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## *The Role of Preferential Trade Agreements in International Investment Policy*

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### ABSTRACT

Preferential trade agreements have played an important role in the evolution of international investment policy. Indeed, the emergence of international investment policies over the last half century or more can be best described as a multilevel process. Policies and rules have been shaped by initiatives at all levels starting from top-down multilateral efforts and ranging through, plurilateral, regional and bilateral initiatives to unilateral actions. Bilateral investment treaties and more recently bilateral comprehensive trade and investment agreements have had a major impact, but these must still be seen in the context of broader plurilateral and regional initiatives. The current debate is shaped by a renewed belief that preferential initiatives will further international, meaning global, investment rules. There are regional (such as the Trans-Pacific Partnership), plurilateral (such as the International Services Agreement) and bilateral initiatives (such as the shape of the Transatlantic Trade and Investment Partnership). But such recent policy developments really confirm the multilevel nature of investment policy and the fact that the choice of level is largely shaped by the strategic interests of key agents.

### 1. INTRODUCTION

This article provides a broad historical background to the current debate on investment in free trade agreements. It covers the period from the late 1940s to the present day and therefore does not reach into the detail of how the content of investment agreements and rules have evolved, although it points

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to differences between the predominant 'models' as these continue to shape policy and international agreements. The article also identifies a number of different phases in the evolution of this multilevel process that suggest shifts in the relative importance of the different levels over time.

## 2. EARLY MULTILATERAL EFFORTS: THE LEAGUE OF NATIONS TO THE OECD

The origins of efforts to introduce international investment rules date, as is well documented, from the 1920s and 1930s with the draft investment provisions of the League of Nations.<sup>1</sup> These were based on the so-called Hull formula of 'prompt, adequate and effective' compensation in cases of expropriation, which in turn dated from US concerns about Mexican expropriations in the 1920s. The central tension at that time was between capital importing countries that subscribed to the Calvo doctrine that investment should be regulated according to Host State law and capital exporting countries that sought protection for investment undertaken by their nationals in independent but developing countries that did not provide, in the view of the investors, adequate protection under their national laws.

The next major multilateral effort to establish multilateral investment rules came with the negotiation of the 1948 Havana Charter of the International Trade Organisation (ITO). Just as in the 1930s there was a tension between the US on the one side and capital importing countries on the other over the scope for national laws and national governments to determine inward investment and investment policy. The US led because it was the capital exporting country *par excellence* of the day with the European economies destroyed or indebted. The US was keen to establish a strong multilateral order in the post-World War II period. This combined with the fact that the State Department led the negotiations and put foreign policy or systemic issues high on its agenda, meant that the US agreed to provisions in the ITO (in Articles 11 and 12 in particular) that ceded to Host States powers to screen and restrict investment and impose 'reasonable requirements' on established investors. These provisions were seen to be too much of a concession to capital importing countries by US business interests and a major reason why the US private sector opposed the ratification of the ITO in the US Congress.<sup>2</sup> With no ITO all that remained was the General Agreement on Tariffs and Trade (GATT) negotiated in 1947, which had no specific provisions on investment. As will be shown below some GATT principles such as national treatment in Article III and the Article XI provisions on restrictions to trade

<sup>1</sup> K Vandeveldc, *Bilateral Investment Treaties: History, Policy and Interpretation*, (Oxford University Press 2010).

<sup>2</sup> W Diebold, *The End of the ITO* (Princeton University 1952).

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could have been applied to limit performance requirements imposed on investment by host governments. But the focus of the GATT was on the reduction of tariff barriers and there was no support for such an expansive interpretation of the GATT. As a result the post 1945 economic order contained no significant provisions on international investment.

The next effort to agree on genuine international investment rules came in the Organisation for Economic Cooperation and Development (OECD) or in reality in its fore runner the OEEC. Again following a US initiative discussions were held on an investment instrument. Once more the divide between capital exporters and capital importers created difficulties. A draft text, building on the so-called Abs-Shawcross text,<sup>3</sup> was produced in an effort to bridge the divide,<sup>4</sup> but this was again seen as too weak by US investor interests that were not ready to accept an agreed text that condoned what they saw as low standards. In the 1960s European governments also wished to retain policy autonomy over foreign investment and so tended to favour investment rules that reflected this. This lack of support for liberal investment policies in Europe was reflected in the Spaak Report<sup>5</sup> and then in the Treaty of Rome establishing the European Economic Community (EEC). Although the Treaty of Rome is presented as providing for the 'four freedoms'—namely for goods, services, capital and labour—it stopped short of full capital liberalization. The freedom of capital anchored in Article 56 was limited to that required for the establishment of a common market. Thus there was provision for free capital movement but EEC Member States continued to screen and restrict foreign direct investment.

