# Bilateral Investment Treaties

United Nations Centre on Transnational Corporations

Published in co-operation with the United Nations by
Graham & Trotman Limited

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# Note

# Preface

Bilateral investment treaties (BITs), intended to promote and protect foreign direct investment, are a relatively new element in international economic relations — but one that has been steadily growing in importance during the past few decades. The present study is essentially devoted to a comparative analysis of the contents of such treaties.

The term "treaty" is used in its general meaning, as defined in article 1 of the Vienna Convention on the Law of Treaties:

*"Treaty means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designations."*

In fact, the legal instruments this study considers are often called "agreements", "conventions", and sometimes, "accords" or "arrangements". The differences in terminology have no bearing on the international legal nature of the text in question.

The major capital exporting countries which adopted a deliberate policy of concluding such bilateral treaties with developing countries in order to facilitate foreign direct investment flows to these countries (they play no part in investment relations among developed countries), elaborated prototype treaties as a basis for negotiations. Seven such model texts are appended to this study.

The prototype treaty most widely used is perhaps that of the Federal Republic of Germany (annex II) since over 60 treaties have so far been concluded by that country. A comprehensive study of these treaties* shows that, with relatively few exceptions, they deviate only a little from the prototype text, although that text has been subsequently developed and still continues to be developed further. The Dutch model of 1979 has been included as being representative of the approach of one of the smaller but important capital-exporting countries (annex III). That model was revised in January 1987. Although no treaty has yet been concluded following its revision, the new text has been included (annex IV) to show the evolution of that country's approach in bilateral negotiations. As far as the United States model is concerned, only ten treaties have so far been concluded on its basis and, as of mid-1987, none of them had entered into force. It has nevertheless been considered appropriate to include it (annex V), as it reflects the present approach of the world's largest capital-exporting country.

Whereas, until recently, bilateral investment treaties were used mainly in the relations between developed and developing countries they are now also being concluded between a number of developing countries, or, more often, newly-industrialized and developing countries. Furthermore, three model investment agreements have been elaborated within the Asian-African Legal Consultative Committee (AALCC) (annex VI, A, B and C), one of which comes fairly close to the prototype texts of the developed market economies. There are no treaties concluded on the basis of the AALCC models, intended to serve as a basis for negotiations involving countries of the Asian-African region, but it seemed appropriate to include them in this survey as indicative of the approach preferred by the relevant countries.

Finally, before proceeding to the assessment of bilateral investment treaties, it should be recalled that these are only one element in a "bundle" of measures destined to encourage and protect foreign investment. Developed countries consider them part of their policy towards developing countries. The latter normally conclude them, among other reasons of a political or legal nature, because they need resources for development which are largely in the hands of transnational corporations and which these countries seek to attract by a variety of measures including guarantees under bilateral treaties with the home countries of the transnational corporations concerned.

The existence of a bilateral investment treaty is often the condition for national insurance against political investment risks such as dispossession, impossibility of currency transfer, war damage, etc. In other words, investors, in case of expropriation, need not only rely on the provisions of the treaty, they can in any case turn to

*See Justus Alenfeld, *Die Investitionsförderungsverträge der Bundesrepublik Deutschland* (Frankfurt, Antenäum Verlag, 1970) and Heinrich Klebes, "Encouragement et protection des investissements privés dans les pays en développement — les traités bilatéraux de la République Fédérale d'Allemagne dans leur contexte", Thesis (Strasbourg, 1983).

their national insurance. Other measures aimed at promoting direct investment abroad, but not necessarily linked to the existence of a bilateral investment treaty, consist of tax advantages, credit facilities, advisory services, etc. On its part, the host country often offers special incentives to foreign investors. Other international instruments, such as commercial agreements, economic or technical co-operation agreements, establisment conventions or double-taxation agreements may be relevant and their effects interrelated with those of bilateral investment treaties. This should be borne in mind when assessing the contents and the utility of the latter.

The Centre wished to acknowledge the important contribution of Mr. Heinrich Klebes in the preparation of this study.

Peter Hansen
*Executive Director*
*United Nations Centre on Transnational Corporation*

