GLOBALIZATION AND JUSTICE AT WTO: INVESTMENT-RELATED DISPUTES SETTLEMENT

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Abstract
Given that trade and investment have become so tightly enmeshed, one would expect this fact to be reflected in the investments legal regulation process advancing more rapidly, at least to the extent that trade relations are regulated. In the last decades, world nations have grown increasingly concerned vis-à-vis governments' low capacity to politically harness foreign investors' activity, especially when the latter are multinational companies. The potential contradiction, in letter and fact, between actions promoted by governments in order to deal with foreign investment and the freedom of trade as reflected in the articles of the GATT, is the chief impediment to the adoption of multilateral norms with regard to foreign investments.

Key words: *international trade, foreign investment, disputes settlement, multilateral agreements, international law*

JEL classification: F13, F23, K33, K41

1. Foreign multinationals vs. sovereign states: a woeful marriage

Under globalization, foreign investments have penetrated international trade to such a high degree that the two fields are now closely intertwined. As-a-matter-of-fact, they have always been interdependent: when home markets are protected by either political or natural barriers, foreign companies have but one single choice, namely to shift production abroad. An illustrating example was offered by Korean chaebols in the 1990s. Since European markets of

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household appliances were highly protected, big Korean companies like Daewoo, Goldstar, Samsung etc. entered the respective markets through foreign direct investment (FDI) or joint venture-type associations. The simple fact of becoming local actors allowed new comers "to cut costs, meet European standards and even avert dumping accusations." (Albaum et al., 2002) Furthermore, trade and investment might sometimes be complementary, for example, when multinational companies shift production in foreign countries in order to capitalize on cheaper factors or other advantages such as tax holidays, intellectual property laxer regimes and others. An important share of foreign production is then re-imported into their home country. An interesting case in point is the "Thames Valley", one of the UK's most dynamic regions, where a host of US companies' affiliates, chiefly those specialized in communications and information technology, are located (Microsoft, Dell, Hewlett Packard etc.).[1] The location in the neighborhood of London was not haphazard but was due to the parent-companies' intention to avail themselves of the host country cutting edge air infrastructure.

Tensions and disputes between investing companies and governments of host countries have worryingly intensified. A good example (DeCarlo, 2007) is offered by the dispute between the US firm Metalcald and the San Luís Potosí district of Mexico. The American firm bought in 1993 a firm headquartered in the mentioned region, which would dump toxic waste. The aim of the acquiring firm was that of using an indigenous firm as a mask for its own center of stacking toxic waste in the foreign country. Following local protests, the scheme was rejected by Mexican authorities. As a consequence, Metalcald took legal action against the Mexican government based on article 11 of NAFTA, claiming the rejection was discriminatory against a foreign firm. The arbitrage panels decided in favor of the American firm: the Mexican state was obliged to pay the claimant a 15 million dollar penalty. In brief, controversy gravitates around measures the former have taken or might take in the future for the purpose, not to stop foreign investment but to make them foster host countries' economic development, which is understandable after all. If one admits that international trade is supposed to yield benefits to all participant countries, the principle must hold in respect of foreign investments too. The question is: why are the latter harder to regulate the former?

The answer to the above question entails highlighting two contradictory tendencies: first, considering the disproportionate clout multinationals are holding in dealing with host countries, especially the little ones, certain constraints imposed to foreign investors are justified. The most eloquent proof is provided by South-East Asian countries, which, by skillfully handling governmental intervention including restrictions for foreign investors, scored high development rates. Yet the problem is, when applied, such measures often lead to the infringement of the very norms of the GATT and implicitly, to a diminution of free trade. The second tendency is related to pressers from the inside to which governments are subject when promoting such measures: not infrequently, authorities face nationalist prejudices and taboo-s like for instance, the notion that foreigners' ownership over national assets, especially when it involves natural resources, is contrary to national interests.

