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Straightening the Purpose of International Investment Law from Litigation to Consolidating Relationships: The Role of Investor-State Conflict Management Mechanisms

Roberto Echandi

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ARTICLE

STRAIGHTENING THE PURPOSE OF INTERNATIONAL INVESTMENT LAW FROM LITIGATION TO CONSOLIDATING RELATIONSHIPS: THE ROLE OF INVESTOR-STATE CONFLICT MANAGEMENT MECHANISMS

ROBERTO ECHANDI*

I. INTRODUCTION

Over the last two decades, the debate around international investment law has gravitated around the pros and cons of investor-State dispute settlement (ISDS) procedures.[1] Such debate, which is still ongoing,[2] has generated a backlash against a relatively young rule-oriented regime that, without doubt, should be modernized and adjusted as a result of the learning curve resulting from its application. However, a negative consequence of such debate has been that it is distracting the attention of investment stakeholders

* Lead Private Sector Specialist, Trade Unit, World Bank Group (WBG); Nonresident Fellow, World Trade Institute (WTI), University of Bern; and Member of the Editorial Board of the Journal of World Investment and Trade. The views expressed in this note do not represent the views of the WBG and are the exclusive responsibility of the author.

1. Most international investment agreements (IIAs) enable foreign investors to directly enforce investment protection guarantees included in those treaties against host States through international arbitration. This mechanism, known as investor-State dispute settlement (ISDS), has been the most controversial issue in international investment law and policy. For further explanation and empirical data on the use of ISDS, see Roberto Echandi, *The Debate on Treaty-Based Dispute Settlement: Empirical Evidence (1987-2017) and Policy Implication*, 34 ICSID REV. - FOREIGN INV. L.J. 32 (2019); SUSAN D. FRANCK, ARBITRATION COSTS: MYTHS AND REALITIES IN INVESTMENT TREATY ARBITRATION (2019); Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005); SCOTT MILLER & GREGORY N. HICKS, INVESTOR-STATE DISPUTE SETTLEMENT: A REALITY CHECK (Ctr. for Strategic & Int'l Stud., 2015); Emily Osmanski, *Investor-State Dispute Settlement: Is There a Better Alternative*, 43 BROOK. J. INT'L L. 639 (2018); GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW (2007).

2. *See* U.N. Comm'n on Int'l Trade L., *Possible Reform of Investor-State Dispute Settlement (ISDS), Dispute Prevention and Mitigation—Means of Alternative Dispute Resolution*, U.N. Doc. A/CN.9/WGIII/WP.190 (Jan. 15, 2020).

away from what should be the main focus of the debate about international investment law.

This article calls attention to a problem that has not been properly appraised until now in the context of international investment regulation. We refer here to the significant amounts of foreign direct investment (FDI) being lost in developing countries as a consequence of unattended grievances arising from irregular government conduct.[3] Thus, it seems that the debate on ISDS has distracted both policy makers and academia away from a critical socio-economic function that international investment agreements (IIAs) should play for development—that is, contributing to foster the degree of long-term certainty and predictability in investor-State relations required to mitigate political risk, thereby facilitating FDI projects to effectively get established, operate, and expand in host countries.

Further, this note also summarizes recent research lead by the author.[4] Such work demonstrates the lack of appropriate legal infrastructure, both at a domestic and international level, enabling host States and investors to manage their conflicts early enough. That is, before investors discontinue their investment projects and grievances escalate into full-blown legal disputes. Such absence of legal infrastructure is not only overemphasizing ISDS as the only outlet to deal with grievances between investors and States but is also claiming a significantly high opportunity cost for investors and States alike.

This article argues that investor-State conflict management mechanisms (CMMs) can fill this legal-infrastructure vacuum. Further, by incorporating CMMs into the framework of international investment regime, international investment law could honor its original goal of enhancing investors' confidence in undertaking FDI projects beyond their home States.[5]

3. While governments from developing countries compete in costly promotion campaigns and incentives to attract FDI, data show that, every year, around one-quarter of all investors investing in developing countries discontinue their FDI projects as a result of unresolved grievances with subnational or specialized regulatory agencies. *See* World Bank Group, *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses* (2019), http://documents.worldbank.org/curated/en/387801576142339003/Political-Risk-and-Policy-Responses [hereinafter *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*].

4. *See* Roberto Echandi, *Complementing Investor-State Dispute Resolution: A Conceptual Framework for Investor-State Conflict Management*, *in* PROSPECTS IN INTERNATIONAL INVESTMENT LAW AND POLICY 270 (Roberto Echandi & Pierre Sauvé eds., 2013) [hereinafter *Complementing Investor-State Dispute Resolution*]; Roberto Echandi, *Investor-State Conflict Management: A Preliminary Sketch*, TRANSNAT'L DISP. MGMT. (2014), https://transnational-dispute-management.com/article.asp?key=2083 [hereinafter *Investor-State Conflict Management*]; *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3.

5. JOSE E. ALVAREZ, THE PUBLIC INTERNATIONAL LAW REGIME GOVERNING INTERNATIONAL INVESTMENT (POCKETBOOKS OF THE HAGUE ACADEMY OF INTERNATIONAL LAW) 14–15 (2007); KENNETH VANDEVELDE, BILATERAL INVESTMENT TREATIES: HISTORY, POLICY AND INTERPRETATION (2010).

Evidence suggests that CMMs can leverage IIAs to foster desired patterns of administrative behavior in host States in a nonlitigious way.[6] By addressing investor-State grievances well before they escalate into legal disputes, CMMs enable both investors and States to address problems arising in the course of investment operations, thereby contributing to the long-term permanence and expansion of FDI projects in the host State.[7]

Furthermore, this article has four additional sections. Section II starts by colloquially explaining the political economy dynamics of investor-State relationships. To make such a complex topic easier to grasp and more enjoyable to the reader, the explanation has been framed within an analogy of human relationships. Such approach will make very evident the limited scope of the current discussion on international investment law. Section III focuses on investor-State CMMs and its conceptual underpinnings. Section IV summarizes recent research led by the author that focused on empirical analysis on patterns of government conduct leading to FDI projects being discontinued, as well as pilot projects that tested the CMM concept and the specific protocols for setting up CMMs proposed by previous literature work. Section V summarizes conclusions and includes some final reflections.

II. Understanding the Political Economy Dynamics of Investor-State Relationships: Starting with an Analogy

In cross-border trade, goods or services are exported by the producer from its home base without entailing a relocation of its productive facilities to serve a market. In the case of undertaking cross-border investments, the situation is very different. FDI necessarily presupposes a need for investors to establish their productive facilities abroad, away from their home countries and jurisdictions, forcing them to operate in legal, economic, social, and cultural environments that are not equally familiar to investors as their home countries. FDI is thus inherently risky. These types of investments are more than just transactions.[8] They entail multidimensional relationships among different stakeholders: there are foreign investors, governments, domestic investors, and civil society.[9]

6. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 54.

7. Roberto Echandi & Mariana H.C. Gonstead, *Investor-State Conflict Management: Systemic Investment Response Mechanisms (SIRMS) and Shared Decisions System Design (SDSD)*, *in* Elgar Encyclopedia of International Economic Law 335, 336 (Thomas Cottier & Krista Nadakavukaren Schefer eds., 2017).

8. Roberto Echandi, *Connecting the Dots Between International Trade & Investment Regulation, Investment Climate Reform & Development*, Current Issues in Asia Pac. Foreign Direct Inv., The APEC Australian Study Ctr. 37 (2015).

9. Mariana H.C. Gonstead, *From Problem to Potential: The Need to Go Beyond Investor–State Disputes and Integrate Civil Society, Investors and State at the Local Level*, *in* Poverty and the International Economic Legal System: Duties to the World's Poor 225, 226 (Krista Nadakavukaren Schefer ed., 2013).

An international firm that chooses to invest abroad and the government that hosts that firm create an ongoing relationship. Too often, states focus only on promotion and attracting new investors to their country.[10] This is important, but it is only one small part of the story. The greater benefits of FDI for development come later on in the relationship, as the foreign firm brings in capital, employs local staff, provides goods and services, generates exports, shares technology and know-how, sources from local suppliers, and helps to diversify and upgrade the economy.[11] Such potential benefits take time. Thus, the critical point for policy making is to grasp the idea that for FDI to contribute to social and economic development, it is paramount to ensure that the relationship between the foreign investor and the host country works in the long-term.

Such relationships have multiple dimensions. One way to visualize them is to follow a sequential approach, demonstrating the investment life cycle as comprising four basic stages.[12] First, foreign investors are attracted to invest into the host country. Second, such investment is established. Third, the investment starts to operate and hopefully begins to expand. This leads to the fourth stage where the investment project generates linkages with other local firms, thereby "rooting" the FDI with the domestic economy.

