

BRIEFING 1: Overview

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This is the first of a series of briefings which discuss the sustainable development issues raised by legal arrangements for the protection of foreign investment. The briefings are based on legal research by IIED and its partners.² The goal is to provide accessible but accurate information for human rights, development and environmental organisations working on issues raised by foreign investment in low- and middle-income countries.

Briefing 1 provides a general overview of key issues.

As trade and investment liberalisation intensifies, many low- and middle-income countries are stepping up efforts to attract foreign direct investment. At the same time, these efforts are increasingly subject to scrutiny in terms of their ability to support, or undermine, key sustainable development goals like poverty reduction, realisation of human rights and environmental sustainability.

BOX 1.1. Definitions

Foreign investment refers to a lasting interest in an enterprise operating outside the investor's country of nationality (UNCTAD, 2006).

Sustainable development refers to the balancing of economic, social and environmental considerations. Key sustainable development goals are poverty reduction, realisation of human rights and pursuit of environmental sustainability.

Legal arrangements are an important part of the overall package that a country can offer to potential foreign investors. They include relevant rules of international law (see **Box 1.2**); the domestic law of the country hosting the investment ("host state") or, in some cases, of a third country; and contracts between investors and host states ("investment contracts"). These arrangements define the terms and conditions of foreign investment, the way its costs and benefits are shared and, ultimately, the extent to which it contributes to sustainable development goals.

To investors, legal arrangements are important to protect their assets and entitlements, and to ensure stability of the regulatory framework governing their activities. Once the bulk of a long-term and capital-intensive investment is made, the investor is a "hostage" of the host state: on the

BOX 1.2. The international law on foreign investment

Legal arrangements to protect and regulate foreign investment have crystallised into a body of international law – the international law on foreign investment. This draws on:

- **International treaties:** a web of more than 2000 bilateral investment treaties, mainly between a developed and a developing country, but increasingly also between developing countries; regional trade agreements such as the North American Free Trade Agreement (NAFTA); and sectoral treaties such as the Energy Charter Treaty;
- **International customary law:** norms shaped by the conduct of states accompanied by their belief of acting under a legal obligation;
- The **general principles of law**, usually interpreted in this context as the principles of domestic law emerging from the main legal traditions (e.g. the principle that contracts must be respected); and
- The **case law of arbitral tribunals** settling disputes between investors and states (e.g. the International Centre for the Settlement of Investment Disputes – ICSID). Although arbitral awards are only binding between the parties to a dispute, subsequent arbitrators tend to refer to earlier awards and take account of their legal reasoning and conclusions (see Briefing 5).

one hand, the financial viability of the investment depends on the investor's ability to mature projected cash flows; on the other, host state action may undermine that ability or even expropriate the investor's assets altogether (Waelde and Kolo, 2001). Such action may be shaped by official policy or by "rent-seeking" behaviour in which officials, or policies, seek to extract "rent" by manipulating the economic environment in which the investment project is implemented.



While legal arrangements may help shelter foreign investment from undue host state interference, they may also hinder the pursuit of some sustainable development goals. For instance, as later briefings in this series show, legal devices to stabilise the legal framework applicable to an investment project can constrain the host country's ability to improve human rights and environmental standards.

The tensions between investment protection and sustainable development goals call for development of innovative approaches that can reconcile the investors' imperative to ensure stability of the investment climate (itself a legitimate need) with efforts to maximise the contribution of foreign investment to the pursuit of sustainable development goals.

Developing such innovative approaches requires vibrant civil society movements that promote open and informed debate in host and home countries as well as internationally. Therefore, although the law regulating foreign investment is complex and highly technical, there is a need for citizen oversight of its development and implementation. ●

References

UNCTAD, 2006, *World Investment Report 2006 – FDI from Developing and Transition Economies: Implications for Development*, Geneva: United Nations Conference on Trade and Development.

Waelde, T. and Kolo, A., 2001, "Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law", 50 *JCLQ* 811.

Useful websites

Amnesty International
<http://web.amnesty.org/pages/ec-index-eng>

International Institute for Environment and Development (IIED)
<http://www.iied.org/SM/CR/index.html>

International Institute for Sustainable Development (IISD)
<http://www.iisd.org/investment/>

United Nations Conference on Trade and Development (UNCTAD)
<http://www.unctad.org/Templates/StartPage.asp?intltemID=2983&lang=1>

The remainder of the briefings in this series tackle four interlinked topics, each representing one of the pathways through which foreign investment is protected:

- Investment treaties;
- The so-called 'regulatory taking' doctrine;
- Foreign investment contracts; and
- International arbitration.

These pathways are mutually reinforcing: provisions of investment treaties, international norms on regulatory taking, and availability of international arbitration all strengthen the effectiveness of commitments embodied in foreign investment contracts.

Each briefing explains some of the key legal issues and their links to sustainable development, and suggests practical action to increase citizens' oversight of the governance of foreign investment. This includes:

- Monitoring host governments' negotiation of investment contracts and treaties, and promoting public debate on these;
- Using the opportunities offered by domestic law to challenge and influence those negotiations, including environmental impact assessments, parliamentary ratification/approval of investment contracts, judicial review and other processes;
- Filing third-party submissions to arbitration proceedings that raise sustainable development issues;
- Stepping up efforts to build citizens' capacity to hold their government better to account.

Useful reports

"Contracting out of human rights"
[http://web.amnesty.org/library/pdf/POL340122005ENGLISH/\\$File/POL3401205.pdf](http://web.amnesty.org/library/pdf/POL340122005ENGLISH/$File/POL3401205.pdf)

"Heavy Mittal? A State within a State: The Inequitable Mineral Development Agreement between the Government of Liberia and Mittal Steel Holdings NV"
http://www.globalwitness.org/media_library_detail.php/156/en/heavy_mittal

"Human rights on the line"
http://www.amnesty.org.uk/news_details.asp?NewsID=14542

"Human rights, trade and investment"
[http://www.unhchr.ch/Huridocda/Huridoca.nsf/\(Symbol\)/E.CN.4.Sub.2.2003.9.En?Opendocument](http://www.unhchr.ch/Huridocda/Huridoca.nsf/(Symbol)/E.CN.4.Sub.2.2003.9.En?Opendocument)

"Lifting the lid on foreign investment contracts: The real deal for sustainable development"
<http://www.iied.org/pubs/display.php?o=16007IIED>

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2 Particularly through "Lifting the lid on foreign investment contracts", coordinated by IIED; and "Global project finance, human rights and sustainable development", coordinated by the University of Essex in partnership with IIED. The briefings are specifically based on: Lorenzo Cotula, 2007, "The legal arrangements underpinning project finance: Tensions between the international protection of foreign investors' property rights and evolution in human rights and environmental standards", London, IIED, unpublished report; and Lorenzo Cotula, forthcoming, "Stabilisation clauses and evolution of environmental standards in foreign investment contracts", *Yearbook of International Environmental Law*.

The briefings also draw on Dominic Ayine, Hernán Blanco, Lorenzo Cotula, Moussa Djiré, Candy Gonzalez, Nii Ashie Kotey, Shaheen Rafi Khan, Bernardo Reyes and Halina Ward, 2005, "Lifting the Lid on Foreign Investment Contracts: The Real Deal for Sustainable Development", London, IIED, Sustainable Markets Group Briefing Paper.

About IIED

The International Institute for Environment and Development is an independent, non-profit research institute working in the field of sustainable development. IIED seeks to change the world in partnership with others by providing leadership in researching and promoting sustainable development at local, national and global levels. Our goal is to shape a future that ends global poverty and sustains fair and sound management of the world's resources.

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