1. Introduction

Bilateral investment treaties (BITs) are the classical facet of the international investment regime while Free Trade Agreements (FTAs) including an investment chapter proliferate. From a policy point of view, the crucial question remains whether these diverse international investment agreements (IIAs), which give shape and substance to the international investment regime achieve their goals, namely to ultimately increase foreign direct investment (FDI).

The negotiations for the recently concluded Trans-Pacific Partnership (TPP), and the ongoing discussions about the Transatlantic Trade and Investment Partnership (TTIP), Regional Comprehensive Economic Partnership (RCEP) and other investment treaties such as the U.S.-China BIT or the EU-China BIT, show that there is little knowledge among lawyers and policy makers about the impact of IIAs on FDI. Economists believe they know a little more, but their knowledge (and often contradictory results) derives from empirical studies treating IIAs (and actually only BITs) as homogenous (notwithstanding measurement problems related to FDI). The limited knowledge is not a result of negligence or lack of interest, but rather due to a lack of information.

There are several reasons why there is divergence of views among scholars on the question.

- First, BITs/FTAs are very heterogeneous and all the provisions in BITs/FTAs are tailor-made to serve contracting parties’ specific interests. All stakeholders will agree that while IIAs by and large have similar structures, the devil is in the detail: Actually, the provisions do not only differ but they greatly vary innerving the whole international investment regime with a complexity that few other international regimes know. Thus, it is misleading to determine the real impact of BITs/FTAs if we treat them as a dummy variable in economic models. In fact, studies that take into account the heterogeneity of BITs/FTAs suggest that they have some impact, though such studies and their analytical scope are limited. Thus, detailed qualitative analysis of BIT/FTA provisions is necessary to examine the real impact of BITs/FTAs on FDI.

- Second, because BITs/FTAs include various provisions, it is critical to examine the interrelationships among various provisions/agreements in assessing the impact of BITs/FTAs. Investment provisions in BITs/FTAs are interrelated and their impacts on FDI are intertwined. In the case of FTAs, other than the investment chapter, there are several chapters that may also have impacts on FDI. Given the significance of GVC in investment decision making, trade liberalization (tariff) and trade facilitation chapters in an FTA seem to have an impact on FDI. Various types of harmonization are also likely to have an impact on FDI because they reduce the cost of business, which is critical to investment decision making. In addition, services chapter in FTAs (Mode 3) has some overlap with investment chapter. Furthermore, one country may sign various types of IIAs with different partners that may have MFN provisions and two countries may sign a multiple number of IIAs that may interact with each other (e.g. both BIT and FTA).

- Third, whether provisions of BITs/FTAs would become effective in attracting FDI depends on external conditions such as the quality of governance of recipient countries. While it is not easy to generalize the argument whether BITs/FTAs are compliment
complements or substitutes for domestic governance, in reality, the way in which the two are interrelated is complex. For example, the investor state dispute (ISD) clause may be a substitute to the domestic juridical system (when domestic juridical system does not work well, ISD is very effective), while the liberalization clause may be complement to domestic system (when institutional quality is good, liberalization clause has an impact on FDI). Hence, provision level analysis is necessary in examining the importance of various types of external conditions.

Since investment-related provisions in BITs and FTAs are heterogeneous and complex, conducting sound empirical analyses is not easy. In order to overcome this, it is helpful to conduct a “conceptual” work to examine the mechanisms in which investment provisions in BITs/FTAs affect FDI, in addition to empirical analyses. All empirical analysis, in order to be compared (over countries, continents or time) should be developed against the canvass of a robust conceptual framework.

The conceptual paper would provide several hypotheses on the impact of BITs/FTAs on FDI, which can be tested in empirical studies. The following are amongst the important points to discuss in examining the mechanisms in which BITs/FTAs affect FDI:

(i) The difference between BIT and investment chapter in FTA in terms of provision coverage.
(ii) Which provisions in BITs/FTAs are likely to have a significant impact on FDI;
(iii) The interrelationships among provisions within one BIT/FTA and, altogether, their impact on FDI;
(iv) The interrelationships among agreements signed by a pair of countries. How does the impact of BITs on FDI vary in combination with FTAs? i.e. when there is a BIT combined to a FTA dealing with trade matters only (e.g. Japan-Malaysia BIT combined to Japan-ASEAN FTA) and/or when there is a BIT coupled to a FTA with investment Chapter (e.g. China-Australia BIT + China-Australia FTA 2015)
(v) The interrelationship among BITs/FTAs signed by one country with various partners, especially through MFN;
(vi) Under what external conditions (e.g. governance quality of recipient country) are provisions likely to be effective and have an impact on FDI; which provision’s impact on FDI is dependent on external conditions?

