

The Social Dimension of International Investment Agreements: Drafting a New BIT/MIT Model?

FEDERICO ORTINO¹

I. Introduction

In the last forty years, the promotion and protection of foreign investment has constituted one of the core objectives of economic cooperation among States. This has been premised on the belief that such cooperation would be instrumental in the economic growth and development of the home and host States. In 1959, in the first of the bilateral investment agreements (BITs) of modern times, Germany and Pakistan expressly recognized “that an understanding reached between the two States is likely to promote investment, encourage private industrial and financial enterprise and to increase the prosperity of both the States.”

While international investment agreements (IIAs) have focused in particular on protecting foreign investors through a few basic treatment guarantees principally against discriminatory, unfair and expropriatory conduct by host States, as well as, more recently, on liberalizing investment flows through the reduction of market access barriers, the principal aim has always been that of promoting economic growth of all the State parties involved (in the form of higher standards of living, higher levels of employment, growing volume of real income, etc.). However, the economic dimension is not the exclusive dimension involving IIAs. In as much as increased prosperity and economic growth constitute essential elements in furthering broader societal interests, it may be said that IIAs also feature an underlying, albeit indirect, social dimension. Economic growth and prosperity engenders higher societal expectation for higher quality jobs, employment protection, workers’ participation in business management, corporate social responsibility, health standards and protection, etc. Even more crucially, economic growth and prosperity makes available the resources necessary to meet such expectations. Thus, while economic growth is IIAs’ immediate goal (achieved by providing a legal framework for the protection and promotion of foreign investment), social spillovers (whether positive or negative) are also part of the IIAs equation.

Today’s challenge focuses on addressing the issue of whether IIAs should do more in order to strengthen their social dimension alongside their economic one.²

¹ Fellow in International Economic Law; Director, Investment Treaty Forum, British Institute of International and Comparative Law, London; Adjunct Professor, Trento University, School of Law.

² See S. Griller (ed.) *International Economic Governance and Non-Economic Concerns – New Challenges for the International Legal Order* (Wien-New York, Springer 2003).

Wealth creation stemming from investment protection and liberalization policies is not disputed. At the same time, such wealth is not equally distributed among and within countries. Unequal distribution of wealth may depend on a variety of factors such as the lack of resources in participating effectively in the global market, the inequities of the multilateral disciplines regulating investment flows, and the failures of national governments to implement appropriate adjustment policies complementing liberalization ones.

The 2004 report of the World Commission on the Social Dimension of Globalisation (WCSDG) (“A fair globalization: creating opportunities for all”) recognizes the significant benefits brought about by the process of globalization. Higher quality – and higher earning – jobs have been created in parts of the world which have previously relied largely on agriculture to maintain their peoples. The report, however, also notes that such benefits are not shared equally across all countries and groups and that, without an effective system of global governance, the current model of globalisation is generating unbalanced outcomes and is not likely to lead to global sustainable development. The drafters of the report

[...] believe the dominant perspective on globalization must shift more from a narrow preoccupation with markets to a broader preoccupation with people. Globalization must be brought from the high pedestal of corporate board rooms and cabinet meetings to meet the needs of people in the communities in which they live. The social dimension of globalization is about jobs, health and education – but it goes far beyond these. It is the dimension of globalization which people experience in their daily life and work: the totality of their aspirations for democratic participation and material prosperity. A better globalization is the key to a better and secure life for people everywhere in the 21st century.³

The agenda envisioned by the WCSDG report is quite demanding. The following pages merely highlight a few of the issues that need to be addressed in order to tackle the question posed by the present article. This brief discussion is structured around two main themes: (i) the interrelation between economic and social dimensions, and (ii) the institutional options for dealing with foreign investment.

II. Economic dimension versus social dimension?

The first issue to be addressed is the interrelation between the economic dimension and the social (or non-economic) dimension in IIAs. As noted above, the economic dimension has always been the principal one in IIAs. This is reflected, for example, in the legal disciplines provided for in IIAs.

³ World Commission on the Social Dimension of Globalisation (WCSDG), “A fair globalization: creating opportunities for all” (February 2004), at vii.