Thus, if a country wants to ensure that foreign investors come, stay, and contribute to development, it is important for governments to undertake certain behaviors at each stage of the relationship, aiming to improve the quality of the interaction between the foreign firm and the domestic economy, and making sure that more investments get to the final stage of the cycle—the point where they create the linkages and spillovers to move the country up the value chain and generate more and better jobs to improve the quality of life of the population.[13]

The easiest way to grasp the complexities of the political economy of the FDI relationships is to invoke an analogy. In a way, as a human relationship phenomenon, the different stages of the FDI resemble those that occur in a couple's marriage. Both investment and marriage entail a long-term commitment and involve significant resources of different kinds. Thus,

10. Roberto Echandi et al., *The Impact of Investment Policy in a Changing Global Economy: A Review of the Literature*, at 11–14, World Bank Policy Research Working Paper, No. 7437 (Oct. 2015), http://documents.worldbank.org/curated/en/664491467994693599/The-impact-of-investment-policy-in-a-changing-global-economy-a-review-of-the-literature.

11. World Bank Group, *Investment Policy and Promotion Diagnostics & Tools: Maximizing the Potential Benefits of FDI for Competitiveness and Development*, at 20 (July 13, 2017), http://documents1.worldbank.org/curated/en/666341500008847215/pdf/117475-PUBLIC-WP-13-7-2017-12-8-30-SPIRAToolKitGuide.pdf [hereinafter *Policy and Promotion*].

12. *Connecting the Dots Between International Trade & Investment Regulation, Investment Climate Reform & Development*, *supra* note 8, at 33–40.

13. *Policy and Promotion*, *supra* note 11, at 14–15.

neither to embark in a FDI project nor to get married are decisions to be taken lightly.

As in marriages, investments presuppose the need and interest of the parties to seek a relationship. Like people, many investors may opt to remain single, do not undertake the risk of investing abroad, and remain in their home markets. However, there are many incentives and needs for both human beings and investors to take the risk of engaging in long-term relationships—either with another individual as in the marriage or with a country as in FDI relationships. Investors need (i) access to natural resources (ii) access to consumers in bigger markets, or (iii) to produce in competitive environments that may enable them to thrive in the significantly competitive world market. This is the first stage of the cycle: to have clarity of whether a relationship will be sought and the reasons for doing so. This corresponds to the vision and strategy of the cycle shown in figure 1 below.

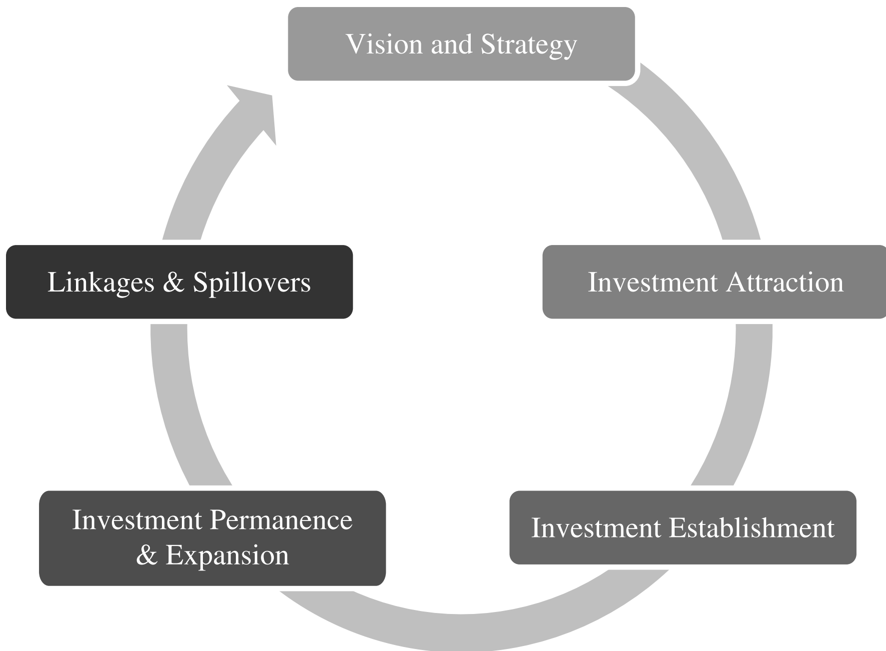

FIGURE 1. THE INVESTMENT LIFECYCLE[14]

Second, as in human relationships, it is not easy for investors to identify the most suitable partner that will enable their enterprise to achieve their goals. At the same time, many countries may be seeking to attract certain types of investors: many governments seem to dream of attracting

14. *Id.* at 15.

big multinational enterprises that can generate thousands of jobs.[15] As in real life, it is not easy to find the ideal partner. Also, like in human relationships, some people may be more attractive than others. In the investment relationship, some countries will have a lot of "pull" for certain type of investors. For instance, natural resource-rich countries will be extremely attractive to investors involved in extractive activities.[16] Countries with huge domestic markets will also be attractive for those investors interested in serving those consumers by selling their goods and products.[17] However, governments of those countries may be looking for other types of investors to whom they may not be as attractive. Often, in those situations, governments tend to incur huge expenses to provide investment incentives to lure investors—like dowries in human relations.[18] However, data show that in most cases, those costly incentives cannot compensate for other critical aspects that are real deal-breakers for investors.[19]

Further, the values and criteria guiding the search of both parties for their respective partners may not be attuned to their needs or own realities. For instance, while some governments may be looking to attract export-oriented firms in high-tech activities, they may not be able to provide the human resources, infrastructure, or business environment that such firms require to operate. Further, some countries may not even be able to be on the radar of certain "ideal" investors that most governments may be attempting to lure. Indeed, visibility is a challenge for many small economies, which often reach international economic press only when a natural disaster or civil conflict erupts. Yes, like in human relationships, reputation matters in the field of international investment.

Last but not least in this phase of investment attraction, which in human relations would be the "courtship" stage of a relationship, information asymmetries and image-building play a big role. Like human relationships where people take care of their image in order to be accepted, governments undertake costly investment promotion campaigns to show their attributes to as many potential investors as possible. Further, governments, like people, will make all sorts of promises to their potential partners in order to convince them to "say yes." Governments will promise they will behave in a fair, transparent, and lawful way. For such purpose, they will show the various IIAs as proof of their commitment to a safe and predict-

15. Torfinn Harding & Beata S. Javorcik, *Roll Out the Red Carpet and They Will Come: Investment Promotion and FDI Inflows*, 121 ECON. J. 1445, 1471 (2011).

16. John H. Dunning, *The Determinants of International Production*, 25 OXFORD ECON. PAPERS 289 (NOV. 1973); JOHN H. DUNNING & SARIANNA M. LUNDAN, MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY (1993).

17. Dunning, *The Determinants of International Production*, *supra* note 16, at 307.

18. *Id.* at 306.

19. Sebastian James, *Incentives and Investments: Evidence and Policy Implications*, at 13–14, WORLD BANK GROUP (Dec. 2009), https://openknowledge.worldbank.org/handle/10986/27875.

able relationship. This phase of investment attraction will conclude with a decision by the parties—that is, the investor on the one hand, and the government on the other hand (often represented by their investment promotion agency)—to go ahead with a particular investment project. Once such a decision is made, the preparation for the formalities and establishment of the investment project will start. The "wedding" between the investor and the host country, materialized in the form of an investment announcement, will then be circulated through economic mass media.

Once again, like human romantic relationships, many weddings are planned and yet, someone gets "cold feet," or the relationship is terminated before the formal ceremony takes place. In the investment context, despite an announcement, an investment project may never become materialized. Often, investment projects get canceled despite the interest of investors to establish their businesses in the host country. Legal or red-tape barriers tend to frustrate a myriad of FDI projects. For instance, in Ethiopia, according to Ethiopian Investment Commission (EIC) records, around 98 percent of investment cancellations between 2008 and 2018 took place in their establishment phase (i.e., during the phase after an investment permit is granted and before the issuance of business license).[20]

Continuing with the analogy, just as if a wedding celebration finally takes place, the establishment and inauguration of an investment project often represents an important celebratory event. Like photo flashes and fanfare in weddings, in the investment world government and investors alike often celebrate the start of operations of a production plant or business by inviting the press and organizing events colored by great optimism and enthusiasm due to the many productive jobs to be created and better economic prospects for all. Contrary to what many government officials think, that is not the end, but rather, just the beginning of the real relationship, which will take significant effort to make work in the long term. In romantic relationships, after the rosy period of planning and celebrating the wedding, the couple must come back to reality and start facing everyday life together. The same occurs in the context of the relationship between foreign investors and host-State governments.

Constant interaction will certainly lead the couple to regularly address a number of disagreements, either over trivial or important matters. An issue that may be important to one may not be as important to the other. Further, as part of becoming a new nuclear family, the newlywed couple will also have to start interacting with their respective extended family-in-law. Most of those in-laws may have their own views regarding their relative's choice of spouse. Some may be very pleased with the new union, some may be less enthusiastic, and some may be indifferent. However, re-

20. *Ethiopia SIRM*, EARLY WARNING SYSTEM (Feb. 27, 2019), https://ewsdata.rightsindevelopment.org/projects/603292-ethiopia-sirm.

gardless of their views on the prospects of success of the newlyweds' marriage, none of those in-laws feel responsible for making such new marriage work in the long term. The same happens in the investment world.