2. The Notion and Scope of Investment: The Critical Determinant

This section must focus on the notion and scope of the “investment”. Because the it investment is narrowly defined it will immediately reduce the likely impact of any investment treaties (including those with generous protection). It is something largely ignored by literature but we must address it as the definition of “investment” is actually a major variable to assess the impact of treaties. Interestingly, the notion of investment is quite complex.

The integration process of economic concepts in the legal regulation is introduced gradually. Its starting point begins with the assimilation by the law of the concept of investment to continue with other economic concepts. It does not exist to date in the legal regulation, a single static conception of foreign investment. Therefore, the analysis must target, for the first time, the definition of this concept, to then bring the main criteria that restrict this definition. The concept of investment is de facto an economic concept. In legal literature it has made its appearance and was devoted relatively late. In general, the investment means contributions and duration in time represents an opposite operation to the act of consumption. The integration of this concept
in the legal regulation allows economic operators to determine the scope of the law, with details of the reception conditions of the investment and its legal regime. However, over time, the concept of foreign investment has changed. Indeed, the evolution of the concept of investment is representative of the economic and political changes that have occurred especially through the twentieth century.

In economic reality several investment agreements include various restrictions to limit the scope of the definition of investment. Among the most frequently used restrictions is a reference which provides that the investment is covered by the agreement only if it corresponds to the laws of the host country. For example, in the bilateral treaty type used by China, in Article 1.1, it is expected that “the investment term means all types of assets invested by investors of one Contracting Party in accordance with the laws and regulations of the other Contracting Party in the territory of the latter [...]” Thus, for agreements which provide that restriction, if the investment has not been established in accordance with the laws and regulations of the country, the investor cannot enter into the definition of investment mentioned in the agreement. Another conceptual alternative provides for the existence of a separate clause that indicates that an agreement will apply only to investments made in accordance with the laws and regulations of the host country or which have been previously approved by government representatives of the country.

The duration of the investment

Another category of restrictions on the definition of investment refers to the date of signature of the agreement or the date of its entry into force, to exclude any investment rights made before that date. This type of restriction is sometimes used by developing countries seeking to exclude benefits investments in their territory before the entry into force of the protection agreement. This is to avoid a windfall that would unduly benefit the earlier investments to the treaty.

Another reason for this trend to exclude pre-existing investments of the financial benefits resulting from the agreement is undoubtedly its legality, when a new agreement replaces former treaties which gave the investor the right to choose between different schemes internationally.

On the other hand, the exclusion of pre-existing investment may disappoint investors who would be placed at a disadvantage vis-à-vis investors who will establish investment after the entry into force of an agreement. The exclusion of pre-existing investment may adversely affect the credibility of a host country with regard to its promises of granting of a favorable investment climate. Despite that, certain agreements do not hesitate to provide for the exclusion of previous investments as shown in this special clause inserted to exclude all investments made before the entry into force of the Indonesian Law No.1 of 1967 on the Investment Foreign Capital – “the rights and obligations of the parties concerning investments made before 10 January 1967 will not be affected in any way by the terms of this agreement”.

In contrast to this reductive option, most BITs do not mention the exclusion of pre-existing investments. Instead, some clearly specify that they apply even to these investments, "this agreement should apply to investments in the territory of a Contracting Party made in accordance with the laws and regulations of the country, for the investor the other contracting party, already existing at the time of entry into force of this Agreement”.

The nature of investment
Another category of limitations refers to the exclusion of investments that are not direct investments, as are portfolio investments. In this case it may well be mentioned that the investment term should refer to “investments for the purpose of establishing lasting economic relations between the investor and the company, which will offer the investor the possibility of exercise significant influence in the management of the company concerned”. Such a restriction may be inserted into an agreement intended to facilitate the flow of international investments, when the host country wants to attract foreign investment, but not necessarily in portfolio investment, where the host country fears the possible harmful effects.

