instruments governing Third World mineral development," *Journal of World Trade Law* 19 (1985), at p. 28. As the author noted in the first footnote: "This article is based on the over 40 advisory missions carried out between 1979 and 1984 for over 30 governments."

II. FDI and MNE Activities Arrive on the International Agenda

Why did the issue of an international framework for FDI arise and why does it continue to be on the international agenda?

The answer to the first of these questions is straightforward: around the mid-1970s, governments became aware of the importance of FDI and of the activities of MNEs, both in their national economies and in the world economy. In developing countries, the focus was on the exploitation of natural resources, typically undertaken by MNEs (although other "commanding heights" of the economy, like banking, also received attention). This heightened awareness about the importance of FDI[7] was embedded in the post-decolonization political climate of developing countries seeking a voice in shaping the international economic system to suit their quest for development.[8] OPEC's successful oil price raise also played a role in encouraging developing countries to assert their bargaining power.[9]

In developed countries too, the rise of FDI and MNE activities was noted. In Europe, *le défi américain*[10] arose passions as American firms were taking over European ones, while the question of the export of jobs through outward FDI received considerable attention in the United States. And the involvement of ITT, a multinational enterprise headquartered in the United States, in the coup against President Allende of Chile received world-wide coverage.

As a result, the role of MNEs in national economies and in the world economy was put on the agenda of the United Nations, with a view toward reaching a better understanding as to what this role was and how to ensure that the benefits of FDI and of the activities of MNEs could be maximized while any negative effects could be minimized.

Since then, the issue has become, if anything, more pressing, although our understanding of the role of FDI and MNEs in development has increased considerably.[11] Suffice it to say that MNEs have become the most important

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[7] United Nations, *Multinational Corporations in World Development*, United Nations (1973). *See also* Barnet, R.J. and Mueller, R.E., *Global Reach: The Power of the Multinational Corporations*, Simon & Schuster (1974).

[8] Which found its expression in, among other things, a spade of nationalizations, especially in natural resources.

[9] This approach was captured in the well-known article by C. Fred Bergsten, entitled "One, two, many OPEC's...? The threat is real," *Foreign Policy* (1974), at pp. 84–90.

[10] Servan-Schreiber, J., *Le Défi Américain* (*The American Challenge*), Denoël (1967).

[11] Discussed in numerous publications and documented since 1991 in UNCTAD's annual *World Investment Report*.

private actors in the world economy. In 2008, there were over 80,000 MNEs,[12] defined as enterprises that have established systems of common governance over their foreign affiliates (of which there are a total of over 810,000),[13] either through direct ownership or non-equity forms of control. The common measurement of the importance of this governance is statistics on FDI.[14] In 2008, world FDI outflows amounted to $ 1.9 billion, with the stock of this investment surpassing $ 16 trillion.[15] Increasingly, the foreign affiliates of individual MNEs are woven together in integrated international production networks. In these networks, any part of the value-added chain can be located where it is the most efficient, both in terms of reaping the (corporate) benefit of an intra-firm international division of labor, and in terms of gaining access to resources (ranging from natural resources to skills) and markets. As a result, some one-third of the world trade is intra-firm trade. These firms also account for the bulk of research and development and of the international transfer of technology. All this makes MNEs important actors in national economies, although, on average, FDI inflows accounted in 2008 for only 12 percent of gross fixed capital formation world-wide. This average percentage is similar in developed countries (11 percent) and developing countries (13 percent), although the percentage varies widely within both groups.[16]

Still, the packages of tangible and intangible resources that are associated with FDI and the activities of MNEs—capital, technology, employment, skills, access to markets, etc.—can make an important contribution to national development and hence make FDI an important tool in this respect. Not surprisingly, therefore, all governments seek to attract FDI and seek to maximize the contribution that FDI and the activities of MNEs can make to development.

At the same time, governments also know that FDI and the activities of MNEs can be associated with a range of negative effects, including the crowding out of domestic firms, restrictive business practices, transfer pricing, undesirable environmental effects, the curtailment of competition, and

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[12] See UNCTAD, *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development*, UNCTAD (2009), p. 17.

[13] *Ibid.*

[14] However, these statistics do not include various non-equity forms of control, such as franchising agreements, management contracts, licensing agreements and the like, although all of them extend the governance of parent firms of MNEs beyond the assets controlled via FDI. Hence the importance of MNEs cannot be measured by FDI alone, but also needs to take into account other activities of these firms.

[15] *Ibid.*, pp. 247, 251.

[16] *Ibid.*, pp. 255–66.

the control of critical resources by foreign entities. Governments, also not surprisingly, seek to minimize such negative effects.[17]

Any policy that governments pursue as regards to FDI and MNE activities—and, therefore, the national and international regulatory frameworks they establish in this respect—reflects how governments perceive the balance of costs and benefits of FDI and MNE activities, and hence their interests and objectives in this respect. Moreover, it was recognized early on that the cross-border nature of the activities of these firms requires an international approach to their regulation. Evaluating these costs and benefits in an international context and finding a regulatory balance that would maximize the positive effects of FDI and MNE activities and minimize their negative effects was the challenge entrusted to the negotiators of the United Nations Code of Conduct in the late 1970s and the 1980s—and it continues to be faced by negotiators of international investment agreements today.