When an investor establishes the business in the host country, often after having benefited from the support of that country's investment promotion agency, it will also have to interact with a plethora of additional public agencies operating at national and subnational levels in that host country. For instance, starting and undertaking operations forces foreign investors to obtain a series of permits and licenses, leading to a constant interaction between investors and the regulatory apparatus of the public administration.[21] These agencies have specific regulatory priorities, such as ensuring compliance with regulations on a diverse fan of matters like environmental, labor, tax, health, safety, and other types of standards. Like family in-laws, these agencies have their own priorities based on their respective legal mandates. And like in-laws, safeguarding the health of the investor-host government relationship is not likely to rank at the top of such priorities. Indeed, most specialized agencies exclusively focus on exercising their regulatory activities. Seldom, if ever, are such regulatory authorities explicitly reminded of the importance of carrying out their functions in such a way as to not harm the relationship between the investor and the host State. Further, most of these regulatory authorities are not even aware of the existence of IIAs, and even less of their contents.[22]

Within this context, it is not surprising that, once again, like many marriages, interaction with in-laws generates tensions, disagreements, and even divorces. In the investment context, it is not then surprising that more than 70 percent of the investor-State disputes submitted to international arbitration involve regulatory conduct undertaken by subnational or specialized regulatory agencies.[23] Further, and continuing with the analogy of a marriage, many divorces happen relatively quietly, and take place by mutual consent of both parties, without any litigation in court. However, there are divorces that tend to be particularly acrimonious, involving costly and long legal battles with many lawyers involved. The same occurs with the investor-State relationship.

The increase in investor-State arbitration cases over the last two decades has attracted the attention of many academics and policy makers, to the extent that ISDS has practically colored the evolution and discussion on international investment law over the last two decades. Before addressing

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21. World Bank Group, *Investing Across Borders 2010: Indicators of Foreign Direct Investment Regulation in 87 Economies* (2010), https://openknowledge.worldbank.org/handle/10986/27883.

22. U.N. Conference on Trade and Development, *Investor-State Disputes: Prevention and Alternatives to Arbitration II*, U.N. Doc. UNCTAD/WEB/DIAE/IA/2010/8 (2011), https://unctad.org/system/files/official-document/webdiaeia20108_en.pdf [hereinafter *Investor-State Disputes: Prevention and Alternatives to Arbitration II*].

23. Echandi, *supra* note 1, at 59–60.

this point in more detail, and returning to the marriage analogy, it is important to stress two points.

First, like in real life, it should not be assumed that relationships should be maintained at all costs. Life and circumstances change, affecting the well-being, values, and character of people. Sometimes it is better to leave a relationship than continuing in a nonconstructive one. Once again, the same occurs with the investor-State relationship. Indeed, not all FDI retention should be perceived as good and not all FDI discontinuation as bad. It makes a difference whether the cause of discontinuation of FDI is economic (e.g., changes in the wage structure) or policy related (e.g., the introduction of a discriminatory regulation).[24] Or even within the latter category, it matters whether the discontinuation is caused by the removal of a subsidy (e.g., end of a tax break) or other form of policy preferences or to policy uncertainty. Changes in the wage structure, for example, can be associated to an upgrade in per capita income in the host country, leading to a change in comparative advantage.[25] Discontinuation of FDI would in this case be a form of adjustment of the economic system that could be welcomed. On the opposite end of the spectrum, preserving tax breaks or other forms of preferential arrangements for a long time just to retain FDI that otherwise may not be economically viable may risk perpetuating inefficient activities, maybe even for private gain.[26] Therefore, like in real life divorces, FDI discontinuation may happen both for the "right" or the "wrong" reasons.

Within the context of international investment law, it is important to clarify that the type of FDI discontinuation that should be prevented is that which most governments would clearly aim to stop, that is, FDI discontinuation that could have been prevented by just timely addressing investor-State conflicts arising out of "irregular" government conduct. This type of conduct can be defined as policies and actions that do not conform with the substantive or procedural standards reasonably expected by affected investors—and most reasonable government officials—based on their reading of the applicable treaties, laws, regulations, and practices in the host country.[27] Given the multiplicity of regulatory agencies that in real life can affect FDI projects, the goal of international investment law in this context should be to provide basic principles and norms that serve as minimum parameters to guide administrative conduct not only between government and investors, but equally important, within the multiple government agencies, thereby preventing lack of a coherent administrative action from pushing investors away.

24. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 5.

25. *Id.* at 9.

26. *Id.*

27. *Id.* at 5.

The second point to be stressed to conclude the analogy between the FDI and the marriage cycle is the main purpose of the investor-State relationship—that is, to generate a series of benefits for both parties, but particularly a series of spillovers contributing to socio-economic development in the host State. Just like how marriages can lead to offspring, not only can the investor-State relationship lead to a stable number of jobs, transfer of know-how, technology, exports, and more, but FDI may also generate production linkages with local firms, starting to source both tangible or intangible inputs in the form of services that are integrated into the former's productive process.[28] This is the multiplier economic effect of investment in the domestic economy. However, all these effects require time, and presuppose the success of the investor-State relationship despite the unavoidable difficulties likely to arise in the normal course of operations between investors and public authorities of the host country.

Figure 2 below illustrates this analogy between the investor-State relationship and marriages. As the graphic shows, the lack of proper management of problems and disagreements among the parties can escalate to conflicts, and if not resolved, can lead to divorces, which may be quiet or acrimonious litigation battles. The current problem affecting the debate on international investment law is that all attention is being paid to the pros and cons of dispute resolution.[29] When the investor-State relationship reaches that stage, the relationship has already been severed, and the parties already have deviated from the path, which would have enabled them to fully maximize the potential benefits of FDI. Simply put, the role of international investment law is currently perceived by most policy makers and academics as dealing with acrimonious divorces.[30] Moreover, because of the high costs entailed by such divorces, many have even questioned whether the international investment regime should be dismantled altogether.[31] Continuing with the analogy, this is like conceiving family law as exclusively focused on enabling divorces. Moreover, this would suggest that, because litigious divorces are nasty and costly, there should be no legal regimes dealing with this problem. In the family law context, such views would seem absurd. However, in the investment law context, this is where the discussion currently is.

28. *Policy and Promotion*, *supra* note 11, at 14.

29. Roberto Echandi, *The Blind Side of International Investment Law and Policy: The Need for Investor-State Conflict Management Mechanisms Fostering Investment Retention and Expansion*, Colum. FDI Persp. (forthcoming 2021).

30. *Id.*

31. *See* Muthucumaraswamy Sornarajah, *International Law as Development Law: The Obsolescence of a Fraudulent System*, *in* European Yearbook of International Economic Law 209 (Marc Bungenberg et al. eds., 2016).

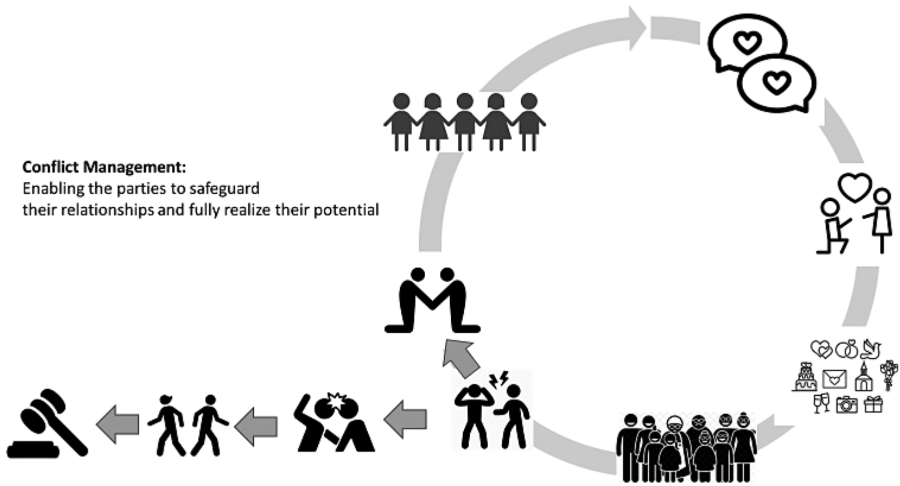

FIGURE 2. THE MARRIAGE AND THE INVESTOR-STATE RELATIONSHIP ANALOGY

As will be shown in section four below, recent empirical research shows that the overwhelming majority of "divorces" affecting investor-State relationships occur quietly, without legal disputes and litigation involved.[32] Because of their low profile, those quiet divorces have been overlooked by academic literature and most governments, becoming a serious blindside of investment policy making.

The focus on the debate about ISDS has tended to merge that discussion with the pros and cons of international investment law as a whole. ISDS does not reflect the implementation of IIAs. On the contrary, investor-State litigation is the result of an alleged violation of an international commitment embedded in an IIA. This raises the question as to whether the discussion is overlooking a problem affecting the effective implementation of these international instruments. In fact, historically, one of the key policy objectives at the root of IIAs was not to generate litigation, but rather to generate a predictable investment climate, minimizing the risk premium for international investors to invest abroad.[33] The assumption was that IIAs, if implemented in practice, should increase foreign investors' confidence in developing countries, thereby generating increasing flows of productive investment in those countries.[34] It is evident that increased litigation under-

32. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 28.