In this context, we should mention other definitions which sometimes do not appear in bilateral agreements, such as the IMF’s definition for direct foreign investment described above. Meanwhile, the OECD definition “recommends that a foreign investment enterprise is defined as an enterprise in which the foreign investor owns 10% or more of the ordinary shares or voting power”.

An investment agreement can still include portfolio investment, if it is long-term. In this case, the most important element that is taken into account is the degree of investor’s influence in the management of the company; but the duration of the investment is not taken into account.

For example, the Convention for establishing the Company for investment guarantees between Arab countries, defines the eligible investments to be provided by the Company: “(1) Eligible investments include guaranteed for all investments made between the participating countries both direct investments (inclusive of companies and their branches or agencies, ownership of part of the capital and real estate), that investments in portfolio (including shares and bonds). Eligible investments also include loans for a term exceeding three years, as well as short-term loans that the Council could decide to treat, in exceptional situations, as eligible. (2) To identify the corresponding investments the objectives announced in the previous paragraph, the Company will consider the IMF guidelines on the definition of assets and long-term liabilities in the context of the preparation of the statistical balance of payments.”

Although short-term investments are not excluded from this definition clearly marks its preference for long-term investment that should be specified as such in an investment agreement.

The size of the investment

Another category of restrictions refers to the exclusion of an investment because of its dimensions. For example, the Investment Code of the Economic Community of Great Lakes Countries states that “the minimum size of an investment is set at one million US dollars or equivalent”. This kind of precision can occur in foreign investment promotion agreements where it is considered an investment is to a large extent determined, but it can bring significant benefits to the host country.

However, many countries are open to investments by small and medium-sized enterprises, so that this type of restriction is not frequently inserted into the agreements. This explains that a large majority of countries is not in favor of a reference to the size of investment in the agreements they spend.

The sector of the economy
As for the economic sector, it is possible that the investment term definition is limited only to certain sectors. For example, in the Treaty for Energy, it is stated that: “the term” investment “refers to any investment associated with an economic activity in the energy sector and to investments or classes of investments mentioned by some Contracting in his field, [...] and notified the secretariat as well”.

In this particular situation, the agreement is clearly intended to cover a specific industry, in this case the energy sector, and all its clauses are limited audit sector. It is not excluded, however, that in some agreements, especially those that liberalize and encourage international investment flows, a host country wanting a specific clause may extend the initial scope of the Agreement, and then it was initially limited to only make investments in a sector of the economy. This approach is illustrated in the General Agreement on Trade in Services (GATS), where, instead of restricting the investment scope of intervention, it is possible for the signatory states, in Article XVI, to opt for sectorial commitments for the extension of the agreement in the desired areas by the state concerned.

**Alternative definitions**

Besides the classical definitions which we have seen, based on the assets of the company, there are alternative definitions that address the concept of commercial business interests and the criterion of control in this business. An example in this regard is constituted by the Free Trade Agreement between Canada and the United States, including in the definition of the term investment creation or acquisition of a commercial company or a share capital in a company or commercial company, which offers the investor control over the company in question.

Although most definitions based on the company’s assets are usually wider than those based on the concept of enterprise, in practice, with staff limitations, there is a considerable rapprochement between the two. Thus it is sometimes difficult to differentiate between them.

Firstly, in the definition based on the criterion of assets, we find the concept of firm, and it is not possible to state whether or not it is a commercial company. The term “corporation” is probably more limited than that of “firm”, but as we have seen, in many chords there are restrictions on the generalized definition of investment with the aim of including in the scope of the agreement the only investment established for commercial purposes.

Secondly, if we consider the agreement between Canada and the United States, it refers to direct investments, which exclude portfolio investments. However, the definitions based on assets, can sometimes limit the concept of investment, excluding the various types of investment, including portfolio investment.

Another alternative to the detailed definition of investment based on assets is to omit the general definition and to include instead a list of transactions covered by the investment in question.