III. Interests and Objectives of the Principal Stakeholders

In contrast to the trade area, there is no multilateral framework governing foreign direct investment and the activities of MNEs. This is not for want of trying. As early as 1948, the aborted Havana Charter for an International Trade Organization had sought to address investment issues, albeit in a limited way.[18] This effort was resumed in a comprehensive manner in the late 1970s with the beginning of negotiation of a United Nations Code of Conduct on Transnational Corporations.[19] The starting question was: what would be the object and purpose of such regulation?

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[17] For a full discussion of the impact of FDI on economic development, see UNCTAD, *World Investment Report 1999: Foreign Direct Investment and Development* (Geneva: UNCTAD, 1999); Moran, T.H., Harnessing *Foreign Direct Investment for Development: Policies for Developed and Developing Countries* (Washington: Center for Global Development, 2006); Stiglitz, J.E., Globalization *and its Discontents* (New York: W.W. Norton & Company, 2003); Gallagher, K.P. and Chudnovsky, D., *Rethinking Foreign Investment for Sustainable Development: Lessons from Latin America*, Anthem Press (2009).

[18] See "Havana charter for an International Trade Organization," Ch. III, article 12 "International investment for economic development and reconstruction," E/Conf. 2/78, 24 March 1948.

[19] For an analysis of the substance of the negotiations and the positions of groups of countries, see Wälde, T.W., "Der UN-Verhaltenskodex fuer transnationale Unternehmen: Schritte zu einem Weltwirtschaftsrecht," *Recht der Internationalen Wirtschaft* 24 (1978), at pp. 285–90. The negotiations took place in the context of the United Nations' wider work on FDI and MNE activities, undertaken by the United Nations Centre on Transnational Corporations (UNCTC); this wider work involved also research and technical assistance. See Sagafi-nejad, T., in collaboration with Dunning, J.H., *The UN and Transnational Corporations: from Code of Conduct to Global Compact* (Bloomington: Indiana University Press, 2008) and Moran, T.H.,

The United Nations Code negotiations established the two dominant themes—and tensions—that have since then characterized efforts to establish an international framework for FDI and the activities of MNEs, namely (1) the struggle to find the proper balance between the rights and responsibilities of host countries on one hand and those of MNEs on the other;[20] and (2) the struggle over the legal nature of these rights and responsibilities (mandatory vs. voluntary). Governments approach these two issues from the perspective of what is in the interest of their countries, including their own enterprises—in other words, in light of the balance of costs and benefits they expect from FDI and the activities of MNEs. These struggles, based on the underlying interests of governments (and the firms they represent), have determined the subsequent evolution of the international investment law and policy regime.

So what *are* the underlying interests that drive the evolution of the international investment regime?

Host countries, as already mentioned, seek to attract FDI (especially of the kind that furthers their economic development the most, as witnessed, for example, by the efforts of countries to target specific types of investment), and to maximize the benefits that they can derive from such investments—after all, FDI is only a tool to advance development. At the same time, they seek to preserve the flexibility they need to minimize any negative impact of FDI and of the activities of MNEs and to safeguard any important non-economic objectives they pursue in their own national interest (including essential security interests). Typically, though, the concept of "national interests" is not defined and can include a range of military, political and economic considerations. When considering their interests, therefore, host country governments seek (to different degrees) to limit their mandatory responsibilities *vis-à-vis* foreign investors, while maintaining a legal right to regulate the entry of MNEs and their behavior once they are established in their territories.

The interests of MNEs, for their part, are represented and pursued by the *home countries* of these firms, typically with a view toward protecting the foreign assets of their outward-investing MNEs and facilitating the operations of their firms abroad. The former involves the establishment of strong and broad protection and dispute-settlement standards, anchored not only in national laws and regulations but also in international (investment) agreements, especially with countries whose judicial systems are considered to be

"The United Nations and transnational corporations: a review and a perspective," *Transnational Corporations* 18 (2009), at pp. 91–112.

[20] There is also the question of what rights and responsibilities, if any, home countries of MNEs should have.

fragile, biased and/or inefficient. The latter involves the liberalization of entry conditions for MNEs into host countries and as few restrictions as possible on foreign affiliates operating in these countries. Home country governments typically do not want to assume direct obligations, except with regard to subrogation and the settlement of disputes between treaty partners. When considering their interests as home countries, therefore, governments seek broad mandatory responsibilities for host country governments regarding the treatment of MNEs and their foreign affiliates, while limiting any responsibilities of foreign investors or keeping any responsibilities voluntary.

IV. The Changing Focus of International Investment Rules

A. *The Responsibilities of MNEs and the Rights of Governments*

The United Nations Code negotiations sought to address the rights and responsibilities of host countries and MNEs in a comprehensive and balanced manner.[21] However, developed and developing countries approached these negotiations with different perspectives. Developing countries contended that the negative effects of FDI and of the activities of MNEs out-weighed the positive ones; developed countries, for their part, held that the positive effects out-weighted the negative ones, for both host and home countries.

