Economists and lawyers working together. A multidisciplinary approach for policy orientated researches in the fields of foreign investments and economic development.[1]

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Contents

[1] The present paper is a revised and enlarged version of the presentation I made during the UNCTAD Symposium on international investments for development, held in Geneva on 15-16 March 2010. I benefited from the discussions I had in that occasion with several participants, who helped me to understand which points of my intervention deserved more in-depth analysis.

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Introduction. Objectives of the paper and its practical utility

The objective of the present paper is to describe a methodology which could be applied in policy orientated researches on the following topic: the impact international investment agreements (IIAs) have on the relation between foreign investments on one side and economic development of the host States on the other side.[3] This methodology relies on a multidisciplinary approach, which consists in combining the efforts of economists and lawyers both. The aim of the researches which will use this methodology is to study the way to reduce the risk that host States might adopt or maintain domestic policies and regulations which adversely affect foreign investments undertaken in their territory and which breach the IIAs of which States are parties. The final aim is to study how to minimise the risk that, because of such policies, host States might be required to pay compensation to the affected investors. This is of the utmost importance especially for developing countries and countries with economies in transition. Here, efforts to attract foreign investments and actual increases in investment inflows go along with the persistence of State policies and more in general of an investment climate which still create many occasions for the host States to breach the provisions of IIAs they are mandated to respect. Therefore, there is the risk that such States actually get able to attract more foreign investments, but later find themselves obliged in an increasing number of occasions to pay compensation to those investors which have been damaged by their conducts. Alternatively, there is the risk that Host States, in order to avoid disputes with investors which are likely to result into a condemnation to pay extremely high compensations, simply renounce to implement certain policies which nonetheless would have been useful to pursue domestic economic development. In both cases the outcome would be the reduction or even the

[3] In this paper I will prefer to talk of foreign investments and I will not limit my discussion to foreign direct investments (FDIs) only. This approach is quite different from the one followed by most literature on this topic, but is made necessary by the following reasons. First, if we look at the definition of investment contained in most IIAs we can see that it also covers portfolio (or financial) investments. Second: also portfolio investments have a relevant impact on the economy and the development of the host State, although they do not involve transfer of technology and know-how and although they entail a lower degree of control of the foreign investors over the assets located in the host countries.

complete annulment of the benefits that foreign investments are expected to bring to the economy of the host States.

The analysis provided in this paper will focus on the host States, as its objective is to propose a method of research which contributes to find the way they might maximise the benefits from foreign investments while minimising the costs that the breaches of IIAs might entail. However it is difficult to deny that the reduction of the occasions in which host States breach IIAs and have to pay compensation is not in the interest of foreign investors too. Foreign investors are in fact expected to prefer to operate in a context in which the rights IIAs confer upon them are respected, instead of being damaged by the violation of the provisions of IIAs and being entitled to receive a compensation after several years and sometimes amid enormous difficulties[4]. In addition, it should be considered that the protection of the interests of the host States and of the investors is not necessarily a zero-sum game. In fact it can occur that some Host State policies might bring benefits to the foreign investors and the host State both, while other State measures might endanger the investors without constituting an effective tool for the promotion of domestic development. The researches which apply the method presented in this paper, when adequately taken into consideration by policymakers, would contribute to improve the business environment of the host State, to the advantage both of the investors (foreign but also domestic) and of the host State itself.

The paper will be organised as follows. The first chapter will explain why and how IIAs affect the relation between international investments and the economic development of the host States. The second and the third chapters will try to find the way host States can simultaneously achieve the following goals: to fully benefit from the foreign investments undertaken on their territory, to preserve their ability to adopt and maintain policies for the promotion of domestic development, to minimise the risk to breach the provisions of those IIAs they have previously concluded. In particular, the second chapter will study how IIAs should be interpreted and drafted in order to achieve the above mentioned goals. It will also stress the limits of such approaches and it will explain the need for different solutions. Consistently with these findings, the third chapter will explain how States could improve their own legal and policy framework governing foreign investments in order to make it more consistent with the commitments they have undertaken in IIAs. It is in this chapter that the methodology for policy orientated researches which constitutes the core of this paper will be described in detail.

[4] A State can be condemned to pay compensation to a foreign investor but, if the State refuses to pay, it becomes really difficult to force it to do so. On this point see, for instance: Blane (2009); Alexandroff and Laird (2008).

1. International Investment agreements (IIAs) and their impact on the relation between foreign investments and economic development

1.1. Basic features of IIAs

The regulation of transnational investments at the international level is essentially provided in international investment agreements (IIAs)[5], which in most cases are bilateral investment treaties (BIT), i. e. agreements negotiated between two States and containing provisions applicable to investments only. At the end of 2008 the number of IIAs in force reached the number of 2,676;[6] however, it must be noted that they are relatively similar in their wording and content, having reached a high level of standardization. A full analysis of the provisions of IIAs falls outside the scope of this paper, therefore attention must be drawn only to some aspects of IIAs in order to make the analysis presented in this paper clearer.

First of all, it must be reminded that IIAs do not create obligations upon investors but exclusively upon host States. The obligations at issue relate to the way the host States shall treat foreign investors who are nationals of the other States with which the host States have entered into an IIA. In particular, host States are required not to discriminate such investors both relative to foreign investors of other States (this is the so called "most favorable treatment clause") and relative to domestic investors ("national treatment clause"). The host State is also mandate to accord fair and equitable treatment[7] to the foreign investors and not to expropriate their assets except in particular circumstances which are listed in the text of the IIA and provided compensation is paid. Other provisions can relate to the transfers of capitals, performance requirements and restrictions to the entry of workers and managers. Some IIAs, for instance BITs concluded by the US, also provide a general obligation to admit foreign investors. However, the majority of IIAs let contracting parties free to refuse access to foreign investors, and they create obligations upon the host States only in relation to those investments they have previously accepted to admit in their territory[8].

From this brief outline of the main provisions of IIAs, it emerges that once an IIA enters into force, the ability and the discretion of the host State to adopt measures and to implement policies which affect the investments undertaken in its territory by foreign investors who are nationals of the other

[5] Provisions affecting investments can also be found in some of the WTO agreements, in particular: the Trade-Related Investment Measures Agreement (TRIMs) and the General Agreement on Trade in Services (GATS). However these instruments regulate transnational investments only in relation to a few areas and precisely when investment issues interact with international trade issues. Therefore in this paper the focus will be exclusively on IIAs, as they are the sole existing international instruments specifically addressing transnational investments. For a review of WTO obligation in the field of transnational investments see: Gugler and Tomsik (2006); Brewer and Young (2009)

[6] UNCTAD (2009c)

[7] For an explanation of the meaning of this clause, see below, chapter 2.2

[8] For a much more detailed analysis of the content of IIAs and of BITs in particular see, for instance: Sacerdoti (1997); UNCTAD (2004)

contracting State is significantly reduced. In fact, the host State is required by the IIA itself to ensure that all its domestic policies are not inconsistent with the provisions of the IIAs of which it is party. Policies whose implementation would deprive the investors of the other contracting States of the rights provided for in the IIA shall be avoided or, if the host State adopts them anyway, an obligation to pay compensation to the adversely affected foreign investors will arise.[9] It must be remarked that this does not mean that any measure that a host State adopts and that could prove unfavorable for the investor is necessarily inconsistent with the IIAs and therefore that it gives rise to an obligation to pay compensation. While this always occurs in case of direct expropriation, which consists into an outright seizure of the assets owned by the foreigners,[10] the situation is more blurred when the host State adopts regulations modifying the business climate in which foreign investors operate. Changes in applicable policies and regulations could increase or reduce the profitability of an investment or even create or destroy business opportunities, without being by themselves prohibited by IIAs, as the latter should not be conceived as a form of insurance of the investor against any kind of risk. However, host State measures and policies which not only reduce the value of the foreign investment but which are also implemented in bad faith, without a sufficient degree of transparency and frustrating the legitimate expectations of the investors, can be regarded as a violation of the IIAs[11]. In particular they would be regarded as a violation of the obligation to accord to investors a fair and equitable treatment. Alternatively, if they result into a complete annihilation of the value of the foreign investment which, formally, would remain in the ownership of the foreign investor, they even could be regarded as a form of indirect expropriation.