In order to protect foreign investors, IIAs include obligations on host States to treat foreign investors in a non-discriminatory, fair and equitable manner, and to compensate them in case of direct and indirect expropriation. Pursuit of other non-economic public policy objectives in violation of such obligations is permitted only in exceptional circumstances as provided for in general exception provisions or in relevant protocols. For example, the national treatment (NT) provision has been interpreted to prohibit both formally and materially discriminatory measures based on the nationality of the investor or investment. This norm usually has been envisioned as a two-step analysis including “nationality discrimination” dealing with the detrimental impact of the national measure vis-à-vis foreign investors (first step) and “public policy justification” focusing on the legitimacy and reasonableness of the national measure in light of the public policy objective pursued by the Member (second step). The formal relationship between these two steps is generally one of “rule” and “exception”. This dichotomy between the “non-discrimination rule” and the “public policy exception” implicitly tends to establish a ranking of values where investment protection represents the fundamental policy and other legitimate policy objectives are relegated to the status of secondary or exceptional policies. While this ranking may be warranted in certain circumstances (for example, against measures explicitly or formally discriminating vis-à-vis foreign investors) it may not be in others (for example, where the introduction of a legitimate health measure has a detrimental effect on certain investors, including foreign ones).⁴

Adopting a more holistic approach to foreign investment regulation may represent a possible option to remedy such an imbalance. According to this approach, economic and non-economic dimensions would be equally embraced as relevant underpinnings of IIAs. This would avoid a stark contraposition of values such as “investment” versus “labour standards” (or “investment” versus “environmental protection”) which seem to be characterizing the current debate on the legitimacy of multilateral institutions for global governance. A holistic approach to foreign investment regulation does not entail that IIAs become instruments of social (or environmental) regulation per se; rather, it tries to make foreign investment disciplines more attuned to their social and environmental spillovers. This is accomplished, first of all, by acknowledging the multidimensional nature of IIAs, for example, through appropriate statements in the Agreement’s preamble. Next to the resolution to “create an expanded and secure market for the goods and services” and to “ensure a predictable commercial framework for business planning and investment”, NAFTA Parties also resolve to “create new employment opportunities

⁴ F. Ortino, “From ‘Non-Discrimination’ to ‘Reasonableness’: A Paradigm Shift in International Economic Law?”, *Jean Monnet Working Papers* 1/2005, at 53-57.

and improve working conditions and living standards in their respective territories; [...] preserve their flexibility to safeguard the public welfare; promote sustainable development; and protect, enhance and enforce basic workers' rights."⁵ Preambular statements are often important in the interpretation of treaty provisions since they constitute relevant "context" (showing the "object and purpose") for purposes of the customary rule of interpretation of public international law as codified in Article 31 of the Vienna Convention.⁶

More fundamentally, a holistic approach would represent the basis for future IIAs negotiations to take into account more directly the social dimension of foreign investment. At a minimum, current foreign investment disciplines could be improved in order to directly promote both economic growth and social policies. In this regard, options that have been advanced and at times included in IIAs, albeit not always as binding provisions, include: (a) strengthening competition policies in order to control investors' behaviour upsetting the fair and competitive operation of the market; (b) enhancing corporate accountability of investors through transparency and corporate governance provisions; (c) protection of weaker parties through employment and consumer protection obligations; and (d) granting appropriate flexibility to developing countries. Existing examples of these types of provisions are: the Reference Paper dealing with certain competition aspects of trade and investment in telecommunication services under the General Agreement in Trade in Services (GATS) within the World Trade Organization (WTO); the Organization for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises, dealing, *inter alia*, with corporate disclosure; the North America Free Trade Agreement (NAFTA) provision restraining, *inter alia*, the lowering of labour, health and safety standards as an instrument to attract inward foreign investment.

This is not the place to explore in any detail each of these options.⁷ The simple point that needs to be made here is that the global market has become a very complex place where differing public and private players participate in the ever increasing

⁵ Preamble to the North American Free Trade Agreement between the Government of Canada, the Government of the United Mexican States, and the Government of the United States of America (NAFTA), signed on 17 December 1992. See also Preamble to the General Agreement in Trade in Services (GATS) where Members recognize "the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives."

⁶ Done at Vienna, 23 May 1969 in 8 *ILM* 679 (1969).

