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67. International investment arbitration: Winning, losing and why

Susan Franck

American University Washington College of Law, sfranck@wcl.american.edu

Karl P. Sauvant

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Todd Allee

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Authors

Susan Franck, Karl P. Sauviant, Jennifer Reimer, Todd Allee, Ilan Alon, Alice H. Amsden, Tadahiro Asami, Reuven S. Avi-Yonah, Paul Barbour, Christian Bellak, Axel Berger, Sjoerd Beugelsdijk, Subrata Bhattacharjee, Harry G. Broadman, Elizabeth Broomfield, Gert Bruche, Matthias Busse, John A. Cantwell, Aleh Cherp, Lorenzo Cotula, Nandita Dasgupta, Kenneth Davies, Alexandre de Gramont, Armand Claude de Mestral, Kabir Duggal, Persephone Economou, John Evans, David N. Fagan, Mark Feldman, Hermann Ferré, Daniel M. Firger, Veljko Fotak, Kevin P. Gallagher, Nilgun Gokgur, Kathryn Gordon, Jose Guimon, Thilo Hanemann, Torfinn Harding, Jean-François Hennart, Seev Hirsch, Wing (Xiaoying) Huo, Beata Smarzynska Javorcik, Nathan M. Jensen, Lise Johnson, Thomas Jost, George Kahale III, Kalman Kalotay, Laza Kekic, John M. Kline, Charles Kovacs, Jürgen Kurtz, Jo En Low, Miguel Pérez Ludeña, Edmund J. Malesky, Geraldine McAllister, William L. Megginson, Sophie Meunier, Michael Mortimore, Joel Moser, Michael D. Nolan, Peter Nunnenkamp, Terutomo Ozawa, Clint Peinhardt, Nicolás M. Perrone, Luke Eric Peterson, Mark Plotkin, Joachim Pohl, Lauge N. Skovgaard Poulsen, Carlos Razo, Daniel Rosen, Martin Roy, Giorgio Sacerdoti, Premila Nazareth Satyanand, Manfred Schekulin, Stephan W. Schill, Francisco Colman Sercovich, Arjen HL Slangen, Roger Smeets, Hans Smit, M. Sornarajah, Frederic G. Sourgens, Jonathan Strauss, Kenneth P. Thomas, Margo Thomas, Perrine Toledano, Julien Topal, Anne van Aaken, Gus Van Harten, Daniel Villar, Sandy Walker, Mira Wilkins, Jason W. Yackee, and Chen Zhao

FDI Perspectives: Issues in International Investment, 2nd Edition

Edited by Karl P. Sauvant and Jennifer Reimer (New York: VCC, 2012).

This second edition provides an overview of important contemporary issues relating to foreign direct investment (FDI) and multinational enterprises for all those who are interested in this subject, but are not always in a position to follow diverse perspectives and what is being written in the various corners of this field. The contributions are grouped under the following headings: attracting FDI and its impact; the rise of emerging market investors; national policies; sustainable international investment; and international investment treaties and arbitration. The volume brings together all Perspectives published since the inception of this series.



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on Sustainable International Investment

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the Earth Institute at Columbia University

FDI

PERSPECTIVES

ISSUES IN

INTERNATIONAL

INVESTMENT

2012

Edited By

Karl P. Sauvant Jennifer Reimer



VALE COLUMBIA CENTER
ON SUSTAINABLE INTERNATIONAL INVESTMENT
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND
THE EARTH INSTITUTE AT COLUMBIA UNIVERSITY

FDI PERSPECTIVES

Issues in International Investment

2nd Edition

Edited by
Karl P. Sauvant
Jennifer Reimer

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The Vale Columbia Center on Sustainable International Investment (VCC) is a leading forum on issues related to foreign direct investment (FDI), paying special attention to the impact of such investment on sustainable development. Its objectives are to analyze important topical policy-oriented issues related to FDI, develop and disseminate practical approaches and solutions, and provide students with a challenging learning environment.

The views expressed by the individual authors of the chapters in this ebook do not necessarily reflect the opinions of Columbia University or its partners and supporters. *Columbia FDI Perspectives* is a peer-reviewed series.

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Table of contents

Annotated table of contents

Acknowledgments

List of peer-reviewers

Authors

Foreword by *John Cantwell*

Preface by *Karl P. Sauvant and Jennifer Reimer*

List of abbreviations

PART I ATTRACTING FOREIGN DIRECT INVESTMENT AND ITS IMPACT

1. *Sjoerd Beugelsdijk, Jean-François Hennart, Arjen Slangen, and Roger Smeets*

FDI stocks are a biased measure of foreign affiliate activity

2. *Mira Wilkins*

FDI stocks are a biased measure of MNE affiliate activity: A response

3. *Kálmán Kalotay*

Does it matter who invests in your country?

4. *Karl P. Sauvant*

The FDI recession has begun

5. *Laza Kekic*

The global economic crisis and FDI flows to emerging markets: For the first time ever, emerging markets are this year set to attract more than half of global FDI flows

6. *Paul Antony Barbour, Persephone Economou, Nathan M. Jensen, and Daniel Villar*

The Arab Spring: How soon will foreign investors return?

7. *Ken Davies*

Why and how least developed countries can receive more FDI to meet their development goals

8. *Karl P. Sauvant and Jonathan Strauss*

State-controlled entities control nearly US\$ 2 trillion in foreign assets

9. *Nilgün Gökgür*

Are resurging state-owned enterprises impeding competition overseas?

10. *Veljko Fotak and William Megginson*

Are SWFs welcome now?

11. *Charles Kovacs*

Sovereign wealth funds: Much ado about some money

12. *Torfinn Harding and Beata Javorcik*

Roll out the red carpet and they will come: Investment promotion and FDI inflows

13. *José Guimón*

It's time for an EU Investment Promotion Agency

14. *Kenneth P. Thomas*

Investment incentives and the global competition for capital

15. *Nathan M. Jensen and Edmund J. Malesky*

FDI incentives pay -- politically

16. *Christian Bellak and Markus Leibrecht*

Improving infrastructure or lowering taxes to attract foreign direct investment?

PART II THE RISE OF EMERGING MARKET INVESTORS

17. *Persephone Economou and Karl P. Sauvant*

From the FDI triad to multiple FDI poles?

18. *Premila Nazareth Satyanand*

How BRIC MNEs deal with international political risk

19. *Miguel Pérez Ludeña*

Is Chinese FDI pushing Latin America into natural resources?

20. *Ilan Alon and Aleh Cherp*

Is China's outward investment in oil a global security concern?

21. *Terutomo Ozawa and Christian Bellak*

Will China relocate its labor-intensive factories to Africa, flying-geese style?

22. *Harry G. Broadman*

The backstory of China and India's growing investment and trade with Africa: Separating the wheat from the chaff

23. *Karl P. Sauvant and Ken Davies*

What will an appreciation of China's currency do to inward and outward FDI?

24. *Karl P. Sauvant, Chen Zhao and Xiaoying Huo*

The unbalanced dragon: China's uneven provincial and regional FDI performance

25. *Gert Bruche*

A new geography of innovation: China and India rising

26. *Gert Bruche*

Emerging challengers in knowledge-based industries? The case of Indian pharmaceutical multinationals

27. *Michael Mortimore and Carlos Razo*

Outward investment by Trans-Latin enterprises: Reasons for optimism

PART III NATIONAL POLICIES

28. *Alice H. Amsden*

National companies or foreign affiliates: Whose contribution to growth is greater?

29. *Terutomo Ozawa*

The role of multinationals in sparking industrialization: From "infant industry protection" to "FDI-led industrial take-off"

30. *Francisco Sercovich*

Knowledge, FDI and catching-up strategies

31. *Terutomo Ozawa*

FDI, catch-up growth stages and stage-focused strategies

32. *Thomas Jost*

Much ado about nothing? State-controlled entities and the change in German investment law

33. *Subrata Bhattacharjee*

National security with a Canadian twist: The Investment Canada Act and the new national security review test

34. *Sandy Walker*

A new economic nationalism? Lessons from the PotashCorp decision in Canada

35. *Mark E. Plotkin and David N. Fagan*

The revised national security review process for FDI in the US

36. *Mark E. Plotkin and David N. Fagan*

Foreign direct investment and US national security: CFIUS under the Obama Administration

37. *Thilo Hanemann and Daniel Rosen*

Chinese FDI in the United States is taking off: How to maximize benefits?

38. *Sophie Meunier et al.*

Economic patriotism: Dealing with Chinese direct investment in the United States

39. *Terutomo Ozawa*

Can the US remain an attractive host for FDI in the auto industry? New labor policy and flexible production

40. *Reuven S. Avi-Yonah*

President Obama's international tax proposals could go further

41. *Geraldine McAllister and Joel H. Moser*

Beyond treasuries: A foreign direct investment program for US infrastructure

42. *Nandita Dasgupta*

FDI in retailing and inflation: The case of India

43. *Persephone Economou and Margo Thomas*

Greek FDI in the Balkans: How is it affected by the crisis in Greece?

44. *Seev Hirsch*

Nation states and nationality of MNEs

45. *Karl P. Sauvant*

The times are a-changin' -- again -- in the relationship between governments and multinational enterprises: From control, to liberalization to rebalancing

PART IV SUSTAINABLE INTERNATIONAL INVESTMENT

46. *John M. Kline*

Evaluate sustainable FDI to promote sustainable development

47. *Manfred Schekulin*

Shaping global business conduct: The 2011 update of the OECD Guidelines for Multinational Enterprises

48. *John Evans*

Responsible business conduct: Re-shaping global business

49. *Tadahiro Asami*

Toward the successful implementation of the updated OECD Guidelines for Multinational Enterprises

50. *Perrine Toledano and Julien Topal*

A good business reason to support mandatory transparency in extractive industries

51. *Lorenzo Cotula*

Law at two speeds: Legal frameworks regulating foreign investment in the global South

52. *Lorenzo Cotula*

Land grab or development opportunity? International farmland deals in Africa

53. *Xiaofang Shen*

Untying the land knot: Turning investment challenges into opportunities for all citizens

54. *Daniel M. Firger*

The coming harmonization of climate change policy and international investment law

55. *Nicolás Perrone*

Responsible agricultural investment: Is there a signification role for the law in sustainability?

56. *Lise Johnson*

Absent from the discussion: The other half of investment promotion

57. *Kathryn Gordon and Joachim Pohl*

Environmental concerns in international investment agreements: The “new era” has commenced, but harmonization still appears far off

PART V INTERNATIONAL INVESTMENT TREATIES AND ARBITRATION

58. *Axel Berger, Matthias Busse, Peter Nunnenkamp, and Martin Roy*

Attracting FDI through BITs and RTAs: Does treaty content matter?

59. *Clint Peinhardt and Todd Allee*

Different investment treaties, different effects

60. *Elizabeth Broomfield*

Reconciling IMF rules and international investment agreements: An innovative derogation for capital controls

61. *Lauge Skovgaard Poulsen*

Political risk insurance and bilateral investment treaties: A view from below

62. *Jason Webb Yackee*

How much do US corporations know (and care) about bilateral investment treaties? Some hints from new survey evidence

63. *Kevin P. Gallagher*

US BITs and financial stability

64. *George Kahale, III*

The new Dutch sandwich: The issue of treaty abuse

65. *Luke Eric Peterson*

International investment law and media disputes: A complement to WTO law

66. *Armand de Mestral*

Is a model EU BIT possible -- or even desirable?

67. *Susan D. Franck*

International investment arbitration: Winning, losing and why

68. *Gus Van Harten*

Thinking twice about a gold rush: *Pacific Rim v El Salvador*

69. *Alexandre de Gramont*

Mining for facts: *PacRim Cayman LLC v El Salvador*

70. *Stephan W. Schill*

The public law challenge: Killing or rethinking international investment law?

71. *Hans Smit*

The pernicious institution of the party-appointed arbitrator

72. *Giorgio Sacerdoti*

Is the party-appointed arbitrator a “pernicious institution”? A reply to Professor Hans Smit

73. *M Sornarajah*

Starting anew in international investment law

74. *Gus Van Harten*

The (lack of) women arbitrators in investment treaty arbitration

75. *Michael D. Nolan and Frédéric G. Sourgens*

State-controlled entities as claimants in international investment arbitration: An early assessment

76. *Mark Feldman*

The standing of state-controlled entities under the ICSID Convention: Two key considerations

77. *Jo En Low*

State-controlled entities as “investors” under international investment agreements

78. *Hermann Ferre and Kabir Duggal*

The world economic crisis as a changed circumstance

79. *Anne van Aaken and Jürgen Kurtz*

The global financial crisis: Will state emergency measures trigger international investment disputes?

80. *Kathryn Gordon and Joachim Pohl*

The response to the global crisis and investment protection: Evidence

Annotated table of contents

PART I ATTRACTING FOREIGN DIRECT INVESTMENT AND ITS IMPACT

1. *Sjoerd Beugelsdijk, Jean-François Hennart, Arjen Slangen, and Roger Smeets*

FDI stocks are a biased measure of foreign affiliate activity

Researchers often call the value added (VA) in a host country by firms based in another country “FDI” and use FDI stocks and flows from a country’s balance of payments to measure it. Because FDI stocks and flows only measure the financial flows between parents and their foreign affiliates, excluding locally raised funds, and because they omit the contribution of local labor to affiliate VA, they systematically underestimate that VA in more developed countries and thus are a biased measure of multinational activity.

2. *Mira Wilkins*

FDI stocks are a biased measure of MNE affiliate activity: A response

The term “FDI” is often used loosely. This chapter explains the historical genesis of that loose use and the relationship between FDI and MNEs. FDI stock is one of many measures of MNE activities, but has advantage over the others, since we have long, albeit imperfect, series on FDI stock. Handled with care, along with a keen recognition of the data limitations, FDI continues to serve as one excellent indicator of MNE activities.

3. *Kálmán Kalotay*

Does it matter who invests in your country?

“Indirect” FDI -- investment in which immediate investors differ from ultimate owners -- plays an increasingly important role in corporate strategies and financial management. This chapter analyses its different forms, explores its implications for development, and suggests ways to minimize the potential negative impact of such investment.

4. *Karl P. Sauviant*

The FDI recession has begun

This chapter examines the various factors that shape the impact of the financial crisis and recession of world FDI flows and discusses some policy implications.

5. *Laza Kekic*

The global economic crisis and FDI flows to emerging markets: For the first time ever, emerging markets are this year set to attract more than half of global FDI flows

For the first time ever, emerging markets are set to attract more FDI inflows than developed countries in 2009. This chapter examines this prospect, based on an analysis of the severe downturn of investment flows worldwide.

6. *Paul Antony Barbour, Persephone Economou, Nathan M. Jensen, and Daniel Villar*

The Arab Spring: How soon will foreign investors return?

The Arab Spring dramatically increased investors' perceptions of political risk in MENA. An examination of these perceptions indicates long-run optimism that political transitions in the region -- if democratic and coupled with political stability -- could increase FDI and contribute to MENA's economic development.