2. Constraints imposed to foreign investors: not always accounted for

The controversy over government-imposed restrictions to foreign investors has two facets, legal and economical respectively. Legally, the pivot is the existing juridical framework, which is GATT. From this point of view, any measure is to be judged according to whether it is against or not free trade rules, as per GATT articles. Economically, it is efficiency criteria that take precedence in judging the opportunity of such measures. Specifically, two aspects must be clarified, that is: (1) if a measure of this kind can yield the nation high enough benefits so as to compensate the efficiency losses generated by the restriction of free trade, which the enforcement of the respective measure would entail; (2) if there is an alternative measure that could possibly yield equivalent benefits without hurting free trade. The first aspect is linked to internal market flaws (the existence or non-existence of distortions) as well externalities generated by foreign investments.

In the absence of market flaws, the two scholars argue, non-interventionism is the optimal policy because constraints imposed on foreign investors decrease welfare. For instance, the requirement that foreign investors buy inputs from local suppliers in a minimum pre-determined percentage of the former's production simply raises the price of intermediary goods: extra-benefits obtained by input suppliers are offset by the higher prices asked by final goods producers. (Grossman, 1981) Thus burdening foreign investors with heavy constraints may yield benefits only when there is imperfect competition on host countries' markets. (Rodrik, 1987) However, if the host country market is beset by distortions that hinder free competition (collusion among firms, tariff or non-tariff barriers etc.), the solution is not necessarily that of containing foreign investors. In this case, the recommendation is normatively more general: measures should be commensurate with the size and cause of distortions. For instance, if the cause lies in the existence of tariffs, removing such barriers is the second best policy[2], which defines the state of an economy that cannot reach optimality because at least one optimality condition cannot be met due to a domestic constraint. The latter can be a distortion or a market imperfection that may be due to various causes such as: the existence of a monopoly, internal market protection through tariffs or subsidies, disproportionately high wages in certain sectors following trade union pressures, the presence of externalities etc. Under such conditions, unless the government pursues the optimal policy, economic growth may make the nation worse off. Thus paradoxically, the concept is in stark contradiction with conventional trade theory according to which, trade liberalization is always and everywhere a preferable policy relative to protectionism, even if pursued on unilateral basis. (Burnete, 2015)

In former central-planning-based economies from Central and Eastern Europe thongs would happen the other way around: the correction never involved import barriers dismantling; it was foreign investors that were imposed conditions. In Romania, for example, the Citroën automaker founded in 1978 a joint venture with the Romanian state, the former holding 36 percent of the share stock. The deal had two strings attached upon the French firm: mandatory legal content of 40 percent respectively interdiction to repatriate profits, which had to be reinvested in Romania. The consequence was a low quality of cars produced by the Romanian plant, from which, one fraction were exported on extremely exigent western market. The deal failed and the French investor withdrew thoroughly from Romania.

3. The legal framework: comprehensive but not exhaustive

Despite numerous difficulties, there still exists a legal and institution framework governing foreign investment, which though imperfect, does works. Basically, it consists of bilateral agreements (including free trade agreements with special parts dedicated to investments), regional agreement (provisions of treatments underlying integration organizations) and multilateral agreement (under the auspices of the World Bank), to which one might add certain legal norms adopted by international organizations that deal with trade and investment issues, e.g. the Organization for Economic Cooperation and Development (OECD) and the United Nations Conference for Trade and Development (UNCTAD). Yet these last two, unlike the agreements, lack legal power. I shall discuss below the main components of the juridical system, designed to settle foreign investment-generated interactions, including various institutions' affiliation, attributes and operation mode.