⁷ For detailed analysis, see P. Muchlinski, "The Social Dimension of International Investment Agreements" in J. Faundez, M. Footer and J. Norton (eds.) *Governance Development and Globalisation* (London, Blackstone Press, 2000).

movement of products, services, capital and labour. Its regulation cannot but be a complex endeavour. Accordingly, there is scope for improving the current legal framework for promoting investment flows across countries in such a way as to pursue economic growth and social policies more effectively. In this regard, it may be worthwhile to emphasize the need for carrying out further analysis in order to clarify many of these issues under consideration, and to quantify the potential benefits and costs, both in economic and social terms, flowing from current and future investment disciplines.⁸

III. Institutional options: multilateral, regional, bilateral and/or national disciplines?

Any effort to integrate the economic and social dimensions in a more holistic manner should not be understood as a mono-dimensional enterprise. Given the complexity of the issues surrounding foreign investment, requiring a mix of liberalisation, protection and regulation policies, all institutional avenues (whether at the multilateral, regional, bilateral or national level) should be explored. For example, it may not be appropriate to pursue investment liberalization policies exclusively at the multilateral or regional level, while pursuing social regulation at the national level.⁹ While none of these policies can in principle be neatly assigned to different levels of government, emphasis should be placed on exploring coordination strategies among and within such different levels of government.

Subsidiarity may be employed as a guiding principle in addressing the issue of vertical allocation of responsibilities. Originating from social thought within the Roman Catholic church, the principle states that no larger entity shall resolve an issue that can be resolved at a more local level. Subsidiarity would guarantee, first of all, that any increase in the scope of action of multilateral or regional structures in the area of foreign investment (such as the WTO or the Free Trade Agreement of the Americas (FTAA)) is mandated by the nature of the very issues that need to

⁸ “While close attention has been paid by researchers to the *economic* impacts of performance requirements – and to the possibility that requirements may be inefficient in economic terms – less attention has been paid to other social policy objectives which might be advanced through the use of performance requirements.” L.E. Peterson, *Bilateral Investment Treaties and Development Policy-Making* (IISD, November 2004) at 34.

⁹ See M.A. Srur, “The International Investment Regime: Towards Evolutionary Bilateral & Regional Investment Treaties?”, 1 *Manchester Journal of International Economic Law* (2004) 54–75, arguing that the existing gap in the field of international investment law is unlikely to be bridged in the near future by a comprehensive multilateral investment agreement; rather, the protection of foreign investment is likely to come from the direction of the ever-growing bilateral and regional investment treaties and regional trade agreements.

be addressed. Secondly, subsidiarity would strive against those structures becoming excessively interventionist mechanisms in themselves.

An application of the subsidiarity principle may be seen, for example, in the field of competition policy. The issue of including competition policy in IIAs may be subject to various considerations such as (i) differing national priorities prevailing across the spectrum of the international community, (ii) costs and capacity constraints (in particular with regard to enforcement) in many developing countries, and (iii) asymmetrical relationships between developed and developing markets (following from the division between capital exporting and capital importing countries). In light of these considerations, there may be a number of policy options arising in IIAs in the area of competition policies, going from omitting any international discipline (i.e., leaving States to adopt exclusively national standards), to cooperation strategies at the bilateral and regional level (of either a procedural or substantive nature), up to minimum harmonization agreements at the multilateral level.¹⁰

Furthermore, subsidiarity may offer guidance in the application of corporate social responsibility to the field of foreign investment. While general concepts of corporate social responsibility pertain equally to both domestic and transnational enterprises, application of these concepts to transnational corporations may raise special considerations and modify a company's special definition of its social responsibility. These corporations have, on the one hand, a duty to behave as good corporate citizens in the host State in which they operate (conforming to local rules), and, on the other hand, a duty of adhering to broader self-imposed social responsibility standards formulated to apply to their corporate systems as a whole, which may at times even be more stringent than those of the host States. This application may be premised on the subsidiarity principle according to which social responsibility is best exercised by actors closest to a given situation. While governments bear primary responsibility for the welfare of their peoples, there may be circumstances in which governments do not or cannot carry out such duties. In such circumstances, transnational corporations may have a tremendous impact on economic and social interests.¹¹ The tension between guaranteeing social rights, and respecting host States' comparative advantage, may be addressed in future IIAs, for example, by including commitments on investors (as well as States) to

¹⁰ See UNCTAD, *Competition – Series on issues in international investment agreements* (New York – Geneva, United Nations, 2004) p. 69-79.

