67. International investment arbitration: Winning, losing and why

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FDI Perspectives: Issues in International Investment, 2nd Edition


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.
FDI PERSPECTIVES

ISSUES IN INTERNATIONAL INVESTMENT 2012

Edited By
Karl P. Sauvant  Jennifer Reimer
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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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. Sauvant
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 Gökgür**
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.
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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

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Jennifer Reimer, Managing Editor
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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

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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. 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

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 multidimensional 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. 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

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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
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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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.  
\(^{8}\) 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 pursing arbitration, there will be times when it is warranted and, ultimately, parties should think carefully about why arbitration is in their interests.