The Abs-Shawcross draft, although not accepted as the basis for an international instrument, did provide the basis for European model bilateral investment treaties (BITs). This model covered investment protection only. It included post-establishment national treatment and classic expropriation provisions (ie no de facto expropriation). Standards of protection were at that time broadly defined with no attempt at refinements on national treatment and fair and equitable treatment. The first such European BIT was negotiated between the Federal Republic of Germany and Pakistan in 1959. Germany was possibly more interested in ensuring investment protection for its investors because compared to Britain, France or even the Netherlands it did not have a concentration of investment in colonies or former colonies.

<sup>3</sup> H Abs and H Shawcross 'Draft Convention on Investments Abroad' in 'The proposed convention to protect private foreign investment: a round table', 1 *Journal of Public Law* (1960) 115–118.

<sup>4</sup> OECD, Draft Convention on the Protection of Foreign Property, No. 15637 (1962).

<sup>5</sup> 'The Brussels Report on the General Common Market' Information Service, High Authority of the European Community for Coal and Steel (1956).

## 3. PLURILATERAL LIBERALIZATION AND BILATERAL PROTECTION: 1960 TO 1980

The period roughly between 1960 and 1980 could be said to have been characterized by a bilateral approach in terms of investment protection and a plurilateral approach to liberalization. The bilateral initiatives came mostly from the European capital exporting States with agreements negotiated with developing countries, using the European model BIT based on the Abs-Shawcross text. Between 1959 and 1980 there were 250 BITs negotiated, mostly by European governments.<sup>6</sup> Note that these were agreements negotiated by individual countries not the EEC or EC. The EC had no competence in investment, except arguably that resulting from implied competence resulting from Article 56 EEC.<sup>7</sup>

The plurilateral liberalisation initiatives came through continued work in the OECD among like-minded OECD countries and took the form of the OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations of 1964.<sup>8</sup> These codes began a long period in which work within the OECD shaped the evolution of investment norms and investment policy.<sup>9</sup> During the initial years of the codes they mostly contributed to removing restrictions on capital movements and enhancing the transparency of controls on investment, without any significant liberalization of controls on foreign direct investment or enhanced access.

The gap between north and south, capital exporting and capital importing countries was if anything accentuated during this period. The south in the shape of the G77 group of developing countries effectively pushed for a reaffirmation of the Calvo doctrine as part of their demands for a New International Economic Order (NIEO) from about 1973 until the late 1970s. This initiative from the G77 led to the 1974 UN Charter on the Economic Rights and Duties of States that was adopted in the General Assembly of the UN and clearly reflected the interests of the developing countries.<sup>10</sup> A motivating factor behind the UN initiative was the desire on the part of developing country governments to reaffirm their ability to control the activities of multinational companies (MNCs). During the 1970s investment by MNCs was seen as potentially undermining the development strategies of developing countries that were based on the promotion of

<sup>6</sup> UNCTAD, *World Investment Report* 2000, UNCTAD Geneva, 2000.

<sup>7</sup> Implied competence in the context of European law is when competence for an external policy is 'implied' as a result of there being EC competence internally within the European Community or now European Union.

<sup>8</sup> E Snyder 'Foreign Investment Protection: a Reasoned Approach' 61 *Michigan Law Review* 6 (1963) 1087-1124.

<sup>9</sup> For a general description of the OECD instruments see OECD, 1987.

<sup>10</sup> General Assembly resolution 3082 (XXVIII) of 6 December 1973 (Charter of Economic Rights and Duties of States)

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indigenous infant industries as a means of countering dependence on the developed economies. This multilateral or global initiative by the G77 was opposed by OECD countries as a retrograde step back from the policy of progressive liberalization followed by the OECD. The OECD countries proposed a plurilateral alternative that then took the form of the 1976 OECD Declaration and Decisions on International Investment and Multinational Enterprises. This provided a non-binding set of Guidelines for Multinational Enterprises<sup>11</sup> and an equally non-binding provision on national treatment.<sup>12</sup>

Perhaps the most significant initiative in the field of investment policy during the period was the shift in national policies to liberalise investment. These unilateral initiatives came right at the end of the period, led by the United States and followed by the United Kingdom. The US had always pursued a liberal investment policy, but before the 1980s many European countries retained policies of screening and controlling inward investment as part of their national-champion-based industrial policies. This was explicit in the case of countries such as France, but rather more implicit in the case of West Germany which maintained a nominally liberal policy. These unilateral initiatives both reflected a shift in thinking away from investment policies shaped by national ownership considerations and contributed to policy change by establishing competition between States in attracting FDI. This competition has been subsequently seen as one of the main vectors of policy diffusion of liberal investment policies and agreements.<sup>13</sup>