7. *Ken Davies*

Why and how least developed countries can receive more FDI to meet their development goals

The 48 least-developed countries (LDCs), most of them in sub-Saharan Africa and a few in Asia, need FDI to help meet their development targets. The FDI they now receive, although inadequate, is enough to demonstrate that investors see potential in them. It is therefore realistic for LDCs to seek more FDI, but they need to enhance their investment environments to attract it in the much greater quantities required. Donors can help by targeting official development assistance on investment in human capital and supporting governance improvements. Meanwhile, LDCs should establish effective investment promotion agencies.

8. *Karl P. Sauvant and Jonathan Strauss*

State-controlled entities control nearly US\$ 2 trillion in foreign assets

State-controlled entities (SCEs) -- especially state-owned entities (SOEs) -- are important players in the world FDI market. Among the 100 largest MNEs from developed countries and the 100 largest from emerging markets, at least 49 are SOEs. They control nearly US\$ 2 trillion in foreign assets, the bulk of them by MNEs headquartered in developed countries. Care needs to be exercised that regulatory initiatives regarding SCEs do not lead to a fragmentation of the international investment law regime.

9. *Nilgün Gökçür*

Are resurging state-owned enterprises impeding competition overseas?

There are no up-to-date systematic data on the size, composition, ownership structure, and economic weight of SOEs, so we are unable to assess the impact of SOE performance on stakeholders in domestic and overseas markets. Yet there is

sufficient evidence of their expansion, especially following the 2008 financial crisis. Emerging markets, led by China, are now increasingly encouraging their SOEs to expand globally as MNEs.

10. *Veljko Fotak and William Megginson*

Are SWFs welcome now?

This chapter documents the change in attitudes of Western governments to FDI from sovereign wealth funds (SWFs). The authors propose an analysis of SWF investments and their impact on target firms in order for recipient governments to formulate the proper regulatory response to sovereign direct investment.

11. *Charles Kovacs*

Sovereign wealth funds: Much ado about some money

This chapter makes the point that SWFs constitute only one of the pools of anonymous capital, and for that matter, not even one of the most important ones. However, the author recognizes that issues of national security are involved and require attention.

12. *Torfinn Harding and Beata Javorcik*

Roll out the red carpet and they will come: Investment promotion and FDI inflows

Foreign direct investment flows to developing countries are hindered by many factors. Two of these factors -- the mere lack of information and red tape -- could be easily remedied through investment promotion efforts.

13. *José Guimón*

It's time for an EU Investment Promotion Agency

The author proposes an EU investment promotion agency (IPA) that coordinates FDI promotion and support for foreign investors at a regional level.

14. *Kenneth P. Thomas*

Investment incentives and the global competition for capital

Investment incentives (subsidies designed to affect the location of investment) are a pervasive feature of global competition for FDI. This chapter analyzes what is known about the extent and cost of incentives used as well as the potential efficiency, equity and environmental consequences of using incentives. Finally, it analyzes methods of controlling incentives, the most successful of which is embodied in European Union regional aid policy.

15. *Nathan M. Jensen and Edmund J. Malesky*
FDI incentives pay -- politically

There are strong political benefits to attracting FDI at the state-level in the United States. The fiscal incentives for attracting such investment, regardless of their effectiveness, may be a strategic political tool for state politicians.

16. *Christian Bellak and Markus Leibrecht*
Improving infrastructure or lowering taxes to attract foreign direct investment?

This chapter compares the impact of improving infrastructure versus lowering taxes on attracting and keeping FDI and discusses the policy implications for countries seeking to attract FDI, especially countries currently debating the relative merits of cutting taxes versus increased spending.

PART II THE RISE OF EMERGING MARKET INVESTORS

17. *Persephone Economou and Karl P. Sauvant*
From the FDI triad to multiple FDI poles?

Twenty years ago, in the inaugural issue of the *World Investment Report*, the United Nations highlighted a shift in the global pattern of FDI from bipolar, dominated by the United States and the European Community, to tri-polar (the FDI Triad), dominated by the European Community, the United States and Japan.

18. *Premila Nazareth Satyanand*
How BRIC MNEs deal with international political risk

The author analyzes the results of a survey of political risk concerns of outward-investing BRIC firms and compares the results to the concerns of global counterparts.

19. *Miguel Pérez Ludeña*
Is Chinese FDI pushing Latin America into natural resources?

Chinese FDI into Latin America reached US\$ 15 billion in 2010, 90% of which was in the extractive industries. An analysis of the figures shows that it is mainly through trade, rather than through FDI that China is influencing South America's productive structure. Moreover, there is potential for Chinese FDI to diversify into other sectors, especially in infrastructure construction and manufacturing for the Brazilian market.

20. *Ilan Alon and Aleh Cherp*

Is China's outward investment in oil a global security concern?

The dramatic increase in investment by Chinese SOEs in overseas oil assets is primarily driven by energy security concerns. Whether such investment will benefit or harm energy security of other countries is hotly contested. On one hand, this investment can supplement the overall lack of investment in the sector, benefiting all consumers. On the other hand, it may exacerbate environmental and political problems associated with fossil fuels.

21. *Terutomo Ozawa and Christian Bellak*

Will China relocate its labor-intensive factories to Africa, flying-geese style?

The authors explore the China-side determinants of China's industrial relocation to sub-Saharan Africa, highlighting several hurdles to substantial translocation that would jump start local economic development.

22. *Harry G. Broadman*

The backstory of China's and India's growing investment and trade with Africa: Separating the wheat from the chaff

Common misconceptions about China's and India's increasing FDI in Africa have arisen because of a lack of systematic evidence-based analysis. Empirically-derived data, including on comparator countries, need to be rigorously analyzed within an objective and coherent framework so that policy conclusions can be drawn, which will benefit the many stakeholders involved.

23. *Karl P. Sauvant and Ken Davies*

What will an appreciation of China's currency do to inward and outward FDI?

A revaluation of the Chinese yuan would affect the country's inward and outward FDI, not just its exports and imports. The impact on FDI inflows to China would be both positive and negative. On the other hand, revaluation is likely to provide a strong boost to overseas investments by China's multinationals, which have been rising rapidly in recent years. Suspicions that China's outward FDI is politically motivated are not so far borne out by systematic evidence. The rest of the world should learn how to benefit from this investment, not try to raise protectionist barriers against it.

24. *Karl P. Sauvant, Chen Zhao and Xiaoying Huo*

The unbalanced dragon: China's uneven provincial and regional FDI performance

This chapter ranks all Chinese provinces in terms of their performance in attracting FDI, examines the reasons for the high unevenness of this performance and makes some policy suggestions on how to deal with it.

25. *Gert Bruche*

A new geography of innovation: China and India rising

This chapter explains the factors behind the sudden shift toward China and India for MNE R&D centers and explores how the financial crisis will affect China's and India's ability to continue to capture the R&D market.

26. *Gert Bruche*

Emerging challengers in knowledge-based industries? The case of Indian pharmaceutical multinationals

The growth of outward FDI from developing countries and of a new generation of emerging multinational enterprises has stimulated a flurry of publications. Emerging MNEs have been portrayed as on their way to adulthood, latecomers that leapfrog into advanced positions, emerging giants, and challengers of conventional MNEs from advanced economies.

27. *Michael Mortimore and Carlos Razo*

Outward investment by Trans-Latin enterprises: Reasons for optimism

Despite the global crisis, outward FDI by Latin American firms grew by more than 40% in 2008. The picture for 2009 is less clear, due to the expected regional GDP contraction, falling commodity prices, and tightening credit markets. Nonetheless, many countervailing factors make Latin American investment more resilient in the crisis than other regions may be.

PART III NATIONAL POLICIES

28. *Alice H. Amsden*

National companies or foreign affiliates: Whose contribution to growth is greater?

National firms fulfill functions that foreign affiliates are less likely to undertake. For this reason, there is a growth/efficiency justification for government programs designed to support and promote national companies (public and private) as opposed to, and in competition with, opening the doors to MNEs.

29. *Terutomo Ozawa*

The role of multinationals in sparking industrialization: From "infant industry protection" to "FDI-led industrial take-off"

Economic development has recently been time-compressed due to an ever-accelerating cross-border dissemination of industrial knowledge, especially at the hands of MNEs. And a new "open-door" strategy of industrial catch-up has come to be adopted, as best exemplified by China's FDI-led take-off, a strategy that is designed to capitalize on the profit-seeking activities of multinationals. This new approach needs to be conceptualized as such, replacing the time-honored

conventional “closed-economy” doctrine of infant-industry protection (or import substitution).

30. *Francisco Sercovich*

Knowledge, FDI and catching-up strategies

There are policies that drive catching-up industrialization other than, but related to, those focused on FDI inflows. The shortening of catching-up periods owes much to the increasing effectiveness of policies addressing education and training, entrepreneurship development and domestic innovation and technology diffusion. FDI inflows work best when those policies are in place. Domestic absorption and innovative capability development policies are also essential.

31. *Terutomo Ozawa*

FDI, catch-up growth stages and stage-focused strategies

For the initial stage of catch-up growth, the “FDI-led takeoff” is an expedient alternative to the traditional infant-industry protection approach. Higher stages call for more nuanced, national-interests-dictated strategies to enhance domestic knowledge capability. A stages perspective cannot be overemphasized.

32. *Thomas Jost*

Much ado about nothing? State-controlled entities and the change in German investment law

Despite a tightening of German foreign investment law in 2009 in reaction to the growing importance of SCEs and national security concerns, Germany has remained open for FDI. So far German authorities have handled the new law carefully. But, was the change necessary?

33. *Subrata Bhattacharjee*

National security with a Canadian twist: The Investment Canada Act and the new national security review test

This chapter discusses issues raised by the new national security test for proposed investments in Canada, including the ambiguity of the “national security” term and the possibility of politicized national security reviews. The government should be careful not to adopt an over-expansive approach to the application of the new test.

34. *Sandy Walker*

A new economic nationalism? Lessons from the PotashCorp decision in Canada

Foreign investors must be alert to the possibility that political sensitivities may impact foreign investment review processes, hence jeopardizing a small number of deals involving perceived national champions. One example, which underlines

that politics can occasionally hijack the review of foreign investments, is the Canadian Government's rejection of BHP Billiton's takeover of Potash Corporation.

35. *Mark E. Plotkin and David N. Fagan*

The revised national security review process for FDI in the US

This chapter explains the new regulations governing the US government's national security review process for foreign mergers and acquisitions of US businesses, which became effective December 22, 2008.

36. *Mark E. Plotkin and David N. Fagan*

Foreign direct investment and US national security: CFIUS under the Obama Administration

The Committee on Foreign Investment in the United States review process slowed during the inaugural year of the Obama Administration. The authors examine the origins of this shift and suggest actions that parties can take to facilitate the process.

37. *Thilo Hanemann and Daniel Rosen*

Chinese FDI in the United States is taking off: How to maximize benefits?

China's outward FDI grew rapidly in the past decade, but flows to developed economies have been limited. Now China's direct investment flows to the United States are poised to rise substantially. This new trend offers tremendous opportunities for the United States, provided policymakers take steps to keep the investment environment open and utilize China's new interest productively.

38. *Sophie Meunier et al.*

Economic patriotism: Dealing with Chinese direction investment in the United States

As Chinese FDI in the United States increases, a few investments are likely to attract negative attention. However, even though hosting Chinese FDI in the United States is not free from risk, the benefits outweigh the costs. As such, the United States should implement policy recommendations to welcome Chinese FDI, while dealing with its potential risks to limit a possible political backlash.

39. *Terutomo Ozawa*

Can the US remain an attractive host for FDI in the auto industry? New labor policy and flexible production

The proposed Employee Free Choice Act, if enacted, would decrease the attractiveness of the United States for FDI in the auto industry.

40. *Reuven S. Avi-Yonah*

President Obama's international tax proposals could go further

The Obama Administration's 2011 international tax proposals represent a very cautious first step toward making US multinationals pay their fair share of the tax burden. Coordination with our FDI partners would allow the Administration to go even further.

41. *Geraldine McAllister and Joel H. Moser*

Beyond treasuries: A foreign direct investment program for US infrastructure

In his jobs address to a joint session of Congress, President Obama returned to a familiar theme: a call for nontraditional infrastructure investment as a generator of economic growth and, ultimately, jobs. There is no assurance that domestic private capital investment alone is sufficient to reverse the degradation of the nation's infrastructure and as host to the largest flows of inward FDI, it is time that the United States employs this critical source of capital in tackling the nation's infrastructure deficit.

42. *Nandita Dasgupta*

FDI in retailing and inflation: The case of India

India's food price inflation is a major driving factor behind the country's overall accelerating inflation. As demonstrated by experiences of other countries, the recent move of the Indian Government to allow FDI in multi-brand retailing is a step in the right direction, transforming the way perishable agricultural produce is acquired, stored, preserved, and marketed -- and thus helping to control India's persistent food inflation.

43. *Persephone Economou and Margo Thomas*

Greek FDI in the Balkans: How is it affected by the crisis in Greece?

Greece accounts for only 6% of the Balkan countries' combined inward FDI stock, but Greek banking presence in the Balkans is significant. The sovereign debt crisis and recession in Greece are having a negative effect on Greek FDI into the Balkans, but it is the reduced lending by Greek bank foreign affiliates or their possible withdrawal that will have a bigger impact on the local economies.

44. *Seev Hirsch*

Nation states and nationality of MNEs

Do nation states have an economic interest in becoming home countries to MNEs? This chapter's tentative answer to the questions is "yes." Other things being equal, extension of global reach, achieved through outgoing FDI by home country enterprises, is likely to more than make up for the tax losses and diminution of sovereignty these countries may experience.

45. *Karl P. Sauvant*

The times are a-changin' -- again -- in the relationship between governments and multinational enterprises: From control, to liberalization to rebalancing

After a long period during which governments made the national and international frameworks for foreign investors more welcoming, a number of indicators suggest that a rebalancing is taking place toward an approach that is more protective of sovereigns, allowing governments more policy space to regulate FDI in the public interest.

PART IV SUSTAINABLE INTERNATIONAL INVESTMENT

46. *John M. Kline*

Evaluate sustainable FDI to promote sustainable development

Prescriptions to increase the role of FDI in promoting sustainable development generally focus on the macro level -- getting policies right and otherwise improving the investment climate. These steps are necessary but not sufficient. Effective implementation processes, especially at the micro project level, are also essential to encourage FDI that matches host country development needs and priorities.

47. *Manfred Schekulin*

Shaping global business conduct: The 2011 update of the OECD Guidelines for Multinational Enterprises

On May 25, 2011, US Secretary of State Hillary Clinton joined ministers from members of the OECD and developing economies to celebrate the Organisation's 50th anniversary and agree on an update of the OECD Guidelines for Multinational Enterprises, the fifth revision since their adoption in 1976. This marked the culmination of an intense one-year negotiating process involving a large number of stakeholders, international organizations and emerging economies.