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# List of abbreviations

| | |
|---|---|
| AAA | American Arbitration Association |
| AALCC | Asian-African Legal Consultative Committee |
| AFDI | *Annuaire Francais de Droit International* |
| AJIL | *American Journal of International Law* |
| BITs | Bilateral Investment Treaties: treaties (agreements, conventions, accords), for the promotion (encouragement) and protection of investments. |
| BYIL | *British Yearbook of International Law* |
| CARICOM | Caribbean Community |
| ECD | Canadian Export Development Corporation |
| EEZ | Exclusive Economic Zone |
| FCN | Friendship, Commerce and Navigation (treaties) |
| IACAC | Inter-American Commercial Arbitration Commission |
| ICC | International Chamber of Commerce |
| ICLQ | *International and Comparative Law Quarterly* |
| ICJ | International Court of Justice |
| ICSID | International Centre for Settlement of Investment Disputes |
| IGAs | Investment Guarantee Agreements (concluded in connection with investment insurance) |
| ILC | International Law Commission |
| ILO | International Labour Organisation |
| ILM | *International Legal Materials* |
| ILW | *Investment Laws of the World* (published under the auspices of ICSID) |
| IMF | International Monetary Fund |
| JDI | *Journal de Droit International* |
| JWTL | *Journal of World Trade Law* |
| OECD | Organisation for Economic Co-operation and Development |
| OIC | Organisation of the Islamic Conference |
| OPIC | Overseas Private Investment Corporation |
| PCA | Permanent Court of Arbitration |
| PCIJ | Permanent Court of International Justice |
| RBDI | *Revu Belge de Droit International* |
| RCADI | *Receuil des Cours*, The Hague Academy of International Law |
| Washington Convention | Convention of 18 March 1965 on the Settlement of Investment Disputes between a State and a National of another State |
| YILC | *Yearbook of the International Law Commission* |

## INTRODUCTION

1. The legal framework governing foreign direct investment at the national level consists mostly of domestic investment laws, administrative regulations and policies and such other specific contractual arrangements as may be entered into between a particular country and a prospective investor. The promotion and regulation of foreign direct investment may also be supplemented by a variety of intergovernmental bilateral, regional and multilateral arrangements. Although, by and large, the developed market economy countries do not normally conclude bilateral investment treaties with the intention either of attracting foreign direct investment or of protecting foreign investors in their territories, 1/ they have perceived them as setting forth necessary guarantees of protection for the investments of their national individuals and corporations in developing countries. They consider that such guarantees in an intergovernmental agreement are higher and more reliable than those provided for under the domestic laws of the host country which are subject to unilateral modification. 2/

2. In this regard it should be noted that the uncertainties about the content of customary international law on foreign investment as well as the difficulty of concluding binding multilateral arrangements for the protection of foreign investors have also contributed to the perception by home countries of a need for bilateral treaties. At the same time the capital exporting countries have felt that developing countries that wish to attract foreign direct investments could do so more easily if they offered, *inter alia*, guarantees of protection to prospective investors.

3. Given their objective, bilateral investment treaties, usually seen as providing legal stability, are now being relied upon by most developed market-economy countries as part of their effort to safeguard the investments of their nationals. On their part, developing countries have negotiated bilateral investment treaties as one of the measures for attracting investment. The existence of a bilateral treaty is only one factor among many which may affect a potential investor's decision to invest in a particular developing country. Such a treaty may be redundant if the prospective

investor considers the existing legal framework or the investment climate as a whole reasonably secure and the proposed venture profitable. Other factors taken into consideration by the prospective investors are the political stability of the host country; the economic, industrial and administrative framework; the economic profitability of an initial investment or the increase in current investments (especially in mineral sectors); the incentives package or the selection of new investment arrangements in the form of licensing agreements, management and marketing contracts, turnkey projects and equity arrangements, etc. In practical terms, unless the host country can offer a secure profit-making venture to the foreign investor, the existence of a bilateral treaty will not in itself attract an investment.

4. Since 1973, the economies of oil-importing developing countries have undergone balance-of-payments deficits on current accounts due to rising import prices and a falling demand in prices for their exports. Many of these countries have come to regard liberalization of their foreign investment codes and the conclusion of bilateral investment treaties as measures to attract foreign direct investment and as a source of development finance, particularly in the natural resources sector. Whilst seeking to attract foreign investments through such measures, it is also clear that developing countries have indicated that they do not wish the activities of foreign investors in their territories to compromise their sovereignty, and that these activities should accord with their development goals and priorities. Hence, they have simultaneously adopted declarations reaffirming their permanent sovereignty over their natural resources and sought to promulgate standards for the activities of transnational corporations in multilateral forums. 3/ There is no necessary inconsistency between bilateral investment treaties and the adoption of global standards for transnational corporations; the two policy initiatives serve specific needs which are compatible, complementary and mutually supportive.

## Part One

## PAST AND PRESENT TRENDS

### I. BACKGROUND ON MEASURES FOR THE PROTECTION OF FOREIGN DIRECT INVESTMENT

5. Foreign direct investments increased dramatically both in developed and developing countries after the Second World War and the upsurge continued into the 1960s. 4/ At that time, when the decolonization process accelerated, capital-exporting countries introduced measures to protect their nationals' investments in developing countries through investment insurance schemes, and provided incentives, such as fiscal and foreign exchange regulations favourable to foreign investments. Capital-importing countries passed investment laws offering incentives to foreign investors, such as exemptions from certain taxes, duties and exchange controls and guarantees against arbitrary State actions.