Developing countries imposed various controls on the activities of MNEs within their territories, *e.g.* through nationalizations, screening mechanisms, restricting sectors for inward investment, operational restrictions for foreign affiliates, controls on transfer pricing, and the like. Mirroring their domestic policy approach, developing countries (and the socialist countries that supported them)—all of them at that time overwhelmingly host countries (with FDI in the socialist countries being very limited)—focused in the Code negotiations on two things: (1) defining the responsibilities of MNEs (and they wanted these responsibilities to be binding); and (2) preserving their own rights as regards the treatment of these enterprises. To put it differently, host developing countries sought to keep their own responsibilities and the rights of MNEs as limited as possible. In line with these objectives, developing countries (and the socialist countries) also sought strong and mandatory language on intergovernmental cooperation and the implementation of the Code, with a view toward giving binding effect to the Code. This focus on the responsibilities of MNEs and on the rights of governments dominated

[21] See http://www.unctad.org/sections/dite/iia/docs/Compendium//en/13%20volume%201.pdf (last checked 9 July 2010). The objective of arriving at a balanced Code was reflected in the title of the instrument, as it was deliberately called "Code of Conduct *on* Transnational Corporations" and not "Code of Conduct *for* Transnational Corporations" [emphasis added].

the international approach to FDI and MNEs during the late 1960s and the 1970s.

Developed countries, on the contrary, focused especially on the responsibilities of host countries with regard to foreign firms, reflecting their status as principal home countries of MNEs and the North-South context in which the negotiations took place. They wanted to keep the responsibility of MNEs as general as possible; and they sought strong language on treatment standards, but (because of the guidelines part) weak provisions regarding international cooperation and implementation. On the question of mandatory vs. voluntary, and in line with their overall approach, developed countries had a preference for a voluntary instrument, primarily because they did not want to impose (even general) mandatory behavioral standards on (at that time mostly "their") MNEs.

The negotiations of the Code, which had begun in 1977, reached their most intensive phase in the early 1980s then slowed down. The interests and objectives of the developed and developing countries concerning the dominant themes of the negotiations could not be reconciled. While substantial agreement on (typically) fairly general responsibilities of MNEs could be reached, host countries resisted the language sought by developed countries on the treatment of foreign investors. This made the Code unbalanced in the eyes of developed countries. Accordingly, they opposed a mandatory instrument with strong international cooperation and implementation provisions.[22]

This stalemate was resolved in favor of the approach of developed countries when the environment within which the negotiations took place changed. In particular, attitudes in host countries toward FDI and the activities of MNEs became more welcoming, as their evaluation of the cost and benefits associated with them became more positive. At the same time, developed countries intensified their efforts to negotiate bilateral investment treaties [BITs] for the protection and promotion of foreign investment, *i.e.*, binding instruments that focus almost entirely on the responsibility of host countries. The negotiations of the Code fizzled out in 1992.[23]

The quest for a comprehensive United Nations Code was embedded in a number of other efforts to regulate FDI and the activities of MNEs, with a number of them leading to the adoption of instruments. Many of these nego-

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[22] Even if developing countries (and the socialist countries) had been more flexible on the provisions regarding treatment, international cooperation and implementation, it is not at all clear whether key developed countries would have accepted an instrument with mandatory provisions.

[23] UNCTAD, *World Investment Report 1993: Transnational Corporations and Integrated International Production*, United Nations (1993). According to this report: "After informal consultations held from 21 to 23 July 1992, delegations concluded that, at present, no consensus was possible on the draft Code." *Id.* at p. 33. This brought the negotiations on the United Nations Code of Conduct on Transnational Corporations to a formal end.

tiations were driven by (host) developing countries, supported by the socialist countries, and pursued in the United Nations system. They all sought to affirm the rights of governments *vis-à-vis* foreign investors or their desire to impose responsibilities on MNEs. Most noteworthy among them were United Nations resolutions on permanent sovereignty over natural resources,[24] the Charter of Economic Rights and Duties of States[25] and the resolutions related to the establishment of a New International Economic Order,[26] as these instruments reflected most clearly the position of host developing countries. Other instruments reflecting the skeptical approach of developing countries negotiated in a multilateral context at that time included the ILO Tripartite Declaration;[27] codes of conduct on restrictive business practices,[28] breast-milk substitutes,[29] consumer protection,[30] and the transfer of technology;[31]

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[24] See e.g., especially *Permanent Sovereignty over Natural Resources*, G.A. res. 1803 (XVII), 17 U.N. GAOR Supp. (No. 17) at 15, U.N. Doc. A/5217 (1962) and *Permanent Sovereignty over Natural Resources of Developing Countries*, G.A. res. 3016 (XXVII), 18 December 1972, 12 ILM 226.

[25] *Charter of Economic Rights and Duties of States*, UN Doc. A/RES/29/3281(1974). The *Charter of Economic Rights and Duties of States* was adopted against the votes of Belgium, Denmark, the Federal Republic of Germany, Luxembourg, the United Kingdom, and the United States; Australia, Canada, France, Ireland, Israel, Italy, Japan, the Netherlands, Norway, and Spain abstained. The roll call vote is registered at 14 ILM 265 (1975).

[26] *Declaration on the Establishment of a New International Economic Order*, UN Doc. A/RES/S-6/3201 (1974), reprinted 13 ILM 715. Article 4 of the Declaration states: "The new international economic order should be founded on full respect for the following principles: ...g. Regulation and supervision of the activities of transnational corporations by taking measures in the interest of the national economies of the countries where such transnational corporations operate on the basis of the full sovereignty of those countries;..." The Declaration was adopted by the General Assembly without a vote on May 1, 1974.

[27] *International Labour Organization Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy*, adopted by the Governing Body of the International Labour Office at its 204th Session (Geneva, November 1977) and amended at its 279th Session (Geneva, November 2000). Available at: http://www.ilo.org/public/english/employment/multi/download/english.pdf (last checked 9 July 2010). The ILO Declaration contains also references to (already existing) binding instruments.