1.2 International arbitration and the interpretation of IIAs

Another important element of most IIAs is that they are formulated in a very broad and vague way: especially the provisions on the standards of treatments to be accorded to the foreign investors act as black boxes, whose precise content needs to be assessed, case by case, by the jurisdictions

[9] Dolzer (2005); Montt (2009); Valenti (2009b); Stigliz (2008); Muchlinski (2008); Marlles (2007)

[10] In case of direct expropriation, compensation shall be paid in any case. See for instance the case: Compañía de Desarrollo de Santa Elena [par 72] where the arbitral tribunal declared that "expropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state's obligation to pay compensation remains".

[11] Legitimate expectations can be defined as the expectation that the investor acting in good faith is reasonably and legitimately induced to have by the same conduct of the host State. For the notion of legitimate expectations and transparency see: Fietta (2006); Reinisch (2008a); Kotera (2008); Parisi (2005). Several arbitral decisions discussed the role of legitimate expectations of the investors and/or of transparency in order to assess whether an indirect expropriation or a breach of the fair and equitable treatment clause has occurred. See, for instance, the following cases: Técnicas Medioambientales (Tecmed) [par. 122 and 149-174], Waste Management [par. 159]; Azurix Corp [par. 316-323] See also below, paragraph 2.2 of this paper.

entitled to adjudicate upon the disputes which can rise when violation of IIAs is claimed[12]. Also for this reason, it is extremely important to know the subjects entitled to interpret and apply IIAs.

IIAs provide for a special system for the resolution of disputes between host States and foreign investors arising from alleged breaches of the IIAs themselves. In accordance with this system, such disputes shall be settled in principle NOT by the domestic courts of the host State, but by international arbitral tribunals.[13] On one side this provision should help the host State to attract more investments, in particular if it is a developing country or a country with economy in transition, whose courts could be perceived by foreign investors as biased and unreliable. In any case, the right for an investor to have its future disputes with the host State settled by a tribunal which is not a body of the host State itself clearly represents an important guarantee. On the other side, there is the risk that the members of arbitral tribunals, who often are outstanding legal practitioners or scholars, might prove to be less aware of and less sensitive to the interests of the host States and their need to pursue policies promoting development, than domestic courts. For this reason, when interpreting and applying the provisions of IIAs, arbitrators would be unable to adequately take into consideration the particular situation of economic underdevelopment of the host State. This does not necessarily mean that arbitrators are in any case investor-friendly in their decisions and that they are enthusiastic supporters of an ideology according to which the interests of private capital must always prevail over the public interests of States and of the collectivity. Simply, that sometimes they have not the adequate instruments and sensibility to correctly understand and consider the situation of the host State and of its People, in particular when the State at issue is a developing country or an economy in transition. As a result, arbitrators may often devote more attention to framing complex legalistic reasoning than to trying to understand the delicate economic situation of the host State and its developmental policies, with evident unfavorable consequences for the host State.[14]

1.3 The effect of IIAs on the policies host States implement with a view to promoting development

In international arbitration, tribunals can decide (and they often do so) that policies adopted by host States even to pursue developmental goals but which adversely affect foreign investors could give rise to an obligation upon the host State to pay compensation to the affected investor. This risks to increase the costs of implementing policies for the promotion of development in the host State or

[12] On the delicate issue of the interpretation of IIAs, and in particular of their clauses on the standards of treatment of the investors see: Valenti (2009a); Grierson-Weiler and Laird (2008)

[13] Reinish and Malintoppi (2008); Sacerdoti (1997); Muchlinski (2007). For some information on the relation between domestic courts of the host State and international arbitral tribunal see below note 37

[14] Montt (2009); Stgliz (2008)

even to prevent their adoption. In practice, if the implementation of a policy whose aim is to pursue social and economic development is detrimental to the private interests of the foreign investors and consists in a violation of applicable IIAs, two alternatives could be presented to the host State. If the benefits of the policy at issue are expected to be greater than the compensation to be paid to the foreign investors, in this case the State should implement the policy and get ready to be condemned by an arbitral tribunal to pay compensation. However, in this case the final benefits of the implementation of the policy at issue could be strongly reduced and in any case they would be lower than those which would have been possible to achieve in the absence of an IIA. If, on the contrary, benefits of the policy at issue are expected to be smaller than the compensation to be paid to the foreign investors, then it is in the interest of the host State simply to renounce to adopt the policy at issue and, as a concrete result, the host State would be deprived of an instrument it could have used in order to promote development. The study of the two above mentioned alternatives largely rely on a cost-benefit analysis. However, it must be stressed that its feasibility is in my view quite dubious. In fact, such an analysis relies on the possibility to assess with a reasonable certainty at least the two following elements. First: the benefits of the implementation of the policy a State means to adopt to promote development. Should such benefits include only those which are expected in the short run, and therefore more likely to be calculated or also the indirect effects and any possible positive externality which may occur even in the long run? Second: the compensation that the arbitral tribunals would decide it shall be paid to the foreign investor. Given the lack of detailed criteria about the compensation that tribunals may award and the lack of consistency in the practice of arbitral tribunal themselves on this subject, it is very difficult for a State to know in advance how much it will be required to pay in case of condemnation by an arbitral tribunal.

1.4 Affording higher protection to foreign investors trough IIAs: benefits and costs for the host State

In the end of this chapter, it must be concluded that IIAs play a relevant role in limiting the ability of the host State to regulate transnational investments undertaken by foreign investors on its territory[15] and, as a result, also to ensure their consistency with the policies the host State may adopt to promote economic development[16]. In the cases studied above in paragraph 1.2, IIAs affect the relations between foreign investments and economic development in the sense that they favor the

[15] Dolzer (2005)
[16] Ben Amida (2008)

protection of the investor even if this limits the ability of host States to adopt measures aiming at the promotion of its economic and social development[17].

On the other side, it could be argued that if the conclusion of IIAs helps to increase the ability of the host State to attract foreign investments with the positive consequences this can entail for the domestic economy, the costs mentioned above should be fully offset. It depends. First of all, there is no consensus on the extent to which the ratification of IIAs might be determinant to increase the inflows of foreign investments, in particular in the absence of other relevant determinants such as proper markets for inputs and outputs, adequate domestic legislation, stable political environment and business facilitation. More probably, IIAs could contribute to increase the ability of a State to attract foreign investments, but only if the other determinants are present[18]. Secondly, while today the majority of the authors think that in principle an increase of foreign investments (and in particular FDIs) have overall positive effects on the economy of the host country, on the other side this does not mean that every foreign investment in every circumstance brings benefits to the host State. It could do so when the host State is able (and it is enabled by international law) to properly use foreign investments in a way consistent with its strategies and policies for the promotion of economic and social development.[19] IIAs reduce the ability of the host State to do so and even to adopt any other policy for development which, although not directly addressing foreign investment can nonetheless (adversely) affect them.