The period from around 1960 to the end of the 1970s therefore illustrates the multilevel nature of investment policy. It started with renewed efforts to establish liberal investment rules at an international level. When these again failed, largely because of ideological differences between capital exporting and capital importing countries, the former opted for plurilateral liberalization initiatives and bilateral treaties to protect investment. Capital importers sought to use their numerical advantage in the UN to push through a resolution that they hoped would help strengthen the collective action of the developing countries in resisting liberal investment pressure. But it was the unilateral decisions to move to significant liberalization among some leading OECD countries that were to have the greatest impact. The various international instruments, such as the OECD codes

<sup>11</sup> <<http://www.oecd.org/daf/inv/mne/oecdguidelinesformultinationalenterprises.htm>>.

<sup>12</sup> OECD *Foreign Direct Investment: Policies and Trends in the OECD Area during the 1980s* (Paris 1993).

<sup>13</sup> Z Elkins, AT Guzman and B Simmons 'Competing for Capital: The Diffusion of Bilateral Investment Treaties 1960-2000', Berkeley Law: Berkeley Law Scholarship Repository: 1-1-2008 (2008) <<http://scholarship.law.berkeley.edu/facpubs>>.

and BITs, became the means by which liberal policies were codified and made irreversible.<sup>14</sup>

#### 4. 1980–1994 POSITIVE SYNERGY?

The period 1980 to 1994 was one of increasing activity at all levels of policy. Initially this activity created a positive synergy in terms of regional initiatives promoting wider international agreement. By the end of the period, however, it became clear that the alternative of bilateral approaches to investment liberalization and rules was undermining efforts to create comprehensive multi-lateral rules for investment.

In the early 1980s the United States took a number of initiatives in the field of investment. At the multilateral level the US administration pressed for investment, as well as services and high technology trade, to be included in the GATT agenda. The apparent intention of the US was to include a fully-fledged investment agreement in the GATT as part of a new round of trade negotiations. This followed an earlier proposal in the 1970s for a GATT for investment.<sup>15</sup> The proposals put forward by the US administration in 1981 did not find support among developing countries and the European Community was also generally negative on the idea of starting a new round of trade negotiations. At that time economic growth was slow so many EC Member State governments were not ready to move on a liberalization agenda and some were concerned that the US would attack the EC on agricultural protection. The GATT Ministerial meeting in 1982 at which the US made the case for a trade round to include, among other things investment, was therefore inconclusive and the US Trade Representative at the time (William Brock) announced that the US would seek alternative routes to liberalise trade and investment in the shape of free trade agreements with Israel and Canada.<sup>16</sup>

<sup>14</sup> While governments can use their sovereign rights to repudiate treaties and agreements this is not without costs in terms of reputation and lost investment. The OECD instruments provided for an explicit ratchet mechanism. OECD governments were not obliged to liberalize a certain sector or category of investment, but once they did the ratchet was there to stop the reintroduction of controls. Bilateral investment treaties can be repudiated and are from time to time, but under international law protection provided by BITs tends to continue for a decade after the repudiation of a treaty by any party. In other words the various investment instruments are there to provide predictability and security for investors.

<sup>15</sup> CP Kindleberger and P. Goldberg 'Towards a GATT for Investment: A Proposal for Supervision of International Corporations' *Law and Policy in International Business* 2 (1970) 295–323.

<sup>16</sup> J Croome *Reshaping the World Trading System: The History of the Uruguay Round* (DIANE 1996).

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The case of Canada is interesting because the US challenged Canadian policy on inward investment under GATT. The dispute concerned the application of performance requirements by Canada and specifically under the Foreign Investment Review Act (FIRA). The FIRA case went through GATT dispute settlement and the GATT panel found that local content requirements were inconsistent with GATT Article III:4, but not export requirements. The case therefore highlighted the limited scope for use of the GATT 1948 to challenge national investment policies and specifically the use of performance requirements. The US response was to seek to negotiate stronger international disciplines at the multilateral level in the GATT or alternatively at the bilateral level in the Canada-US Free Trade Agreement.