33. ALVAREZ, *supra* note 5, at 99–100; VANDEVELDE, *supra* note 5.

34. Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and their Grand Bargain*, *in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES AND INVESTMENT FLOWS 109, 118–19 (Karl P. Sauvant and Lisa E. Sachs eds., 2009).

mines the development of long-term harmonious relationships between foreign investors and host States. Further, as section four below will explain in more detail, evidence shows that the behaviors that IIAs are supposed to prevent are precisely the ones leading to grievances and conflicts that also erode the investor-State relationship, making foreign investors discontinue their investment projects already established in developing countries.[35]

The point of conceiving IIAs as instruments to contribute to fostering harmonious relationships between foreign investors and host States, rather than just a legal framework to facilitate adjudication for dispute resolution, is more than a philosophical one. It has very concrete and practical implications, in particular for developing countries. Around 25 percent of foreign investors investing in developing countries opt to totally withdraw or abstain from carrying out already planned investment projects, not as a result of risks such as macroeconomic instability, civil strife, or wars, but rather due to unattended grievances between investors and public agencies arising from irregular government conduct that never reached international tribunals.[36] Thus, significant amounts of FDI—a conservative estimate shows that around 100 billion USD a year—are being lost in developing countries as a consequence of not addressing conflicts arising between investors and regulatory agencies early enough.[37]

Thus, paradoxically, despite the significant efforts and costly investment promotion campaigns that many governments worldwide undertake to attract FDI, most of them are not even aware of, and even less are able to properly prevent, not only the significant amounts of FDI being lost as a result of irregular government conduct, but also the escalation of investor-State conflicts into full-blown legal ISDS disputes.[38] Recent research has shown that such outcome stems from the lack of an appropriate legal infrastructure, both at a domestic and international level, enabling host States and investors to identify and properly manage their conflicts early enough to prevent FDI divestments and international dispute escalation. Filling this gap is precisely the rationale of investor-State conflict management mechanisms (CMMs).

Continuing with the analogy between the investor-State relationship and marriages, CMMs can be visualized as those mechanisms that enable the States—comprising many agencies with multiple priorities—to rapidly articulate a coherent response to address in a nonlitigious context, a grievance raised by an affected investor. Like in marriages, the earlier a problem is directly addressed by the parties, the easier it is to deal with it, and the chances for reaching a successful and mutually beneficial solution increase.

35. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 26.

36. *Id.* at 33.

37. *Id.* at 5.

38. *Id.* at 5–7.

As problems become resolved, confidence among the parties is boosted and the relationship is strengthened. CMMs act as mechanisms that may prevent not only discontinuation of FDI projects arising from irregular government conduct, but also costly litigation processes.

III. Investor-State Conflict Management Mechanisms

Investor-State conflict management mechanisms (CMMs) can be defined as those institutional or contractual mechanisms that are meant to enable host States and investors to effectively address their grievances at a very early stage, preventing their conflicts from escalating into full-blown legal disputes.[39] The concept of conflict management is rooted in the distinction between the notion of "conflict" on the one hand and "legal dispute" on the other. While conflict is the process of expressing dissatisfaction, disagreement, or unmet expectations with any organizational interchange, a legal dispute is instead one of the products of conflict. While conflicts are often amorphous and intangible, a legal dispute is tangible and concrete in the sense that it has issues, positions, and expectations for legal relief.[40] Further, while conflicts are usually dealt with between parties themselves through the flexible use of diverse problem-solving techniques, adjudication of legal disputes entails the application and interpretation of legal frameworks by a third party, i.e., an arbitrator or a judge, resolving the dispute on the basis of legitimate legal norms and principles.[41]

39. *Complementing Investor-State Dispute Resolution*, *supra* note 4; Echandi & H.C. Gonstead, *supra* note 7, at 335.

40. Cathy A. Constantino & Christina Sickles Merchant, Designing Conflict Management Systems (1996); Stephanie Smith & Janet Martinez, *An Analytic Framework for Dispute Systems Design*, 14 Harv. Negot. L. Rev. 123, 126 (2009).

41. Susan D. Franck, *Integrating Investment Treaty Conflict and Dispute Systems Design*, 92 Minn. L. Rev. 161, 192–94 (2007); Mariana H.C. Gonstead, *From Paper to People: Building Conflict Resolution Capacity and Frameworks for Sustainable Implementation of IIAs to Increase Investor-State Satisfaction*, *in Investor-State Disputes: Prevention and Alternatives to Arbitration II*, *supra* note 22, at 55–56.

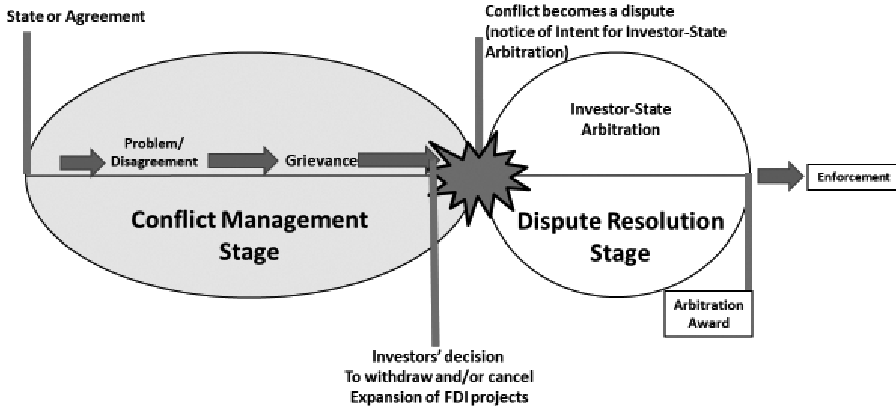

FIGURE 3. THE INVESTOR-STATE CONFLICT CONTINUUM[42]

The distinction between "conflict management" and "legal dispute resolution" in the context of the investor-State relationship is a distinction with many practical implications. Although CMMs may be useful to prevent disputes, their most important role is to prevent investor-State grievances from inducing investors to give up and discontinue their investments. Thus, conflict management should not be equated with dispute prevention policies.[43] As stated before, recent research shows that only a minor fraction—less than 10 percent—of investors who discontinue their FDI projects due to grievances with governments seek redress through ISDS.[44] The overwhelming majority withdraws quietly, well before even considering international litigation. ISDS may be successfully prevented, and yet it may already be too late to prevent the withdrawal or cancellation of planned FDI expansion projects. Thus, although CMMs may be an excellent tool to prevent ISDS disputes, the same may not work vice-versa. With their focus on the dispute resolution phase, if successful, dispute prevention policies may prevent litigation, but not necessarily be useful to support the investor-State relationship and enable FDI retention and expansion.[45]

42. *Complementing Investor-State Dispute Resolution*, *supra* note 4, at 291.

43. U.N. Conference on Trade and Development, *Investor-State Disputes: Prevention and Alternatives to Arbitration*, U.N. Doc. No.E.10.II.D.11 (May 2010), https://unctad.org/system/files/official-document/diaeia200911_en.pdf [hereinafter *Investor-State Disputes: Prevention and Alternatives to Arbitration*].

44. Echandi, *supra* note 1, at 38.

45. *Investor-State Disputes: Prevention and Alternatives to Arbitration*, *supra* note 43, at 6.

States are multilayered and administratively complex. It is not easy for governments to identify and address an investment grievance before it degrades into a dispute. The objective of CMMs is to enable a lead agency or joint body to swiftly coordinate an adequate Statewide response to a grievance while it is still at an early stage of the conflict management stage. CMMs can be contractual or institutional.[46] Contractual CMMs are pre-agreed, embedded in contracts between investors and countries—particularly useful for public private partnerships.[47] Institutional CMMs exist within the administrative structure of host countries, entailing the establishment of a lead agency in charge of identifying, filtering, tracking, and attempting to resolve investor-State conflicts at an early stage—similar to the various ombudsperson offices recently established in many countries inspired by the Korean Foreign Investment Ombudsman experience.[48]

Over the last decade, literature has started to advocate for the integration of innovative dispute system design approaches into international investment law.[49] As part of such effort, some academic works started to suggest elements to develop investor-State CMM protocols comprising eight fundamental steps.[50] First, stocktaking and diagnostics—understanding the type of sectors and agencies involved in investor-State grievances in a particular country.[51] Second, a lead agency or lead government instance is established to administer the CMM, including administering a tracking tool to monitor and measure amount of FDI and jobs potentially at risk due to the grievance.[52] Third is the information sharing campaigns—alerting other agencies and private stakeholders of the existence and functioning of the CMM to be established.[53] The fourth step is early alert mechanisms—procedures to enable the lead agency to learn about the existence of a grievance and address it as early as possible. The fifth step is a legal and economic assessment of the grievances, determining potential liability and jobs and FDI at risk.[54] Sixth is problem-solving techniques that enable the lead

46. *Complementing Investor-State Dispute Resolution*, *supra* note 4, at 296.

47. *Id.*

48. Ricardo Figueiredo de Oliveira, *The Useful Institution of an Investment Ombudsperson*, COLUM. FDI PERSP., No. 273, 1 (Mar. 9, 2020), http://ccsi.columbia.edu/files/2018/10/No-273-Figueiredo-de-Oliveira-FINAL.pdf.