6. With the elimination or reduction of government barriers to capital outflows, a significant increase in the development of international direct investment occurred from the early 1960s to the mid-1970s. 5/ Foreign investors were attracted by profitable investment opportunities in developing countries arising out of rapidly growing domestic markets, resource development projects, particularly in the petroleum and mineral sectors, import substitution and export-oriented manufacturing sectors benefiting from low labour costs. Thus, the industrialized countries advocated various legislative measures and combinations of schemes to eliminate or reduce non-commercial risks and supported policies to protect private direct investment in developing countries.

#### A. Friendship, Commerce and Navigation Treaties

7. Chronologically, the first bilateral agreements dealing with the protection of foreign investment were the "Friendship, Commerce and Navigation" (FCN) treaties, which were concluded during the post-war period and up to the late 1960s, by the United States 6/ and, to a lesser

extent, Japan and a few western European countries. These treaties generally provided for the protection of natural and juridical persons, and the treatment of the property and interests of such persons. They were reciprocal and long-duration agreements designed to establish the ground rules regulating economic intercourse and setting international legal standards for the protection of nationals of the contracting parties. Although they dealt only in a limited manner with foreign direct investment, which was not as important then as it is now, some of these treaties contained significant provisions in this area.

8. Most of these treaties, concluded initially between developed countries, have a very broad scope and deal with issues such as entry and freedom of movement; protection of persons, right to counsel and prompt trial, etc.; national treatment in application of local laws; enforceability of arbitration awards; protection of acquired property; right to lease and purchase land freely; patents, trademarks, etc.; equal tax treatment; administration and exchange controls; transit of goods and persons; import and export duties and taxes; right to compete with local monopolies; consultations on restrictive business practices; freedom, commerce and navigation and freedom of transit for persons.

9. This type of treaty is no longer being negotiated, but there are Friendship, Commerce and Navigation Treaties still in effect for a number of countries. The last of these treaties were concluded by the United States with Thailand and Togo in the late 1960s. 7/

## B. Political risk insurance

10. After the Second World War, capital-exporting countries began establishing insurance schemes to insure their nationals' investments abroad against certain well-defined non-commercial risks, such as expropriation, nationalization, damage due to armed conflict, non-transferability and inconvertibility. The oldest and largest such programme is that of the United States of America, administered by the Overseas Private Investment Corporation (OPIC). This was introduced (through the 1948 Economic Co-operation Act) not to promote private investment in developing countries but, in the context of

the Marshal Plan, to protect United States investors against the risks of inconvertibility in Europe. The United States was followed by Japan in 1956 and by the Federal Republic of Germany in 1958. As of 1986, about 20 countries, 16 of which are members of OECD, offer their investors political risk insurance. As mentioned earlier, there is a link between investment insurance and bilateral investment treaties. Unless the insurer is satisfied that the legal protection of an investment is sufficiently guaranteed under the domestic law of the host State or in some other way, the existence of a treaty may be the condition sine qua non for political risk insurance. Sometimes, this may indeed be the main reason for a developing country to enter into negotiations with a developed country or to conclude a bilateral investment treaty.

11. In the longer run, this pattern might well be broadened by the existence of an effective multilateral insurance scheme. After numerous unsuccessful attempts - involving, among others, the World Bank, OECD, the Council of Europe, the Inter-American Development Bank and the European Economic Community - the World Bank Convention on the Multilateral Investment Guarantee Agency (MIGA) was opened for signature in October 1985. 8/

## C. Investment guarantee agreements

12. Investment guarantee agreements (IGAs) have been used by the United States and Canada, in connection with the investment insurance schemes offered to United States and Canadian investors by the Overseas Private Investment Corporation (OPIC) and the Canadian Export Development Corporation (EDC), respectively. They provide for subrogation of OPIC/ECD to the rights and claims of the investor, whenever the latter has been paid compensation by the former. They further stipulate that any dispute regarding the interpretation of the agreement which, in the opinion of one of the Governments involves a question of public international law arising out of any investment, shall be settled by negotiation or, failing agreement, by international arbitration. Investment guarantee agreements do not constitute an alternative to bilateral investment treaties in that they do not contain any provision on the treatment of investments in the host country. However,

this has facilitated their acceptance by a number of developing countries which have not been prepared to conclude investment promotion and protection agreements.