At the same time the US developed a comprehensive policy on investment in the shape of the 1982 US model bilateral investment treaty (BIT). Up to this time the US had not engaged in many bilateral investment negotiations and it had been the Europeans using the Abs-Shawcross format that had shaped the nature of investment agreements. The 1982 US model BIT was far more comprehensive. It covered investment liberalization (pre-establishment national treatment) as well as investment protection (post-establishment national treatment). The 1982 US model BIT also set out to prohibit a large number of performance requirements, reaching far beyond those that could be challenged under existing GATT rules. In terms of investment protection the US model included provisions on both classic and de facto expropriation, or 'regulatory takings' as it became known, in other words protection against regulation by host governments that effectively reduces the value of assets. This was all to be backed-up by investor-State dispute settlement.<sup>17</sup> Here, then, was a statement of the high standards the US was seeking in investment agreements and a model that was to be used by the US in subsequent negotiations, whether with Canada and Mexico in the subsequent North American Free Trade Agreement) or in bilateral negotiations for subsequent comprehensive trade and investment agreements. It also established a high standard and thus high expectations for any plurilateral or multilateral negotiation. Anything that fell short of these standards was certain to be criticized by US investors and the US Congress as sub-standard.

At the multilateral level negotiations on what was to become the Uruguay Round of the GATT began to gather pace during the 1980s. The European Community in particular moved to adopt a more positive position on a new round including on the topics of services and to a lesser degree investment. The services issue relates to investment because one of the four modes by which services can be delivered is establishment. Commitments

<sup>17</sup> US Senate, US-Panama Bilateral Investment Treaty, Senate Treaty Document 99-14, 99th Congress, 2nd Session, 27 October (1987).

on establishment in services were to take the form of national treatment and thus liberalization. The Uruguay Round also included what came to be called Trade Related Investment Measures or TRIMs. This term covered all those investment measures adopted by host governments seeking to ensure that foreign investment contributes to the local value added. These are referred to as performance requirements on inward investors. Developing countries, led by India and Brazil, were opposed to the inclusion of investment per se in the Uruguay Round so the compromise was to look at investment measures that could be seen as restricting trade. This concerned the negotiation of increased GATT disciplines governing performance requirements. Ambitions varied between the US, which was seeking GATT disciplines of 14 TRIMs and developing countries and the Newly Industrialising Countries that favoured merely a clearer definition of which TRIMs were covered by the existing GATT. The European Community's position and that of Japan took up an intermediate position favouring a ban on a limited number of six core TRIMs.

During the course of negotiations the US used unilateral measures to strengthen its leverage. This took the form of the threat to use US trade legislation in the shape of section 301 of the US Trade Act of 1974 to act against countries that were seen to be 'unfairly' restricting investment. The domestic political economy of US trade policy and the interaction between the US Administration, which was seeking agreement on the round, and the US Congress, which had rather more aggressive aims of opening up large developing country markets for US investors, meant that support for a new round of trade liberalization could only be obtained from Congress in return for a strengthening of US trade legislation. This took the form of the Omnibus Trade and Competitiveness Act of 1988, which provided the US with powers to act against countries that pursued what were defined as unfair measures, including some restrictions on investment and a lack of respect of intellectual property rights. For developing countries this then increased the costs of rejecting any discussion of investment in the Uruguay Round.

The Omnibus Trade and Competitiveness Act also granted formal negotiating authority to the executive branch to negotiate a free trade agreement with Canada. The negotiations with Canada had begun in 1986 and were finalized in 1988. The Canada-US FTA effectively incorporated the comprehensive provisions of the US model BIT. It was presented by US negotiators as 'showing how it can be done', in other words as a model for a wider trade and investment agreement. Discussions on a regional agreement to include Mexico also began in 1990. These were to lead to the NAFTA agreement, which was signed in December 1992 but first implemented in 1994 after the Clinton Administration had negotiated a number of side agreements to obtain congressional approval. The NAFTA again embodied the US model BIT provisions. It covered pre-establishment national treatment and thus



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liberalization, based on a negative list system. Twelve performance requirements were prohibited. There was protection against classic and de facto expropriation and unrestricted freedom for funds transfer. Finally, the NAFTA included detailed provisions on investor-state dispute settlement including the use of international arbitration procedures.

There was another important regional initiative in investment policy taking place in the European Union. By the mid to late 1980s many national policies had shifted to a more liberal stance. This can be seen to have been in part due to the effects of competition leading to unilateral liberalisation of investment policies. The general move to create a Single European Market and thus end the fragmentation of the European market due to the pursuit of national champion strategies by many European governments also facilitated a shift towards more liberal investment policies. In 1988 the European Community adopted an Investment Directive that finally implemented the treaty aim set out in Article 56 EEC of free movement of capital within the single market.<sup>18</sup> This meant full liberalization of capital flows, but with the safeguard that capital controls could be reintroduced in exceptional circumstances when flows disrupt monetary policy objectives.

