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**INVESTMENT PROVISIONS
IN
ECONOMIC INTEGRATION
AGREEMENTS**

CHAPTER 6



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VI. POLICY CHALLENGES

The number of EIAs has increased greatly, especially since the 1990s, and there are indications that it will continue to grow in the near future. Increasingly, EIAs involve countries with dissimilar economic characteristics and levels of development. A country contemplating the negotiation of an EIA faces a number of policy challenges, some of which are addressed here.

First, a country wishing to provide investors with assurances of a favourable investment climate may choose to do so through the inclusion of investment provisions in an EIA or through negotiation of another type of investment agreement. Therefore, an initial issue that arises concerns the nature of the agreement. To some extent, the choice of instruments between an EIA and another type of IIA, for example BITs, may depend upon a country's objectives in negotiating the agreement. The goal of attracting selected foreign investment by offering certain protections perhaps militates in favour of concluding a BIT type of agreement, while the goal of seeking some level of real integration into the regional or global economy by lowering at least some barriers to the international flow of capital may militate in favour of an EIA. Certain advantages of negotiating either EIAs or BITs relate not to the type of agreement but to the number of parties involved (UNCTAD, 1996). One of the main advantages of EIAs *vis-à-vis* other types of IIA is that, by addressing related economic transactions in a single framework, these agreements can provide policy coherence and coordination in the economic area.

Indeed, as noted in the introduction, the inclusion of investment provisions as part of an economic integration agreement covering trade and other types of economic transactions reflects a desire to expand and deepen integration efforts among a number of economies by facilitating investment flows between the parties. However, EIAs' approaches to investment issues vary considerably and reflect different visions concerning the policies that will best promote the economic welfare and development of the parties involved. A few EIAs, particularly some of the EIAs that include only developing countries and that date from the period before the late 1980s, assume that economic development rests on providing preferential treatment to investment from within the EIA area. The majority of recent EIAs, however, including many that involve only developing countries, assume that liberalizing investment flows among different economies will promote economic development by fostering the efficient allocation of resources and augmenting the factors of production available to developing economies.

Second, once the decision to negotiate an EIA has been made, a country faces a large number of more specific policy choices relating to the inclusion of particular investment provisions. Negotiation of an EIA does not occur in a vacuum, but in the context of the 218 EIAs that have already been concluded. Countries will inevitably come to the bargaining table with expectations about what should be included, based on their prior negotiating history or on the prior negotiating history of other States whose practices they consider instructive or wish to emulate.

As has been shown in this study, there are strong regional patterns among EIAs. For example, a country preparing to negotiate an EIA with the European Community or with EFTA will very likely find investment liberalization, competition policy and intellectual property protection high on the agenda. A country preparing to negotiate an EIA with a country from the Americas will find liberalization and intellectual property issues on the agenda, but also issues involving many of the kinds of investment protection provisions found in a traditional BIT. Many factors play a role in choosing a country with which to negotiate an agreement, but these

strong regional preferences are one consideration that may influence the choice of potential treaty partners.

As noted also in the introduction, a key driving force behind the conclusion of EIAs is the insertion of national economies in the globalization process as a means of counteracting the risk of economic marginalization. Thus, for many developing countries in particular, EIAs may be considered in themselves a development option. This consideration is of critical importance because, as the process of economic integration through an EIA intensifies, the lock-in effect of the agreement would affect an increasingly wider range of policies and options, thus limiting the policy space available for the adoption (or reconsideration) of appropriate development-oriented strategies (UNCTAD, 2003a; Abugattas, 2004, p. 3). Thus, developing countries negotiating EIAs must consider how best to incorporate a development dimension into the agreements. At a basic level, this raises the question of how an EIA contributes to economic development, a question that may not be answered in the same way for all countries. Some countries may be at a stage of development where they regard rapid and extensive integration into the global economy as an appropriate development strategy and will thus be willing to conclude high-standard agreements that apply equally to all parties. Other countries may be at a stage of economic development where integration must be slower and less extensive. They may wish to conclude agreements that have a narrower scope, fewer or weaker commitments, more exceptions, and transitional periods for implementation, and that apply differently to different parties at different stages of development.