[28] UNCTAD, *The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices*, UN doc. TD/RBP/CONF/10/Rev.1 (1981). The Set of Principles and Rules was adopted by the United Nations Conference on Restrictive Business Practices on April 22, 1980 and by the General Assembly in resolution 35/63 on December 5, 1980. These documents are available at: http://www.unctad.org/en/docs/tdrbpconf10r2.en.pdf (last checked 9 July 2010).

[29] World Health Organization, *International Code of Marketing of Breast-milk Substitutes* (1981). The Code was adopted by the Thirty-fourth World Health Assembly by resolution WHA34.22 on May 21, 1981. These documents are available at: http://www.who.int/nutrition/publications/code_english.pdf (last checked 9 July 2010).

[30] *Guidelines for Consumer Protection*, adopted by the United Nations General Assembly Resolution 39/248 on April 9, 1985.

[31] The *Draft International Code of Conduct on the Transfer of Technology* was negotiated between 1976 and 1985. It was not adopted by the United Nations General Assembly. The text of the draft is available at: http://stdev.unctad.org/compendium/documents/totcode%20.html (last checked 9 July 2010).

and a model convention for double taxation treaties between developed and developing countries.[32] Decision 24 of the Andean Pact[33] was infused with the same spirit at the sub-regional level.

Developed (home) countries were not inactive at the multilateral level. Even before the initiative had shifted to the developing and socialist countries at the beginning of the 1970s, they had succeeded in the adoption (1965) of a convention that established the International Centre for Settlement of Investment Disputes,[34] an institution that was largely dormant until the number of international investment disputes began to rise substantially in the late 1990s. But developed countries were largely defensive, trying to limit the initiative of the developing and socialist countries by seeking to keep responsibilities of MNEs voluntary. Their only major initiative concerned the proposal for an international agreement on illicit payments, proposed by the United States; but since neither the developing countries nor other developed countries were supportive, this effort fizzled out as well.[35]

At the regional level, however, the developed countries adopted (1976) the OECD Declaration on International Investment and Multinational Enterprises.[36] It consisted of Guidelines for Multinational Enterprises, complemented by Decisions by the OECD Council on follow-up procedures related to the Guidelines, national treatment, conflicting requirements, and international investment incentives and disincentives. Although this instrument was adopted within a relatively like-minded group of countries ("relatively" because Australia and Canada, in particular, were very much aware of their status as host countries), it reflected the tensions identified earlier in the North-South context, as well as a trade-off between the rights of foreign investors and the desire to regulate the activities of MNEs, with the guide-

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[32] *United Nations Model Double Taxation Convention between Developed and Developing Countries*, ST/ESA/102, United Nations (1980), adopted by the Committee of Experts on International Cooperation in Tax Matters in 1979.

[33] "*Decision 24: Common Regime of Treatment of Foreign Capital and of Trademarks, Patents, Licenses, and Royalties*," November 30, 1976, 16 I.L.M. 138 (1977).

[34] *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, entered into force on October 14, 1966, available at: http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp. Several years earlier, in 1958, the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (the "New York Convention") was adopted by the United Nations Conference on International Commercial Arbitration. It entered into force on June 7, 1959.

[35] See brief history and text of the *Draft International Agreement on Illicit Payments* available at: http://www.unctad.org/sections/dite/iia/docs/Compendium//en/9%20volume%201.pdf (last checked 9 July 2010). The draft was put before the General Assembly in 1979, but the General Assembly took no action.

[36] OECD, *Declaration on International Investment and Multinational Enterprises* (Paris: OECD, 1976).

lines being strictly voluntary, although monitoring and review arrangements were made. Since the Declaration was adopted after the New International Economic Order [NIEO] resolutions were passed and before the negotiations on a United Nations Code of Conduct had begun, it prepared the developed countries for those negotiations and signaled that, if they would agree to anything at all, it would have to be in the context of a package addressing the rights and responsibilities of host countries and MNEs, with the responsibilities of MNEs being voluntary.[37]

B. *The Responsibilities of Host Countries and the Rights of Investors*

Thomas could observe how the objectives of the developing (host) countries drove the efforts to formulate international investment agreements during the 1970s.[38] He could also observe how, around the middle of the 1980s, the initiative shifted to the developed countries. Negotiations on virtually every instrument that had not been concluded by then were eventually abandoned, most notably among them (as already mentioned) the United Nations Code of Conduct. The window of opportunity closed for those governments that sought stronger international regulation of FDI and the activities of MNEs.

The second oil-price shock in 1979 had been absorbed, and the price of oil was actually falling, while the organization of producer cartels was not successful, weakening the actual and psychological bargaining power of developing countries. The debt crisis that had begun in the early 1980s[39] not only further undermined the bargaining power of the developing world, but led to a greater appreciation of the benefits of long-term investment capital as embodied in FDI. Later on, the disintegration of the socialist camp deprived developing countries of an important ally. Most importantly, and partly as a result of these developments, the benefits of FDI came to be more appreciated and countries learned, at least to a certain extent, how to maximize their benefit from such investment. A better understanding of the effects of FDI

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[37] It should be noted in this context that the OECD countries had agreed much earlier among themselves on instruments liberalizing capital movements and invisible transactions (OECD, *Code of Liberalisation of Capital Movements*, and OECD, *Code of Liberalisation of Current Invisible Operations*, both adopted in 1961).

[38] See Wälde, "Der UN-Verhaltenskodex," op. cit.