During the negotiations on multilateral rules on investment in the Uruguay Round of the GATT, which covered both TRIMs and the establishment provisions in the General Agreement on Trade in Services (GATS), based on a positive list approach to coverage, there were therefore parallel bilateral and regional initiatives. Whether these bilateral and regional initiatives facilitated multilateral negotiations or detracted from them has not been definitively resolved.<sup>19</sup> At the time regional initiatives were certainly presented as models for wider multilateral agreements, but the NAFTA approach failed to gain much traction in the GATT negotiations. The draft final text of the Uruguay Round that emerged in December 1991 was closer to the EC/Japanese position and prohibited only six TRIMs. By at least as early as 1991 it was clear that the GATT was not going to deliver high standard rules on investment liberalization, let alone investment protection.

At about the same time that the scope of the Uruguay Round provisions on investment were becoming clear there were renewed efforts to strengthen the OECD's investment instruments. These took the form of the OECD review of the National Treatment instrument of 1991. This encompassed the section on national treatment of the 1976 Declaration on International Investment and Multinational Enterprises (the 'Declaration') and the procedures adopted to implement the Declaration, such as the requirement to

<sup>18</sup> See the Capital Liberalisation Directive, Council Directive 88/361/EEC June 24<sup>th</sup> for the implementation of art 56 of the Treaty.

<sup>19</sup> S Woolcock, (ed) *Trade and Investment Rule-making: The Role of Regional and Bilateral Agreements* (United Nations University Press 2006).

notify exceptions to national treatment, the obligation not to reintroduce a restriction on investment once it had been removed (the ratchet mechanism) and peer review procedure. The aim of the 1991 review was to make the instrument binding. But differences emerged within the OECD membership. For example, should the instrument cover sub-federal level government? This was a demand of the European Community because EU legislation reached down to the level of states and provinces, whereas federal states and provinces in the US and Canada were not covered. Another sensitive issue was whether investment controls could be imposed on the grounds of national security, such as when a foreign company invests or gains control of a company that is seen to have strategic importance for the host state. The problem here was (and remains) how to define what was necessary for national security in order to prevent such an exception being abused as a means of restricting foreign investment. There was also a question concerning the treatment of preferential (trade) agreements under the OECD instrument. These differences prevented an agreement at the plurilateral level of the OECD on a strengthening of the investment instruments. The negotiations were concluded with an agreement to continue discussing the scope for a wider investment instrument within the OECD.<sup>20</sup> This was to later emerge as the proposal for a 'Multilateral Agreement on Investment' (MAI). The issues raised in the negotiations on the National Treatment instrument continue to shape the debate today and remain to be addressed in the current negotiations on a Transatlantic Trade and Investment Partnership (TTIP).<sup>21</sup>

As noted above the nature of the Uruguay Round outcome on TRIMs was more or less clear by 1991. This was not the case for the negotiations on establishment under the auspices of the GATS. A framework agreement and commitments on some sectors were agreed as part of the Uruguay Round in 1993 and ratified in 1994, but negotiations continued until 1997 on sector agreements in financial services and telecommunications. These latter sector agreements were in effect plurilateral agreements and took binding rules further than for the GATS as a whole.

##### 5. 1995–2000: COMPETITIVE LIBERALIZATION

The Uruguay Round resulted in rather modest advances in two areas of investment rules, those on performance requirements and on establishment in the service sector, where commitments were disappointing with most being limited to the OECD countries that were already engaged in liberalization. In

<sup>20</sup> OECD, C (91)147/FINA (12 December 1991).

<sup>21</sup> See for example, the Resolution of the European Parliament on European Union trade and investment negotiations with the United States of America 2013/2558(RSP)

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retrospect the GATS has come to be seen as a means of codifying or binding unilateral moves towards liberalization. In the immediate post Uruguay Round period there was a general consensus among policy-makers in the established developed economies that investment represented an area in which liberalization was lagging compared to trade, but there was no consensus on the level at which new initiatives should be taken. In terms of policy statements the European Union came out in favour of a multilateral approach to investment and pushed for the inclusion of investment in the WTO. In 1994 the European Commission produced a communication arguing for a level playing field for investment.<sup>22</sup> This favoured negotiations at a multilateral level on investment, because most of the barriers to investment were in developing countries and not in the OECD where considerable progress had been made in liberalization. The Commission also argued that developing countries would not accept a 'fait accompli' from the OECD and could therefore not be expected to sign up to a wider investment instrument emanating from the OECD process. There were also internal EU issues and interests at stake. The Commission argued that the growing number of EU Member State BITs was distorting investment flows within the EU as some Member States had far more bilateral BITs with third countries than others. A negotiation in the WTO would also have furthered the Commission's aim of extending de facto EU competence, as it was the norm that only the Commission spoke in the WTO whereas the Member States negotiated in the OECD.<sup>23</sup> The fact that the Commission had right of initiative in matters of trade and in effect in the WTO, meant that it was able to include investment as one of the so-called Singapore issues pushed by the European Union at the time of the first WTO Ministerial meeting in Singapore in 1996.