2. Possible developments related to the interpretation and to the drafting of IIAs in order to ensure an higher degree of protection of the interests of the host State

2.1. The objectives of the research

Policy orientated researches on the impact of IIAs on the relation between foreign investments and economic development of the host State should try to find the way which allows to pursue at the same time the four following goals:

- Increase the ability of the host State to attract foreign investments
- Increase the ability of the host State to maximize the benefits it can derive from foreign investments undertaken in its territory
- preserve and enhance the ability of the host State to pursue policies for the promotion of economic and social development

[17] Montt (2009); Stigliz (2003)
[18] UNCTAD (2009a); Salacuse (2005)
[19] The literature on the link between FDIs and development is exterminate. See, for instance: UNCTAD (1999); Cuyvers (2005); Resmini (2009); Stigliz (2003). For a more general discussion on FDIs and policies of the host States see: Kobrin, (2009); Rugman and Verbeke (2009); Spar (2009)

- minimize the risk that the host State might be condemned by arbitral tribunals to pay high compensation to foreign investor as a result of the implementation of policies aiming at the promotion of development

In this chapter it will be investigated whether such goals could be reasonably achieved through a particular way of interpreting IIAs (paragraph 2.2) or through a partial rewording of their texts (paragraph 2.3)

2.2 Towards an interpretation of IIAs which adequately take into account the fundamental interests of the host State?

The first manner in which the goals listed in the previous paragraph could be achieved, and which therefore deserves to be analyzed, relates to the *interpretation* of IIAs. As argued above, at paragraph 1.1 and 1.2, IIAs are formulated in a very broad and somehow vague way. The actual content and extent of the provisions on the standards of treatments to be accorded to the foreign investors need to be detailed by arbitral tribunals deciding on a case by case basis and often quite inconsistently and unpredictably. This is particularly true with respect to the application of the fair and equitable treatment clause, which provides that foreign investors shall be treated in a fair and/or reasonable and/or equitable way. For the purposes of the analysis undertaken in this paragraph, it is necessary to provide some more in depth information about this clause. The growing recourse to the fair and equitable treatment clause by investors is a recent development in international investment arbitration. First of all, it is linked to the fact that while in the past most disputes between the State and the investors concerned cases of direct expropriations, today disputes mainly arise as a result of the exercise by the host State of its regulatory power in a way such as to adversely affect the interests of the investors. As investors were aware of the indeterminate and hardly determinable content of the fair and equitable treatment clause, in the beginning they preferred to claim that an indirect expropriation has occurred any time a regulatory measure adopted by the host State severely deprived them of the benefits accorded by applicable IIAs. However, as a State measure can be regarded as an indirect expropriation only if it entirely destroys the value of the investment, those State acts which reduce but not fully annihilate the value of the assets owned by the foreigners and which are not contrary to other more specific provisions of IIAs, could only be regarded as inconsistent with the fair and equitable treatment clause. In conclusion, there is an increasing number of cases in which the only possibility that investors have to obtain a compensation, is to prove that a breach of the fair and equitable treatment has occurred[20]. Although, as explained above, the exact content of the fair and equitable treatment clause is difficult to determine in practice,

[20] Valenti (2009 a)

nonetheless some of its basic elements can be drawn from an analysis of the "case law" of arbitral tribunals. It has been consistently found that the lack of stability, predictability, consistency and transparency of the conduct of the host State prevents the investor from enjoying fair and equitable treatment. In addition, if the host State through its actions makes the investor legitimately expect a certain treatment or a certain State conduct and if later such legitimate expectations are frustrated by the conduct of the host State acting in bad faith, a further evidence of the violation of the fair and equitable treatment clause is provided.[21] Such an interpretation can prove particularly harmful for developing countries and economies in transition. In fact, in the same period they start to open up their economy and to attract more foreign investments, they are still struggling to improve their investment climate and to afford a higher protection to investors (and not only foreign investors but also domestic ones). Therefore, as the legal framework governing investment operations in their territory still presents very relevant shortcomings, the risk to be condemned to pay large amount of money as a compensation will be very high for them. In addition, foreign investors are particularly advantaged by an interpretation of IIAs as described above. In fact they can invest in countries with higher country risk and therefore they can expect higher returns if their businesses were successful. In the meanwhile if their business is a failure because they have not been able to operate in the difficult investment environment of the host (developing) country, they could claim that their losses were due to the conduct of the host State and therefore they can ask it to pay a compensation. In such a situation there may be a sort of privatizations of gains (in favor of the foreign investors) and a collectivization of losses (at the expenses of the host State).

Although it has been correctly argued that so far arbitral tribunals have interpreted the fair and equitable treatment in a way favorable to investors rather than to the host State, this does not imply that the same vague wording of IIAs could not allow in future a development of the "case law" of arbitral tribunals which might be more sensitive to the interests of the host State, in particular when the latter is a developing country and when an excessive investor-oriented approach could seriously undermine its ability to govern foreign investments in a manner consistent with its domestic developmental strategies. At least from the standpoint of developing countries and economies in transitions which are the recipients of foreign investments, an evolution in this sense of the interpretation of IIAs must be welcomed. To this purpose, attention should be paid to some recent arbitral decisions, which, when applying the fair and equitable treatment clause, took into consideration also the conduct of the investors in relation to the situation of the host States in which

[21] For a more detailed discussion of the content of the fair and equitable treatment clause see for instance: Valenti (2009a); Muchlinski (2006); Fietta (2006); Grierson-Weiler, and Laird (2008). Among the arbitral decisions which provide useful elements for the analysis of the content of the fair and equitable treatment clause see, for instance: Metalclad Corporation [par 99] Técnicas Medioambientales Tecmed [152-174] Occidental par. [183-185]

they operate[22]. In particular, it seems that fair and equitable treatment must be interpreted as follows. "Fair" should mean consistent with the domestic law of the host State which in turn must be consistent with IIAs and other applicable sources of international law. "Equitable" should mean that all the interests at stake, both those of the investors and of the host State, must be adequately taken into consideration, together with all relevant circumstances which are specific of the case at issue. In other words, the principle of equity should help to rebalance the principles of fairness and respect of the law in the assessment of the conduct of the Host State[23]. This means, first of all, that if a conduct of a State which adversely affects the activity of the investor is a consequence of a previous conduct of the investor himself, in this case the latter cannot claim a violation of the fair and equitable treatment clause.[24] Secondly, this means that the notion of legitimate expectations must not be understood as an absolute concept, but rather in relative terms and precisely in relation to the peculiar features of the host State.[25] The particular economic, social and political situation of the host State contribute to determine which the legitimate expectations of the foreign investors must be. If an investor has unreasonable expectations on the predictability, stability and transparency of the legal, administrative and political system of the host country and if later such expectations are frustrated by the conduct of the host State, the investor cannot claim that a violation of the fair and equitable treatment clause has occurred. In fact investors must be aware that the level of consistency and stability of the framework governing business activities in a developing country or in a country with economy in transition could be different from the one of a developed country. If a foreign investor decides to invest in a developing country or in an economy in transition, it does so because it expects that the higher risk he undertakes will be remunerated by higher returns. IIAs must not be an insurance against wrong business assessments made by the investors or against the consequences that disappointed unreasonable expectation might entail.[26]

In conclusion, If in the future arbitral tribunals interpret the fair and equitable treatment clause as in the cases mentioned above, IIAs will be applied in a way less detrimental to the interests of the host States. Conducts of the host State which adversely affect foreign investments but which are, at least in part, the consequence of an unconscious conduct of the foreign investors or which had to be predicted and taken into account by a sufficiently aware foreign investor who acts in good faith, shall not be regarded as amounting to a breach of the fair and equitable treatment clause and therefore shall not give rise to an obligation upon the host State to pay compensation.