Thus the most important development challenge, especially for the negotiation of future EIAs involving countries at different levels of development, is to strike a balance between the potential for the EIA to increase investment flows and the flexibility of countries to pursue their particular policy objectives in the light of their characteristics and changing circumstances. Economic development is more complex than merely increasing the total quantity of resources or ensuring their most efficient use. No country promotes economic development through a purely liberal investment policy. As part of their development policies, countries need to balance a series of potentially conflicting interests, some of which advocate in favour of excluding or regulating foreign investment and others of which may advocate in favour of promoting or protecting international investment flows.

This implies, among other things, that the EIA needs to allow a sufficient level of policy autonomy to national Governments of member countries to pursue their investment objectives. This autonomy may be best reflected in a number of investment issues on which diverging views exist. These include, notably, the substantive scope of the agreement, whether to afford the right of establishment, the scope of the national treatment provisions, regulation of the use of performance requirements and incentives, and competition policy, because they determine whether, and to what extent, preferences can be given to domestic enterprises. The flexibility instruments alluded to before may be specifically applied to these issues (UNCTAD 2003a, p. 173).

Furthermore, all countries have vital non-economic interests, which may be political, social or cultural, that require priority attention. Investment issues, such as the scope of expropriation actions and the recourse to investor-State dispute resolution, are sensitive because they directly affect the sovereignty of the host country to regulate in the public interest and to adjudicate on national public policy issues. As noted in chapter IV, various solutions to these issues are reflected in existing EIAs (UNCTAD 2003a, p.171).

Indeed, the negotiation of investment provisions in an EIIA often involves difficult policy issues that touch upon a range of social and environmental concerns traditionally thought to belong to the domestic policy domain. As a result, EIAs are becoming one of the most visible manifestations of the growing internationalization of the domestic policy agenda. This implies that EIAs need to reflect in a balanced manner the rights and obligations of foreign investors and states. Failure to address this balance, either within the same instrument or by establishing bridges with other instruments, can have important development implications for host countries.

The key point is that economic development is the goal of every EIIA and development concerns must therefore be addressed in every provision of the agreement, although for different countries those concerns might well be addressed in quite different ways. Thus, the value of a given EIIA must be assessed in the light of all the economic circumstances of each party and that party's own economic development policy.

Third, the growing proliferation of EIAs and other investment agreements is resulting in a multilayered and multifaceted web of interrelated investment rules and commitments, and this is creating increasing difficulties for the interpretation and application of the rules (see the spaghetti bowl figure (figure I.1)). The types of difficulties that arise with the cross-membership of investment agreements of various types and at various levels have been illustrated in the preceding chapter. Other difficulties arising from the complexity and ambiguity of investment rules at all levels are even more difficult to tackle. Some relate, for example, to the lack of comparability in the scheduling of commitments and reservations. Others refer to the lack of consistency in the implementation of rules requiring national policy changes. Yet other inconsistencies may arise from the application of MFN obligations, as MFN clauses differ in their scope and coverage (UNCTAD, 2004a, pp. 237-238).

Several solutions exist to mitigate some of these problems. However, some of the difficulties are likely to persist, and this raises the broader policy issue of whether the elaboration of investment rules could proceed in a more consistent way through the establishment of adequate interpretation mechanisms and institutions.

Clearly, the difficulties of interpretation and implementation created by the interaction of an increasingly complex web of investment rules are particularly problematic for countries suffering from insufficient human resource and institutional capacity to interpret and implement EIAs. Unclear and complex rules are likely to translate into lengthy and costly disputes and, again, the most directly affected are likely to be the poorer countries. It is therefore crucially important that countries engaging in the negotiation of an EIIA bear in mind these potential difficulties and make provision for avoiding them. In particular, the provision of technical cooperation to the less developed parties of an EIIA should be an important way of ensuring the accomplishment of the EIIA's goals.

In the final analysis, the fundamental policy question becomes whether the proliferation of EIAs is likely to result in a large number of countries, especially the poorer countries, facing discrimination and exclusion, or whether EIAs can contribute to the global expansion of investment flows through investment rules that are clear, predictable, consistent and fair. Some existing implementation and interpretation arrangements are already contributing to the latter. But more institutional efforts might still be needed in that direction. In sum, EIAs are not a substitute for the lack of a multilateral system in the area of investment — just as they are not a substitute for the multilateral trading system established by the WTO — but, in the absence of

such a system, policymakers need to ensure that the expansion of EIAs is supported by institutional mechanisms that contribute to the elaboration of a clear, predictable, consistent and fair framework of international investment rules for the benefit of all countries.