49. Franck, *supra* note 41, at 163; *see also* Mariana Hernandez-Crespo Gonstead, *Remedy Without Diagnosis: How to Optimize Results by Leveraging the Appropriate Dispute Resolution and Shared Decision-Making Process*, 88 FORDHAM L. REV. 2165 (2020); Mariana Hernandez-Crespo Gonstead, *A New Dance on the Global Stage: Introducing a Cultural Value-Based Toolbox to Optimize Problem-Solving, Innovation, and Growth*, 34 OHIO ST. J. ON DISP. RESOL. 675 (2019).

50. *Investor-State Conflict Management*, *supra* note 4; *Complementing Investor-State Dispute Resolution*, *supra* note 4, at 299.

51. *Complementing Investor-State Dispute Resolution*, *supra* note 4, at 299.

52. *Id.* at 300.

53. *Id.* at 300–01.

54. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3.

agency to interact with stakeholders in order to seek a solution to the problem.[55] The seventh step is political decision-making—protocols to escalate the matter to the highest authorities within the administration when solutions have not been found at a technical level.[56] And last but not least, the eighth step is setting up appropriate mechanisms and incentives to ensure the execution and enforcement of the political decision.[57]

Both the CMM concept and suggested protocols were tested in practice as part of a comprehensive project lead by the author and implemented between 2013 and 2019 by the investment policy and promotion team of the World Bank Group (WBG).[58] A detailed analysis of the project and its key findings have been published elsewhere.[59] For purposes of this article, a succinct summary is presented in section VI.

IV. CMMs: Findings from Recent Research

Research recently published by the WBG in cooperation with the European Commission focused on two critical points.[60] First, it examined empirical evidence to better understand the nature, sectors, and political economy dynamics of the investor-State conflict and contrasted such information with available data on ISDS in order to test in practice the hypothesis of the investor-State conflict continuum.[61] Second, the research project also tested the feasibility of CMM protocols proposed by literature[62] through a series of pilot projects undertaken in eight countries in different regions of the world.[63]

A. *Findings from Empirical Research*

As stated above, empirical research tested in practices the hypothesis of the investor-State conflict continuum. For that purpose, it examined empirical evidence to better understand the nature, sectors, and political economy dynamics of the investor-State conflict and contrasted such information with available data on ISDS. The hypothesis of the existence of the continuum would be demonstrated if empirical data showed a correspondence between the type of regulatory conduct generating conflicts and those elevated to international investor-State arbitration. Data on investor-

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3.

61. *Id.*

62. *Complementing Investor-State Dispute Resolution*, *supra* note 4.

63. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3.

State conflict was collected on the basis of surveys and data on investor-State disputes on available statistical evidence on investor-State arbitration.

1. Survey evidence on investor-State conflict

The empirical research project started with a set of six different surveys done by the WBG, five done by the Multilateral Investment Guarantee Agency (MIGA) between 2008 and 2013 and another one done by the Investment Policy and Promotion (IPP) Team of the WBG in 2017.[64] Taken together, these surveys cover almost a decade and more than 2,500 international investors investing in developing countries.[65] These surveys targeted international investors—from both developed and developing countries—and asked a series of questions to explore how government conduct has influenced their decisions to remain or expand their FDI projects in developing countries, or conversely, withdraw or cancel investment plans.[66]

Based on this survey data, research addressed the following four questions: (i) to what extent have political risks arising from government conduct influenced investors' decisions? (ii) which are the specific types of government conduct that have been most disruptive to FDI over the last decade? (iii) if patterns of disruptive government conduct over FDI can be identified, have they affected different types of FDI in a similar manner? and (iv) what does empirical evidence suggest regarding the means that investors have used to deal with grievances arising from government conduct?[67]

The WBG research project also went beyond survey data and contrasted the findings of investors' perceptions with factual trends identified by recent empirical analyses on ISDS cases.[68] In particular, the study focused on four key aspects: (i) whether investors' views regarding the types of government conduct generating FDI project withdrawal and cancellation coincide with the type of government conduct subject to international investor-State adjudication, (ii) whether the types of conduct generating greater impact on FDI withdrawal and expansion cancellation coincide with the types of conduct most frequently contested in ISDS procedures, (iii)

64. Multilateral Inv. Guar. Agency, *World Investment and Political Risk* (2009), https://www.miga.org/report/world-investment-and-political-risk-2009; Multilateral Inv. Guar. Agency, *World Investment and Political Risk* (2010), https://www.miga.org/report/world-investment-and-political-risk-2010; Multilateral Inv. Guar. Agency, *World Investment and Political Risk* (2011), https://www.miga.org/report/world-investment-and-political-risk-2011; Multilateral Inv. Guar. Agency, *World Investment and Political Risk* (2012), https://www.miga.org/report/world-investment-and-political-risk-2012; Multilateral Inv. Guar. Agency, *World Investment and Political Risk* (2013), https://www.miga.org/report/world-investment-and-political-risk-2013 [hereinafter *World Investment and Political Risk 2013*].

65. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 2.

66. *Id.*

67. *Id.*

68. Echandi, *supra* note 1, at 32; Franck, *supra* note 1.

whether the sectors and type of FDI affected by withdrawal of existing investment or cancellation of planned ones coincide with those most common in ISDS trends, and (iv) what the empirical data reveal about the context in which investors would opt to invoke ISDS.[69]

In a nutshell, the survey data used in the first part of this paper showed four basic trends. First, international investors have consistently ranked political risk among the top important constraints for FDI.[70] In this context, political risk is defined as the probability of disruption of operation of multinational enterprises by political forces or events.[71] In fact, political risk was identified by investors as the most important constraint for FDI in developing economies during the surveys done between 2008 and 2013, which resonates with the fact that in 2017, 86 percent of the investors surveyed found the legal and regulatory environment important or critically important when making investment decisions.[72]

Between 2008 and 2013, when investors were asked to specify what type of political risk they cared most about, their concerns were not focused on variables such as war, civil unrest, or terrorism.[73] Instead, investors were consistently more disrupted by political risks related to government conduct, such as adverse regulatory changes, breach of contract or transfers, and convertibility restrictions.[74] Such finding may explain why in 2017, 45 percent of investors surveyed rated investment protection guarantees as critically important or deal-breakers when investing abroad, notably, the highest among all investment climate factors.[75] In addition, over 80 percent of investors rated various types of legal protections as important or critically important.[76]

Second, all surveys consistently showed an average of 25 percent of investors surveyed over the period either totally withdrew or canceled already planned FDI expansion plans due to government conduct.[77] Grievances related to expropriation, transfers and convertibility restrictions, breach of contract, and adverse regulatory changes have continuously ranked among the most impactful actions by governments leading to FDI

69. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 2.

70. *Id.* at 20.

71. Yadong Luo, *Political Risk and Country Risk in International Business: Concepts and Measures*, *in* OXFORD HANDBOOK OF INTERNATIONAL BUSINESS 740, 741 (2d ed.) (Alan M. Rugman ed., 2008).

72. *World Investment and Political Risk 2013*, *supra* note 64, at 37.

73. *Id.* at 21.

74. *Id.* at 19.

75. World Bank Group, *Global Investment Competitiveness Report 2017/2018: Foreign Investor Perspectives and Policy Implications*, at 27 (2018), https://openknowledge.worldbank.org/handle/10986/28493 [hereinafter *Report 2017/2018*].

76. *Id.* at 20.

77. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 24.

withdrawals and expansion cancellations.[78] Despite being the most impactful regulatory risks, the frequency of situations related to expropriation and breach of contract has tended to decline over the last decade, while risks associated with sudden adverse regulatory changes have been a constant prominent role over the period, both in terms of frequency and impact.[79] Problems related to transfer and convertibility restrictions have constantly remained in the middle of the curve in terms of frequency and impact.

The 2017 survey revealed two additional types of government conduct with significant frequency and impact on FDI retention and expansion: the lack of transparency and predictability in dealing with public agencies and the delays in obtaining the necessary government permits to start or operate a business.[80] These two types of regulatory risks, together with sudden adverse regulatory changes, mean that the lion's share of the grievances leading to FDI divestments relate to the ways that government agencies perform their routine regulatory functions.

Third, turning to which sectors concentrate the majority of FDI divestments as a result of regulatory risks, data show that political risk affects all sectors and types of investment.[81] However, as the composition of FDI has changed over time, the relative share of different sectors on total FDI divestments occurring due to disrupting government conduct has also tended to evolve. While in the 1970s most FDI divestments were associated with expropriations occurring in the natural resource sector, the 2017 data showed a higher frequency of FDI withdrawal among investors in the services sector.[82] Services comprise the largest share of FDI worldwide.[83] Furthermore, services trade is inherently about managing horizontal and sector-specific regulations. Because the frequency of political risks arising from government conduct related to the enactment and operation of regulations has increased, it follows that the services sector will be particularly vulnerable.

Data also show that investors in the services sector are not only more frequently hit by regulatory risks than manufacturing but are also more sensitive to such risks and, as a result, withdraw and cancel expansion plans more frequently.[84] Within this context, it is not surprising that investors in services are also those who place investment protection guarantees as the most important item on an investment climate agenda in developing countries and are those who value more IIAs.