[39] In August 1982, Mexico's finance minister informed the chairperson of the Federal Reserve, the U.S. Treasury Secretary and the IMF Managing Director that Mexico would be unable to meet its obligation to service its debt that month. By October 1983, 37 countries had rescheduled their debts, and more followed. *See* Federal Deposit Insurance Corporation, *History of the Eighties: Lessons for the Future. Volume 1: An Examination of the Banking Crisis of the 1980s and Early 1990s*, at 191, available at: http://www.fdic.gov/bank/historical/history/191_210.pdf (last checked 9 July 2010).

and the activities of MNEs allowed them to negotiate more effectively[40] (when negotiations took place, especially in natural resource sectors) and to adopt legislation (*e.g.* competition laws) to minimize certain negative effects. Also, the rising number of MNEs increased competition among these firms for lucrative investment opportunities. The general acceptance of market-based development, as promoted in the framework of the Washington Consensus,[41] provided the overall framework for a change in approach toward FDI and the activities of MNEs.

As the benefits of FDI came to be seen as out-weighing its costs (and governments learned how to reduce the costs), the cost/benefit calculation of host developing countries changed. With it, the approach of these countries (and, eventually, also that of the formerly socialist countries) to the regulatory framework changed, from controlling FDI and MNE activities, to attracting MNEs and their investments. Red carpets replaced red tape and the laws, regulations and mechanisms that had been put in place to control MNEs; screening agencies became investment promotion agencies [IPAs]. This change in approach occurred both at the national and international levels.

At the national level, countries (and not only developing ones) moved strongly—some more, some less—in the direction of creating a more welcoming framework for FDI. While systematic data are not available for the 1980s, they do exist for regulatory changes beginning in 1992. In particular, out of 2,650 changes in national FDI laws in countries across the world between that year and the end of 2008, 90 percent made the investment climate more welcoming for foreign investors.[42] A good part of the changes involved the reduction or elimination of entry conditions for MNEs, facilitating their operations and offering incentives for foreign investors.

Beginning in the 1990s, furthermore, countries not only sought to make the investment climate more welcoming, but they also made active and increasing efforts to attract FDI. The instrument of choice became the IPA. Eventually, nearly all countries established such agencies, increasingly also at the sub-national level. In 1995, the World Association of Investment Promotion Agencies was set up; by May 2010, its membership had grown to 249 members agencies, from 157 countries.[43] World-wide, an estimated 10,000

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[40] At times assisted by Interregional Advisors like Thomas.

[41] John Williamson coined the phrase in 1990 "to refer to the lowest common denominator of policy advice being addressed by the Washington-based institutions to Latin American countries as of 1989." John Williamson, "What should the World Bank think about the Washington Consensus?" *World Bank Research Observer* (15) (2000), at pp. 251–64.

[42] See UNCTAD, *World Investment Report 2009*, op. cit., p. 31.

[43] See http://www.waipa.org/why.htm (last checked 9 July 2010).

government agencies at the national and sub-national levels have the mandate to attract foreign investors.[44] Among the various instruments IPAs use for this purpose are investment incentives, whose incidence and importance have risen substantially over the past two decades. As a result, the world market for FDI has become highly competitive.

It is against this background of a changing cost/benefit calculation and the regulatory changes at the national level that international investment rule-making continued, but now with developed countries in the driver's seat. In line with the objectives of developed (home) countries, efforts to define and enforce the responsibilities of MNEs were largely abandoned. Instead, the focus shifted toward host countries assuming binding responsibilities for the treatment (and especially the protection) of foreign investors, further strengthened by procedural rights that provided for investor-State dispute settlement in case investors felt aggrieved by the actions of host country governments; moreover, host countries increasingly assumed commitments (although hesitantly) regarding the improvement of conditions governing the entry and operations of MNEs. In other words, the pervasive liberalization trend at the national level became complemented by the rapid rise of IIAs (at the bilateral, regional or multilateral levels) focusing on the protection of investors and the liberalization of the conditions for their operations. The international investment regime that resulted from this treaty-making has become an important parameter for national policy making, setting the boundaries of what countries can or cannot do domestically in order to promote growth and development.

There remains however an important difference between the extent to which developing countries were prepared to assume commitments at the multilateral level, compared to the regional and bilateral levels.

At the multilateral level, the most important successes of the developed countries included agreement on the Multilateral Investment Guarantee Agency [MIGA] (1985),[45] the General Agreement on Trade in Services [GATS][46] and the Agreement on Trade-Related Investment Measures [TRIMs],[47] the latter two concluded in the framework of the Uruguay Round

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[44] Loewendahl, H., "The rise of emerging market multinationals: investment challenges ahead," in: Sauvant, K.P. and McAllister, G. with Maschek, W., [Eds.], *Foreign Direct Investment from Emerging Markets: The Challenges Ahead* (New York: Palgrave Macmillan, forthcoming).

[45] *Convention Establishing the Multilateral Investment Guarantee Agency*, 24 ILM 1598 (1985).

[46] *General Agreement on Trade in Services* [GATS], 1869 UNTS 183; 33 ILM 1167 (1994). This agreement is particularly important, as FDI in services accounts for the bulk of FDI flows and stock.

