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Introduction

Few areas of international law excite as much controversy as the law relating to foreign investment.[1] A spate of arbitration awards resulting from investment treaties has added much to the debates in recent times. These have been followed by massive literature analysing the law resulting from the treaties and the arbitration awards. Since the awards often conflict, the confusion has been exacerbated. Though the conflict in the awards is often attributed to the inconsistencies in the language in the treaties each tribunal had to interpret, the more probable explanation is that there are philosophical, economic and political attitudes that underlie the conflict which in turn reflect the underlying causes for the controversies that have existed in the area for a long time.

The law on the area has been steeped in controversy from its inception. Much controversy has resulted from the law on the subject being the focus of conflict between several forces released at the conclusion of the Second World War. The cyclical nature of the ebbs and flows of the controversy is evident. The ending of colonialism released forces of nationalism. Once freed from the shackles of colonialism, the newly independent states agitated not only for the ending of the economic dominance of the former colonial powers within their states but also for a world order which would permit them more scope for the ordering of their own economies and access to world markets. The Cold War between the then superpowers made the law a battleground for ideological conflicts. The non-aligned movement, which arose in response to this rivalry, exerted pressure to ensure that each newly independent state had complete control over its economy. One avenue for the exertion of such pressure by the non-aligned movement was the formulation of new doctrines through the use of the numerical strength of its members in the General Assembly of the United Nations. Several resolutions were enacted asserting the doctrine of permanent sovereignty over natural resources and calling for the establishment of a New International Economic Order, the aim of which was to ensure fairness in trade to developing countries as well as control over the process of foreign investment. The oil crisis in the 1970s illustrated both the power as well as the weakness of the states which possessed natural resources. It brought

[1] Compare Harlan J in *United States* v. *Sabbatino*, 374 US 398 (1964), who said, regarding one aspect of this branch of the law: 'There are few if any issues in international law today on which opinion seems to be so divided as the limitation of the state's power to expropriate the alien's property.' The statement seems equally applicable to other areas of the international law on foreign investment.

about industry-wide shifts through collective action organised by the oil-producing states. The producers of other mineral resources were not able to achieve the same success.

The ability of the developing states to exert their collective influence on shaping the law shifted dramatically towards the end of the twentieth century. Sovereign defalcations associated with the lending of petrodollars dried up private lending by banks. Aid had already dried up due to recession in the developed states. The rise of free market economics associated with President Reagan of the United States and Prime Minister Thatcher of the United Kingdom gave a vigorous thrust to moves to liberalise foreign investment regimes. The acceptance of an 'open door' policy by China and the success of the small Asian states like Hong Kong and Singapore, which had developed through liberal attitudes to foreign investment, made other developing states choose a similar path.[2] The dissolution of the Soviet Union led to the emergence of new states committed to free market economics. Developing states began to compete with each other for the foreign investment that was virtually the only capital available to fuel their development. Third World cohesion, which drove the ideas behind the New International Economic Order, was on the verge of collapse, though it had by then evolved competing norms challenging the previously existing ones. The vigorous espousal of free market economics by the International Monetary Fund and the World Bank also led to pressures being exerted on developing countries to liberalise their regimes on foreign investment. Neo-liberal economic theories became prominent. The view that the market will allocate resources fairly came to be adopted in the domestic economic sphere. Liberalisation of assets in the international economy became the favoured policy. In the context of this swing in the pendulum, the developing states entered into bilateral treaties containing rules on investment protection and liberalised the laws on foreign investment entry. They also participated in regional treaties like the North American Free Trade Agreement (NAFTA) and sectoral treaties like the Energy Charter Treaty. The World Trade Organization (WTO) came into existence with the avowed objective of liberalising not only international trade but also aspects of investment which affected such trade. The link between international trade and international investment was said to justify the competence of the WTO in this area. The Singapore Ministerial Conference of the WTO decided to study the possibility of an instrument on investment.[3] New factors had entered the area of the international law on foreign investment. Many of the new instruments of the WTO dealt directly with areas of foreign investment.[4] But, the WTO was unable to bring about a comprehensive instrument on investment.