[22] For an in depth analysis of this issue, see: Valenti (2009a); Valenti (2009b); Ben Amida (2008); Muchlinski (2006)
[23] Carreau and Juillard (2007); Valenti (2009 a)
[24] This is what occurred, for instance, in the case Alex Genin [par.352-363]. For a more detailed analysis of the arbitral decisions dealing with this issue, see: Muchlinski (2006)
[25] On the role of the frustration of the legitimate expectations of the investors see above paragraph 1.2.
[26] Valenti (2009a); Valenti (2009b) Muchlinski (2006). For the arbitral decisions see, in particular the following cases: Parkerings-Compagniet [par: 320-346] Thunderbird [par. 148-166] Saluka [par. 297-306]

However, the approach proposed in this paragraph, which focuses exclusively on the interpretation of IIAs in order to achieve the goals listed above at paragraph 2.1 presents a relevant limit: it entirely relies on the arbitrators. Although formally their absolute discretion should be constrained by the fact that they are required to apply the international law and especially the IIAs, the vague formulation of such treaties, as explained above, finally gives them a very broad discretion in determining the exact content and extent of the duties of the Host States and the rights of the investors. In addition, in international investment arbitration tribunals are not bound by the precedent, nor an appellate system for their decision is established.[27] Although tribunals in the decisions they issue often quote previous awards in order to give more strength to their arguments, they are not forced to do so and therefore it is impossible to ensure a decent level of consistency and predictability to their decisions. It is not for sure that the recent development of an arbitral "case law" which is more sensitive to the interests of the host States will be fostered in future decisions. It could also occur that it will be reversed or simply that some tribunals will follow it while other will adopt a more investor-friendly stance.

2.3 The hypothesis of amending IIAs in order to increase the protection of the interests of the host State

Given the impossibility for host States to rely with an acceptable degree of predictability on a more favorable *interpretation* of the IIAs made by the arbitrators, an alternative way to achieve the goals mentioned at paragraph 2.1 can focus on the *drafting* of IIAs. In other words, it must be studied whether IIAs could be drafted or re-drafted in order to include provisions which ensure a higher degree of protection of the interests of the host States and of their need to promote their economic and social development. In particular such provisions could limit the discretion of arbitrators when they are required to rebalance the interests of the host States against those of the foreign investors and they should lead arbitrators to consider the interests of host States more carefully. This paragraph will offer an overview of the provisions which could be included (or which in some cases have already been included) in IIAs consistently with this purpose.

First of all, the preambles of several IIAs explicitly state that one of the objectives of the agreements themselves is to promote harmonious development, also through the transfer of technology, know-how and capitals. Other IIAs in their preambles declare that the their provisions applicable to the treatment and the protection of the foreign investors shall not be interpreted in a way to lower the level of protection of the environment, the human health, the rights of workers etc

[27] Under this point of view international investment law is very different from international trade law, where an higher degree of consistency and predictability is ensured by the existence of a Dispute Settlement Body of the WTO. For an introduction to dispute settlement mechanism of the WTO see: Van den Bossche (2005)

in the host State. Although the preamble is part of the IIA, nonetheless it seems it is able to provide guidance for the interpretation of the provisions of the agreement, but not to provide for supplementary rights and obligations which are not expressly provided for in the articles of the IIA.

A more effective way to upgrade the protection of the interests of the host State can consist in the inclusion of a clause in IIAs, according to which the notion of foreign investment shall be defined by domestic legislation of the Host State. This means, in practice, that rights and benefits deriving from the IIAs will apply only to those operations of the foreign investor which shall be regarded as foreign investments NOT by arbitrators in future disputes, but by the host State itself. This increases the ability of the host State to decide which economic operations undertaken by foreigners in its territory are more consistent with its developmental needs and interests and therefore which of them deserve to enjoy the special protection accorded by the provisions of IIAs. [28] It could be argued that such a clause could be used (or better: abused) by a State which can change its legislation defining foreign investments for the purposes of IIAs by mean of unilateral acts in order to prevent the applicability of the IIAs and the jurisdiction of those arbitral tribunals which might condemn it. When a State behaves this way, the fairness and predictability of its investment climate would be reduced, finally affecting its ability to attract foreign investments. To a certain extent, these worries should be assuaged, by remembering that such a conduct of the host State might be forbidden by several clauses of the IIA, in particular by those prohibiting discrimination and those obliging the State to accord a fair and equitable treatment. Therefore, the host State, could only lawfully determine *ex ante* which are covered investments (and therefore entitled to the rights deriving from the IIAs). On the contrary it could be prevented from depriving of the character of foreign investments covered by IIAs those operations it has already acknowledged as covered investments.

When signing an IIA, contracting parties can also include some clauses enabling the host States to adopt measures which adversely affect foreign investors but which do not give rise to an obligation to pay compensation to the extent they are justified by reasons of public emergency or public security[29]. Nonetheless such clauses should be given more details, otherwise there is the risk that they could be interpreted too narrowly by arbitral tribunals and finally in a way unfavorable to the host States. In addition such clauses should contemplate situation of severe economic emergency in order to prevent that arbitrators could restrict the applicability of the notion of public security to military issues or to those occasions in which the same existence of the State and the survival of its People is put in danger. However, it must be reminded that the inclusion of "economic emergency clauses" rises particular difficulties, as arbitrators, who mostly have a background as lawyers or

[28] See: Ben Amida(2008) for a more detailed explanation of these issues and for some examples of IIAs containing the above mentioned clauses.

[29] UNCTAD (2009 d)

scholars expert in law, would be required to make an assessment of the economic situation of the host State which is often difficult to make even for an economist. It is doubtful that an arbitrator, making use of legal (or legalistic) arguments, might appropriately assess whether some measures which would be otherwise prohibited by the IIAs shall be nonetheless justified by the existence of a situation of economic emergency and therefore whether they shall not entail the liability of the host State. In fact arbitrators would be required to evaluate if there is a real situation of economic emergency (and not a "simple" economic crisis), if the measures that the host State adopts are necessary and if they are the sole measures available to adequately cope with the emergency. To provide an example of all these difficulties it could be reminded what occurred in relation to the economic crisis which affected Argentina in the beginning of our century. In that occasion, several arbitral tribunals adjudicated upon disputes risen between Argentina and foreign investors who claimed their rights deriving from IIAs have been impaired by emergency measures enacted by Argentine authorities to tackle the crisis. Arbitral tribunals reached very different conclusions as to whether and eventually to what extent the public emergency clause could be invoked in case of that economic crisis. They did not fully agree as to whether actions undertaken by Argentine authorities were "necessary", and therefore justified, in the context of the financial crisis. In addition, they inconsistently considered whether Argentina had contributed through its acts and omissions to the inception or to the worsening of the crises and the extent to which this could prevent it to invoke the existence of a situation of emergency to lawfully justify the breaches of IIAs it committed.[30]

Together with public security exceptions, which have been analyzed above, an increasing number of IIAs contain further clauses providing for other exceptions. In some cases they allow host States to adopt appropriate laws or regulations in order to protect the environment, human health, human rights or to ensure the respect of certain standards concerning the conditions of workers and the safety of products.[31] The more detailed such clauses are, the more the discretion of arbitrators will be reduced. In this sense, arbitrators will be led to interpret and apply IIAs in a manner which should ensure a higher concern and respect for the interests of the host State.