[47] *Agreement on Trade-Related Investment Measures* [TRIMs], 1868 UNTS 186.

of GATT (1994). On the other hand, efforts to formulate Guidelines on the Treatment of Foreign Direct Investment (1992),[48] undertaken in the framework of the World Bank Group, yielded only a voluntary instrument. The effort, led by the European Union and Japan, to include investment in the negotiations of the WTO Doha Round (launched in 2001) (as part of the "Singapore issues") yielded a mandate[49] to clarify key elements of an eventual multilateral framework on investment and to move to formal negotiations after the Cancun Ministerial Conference of the WTO (2003); but failure to reach consensus at that Conference led to the discontinuation of further discussions of investment in the WTO.

In all these instances, it was the opposition of developing countries that prevented more far-reaching agreements: they resisted, where they could, the assumption of greater binding responsibilities *vis-à-vis* foreign investors that would reduce their national policy space and limit their right to regulate—mirroring in this manner the efforts of developed countries during the 1970s to limit the imposition of responsibilities on MNEs. The agreement to establish MIGA could be concluded (at the time of the debt crisis) because it was limited to offering FDI insurance to MNEs from developed and developing countries, *i.e.*, it did not impose standards of treatment.[50] The GATS and TRIMs Agreement were opposed by developing countries, but became part of a broader trade-off in the framework of the Uruguay Round. Besides, GATS most notably adopted a positive list approach to scheduling commitments (which allows countries to enter into commitments on a sector-by-sector basis when they see fit to do so), while the TRIMs Agreement was restricted to clarifying the application of existing GATT Articles (III and IV) to four performance requirements.

The World Bank Guidelines effort remained voluntary, as it was judged from the beginning that a mandatory effort would not be successful. Finally, the attempt by the WTO to launch negotiations on a multilateral investment framework faced, from the beginning, the resistance of key developing countries (although it was supported by others) and was eventually abandoned in the context of a stalled overall Doha Round. Among the reasons invoked was the fact that the benefits of a multilateral approach had not been

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[48] World Bank Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment 21 September 1992, published as *Legal Framework for the Treatment of Foreign Direct Investment* (Volume II, Guidelines) (World Bank, 1992), reproduced as 21 ILM 1363 (1992).

[49] See Singapore Ministerial Declaration: World Trade Organization, *Singapore Ministerial Declaration*, 13 December 1996, WT/MIN(96)/DEC, para. 20.

[50] MIGA offers political insurance to enterprises from its members for investments in developing countries against risks, such as expropriation, war and civil unrest, transfer restrictions, and breach of contract.

demonstrated, while the costs of a multilateral agreement (in terms of having to enter binding commitments regarding the treatment of foreign investors, possibly coupled with cross-retaliation in cases of infringements) were clear. The WTO exercise, moreover, followed the aborted attempt of developed countries to negotiate, among themselves, a Multilateral Agreement on Investment, an effort that was abandoned in 1998 for lack of consensus among the negotiating parties—not because the tradeoff between rights and responsibilities of countries and firms was a stumbling block, but because, in the end, key constituencies did not see the benefit of a compromise in the OECD framework, a compromise that would have left out developing countries while adding little to the existing framework among developed countries.[51]

At the regional and bilateral levels, however, the regulatory framework for international investment developed rapidly, focusing almost entirely, in a mandatory manner, on the responsibilities of host countries *vis-à-vis* foreign investors. Developing countries were willing to enter into commitments at these levels since they took place in the context of trade-offs in specific regional settings and since, in the context of bilateral agreements, they could protect themselves through exceptions. Moreover, in their efforts to attract FDI in competition with other countries, they were individually prepared to grant rights that they were not willing to grant multilaterally.[52]

Bilateral treaties for the promotion and protection of investment, in particular, became the instrument of choice for defining the responsibilities of host countries. Their number grew rapidly, reaching 2,676[53] at the end of 2008, involving (at the end of 2007) 179 countries.[54] They are complemented by bilateral and regional free trade agreements containing substantial investment commitments; most modern free trade agreements are also free investment agreements. Moreover, the effectiveness of IIAs has risen with the active utilization of the investor-State dispute-settlement mechanism that most of them provide for. While there were few international investor-State arbitrations during the 1980s and the first half of the 1990s, by the end of 2009 at

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[51] The documentation of the MAI negotiation process is available on the OECD website. See http://www.oecd.org/daf/mai/ (last checked 9 July 2010). See also Graham, E.M., *Fighting the Wrong Enemy: Antiglobal Activists and Multinational Enterprises* (Washington: Peterson Institute, 2000) and UNCTAD, "Lessons from the MAI," *UNCTAD Series on Issues in International Investment Agreements* (New York and Geneva: UNCTAD, 1999), available at: http://www.unctad.org/en/docs/psiteiitm22.en.pdf (last checked 9 July 2010).

[52] *See* Guzman, A.T., "Why LDCs sign treaties that hurt them: explaining the popularity of bilateral investment treaties," 38 *Virginia Journal of International Law* 639 (1998), pp. 639–88.

[53] See UNCTAD, *World Investment Report 2009*, op. cit., p. 32.

[54] See UNCTAD, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge*, UNCTAD (2008), p. 14.

least 357 known[55] international treaty-based arbitration cases had been initiated, over half during the preceding five years.

V. Conclusion: Toward Rebalancing the Rights and Responsibilities of Host Countries and Investors

The 1990s and early 2000s were the high-water mark of the creation of an investment environment favorable to MNEs and FDI. Led by the developed countries, virtually all governments liberalized, albeit to various degrees, their national regulatory regimes for FDI and strengthened the protection of foreign investors by enshrining it in binding international treaties that define the responsibilities of host countries and the rights of foreign investors. This opened markets for foreign investors and made it safer for them than at any time in the recent past to establish themselves abroad. In the struggle of defining rights and responsibilities in a mandatory manner, the interests and objectives of the developed countries prevailed.