The US government's position favoured a plurilateral route in order to ensure that any agreement that was reached would set high standards. The poor record of negotiations at the multilateral level stretching back over decades and confirmed by the experience of the Uruguay Round efforts to strengthen multilateral disciplines on investment, had convinced US interests in the private sector and government, that any WTO agreement would not fit the bill in terms of a high standard agreement. The idea with what became the Multilateral Agreement on Investment (MAI) negotiations that were launched in May 1995, was that international rules for investment would be negotiated that would in time replace the patchwork of different bilateral

<sup>22</sup> European Commission 'Towards a Level Playing Field for International Investment' (1994).

<sup>23</sup> The European Commission also participated in OECD discussions and there was an effort to coordinate Member State positions, but the fact that Member State governments negotiated and spoke in OECD meetings meant it was easier for national governments to hold off any slippage of competence to the EU.

agreements that had emerged. Negotiating an agreement among likeminded states would facilitate agreement on high standard rules that would then attract new signatories.

In the event both the plurilateral and the multilateral approaches failed. The OECD initially made more rapid progress and draft agreements were developed by 1998. But the negotiators were not able to resolve some of the underlying differences between OECD countries that had already been present at the time of the debate on the binding National Treatment instrument in the early 1990s. To these persistent differences between OECD members came the now well known concerted civil society campaign against the MAI as the latest embodiment of a form of globalization that was seen to be counter to the interests of developing countries, the environment and organized labour.<sup>24</sup> Negotiators began to modify the draft agreement to address the concerns of civil society, which then undermined business support. Governments then saw little to gain from supporting the MAI but a potential to lose votes and, led by France, they withdrew from the negotiations in 1998.

The failure of the MAI undermined the probably already remote prospect of including investment in the planned millennium trade round that was to be launched in Seattle in late 1999. Although a WTO working group had been established<sup>25</sup> to look at trade and investment after the Singapore ministerial meeting, work on investment was opposed by developing countries and the developed economies gave a clear preference to the OECD work. The collapse of the MAI was seen as a victory for global civil society, which went on to campaign against the launch of a new round of the WTO in Seattle. In the Seattle meeting the Singapore issues, including investment, were supported only by the EU, Japan, Korea, Hungary and Switzerland. Although the EU in particular continued to press for the inclusion of the Singapore issues in the WTO agenda, the prospects after the MAI were slim and investment along with government procurement and competition were finally dropped from the WTO's Doha Development Agenda at the Cancun Ministerial meeting in September 2003.<sup>26</sup>

In the background of these plurilateral and multilateral efforts there was a burgeoning of bilateral initiatives in the shape of comprehensive trade and investment agreements. From the mid-1990s there was also a shift in opinion in the United States away from seeing preferential agreements as a means of furthering wider multilateral approaches, as had been the position up to then, to a policy of competitive liberalization, which saw preferential approaches as an alternative to multilateral or wider international approaches

<sup>24</sup> D Henderson *The MAI Affair: a story and its lessons* (RIIA, 1999).

<sup>25</sup> <[http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/bey3\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey3_e.htm)>

<sup>26</sup> <[http://www.wto.org/english/thewto\\_e/minist\\_e/min03\\_e/draft\\_decl\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min03_e/draft_decl_e.htm)>

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provided they brought about liberalization.<sup>27</sup> Initially held up by the lack of formal negotiating authority, the policy of competitive liberalization was applied actively from 2001 when the Bush Administration gained Trade Promotion Authority. There followed a series of comprehensive FTA negotiations that applied the US model BIT with regard to investment.<sup>28</sup> The US BIT model was also updated in 2004 and again in 2012.<sup>29</sup> With rare exceptions, the investment provisions in these agreements were based on the NAFTA and thus the US model BIT. This strategy of opting for the alternative of bilateral agreements meant that the US was able to extend its influence over international investment policy. It did so in order to seek high standards and not accept weaker rules in any plurilateral or multilateral agreement.