48. *John Evans*

Responsible business conduct: Re-shaping global business

The OECD's Guidelines for Multinational Enterprises were updated in 2011. Trade unions are calling on the OECD and the 42 adhering governments to ensure that the new Guidelines help close the global governance gaps that leave millions of workers around the world facing hardship and insecurity and denied access to their fundamental rights.

49. *Tadahiro Asami*

Toward the successful implementation of the updated OECD Guidelines for Multinational Enterprises

The OECD's Guidelines for Multinational Enterprises have several potential impacts, including impacts on MNEs' interactions with their supply chains. Further, to be successful, it is important that the Guidelines are incorporated into MNEs' codes of conduct. It is also essential for emerging markets to adhere to the Guidelines.

50. *Perrine Toledano and Julien Topal*

A good business reason to support mandatory transparency in extractive industries

The Cardin-Lugar Transparency Amendment is a promising step toward ending the resource curse by improving accountability and access to information for both citizens and investors. The Amendment has run into heavy corporate opposition, and its implementation has been much delayed. However, there is a business case for mandatory transparency requirements.

51. *Lorenzo Cotula*

Law at two speeds: Legal frameworks regulating foreign investment in the global South

The global legal system regulating foreign investment in lower-income countries is more geared towards enabling secure transnational investment flows than it is towards ensuring that these flows benefit people in recipient countries. There is a need to improve national and international law safeguards for rights that may be affected by investment flows, and to strengthen local capacity to exercise those rights and get a better deal from incoming investment.

52. *Lorenzo Cotula*

Land grab or development opportunity? International farmland deals in Africa

This chapter discusses the increasing number and size of large-scale farmland acquisitions in Africa by foreign investors over the past five years, including the opportunities and risks created by this trend.

53. *Xiaofang Shen*

Untying the land knot: Turning investment challenges into opportunities for all citizens

Land-use conflicts also occur frequently outside the agricultural sector. In dealing with these conflicts, systematic change is necessary to lead to a fair, efficient and transparent system that both encourages investment and safeguards public interests. Diverse examples demonstrate that, although such change is difficult, it is possible and desirable.

54. *Daniel M. Firger*

The coming harmonization of climate change policy and international investment law

The author examines recent trends in international climate finance and foreign direct investment to identify connections -- and potential areas of harmonization -- between the two regimes. On the one hand, international climate policy is emphasizing the growing role of private sector investment in clean energy and sustainable development. On the other hand, international investment law is changing to take account of social and environmental goals, including climate mitigation.

55. *Nicolás Perrone*

Responsible agricultural investment: Is there a signification role for the law in sustainability?

Today, the world food situation remains delicate. International investment and MNE involvement could be part of the solution to this problem. However, there are many concerns regarding the effects of these activities in host countries. An adequate interpretation of the Principles for Responsible Agricultural Investment could serve to promote sustainable foreign investment in agriculture.

56. *Lise Johnson*

Absent from the discussion: The other half of investment promotion

Investment treaties can be tools for promoting the quantity and quality of foreign investment that furthers sustainable development. But to do so, they should move beyond their current focus on simply regulating the conduct of host states, and include appropriate home-country commitments to facilitate and encourage outward investment.

57. *Kathryn Gordon and Joachim Pohl*

Environmental concerns in international investment agreements: The “new era” has commenced, but harmonization still appears far off

The authors present findings of a large-sample survey of references to environmental concerns in international investment agreements carried out by the OECD.

PART V INTERNATIONAL INVESTMENT TREATIES AND ARBITRATION

58. *Axel Berger, Matthias Busse, Peter Nunnenkamp, and Martin Roy*

Attracting FDI through BITs and RTAs: Does treaty content matter?

The authors analyze empirically whether the impact of bilateral investment treaties (BITs) and regional trade agreements (RTAs) on bilateral FDI flows depends on the inclusion of two legal innovations: investor-state dispute

settlement (ISDS) and pre-establishment national treatment (NT) provisions. Indeed, they find strong evidence that liberal NT provisions promote FDI. ISDS mechanisms appear to play a minor role. Surprisingly, the impact of similar investment provisions on FDI depends on whether these provisions are contained in RTAs or BITs.

59. *Clint Peinhardt and Todd Allee*

Different investment treaties, different effects

Until recently, quantitative assessments of IIAs have tended to treat them as interchangeable. Such assessments assume that the only measure of investor protections encoded in IIAs is whether a treaty had been signed and/or entered into force. However, the actual investment effects of investment treaties depend greatly on context.

60. *Elizabeth Broomfield*

Reconciling IMF rules and international investment agreements: An innovative derogation for capital controls

In the absence of an international framework governing capital controls, a conflict has developed due to the different approaches toward such controls taken by various international organizations and IIAs. IIAs should incorporate derogations for countries when treaty obligations conflict with IMF recommendations to impose controls in response to severe economic hardship.

61. *Lauge Skovgaard Poulsen*

Political risk insurance and bilateral investment treaties: a view from below

While BITs are basically aimed at reducing the risk of investing abroad, many agencies that price the risk of foreign investments rarely take them into account, as evidenced by a survey of political risk insurance providers.

62. *Jason Webb Yackee*

How much do US corporations know (and care) about bilateral investment treaties? Some hints from new survey evidence

New evidence shows that top US corporations are surprisingly unfamiliar with -- and/or lack confidence in -- BITs that are designed to benefit their investments in other countries. To understand whether or not such treaties “work,” it is necessary to find out how and why they do, or do not, form part of firms' investment decision-making.

63. *Kevin P. Gallagher*
US BITs and financial stability

The author, a member of the State Department subcommittee tasked with reviewing the US Model BIT, addresses the potential impact of BIT provisions on the ability of governments to prevent and mitigate financial crises and makes specific recommendations for the revised Model BIT.

64. *George Kahale, III*
The new Dutch sandwich: The issue of treaty abuse

Years ago, international tax lawyers introduced us to the term “Dutch sandwich.” A different type of Dutch sandwich has emerged over the past fifteen years, this time not related to taxes. Companies from all over the world having little if anything to do with The Netherlands seek to acquire Dutch nationality to take advantage of the protections offered by Dutch BITs. However, this type of nationality planning is giving BITs a bad name.

65. *Luke Eric Peterson*
International investment law and media disputes: A complement to WTO law

International investment law is a potentially powerful legal tool to protect freedom of expression, at least for foreign-owned media companies.

66. *Armand de Mestral*
Is a model EU BIT possible -- or even desirable?

The author explores whether the EU is in a position to adopt a model BIT articulating a common policy on FDI.

67. *Susan D. Franck*
International investment arbitration: winning, losing and why

This chapter reviews recent empirical research about investment treaty arbitration in order to help create a more accurate framework for policy choices and dispute-resolution strategies.

68. *Gus Van Harten*
Thinking twice about a gold rush: *Pacific Rim v El Salvador*

Drawing on the case brought against El Salvador by Pacific Rim, the author examines the tension in international investment law between encouraging stability and allowing adaptation to new circumstances and raises a number of resulting concerns about the international arbitration process.

69. *Alexandre de Gramont*

Mining for facts: *PacRim Cayman LLC v. El Salvador*

The author by briefly presents Pacific Rim's case in *Pacific Rim v. El Salvador* and defends the international arbitration process by which this case is being adjudicated as fair, neutral and objective for both parties.

70. *Stephan W. Schill*

The public law challenge: Killing or rethinking international investment law?

The current legitimacy crisis of international investment law results primarily from the friction investor-state arbitration creates with domestic public law values. As a response, arbitrators should enculturate public law thinking. They should draw on comparative public law when applying investment treaties and reconsider their role as public law adjudicators with concomitant responsibilities for the entire system of international investment protection.

71. *Hans Smit*

The pernicious institution of the party-appointed arbitrator

Party-appointed arbitrators should be banned unless their role as advocates for the party that appointed them is fully disclosed and accepted. Until this is done, arbitration can never meet its aspiration of providing dispassionate adjudication by those with special skills and experience in a process designed to combine efficiency with expertise.

72. *Giorgio Sacerdoti*

Is the party-appointed arbitrator a "pernicious institution"? A reply to Professor Hans Smit

The appointment of arbitrators by parties is an essential valuable feature of arbitration. Prof. Smit's concerns regarding party-appointed arbitrators can be met by the application of conflict-of-interest rules, obligations to disclose and oversight by arbitral institutions.

73. *M Sornarajah*

Starting anew in international investment law

There is a crisis in international investment law brought about by rapid changes in the economic order resulting in movements of capital from erstwhile developing countries like China and India into developed ones. This is accentuated by the stances taken in investment treaty arbitration that restrict regulatory control. The reaction has been to bring about so called "balanced treaties" that neither secure investment protection nor bring about clear rules on regulatory control. There is a need for a new beginning.

74. *Gus Van Harten*

The (lack of) women arbitrators in investment treaty arbitration

Investment treaty arbitration appears to be a boy's club. Just 4% of individuals appointed as arbitrators in known cases to May 2010 were women. This casts doubt on the system's ad hoc and partly-privatized appointments process. A roster-based model would enable a more deliberative and merit-based process of appointments and ensure public accountability and independence in the system.

75. *Michael D. Nolan and Frédéric G. Sourgens*

State-controlled entities as claimants in international investment arbitration: An early assessment

State-controlled entities, including SOEs and SWFs, are increasingly important participants in international investment flows and international trade. As claimants in contractual arbitrations, they may face some unique issues, since it is not always clear whether such disputes may be considered "commercial." Until the status of such claims has been resolved, each case has to be examined on its merits.

76. *Mark Feldman*

The standing of state-controlled entities under the ICSID Convention: Two key considerations

ICSID tribunals likely will need to address with greater frequency the fundamental issue of whether disputes arising from SCE investments fall within the scope of the ICSID Convention. To help preserve clear ICSID Convention boundaries -- which exclude public foreign investment disputes between states -- ICSID tribunals should consider not only the nature, but also the purpose, of SCE investments.

77. *Jo En Low*

State-controlled entities as "investors" under international investment agreements

A review of the definition of "investor" and investor-state dispute resolution clauses in 851 IIAs reveals that, except in two cases, SCEs (including SWFs and SOEs) have equivalent standing to their purely private counterparts as "investors" under such IIAs. This article highlights the various ways in which SCEs are covered under the definition of "investor."

78. *Hermann Ferre and Kabir Duggal*

The world economic crisis as a changed circumstance

There is little evidence that the investment treaty regime anticipated the possibility of a worldwide economic crisis like that of 2008-2010. While claims against states responding to the crisis have yet to materialize, most investment

treaties are silent with respect to a limitations period. Such claims may appear long after the crisis. States have, however, another defense: changed circumstances.

79. *Anne van Aaken and Jürgen Kurtz*

The global financial crisis: Will state emergency measures trigger international investment disputes?

It is possible that emergency measures countries are taking to mitigate the effects of the global financial crisis will give rise to liability under international investment law.

80. *Kathryn Gordon and Joachim Pohl*

The response to the global crisis and investment protection: Evidence

The authors, presenting findings of the OECD, challenge the claim that investment policy measures taken during the crisis were driven by a protectionist agenda but caution that crisis response and exit policies pose a potential threat to investment openness.

Acknowledgments

Foreign direct investment by multinational enterprises continues to be a key mechanism integrating the production systems of individual countries. Not surprisingly, this process - which, in many ways, represents the productive core of the world economy and is more intrusive than trade -- gives rise to a range of issues. The purpose of the *Columbia FDI Perspectives* is to address these issues in a concise, easily understandable and policy-oriented manner. The *Perspectives* are distributed widely.

In January 2011, the *Perspectives* issued until then were brought together in the first edition of *FDI Perspectives: Issues in International Investment*, edited by Karl P. Sauvant, Lisa Sachs, Ken Davies, and Ruben Zandvliet, published by the Vale Columbia Center on Sustainable International Investment. Since then, nearly 50 *Perspectives* have been issued, covering a wide range of topics; they are all brought together (in addition to those contained in the first edition) in the present volume.

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We hope that our readers will find this publication of interest!

New York and Dubai, November 2012

Karl P. Sauvant, Editor-in-Chief
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List of peer-reviewers

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Stephen R. Yeaple
Stephen Young
David Zaring
Zbigniew Zimny

Authors



Todd Allee is Assistant Professor of Government and Politics at the University of Maryland. He received his PhD in Political Science from the University of Michigan as well as an MSc in Government from the London School of Economics and a BA with Honors in Political Science from the University of Missouri. His research focuses on international organizations, FDI, dispute settlement, international trade, the WTO, and territorial conflict resolution. His work has been published in journals such as the *American Political Science Review*, *International Organization*, *The World Economy*, *International Studies Quarterly*, and *Journal of Conflict Resolution*. He can be contacted at tallee@umd.edu.



Ilan Alon is Cornell Chair of International Business and Director of the China and India Centers & Asian Studies at Rollins College, as well as Visiting Scholar Asia Fellow at Harvard University. He is also editor-in-chief of the *International Journal of Emerging Markets*. He has published 27 books and over 100 peer-reviewed articles, including articles appearing in *Harvard Business Review*, *Management International Review*, *Journal of International Marketing*, *Cato Journal*, and *Asian Survey*. His recent books on China include: *Chinese International Investments* (Palgrave, 2012), *China Rules: Globalization and Political Transformation* (Palgrave, 2009) and *The Globalization of Chinese Enterprises* (Palgrave, 2008). He can be contacted at IALON@rollins.edu.



Alice H. Amsden was Barton L. Weller Professor of Political Economy at MIT, Department of Urban Studies and Planning. Her work focused on the process of industrialization in emerging markets, particularly in Asia. She frequently emphasized the importance of the state as a creator of economic growth and challenged the idea that globalization had produced generally uniform conditions in which emerging markets could find a one-size-fits-all path to prosperity.



Tadahiro Asami was named the Business and Industry Advisory Committee to the OECD's (BIAC's) Secretary General in January 2007. He is responsible for the operational leadership and management of BIAC. This includes the representation at the OECD of the business communities of 34 member countries with regard to the full spectrum of public policy issues addressed by OECD governments and advanced by the private sector. Before coming to BIAC, Mr. Asami was immersed in international finance for more than 40 years, beginning his career with the Bank of Tokyo. With extensive experience in the fields of capital markets, project finance and corporate and emerging market finance, he dealt with

financial crises including Latin America in the 1980s and Asia in the late 1990s. He has also served at the World Bank and the Asian Development Bank. He can be contacted at asami@biac.org.



Reuven S. Avi-Yonah is Irwin I. Cohn Professor of Law and Director of the International Tax LLM Program at the University of Michigan Law School. He teaches the basic course on taxation and courses on international taxation, corporate taxation, tax treaties, and transnational law. He has published numerous articles on domestic and international tax issues and is the author of *International Tax as International Law: U.S. Tax Law and the International Tax Regime* (Cambridge University Press, 2007) and *U.S. International Taxation: Cases and Materials* (Foundation Press, 2nd ed. 2005, with Brauner & Ring), and co-editor of

Comparative Fiscal Federalism: Comparing the U.S. Supreme Court and European Court of Justice Tax Jurisprudence (Kluwer, 2007). He can be contacted at aviyonah@umich.edu.