The result is a strong international investment regime, primarily geared toward protecting investors, liberalizing their operating conditions and providing them, in particular, with a dispute-settlement mechanism. To quote Thomas:

> Investment treaties [...] have built, indubitably, one of the most effective and truly legal regimes within the fragmented and mostly quite rudimentary institutional frameworks for the global economy. Comparable in terms of legal character and effectiveness to the WTO regime, the international investment regime is arguably more advanced, as it fully incorporates the most important and directly affected non-state actors. In a longer term perspective, claimants (and their lawyers), who are essentially driven by private interests, help ensure greater compliance and effectiveness for the treaties and their underlying objectives than can or is achieved by exclusively inter-state implementation procedures. It also goes beyond the prospective-remedy-only sanction available under the WTO.[56]

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[55] Only ICSID reports the number of cases; hence the actual number of disputes is likely to be somewhat higher. The following data are from UNCTAD, "Latest developments in investor-State dispute settlement," *IIA Issues Note*, No. 1 (2010), p. 2, available at: http://www.unctad.org/en/docs/webdiaeia20096_en.pdf (last checked 9 July 2010). (UNCTAD has the most comprehensive database on international investment disputes). For a discussion of the reasons for this explosion of investment disputes, see Salacuse, J.W., "Explaining the increased recourse to treaty-based investment dispute settlement," in: Sauvant, K.P. with Chiswick-Patterson, M. [Eds.], *Appeals Mechanism in International Investment Disputes*, New York: Oxford University Press (2008), at pp. 105–26.

[56] Wälde, T.W., "Improving the mechanisms for treaty negotiation and investment disputes: competition and choice as the path to quality and legitimacy," in: Karl P. Sauvant, [Ed.], *Yearbook on International Investment Law and Policy, 2008–2009*, OUP (2009), at p. 514.

And he added: "Investment arbitration is arguably the most astounding success in international law over the past decades [...]."[57] Thomas witnessed the rise of the international investment law and policy regime and watched—and influenced—how it has gone from efforts to focus on the rights of host countries and the responsibilities of investors, to a focus on the rights of investors and the responsibilities of host countries.

However, it is the very strength of the regime in reflecting the interests and objectives of home countries and their investors that is also its greatest weakness. The principal reason is that the regime, as it has emerged, does no longer necessarily and adequately reflect the evolving interests of all stakeholders in the regime, hence, is not stable. To quote Thomas: "[t]he main function of legal instruments—and their capacity to contribute to development oriented economic cooperation—seems to lie in their ability to foster what we may call 'stability.'"[58] As Thomas pointed out, "[i]t is, however, not appropriate to perceive '*stability*' exclusively in the sense of the term '*investment security*'". Rather, the appropriate concept for him was "dynamic stability" which he defined as the "ability to provide necessary reliability with requisite adaptation to external changes" and which, at least for his analysis at that time, served to define for him "the function of law in contributing to Third World economic development."[59] Central is that "a legal system must accommodate the interests of all Parties concerned."[60] Not surprisingly, therefore, the question of the proper balance between the rights and responsibilities of host countries and investors is back on the agenda, as is the question of what form this should take. This, in turn, is embedded in the broader issue of a certain re-evaluation of the costs and benefits of FDI and hence the interests and objectives that governments have in the investment area.

Several factors suggest and support a movement toward a more balanced regime. To begin with, at the national level, some governments are no longer considering all incoming FDI as equally desirable. In particular, greenfield investment is typically preferred, as it creates new capacity and jobs. M&As, on the other hand, are at times looked upon with suspicion, especially if they take place in sensitive sectors and are undertaken by state-controlled entities. As a result, a number of countries have introduced laws and regulations that

[57] *Ibid.*, p. 543.

[58] Wälde, T.W., "North/South economic cooperation and international economic development law: legal process and institutional considerations," in: Lambert, J.D. and Fesharaki, F. [Eds.], *Economic and Political Incentives to Petroleum Exploration*, International Law Institute (1990), at p. 59.

[59] *Ibid.*, p. 61.

[60] *Ibid.*, p. 62.

specifically mandate the screening of M&As by state-controlled entities;[61] in the United States, for example, the Foreign Investment and National Security Act[62] establishes a presumption that such transactions are subject to investigation. Moreover, countries that have traditionally defined themselves primarily as home countries when it came to regulatory frameworks for FDI (*i.e.* primarily developed countries) have begun to pay more attention to the fact that they are also host countries, and important ones at that. This changes their interest situation as regards the objective of regulation, as, in that capacity (and like developing countries before), they, too, want to have sufficient policy space to pursue their policy objectives and exercise their right to regulate. This perspective is further reinforced, thirdly, by the fact that an increasing number of developed countries are becoming respondents in international arbitration cases and, hence, have a certain interest in circumscribing protections of foreign investors. Thus, by the end of 2009, 17 developed countries had been respondents in known treaty-based investor-State disputes (compared to 45 developing countries and 15 economies in transition).[63] This number might well rise substantially, given the high number of MNEs and foreign affiliates that, depending on the applicable treaties, may initiate investment disputes.[64]

Fourthly, to a certain extent, these new developments are driven by the growth in importance of FDI from non-traditional home countries, namely emerging markets. Outflows from these economies amounted to $ 350 billion in 2008, seven times the average of *world* FDI outflows during the first half of the 1980s.[65] In a number of emerging markets, state-owned enterprises play a particular important role and increasingly use M&As to enter foreign markets; in the case of China, for example, some 80–90% of outflows are controlled by state-owned enterprises.[66] In the future, furthermore, sovereign wealth funds may become more active, not only through portfolio investment but also foreign direct investment. The rise of these new actors

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[61] For a review, see Sauvant, K.P., "Driving and countervailing forces: a rebalancing of national FDI policies," in: Sauvant, K.P. [Ed.], *Yearbook on International Investment Law and Policy, 2008–2009*, OUP (2009), at p. 514.