[2] Though initially it was thought that these states achieved prosperity by the adoption of liberalisation measures, this view has since been queried, with many holding the view that astute interventionist measures by the state combined with selective liberalisation measures and regulation of foreign investment were the reason for the growth.

[3] The move to create an instrument on investment within the WTO failed as a result of concerted opposition from developing states.

[4] Intellectual property was covered by the Trade-Related Aspects of Intellectual Property Rights (TRIPS) instrument. The General Agreement on Trade in Services (GATS) deals with the services sector and covers the provision of services through a commercial presence in another country, which is foreign investment in the services sector. The Trade-Related Investment Measures (TRIMS) instrument deals with performance requirements associated with foreign investment. The Singapore and Doha Ministerial Meetings of the WTO agreed to consider an instrument on investment and an instrument on competition which would directly impact foreign investment. But, these efforts failed, signalling disenchantment with the free market model of development.

Economic liberalism was generally triumphant at the end of the last millennium. The impact of its triumph was felt on the international law on foreign investment. The incredible proliferation of bilateral investment treaties was evidence of this triumph. United Nations Commission on Trade and Development (UNCTAD) reports indicate that the 1990s began with some 900 treaties and ended with over 2,900 treaties. The treaties created jurisdiction in arbitral tribunals at the unilateral instance of the foreign investor. After *AAPL* v. *Sri Lanka*,[5] where such unilateral recourse to arbitration on the basis of appropriately worded dispute-settlement provisions in treaties was first upheld, the number of arbitral awards based on standards of treaty protection of foreign investment increased substantially. This in turn led to the articulation by these tribunals of principles which confirmed and extended notions that favoured movement of foreign investment and their treatment in accordance with external standards. It also restricted governmental interference with such investment significantly by considerably expanding the notion of compensable taking to include regulatory takings.[6]

There is evidence of yet another swing taking place at the beginning of the new millennium. Successive economic crises in Asia and Latin America attributed to the sudden withdrawal of foreign funds have led to the re-evaluation of whether the flow of foreign funds and investments is the panacea for development as originally thought. The Organization of Economic Co-operation and Development (OECD) attempted to draft a Multilateral Agreement on Investment (MAI) in 1995 thinking that the time was ripe for such an effort, given the seeming willingness of developing countries to liberalise their economies and enter into bilateral economic treaties. But, during the discussions, the members of the OECD, all developed states, found that they could not agree among themselves on the principles of the rules on foreign investment protection. The attempt also spawned a protest coalition of environmentalists and human rights activists who complained that the draft of the MAI emphasised the protection of investment without adverting to the need to protect the environment and human rights from abuse by multinational corporations. An important idea had been articulated during this protest that the multinational corporation may be an agent of progress and deserves protection but that it could also be an agent of deleterious conduct, harmful to economic development. In this case, it requires not protection but censure through the withdrawal of such protection and, even, the imposition of liability. As a result, there have been various efforts made to formulate standards of conduct for multinational corporations.

The collective protests against the MAI were a prelude to the protests against globalisation that were to mar the meetings of economic organisations like the WTO, the IMF and the World Bank at Seattle, Prague, Montreal and other capitals of the Western world. These protests have continued. The protests signified the emergence of lobbies within the developed world which required the rethinking of issues relating to foreign investment. The protests signified that the dissent was not the concern solely of developing states but that sections within the developed

5 *Asian Agricultural Products Ltd* v. *Sri Lanka* (1990) 4 *ICSID Reports* 245.

