The Development of International Investment Law

Lessons from the OECD MAI Negotiations and Their Application to a Possible Multilateral Agreement on Investment

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THE DEVELOPMENT OF INTERNATIONAL INVESTMENT LAW:
LESSONS FROM THE OECD MAI NEGOTIATIONS AND THEIR
APPLICATION TO A POSSIBLE MULTILATERAL AGREEMENT ON
INVESTMENT

By

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ABSTRACT OF THE DISSERTATION

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This dissertation analyses developments in the international regulation of foreign direct investment (FDI). The international legal framework of investment encompasses numerous binding or non-binding legal instruments, including customary international law, bilateral investment treaties, and international organizations’ decisions and resolutions. The rules established by the international legal framework become effective and significant when they are able to be adapted by appropriate and compatible domestic law frameworks. Through analyzing the Turkish foreign investment regulations and policies, this study concludes that that there is a successful and complex interaction between international rules and domestic rules on FDI. Like many developing countries, since the 1980s Turkey has revamped its FDI regulations in response to changes and developments in international investment law. This interaction will reach its culmination,
if there is a comprehensive multilateral agreement on investment. This dissertation examines failures of the OECD MAI draft treaty since there are lessons to be learned from the MAI negotiations. Thus, it makes some recommendations both in relation to the substance and the procedure for a possible future negotiation of multilateral investment agreement.
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CHAPTER ONE. INTRODUCTION

Recently one of the most important aspects of international economics, foreign investment is growing among countries all around the world, and it seems that it will keep increasing in the near future. Even though some distrust of foreign investment still remains among some of the developing countries, the world community has recognized that foreign direct investment is central to the process of international economic integration, namely globalization. Foreign direct investment offers recipient countries the opportunity to upgrade productivity and competitiveness, to benefit from the transfer of technical and managerial expertise, and to promote integration into the international economy.¹

The essential thing that the parties in this foreign investment movement have is different interests and rights, which are controversial. Those interests are, profit-based on ownership of property for investor and development based on the sovereign rights for the host country.² Generally, “if the interests and the rights are different, there will be a conflict. The most effective way to avoid conflicts is through the law.”³ Therefore, this dissertation will explain the development of international law on foreign investment with respect to customary international law and treaty law. Especially the role of bilateral and multilateral treaties on foreign investment will be scrutinized in order to purpose what the newest and most effective approach of a multilateral treaty on investment would be.

³ Id.
The purpose of dissertation is to make a contribution to the interaction between national and international rules on FDI. This dissertation proposes to examine the adequacy of the role of domestic and international legal principles used to reach economic liberalization and economic development. Economic liberalization is a policy that reduces or eliminates restrictions on foreign trade and investment. A liberal investment regime can be defined as follows: “{it} is one in which States permit the market to determine allocations of capital, ensure the proper functioning of the market, and provide legal protection for investment against wrongful injury by public or private agents.”

On the other hand, due to the fact that this task is rather complex and extensive in its scope, this dissertation proposes to focus only on foreign direct investment, not portfolio investment. FDI differs from portfolio investment in that FDI embodies control of the asset, while portfolio investors are passive investors, motivated only by rate or return on the asset. Foreign direct investment provides better domestic competition and access to markets. Investment in research and development creates new products and processes that will increase productivity and competitiveness internationally. Moreover, international trade and economic growth are improved when inputs such as capital, technology and managerial skills are facilitated.