Paul Barbour is a Senior Risk Management Officer, in the Economics and Policy Group of MIGA, the political risk insurance arm of the World Bank Group. He worked previously for the International Finance Corporation (the private sector investment arm of the World Bank Group), as an economist and strategist. Prior to this, he was a senior economic advisor in the UK's Department for International Development, advising on a number of projects across Africa. In his early career, Mr. Barbour served as an economic adviser for the Government of Fiji. He has a master's degree in Economics from Oxford University and an MBA from the Yale School of Management. He is also a Chartered Financial Analyst. He can be contacted at pbarbour@wolrdbank.org.



was a visiting lecturer
bellak@wu.ac.at.

Christian Bellak is Associate Professor of Economics at the Department of Economics, University of Economics and Business, Vienna (Austria). His research interests include international factor flows (determinants and effects of FDI, migration) and economic policy. He has published several book chapters and is the author of several articles published in international scientific journals, e.g. *Oxford Bulletin of Economics and Statistics*, *Applied Economics*, *International Journal of the Economics of Business*, *Transnational Corporations*, *Economic Dynamics and Structural Change*, *The World Economy*, and *Public Finance Analysis*. He is a consultant to UNCTAD and other international bodies and at several universities abroad. He can be contacted at



Axel Berger is Researcher at the German Development Institute/Deutsches Institut für Entwicklungspolitik (DIE), one of the leading development policy think tanks worldwide. He joined the Institute in 2007 and is currently working in the Department for World Economy and Development Financing. Mr. Berger holds a master's degree from the Munich Ludwig-Maximilians-University in Political Science, Economics and Modern History. His areas of expertise include the implications of FDI from emerging markets, China's international investment agreements, the effects of international investment agreements on developing countries, and low carbon development. He can be contacted at axel.berger@die-gdi.de.



sciences of the Netherlands Organisation for Scientific Research (NWO). He can be contacted at S.Beugelsdijk@rug.nl.

Sjoerd Beugelsdijk is Full Professor in International Business at the University of Groningen, The Netherlands. His research interests are in the field of culture (as in norms, values and beliefs) and economics, globalization and the internationalizing firm. He has published in a wide range of academic journals and recently published (together with Robbert Maseland) a monograph titled *Culture in Economics: History, Methodological Reflections and Contemporary Applications* (Cambridge University Press). Mr. Beugelsdijk has held visiting positions at, inter alia, Copenhagen Business School, Vienna University of Economics and Business and Bocconi University. He has written numerous prize winning articles and is one of the few scholars in social sciences who received both the prestigious VENI and VIDI grants in social



Subrata Bhattacharjee is Co-Chair of Heenan Blaikie's National Trade & Competition Group and Partner in the Toronto office of the firm. He carries on an extensive foreign investment practice, and advises non-Canadian investors on Canadian foreign investment issues under the Investment Canada Act and other federal legislation. In this regard, he has advised foreign buyers, including state-owned enterprises, on some of the most high profile foreign takeovers in recent years, including Phelps Dodge/Inco/Falconbridge, Abu Dhabi National Energy Company/PrimeWest and Philip Morris/Rothmans. Mr. Bhattacharjee has repeatedly been recognized as one of Canada's leading lawyers in his areas of expertise in the most recent *Chambers Global: The World's Leading Lawyers for Business* and other major peer-rated surveys. He can be contacted at sbhattach@heenan.ca.



Harry G. Broadman is PwC's Emerging Markets Leader and PwC's Chief Economist. Prior to coming to PwC, he was Managing Director of The Albright Group and Chief Economist of Albright Capital Management. Earlier he was a senior official at the World Bank, Assistant US Trade Representative, Chief of Staff on the President's Council of Economic Advisers, Chief Economist of the Senate Committee on Governmental Affairs, Consultant at the Rand Corporation, a Fellow at the Brookings Institution, and on the faculties of Harvard and Johns Hopkins Universities. He is a Member of the Council on Foreign Relations and of the Board of the Corporate Council on Africa. He graduated magna cum laude from Brown University, where he was elected to *Phi Beta Kappa*, and obtained his PhD in Economics at the University of Michigan. He can be contacted at harry.g.broadman@us.pwc.com.



Elizabeth Broomfield is Associate at Cleary Gottlieb Steen & Hamilton in New York, where she focuses on financial regulatory reform and sovereign debt. She graduated from Yale University in 2008, where she double majored in Electrical Engineering and EP&E (Ethics, Politics, and Economics). She completed a JD degree in 2011 from Columbia Law School, where she was designated a James Kent Scholar. She simultaneously completed an LLM in International Business Law with Distinction from the London School of Economics as part of Columbia Law School's JD/LLM program. While in law school, she worked at the Securities & Exchange Commission and was a part-time law clerk in the Cleary Gottlieb London office. Elizabeth Broomfield is published in the *Columbia Business Law Review*

in 2010 with a note titled “Subduing the vultures: Assessing government caps on recovery in sovereign debt litigation.” She can be contacted at ebroomfield@cgh.com.



Gert Bruche is Professor of International Management at the Berlin School of Economics and Law (BSEL) and Managing Partner of BGM Associates, a strategy consulting firm. After his studies (Dipl. Ing., Technische Universität Berlin, Dr. rer. pol., Freie Universität Berlin) he worked for the UN in Turkey, with the International Institute of Management in Berlin (WZB) and in senior management positions with Schering AG in Germany and China. He served as BSEL's Dean and Vice President and as Director of an Executive Training Programme at Nanyang Business School in Singapore. In his research, he focuses on the Asia Pacific with particular reference to R&D offshoring and to Chinese and Indian Multinationals' FDI strategies. He can be contacted at gert.bruche@hwr-berlin.de.



Matthias Busse is Professor of International Economics at the Ruhr-University Bochum. Before joining the Ruhr-University, he acted as Interim Professor of Economics at the University of Trier in 2008/2009. From 2000 to 2008 he worked as Senior Economist and Head of the Programme World Economy at the Hamburg Institute of International Economics (HWWA/HWWI). He is Research Fellow at the HWWI and Director at the Institute of Development Research and Development Policy at the Ruhr-University. He received his PhD and his habilitation degree in Economics, both at the University of Hamburg. His research interests include international trade, FDI and development economics. He can be contacted at Matthias.Busse@ruhr-uni-bochum.de.



John Cantwell is Professor of International Business at Rutgers. He was previously Professor of International Economics at the University of Reading, UK, and he has also been a Visiting Professor at the Universities of Rome, Toulouse, and Vienna. His research focuses on technological innovation and multinational corporations. He is a pioneer in the field of multinational companies and international technology creation, beyond merely international technology transfer. He has been Program Chair of the Academy of International Business (AIB), President of the European International Business Academy (EIBA), and he is an elected AIB Fellow and EIBA Fellow. He has published 12 books, over 65 articles in refereed academic journals, and over 80 chapters in edited collections. He is the Editor-in-Chief elect of the Journal of International Business Studies, the leading international journal in the field of international business. He can be contacted at cantwell@rbsmail.rutgers.edu.



Aleh Cherp is Professor of Environmental Sciences and Policy at Central European University (CEU, Budapest) and Associate Professor at Lund University, Sweden where he also coordinates the Erasmus Mundus Masters course in Environmental Sciences, Policy and Management. From 2008 to 2012 he served as Research Director of CEU and the Convening Lead Analyst on Energy Security of the Global Energy Assessment. His research interests include energy security and sustainable development strategies under transitions. Prior to joining CEU Aleh Cherp worked with various UN agencies and international environmental organizations in Russia, Central Asia and other parts of the former USSR. He can be contacted at cherpa@ceu.hu.



of Economics and a PhD in Law from the University of Edinburgh. He can be contacted at lorenzo.cotula@iied.org.

Lorenzo Cotula is Senior Researcher in Law and Sustainable Development at the International Institute for Environment and Development (IIED), a think-tank based in the UK. At IIED, he leads work on natural resource investment in the Global South. He has published extensively on investment in agriculture and on the legal frameworks that regulate natural resource investments. Before joining IIED in 2002, Mr. Cotula worked on assignments with the Food and Agriculture Organization of the UN. He holds a Law Degree (cum laude) from the University La Sapienza of Rome, an MSc in Development Studies (Distinction) from the London School



been published in refereed journals and also as a chapter in a book on outward FDI from India. She can be contacted at nandita@umbc.edu.

Nandita Dasgupta teaches Economics at the University of Maryland, Baltimore County (UMBC). She is also Visiting Faculty at Johns Hopkins University. She has received the Best Teacher Award six times at UMBC. A PhD in Economics from Calcutta University, India, she publishes in the area of FDI. Her current research interests include international trade and business, in particular the implications of FDI outflows from developing countries. She was a consultant with the Columbia Earth Institute at Columbia University from 2002 to 2004, where she co-authored several working papers on FDI inflows in India. She presents research papers at academic conferences. Her research studies have



Ken Davies is President of Growing Capacity, Inc., a consultancy promoting investment for development. He has a BA in Chinese Studies and Sociology from the University of Leeds and a BSc in Economics from the University of London. He was Senior Economist at the Vale Columbia Center on Sustainable International Investment. Before that, he was Chief Economist for Asia at the Economist Intelligence Unit (EIU) in Hong Kong and then Head of Global Relations in the Investment Division of the OECD in Paris. He can be contacted at kendavies@growingcapacity.com.



Alexandre de Gramont is Partner in the Washington, D.C. office of Weil, Gotshal & Manges LLP, where he is a member of the firm's International Arbitration practice. He has represented both investors and states in numerous investor-state arbitration matters. He has also written and spoken widely on the subject of investor-state arbitration and international investment law. Mr. de Gramont received his law degree from NYU School of Law and his undergraduate degree from Wesleyan University. As noted in his chapter, he and his firm represented the claimant in *Pac Rim Cayman LLC v. El Salvador*. He can be contacted at

alex.degramont@weil.com.



Armand de Mestral, C.M. is Emeritus Professor of Law and Jean Monnet Professor of Law at McGill University. He served as Co-Director of McGill Université de Montréal, Institute of European Studies (2002-2008) and Interim Director of McGill's Institute of Air and Space Law (1998-2002). His recent publications include *International Law* (co-author) (7th ed., 2006); *Law and Practice of International Trade* (2nd ed., 1999); *The North American Free Trade Agreement: A Comparative Study*, Hague Academy of International Law, *Receuil des cours* (2000). He has also served as a panelist and arbitrator in disputes under WTO, CUFTA and NAFTA. Mr. de Mestral served as a member of the Canadian Delegation to the UN Law of the Sea Conference from 1973 to 1980, a consultant to NACEC and Law Commission of Canada, and President of the Canadian Red Cross Society (1999 to 2001). He was appointed Member of the Order of Canada December 28, 2007. He can be contacted at armand.de.mestral@mcgill.ca.



Kabir Duggal is Associate in the International Arbitration Group of Curtis Mallet-Prevost Colt & Mosle LLP. He has worked on some of the largest international investment arbitration cases and currently assists Mr. Ian Laird in teaching a course on international investment arbitration at Columbia Law School. He is a graduate of the University of Mumbai, Oxford University and NYU School of Law. The views expressed in Mr. Duggal's chapter are his and do not represent the views of Curtis Mallet-Prevost Colt & Mosle LLP or its clients. He can be contacted at kduggal@curtis.com.



Persephone Economou is a staff member of the World Bank's MIGA. Before that, she was Managing Editor of the *Journal of International Business Studies*, where she co-edited a special issue on International Business Negotiations. Previously, she was a staff member of UNCTAD in Geneva and of the United Nations Centre on Transnational Corporations in New York. She was involved extensively in the *World Investment Report* series and was the Associate Editor of *Transnational Corporations*. Ms. Economou has been a consultant to various organizations, including the World Bank's Development Economics and MIGA. She can be contacted at peconomou@worldbank.org.



John Evans is General Secretary of the Paris-based Trade Union Advisory Committee to the OECD (TUAC -- www.tuac.org). He holds a degree in Politics, Philosophy and Economics from University of Oxford. Former posts include positions with the European Trade Union Institute, Brussels; the International Federation of Commercial, Clerical and Technical Employees, Geneva; and the Economic Department, Trades Union Congress, London. Past not-for profit board positions included the Global Reporting Initiative and the Helsinki Group. Currently, Mr. Evans is a member of the Comité Médicis, Amundi and the Conseil d'Orientation, IDDRI. He is also Vice-Chair of the World Economic Forum

Global Agenda Council on Employment and Social Protection. He can be contacted at evans@tuac.org.



David N. Fagan is Partner in the Washington, DC office of Covington & Burling LLP. His practice covers national security law, international trade and investment, cybersecurity, and global privacy and data security. Mr. Fagan has represented clients in connection with issues including regulatory approvals of international investments, national security-related criminal investigations, high-profile congressional investigations, cybersecurity matters, and federal and state regulatory and enforcement actions in the data security area. He has represented clients in securing the approval of the Committee on Foreign Investment in the United States (CFIUS), as well as in connection with ongoing compliance matters related to mitigation agreements with CFIUS. Mr. Fagan has written extensively on national security, foreign investment, data security, and cybersecurity matters. He can be contacted at dfagan@cov.com.



Mark Feldman is Assistant Professor of Law at the Peking University School of Transnational Law. He previously served as Chief of NAFTA/CAFTA-DR Arbitration in the Office of the Legal Adviser at the US Department of State. As Chief, he represented the United States as a respondent or non-disputing Party in over a dozen investor-state disputes and provided legal counsel supporting the negotiation of US BITs and investment chapters of FTAs. He holds a BA from the University of Wisconsin, where he was elected to Phi Beta Kappa, and a JD from Columbia Law School, where he was a James Kent Scholar, Harlan Fiske Stone Scholar and recipient of the Parker School Certificate in International and Comparative Law. He can be contacted at mef31@columbia.edu



Hermann Ferré is Partner in the Litigation and International Arbitration groups at Curtis Mallet-Prevost Colt & Mosle LLP. His substantive areas of experience include energy, construction, business law, and international law. He has represented US and foreign government officials in state and federal proceedings, and recently has been representing sovereign states in international arbitration, in matters concerning energy and construction materials. Before practicing law, Mr. Ferré, who also is an architect, managed construction projects for Los Angeles County. In addition, he helped establish the county's Energy Management Division, focusing on mechanical design and maintenance for increased energy efficiency, and was instrumental in partnering Los Angeles County with Southern California Edison in its innovative 1995 Demand-Side Management Program. He can be contacted at hferre@curtis.com.



Daniel Firger is Vice President of Real Options International, Inc., a carbon markets and renewable energy advisory firm. He previously served as US Associate in the environmental and climate change practice at Linklaters, LLP and as Postdoctoral Research Fellow and Associate Director of the Center for Climate Change Law at Columbia University. He holds a JD from NYU School of Law and a master's degree in Public Affairs from the Woodrow Wilson School at Princeton University. He can be contacted at firger@gmail.com.