Under this point of view, it must be remarked that the United States, after having pledged for an extremely open and investor-friendly environment for foreign business, have recently become more sensitive to the need to properly reconcile the interests of the foreign investors with those of the host State. This partial change is explained by the fact that while in the past the US mainly were

[30] On this point see the particularly critic (and convincing) article of Stigliz (2008). See also: UNCTAD (2009d). The arbitral decisions which have been taken into consideration in this discussion are: Continental Casualty Company [par.160–168]; CMS Gas Transmission Company [par. 353-358]; LG&E Energy Corp./LG&E Capital Corp./LG&E International [par. 213]; Enron Corporation Ponderosa Assets [par.335–339]; Sempra Energy International [par.379–388.]

[31] It is impossible in this paper to mention a significant number of IIAs containing such clauses. Some examples may nonetheless be found in: Ben Amida (2008)

capital exporters, in recent time they have also received a growing amount of foreign investments and therefore they have re-discovered the importance for host States to adequately govern them. To this purpose, the US in 2004 have adopted a new model BIT, which will serve as a basis for the negotiations of future bilateral IIAs of which the US will be contracting parties. The text of the US model BIT of 2004 is more detailed than that of most IIAs. It contains several provisions explicitly referring to the protection of the environment and, what is even more important, it provides clearer and more detailed definitions to a number of strategic issues, for instance in relation to the content of the fair and equitable treatment and the way arbitrators are required to interpret it. This is expected to limit the discretion of arbitrators who will apply IIAs and a possible, positive outcome could be a limitation of the risks of an interpretation excessively favorable to the investor and detrimental to the host State.[32] Under this point of view, the US model BIT can be used as a source of inspiration also for other States, even if they are considerably different from the US. In fact, some of the basic interests of the Host States that the 2004 US model BIT means to protect are the same of developing countries and of States with economies in transition.

From the discussion carried out by now, it seems that the best way to ensure a higher level of protection of the interests of the host State and finally, the attainment of the goals mentioned at paragraph 2.1, consists in the inclusion in the text of IIAs of the clauses mentioned in this paragraph. However, this is not so easy as it might seem. In fact, this does not only mean to discuss such clauses in any future negotiation for the adoption of new IIAs. It also requires to amend the IIAs currently in force. Currently more than 2,600 IIAs are in force and almost any State is party to a network of dozens of IIA. The first IIAs were signed in the 1960s, although the number of such instruments has dramatically increased only in the 1990s. Since the beginning, IIAs were traditionally concluded between a developed country (a capital exporter) and a developing country (a recipient of foreign investments), with the former preparing a text which was consistent with its interests and the interests of its corporations and with the latter accepting to sign the agreement quite passively and without being able to include in the text many provisions consistent with its own interests, also because it lacked technical, legal and economic expertise to do so[33]. In other words, the different degrees of protection of the interests of the different stakeholders, reflected their respective bargaining power, with the consequence that the interests of the developing countries where not adequately protected. Although today the situation is more complex, with developing countries increasingly investing abroad and also in developed States[34] and with the

[32] For an in depth analysis of the US model BIT 2004 and of the relevant changes it provides with respect to the protection of the interests of the host State see: Juillard (2004); Kantor (2004)
[33] For a short history on IIAs and especially BITs see: Vandevelde (2005)
[34] On this trend see, for instance: UNCTAD (2009 e)

conclusion of IIAs also between developed countries and between developing countries, the original framework and formulation of IIAs has essentially persisted. This means that the original focus on the interests of the investors has remained. This is also proved by the fact, outlined in the beginning of this paper, that IIAs create only rights upon investors and only duties upon host States.

In particular for developing countries, the renegotiation of several IIAs also with countries which can rely on more resources, expertise and know-how is a complex and costly task. It could be argued that a developing country could reduce such costs limiting itself to renegotiate only those IIAs with the countries from which it receives more investments or the investments which, by their nature, are particularly likely to affect its basic interests. Nevertheless, the existence of the "most favored nation" (MFN) clause in virtually all IIAs makes this option unworkable. The MFN clause provides that foreign investors who are nationals of one of the contracting States of the IIA shall be treated at least as much favorably as any other foreign investor from a third country. In practice, any benefit accorded by the host State to any third country investor is automatically extended to any investor who is national of the other States parties to the IIA at issue.[35] A simple example will show how this can nullify the efforts of developing States trying to selectively modify the IIAs to which they are parties. Let's assume that country A has concluded a BIT (which contains a MFN clause) with country B and another BIT with country C. Let's also assume that it renegotiates only the BIT with country B in order to increase its ability to control foreign investments undertaken in its territory (but the MFN treatment clause is maintained). If, as a result of this modification, an investor from country B is deprived of some benefits investors from country C keep on enjoying, then he can claim the application of the MFN clause in order to obtain the same benefits accorded to investors from country C. As a consequence, the MFN clause would re-introduce those limits to the sovereignty of the Host State which the renegotiation of the BIT between A and B was expected to reduce. In order to prevent this pitfall a simultaneous renegotiation of BIT between A and B and between A and C is therefore necessary. Clearly, if a State has not concluded only two IIAs (like in our simplified example), but dozens of IIAs (as it occurs in the real World), this process becomes extremely costly. In addition, the renegotiation of a treaty cannot be made unilaterally, but it requires the consent of all the other contracting parties. It is not for sure that the other State parties to the IIAs will accept a renegotiation or that they will reach an agreement on how to renegotiate the Treaty at issue.

[35] For a further explanation of the functioning of the most favorable treatment clause and for a more precise discussion of its legal aspects see: Acconci (2008); Sacerdoti (1997).

3. Enhancing the consistency of host State policies with IIAs

3.1 The need for interdisciplinary researches and the presentation of a new three-step approach. Preliminary observations.

The previous chapters have showed some of the shortcomings of the current legal framework established at the international level governing transnational investments. In particular, they have emphasized its partial inability to reconcile the protection of foreign investors with the need for host countries to properly regulate investments undertaken in their territory, to use them to promote domestic development and to ensure their consistency with other developmental domestic policies. Chapter two has explained why relying on a more host-State-friendly attitude of arbitrators to ensure the proper protection of the interests of the host State is not a satisfactory option, in particular because of the lack of consistency and predictability of the decisions of arbitral tribunals, which retain a high level of discretion when interpreting IIAs. Moreover, it has stressed that the modification of existing IIAs in order to include in their texts more provisions for the protection of the interests of the host States and of their need to promote economic development is hardly feasible. Therefore, in this chapter an attempt to suggest another approach for policy-orientated research in the field of foreign investments and economic development will be made. The methodology presented hereby is articulated in three phases, which can be outlined as follows:

- First step. Study the features of the investment climate of the host State in relation to which foreign investors are less satisfied and disputes are most likely to rise.
- Second Step. Study whether as a result of this situation foreign investors could start proceedings against the host State before international arbitral tribunals and whether, as a result of the decision of arbitrators, the host State might be required to pay compensation to foreign investors. This step consists therefore in a discussion of hypothetical disputes which are expected to rise according to the findings of step one.
- Third step. Study how to modify certain policies and laws of the host State in order to reduce the risk that disputes with investors might arise, might be submitted to international arbitral tribunals and might result into a condemnation of the host State to pay compensation.

The approach presented in this paper is multidisciplinary in character, as it combines the efforts of lawyers and economists both; however the role played by these two categories of experts will not be the same in all the three phases. Another character of this method which deserves to be underlined is that it focuses on dispute prevention, as it pursues the goal to minimize the number of occasions in which investor-State disputes may arise. Finally, it must be remarked that in this method the

focus is not only on IIAs and arbitral decisions, but also on the business environment of the host State.