78. *Id.* at 26.

79. *Id.*

80. *Report 2017/2018*, *supra* note 75, at 33.

81. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3.

82. *Id.* at 26.

83. *Id.*

84. *Id.* at 32.

The relative lower frequency of withdrawals in natural resource-seeking FDI should not be interpreted as indicating that the primary sector is now less affected by political risks. That conclusion would be incorrect. This trend may have more to do with the fact that these types of FDI projects are more difficult to withdraw simply because they are tied to the location where the natural resources are located. Further, with the exception of Africa, the primary sector represents a significantly lower share of the total FDI stock in developing countries.[85] Natural resource-seeking FDI is particularly vulnerable to risks of expropriation and to breach of contract, especially in extractives.[86] As expropriations have become less frequent, the primary sector has decreased its exposure to this type of political risk. The practical difficulty of withdrawal, and the inherent risk of this type of FDI towards these types of government practices, explains why investor-State conflict in natural resource-seeking FDI ranks among the top types of FDI projects that in the end escalate to investor-State legal dispute resolution.

Fourth, regarding the question as to how investors deal with political risks arising from government conduct, the set of surveys conducted over the period reveals a paradox.[87] On the one hand, direct engagement with governments ranks among the risk mitigation tools most frequently used by foreign investors in developing countries to address this type of problem.[88] On the other hand, when asked about how effective such engagement is in practice, most investors show a high degree of dissatisfaction.[89] This finding shows that, when problems arise, investors' first step is to engage in consultations with host governments, rather than turning to litigation. Further, it also shows "that the high rates of FDI withdrawals and expansion cancellations result not only from the disruptive conduct, but also from the lack of a timely and appropriate response by the authorities involved in resolving that problem."[90] This fact evidences the existence of factors affecting the capacity of the governments to promptly and appropriately respond to foreign investors when the latter attempt to engage with public authorities to resolve an investment-related problem or grievance. The analysis of the experience of ISDS over the last thirty years, provides important hints to explain the political economy behind this trend.

85. U.N. Conference on Trade and Development, *International Production Beyond the Pandemic*, World Investment Report (2020), https://unctad.org/system/files/official-document/wir2020_en.pdf [hereinafter *International Production Beyond the Pandemic*].

86. *World Investment and Political Risk 2013*, *supra* note 64, at 19.

87. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 27.

88. *Id.*

89. *Id.* at 27.

90. *Id.* at 28.

2. *Contrasting survey evidence on investor-State conflict with empirical evidence on ISDS*

Contrasting the findings derived from survey data with findings derived from the empirical analysis on ISDS revealed five basic trends.

First, empirical evidence shows a clear correlation between the specific types of government conduct inducing FDI divestments with those leading to ISDS claims. The most common breaches alleged by investors in ISDS proceedings are those violating the fair and equitable treatment (FET); indirect expropriation; full protection and security, or similar; and arbitrary, unreasonable, and discriminatory measures. When examining the co-relation with the four types of government conduct categories leading to FDI divestments, it turns out that a lack of transparency and predictability of government agencies as well as adverse regulatory changes seem to be the main sources of contention between investors and host governments.[91] Thus, this is an area where empirical data on investors' surveys and ISDS data coincide.

Second, the research showed that in addition to indirect expropriations, the most common types of regulatory conduct found to breach IIAs also tend to coincide with those most frequently alleged by investors: fair and equitable treatment; full protection and security; and arbitrary, unreasonable, and discriminatory measures.[92] This trend is very revealing, as all of these types of conduct are comprised by a single standard of protection included in many IIAs as well as customary international law called the Minimum Standard of Treatment that host governments are obliged to provide to aliens.

The Minimum Treatment Standard is a commitment that imposes on governments not an obligation to generate a specific outcome in favor of investors (an obligation of results), but rather an obligation of conduct, prescribing how governments should behave in their routine regulatory action. This standard asks that government action be transparent, coherent, reasonable in performing their actions, use proportionate solutions to the problems governments are dealing with, and act consistently with expectations raised to foreign investors based on written commitments undertaken by governments either through contracts or investment authorizations. This finding corroborates surveys' data that places lack of transparency and predictability in dealing with public agencies and sudden adverse regulatory changes as the most frequent government conduct inducing FDI divestments.[93]

Third, a key finding complementing the previous one is that around 70 percent of ISDS claims involved measures adopted by subnational or sec-

91. *See* Echandi, *supra* note 1, at 60.
92. *Id.* at 38 n.21.
93. *Id.* at 29.

tor-specific regulatory agencies.[94] This confirms that one of the key challenges of modern administrative regimes is how to foster coherent policy implementation within a multilayered governance structure. It also reveals a tension between the single state paradigm at the core of domestic and international legal systems on the one hand and the multilayered agency composition of governments on the other. There is a gap between the law "in the books" and reality. In this sense, evidence suggests that IIAs in general, and ISDS in particular, have been generating pressure for States to behave in accordance with the one State legal paradigm, an outcome that is not always easy to achieve.[95] The fact that most of the measures generating ISDS disputes have been taken by subnational or autonomous regulatory authorities shows the challenge that many governments face in ensuring this minimum level of policy coherence.[96]

Fourth, examining the economic sectors where ISDS occurs most frequently reveals a clear political economy pattern of investor-State grievances. Empirical data clearly show that, although ISDS has taken place in a wide range of areas, many of the disputes tend to arise in economic sectors characterized by high levels of State intervention.[97] First, there are services that many countries consider of "public interest" and are thus subject to close State supervision, such as utilities—water and electricity distribution—and other highly regulated services like telecommunications, transportation, and to a lesser degree, financial services. Second, another area where ISDS tends to occur most frequently is in services where public-private partnerships are typical, such as construction, and power and transport infrastructure. A third area where ISDS also frequently tends to occur in natural resource industries, such as extractives (oil, gas, and mining) as well as agriculture, fishing, and forestry.[98]

Fifth, data also show that only a very minor share of investors withdrawing or canceling FDI expansion plans opt to invoke ISDS. The rate of frequency of investors divesting from developing countries in all surveys consistently was around 25 percent of the total interviewed.[99] Considering that today there are more than one hundred thousand foreign affiliates un-

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94. *See* Jeremy Caddel & Nathan M. Jensen, *Which Host Country Government Actors are Most Involved in Disputes with Foreign Investors?*, Vale Colum. Ctr. on Sustainable Int'l Inv. (Apr. 28, 2014), http://www.vcc.columbia.edu/content/which-host-country-government-actors-are-most-involved-disputes-foreign-investors; *see also* Zoe Phillips Williams, *Risky Business or Risky Politics: What Explains Investor-State Disputes?*, Inv. Treaty News (Aug. 12, 2014), https://www.iisd.org/itn/en/2014/08/12/risky-business-or-risky-politics-what-explains-investor-state-disputes.

95. Mark A. Clodfelter, *"Why Aren't More Investor-State Treaty Disputes Settled Amicably?"*, U.N. Conf. on Trade and Dev. 49–52 (2011).

96. *Id.*

97. Echandi, *supra* note 1, at 51.

98. Franck, *supra* note 1.

99. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at IX.

dertaking multiple investment projects worldwide,[100] and even assuming that only half of them invested in developing countries, a 25 percent rate of FDI divestments would represent more than ten thousand potential ISDS claims against developing countries.[101] Even cutting such rough estimate by half would lead to a figure that would still be significantly higher than the actual number of ISDS submitted against developing countries over the last thirty years.

The finding that most foreign investors who may be canceling investment plans or withdrawing their investments and yet abstaining from invoking ISDS has a very critical and practical policy implication. Governments should be careful to avoid falling into the trap of confusing mechanisms to prevent ISDS disputes—dispute prevention—from mechanisms to prevent investors from withdrawing or canceling FDI projects. Investment retention and expansion and dispute prevention are two very different things, and one may not necessarily entail the other.

B. *Findings from CMMs pilot projects*

Not only has the investor-State conflict continuum concept been tested empirically, but the mechanisms on how to manage it have as well. The CMMs developed by specialized literature have also been tested in practice. Between 2015 and 2019, the WBG developed a solution package not only to pilot CMMs, but also seeking two additional concrete objectives.[102] First, such pilots should be able to be implemented within real political time frames—maximum three to four years—which correspond to the time of most government administrations. Second, this tool should be designed in such a way that its effectiveness could be measured in terms of objective impact indicators.

The design of such a solution package started with literature review[103] and a series of case studies observing different experiences and good practices around the world as to how different governments were addressing risks derived from government conduct.[104] The research found that most policy makers have not yet "connected the dots" between investment retention and expansion on the one hand and political risk derived from government conduct on the other.[105] However, various governments nevertheless had started to take steps in different—yet convergent—directions. In this regard, two patterns became evident.[106]

100. *International Production Beyond the Pandemic*, *supra* note 87, at 22, 124.

101. Author's calculation based on UNCTAD and WBG data.

102. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 39.

103. Echandi et al., *supra* note 10.

104. *Investor-State Disputes: Prevention and Alternatives to Arbitration*, *supra* note 43.

105. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 41.