The principal aim of this dissertation is to study the emerging international regulation of cross border direct investment and its impact on Turkey. Apart from being a Turkish legal scholar, there are many striking reasons I have chosen Turkey as a case study. Turkey is an extraordinary state that provides an ideal framework for the analysis of the interaction between national law and international law on foreign investment, due to its geographic and strategic

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location in Euro-Asia, and its alliances with the East and the West. In addition, even though 99% of the Turkish population is Muslim, Turkey has a secular and democratic regimen that differentiates her from with almost all other countries with Muslim majorities. Since the introduction of western reforms by Mustafa Kemal Ataturk, founder of modern Turkey, Turkey has been a model country for the modernization process of other developing countries.\textsuperscript{5}

This study analyses following international legal instruments in order to illustrate the interaction between international rules and Turkish legal framework on FDI: Bilateral investment treaties, international organization activities. The number of bilateral investment treaties has increased constantly during the first half of the 1990s.\textsuperscript{6} Bilateral investment treaties classically contain provisions guaranteeing fair and non-discriminatory treatment for investment, protecting investment against expropriation and other forms of non-commercial risk, and resolving dispute through settlement process. Many international legal scholars claim that BITs typically address the same topics in much the same terms, although there are significant differences among them.\textsuperscript{7}

This dissertation tries to find out the role of bilateral investment treaties in the development of national law and international law. In order to do that, there are number of questions that need to be considered: What are the main reasons for which individual countries have decided to conclude BITs? What issues do these treaties cover? What would be BITs

\textsuperscript{5} Bernard Lewis spells out that “Twice before in the course of history, the Turks have set an example and served as a model for others, under the Ottomans of militant Islam; under Kemal Ataturk, of Secular patriotism. If they succeed in their present endeavor to create, without the loss of character and identity, a liberal economy, and open society, and a liberal democratic policy, they may once again serve as a model to many other peoples.” Metin Heper, \textit{Islam and Democracy in Turkey: Toward Reconciliation?} The Middle East Journal, Volume 51, No. 1, at 33, Winter (1997).


implications for the status of customary international law? Moreover, according to the majority opinion of legal scholars, BITs accepted as a *lex specialis* that is mutually binding to the parties.\(^8\) This situation has led many countries to establish regional and international organizations deal with trade and FDI. Therefore, this dissertation will also analyze the existing international instruments and activities in the area of investment. Notably the United Nations (UN), the OECD, the WTO, the MIGA are dealt separately in view of their special importance in this study.

The activities of the international organizations have contributed to establishing an international legal framework in foreign investment through binding and non-binding legal instruments. This study will explain the UN’s and the OECD’s activities on foreign investment. The UN provides technical assistance and other services for the promotion of foreign direct investment in developing countries through the UNDP, UNCTAD, and its regional commissions.

The existing network of bilateral and regional investment instruments is effective to some degree in creating a favorable climate for foreign investment. On the other hand, provisional differences of these instruments may create more complicated problems and distort investment flows. Multilateral investment rules can solve such problems and promote foreign investment. The world community needs truly comprehensive and binding international rules on foreign investment. For many years, international organizations like the UN, the WTO, and OECD have been searching for a new investment agreement which will facilitate the unique needs of a global economy. In other words, many proposals have been made for creation of a multilateral agreement on investment (MAI). One was discussed within the organization for

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\(^8\) UNCTAD, *supra* note 6, at 4.
economic cooperation and development (OECD).\(^9\) Even though the MAI has failed to materialize comprehensive multilateral investment agreement, it is still important to understand further multilaterialization process of investment, so this dissertation will examine why MAI failed. In addition, this dissertation demonstrates some lessons from the MAI negotiations and their application to a possible multilateral agreement on investment.

Some countries have asserted that multilateral investment agreement should be negotiated and concluded under the WTO. There is a complex interaction between trade and investment policies.\(^{10}\) Trade barriers can influence investment decisions. Likewise, investment measures can affect the flow of goods and services. Considering the relationship between trade and investment, investment is an issue that should be negotiated by the WTO. The paper will analyze the framework for negotiations in the WTO for an agreement on direct investment and the conflicting interests of developed and developing countries regarding such an agreement. The most significant part of the Uruguay Round dealt with new issues, including services, trade related investment measures (TRIMS), and intellectual property protection. Each of these issues will be analyzed briefly in this paper so as to understand the framework for negotiations in the WTO for an agreement on FDI.