Veljko Fotak is Assistant Professor of Finance at SUNY Buffalo and a Research Fellow at the Sovereign Investment Lab, Paolo Baffi Centre at Bocconi University. He holds an MBA and an MS in Applied Statistics from the Rochester Institute of Technology and a PhD in Finance from the University of Oklahoma. His research focuses on the role of governments in financial markets and, in particular, on state capitalism and sovereign wealth funds. He teaches courses in International Finance and Corporate Finance. He can be contacted at veljkofo@buffalo.edu.



Susan Franck is Associate Professor at the Washington and Lee University School of Law. Ms. Franck's teaching and scholarship relates to international economic law and dispute resolution. She has recently served as a Scholar-in-Residence at UNCTAD in Switzerland (spring 2010) and a Visiting Associate Professor at Vanderbilt University (fall 2010). Prior to joining W&L, she was Assistant Professor at the University of Nebraska Law College and a Visiting Associate Professor at the University of Minnesota Law School. Before returning to the academy, she practiced in the area of international economic dispute resolution on both sides of the Atlantic. She can be contacted at francks@wlu.edu.



Kevin P. Gallagher is Associate Professor of International Relations at Boston University and Senior Researcher at the Global Development and Environment Institute. His recent books are *The Dragon in the Room: China and the Future of Latin American Industrialization* (Stanford University Press, 2010), *The Enclave Economy: Foreign Investment and Development in Mexico's Silicon Valley* (MIT Press, 2007), and *Rethinking Foreign Investment for Development: Lessons from Latin America* (Anthem Press, 2009). He serves on the investment subcommittee of the US Department of State's Advisory Committee on International Economic Policy. He

can be contacted at kpg@bu.edu.



Nilgün Gökğür works on SOE governance, privatization impact assessments of infrastructure utilities and private sector development for inclusive and job-rich growth in developing countries. She has worked extensively both as a team leader or team member in Africa, the Middle East and South East Asia for the World Bank, the EU and various bilateral development agencies. Previously, she worked as Research Associate at Harvard Business School and at the former Harvard Institute for International Development (HIID). She holds an MPA in development economics from the Woodrow Wilson School of Public and International Affairs, Princeton University, and an MA and BA in Economics from University of Basel, Switzerland. She is a dual citizen of the US and Turkey. She can be contacted at nilgun.gokgur@gmail.com.



Kathryn Gordon is Senior Economist in the Investment Division of the OECD. She is currently working on the role of national security in international investment policies and on investor-state dispute settlement. Earlier, she was one of the main Secretariat participants in the negotiations that led up to the successful 2000 and 2011 updates of the OECD Guidelines for Multinational Enterprises (a code of conduct for international business) and was responsible for OECD research on corporate responsibility. In earlier positions at the OECD, she dealt with fiscal, tax and regulatory issues. Prior to taking her position at the OECD, Ms. Gordon was a professor at a French business school (École Supérieure des Sciences Économiques et Commerciales). She obtained a PhD and an MBA-Finance from the University of California, Berkeley, before moving to France. She can be contacted at kathryn.gordon@oecd.org.



José Guimón is Lecturer in International Economics at Universidad Autónoma de Madrid, Spain. His research focuses on the interaction between multinational enterprises, innovation systems and economic development. He has participated in two EU-funded research projects and has been a short-term consultant for The World Bank on several occasions. He has also worked over nine years as a public sector consultant for CSC. He holds a PhD in economics from Universidad Autónoma de Madrid, a master's degree in Industrial Engineering from Cornell University and has been a visiting researcher at Trinity College Dublin. He can be contacted at jose.guimon@uam.es.



Thilo Hanemann is Research Director at RHG and leads the firm's cross-border investment work. He coordinates RHG's research assets across different practice areas and supports the investment management, strategic planning and policy analysis requirements of RHG clients within his fields of expertise. His work on cross-border investment assesses the rise of China, India and other emerging markets as global investors and the implications for FDI flows, the allocation of portfolio investment and global competitiveness. He and his team analyze new trends in global capital flows, related policy developments and specific transactions involving emerging market players. One of his areas of expertise is the evolution of China's outward FDI and the economic and policy implications from this new trend. He can be contacted at thanemann@rhgroup.net.



Torfinn Harding is Lecturer in the Department of Economics, University of Sussex. He is associated with Oxcarre/University of Oxford, Statistics Norway and CESifo. Previously he worked at the Research Department of the World Bank. He holds a PhD in Economics from the Norwegian University of Science and Technology. His research covers FDI promotion, export upgrading and effects of natural resource exports. His work is published in journals such as the *Review of Economics and Statistics* and *Economic Journal*. Recently he led a Norwegian aid project providing support on macroeconomic analysis and policy to the Ministry of Finance and Economic Planning in South Sudan. He can be contacted at T.Harding@sussex.ac.uk.



Jean-François Hennart is Professor in Strategy and International Business at Queen's University Management School, Distinguished Visiting Professor at Singapore Management University and Extramural Scholar at Tilburg University's CentER. His research focuses on the comparative study of international economic institutions such as multinational enterprises and their contractual alternatives, joint ventures and alliances and modes of foreign market entry. His *Theory of Multinational Enterprise* pioneered the application of transaction cost theory to international business. He is Consulting Editor for *JIBS* and Fellow of the Academy of International Business and of the European International Business Academy. He holds an honorary doctorate from the University of Vaasa. In 2012 he was named Booz&Co/Strategy+Business Eminent Scholar in International Management. He can be contacted at j.f.hennart@uvt.nl.



Seev Hirsch was born in pre-World War II Germany. In 1934, he immigrated to British ruled Palestine (most of which later became Israel) and has lived there since. In 1949 he was a founding member of Kibbutz Tel Katzir. Years later, after earning an MBA and doctorate at Harvard Business School, Mr. Hirsch joined the faculty of the Tel Aviv University, where he became the second Dean of the recently established Recanati School of Business Administration. His academic interests are international economic policy, international business, globalization, and the role of business transactions in ameliorating international political conflicts. He is a Fellow of the European International Business Academy. He can be contacted at hirsch@post.tau.ac.il.



Wing (Xiaoying) Huo, Master of Public Administration Candidate 2013, grew up and received her education in China and has worked and lived in Denmark, Germany and Kenya during the past seven years. Her primary experience has been in the private sector, for example managing the pilot corporate partnership program with UNICEF as well as setting up a framework for carbon accounting in the logistics sector. Her interest areas include the role of the private sector in development and climate change and its potential impact, especially from developing countries' perspectives. She can be contacted at h2165@columbia.edu.



Beata Javorcik is Professor of International Economics at the University of Oxford and Research Affiliate at the Centre for Economic Policy Research in London. She specializes in international trade and economic development. Prior to coming to Oxford, she worked at the World Bank in Washington DC where she was involved in research activities, lending operations and the provision of policy advice to developing countries in Central and Eastern Europe, Latin America and Asia. Her research interests focus on determinants and consequences of FDI inflows, links between exporting and firm performance and tariff evasion. She has published in the *American Economic Review*, *Review of Economics and Statistics*, *European Economic Review*, *Economic Journal*, *Journal of International Economics*, and *Journal of Development Economics*. She holds a PhD in Economics from Yale University and a BA from the University of Rochester. She can be contacted at beata.javorcik@economics.ox.ac.uk.



Nathan Jensen is Associate Professor in the Department of Political Science at Washington University in St. Louis, Fellow at the Center for Political Economy and Director for the Program on Multinational Enterprises and the Global Economy at the Weidenbaum Center on the Economy, Government, and Public Policy at Washington University. He teaches courses and conducts research on international financial markets, multinational enterprises and development, political risk in emerging markets, trade policy, international institutions, and civil conflict. His research includes *Nation-States and the Multinational Corporation* (Princeton University Press, 2008), and his peer-reviewed articles include publications in the *American Journal of Political Science*, *Journal of Politics*, and *International Organization*. He can be contacted at njensen@wustl.edu.



Lise Johnson is the Lead Investment Law and Policy Researcher at the Vale Columbia Center on Sustainable International Investment (VCC). Her work centers on analyzing treaty-based investor-state arbitrations, and examining the implications those cases have for host countries' domestic policies and development strategies. In addition, she concentrates on key institutional and procedural aspects of the legal framework, including efforts to increase transparency in and legitimacy of investor-state dispute settlement. She has a BA from Yale University, JD from University of Arizona, LLM from Columbia Law School, and is admitted to the bar in California. Prior to joining the VCC, she was a legal consultant for the International Institute for Sustainable Development, and

a fellow at the Center for International Environmental Law. She also spent four years as a litigator at the international law firm Gibson, Dunn & Crutcher. She can be contacted at lj2107@columbia.edu.



Thomas Jost is Professor of Economics at the Faculty of Economics and Law at the University of Applied Sciences Aschaffenburg, Germany, which he joined in 2000. From 1989 to 2000 he served as a Head of Unit in the International Economics Department of Deutsche Bundesbank. He was a member of the Economics Research Group of Deutsche Bundesbank and of the Short Term Economic Prospects Group of OECD. From 2004 to 2010 he worked as a consultant for the Division on Investment, Technology and Enterprise Development of UNCTAD. His research focuses on European integration and FDI. He can be contacted at Thomas.Jost@h-ab.de.



George Kahale III has been Chairman of Curtis, Mallet-Prevost, Colt & Mosle LLP since 2008, when the position was created after he served 15 years as the firm's Managing Partner. Mr. Kahale has acted as lead counsel in some of the world's largest and most publicized transactions in the international petroleum industry. He also has been lead counsel in several of the world's largest investor-state arbitrations. Mr. Kahale's practice was the subject of a feature article in the June 2008 issue of *The American Lawyer*. In February 2009, *Latin Lawyer* awarded its Restructuring Deal of the Year honor to a team led by Mr. Kahale, and in April 2009, *The American Lawyer* named him one of its "Dealmakers of the Year." He can be contacted at gkahale@curtis.com.



Kálmán Kalotay has been working for UNCTAD since 1990. He is member of the *Investment Policy Review* and *World Investment Report* teams. In the past he also served as associate (1996–2003) and deputy editor (2003–2004) of UNCTAD's *Transnational Corporations* journal. Between 1990 and 1996, he worked on the promotion of economic cooperation among developing countries at the UNCTAD secretariat. Before joining the UN, he taught world economics at the Budapest University of Economic Sciences and Public Administration (currently Corvinus University) (1983–1990). He holds a PhD in International Economics from the same university. He can be contacted at kalotayk@gmail.com.



Laza Kekic is Regional Director, Europe, and Director of Country Forecasting Services, at the Economist Intelligence Unit (EIU), London. He heads the EIU's regional team of analysts who provide economic, political and business coverage for all the countries of Europe. He also heads the EIU's Country Forecasting Services, which include the EIU's main traditional product, the *Country Reports*, as well as the *Country Forecasts* (forecasts and analysis for 82 countries aimed at direct investors). He can be contacted at LazaKekic@eiu.com.



John M. Kline is Professor of International Business Diplomacy in the Walsh School of Foreign Service, Georgetown University. His teaching focuses on international investment strategies and negotiations, business-government relations and international business ethics. The second edition of Mr. Kline's textbook, *Ethics for International Business: Decision-Making in a Global Political Economy* was released by Routledge in 2010. He is the author of three other books, as well as numerous scholarly articles and chapters in co-authored and edited books. Prior to joining the Georgetown faculty, Mr. Kline was Director of International Economic Policy at the National Association of Manufacturers. He received a doctorate in political science from The George Washington University and holds a master's degree from The Johns Hopkins University School of Advanced International Studies. He serves as a consultant to private multinational enterprises and various international organizations. He can be contacted at klinej@georgetown.edu.



Charles Kovacs is an American living in Budapest where he is Chair of Hid Radio Zrt and Vice Chair of BIAC's (Business and Industry Advisory Committee to the OECD) Task Force on Finance. By profession an international and investment banker, including 25 years with the Chase Manhattan Bank and Barclays de Zoete Wedd, he has also worked for UNCTAD on projects on attracting foreign investment in Bosnia-Herzegovina and in Kenya. Born in Hungary, he is a graduate of Clark University (BA) and the Fletcher School of Law and Diplomacy (MA, MALD). He can be contacted at charles.kovacs@hidradiort.hu.



Jürgen Kurtz is Associate Professor and Director of the International Investment Law Program of the Institute for International Law and the Humanities at the University of Melbourne, Australia. He researches and teaches in various strands of international economic law, including the jurisprudence of the WTO and that of investor-state arbitral tribunals. His work has been published in a range of leading international law journals and has been cited by international tribunals in adjudication. He was recently appointed Fernand Braudel Senior Fellow at the European University Institute and teaches annually in the LLM in a European and Global

Context at Universidade Catolica in Portugal, the LLM in International Economic Law and Policy at the University of Barcelona and the Singapore International Arbitration Academy at the National University of Singapore. He can be contacted at j.kurtz@unimelb.edu.au.



Markus Leibrecht is Fixed-term Professor at the Institute of Economics, Leuphana University, Lüneburg, Germany. His research interests include the impact of globalization on the functioning and the structure of the public sector. He has published several articles in international journals, and he is author of several chapters in edited volumes. He can be contacted at leibrecht@leuphana.de.



Jo En Low is Associate in the London office of Clifford Chance LLP. She specializes in cross-border M&A in the energy, infrastructure and telecommunications sectors. Her research interests include FDI and development, business and human rights. She is a graduate of Columbia Law School (LLM 2012) and the University of New South Wales (BA, LLB 2006). She was formerly Research Associate at the Harvard Kennedy School of Government Corporate Social Responsibility Initiative, where she assisted with a paper designed to inform the mandate of the Special Representative of the UN Secretary-General on Business and Human Rights.

As a student, Ms. Low was a staff editor of the *Columbia Journal of Transnational Law* and has published on subjects such as state-controlled entities, international investment agreements and the UN human rights treaty bodies. She can be contacted at jl3742@caa.columbia.edu.



Miguel Pérez Ludeña is Economic Affairs Officer at the UN. Currently he works in the Economic Commission for Latin America and the Caribbean (ECLAC), where he analyses FDI trends and determinants in that region. His most recent research focused on Chinese FDI in Latin America, Translatin enterprise strategies and investments in renewable energy. He previously worked in the Economic and Social Commission for Asia and the Pacific (ESCAP), where he advised governments on private sector participation in basic infrastructure, and in UNCTAD, where he participated in various *World Investment Reports*. Before joining the UN, he worked for NGOs in Central America and Investment Managers in London. He can be contacted at Miguel.PEREZ@cepal.org.



Edmund Malesky is Associate Professor of Political Economy at Duke University. He has published in leading political science and economic journals, including the *American Political Science Review* and *Journal of Politics*, and has been awarded the Harvard Academy Fellowship and Gabriel Almond Award for best dissertation in comparative politics. He serves as the lead researcher for the Vietnam Provincial Competitiveness Index and Cambodian Business Environment Scorecard. He has consulted for the Asia Foundation, USAID and the World Bank Group. He is a noted specialist in political development in Vietnam and China, comparative political economy in Southeast Asia, as well as economic transitions in developing economies, especially Southeast Asia. He can be contacted at ejm5@duke.edu.