The fact that the US was able to influence international investment policy right through to the current period was in part because there was no single comprehensive common EU investment policy. In the Uruguay Round there had been a common EU position on GATS and TRIMs because the Member States had effectively ceded de facto, if not de jure, competence to the EU. But formal competence remained divided between the EU where the Commission played a strategic role in trade negotiations and the Member States which retained competence to negotiate and conclude BITs. The European approach to investment protection was still essentially based on the old Abs-Shawcross text and applied through separate Member States BITs. The Member State BITs generally do not include any liberalization of investment. The standards of protection, moreover, continue to be couched in general principles of national treatment and fair and equitable treatment that are not more closely defined. This has been seen as providing a significant scope for interpretative discretion in arbitration proceedings such that national policy could well be shaped by arbitral bodies outside the political process. This concern is exacerbated by the fact that the transparency provisions in the Member State BITs are not well developed either. With shifts in the flow of investment it has been argued that the EU Member States may find themselves on the receiving end of expensive damages claims, as has been the case for some of the new Member States. With more investment flowing into the EU from emerging markets there may be more claims. But this position has been countered by a majority of Member States that argue that they have not yet lost a case. In 2010 the adoption of the Treaty on Functioning of the European Union (the Lisbon treaty) resulted in foreign

<sup>27</sup> S Evenett and M Meier 'An Interim Assessment of the US Trade Policy of Competitive Liberalization' *The World Economy*, Vol 31 Issue 1 pp 31–66.

<sup>28</sup> Agreements with Jordan 2001, Singapore and Chile 2004, Australia 2005, Morocco and Bahrain 2006 and agreements were signed with CAFTA-DR in 2005–6, Colombia and Peru 2004 and Korea 2007 that were only ratified with a delay.

<sup>29</sup> The US Model BIT had already been revised as a result of experience with NAFTA.

direct investment becoming the exclusive competence of the EU. This means that Member States have lost the ability to negotiate bilateral investment agreements without EU authorization, but in the transition period from Member State to EU BITs the Member State governments have continued to resist any change in the established policies and have sought to stick to the existing European style of BIT in negotiations with third countries.<sup>30</sup>

The shared competence between the EU and Member States prior to the Treaty of Lisbon meant that the EU was not able to negotiate comprehensive trade and investment agreements as the US did during the 2000s. The EU did, however, negotiate some bilateral FTAs, such as EU–Chile in 2001, which included liberalization of investment. In July 2006 the Commission, which had long sought to enhance the EU's role in investment policy, developed a so-called agreed platform for establishment, trade in services and e-commerce for future FTA negotiations. This came at a time when the EU shifted (back) to a more active strategy of negotiating bilateral FTAs with growth markets in the Global Europe policy statement of 2006 (Evenett, 2006). The platform then shaped the liberalization elements of subsequent EU FTAs.<sup>31</sup>

The inability to conclude comprehensive trade and investment agreements on a par with the US reduced the EU's influence on international investment policy over the past 20 years. After the adoption of the Lisbon treaty the question now becomes whether the EU can develop an EU model BIT and whether it can use this to shape international policy. The early discussions on EU investment policy suggest, as noted above, that the Member States are fighting a rear guard action to retain the existing approach and the Commission has ruled out the formal development of model treaty language.<sup>32</sup> European business is concerned that investment policy will become politicised, as the MAI was in the 1990s, and would therefore prefer to avoid a broad public debate. Following the Treaty of Lisbon any formal EU model investment agreement would need to get the consent of the European Parliament, which is sometimes seen as a source of politicizing EU external trade and investment policy. The shift in the EU to an active policy of negotiating comprehensive trade and investment agreements therefore

<sup>30</sup> 'The EU Approach to International Investment Policy after the Lisbon Treaty', Directorate General for External Policies, Policy Department, the European Parliament, EXPO/B/INTA/FWC/2009-01/Lot7/07-08-09 (2010).

<sup>31</sup> See for example the EU's agreements with Colombia and Peru, the Comprehensive Economic Partnership Agreement with CARIFORUM and the FTA with Korea. The Interim EPAs with developing countries in the ACPs have not included these provisions on establishment, cross border supply of services and e-commerce.

<sup>32</sup> NJ Calamita, 'The Making of Europe's International Investment Policy: Uncertain First Steps' in NJ Calamita et al (eds) *The Future of ICSID and the Place of Investment Treaties in International Law* (BIICL 2013).