106. *Id.*

First, those countries focusing on investment retention and expansion had deployed aftercare programs. In this regard, a particular case study worth mentioning is Korea with its Foreign Investment Ombudsman Office (OFIO), considered as one of the most sophisticated aftercare programs in the world.[107] A second strand of policies undertaken by many governments prioritized the focus on the political risk side of the equation, rather than the investment retention and expansion. This has been the experience of various Latin American countries, which over the last two decades have been the most frequently hit by claims submitted by foreign investors to International Investment arbitration under IIAs.[108] Within this context, it is not surprising that over the last decade, the issue of ISDS dispute prevention started to strongly resonate among Latin American countries, leading them to start taking pioneering steps in this field.[109]

These two sets of experiences revealed that while some countries have started to concentrate their attention on the beginning of the investor-State conflict continuum, focusing on addressing problems affecting investors at an early stage before they have escalated to grievances and placing the FDI at risk of withdrawal of expansion cancellation, efforts by other countries have focused on the opposite side of spectrum—that is, dispute prevention. In these later cases, governments frequently hit by ISDS have started to focus their inter-institutional coordination efforts on properly responding to and managing ISDS disputes, and more recently focusing on efforts to prevent international legal dispute escalation—dispute prevention. The problem with both of these approaches is that none of them fully connects the dots between the two extremes of the investor-State conflict continuum.

While aftercare may focus on investment retention, it may have to deal with issues that go beyond government conduct placing FDI at risk of withdrawal or cancellation of expansion. It is often very difficult for investment promotion agencies to learn about grievances arising with investors who usually do not interact with those agencies in the first place. WBG research shows that a significant share of grievances arises with investors engaged in domestic-market seeking activities, in particular in services sectors and investors involved in public/private partnerships and other government contracts.[110] Investors investing in natural resources, particularly in extractives, often interact with ministries in charge of mining, energy, and/or the environment directly. In those cases, investors do not usually enter the host economy with the support of investment promotion agencies, and therefore,

107. Foreign Investment Ombudsman of Korea, http://ombudsman.kotra.or.kr/eng/au/message.do (last visited Nov. 8, 2020); *see* Nicolas et al., *Lessons from Investment Policy Reform in Korea*, OECD Working Papers on International Investment, Working Paper No. 2013/02 (2013).

108. Echandi, *supra* note 1, at 59.

109. *Investor-State Disputes: Prevention and Alternatives to Arbitration II*, *supra* note 22.

110. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses, supra* note 3, at XI.

they may not seek the latter to provide any assistance when dealing with their government counterparts. Further, agencies in charge of servicing foreign investors (investment promotion agencies) do not have the mandate, legal attributions, or political clout to deal with other government agencies whose conduct may risk losing FDI.

On the other hand, dispute prevention policies focus on preventing escalation of grievances into international legal disputes but not on FDI retention and expansion. Agencies interested in preventing investor-State arbitration are often those in charge of implementing IIAs, ministries of trade and investment, and/or ministries of justice or attorneys general offices that are in charge of representing the host State in international arbitration proceedings (hereinafter "competent agencies"). These competent agencies often have staff with technical skills and, in certain circumstances, may even have enough political clout to settle certain ISDS disputes. However, because the mandate of these competent agencies is focused on negotiating, implementing, or enforcing IIAs, they traditionally get involved in investor-State grievances once the latter have in fact escalated into legal disputes.[111]

Review of practices around the world led the WBG to develop a CMM protocol that was denominated the "Systemic Investment Response Mechanism" (SIRM) as a practical solution package to (1) enable governments to identify, track, and timely resolve investor-State grievances that put investment projects at risk of divestment and (2) quantify the host State's risk of facing potential liability under applicable domestic or international investment rules.[112] The SIRM collects data, identifies patterns on the source of government-generated political risks affecting investments, and quantifies investment retained, expanded, or lost as consequences of addressing or not addressing those political risks.[113] The SIRM entails the empowerment of a reform-oriented government agency and the establishment of an inter-governmental mechanism to systematically address grievances arising from government conduct, thereby reducing this type of political risk at their source. The lead government agency brings to the attention of high levels of government problems affecting investments to address them before they escalate further.[114]

Thus far, the WBG has piloted the SIRM/CMM in at least eight countries in Latin America, Eastern and Southern Europe, Central Asia, the Mid-

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111. *Id.* at XII.

112. *The G-20 Compact with Africa, A Joint AfDB, IMF and WBG Report*, G-20 FIN. MINISTERS AND CENT. BANK GOVERNORS MEETING, Mar. 17–18, 2017, at 22–23, https://www.compactwithafrica.org/content/dam/Compact%20with%20Africa/2017-03-30-g20-compact-with-africa-report.pdf.

113. *Id.*

114. *Id.* at 23.

dle East, North and Southeast Asia, and East Africa.[115] Up to the end of 2019, with just one exception, all the SIRM pilots were still in execution.[116] Depending on the particular context of the host country, some pilots have advanced more swiftly than others. Therefore, although it may still be early for a sample big enough to generate statistically relevant data, the pilots do provide some preliminary firm-level evidence regarding the type of grievances impacting the investors, the most frequent matters that generate conflicts, the most common sectors and types of FDI affected by regulatory conduct, and even some—albeit very initial—estimates on the magnitude of investments at risk that have been already retained and expanded in selected cases.[117] Equally important, these pilots have tested in practice the feasibility for host governments to set up effective CMMs.

Regarding the investor-State conflict continuum, data so far generated from SIRM/CMM pilots clearly confirm the findings of WBG empirical research on the impact of government conduct on investment retention and expansion.[118] Pilots show that the number of grievances that are serious enough to place investment at risk tends to be significantly lower than the number of minor problems that investors face in their routine operations and that are usually dealt with via aftercare programs.[119] Despite being less frequent than minor problems, the economic impact of grievances placing FDI at risk is significant. In the case of one SIRM/CMM pilot, three specific FDI projects where the grievances were effectively resolved led to an amount of investment effectively retained/expanded equivalent to 200 million USD in investment retained, 20 million USD in reinvestments, and a conservative estimate of 10 million USD in public cost savings derived from verified prevention of three investor-State arbitration proceedings.[120]

Among all regulatory risks arising from government conduct, patterns of sudden/arbitrary regulatory conduct seem to be the most common type of grievances placing investment at risk. Although each pilot sample has a different period, except for just one country, the most common type of conduct leading to serious grievances falls within this type of regulatory risk conduct. Drilling down into more detail within this category, abuse of authority, abuse of discretion when interpreting laws and regulations, and lack of transparency are the most common sources of grievances. This finding resonates with the trend revealed by empirical research that alleged violations to the minimum standard of treatment is the most frequent investment

115. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses, supra* note 3, at XII.

116. *Id.*

117. *Id.* at 57.

118. *Id.* at 57–58.

119. *Id.* at 57.

120. *Id.*

protection guarantee invoked in ISDS proceedings and the most frequently breached in international arbitration awards.

Further, it is worth noting that arbitrary conduct as perceived by investors invoking the SIRM/CMM tend to concentrate in matters related to taxation and compliance with investment incentives offered to investors—both in terms of custom duties and tax benefits. In addition, other very common problems perceived as arbitrary conduct relate to the application of customs procedures, cancellation or lack of renewal of licenses required for operations both for mining and services, problems related to renewal/cancellation of land leases, environmental and labor permit delays, or inspection infractions leading to cancellation of operations.

As far as sectors are concerned, pilots have shown that grievances arise in all primary, manufacturing, and services sectors. However, once again, following the same trend evidenced by empirical research, most of the grievances tend to significantly concentrate in the primary and tertiary sectors.[121] Cancellation or nonrenewal of land leases, exploration licenses and concessions on extractive activities, infractions due to alleged violations of local content requirements or labor standards, and environmental permit withdrawals tend to concentrate grievances in natural resource-seeking FDI.[122] Taxation problems, allegations of breach of contract, cancellation of land leases and operation licenses, and fines imposed due to alleged regulatory infractions tend to be the most common types of grievances affecting domestic market-seeking in services.[123]

Pilots have also confirmed findings of empirical research on the types of FDI most frequently affected by regulatory risks. In this regard, investors involved in export-oriented activities as part of global value chains (GVCs) experience a significantly lower number of grievances.[124] It seems that the fact that the bulk of this efficiency-seeking FDI operates within special economic zones or industrial parks in a way shields it from the challenge of interacting with an uncoordinated multilayered web of public agencies. Regarding which types of agencies tend to more frequently generate investor-State grievances, once again, SIRM pilots coincide with empirical research, revealing the critical role that specialized and subnational regulatory agencies play in generating most of the conflicts.[125]

Third, although still ongoing, SIRM/CMM piloting also provides very useful practical lessons, both on the operation of CMMs and their functioning from a political economy perspective. Regarding operational lessons

121. *See Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses, supra* note 3, at 31.

122. *Id.* at 59–60.

123. *Id.*

124. Echandi, *supra* note 1, at 53.

125. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses, supra* note 3, at XIII.

learned so far, pilots show that although CMMs require country-specific customization, there are a series of hands-on common issues that come across all countries on various components, for instance, the composition and positioning of the lead agency, the design and deployment of the information and communication technology (ICT) tracking tool to register, follow up, and measure the impact of resolving—or failing to resolve—grievances, and the coordination protocols to ensure inter-agency coordination and collaboration in resolving investor-State conflicts. This note drills on each of these elements in significant detail. A similar situation occurs regarding the political economy within which CMMs must operate. Within the highly idiosyncratic nature of political economy to each country, SIRM/CMM pilots have nevertheless started to reveal interesting common patterns.