An example, in this sense, is in the code of liberalization of capital movements in the OECD, where “investment” and “capital” terms are not really defined, but there exists in Schedule A a list of liberalized capital movements. This list is quite long and includes a wide variety of capital movements, among which are also the direct investments.

Another alternative encountered in legal instruments provides a definition of investment based on transaction. It is different from the conceptual point of view of the definition based on the
asset. The OECD Code by its nature applies to transactions, not to the assets. Because the code’s main objective is the liberalization of capital movements, its design investment takes into account only transactions involving the establishment and liquidation of an investment, but not the protection of property.

It is on this aspect that arises the distinction between the two definitions, and could well join the idea expressed earlier that the definition of investment should be dependent on the purpose of the agreement is to liberalize or to protect the investment.

3. Independent impact of each BIT/FTA provision on FDI: micro approach

Once the notion of “investment” has been defined, we need to relate it to the scope of protection provided under IIAs. There are many and the paper will not be able to cover all. So I suggest a brief overview which will allow to justify on the issue of treatment, i.e, NT, MFN and FET.

A foreign investor could expect to receive (heavy) compensation in the case of the host state refusing to comply with WTO rulings. In essence, the investment treaties would provide financial compensation for the non-respect of WTO obligations without, however, automatically securing compliance. Practically, what is then going to be the decisive legal question is the calculation of compensation under investment treaties, which can be expected to be higher than compensation in the WTO context because WTO law provides only ex tunc compensations while investment law might allow a greater flexibility to international tribunals.

In principle, the treatment of international investment is defined by domestic law, that is to say the law of the state of the investment of territoriality. Thus, an investment host state makes the rules and regulations applicable to investments according to the desired orientation, incentive, or disincentive. Exporting countries of investment, for most northern countries are favorable to domestic law mechanisms because they allow them greater concessions in terms of treatment and protection from the state of territoriality. For their part, importing countries investments, often those of developing countries, are favorable to the mechanisms of international law, because the use of an international interest allows them to mitigate the concessions would welcome the state of nationality investment. This feature was debated in a lively way during the 1960s, and it was the cause of the proliferation of conventional instruments on the treatment and protection of investments. In general, a treaty invariably stipulates that the host country should pay for investment once it is established in its territory. Very often bilateral treaties include one or more general principles, together or individually, which are intended to provide global criteria through which it is possible to judge whether the treatment accorded to an investment is satisfactory, and they also help to interpret special situations which should be applied to more specific provisions.

3.1. The Difference between BIT and Investment Chapter in FTA

This section briefly discusses the difference between BIT and investment chapter in FTAs. It also explains the variety in investment chapter in FTAs.

3.2. The likely impact of each BIT/FTA provision on FDI

1 SERGEY RIPINSKY & KEVIN WILLIAMS, DAMAGES IN INTERNATIONAL INVESTMENT LAW, 55–56 (2008).
This section discusses which provisions in BITs/FTAs are likely to have an impact on FDI. BIT/FTA provisions to be discussed should include but not limited to: (i) national treatment (NT), (ii) fair and equitable treatment (FET), (iii) Investor State Dispute Settlement (ISDS), (iv) performance requirements (PR) prohibition, (v) expropriation and (vi) liberalization commitments, including non-conforming measures.

The treatment of investments is defined as “the set of principles and rules of international law as national law governing the regime of international investment, since the moment of its formation until its liquidation”. An initial distinction can be made, according to UNCTAD, between the general standards of treatment, that is to say, the standards for all aspects of the existence of a foreign investment in a host country, and specific standards processing that refer to particular aspects. The general standards of treatment found systematically in a bilateral agreement include absolute norms and standards. This generally means that the absolute standards are those that set out the treatment to be given. The standards are the standards that define the required treatment by reference to the treatment accorded to other investments. However, it should be noted that “absolute” terms and “relative” terms are not universally accepted. Thus, this classification, mainly initiated and used by UNCTAD, has no legal implication. Generally, bilateral treaties can therefore include several provisions on absolute standards for the treatment to be accorded. BITs provide several clauses that are part of the absolute standard of treatment accorded to investments. These provisions for the FET, full protection and security, the prohibition of arbitrary or discriminatory measures and treatment in accordance with international law, and one or more provisions relating to the treatment. BITs use two different terms in order to prevent the discriminatory treatment of investments. These are the MFN clause and the standard of national treatment (NT). We discuss below the applicability of these two types of treatment in bilateral treaties, as well as exceptions to these two treatment standards.