Geraldine Mc Allister is Program Coordinator at the Center on Global Economic Governance at the School of International and Public Affairs (SIPA), Columbia University, and SIPA Associate, researching regulation of US financial markets. She is co-author (with Karl P. Sauvant) of “Foreign direct investment by emerging market multinationals: Coping with the global crisis,” (forthcoming) in Marin Marinov, ed., *Emerging Economies and Firms in the Global Crisis* (Palgrave Macmillan). She contributed to and co-edited *Foreign Direct Investments from Emerging Markets: The Challenges Ahead* (Palgrave Macmillan, 2010) with Karl P. Sauvant and Wolfgang A. Maschek. Ms. Mc Allister has over ten years of business development experience, working in the emerging markets of East-Central Europe, Russia and CIS and the Middle East. She holds a master’s degree in international affairs from Columbia University. She can be contacted at gam2116@columbia.edu.



Bill Megginson is Professor and Rainbolt Chair in Finance at the University of Oklahoma's Michael F. Price College of Business and was recently named George Lynn Cross Research Professor. From 2002 to 2007, he was a voting member of the Italian Ministry of Economics and Finance's Global Advisory Committee on Privatization. During spring 2008, he was the Fulbright Tocqueville Distinguished Chair in American Studies and Visiting Professor at the Université-Paris Dauphine. He has published refereed articles in several top academic journals, including the *Journal of Economic Literature*, the *Journal of Finance*, the *Journal of Financial Economics*, the *Journal of Financial and Quantitative Analysis*, and *Foreign Policy*. He has been Visiting Professor at Duke University, Vanderbilt University, the University of Zurich, the University of Amsterdam, Bocconi University, and Université-Paris Dauphine. He can be contacted at wmegginson@ou.edu.



Sophie Meunier is Research Scholar in the Woodrow Wilson School of Public and International Affairs at Princeton University and co-Director of the European Union Program at Princeton. She is the author of *Trading Voices: The European Union in International Commercial Negotiations* (Princeton University Press, 2005) and the co-author of *The French Challenge: Adapting to Globalization* (with Philip Gordon, Brookings Institution Press, 2001), winner of the 2002 France-America book award. Ms. Meunier has edited several books and published many articles on the European Union, the politics of international trade, globalization, anti-Americanism, and French politics. Her current research focuses on the politics of hosting Chinese direct investment in Europe and the US. She holds a BA Sciences Po Paris 1989 and a PhD in Political Science MIT 1998. She can be contacted at smeunier@princeton.edu.



Michael Mortimore is a Canadian with a PhD from the University of Toronto, whose career in the UN included many years as Chief of the Unit on Investment and Corporate Strategies of the UN Economic Commission for Latin America and the Caribbean (ECLAC) in Santiago, Chile, as well as Chief of the Development Issues section of the Division on Investment, Technology and Enterprise Development of UNCTAD in Geneva, Switzerland. The UN-ECLAC Unit produces the ECLAC annual report entitled *Foreign Investment in Latin America and the Caribbean*. The UNCTAD Unit that Mr. Mortimore managed produces the thematic section of the annual report entitled *World Investment Report*. Mr. Mortimore retired in 2009. He can be contacted at michaeldmortimore@gmail.com.



Joel Moser is Partner in the Energy & Infrastructure Group of Kaye Scholer LLP where his practice is focused on the planning, development, acquisition, financing, refinancing, operation, and sale of energy and infrastructure assets around the world. He has counseled investment funds, developers, industrial sponsors, banking and investment firms, governments, and agencies in investments and transactions in a wide variety of industries, including oil and gas, transportation, power, water, professional athletics facilities, and education. He is a member of the Council on Foreign Relations, an Adjunct Professor at the Columbia School of International and Public Affairs and the founding editor of

Global Infrastructure. Mr. Moser is recognized as a leading projects lawyer by Chambers Global. He can be contacted at Joel.Moser@kayescholer.com.



Michael D. Nolan is Partner in the Washington, DC, office of Milbank, Tweed, Hadley & McCloy LLP. Mr. Nolan has served as counsel or arbitrator in cases under AAA, ICC, ICSID, UNCITRAL, and other rules and is consistently listed in *Euromoney Guide*, *Experts in Commercial Arbitration* and *Chambers USA* for international arbitration. Mr. Nolan is a member of the Board of Directors of the AAA and of the Panel of ICSID Arbitrators. He teaches as an Adjunct Professor at the Georgetown University Law Center and is General Counsel of the Intellectual Property Owners Association. He is the author of many articles and co-editor

of a two-volume collection of the determinations of OPIC in political risk insurance disputes (Oxford University Press). Mr. Nolan is a graduate of Harvard College and the University of Chicago Law School. He can be contacted at mnolan@milbank.com.



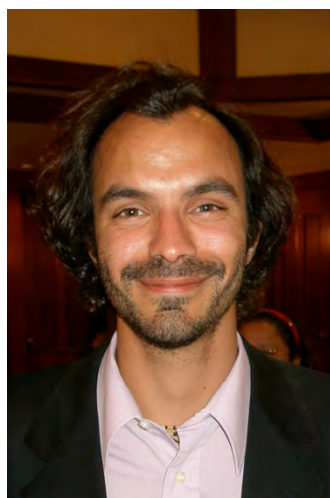
Peter Nunnenkamp is Senior Economist at the Kiel Institute for the World Economy. He joined the development economics department of the Kiel Institute about 30 years ago and has headed several research divisions, including International Capital Flows until 2005, and the Global Division of Labor until 2009. Currently, he is also a member of the research area Poverty Reduction, Equity and Development. His major research interests are the determinants and effects of FDI in (developing and developed) host countries, possible repercussions of FDI in home countries and the allocation and effectiveness of official, as well as private, aid. He has published several monographs and various articles in peer-reviewed journals, including *Canadian Journal of Economics*, *Economic Inquiry*, *European Economic Review*, *World Bank Economic Review*, and *World Development*. He can be contacted at peter.nunnenkamp@ifw-kiel.de.



Terutomo Ozawa is Professor Emeritus of Economics, Colorado State University, and Research Associate, Center on Japanese Economy and Business, Columbia Business School. He served as a consultant for the World Bank, OECD, UNCTAD, UNESCAP, UNITAR, ADB, and APO. He was president of the International Trade and Finance Association in 2003. His recent publications include *The Rise of Asia: The “Flying-Geese” Theory of Tandem Growth and Regional Agglomeration* (Edward Elgar, 2011, paperback), “The (Japan-born) ‘flying-geese’ theory of economic development revisited -- and reformulated from a structuralist perspective,” *Global Policy* (2011), and “Will the World Bank’s vision materialize? Relocating China’s factories to Sub-Saharan Africa, flying-geese style” (coauthored by Christian Bellak), *Global Economy Journal* (2011). He can be contacted at T.Ozawa@colostate.edu.



Clint Peinhardt is Assistant Professor of Political Science at the University of Texas at Dallas. He specializes in International Political Economy and International Organizations. His research investigates the interaction between sovereign governments and multinational enterprises in several contexts, including international financial liberalization, investment treaties and investor-state arbitration and political risk insurance. His other work explores domestic political support for globalization across countries, and argues that support can be encouraged with appropriate policies. His work has appeared in *International Organization*, *International Studies Quarterly* and *The World Economy*. He can be contacted at clint.peinhardt@utdallas.edu.



Nicolás Marcelo Perrone is pursuing a PhD at the London School of Economics and Political Science. He is also a researcher at the Centre of Interdisciplinary Studies of Industrial and Economic Law (University of Buenos Aires). He holds a law degree (UBA), a Master in International Relations and Negotiations (FLACSO Argentina) and a LLM (LSE). He has worked as a consultant for the OECD Directorate for Financial and Enterprise Affairs, and as a fellow of the UNCTAD Division on Investment and Enterprise. Mr. Perrone has taught in Argentina and as a visiting lecturer at the Xi’an Jiaotong Law School. Previously, he worked in the Argentine Judiciary and as an advisor of the Argentine Government in Judicial Affairs. He has published in several countries and has given presentations to academic conferences internationally. His main interests are international investment and economic law and international investment governance, in particular foreign investment in agriculture. He can be contacted at n.m.perrone@lse.ac.uk.



Luke Eric Peterson is the publisher of the website InvestmentArbitrationReporter.com, a popular electronic news and analysis service dedicated to legal disputes between foreign investors and their host governments. He can be contacted at editor@iareporter.com.



Mark Plotkin is Partner in the Washington, DC office of Covington & Burling LLP. He co-chairs the firm's National Security and Defense Industry Group. Mr. Plotkin represents clients before the Committee on Foreign Investment in the United States (CFIUS) in obtaining Exon-Florio approval for foreign investments in the United States and before the Defense Security Service (DSS) of the US Department of Defense in connection with foreign ownership, control or influence (FOCI) reviews. Mr. Plotkin has advised some of the world's leading companies and private equity funds on national security matters and also represents some of the most active and respected Asian and Middle Eastern sovereign wealth funds and state-owned companies. He can be contacted at mplotkin@cov.com.



Joachim Pohl works in the OECD Investment Division, where he monitors and analyses governments' investment policies. Mr. Pohl, a German national, joined the OECD in 2003 to advise countries, predominantly in Asia, on public governance and anti-corruption policies. Prior to his career at the OECD, he taught public law at the Humboldt University, Berlin, and MGLU Moscow. Mr. Pohl holds a PhD in Law from Humboldt-University and a master's degree in Political Science from the University of Bordeaux. He can be contacted at joachim.pohl@oecd.org.



Lauge N. Skovgaard Poulsen is a Danish Research Council Postdoctoral Fellow at Nuffield College, Oxford University. His PhD from the London School of Economics investigated why, and how, developing countries entered into bilateral investment treaties. He has been a non-residing guest-scholar at the Brookings Institution (spring 2009) and did his graduate coursework at the London School of Economics (2006-2007) and the University of California, Berkeley (2005-2006). He can be contacted at skovgaard.poulsen@nuffield.ox.ac.uk.



Carlos Razo is an economist with UNCTAD. His areas of expertise are industrial organization and international economics. He has coordinated various studies on industrial development and has been one of the main authors of the annual report on FDI in the Latin American and Caribbean region (UN ECLAC) and the Innovation and Technology Report (UNCTAD). Before joining the UN, he worked in London for one of the leading European consulting firms in the area of competition policy. Mr. Razo holds a PhD in Economics from Stockholm University, a master's degree from the University of Essex and BA in Industrial Engineering. He can be contacted at carlos.razo@unctad.org.



Jennifer Reimer is Associate at HPL Yamalova & Plewka JLT in Dubai, United Arab Emirates. She also serves as Managing Editor of the *Columbia FDI Perspectives*. Ms. Reimer is admitted to the bar in California and is licensed in Dubai as a Legal Consultant. Prior to beginning her legal studies, Ms. Reimer was appointed by Governor Arnold Schwarzenegger and served as Trustee for the California State University system (2006-2008). Ms. Reimer holds a JD from the University of California, Davis (2011), and from California State University, Fresno, she holds an MA in Music Performance (2009), an MBA (2008) and a BS in Business - Finance (2006). She can be contacted at jreimer01@gmail.com.



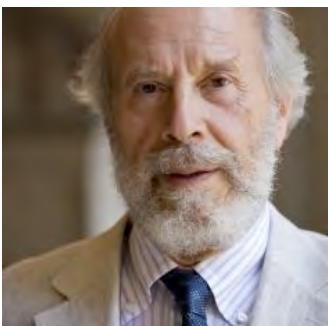
Daniel Rosen is Partner at Rhodium Group and leads the firm's work on China. Since 1993, he has been a staff member of the Peterson Institute for International Economics in Washington, DC, focusing on China and authoring seven major studies. Since 2001 he has served as Adjunct Associate Professor at Columbia University, teaching graduate seminars on the Chinese economy at the School of International and Public Affairs. He writes and speaks extensively on China and other emerging economy topics. His sixth book, on China-Taiwan economic relations, and his seventh, on Chinese FDI in the United States, were published in 2011. From 2000 to

2001, he was Senior Advisor for International Economic Policy at the White House National Economic Council and National Security Council, where he played a key role in completing China's accession to the WTO. He can be contacted at dhrosen@rhgroup.net.



Martin Roy is Counsellor in the Trade in Services Division of the WTO Secretariat. He has published on trade and political economy issues in a number of journals and is the co-editor of the book *Opening Markets for Trade in Services: Countries and Sectors in WTO and Bilateral Negotiations* (Cambridge University Press and WTO, 2008). He holds a PhD from Johns Hopkins University's School of Advanced International Studies. Before joining the WTO in 2002, he was Senior Economist in the Canadian Department of Finance, where he worked on trade negotiations and

investment issues. His recent research focuses on trade agreements on services and on the impact of investment agreements on FDI flows. Recently published works include WTO staff working papers as well as journal articles in *Journal of World Trade* and *Economics Letters*. He can be contacted at Martin.Roy@wto.org.



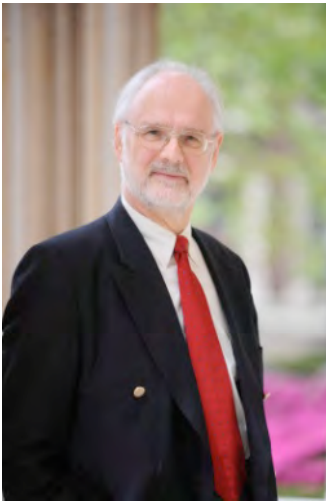
Giorgio Sacerdoti is Professor of International Law and European Law (Jean Monnet chair) at Bocconi University, Milan, Italy. From 2001 to 2009, he was a Judge at the WTO's Court in Geneva and its Chair in 2006-7. Mr. Sacerdoti had been Vice-Chair of the OECD Working Group on Bribery in International Business Transactions until 2001. He is a member of the Milan Bar and Of Counsel of *Eversheds Bianchini* in Milan. He frequently serves as arbitrator in international commercial disputes and has chaired

various ICSID arbitral tribunals. He has published more than 150 works in the fields related to his expertise, in public international law, trade, international contracts, investment law, and arbitration. He can be contacted at giorgio.sacerdoti@unibocconi.it.



Premila Nazareth Satyanand started her career at the UN Centre on Transnational Corporations, New York (1988-1993), and served with the UN's electoral missions in South Africa and the Western Sahara. She joined the Economist Intelligence Unit, New Delhi, in 1996, where she helped facilitate the government-MNE dialogue around FDI liberalization and advised foreign investors on India strategy. She now writes independently on FDI issues for the Economist Intelligence Unit, the UN, and the Multilateral Insurance Guarantee Agency, among others. She has a BA in History from St. Stephen's College, New Delhi, and an MA in International Relations from Columbia University, New York. She can be contacted at

premila@foreigndirectinvestment.in.