3.2 The first step. Which kind of State-investor disputes are most likely to rise?

The first step consists in three sub-steps:

- Analyze the domestic legal and policy framework (of the host State) which affects foreign investments.
- Find which are the features of such framework with which foreign investors are severely not satisfied.
- Assess whether the dissatisfaction of the foreign investors can bring them to file claims against the host State before international arbitral tribunals.

The starting point of any research using the method explained in this paper must consist in an in-depth analyze of the legal and policy framework governing foreign investments in the host country. This could be made within the framework of a broader research on the general investment climate of the host State. It is well known that the investment climate depends on several factors. Some of them, like the size of the population, the presence of natural resources, the geographical position and the climate are hardly or no modifiable by the State. Other economic determinants can be improved (or worsened) through the implementation of certain State policies, which are able to affect the potential of the domestic economy. They are, for instance, market size and capital income, market growth, access to global or regional markets, costs and skills of the workforce, quality of infrastructures. Improving them is strategic, however it is a long process and the time lag between the implementation of policies and the enjoyment of the benefits they are expected to bring is often measured in terms of decades. Other elements which determine the ability of a State to attract foreign investments consist in the economical, political and social stability, as they ensure a decently predictable framework any business activity needs. The policy and legal framework governing business, and in particular the operations of foreign investors, also plays a key role. All these determinants should be analyzed by the host State when assessing how to increase its ability to attract foreign investors.[36]

The three step-method presented in this paper focuses on the analysis of the policy and legal framework, as the core of the method itself consists in the pre-emptive evaluation of the consistency of the domestic legal framework with IIAs. Of course this does not mean that I consider that legal aspects are more important than other determinants in attracting foreign investments. The other

[36] On the discussion concerning the State bodies which should perform this task see, for instance: UNCTAD (2008 a) and UNCTAD (2008 b)

determinants can and must constitute the topic of other studies, which are to be considered as complementary rather than alternative to the one presented in this paper.

The assessment of the policy and legal framework entails a review of all applicable laws and regulations, but also of the way in which State authorities apply them. In other words, it is important not to focus on the formal element only, but also on the actual State practice, as in particular in developing countries and economies in transition with a weak institutional framework the real application of laws and regulations can prove very different from what provided for in their wording. The elements of the legal and policy framework which must be analyzed could be: the procedures to register and to start a new business, the procedures to obtain licenses and permits, the manner in which and the frequency with which the rules governing such procedures change. Other elements to be assessed concern the way laws and regulations which can affect the activity of foreign investors are adopted. The main issues are: the level of transparency and the predictability of the process, the degree of involvement in the decision making process of the persons who are expected to be affected by the changes, the frequency with which such changes occur. Attention must be paid in particular to antitrust law, taxation, environmental provisions, provisions for the protection of consumers, human health, public morality and public security. Also the functioning of the judiciary system of the host State, especially in civil and commercial matters, deserves careful evaluation. The elements which should be assessed are: the impartiality of judges, the level of the protection of the rights of the parties during the proceedings, the period of time needed to obtain a judgment and the enforceability of judicial decisions.[37] An assessment should also be made as to the level of corruption, of arbitrariness and unaccountability of State officers whose actions are able to have an impact on the operations of foreign investors. Also the existence (and the actual

[37] This reference to the role of domestic courts might appear surprising, as in the present paper it has been emphasized the importance of arbitral tribunals in adjudicating upon investor- State disputes. However, domestic courts still play a fundamental role and the impact of the administration of justice on the investment climate of the host country is very relevant. This note will briefly explain why.

In several cases disputes between the State and the investor and concerning an alleged breach of a provision of an IIA must first be settled by domestic courts and, only later, (for instance in case of deny of justice) by international arbitration. It depends on the existence in the IIA of a clause providing so. In addition, several IIAs contain a "fork of the road" provision according to which, once a dispute has arisen, the investor can chose whether to submit it to domestic courts of the host State or to international arbitration: however, when he has decided in either way, he cannot change its mind later. It must be underlined that investor-State dispute can concern not only alleged breached of IIAs but also, for instance, alleged violations of contracts that the investors sign with the State (in particular in relation to public procurements or important construction projects). In principle, such disputes must be settled by domestic courts of the host State, except otherwise provided.

For a discussion of the difference between claims arising out of a breach of an IIA and of a contract see: Crawford (2008). For a more detailed analysis of the relation between international arbitrators and domestic Judges in investor-State disputes see: Van Haersolte-van Hof and Hoffman (2008).

Finally, it must be reminded that in case of disputes between foreign investors and domestic non-State actors, in principle domestic courts only are competent (except otherwise provided). However, if such municipal tribunals are biased against the foreign investor and if they grossly discriminate against him, this can represent a violation of IIAs. This further proves how much the administration of justice in the host State is so relevant to the purpose of the researches discussed in the present paper.

application) of law and regulations adequately protecting foreign investors not only from harassment by State officers, but also by non State-actors (like insurgents, violent movements of protest, political or common criminality) is important. Finally, it must be studied whether foreign investors are discriminated, both relative to domestic investors and relative to foreign investors from other countries.

The list of elements to be considered which has been provided so far is not necessarily exhaustive. It is possible to take into consideration more or less elements, according to the peculiarity of the country whose investment climate is the object of the research which applies the method presented in this paper.

At this point it could be questioned how the assessment of these elements must be made in practice. The proposed method consists in a survey in which foreign investors are required to communicate their level of satisfaction in relation to the features of the legal and policy framework which have been listed in the first part of this paragraph. In practice, a list of the elements which determine the quality of the legal and policy framework of the host State is provided to a representative sample of foreign investors and each of them will declare whether or not he is satisfied of each element. The results which are collected permit to know which are the features of the legal and policy framework in relation to which most foreign investors are not satisfied[38]. In principle these are the areas in which more State-investors disputes are expected to rise, although it is important to be aware of the fact that there is not an automatic link between a widespread discontent about certain State policy on one side and on the other side the actual rise of disputes which are brought before an arbitral tribunal, between a State and an investor, concerning an alleged breach of an IIA. First of all, some features of the legal and policy framework governing foreign investments, although not favorable to foreign investors, could be not prohibited by IIAs or even they could be explicitly allowed by them[39]. In addition, if an investor is seriously not satisfied with a conduct or a policy of the host State (and this policy is also inconsistent with an applicable IIA) he can nonetheless pursue a variety of strategies other than recourse to international arbitration. For instance, a foreign investor can decide to accept not to benefit from certain rights to which he would have been entitled under the IIAs and therefore he can renounce to initiate arbitral proceedings because he desires to preserve good relations with the host State, for instance as he still deems that the opportunities for profit remain high despite some unfavorable conducts of the host State. Alternatively, an investor could

[38] Investors may be asked to judge not only those features related to the legal and policy framework but also other determinants of foreign investments. This could enable the host State to have a more complete picture of what investors think on the weaknesses and the potential of the host State. However, only those aspects related to the policy and legal framework, as listed in the first part of this paragraph, will be taken into consideration for the researches which can be made using the method described in this paper.

[39] See paragraph 2.3

decide to liquidate the investment, and to leave the State whose investment environment has proven not suitable for his businesses, but without starting a complex and expensive arbitral proceeding whose outcome could be uncertain and arrive very late in time. These few examples do not aim at denying the validity of the method which is presented in this paragraph. Their goal is to underline that policy makers should always be careful when applying any method of research to concrete cases and must be ready to consider the need for adjustments on a case by case basis in order to better fit the reality the method of research employed is supposed to help to understand.