Bilateral Investment Treaties

Bilateral Investment Treaties (BIT) are agreements between states providing conditions in which public or private entities from one party may act as investors in the other. They were particularly popular during the 1990s, in the context of OECD countries having failed to reach a multilateral accord. The obvious goal was to foster foreign investment flows, in view of the fact that all of countries of the world are virtual senders and/or receivers of capital.[3] From among the specific objectives it is worth mentioning the belief of many nations, especially of the developing ones, that BITs will make for the loopholes existing in national legislations in the field of intellectual property, thereby making their countries more attractive to foreign investors. Technically, even if there are a lot of differences among countries from this viewpoint, BIT also exhibit similarities as to how foreign investments are defined as well as the principle governing major issues related to foreign investors' behavior in the alien country that is: the treatment they enjoy, funds transfer, expropriation, dispute settlement mechanisms etc. Significantly, the question that invariably emerges in all of the treaties and at the same time is also the thorniest is linked to expropriation, namely the host country government unilaterally appropriating, either through nationalization or enforced public auction, foreign investors' assets, which most often are the very object of the latter's investment. Essentially, expropriation involves two major juridical aspects: first, the investor's right to take legal action against the host country government. This option is awkward enough considering the public authorities' possibility to invoke sovereignty in support of their action, which not only will place the investor in an inferior state but could also engender political tensions. Second, there is no less controversy as to the conditions and mode of carrying out expropriation. In general, the parties insist that governments should resort to this kind of measure solely for purposes of public interest, with strict observance of the legislation in force, without discrimination and with a compensation fee in favor of the foreign investor that is subject to it. With reference to this last point, although most BITs include compensation clauses, there are large discrepancies in respect of the amount of compensations, which involves evaluating the assets that fall under expropriation. Certain treaties have duly-formulated clauses, stating for example, that investors' assets must be taken over at their market value existing at the moment prior to the expropriation. Other agreements have more vague formulations, while others specify nothing in this respect, referring the matter to judges.[4]

Regional agreements

The shift from bilateralism to multilateral regulation in respect of investments is entangled with the regional economic integration process. Integration organizations are making efforts to support foreign investment inflows and enhance juridical regulation of relationships between investing firms from outside the blocs and member states. The European Union (EU) for example, is attaching special importance to foreign investments, which seems to make up for the lack of interest for the issue in the past century. Although the regulation framework still rests on the common trade policy principles enshrined in the Treaty of Rome, it is subject to an ample reform process, based on the Treaty on the Functioning of the EU, aka the Lisbon Treaty, adopted in 2009. The major change the present reform is expected bring about is undoubtedly the transfer of competencies in the field of foreign investment, from member states to the Union level. Thus, besides exclusive competence in negotiating trade agreements, the European Commission is empowered to equally negotiate those related to investments.[5] The new prerogatives will allow the Commission to sign bilateral treaties with third countries, which will replace the existing ones previously concluded by member states.[6]

The core of the new EU approach is the idea that Europe needs more investment, from both inside and outside. The EU policy in the field will therefore have to secure protection to foreign investors and additionally, to attain the fundamental objective of increasing EU competitiveness.[7] However, in spite of the firmness of recent undertakings, Europe lags behind its partners beyond the Atlantic, members, in respect of foreign investment regulation. The North-American Free Trade Agreement (NAFTA), which came into force in 1993, includes no less than 4 articles dedicated to the investment issue, as follows: chapter 11 states basic rules as to the treatment of foreign investors as well as the settlement of disputes between investors and host countries; chapters 12 and 14 deals with services provision problems; chapter 17 is focused on intellectual property rights.[8]

Multilateral agreements under the auspices of WTO

Because the article of NAFTA deal with the investments issue in a comprehensive and pragmatic way, its provisions underlay the negotiation, under the auspices of OECD, of the Multilateral Agreement on Investment (MAI), which nevertheless could not be adopted, having been boycotted by a number of non-governmental organizations (NGOs) that oppose globalization and even by certain OECD countries' governments. In general the opponents of MAI contend that this type of international accords open the gate for unfettered domination of multinational companies, rendering poor economies vulnerable to market flaws. "But in developing countries, markets are often absent or, even when present, often do not work well, and prices accordingly are not able to perform this function." (Stiglitz, Charlton; 2005) It is therefore normal that governments of these countries should pursue policies apt to counteract such market defects, in order to diminish their economies' vulnerability. To this purpose, host countries' authorities may take a variety of steps such as: a) supporting indigenous production; hence the condition that foreign investors' output has minimum local content or that inputs are supplied locally; b) balancing the current account; hence the condition that foreign investors export to an extent at least equal to the imports they make; for this purpose, the government may place a ceiling on the funds investors may exchange into hard currency up to the amount they yield from exports; c) technology transfer; hence the condition that foreign investors allow local partners to know and assimilate the technology used etc. However, the provisions contained in the final draft of MAI prevent host countries' governments from imposing such conditions. At the same time, the opponents of the accord contend it shrinks multinationals' responsibility in a number of domains that affect the sustainable development of host countries such as environment protection, labor standards, cultural policies etc.