Karl P. Sauvant, is Resident Senior Fellow at the Vale Columbia Center on Sustainable International Investment (VCC), a joint center of Columbia Law School and the Earth Institute at Columbia University; Adjunct Senior Research Scholar and Lecturer-in-Law at Columbia Law School and Guest Professor at Nankai University, China. Until February 2012, he was the VCC's Founding Executive Director. Until July 2005, Mr. Sauvant was Director of the UNCTAD's Investment Division. While at the UN, he created the prestigious annual *World Investment Report*, of which he was the lead author until 2004. He authored a substantial number of publications on issues related to economic development, FDI and services. He is a Fellow of the Academy of International Business and an Honorary Fellow of the

European International Business Academy. He received his PhD from the University of Pennsylvania in 1975. He can be contacted at karlsauvant@gmail.com.



Manfred Schekulin is Director for Export and Investment Policy and Deputy Director General for Trade Policy and European Integration at the Federal Ministry of Economy, Family and Youth of Austria. Since 2004, he has been Chair of the OECD-Investment Committee. He holds a Doctor of Law and a Master of Social and Economic Sciences/Economics from the University of Vienna and an MBA from the Vienna University of Economics and Business Administration. He has currently teaching assignments at the University of Management Studies, Krems, and at the Vienna University of Economics and Business Administration. He has published on trade, investment and public management topics. He can be contacted at Manfred.Schekulin@bmwfi.gv.at.



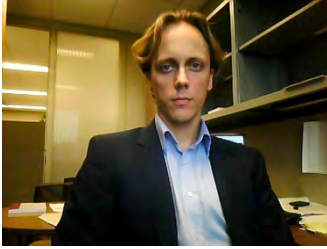
Stephan Schill is Senior Research Fellow at the Max Planck Institute for Comparative Public Law and International Law in Heidelberg. Prior to that, he clerked for The Honorable Charles N. Brower, 20 Essex Street, London, and for Judge Abdul G. Koroma at the International Court of Justice. He holds a degree of Dr. iur. from Johann Wolfgang Goethe-Universität, Frankfurt/Main, and an LLM from New York University. His expertise covers general international law and international dispute settlement, international investment law and arbitration, EU law, the European Convention on Human Rights, and comparative public law. He is admitted to the bar in Germany and New York and has acted as counsel before the European Court of Human Rights. He can be contacted at sschill@mpil.de.



Francisco C. Sercovich (PhD, SPRU, Sussex University) is Professor at the University of Buenos Aires. He has been Visiting Scholar at Harvard and Columbia Universities, Visiting Professor at Hofstra University, Director of Policy Research at the UN Industrial Development Organization in Vienna and Chair of the UN Task Force on Economic Development. Currently he advises the Argentine Ministry of Science, Technology and Innovation and conducts research on innovation policy evaluation. He has just completed his latest journal article titled “An evolutionary view of the infant-industry argument,” in co-authorship with Morris Teubal (forthcoming). He can be contacted at fcsercovich@rec.uba.ar.



Arjen Slangen is Associate Professor of International Business at the department of Strategic Management & Entrepreneurship of RSM Erasmus University, the Netherlands. After obtaining his PhD from Tilburg University in 2005, he was a postdoctoral researcher and Assistant Professor at RSM's department of Business-Society Management and Assistant Professor at the Strategy & Marketing section of the University of Amsterdam. He also was Visiting Scholar at the department of International Business of the University of South Carolina. Mr. Slangen's research focuses on how MNEs' foreign activities and entry mode choices are affected by institutional factors. His work has been published in leading international journals such as the *Journal of International Business Studies* and *Journal of Management Studies*. He can be contacted at aslangen@rsm.nl.



and how (statistically) to measure their activities. He can be contacted at rsmeets@business.rutgers.edu.



Hans Smit was the Stanley H. Fuld Professor Emeritus of Law at Columbia Law School.



lawsorna@nus.edu.sg.

M Sornarajah is CJ Koh Professor of Law at the National University of Singapore and the Tunku Abdul Rahman Professor of Public International Law at the University of Malaya. He was previously Head of the Law School of the University of Tasmania, Australia. He studied law at the University of Ceylon, the Yale Law School, the London School of Economics, and King's College, London. He is the author of several books on international law, including the *International Law on Foreign Investment*. He has been counsel or arbitrator in several leading investment arbitrations. He is an Honorary Member of the Indian Society of International Law. He can be contacted at



Professor Sourgens is an Associate Professor of Law at Washburn University School of Law. His scholarship focuses on resolution of disputes involving political risk. He serves as editor for the Oxford University Press reporter of investor-state arbitral decisions. Prior to joining Washburn, Mr. Sourgens practiced international arbitration in the Washington, D.C., office of Milbank, Tweed, Hadley & McCloy and the Houston office of Fulbright & Jaworski, representing diverse clients such as Yukos Oil Company, Fraport AG, the Government of Mongolia, and US private equity and financial services companies. While in Washington, D.C., he was an Adjunct Professor of Law at Georgetown University Law Center. He can be contacted at

freddy.sourgens@washburn.edu.



Jonathan Strauss is an attorney for the Georgia Secretary of State. Mr. Strauss previously worked as Associate at a large New York law firm, before serving as a fellow at the Vale Columbia Center. He graduated, with honors, from Emory University School of Law and received his LLM in Law and Entrepreneurship from Duke University School of Law. He can be reached at jstrauss01@gmail.com.



Kenneth P. Thomas is Professor of Political Science and Fellow at the Center for International Studies at the University of Missouri-St. Louis. He is the author of *Investment Incentives and the Global Competition for Capital* (Palgrave Macmillan, 2011) and *Competing for Capital: Europe and North America in a Global Era* (Georgetown University Press, 2000). His research focuses primarily on competition for investment through subsidies to investors, both foreign and domestic. He can be contacted at kpthomas@umsl.edu.



Margo Thomas is Lead Operations Officer at the International Finance Corporation (IFC), World Bank Group. She lived in Serbia (2005-2010) and served as the Regional Business Leader, Investment Climate Advisory Services in the Western Balkans. She is currently on assignment in the Office of the Vice President, Finance and Private Sector Development. She holds a PhD in Public Policy from the University of Manchester and her research focuses on public policy, regulatory governance and the political economy of business environment reform. She is currently co-editing *Public Policy Making in the Western Balkans: Actors, Networks and Coalitions* (forthcoming). She can be contacted at

mthomas@ifc.org.



Perrine Toledano is Lead Economics and Policy Researcher at the Vale Columbia Center on Sustainable International Investment (VCC). At the VCC, Ms. Toledano specializes in natural resources investments, building financial models for oil and mining contracts as well as researching and advising on issues such as transparency, competitive bidding and optimal legal clauses for development benefits. She also leads work on economic diversification, including leveraging extractive industry investments in rail, port and energy infrastructure for the broader development needs of a country,

as well as optimizing direct and indirect local job creation. Prior to the VCC, Ms. Toledano worked as a consultant for several non-profit organizations (World Bank, DFID, Revenue Watch Institute) and private sector companies (Natixis Corporate Investment Bank, Ernst and Young). She holds an MBA from ESSEC (Paris) and a Master of Public Administration from Columbia University. She can be contacted at ptoled@law.columbia.edu.



Julien Topal holds a BA and a Master of Research in Philosophy from the University of Amsterdam, the Netherlands and a Master of Research in Social and Political Sciences from the European University Institute (EUI) in Florence, Italy. He worked as a lecturer in political philosophy at Maastricht University and is currently a PhD researcher at the EUI. His research focuses on theories of justice, corporate responsibilities, the investment regime, and poverty. He is a research associate at the Vale Columbia Center and a member of the Advisory Editorial Board of the European Journal of Legal Studies. He can be contacted at Julien.Topal@eui.eu.



Anne van Aaken is Professor for Law and Economics, Legal Theory, Public International Law and European Law at the University of St. Gallen, Switzerland. She was a Fellow at the Institute for Advanced Study in Berlin 2010-2011, is Vice-President of the European Association of Law and Economics, Chair of the Programmatic Steering Board of the Hague Institute for the Internationalization of Law, Member of the Executive Board of the European Society of International Law and Member of the ILA Committee on Non-State Actors. Her main research areas are International Law, with a focus on International Investment Law and its interaction with other areas of international law, legal theory, law and economics, and corruption. She can be contacted at Anne.vanAaken@unisg.ch.



Gus Van Harten is Associate Professor at Osgoode Hall Law School of York University in Toronto. He taught previously at the Law Department of the London School of Economics. He is the author of *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007) and numerous articles available at <http://ssrn.com/author=638855>. His research database is freely accessible at www.iiapp.org. He can be contacted at GVanHarten@osgoode.yorku.ca.

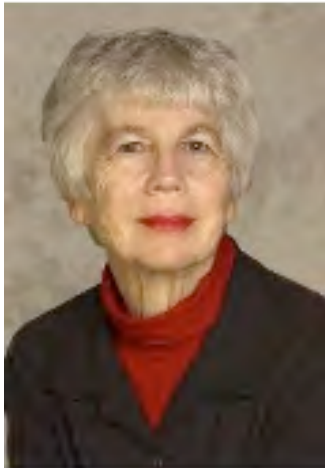


Daniel Villar is Lead Risk Management Officer at MIGA. In this capacity, he is responsible for overseeing country risk analysis and the economic analysis of projects. He also leads MIGA's research team. Prior to joining MIGA in 2000, Mr. Villar worked for four years in the management consulting firm Booz, Allen & Hamilton, focusing on financial management projects. Previously he was a member of the International Finance Department of the French MNE Bouygues. He also worked for three years at the World Bank on policy research. Mr. Villar holds an MBA from Insead in Fontainebleau, France, an MA in International Development from the American University in Washington, DC and a BA in Politics and Government from the University of Maryland, College Park. He can be contacted at dvillar@worldbank.org.



Sandy Walker is Partner in the Competition/Antitrust and Foreign Investment Group of Fraser Milner Casgrain LLP in Toronto. Her practice focuses on securing regulatory approvals for mergers and foreign investments under the Canadian Competition Act and the Investment Canada Act, Canada's foreign investment review law. She also advises a wide range of clients on antitrust issues relating to pricing, distribution and trade practices. Ms. Walker is Vice-Chair of the International Antitrust Committee of the American Bar Association's Section of International Law and Vice Chair of the Canadian Bar Association's Mergers Committee. She was

Chair of the CBA's Foreign Investment Review Committee from 2007 to 2009 and is an active member of the ABA's Antitrust Law Section and the Canada China Business Council. She is a frequent speaker and writer on competition and foreign investment issues, including state-owned investments in Canada. She can be contacted at sandy.walker@fmc-law.com.



Mira Wilkins is Professor of Economics at Florida International University. A new edition of her first (1964) book has recently been published: *American Business Abroad: Ford on Six Continents*, an archive-based history of Ford Motor Company's worldwide operations. Her books *The Emergence of Multinational Enterprise: American Business Abroad from the Colonial Era to 1914* (1970) and *The Maturing of Multinational Enterprise: American Business Abroad from 1914 to 1970* (1974) presented a general history of US global business. From the 1970s onward, she has been preparing a history of foreign investments in the United States (direct and portfolio investments): Volume I was on the colonial period to 1914 (1989) while Volume II covered 1914 to 1945 (2004); Volume III -- 1945 to 2012 -- is in process.

Her general historical studies of American business abroad and of foreign investment in the United States were published by Harvard University Press. She can be contacted at wilkinsm@fiu.edu.



Jason Yackee's research centers on international investment law and administrative law and politics. He earned a PhD in Political Science (International Relations) from the University of North Carolina at Chapel Hill, and a JD from Duke University School of Law. He has also studied French and European law at L'Universite Pantheon-Assas (Paris-2). Mr. Yackee has published articles in a variety of peer-reviewed social science journals, student-edited law reviews and edited volumes. His most recent articles include "Breaking the myth of ossification," forthcoming in the *George Washington Law Review*, and "Controlling

the international investment law agency,” forthcoming in the *Harvard International Law Journal*. Mr. Yackee serves as Co-Vice Chair of the American Society for International Law’s (ASIL’s) International Economic Law Interest Group. He can be contacted at jyackee@wisc.edu.



Chen Zhao received her master's degree in International Affairs from Boston University, where she specialized in US-China relations and the regional development of China. Prior to joining the Vale Columbia Center, she worked for the Institute of Policy and Management at the Chinese Academy of Sciences, conducting research on the economic implications and sustainability of China’s energy and climate policy. She is the co-author of “Policy modeling on the GDP spillovers of carbon abatement policies between China and the United States.” Currently, Ms. Zhao serves as an intern at the National Committee on US-China Relations, where she assists and coordinates various programs and events (including the welcome luncheon honoring Chinese Vice President Xi Jinping on February 15, 2012) dedicated to fostering constructive US-China Relations. She can be contacted at czhao@ncuscr.org.

Foreword

This volume is a welcome contribution to discussions on international business research, establishing important connections between that research and the world of policymaking and practice. Special emphasis is given to questions of the relationship between international business and national economic development and to how foreign direct investment (FDI) has affected -- and is being affected by -- recent trends and changes in the global economy. While the chosen format of brief articles concisely presents each subject, what is effectively a substantial series of executive summaries sets out key ideas on a wide variety of issues. What is more, the selection of topics draws our attention to principal areas of interest and debate in this field.

The coverage of this collection is certainly impressive. It deals with a wide range of the most topical issues under discussion today, including, for example, the global economic and financial crisis, multinational enterprises (MNEs) in and from the emerging markets, the Arab spring, sovereign wealth funds, Chinese investment in Africa and its effects, inward FDI and various countries' concerns over national security, and investment codes and regulations pertaining to corporate social responsibility. It is not only the broad coverage of issues that is noteworthy, but also that the long list of reputable authors reflects a broad spectrum of views about the major issues at hand. The brief format of each *Perspective*, as well as the large audience to which the articles are distributed, provide a platform on which members of the FDI community can challenge each other by presenting rebuttal articles. Because of this possibility of dialogue, the present volume brings out debates in the field, including different ways of addressing policy questions, apart from simply putting forward different ways of addressing a given research question.

Another attractive feature of this volume is that a number of articles revisit in a contemporary context some very long-standing questions in the field of international business and, as a result, generally add new gloss to our understanding. This applies in the case of the nature of FDI data and some of the practical difficulties in their use, whether the origins of ownership of firms matter to a host country, the networking of MNEs and their country of origin, the role of FDI in national and local economic development policy, the effectiveness of investment promotion agencies and investment incentives in attracting FDI, investment treaties viewed from the perspectives of firms and countries, and the creation of international investment law and policy. By their very nature, these are often issues worth revisiting from time to time, as the subject under investigation and the context within which it is set often change or become more complex over time.