At the conclusion of this paragraph it is necessary to indicate by whom this "first step" must be developed. The survey should be prepared by economists and statisticians, who are best placed to select a representative sample of foreign investors and to collect and adequately process the answers which will be obtained. However, as to the formulation of the questions of the survey, an effective cooperation between lawyers and economists may help. In fact in this way it will be possible to obtain the answers of foreign investors exactly on those features of the legal and policy framework which are more relevant for the analysis which will be undertaken in the second step.

3.3. The second step: how will an arbitral tribunal adjudicate upon disputes as those indicated at paragraph 3.2?

While the first step largely relied on the efforts of the economists, the second step consists almost entirely in an analysis which needs to be carried out by legal experts.

The second step consists in fact in a discussion of the hypothesis in which those disputes which have been found to be more likely to arise according to the analysis made in step one, are submitted to international investment arbitrations. This entails an effort to understand which could be the possible outcome of such arbitrations. It must be pointed out that this is a discussion on hypothetical arbitrations, concerning disputes which have not risen yet but which simply are reasonably expected to rise according to the analysis carried out in the first step.

The second step must be articulated as follows:

- study the IIAs which have been concluded by the State whose investment climate is the object of the research.
- try to understand which are the provisions of such IIAs whose breach could be claimed by a foreign investor, in disputes like those which have been found to be more likely to arise according to the analysis made in step one. In other words, this means to figure out the issues on which arbitrators will be asked to decide.
- study the way similar provisions of IIAs have been interpreted by arbitral tribunals in other, similar cases.

- discuss whether the interpretation made of similar provisions in similar cases can be valid for the hypothetical disputes at issue.
- assess whether, according to this interpretation, the arbitral tribunals adjudicating upon the hypothetical disputes at issue will condemn the host State to pay compensation.

First of all, it is necessary to study the IIAs concluded by the State whose legal and policy environment is the object of the research. An effort must be made in order to understand which are the provisions of such IIAs whose breach could be claimed by a foreign investor. In other words, this means to understand whether one or more elements of the investment climate of the State at issue, which are regarded as highly disappointing by foreign investors, actually deprive the investors themselves of the rights deriving upon them from the IIA. In case of positive answer, it must be studied which is the exact provision of the IIA which is alleged to be breached.

As it has been mentioned in the previous paragraph, a very important feature of the investment climate is the degree of stability and predictability of the framework governing business activities. Changes of the regulatory framework applicable to investments affect the conditions in which investors operate: while on one side they can create new business opportunities, on the other hand they could cause losses to investors. As it has been explained in paragraph 2.2, changes in laws and regulations in the host State, although detrimental to the interests of the foreign investors, by themselves do not amount to a breach of IIAs. However, if further circumstances occur, they could be deemed to be tantamount to a breach of IIAs. If such regulatory changes occur in a non-transparent and unpredictable way, if the host State acts in bad faith or arbitrarily, if it clearly assures that it will act in a certain way and then behaves completely differently, thus frustrating the legitimate expectations of the foreign investor, then regulatory changes adversely affecting foreign investors could be regarded as a breach of the fair and equitable treatment clause or even as a form of indirect expropriation. Some arbitral tribunals have also taken into consideration a further criteria: the lack of proportionality. Therefore, if the host State adopts a policy whose objective is to achieve a public goal but which imposes a burden upon the foreign investor which is not proportional to the public benefits it pursues, this could be regarded as inconsistent with the IIAs.[40]

In principle, if the outcome of the conduct of the host State is a complete destruction of the value of the investment, it will be possible to claim that an indirect expropriation has occurred. On the contrary, a severe loss suffered by the investor which however does not involve the entire annihilation of the value of its assets can give rise to a claim for a breach of the fair and equitable treatment clause.

[40] This criteria has been used in particular in the following case: Técnicas Medioambientales (Tecmed)

Other elements to be taken into consideration are related to the procedures for the issuance of licences and permits. When a licence is not obtained or not renewed after the investor has already provided a relevant contribution of capitals and after State authorities have made him reasonably expect that the licence would have been granted, this could bring arbitral tribunal to decide that an indirect expropriation or, more frequently, a violation of the fair and equitable treatment clause has occurred. Such risk is bigger if the whole process is characterized by lack of transparency and predictability.[41]

Also the application of environmental and antitrust legislation, as well as of laws and regulations for the protection of consumers, human health, morality, etc... can involve breaches of the fair and equitable treatment clause or could be regarded as indirect expropriation. Once again, lack of transparency, bad faith and frustration of legitimate expectations will be taken into consideration by arbitrators. Although most IIAs exclude from their scope tax issues, which are usually governed in other international instruments like double taxation treaties, nonetheless in some cases the administration of the tax system can be used by the host State to harass investors or in general to deprive them, in whole or in part, of the use and control of their assets. As a result, some State acts related to the tax administration could also be regarded as a form of creeping expropriation or as entailing a breach of the fair and equitable treatment clause.[42]

Other clauses of the IIAs whose breach could be claimed are those prohibiting discrimination. Discrimination against foreign investors can occur relative to other foreign investors who are national of third countries (thus determining a breach of the most favoured nation treatment clause) or relative to domestic investors (and this would constitute a breach of the national treatment clause). However, in order to assess the breach of one of these two clauses, it is not sufficient that foreign investors lament they have been treated differently from a domestic or third country investor. It is necessary that the different treatment occurs in relation to the same or to highly similar circumstances.[43]

After having pointed out which are the provisions of the IIAs whose breach could be claimed before arbitral tribunals when most foreign investors are particularly disappointed of certain features of the investment climate of the host State, it is important to try to understand how arbitrators will interpret such provisions, in order to forecast if the host State actually risks to be condemned. It is necessary to take into consideration those decisions which have been issued by arbitral tribunals which adjudicated upon similar disputes. From the analysis of such decisions it is possible to find

[41] See the cases mentioned above at paragraph 2.2 when discussing the role of transparency, good faith, legitimate expectations and proportionality with respect to indirect expropriation and the breach of the fair and equitable treatment.
[42] For an in depth analysis of the relation between IIAs and tax issues see: Walde and Kolo (2007); UNCTAD (2004)
[43] See, for instance the case Parkerings-Compagniet [par.366- 430]

which interpretation can be expected from arbitrators in those future, hypothetical disputes which could rise according to the analysis carried out so far in the first and second step. It will often be necessary to take into consideration disputes involving States different from those whose investment climate is the object of the research. In fact, the method for policy orientated researches suggested in the present paper is meant to be used in particular in developing countries and economies in transition, and especially in the delicate phase in which they try to attract more foreign investments while their legal and policy framework still remain relatively unable to accord investors high level of protection and high standards of treatment. For this reason, as in the past these States received a limited amount of investments, then few occasions for disputes with foreign investors have existed and even fewer cases in which such disputes were submitted to international arbitration are reported. This explains the need to take into consideration the outcome of investor-State arbitrations which occurred in relation to similar situations and which involved especially (although not exclusively) States which share, or which shared in the past, some characteristics with the State whose legal and policy framework is made the object of the research undertaken in accordance with the method suggested in this paper.[44]

As it has often been argued in the present paper, arbitral decisions are characterised by a certain level of inconsistency and unpredictability. As it has already been discussed above, this is determined by the broad and open-ended wording of IIAs, which makes it impossible to restrain the discretion of arbitrators, as well as by the absence of a centralised system for appealing and reviewing arbitral decisions. This must always be kept in mind, because if arbitral tribunals have decided in a certain way in previous, similar disputes, it is not for sure that another arbitral tribunal will interpret and apply similar provisions of IIAs exactly in the same way. This *caveat* should not be meant in a sense as to deny the validity of the method described in this paper, but only in order to remind policymakers and experts involved in the researches which apply the method presented in this paper that a certain level of unpredictability remains, notwithstanding the fact this method precisely aims at reducing such uncertainty.