13. As of 1986, the United States has concluded 116 such agreements, mostly in the form of exchanges of letters, and Canada 36. Investment guarantee agreements will no doubt continue to be negotiated, in any case by Canada and the United States. It must be borne in mind, in this connection, that the United States Government has only recently embarked on a policy of seeking the conclusion of bilateral "Treaties concerning the Reciprocal Encouragement and Protection of Investment". For its part, Canada has concluded none. 9/

## II. THE EMERGENCE OF BILATERAL TREATIES ON THE PROMOTION AND PROTECTION OF INVESTMENTS

### A. A network of over 260 treaties

14. Bilateral investment treaties, to which this study is devoted, are both specific and general in nature: specific, in that they are exclusively concerned with the protection of investments originating from one contracting party in the territory of the other contracting party; general, because - subject to admission by the host country - they are meant to apply to all investments coming within the normally very wide definition contained in the treaty. In other words, they are not limited to particular projects or sectors of the economy, although some bilateral investment treaties may expressly exclude certain types of investments. It is true that another type of treaty, namely, the project or sector-specific agreement, was commended in the European Community context - among others - as from 1979. 10/ However, there seems to be no practical experience so far with this type of bilateral treaty (not to be confused with an investment contract between the host State and the foreign investor). It had been thought that such agreements might be useful in cases where the conclusion of a general

investment agreement proved impossible or where a general agreement existed but was thought to offer inadequate protection. The idea of project or sector-specific agreements was taken up in 1985 by the Asian-African Legal Consultative Committee in one of the three model agreements elaborated by this body. 11/

15. By mid-1987, some 265 bilateral investment promotion and protection treaties have been concluded, mostly between industrialized market economy countries and developing countries, but also between market-economy countries and socialist countries in Europe and Asia (Bulgaria, China, Hungary, Romania and Yugoslavia); developing countries and newly industrialized countries (Singapore, Republic of Korea); developing and socialist countries; or among developing countries (see Annex I below). At the time, about 55 of these treaties had not yet entered into force. Over 70 developing countries have signed - though not necessarily ratified - one or more treaties, including some 13 Asian and Pacific countries, about 12 North African and Middle Eastern countries, about 30 African countries south of the Sahara and some 15 Western Hemisphere countries; 4 Eastern European countries (Bulgaria, Hungary, Romania and Yugoslavia), as well as 18 developed market economy countries (15 in Western Europe, plus Japan, New Zealand, and the United States of America) are parties to bilateral investment treaties.

16. The majority of developing countries which have signed bilateral investment treaties are to be found in Africa and South-East Asia. A number of Latin American countries (including Belize, Costa Rica, the Dominican Republic, Ecuador, El Salvador, Haiti, Honduras, Panama, Paraguay and Saint Lucia, and recently Bolivia and Uruguay), have concluded such treaties. Thus far, some of the most advanced developing countries, including the largest Latin American countries, which attract the largest share of foreign direct investment, seem to have shown no particular interest in concluding investment treaties with industrialized countries.

17. About twelve of these bilateral investment treaties have been concluded between developing countries. Mention has already been made of the three model agreements prepared by the Asian-African Legal Consultative Committee. Whereas Model A is comparable - with some reservations - to the majority of existing bilateral investment treaties, the

protection standard of Model B (which is closer to the philosophy of the Charter of Economic Rights and Duties of States) would be less far-reaching. Model C would correspond to Model A, the definition of investment being limited to one or more specific sectors. 12/

18. The initiative of concluding bilateral treaties specifically devoted to the promotion and protection of investments was launched by the Federal Republic of Germany. That country concluded its first bilateral investment treaty in 1959 with Pakistan. It has been said that the Federal Republic of Germany was particularly sensitive to investment protection, its investors having lost their foreign assets twice in a great number of countries following the two world wars. With over 60 treaties in force, the Federal Republic still leads the movement among developed capital-exporting countries.

19. Switzerland concluded its first Agreement on the Protection and Encouragement of Investments with Tunisia in 1961. It now has a network of about 20 treaties of this specific type, to which might be added some 17 others (agreements on commerce, investment protection and technical cooperation, etc.), which contain substantial sections on investment protection and promotion.

20. The tendency towards the conclusion of bilateral investment treaties was reinforced by the elaboration, within OECD, of a "Draft Convention on the Protection of Foreign Property". It is true that this was not, originally, intended to be a model for bilateral treaties but a multilateral convention aiming at setting common standards for the treatment of foreign property within OECD member countries. If the project failed, it is partly owing to the fact that the Organisation's less developed members (such as Greece, Portugal and Turkey), but also some others, were reluctant to commit themselves to some of the proposed provisions. In fact, the draft Convention was never opened for signature. Instead, the Council of OECD, by a resolution adopted on 12 October 1967, commended it to member States for the preparation of agreements on the protection of foreign property. The OECD's text provided important guidelines for some of the more fundamental provisions on the treatment and protection of investments included in bilateral investment treaties.