The key provisions analyzed in this paper are the following.

3.2.1. MFN

While the idea of MFN is relatively straightforward, namely “all treaty partners should be treated equally”, the significance of MFN in terms of FDI impact depends on its scope. The actual applications of MFN provisions are various; (i) pre-establishment MFN and post establishment MFN; (ii) whether MFN covers substantial provisions only or covers both substantial and procedural provisions; (iii) whether MFN provision in investment treaty is applicable to investment chapter in FTAs and vice versa (REIO exception); (iv) whether provisions in “old” agreements can be imported or only provisions in future agreements can be imported by MFN; (v) auto MFN and conditional MFN (MFN subject to negotiation).

3.2.2. NT

The second notion of equal treatment and mainstay of the investment regime under IIAs is the principle of national treatment prohibiting discrimination between national and foreign investors. The protection of national treatment has important effects on investment protection. Together with the MFN obligation, it forms the fundamental principle of non-discrimination in investment law. NT obligation is one of the cornerstones of the system and applicable throughout the IIAs. National treatment is subject to a number of important exceptions (with regard to FDI in specific sectors or volume), thus permitting differential treatment for various policy reasons. These
exceptions and qualifications confirm the central role of national treatment but also prove the system’s sophistication in taking into account legitimate privileges accorded to domestic production and other legitimate policy goals. As to the schedules of commitments in the context of pre-establishment rights, national treatment basically applies to the extent that the countries concerned have not set out specific conditions and qualifications for the different modes of supply.

3.2.3. ISD

The dispute settlement provisions provide the means of ensuring that the standards of treatment and protection granted by the treaty are binding and effectively implemented. As such they play a critical role in bilateral treaties.

According to experience, difficulties can easily arise concerning the interpretation and application of the treaties, and although some could be resolved by the parties themselves, others might require external means of resolution. The presence of effective mechanisms for conflict resolution is the ultimate guarantee of security for foreign investors. Investment disputes in bilateral investment treaties may involve disputes between private investors, between a state and investors of the other state, or between state parties to a treaty. Conflicts between private parties are normally resolved by recourse to the courts of the state which has jurisdiction under the rules of private international law or commercial arbitration. Therefore, they are not the object of this article.

The conflict between a state and investors of the other state should normally be also submitted to courts or competent national authorities. These conflicts could also be subject to another mechanism, mutually agreed. This appeal is currently the standard practice for BITs.

Before analyzing the dispute resolution mechanism, it should be noted that several treaties provide for a provision that the contracting parties shall consult each other on a subject of the treaty at the request of either contracting party.

Most bilateral treaties contain clauses on the settlement of disputes between investors and host states. In older treaties that provision specifically mentions the types of conflict to which it applies. Thus, only those that meet the criteria of the definition can be submitted to arbitration.

For some time, the most frequently used approach requires only that the dispute is related to an investment. Under this approach, most treaties use different formulations, among which there is very little difference.

For example, a treaty may mention that the clause of the conflict between the investor and the state applies to disputes “related to” investment, “relating to” investment “in respect” of the investment, or “about” investing. “Each Contracting Party consents to submit any legal dispute occurred between that Contracting Party and an investor of the other Contracting Party concerning an investment of that investor in the territory of the Contracting Party, the International Centre for Settlement of Disputes regarding investments between States and nationals of other States (...).”

A second approach requires that a dispute concerns a provision of the treaty. Some treaties apply the provision for disputes “investor–state” in any dispute concerning the “interpretation or application” of the treaty or on the obligations of the host country under the treaty. This is a
more specific provision than the last. Another variant of this second approach proposes to limit the application of this clause only to disputes concerning certain provisions of a treaty. It reflects a desire to treat the arbitration of disputes with foreign nationals as an exceptional means on relatively rare occasions. A third approach, characteristic of treaties signed by the United States, is between these two extremes. It applies to disputes concerning the breach of an obligation under a treaty or an obligation stipulated in an investment license. Unlike the second approach, it is not limited to the obligations created or codified by the Treaty.