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provides further impetus to 'competitive liberalization' as the EU seeks to match what the US does and others seek to match what such major WTO Members do.<sup>33</sup>

Apart from the US and the EU a number of other countries are concluding comprehensive trade and investment agreements. Many of these follow the NAFTA model, thus agreements negotiated by Mexico, Chile and Singapore with third countries following their agreements with the US, also adopted the NAFTA model, as has Canada.<sup>34</sup> China has negotiated some FTAs that include investment, for example the bilateral agreement with Peru includes both investment liberalization and investment protection, and even include investor-State dispute settlement although with a less detailed set of enforcement mechanisms. The one notable absence is anything on labour or environmental standards. There is a trend among capital importing developing countries to reassess their BITs. In the 1990s developing countries were falling over themselves to conclude BITs in the belief that this would lead to more FDI and facilitate their access to the international economy and global supply chains. With limited evidence that BITs have made such a contribution there has been a reassessment in a growing number of countries such as South Africa and a number of Latin American States.

#### 6. CURRENT CHALLENGES

The current period is dominated by preferential trade and investment negotiations rather than initiatives at the multilateral or plurilateral level. In the services sector there is an initiative, led by the United States, to negotiate an International Services Agreement. This was initially presented as a plurilateral initiative in which only like-minded countries ready to make real commitments would participate. Given the WTO rules on plurilateral agreements, however, which require the endorsement of the Ministerial Conference by consensus, it soon became clear that a plurilateral agreement within the WTO would be improbable. This would require developing countries that had previously opposed the inclusion of investment as one of the Singapore issues in the Doha Development negotiations to accept an agreement that could shape the de facto policy environment, but which they had had no say in shaping. The promoters of a services agreement will therefore probably use

<sup>33</sup> Another policy consideration here is that if the EU were to manage to develop a clear comprehensive model for investment agreements it may set the bar at a specific level in terms of standards just as the US NAFTA model has. This would reduce the EU's flexibility in negotiating preferential agreements. To date the EU has shown more flexibility than the US in such negotiations (K Heydon and S Woolcock *The Rise of Bilateralism* (Ashgate 2009).

<sup>34</sup> J Reiter 'Investment' in Woolcock (n 19).

Article V of the GATS, which provides for preferential agreements in the services sector, if they wish to ensure the agreement comes within the WTO.

A theoretical case might be made that the time is now ripe for negotiation of a genuine multilateral investment agreement. The case for this is based on the view that the emerging markets will become progressively more important as capital exporters and the established OECD countries will become increasing importers of capital, thus redressing the structural imbalance of investment flows that has been at the root of many differences in previous negotiations. It may also be argued that the emergence of globalized production and value chains has meant that all governments have an interest in ensuring that investment is liberalized and protected. The emergence of the EU as a stronger actor in investment policy could also be seen as strengthening the chances of a multilateral agreement as EU policy since the 1990s has supported multilateralism. The historical record should, however, be enough to warn against undue optimism on this front.

The US does not appear to have changed its strategy of competitive liberalization, which includes the aim of seeking to shape international rules and standards by means of preferential agreements. For a period in the second half of the 1990s and the beginning of the 2010s US policy on trade and investment was quiescent due to a lack of domestic support for active policies. In the last two years however the US has re-emerged with an active strategy and it remains one of competitive liberalisation through the promotion of the Trans-Pacific Partnership (TPP), the International Services Agreement and more recently the Transatlantic Trade and Investment Partnership (TTIP). The belief is that agreements covering such important economies will establish *de facto* international standards for trade and investment. Since 2006 the EU has also pursued an active FTA strategy. Thus whilst appearing more supportive of multilateral solutions than the US the EU has begun to follow a similar approach. Recent trends therefore seem to confirm that bilateral or other preferential initiatives will undermine the prospect of international agreement on investment.

## 7. CONCLUSIONS

International investment policy has always been multilevel. For much of the post-war period the United States as the major capital exporter has been the driving force behind international investment policy. It has sought multilateral approaches and repeatedly promoted plurilateral initiatives but without success. In the recent past it has adopted a competitive liberalization strategy that seeks to both open investment markets and shape international investment standards through bilateral or preferential agreements. As a result the dominant norm for investment agreements has become the NAFTA model.



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Europe has offered something of an alternative approach based on bilateral agreements of EU Member States and EU efforts at liberalization, but the fragmented nature of the EU has meant this has had less influence in shaping policy, at least to date.

A case can be made that there is a chance to develop multilateral investment policies. The major shifts in the world economy brought about by emerging markets means that there are changes in the balance of capital flows. The EU now has an opportunity to develop a coherent investment policy following the extension of exclusive competence to foreign direct investment. And developing economies are reassessing their positions on FDI. But the analysis above suggests that preferential agreements will remain the main factor shaping investment policy.