The last two decades of the 20^{th} C were marked by the advance of globalization, which altered even the nature of trade (Gilpin, 2004), rendering its rules and regime obsolete. Trade, argues the reputed scholar, is in interplay with the global activity of multinational firms and keeps expanding rapidly in both services and processed goods. Under these conditions, nations' obligations deriving from GATT could be applied to the measures taken by governments against foreign investors to the extent that such measures discriminate between indigenous and imported goods. (Trebilcock, Howse; 2007) As a consequence, the problem of foreign investments regulation could not be postponed any longer and was included on the Uruguay Round' negotiation agenda. Dissenting voices emerged from the very beginning, in connection with the meaning of the term "trade-related disputes". Whereas developed countries opted for a broader definition of the term, many developing countries attached it a much narrower sense, thereby shrinking its area of applicability. The latter claim that WTO is not capable to rule on investment-related matters and therefore it should stick to its traditional domain, trade. In the end, the accord on Trade Related Investment Measures (TRIMS) was adopted and included in the Final Act of 1994. In the preamble, of TRIMS it is written: "Following an examination of the operation of GATT Articles related to the trade-restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects on trade."[9]

Article 2 of TRIMS specifies two categories of measures governments must not take that is: the ones considered incompatible with article II, paragraph 4 of GATT regarding national treatment, respectively the ones that infringe article XI of GATT regarding removal of quantitative restrictions. The first category includes measures such as: a) local content or local procurement, namely the investor's obligation to buy or make use of products of indigenous origin or originating in internal sources, bearing due specification thereof or expressed as a percentage of output; b) conditions for the current account balancing, meaning that the amount of imports used in production by the investor is limited to the amount of indigenously-produced goods it exports. Still, the TRIMS accord included exceptions: article 4 provides the possibility for a developing country to temporarily deviate from the provisions of article 2 should it be in a state covered by article XVIII of

GATT, which allows a signatory party to deviate from the provisions of articles III and IX of GATT with the aim of improving its balance of payments. As to the settlement of disputes deriving from the application of TRIMS, article 8 states that articles XXII and XXIII of GATT regarding trade disputes settlement are also applicable to investment-related litigation.

Conventions under the auspices of the World Bank Group

Foreign investments have been a thorny issue for the WTO ever since the signing of the GATT accord in 1947. Disputes around the investments issue were in fact one of the chief causes for the non-adoption of the Havana Charter. After the coming into force of the accord, many countries still attempted to keep the issue outside the WTO's preoccupations and attributes. During this period (until the adoption of the TRIMS accord in 1994), the only competent forum in foreign investments regulation has been the World Bank Group through its International Center for the Settlement of Investment Disputes (ICSID), headquarters in Washington, an autonomous international institution founded in 1966. ICSID is not a court proper, namely it neither conciliates nor arbitrates in litigation. Its main objective is to coordinate, as impartial forum, conciliation and arbitration of legal disputes between eligible parties (most often states vs. investing firms), amiably or through arbitration.[10] More specifically, the Center provides the institutional and procedural framework, while litigation settlement is the responsibility of independent commissions of conciliation and arbitrage.