This study will evaluate provisions and effectiveness of the MIGA and the pertinence of the principles and standards of the MIGA to Turkey. The Multilateral Investment Guarantee Agency (MIGA) was created to provide political risk insurance to foreign investors in developing countries. MIGA was established by an international convention on 12 May 1988.

\(^{9}\) OECD, POLICY BRIEF, No. 2, (1997).

\(^{10}\) Mr. Renato Ruggiero, ex WTO Director-General, at the UNCTAD seminar on foreign direct investment and multilateral trading system in Geneva on 12 February 1996, said that: “Indeed, in today’s economy, trade and investment are not merely increasingly complementary, but also increasingly inseparable as two sides of the coin of the process of globalization.” WTO PRESS/42, 13 February 1996, http://www.wto.org (visited 3/12./1999).
as one of the World Bank Group’s financial institutions designed to encourage the flow of investment to member countries and, in particular, to developing member countries.\textsuperscript{11}

Domestic foreign investment law is one of the legal sources on foreign investment disputes since foreign investors and investments are subject to the host country’s national law. The foreign investor cannot just trust domestic laws to protect its interests. The only acceptable legal concept is the national law consistent with international law on foreign investment. Recently, most developing countries have enacted new liberal national investment law. This dissertation will evaluate Turkey’s foreign investment policy as a case study.

Turkey has been pursuing liberal and outward oriented economic policies since the 1980s.\textsuperscript{12} Turkey views FDI as vital to its economic development and prosperity. This study will analyze the legal framework of foreign investment in Turkey, particularly, of existing regional commitment and applicable international treaties.

In Turkey developments in foreign investment occurred in the early fifties. During this period, with the formation of rapid development strategies and international economic cooperation, “Turkish Foreign Investment Law (herein after TFIL)” was enacted. Since the 1980s, the Turkish Government has followed liberalized, outward-oriented economic policies. The foreign investment law was amended. There were rapid changes in the economic and social structure of Turkey. For example, the deregulation of interest rates, the establishment of organized markets for money, foreign exchange, stocks and securities were some of the changes.\textsuperscript{13} Following these measures, one of the major policy decisions was the adoption of liberal and flexible foreign investment policy. As a result of the changes in the TFIL, the


\textsuperscript{12} DAVID BARCHARD, TURKEY INVESTING IN THE FUTURE, 113-117 (1990).

\textsuperscript{13} Id. at 116.
investment climate was made more efficient and suitable for potential investors.\textsuperscript{14} Furthermore, Turkey amended its Constitution provision pertaining to international arbitration on concession agreement, which was a very controversial issue, in summer 1998. This study will focus on Turkish point of view on international arbitration in international investment disputes. In summary then, this study will examine Turkey’s policies on foreign investment and the role played by foreign investment in the Turkish economy. It will also explain legal structures and policies affecting foreign investment in Turkey.

This dissertation does not completely deal with all of the developments on FDI. It deals with current changes taking place in this field. Thus, the BITs, OECD and the WTO are the main investment instruments examined critically in this dissertation. International rules on foreign investment protection contribute to create a favorable investment climate that benefits both international investors and host countries. Chapter Two examines the sources of international investment law. Chapter Three analyzes the proliferation of the BITs and the impacts of the BITs on customary international law. Chapter Four analyzes international organizations activities on foreign investment, specifically, the UN, and the OECD instruments. Chapter Five analyses the OECD MAI draft treaty in terms of its substantive and procedural provision by comparing it with BITs. Chapter Six analyzes failure of MAI so as to help future negotiations on multilateral investment agreement. Chapter Seven analyzes the framework for negotiations in the WTO for an agreement on FDI. Chapter Eight examines the MIGA’s provisions and activities. Chapter Nine is devoted to an overview of Turkish foreign investment law policy. It shows the state’s interest and attempts in changing its legal system in line with its international commitments in order to provide better protection for FDI. It also

\textsuperscript{14} Eric Schneider, Alev Bilgen, \textit{Foreign Investment laws in the Republic of Turkey: A Model for Reform, 5 TRANSNAT’L LAW. 99, Spring, 101-102 (1992).}