The treaties signed by the United States contain an exception that does not appear in other treaties. This exception excludes from the scope of a treaty the disputes affecting the export credits and insurance programs, which are usually covered by other agreements. The vast majority of BITs require that the investor and the host country shall endeavor to resolve the dispute amicably, through negotiations, before submitting it to arbitration.

In most cases, the treaties require a minimum time between the onset of the conflict and its submission to arbitration. The specified time is usually six months, but it is not unusual that a treaty provides for a different period of time.

Under international law, especially the Washington Convention of 1965, a host country cannot accept the claim of a private investor against it if it did not first exhaust all domestic remedies available to it under the law of the host state.

The question that then arises is whether the investor must exhaust these internal remedies before appealing to the bilateral treaty mechanism for dispute resolution and to do so directly against the host country.

3.2.4. Liberalization methodology

Liberalization in the context of investment treaties is characterized by the application of both NT and MFN at the pre-establishment stage. In this respect, even before the FDI crosses the border it has been granted NT and MFN which in effect amounts to an opening up of the market.

However, just because IIAs cover investment liberalization does not mean the liberalization is significant. In fact, an investment treaty providing for pre-establishment rights may well be full of exceptions which may annihilate the effective liberalization.

In addition, there are variations as for the techniques to deal with pre-establishment rights. Positive list or negative list. Non-conforming measures (existing measures and future measures). The relationship between service and investment chapters in FTA. Whether service commitments in FTA is GATS plus. The significance of “SS commitment” in positive list service schedules.

4. Interrelationships among provisions: endogenous dimension

4.1. How provisions in one BIT/FTA are interrelated with other provisions in the same agreement

The interpretation/value of each provision depends on other provisions in the same agreement to a certain degree. This subsection will consider such interrelationships with concrete examples.
For example, the value of NT may depend on liberalization commitment and non-conforming measures included in the agreement. We should also analyze the interrelationship between investment and services chapters to identify the impact of BITs/FTAs on services FDI.

4.2. How several agreements signed by the two countries are interrelated

Two countries may sign several IIAs that have an impact on FDI, such as BIT and FTA with or without investment chapter. There is a possibility that a certain type of agreement brings “booster” effect on the impact of the other agreement’s impact on FDI. There might be a “best combination” of agreements in terms of the impact on FDI.

There are several issues regarding the combinations of agreements that need careful examinations.

BIT + FTA. This is an interesting scenario to examine the impact of BIT. FDI may be increased only when FTA is signed, not when BIT is signed. There are two possibilities: (i) BIT + FTA (without investment chapter) (BIT to be absorbed in an FTA); BIT + FTA (with investment chapter).

Which chapters in FTA have a large FDI impact. Just because FTA with investment chapter seems to have a large FDI impact, we should not easily conclude that investment chapters bring FDI. It may be chapters other than investment in FTAs that have a large impact on FDI, such as provisions to ease the conduct of business, including trade facilitation provisions.

4.3. How one IIA/FTA is interrelated with other BITs/FTAs via MFN

The interpretation/value of each BIT/FTA depends on the quality of other BITs/FTAs signed by the contacting parties of the BIT/FTA to a certain degree. This subsection will consider such an interrelationship with concrete examples. For example, in terms of substantive provisions, the value of poor quality BIT/FTA with strong MFN may be higher than an average quality BIT/FTA with weak MFN, provided that the contracting parties of the former have signed or will sign high quality BIT/FTA in terms of substance. This section should also explain a variety of MFN provisions in terms of scope.

5. Interlinkages with external conditions: heterogeneous dimension

In this section, essential external conditions that are critical for provisions in BITs/FTAs will be discussed. Some provisions may be effective in attracting FDI only when certain external conditions are met. Critical external conditions to be considered should include, but not limited to (i) quality of governance; and (ii) stage of development; (iii) stage of investment (e.g. initial stage of investment).

6. Implications for empirical studies

As a summary of the paper, based on the conceptual analysis, this section will lay down interesting hypotheses regarding the impact of BITs/FTAs on FDI, which will be tested in economic analyses to be conducted in the future. In particular, the conceptual paper will identify the best countries, region or period to conduct empirical studies.