The insufficiency, for decades, of regulations in the domain of foreign investments and the repeated postponement of the inclusion of the issue on the GATT's negotiation program induced among companies reluctance to invest in certain countries or regions of the globe characterized by political instability. Fears are related to the possibility of expropriation or nationalization of the investment by host countries governments but also to damages inflicted by military conflicts. In order to improve the state of affairs and encourage firms to invest in poor countries too (the so-call IDA[11] countries), where investors often face non-commercial risks, the World Bank adopted in 1985 the Convention for the establishment of the Multilateral Investment Guarantee Agency (MIGA). The Agency promotes foreign direct investment in developing countries in order to foster economic development, reduce poverty and improve people's life. MIGA encourages investments that further development, providing investors with guarantees against political risk resulting from: restrictions to exchanges of funds into hard currency and transfer of funds; expropriations; war, terrorism, civil turmoil; breach of contracts by host nations.[12] Since its establishment, MIGA granted guarantees worth $27 billion for more than 700 projects in over 100 developing countries.[13] Today, a significant share of the total amount of guarantees granted by MIGA is held by investment projects designed for the financial-banking sector. MIGA-backed projects facilitate the penetration of foreign banks in developing countries, supporting the development of financial-banking systems in the respective countries through new technologies and management systems.

4. Conclusions

Under globalization, international trade has got ever more entangled with the global activity of multinational firms. Yet unlike trade rules, which enjoy a legal framework in the form of GATT articles, foreign investment flows are largely unregulated. Ever since the GATT accord came into force, member countries attempted to keep foreign investments outside the WTO's preoccupations and attributes. The consequence has been the surge in the number of tensions and legal disputes between foreign investors and governments of host countries. This "cold war" is being fueled by the clash between vested interests on either side: the former wish to enjoy equal treatment to the one applied to indigenous firms; the latter wish to make sure foreign investments further the country's economic development. Specifically, host countries governments often impose conditions to ensure that foreign investments support indigenous production such as: minimum local content; supplying inputs locally etc. Concomitantly, foreign investors may be forced to balance the host country's current account. To this purpose, governments may: oblige foreign investors to export to an extent at least equal to the imports they make; limit the funds investors may exchange into hard currency up to the amount they yield from exports; allow local partners to become acquainted to and even assimilate foreign investors' technology etc.

5. Notes

1. 'Air hub to east of London leaves Thames Valley cold', *Financial Times*, Aug. 26, 2013
2. The second best theory belongs to Lipsey and Lancaster (Lipsey, R. & Lancaster, G.K., "The General Theory of Second Best", *The Review of Economic Studies*, 1956, Vol. 24, pp.11–32)
3. The first BIT was signed in 1959. Their number has continuously increased since then. In the 1990s, 470 such treaties were in force, while in the first decade of the present century, there were over 2000. At present, BITs encompass over half of the investment flows from OECD countries towards developing ones. The number of such treaties concluded among the latter is equally rising. After 1990, ex-communist countries from Central and Eastern Europe signed such treaties themselves with a host of countries. (Hallward-Driemeier, M.: *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit and They Could Bite*, in World Bank, Development Research Group, Investment Climate, 2003)
4. M. Hallward-Driemeier: the quoted report.
5. European Commission: Reaping the Benefits of Globalization, *European Competitiveness Report*, ch.4, 2012
6. For example, the future UE-China agreement will replace the 26 existing agreements previously concluded by member states with this country . (Berger, A., Bungenberg T., Manjiao, M.C.: China-EU Investment Rule-Making and the Future of International Investment Law, International Conference, Xiamen, China, Sept. 2013)
7. For example, article 173 from the Treaty of Lisbon provides a number of concrete objectives meant to ensure the conditions required with a view to enhancing EU economy's competitiveness. The text of the said article also underscores the importance of maintaining a favorable, attractive business environment. (European Commission, *European Competitiveness Report*, ch.4, 2012)
8. NAFTA – http://www.worldtradelaw.net/fta/agreements/nafta.pdf
9. WTO: TRIMS, text integral, http://www.wto.org/english/docs_e/legal_e/18-trims_e.htm
10. https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=AboutICSID_Home
11. International Development Association
12. MIGA Convention: http://www.miga.org/documents/miga_convention_november_2010.pdf
13. The World Bank (2013), *News & Broadcast*:

http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20040648~pagePK:64257043~piPK:437376~theSitePK:4607,00.html
14. World Bank (2011) 'MIGA's Financial Sector: Guarantee in a Strategic Context': http://lnweb90.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/744A3E09A22D26D7852578D500595A27/$file/MIGA2011_AR.pdf

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