[62] *Foreign Investment and National Security Act of 2007*, Pub.L. 110–49, codified as 50 U.S.C. App. 2170 (2007).

[63] UNCTAD, "Latest developments in investor-State dispute settlement," *IIA Issues Note*, No. 1 (2010), p. 2.

[64] In 2009, at least 32 new cases were initiated; see ibid.

[65] See UNCTAD, *World Investment Report*, United Nations (various years).

[66] See Cheng, L.K. and Ma, Z. "China's outward FDI: past and future," (July 2007), p. 15 online: http://www.nber.org/books_in_progress/china07/cwt07/cheng.pdf (last checked 9 July 2010). (These figures do not include state-owned enterprises administered by regional governments).

(and competitors), including from countries that may be regarded as strategic competitors, is a new element in the world FDI market and has contributed to the changing cost/benefit calculation of governments, as evidenced most notably in the regulatory changes in a number of developed countries. Indicative of this is how the number of notifications and investigations of cross-border M&As into the United States rose between 2003 and 2008, namely from 41 to 155 in the case of filings, and from 2 to 22 in the case of investigations.[67] In line with a substantial decline of cross-border M&As into the United States in 2009, the number of notification decreased significantly that year (to between 70 and 75 transactions), while the number of investigations rose significantly, perhaps to as many as half of the number of filings.[68] More broadly, the changing approach to investment is reflected in the nature of the regulatory changes that have taken place at the national level: while, during 1992–2002, only 6 percent of all these changes made the regulatory framework less welcoming for foreign investors, that figure rose to 12 percent during 2003–2004 and 21 percent during 2005–2008.[69]

Not unrelated to this is, fifthly, the higher propensity of at least some governments (including that of the United States), to place more emphasis on national interest, "essential security interest," "emergency actions" and similar considerations, in order to reserve possibilities for themselves to take actions, under certain conditions, that contravene treaty obligations in the investment field. Incorporating such considerations into international investment agreements becomes particularly problematic when the relevant clauses are self-judging as this potentially undermines a central pillar of the international investment law edifice.[70]

These developments—in a process of "dynamic stability" described by Thomas—are likely to contribute to a rebalancing of the international investment regime toward a new balance regarding the rights and responsibilities of host countries and investors in international investment law. This is facilitated by the fact that the relatively clear-cut distinction between host and home countries (and their underlying interests) is fading. Emerging markets,

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[67] See Sauvant, K.P., "Is the United States ready for FDI from China? Overview," in: Sauvant, K.P., [Ed.], *Investing in the United States: Is the US Ready for FDI from China?*, Edward Elgar (2010), at p. 12. The number of notifications for 2008 contained in that source is 165; it was subsequently revised to 155.

[68] See Plotkin, M.E. and Fagan, D.N., "Foreign direct investment and U.S. national security: CFIUS under the Obama Administration," *Columbia FDI Perspectives, No. 24, 7 June 2010.* At the time of the writing of this chapter, the final figures for notifications and investigations were not yet available.

[69] See UNCTAD, *World Investment Report 2009*, op. cit.

[70] See, for example, US Model BIT of 2004, article 18, available at: http://www.state.gov/documents/organization/117601.pdf (last checked 9 July 2010).

traditionally primarily host countries, are increasingly becoming home countries as well; as a result, emerging markets are becoming more sensitive to the concerns of investors. Conversely, the traditional home countries (principally developed countries) pay now more attention to their position as host countries. And all of them are interested in advancing their economic growth and development.[71]

As the underlying FDI interest situations of countries become similar, host/home country interests are likely to be rebalanced. This, in turn, affects how the two dominant themes—and tensions—that governed the United Nations Code of Conduct negotiations are addressed in the evolving international investment law and policy regime: (1) the struggle to find the proper balance between the rights and responsibilities of host countries on one hand and those of MNEs on the other; and (2) the struggle over the legal nature (mandatory vs. voluntary) that any rights and responsibilities should have. I am sure that Thomas would have been an active participant in the discussions of this very difficult process of advancing dynamic stability, had he had the chance to do so.

[71] In fact, even during the 1970s, when the FDI/MNE *problematique* reached the international agenda, a number of developed countries were also interested, at least to a certain degree, in regulating the activities of MNEs, supporting for example (voluntary) guidelines for these enterprises. (For example, The Netherlands was a co-sponsor of the resolution initiating work by the United Nations on this subject; *see* ECOSOC Res. 1721, 53 U.N. ESCOR, Supp. (no. 1), U.N. Doc. E/5209 (1972) which called on the United Nations Secretary-General to establish a Group of Eminent Persons to study the effects of multinational enterprises on world development and international relations). Today, this interest has become much more pressing, for the reasons outlined earlier.