[44] An example, taken from an ongoing research of mine which applies the method presented in this paper, can be hereby provided.
Belarus has recently started a new privatization process and it is reforming the legal framework governing foreign investments with a view to attracting more foreign investments. An increase of foreign investments is therefore expected, but this also makes it foreseeable an increase of disputes between foreign investors and the Belarusian State. So far the few investor-State disputes in Belarus have been mainly settled by local courts, while arbitration has been rarer and in particular no ICSID arbitration has been reported (although Belarus is part to the ICSID convention and several IIAs it has concluded provide for ICSID arbitration in case of State-Investor disputes). For this reason, in order to apply the method suggested in this paper to researches concerning Belarus, it is necessary to take into consideration previous decisions adopted by arbitral tribunals in disputes which concerned claims similar to those which are expected to rise with respect to Belarus, but which involved other States, in particular those which at the time of the facts giving rise to the disputes found themselves in a situation similar to that of Belarus today (for instance Ukraine and Russia, but also Latvia, the Czech Republic, Lithuania and other eastern European countries in the earliest stages of their transition from a socialist to a market economy.)

3.4 Third step. How to improve the legal and policy framework governing foreign investments?

The first and second steps have pointed out which are the policies and laws which, when implemented or maintained, are expected to give rise to an obligation upon the host State to pay compensation to the foreign investor. With these elements, it is possible in step three to find out the way to modify State policies (even before their adoption, if they are new policies) to the extent necessary to ensure they might be more consistent with IIAs obligations while preserving their ability to pursue domestic development. This third step requires a joint effort of economists and lawyers both. The economists shall identify the policies that the host State has an interest in implementing to promote development. The lawyers shall provide consultancy as to the best way to draft domestic laws and regulations which allow the implementation of these policies and at the same time which are, as much as possible, consistent with IIAs.

It must be recalled that in paragraph 1.3 it has already been carried out a brief discussion of the two main options that States retain when the policies they mean to implement are inconsistent with IIAs obligations. If the benefits of the policies at issue are expected to be greater than the compensation to be paid to the foreign investors, in this case the State could find it acceptable to implement the policy and to get ready to be condemned by an arbitral tribunal to pay compensation. If, on the contrary, the benefits of the policy at issue are expected to be smaller than the compensation to be paid to the foreign investors, then the host State would abandon the idea of adopting the policy at issue. The method which is proposed in the present paper addresses this problem in two ways. First of all, it helps to make the choice between "implement the policy and pay the compensation" vs. "not to implement the policy and not to pay the compensation" smoother. In fact, researches made in accordance with step one and step two help to clarify which are the policies of the host State inconsistent with the IIAs and, at least in part, which are the expected costs of their implementation (measured in terms of the compensation that arbitral tribunals will require to pay). In other words, this can make the cost-benefits analysis referred to in paragraph 1.3 more feasible.

However, what is even more important is that the application of the method presented in this paper should reduce the same risk that a State must choose between the two unhappy options mentioned above. In fact the researches which will adopt the method described in this paper will allow policymakers to know which policies, and more precisely, which specific aspects of such policies, rise problems of consistency with applicable IIAs. The modification of some aspects and features of the policies at issue could ensure that they will be consistent with IIAs and, at the same time, that they will preserve their ability to promote domestic development. In other words, thanks to the application of this method, host States will be no more (or at least not always) forced to choose

between: "implement the policy and pay the compensation" vs. "not to implement the policy and not to pay the compensation". A third option, much more favorable, is made available, and it sounds: "implement the policy and NOT to need to pay compensation".

As the reader may have noticed, the description of the third step has been shorter and less detailed than the discussion developed in relation to the two previous steps. This can be explained by the fact that the third phase is the most flexible one out of the three. It requires a careful analysis of the peculiarities of the host State, of the impact that certain policies might have on its particular situation, and also of the preferences of its People and its political leaders. For this reason, step three has mainly consisted in an explanation of the correct use of the findings emerged from the researches made in accordance with step one and step two.

Conclusions

The paper has tried to develop a method which can be used in policy oriented researches whose objective is the study of the impact of IIAs on the relation between economic development of the host State and inward foreign investments. In particular, the researches which adopt this method should provide advice on how to increase the consistency with IIAs of those policies adopted by the host State in order to promote domestic development. This also means that researches applying the method suggested in the paper would provide advice on how to reduce the limitations that IIAs may pose to host States when they formulate domestic policies consistently with their developmental goals.

Chapter one has explained that the wording of IIAs, their interpretation and their application can significantly reduce the ability of host States to implement and maintain many policies of theirs, included those for the promotion of economic development. This has made it necessary to study how such shortcomings could be mitigated. To this end, chapter two has investigated some interesting developments in the arbitral "case law" especially in relation to the interpretation of the fair and equitable treatment clause, which is contained in most IIAs. It has stressed the importance of those arbitral decisions which, at least in part, take into account also the conduct of the investor in order to assess the lawfulness and the fairness of the conduct of the host State. In these cases, it has been argued that foreign investors must be aware of the particular situation of the States where they invest and that their behavior and expectations must be assessed keeping in mind the general investment climate of the host States. However, it has been explained that relying on a more host-State-friendly attitude of arbitrators in order to ensure a proper protection of the interests of the host State is not a satisfactory option, in particular because of the lack of consistency and predictability

of the decisions of arbitral tribunals, which retain a high level of discretion in their interpretation of IIAs. Again in chapter two, an alternative solution has been explored. It has focused on the possibility to modify IIAs in order to include more provisions which might ensure the protection of the interests of the host States and of their need to promote economic development. However it has also explained the obstacles a State, and especially a developing country, meets when it tries to re-draft the IIAs of which it is party. As a result, it has been concluded that this alternative too is hardly feasible.

Finally chapter three, which actually is the most original part of the paper, has presented a third, new method which can be used for policy orientated analysis. This method has been articulated in three steps. The first step consists in an assessment of the legal and policy framework governing the operations of foreign investors in the host State. This analysis permits to find which are the features of such framework in relation to which foreign investors are less satisfied and disputes are most likely to rise. The second step consists in a discussion of such (hypothetical) disputes, of the way they are likely to be settled by arbitral tribunals and of the risk that, as a result, the host State may be condemned to pay compensation. Finally, the third step involves an analysis of the way the host State can modify certain policies and laws so as to reduce the risk to be required to pay big compensations to investors or to renounce to implement policies which might have helped it to promote development but which are inconsistent with IIAs.

While the approaches studied in the second chapter have focused on the international dimension of the governance of transnational investments, the approach proposed in the third chapter has focused on the international and on the domestic dimensions both, the latter consisting in a careful assessment of the investment climate of the host country. In addition, while the approaches discussed in chapter two have almost entirely consisted in a legal analysis and in the study of international legal sources, (IIAs and arbitral decisions) on the contrary the approach proposed in the third chapter has emphasized the need for multidisciplinary researches. In particular, it has stressed the need for joint efforts of economists and lawyers, although political scientists and sociologist could be involved as well, since it is my convincement that foreign investments, IIAs, international arbitration are not simply technical issues which concern a restricted number of specialists but, given their impact on State policies and economic development, they increasingly affect the Peoples of the host States and their lives.

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