A fundamental finding derived from observing successful problem-solving techniques in SIRM pilots is the critical role that IIAs—more than domestic law—play in enabling the SIRM/CMM lead agency to negotiate in the "shadow of the law" when seeking the collaboration of peer agencies in attempting to resolve a grievance.[126] The same can be said of the very persuasive effect that diplomatic pressure exerted by investors' home-State governments can have in invoking previously agreed international commitments with the host countries. Pilots demonstrate that, rather than fostering power-oriented politics, IIAs are starting to play a catalytic role in fostering patterns of rule-based negotiation among different agencies within a host government, even to the benefit of domestic investors.[127]

SIRM/CMM pilots have also shown the importance of using key performance indicators (KPIs) to measure the impact of these mechanisms and how such KPIs can shift the political economy of investor-State conflict into positive dynamics for politicians and government officials.[128] As shown in figure 4 below, the pilots have entailed setting up a tracking tool to measure the investment and jobs at risk of being lost as a result of an investor-State grievance.

126. *Id.* at 65–66.
127. *Id.* at 66.
128. *Id.*

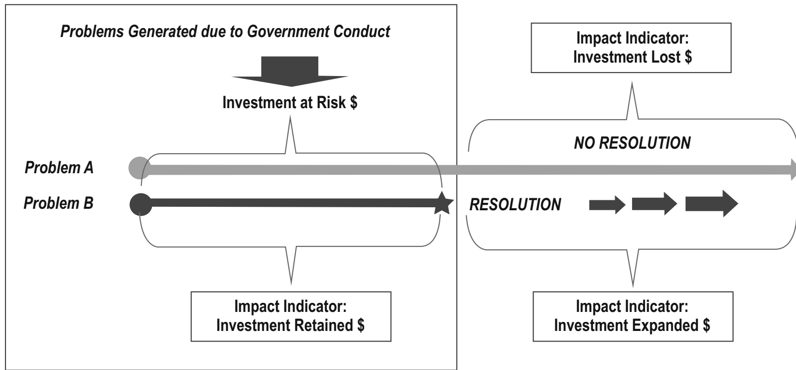

FIGURE 4. SIRM/CMM PILOTS: THE USE OF KEY PERFORMANCE INDICATORS[129]

As soon as the grievance is registered by the lead agency, a first assessment entails a determination of the "temperature" of the conflict with the investor. That is done by examining different objective variables, such as how long the problem has remained unresolved, what that problem costs the investor, whether the investor has already contacted another government agency to address the problem, whether the matter has also been communicated to the home-State country's embassy in the host State, etc. On such objective criteria, the lead agency can get an idea of the extent the grievance at hand has degraded within the investor-State conflict continuum line. Once such determination is made, a legal early evaluation is conducted, basically assessing, if the grievance at hand escalated into a full-blown dispute, how likely it is that the host State will be found liable under an IIA. Last but not least, the assessment also measures the amount of investment at risk and, more importantly, how many jobs are also at risk of being lost if the FDI project was discontinued. WBG pilots in countries like Vietnam, Georgia, and Mongolia corroborate these trends.[130]

The amount of investment and jobs at risk of being lost as a result of the grievance would immediately cease to be at risk if the conflict was effectively resolved. Therefore, it follows that such investment and jobs originally at risk would become jobs and investment retained as a result of the functioning of the SIRM/CMM. Further, if as a result of resolving the conflict, investors opted to expand their operations in an environment where their confidence and level of comfort in the country improved, such invest-

129. *Id.* at 52.
130. *Id.* at 4, 51, 61.

ment and associated jobs would be tantamount to the investment and jobs expanded/generated. In sum, by measuring the positive effects of maintaining the investor-State relationship rather than focusing on the costs of the conflict and disputes, the SIRM/CMM pilots have tended to generate political economy dynamics positively inducing government behaviors that correspond to those expected as a result of the application of the IIAs and domestic laws in most jurisdictions.

By focusing on measuring results that may be politically attractive for governments to publicly announce, the incentives for the administrative bureaucracy to make use of the SIRM/CMMs have increased.[131] Indeed, measuring the amount of FDI and jobs that an intervention of technical-level bureaucrats can generate as a result of timely addressing investor-State conflicts has been much more productive than measuring the costs or negative consequences of not doing so. Few government officials are interested in measuring negative effects that, if publicly disclosed, may negatively taint the performance of the administration. Conversely, most government officials have been much more interested in measuring the positive results that their efficient performance may have on aspects that are politically valuable for their bosses. What is more valuable for politicians than showing how their administrations are contributing to retaining and expanding jobs, investment, and exports? Further, aren't these the same results that international investment law should promote?

In sum, SIRM/CMMs pilots have shown a very practical way for countries to leverage IIAs in a nonlitigious manner to induce desired patterns of behavior among domestic regulatory agencies. From this perspective, it could be argued that SIRMs/CMMs are not only tools to properly implement IIAs on the ground, but also more in tune with IIAs' original intent: to mitigate political risks in cross-border investment transactions.

V. Conclusions: Leveraging CMMs to Strengthen Investor-State Relationships and Maximize Potential Benefits of International Investment Law

There is consensus that from a historical point of view, the original purpose of IIAs was to mitigate risk from opportunistic government behavior, thereby increasing investors' confidence to undertake productive FDI projects beyond their home States. However, recent research has demonstrated a more specific point: from an economic development perspective, such political risk mitigation function is not useful—neither to host States nor investors—if it is exclusively done *ex-post facto* (that is, if enforcement of rules and disciplines is sought after the damage has been done and the investor-State relationship has been already severed, leading the investor to

131. *Retention and Expansion of Foreign Direct Investment (Vol. 2): Political Risk and Policy Responses*, *supra* note 3, at 60–61.

withdraw or cancel the expansion of an investment project). For IIAs to fulfill their development function, mechanisms have to be put in place to ensure that their provisions actually influence government behavior well before the investor-State relationship has deteriorated to such a degree that investors opt to discontinue their FDI projects. Simply said, from this vantage point, a key function of IIAs is to contribute to retention and expansion of FDI.

Regardless of how obvious this conclusion may be, surprisingly, neither academia nor policymaking have paid attention to the practicalities of how to implement those IIAs on the ground to achieve that objective. Implementation is meant here to leverage IIAs in such a way that their provisions influence government behavior on the ground, thereby improving investors' confidence and contributing to the retention and expansion of investments and its externalities in the host economy. Evidently, ISDS does not entail implementation of IIAs, but is rather a symptom of a lack of it. Yet, despite the controversy ISDS has generated in the academic and policy community about the role of international investment law and development, the attention on whether IIAs are contributing to retention and expansion of FDI has been absent. This is the blindside of international investment law that this article has attempted to unveil.

This article has argued that recent research has demonstrated that, in fact, it is through the use of CMMs that countries can effectively implement IIAs. The findings of such research echo the seminal work of Cottier[132] on multilayered governance and Kingsbury and Schill on global administrative law[133] by showing how trends in the evolution of investor-State conflicts evidence one of the key challenges for governments in times of globalization: the growing tension between the single-state paradigm at the core of domestic and international legal systems on the one hand, and on the other, the governance fragmentation derived from the multilayered agency composition of most governments worldwide—which has been exacerbated in the last three decades by administrative decentralization.

Just as globalization is pressuring investors to compete in more interactive and contestable markets, it is also pressuring governments to set up mechanisms to ensure a minimum level of administrative coherence among dozens, hundreds, or even thousands of agencies comprising the public administration, both at a national and subnational level. Capacity to ensure coherent, regular government conduct based on the fundamental norms and

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132. Thomas Cottier, *Towards a Five Storey House*, *in* CONSTITUTIONALISM, MULTILEVEL TRADE GOVERNANCE AND INTERNATIONAL ECONOMIC LAW 495 (Christian Joerges & Ernst-Ulrich Petersmann eds., Hart Publishing 2011).

133. *See* Benedict Kingsbury & Stephan Schill, *Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law* (New York University School of Law, Public Law & Legal Theory Research Paper No. 09-46, 2009), https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=657655v.

principles of IIAs among a plethora of administrative actors is becoming challenging for governments. However, such challenge should not be ignored by promoting the elimination of international rules fostering administrative discipline. On the contrary, this calls for more efficient, creative, and pragmatic mechanisms to foster the rule of law, especially if FDI is to be leveraged for development. This is precisely the role that CMMs aim to fulfill.

Nowadays, the most frequent and pressing political demand posed by civil society to their respective governments is the generation of jobs and better standards of living. Such objectives cannot be reached if investment projects are constantly canceled. CMMs incorporating tracking mechanisms provide a great opportunity for both bureaucrats and governments as a whole to quantify the results of their efforts to retain and expand investment and their associated jobs and externalities. By measuring politically attractive data, government officials have an incentive to behave in line with the principles that IIA aim to promote.