¹¹ UNCTAD, *World Investment Report 1994 – Transnational Corporations, Employment and the Workplace* (New York – Geneva, United Nations, 1994) at 23-24.

conform their business practices at a minimum to internationally-recognized core labour standards.¹²

Within a discussion of institutional options, the issue of horizontal allocation of responsibilities at the multilateral level should also be emphasized. Currently, a variety of international organizations is in charge of developing policies at the multilateral level each in a specific field: monetary policy (IMF), trade (WTO), health (WHO), labour (ILO), development (UNDP), environment (UNEP), etc. This is clearly an oversimplification of reality. There are in fact organizations that look at relevant interlinkages such as trade and development (UNCTAD) or finance and development (World Bank), as well as more or less formal linkages between different organizations.¹³ However, there seems to be a problem of excessive specialization and lack of dialogue within the international cooperation architecture.¹⁴ There is a risk that this sort of institutional contraposition at the international level may exacerbate the contraposition of values which, as noted above, seems to characterize each sectoral governance regime as well as the broader debate of global governance. The institutional structure at the multilateral level needs to keep apace and conform to the realities of a more complex and interrelated world. Whatever will be the role for such level of government in the future, the interlinkages and cooperation between the various existing bodies will need to be strengthened.

IV. Brief Conclusions

As the process of integration of the global market place continues, the need to take into account more directly the social implications of promoting international investment flows increases. Regional experiences with deeper (i.e., economic and political) integration such as the European Union, teach that as economic integration is gradually achieved, other non-economic issues arise and need to be addressed

¹² See Article 14 of the International Institute for Sustainable Development (IISD) Model International Agreement on Investment for Sustainable Development (IISD, 2005). See the discussion of “corporate social responsibility” and “good corporate citizenship” developed in UNCTAD, *World Investment Report 2003 – FDI Policies for Development: National and International Perspectives* (New York – Geneva, United Nations, 2003) ch. 6.

¹³ See D. Ahn, “Linkages between International Financial and Trade Institution – IMF, World Bank and WTO”, *34 Journal of World Trade* 1 (4, 2000).

¹⁴ For a recent call for a higher level of dialogue between the human rights and development communities, see P. Alston, “Ships Passing in the Night: The Current State of the Human Rights and Development Debate Seen Through the Lens of the Millennium Development Goals”, *Human Rights Quarterly* 27 (2005) 755–829.

in order, first of all, to continue with such integration, and, secondly, to strengthen the legitimacy underpinnings of the integration process itself.¹⁵

In addressing the challenge of strengthening IIAs' social dimension alongside the economic one, this paper argues for a more holistic approach to the regulation of international investment flows, whereby the legal disciplines for protecting and promoting foreign investment should be drafted so as to maximize the positive economic and social spillovers of foreign direct investment. Furthermore, the paper has highlighted the necessity of evaluating the best institutional options available in order to pursue such objectives. Recourse to the subsidiarity principle as a guiding criterion to address the issue of vertical assignment of responsibility, as well as an increased emphasis on horizontal dialogue and cooperation among multilateral institutions, are options suggested in the paper.

In light of the complexity of the issues involved and the lack of resources at the national level to carry out all necessary research, at a minimum, a clear role for international institutions and cooperation in this field is one which focuses on further analysis, exchange of information, and capacity-building, in order to allow all States the ability to choose the appropriate path to follow in promoting economic growth and social policies through the protection and regulation of investment flows.

¹⁵ See F. Ortino, *Basic Legal Instruments for the Liberalisation of Trade: A Comparative Analysis of EC and WTO Law* (Oxford, Hart Publishing, 2004); Emily Reid, "Squaring the Circle for Tomorrow's World: A Comparative Analysis of the Approaches of the EC and WTO to balancing Economic and Non-economic Interests in International Trade" in T. Tridimas and P. Nebbia (eds.) *European Union Law for the Twenty-First Century: Volume 1 – Rethinking the New Legal Order* (Oxford, Hart Publishing, 2004) at 303 et seq.