Various articles connect topicality and revisit ongoing issues, perhaps thereby giving us a taste of familiar old wine but in new bottles, influencing the flavor we taste. Here we can refer, among other things, to discussions of the role of state-owned enterprises, which has re-emerged as a key issue for the field in an emerging market context; how what used to be described as Third World outward FDI has given way to a literature on emerging market MNEs and to a re-evaluation of the aggregate geographic patterns of world FDI, in or beyond the so-called triad of mature industrialized regions (Western Europe, North

America, Japan); and the association between currency appreciation and outward FDI from China, which recalls the discussion 40 years ago of currency overvaluation under the Bretton Woods regime and outward FDI from the United States, in the work of Aliber and others.

Finally, this volume offers us an updated refinement of some longer-standing concepts in the subject area of international business. These areas include the relationship between FDI and longer term paths of national economic development and the potential for countries catching up (most especially in the earlier work and the contributions here of Terutomo Ozawa, which are full of insight); and a re-working of the evolution of government-MNE relationships, such as in the reflections from many years of practical experience and knowledge of the co-editor of this volume, Karl P. Sauvant.

All in all, this is a valuable set of topical contributions to the field, which reflects the current state of thinking on a variety of crucial issues and concerns for researchers and policymakers.

Newark, October 2012

John Cantwell

Distinguished Professor (Professor II), Rutgers University
Editor-in-Chief, Journal of International Business Studies

Preface

The Western financial and economic crisis of 2008-2009, from which recovery has been slow and with significant risks, has taken its toll on world foreign direct investment flows: from a historic peak of US\$ 2.2 trillion of outflows in 2007, they almost halved to US\$ 1.2 trillion in 2009, recovering only slowly since then, to US\$ 1.7 trillion in 2011.¹ Given the continuing uncertainty in the world economy, flows may well not rise much, if at all, in 2012 and 2013. Still, world investment flows have remained at a high level compared to the 1980s, when they barely averaged US\$ 100 billion. This reflects, among other things, the growing internationalization of firms: by the end of 2011, more than 100,000 firms qualified as “multinational,” i.e., firms that control assets abroad.

Importantly, however, as long as FDI flows remain positive, the stock of this investment continues to grow (at least as a rule). By the end of 2011, this (outward) stock had surpassed US\$ 21 trillion. It represented at least 900,000 foreign affiliates, whose sales that year amounted to an estimated US\$ 28 trillion -- distinctly a higher amount than world exports (of US\$ 22 trillion) that year. Hence, foreign direct investment has become the most important vehicle to bring goods and services to foreign markets. This is more so the case because the actual reach of multinational enterprises is much wider than foreign direct investment data indicate, as these data do not capture the myriad of non-equity relationships (management contracts, franchising, etc.) that bring the production of firms abroad under the common governance of multinational enterprises.

As the flows and stock of foreign direct investment have grown, some of its salient features have changed. Particularly noteworthy in this respect is that emerging markets (all economies that are not members of the OECD) attract now more than half of such investment flows and (by the end of 2011) had attracted over one-third of the world's inward foreign direct investment stock. Simultaneously, firms headquartered in emerging markets have become important outward investors in their own right: at the end of 2011, there were over 30,000 multinational enterprises headquartered in these economies, investing that year US\$ 460 billion abroad, for a stock of over US\$ 4 trillion. A number of important emerging market multinational enterprises are state-controlled entities (although the foreign assets controlled by such entities headquartered in developed countries are much higher than those controlled by multinational enterprises headquartered in emerging markets). Emerging market firms have become important players in the world foreign direct investment market.

Given the importance of foreign direct investment, it is not surprising, therefore, that all countries, without exception, seek to attract such investment, as it can bring a range of tangible and intangible assets (including capital, technology, skills, managerial practices, access to world markets). Virtually every country has an investment promotion agency, supplemented often with similar institutions at the sub-national level. Also, countries continue to improve their investment climate for foreign direct investors. This is reflected in the fact that the majority of changes in national investment regimes have been in the

¹ Unless indicated otherwise, all data are from UNCTAD, *World Investment Report 2012: Towards a New Generation of Investment Policies* (Geneva: UNCTAD, 2012).

direction of making the investment climate more favorable for foreign investors and that countries continue to conclude international investment agreements that protect foreign investors and facilitate their operations.

Still, the attitude of a number of countries toward foreign direct investment is becoming more differentiated, as a number of them pay more attention to undesirable effects of such investment or certain types of it. After all, for governments, foreign direct investment is but a tool to promote their own national interests, especially economic growth and development. As a result, the screening of incoming mergers and acquisitions (especially when they are being undertaken by state-controlled entities) from the point of view of national security and protecting national champions is becoming more frequent. While red tape has not replaced red carpet, market entry has become somewhat more difficult in a growing number of countries. Similarly, while the international investment regime is expanding and becoming stronger (including because it is being enforced through investor-state dispute mechanisms), some governments have begun to circumscribe, at least to a certain extent, the protection of foreign investors in the interest of preserving national policy space.

Thus, a certain rebalancing of the national and international framework for foreign direct investment is underway, in order to put governments into a better position to pursue policies that maximize the positive effects of such investment and minimize its negative effects. In so doing, we may well also expect that governments will pay more attention not only to the quantity of incoming foreign direct investment, but also to its quality (or “sustainable foreign direct investment” -- defined as investment that makes a maximum contribution to a country’s economic, social and environmental development and takes place in the framework of fair governance mechanisms, without jeopardizing its commercial viability).

While these developments unfold, many governments -- including now also those of a number of emerging markets -- encourage their own firms to become multinational, in order to protect, or increase, the international competitiveness of these firms. In fact, a portfolio of locational assets is increasingly becoming an important source of the international competitiveness of firms in general. Thus, the regulatory framework for outward foreign direct investment is receiving more attention. Virtually all developed countries have removed regulatory barriers to such investment, and most of them have put in place frameworks that actually encourage it. The great majority of emerging markets, on the other hand, lag considerably behind in this respect -- which puts their own firms at a competitive disadvantage vis-a-vis their competitors headquartered in developed countries. At the same time, the question of to what extent encouraging outward foreign direct investment (especially when it involves special financial and fiscal benefits for outward investors, in particular state-controlled entities) might distort the working of the world foreign direct investment market and hence might negate “competitive neutrality” is becoming an issue on the international policy agenda.

The importance that foreign direct investment has achieved, that it can have not only positive effects but also negative ones; that issues relating to such investment extend

beyond economic ones (e.g., the potential compromise of national security); that foreign direct investment is more complex and intrusive than trade (involving, as it does, the entire range of issues related to the production process); and that the whole subject raises all sort of policy issues are among the reasons for which the Vale Columbia Center on Sustainable International Investment launched, in late 2008, the *Columbia FDI Perspectives*. The *Perspectives* take an interdisciplinary approach, reflecting the multi-dimensional nature of the growth and impact of foreign direct investment and its regulatory framework and implications. As a rule, the *Perspectives* seek to pay special attention to policy implications. They are deliberately short in order to present readers with a concise analysis of an issue at hand. And they can be provocative in order to promote a dialogue, stimulate further research or present policy options.

This volume brings together all *Perspectives* published since the inception of this series until November 2012. It updates the first edition of this volume, released in January 2011.² This second edition is intended to provide an interesting overview of important contemporary issues relating to foreign direct investment and multinational enterprises for all those who are interested in this subject, but are not always in a position to follow diverse perspectives and what is being written in the various corners of this field. And, of course, we hope that this volume will spark further interest in the field of foreign direct investment and multinational enterprises.

New York and Dubai
November 2012

Karl P. Sauvant
Jennifer Reimer

² See, Karl P. Sauvant, Lisa Sachs, Ken Davies, and Ruben Zandvliet, eds., *FDI Perspectives: Issues in International Investment* (New York: Vale Columbia Center on Sustainable International Investment, January 2011), available at: www.vcc.columbia.edu.

List of abbreviations

BIT - bilateral investment treaty

BRIC - Brazil, Russia, India, China

CAFTA - Central America Free Trade Agreement

FDI - foreign direct investment

FTA - free trade agreement

GDP - gross domestic product

ICSID - International Centre for Settlement of Investment Disputes

IMF - International Monetary Fund

M&A - mergers & acquisition

MAI - Multilateral Agreement on Investment

MENA - Middle East and North Africa

MNE - multinational enterprise

NAFTA - North American Free Trade Agreement

NATO - North Atlantic Treaty Organization

NGO - nongovernmental organization

OECD - Organisation for Economic Co-operation and Development

R&D - research and development

SWF - sovereign wealth fund

TRIPS - Agreement on Trade-related Aspects of Intellectual Property Rights

UNCTAD - United Nations Conference on Trade and Development

WTO - World Trade Organization

PART V

INTERNATIONAL INVESTMENT TREATIES
AND ARBITRATION

Chapter 67

International investment arbitration: Winning, losing and why

*Susan D. Franck**

We know several things about foreign investment. First, foreign investment matters, reaching US\$ 1.7 trillion in 2008. Second, we know that foreign investors have new international law rights to protect their economic interests. Third, we know that those rights are now being used. So since we now know that the international legal risk is not illusory, the real questions are: who wins, who loses and why? While various commentators have asserted a variety of answers to those questions, many have done so without reference to valid and reliable data.¹ In its most benign form, these observations create misinformation, but perhaps more troublingly, might also lead to policy choices based upon unrepresentative anecdotal evidence, supposition or political rhetoric. To help alleviate these possible outcomes, this Chapter reviews recent empirical research² in order to provide basic information to fundamental questions about investment treaty arbitration (ITA) to create a more accurate framework for policy choices and dispute-resolution strategies.

So who does win and lose international investment treaty arbitration? The answer is: both foreign investors and host states win and lose.³ The data suggest, however, that they lose in reasonably equivalent proportions. Not including the disputes that ended with an award embodying a settlement, respondent governments, for example, won approximately 58% of the time. Meanwhile, investors won 39% of the cases.⁴

Winning and losing, however, is not just about whether there is a breach of the underlying investment treaty. The amount awarded is also critical. Despite the fact that

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¹ See, e.g., Press Release, Food and water watch, World Bank court grants power to corporations (April 30, 2007), available at: <http://www.foodandwaterwatch.org/press/releases/world-bank-court-grants-power-to-corporations-article12302007>.

² See Susan D. Franck, "Empirically evaluating claims about investment treaty arbitration," *North Carolina Law Review*, vol. 86 (2007) 1, pp. 16-23 [hereinafter *Evaluating Claims*] (describing the method of gathering data from publicly available arbitration award to identify 102 public awards from 82 disputes that resulted in 52 final determinations); Susan D. Franck, "Development and outcomes of investment arbitration awards," *Harvard International Law Review*, vol. 50 (2009) 2, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1406714 [hereinafter *Development and Outcomes*] (conducting chi-square and analyses of variance tests at significance levels of $\alpha = .05$).

³ This Chapter defines "winning" and "losing" using quantitative measures: (a) a binary yes/no answer about whether a government breached a treaty, or (b) a scaled quantitative variable of damages awarded. Qualitative approaches might assess experiences with ITA and measure "success" differently. Subjective approaches could consider how parties, with varying levels of familiarity with ITA, and other situational differences understand success.

⁴ Approximately 4% of the cases were settlement agreements. Figures do not add up to 100% due to rounding.

investors claimed US\$ 343 million in damages on average, that is not what they received. Rather, tribunals awarded investors only US\$ 10 million on average. This US\$ 333 million difference is not insubstantial, and it may give investors a basis for some reflection about the value of arbitration -- particularly given the need to pay the arbitral tribunal and the other legal costs associated with bringing a claim.⁵

Knowing which parties actually win and lose begs a further question -- namely: why are parties successful? This question is critical given suggestions that ITA is potentially biased.⁶ There has been some debate about whether respondents' development status or whether arbitrators come from the developing world improperly affects outcome. If these development variables cause particular results, this would raise issues about the integrity of investment treaties and arbitration.

To address this critical issue, recent research considered whether there was a reliable statistical link between the level of development and ITA outcomes. The results suggest that development variables did not generally cause particular outcomes. One study found that there was no relationship between a government's level of development and the outcome of ITA.⁷ A second study then showed that -- at a general level -- outcome was not reliably associated with the development status of the respondent, the development status of the presiding arbitrator, or some interaction between those two variables. This held true for both: (1) winning or losing investment treaty arbitration, and (2) amounts tribunals awarded against governments. Follow-up tests in the same study showed, however, that there were two statistically significant effects -- found in one sub-set of potentially non-representative cases -- that suggest arbitration must be used carefully in certain situations. Only where the presiding arbitrator was from a middle income country, the data showed that high income countries received statistically lower awards than: (1) upper-middle income respondents, and (2) low income respondents. Nevertheless, in other circumstances involving middle income presiding arbitrators or all cases involving presiding arbitrators from high-income countries, the amounts awarded were statistically equivalent.⁸ In other words, in limited circumstances, tribunals with presiding arbitrators from middle-income countries made awards that tended to favor developed countries and were different than one might expect from chance alone.

The overall results cast doubt on the arguments that: (1) ITA is the equivalent of tossing a two-headed coin to decide disputes, (2) the developing world is treated unfairly in ITA,

⁵ Franck, *Empirically Evaluating Claims*, op. cit., pp. 49-50, 64.

⁶ See e.g., Third World Network, *Finance: Bias Seen in International Dispute Arbiters*, June 22, 2007 (JUN07/02), available at: <http://www.twinside.org.sg/title2/finance/twninfofinance060702.htm> ("A little-known entity closely affiliated with the World Bank that mediates disputes between sovereign nations and foreign investors appears to be skewed toward corporations in Northern countries"); Gus Van Harten and Martin Loughlin, "Investment treaty arbitration as a species of global administrative law," *European Journal of International Law*, vol. 17 (2006). ("No matter how well arbitrators do their job, an award will always be open to an apprehension of an institutional bias against the respondent state").

⁷ Susan D. Franck, "Considering recalibration of international investment agreements: Empirical insights," in José E. Alvarez, Karl P. Sauvant and Kamil Gerard Ahmed, eds., *The Evolving International Investment Regime: Expectations, Realities, Options* (New York: OUP, 2009).

⁸ Franck, *Development and Outcomes*, op. cit.

and (3) arbitrators from the developed and developing world decide cases differently. The evidence creates a basis for cautious optimism about the integrity of ITA and suggests radical overhaul, rejection or rebalancing of these procedural rights is not necessarily warranted. While the follow-up tests and limitations of the data suggest optimism must be tempered properly, a sensible approach would involve creating targeted solutions to address particularized problems and enacting targeted reforms to redress perceived concerns about the international investment regime.

Ultimately, the data suggest that investors and governments won and lost in relatively equal measure, but governments won a bit more. While the data show also that, when they did win, investors ended up with substantially less than they requested. Moreover, the data do not establish that a respondent's development status was a reason why investors or governments were successful in pursuing arbitration. This suggests that why a party wins or loses arbitration may ultimately have more to do with factors other than development, such as the merits of a particular claim or defense. Other factors may also be linked with outcome, such as the business sector involved, the amounts claimed or the type of host state government, but they may not necessarily cause particular results. This suggests that although there are risks in pursuing arbitration, there will be times when it is warranted and, ultimately, parties should think carefully about why arbitration is in their interests.