6 Thus, for example, in *Santa Elena* v. *Costa Rica* (2000) 39 *ILM* 317; (2002) 5 *ICSID Reports* 153, an environmental measure was held to be expropriatory. Later awards, which recognised that such regulatory takings may be non-compensable, cast doubt on these trends.

states were concerned with the fact that the law was being used in a manner that gave protection to the interests of foreign investment to the detriment of the interests of the eradication of poverty, the protection of the environment and the promotion of human rights. New forces that could reshape the law had been released. There were dramatic disclosures of massive corporate frauds resulting in disenchantment with once admired corporations, resulting in stringent corporate disclosure laws. These events have been accentuated by the global economic crisis resulting from the massive unsecured loans given by banks in Europe and North America. There has emerged a disillusionment with neo-liberal policies that had been adopted in the previous decade. The law, particularly the international law on foreign investment, was an instrument of effecting neo-liberal policy, and the issue has to be faced whether some of the changes made in the past need to be changed in light of new circumstances. The instrumental role that the law played may have to go into reversal.

A new phenomenon that has emerged in the area is the role of non-governmental organisations (NGOs) committed to the furtherance of environmental interests and human rights and the eradication of poverty. These NGOs operate within developed states and espouse, to a large extent, what they believe to be the interests of the people of the developing world and the world as a whole. In addition, there are the protest movements against globalisation which also seek to espouse causes that favour developing-world interests, ranging from economic development, the writing-off of Third World debt and foreign investment.[7] It has been suggested that, with the increase in the gap between rich and poor within developed states brought about by globalisation, there is a Third World within developed states ready to protest against excessive reliance on free market ideas.[8]

More dramatic has been the fact that there has been a change in the patterns of foreign investment. Newly industrialising countries such as China, India and Brazil have become exporters of capital. Sovereign wealth funds of many small countries are playing leading roles in acquiring established businesses in developed countries. As a result, developed states in North America and Europe are becoming massive recipients of foreign capital. These changes will result in the assertion of sovereign control of such investments by the developed states and a selective relinquishing of the inflexible rules on investment protection that these states had built up.

This trend is already evident as leading companies of the United States and Europe are taken over by foreign investors from Asia and elsewhere. The rules the developed states crafted to protect the foreign investment of their nationals will soon come to haunt them. As a result, they may be bent on backtracking on these rules and creating, as developing countries did in the past, significant sovereignty-based defences to liability and redrawing the boundaries of investment protection.[9] These sovereignty-based defences are often the

[7] This clash of globalisations is discussed in M. Sornarajah, ‘The Clash of Globalisations: Its Impact on the International Law on Foreign Investment’ (2003) 10 *Canadian Foreign Policy* 1.

[8] Caroline Thomas, ‘Where Is the Third World Now’, in Caroline Thomas (ed.), *Globalisation and the South* (1997) 1.

[9] This is already evident in the introduction of exceptions relating to regulatory takings, defences based on the environment, the devising of an exceptional regime for taxation, self defined national security exceptions and broad necessity defences which can be found in the US and Canadian model investment treaties. The changes resulting in the recognition of defences to liability justify a new chapter in this edition.

refuge of the developed states in response to the neo-liberal expansions that were made. That this reaction took place over such a short period attests to the responsiveness of the law to the changes that are effected by circumstances as well as by the expansive attempts at the interpretation of instruments in the field by decision-makers in the area, principally, arbitrators.[10]

But, still, there will be considerable restraint in dismantling the existing system. As the power of multinational corporations increases,[11] developed states will continue to espouse their interests not only because of the enormous power that these corporations achieve through lobbying but also because it is in their interests to do so. The expansion of trade and investment increases the economic power of developed states. They have traditionally seen the need to ensure the protection of the multinational corporations responsible for such trade and investment as coincidental with their own interests.

The multinational corporations themselves must be seen as distinct bases of power capable of asserting their interests through the law. Their individual economic resources far exceed those of many sovereign states. Their collective power to manipulate legal outcomes must be conceded. It is a fascinating fact that, through the employment of private techniques of dispute resolution, they are able to create principles of law that are generally favourable to them. That they can bring about such outcomes through pressure on their states is obvious. It is notable that textbooks on international law do not contemplate the legal personality of these corporations when they wield so much power in international relations.[12] The role of these actors in the international legal system is seldom studied due to the dominance in the field of positivist views which stress that states are the only relevant actors in international relations.[13] They provide a convenient cloak for hiding the absence of corporate liability. Positivism also enables law-creation by an entity often held to lack legal personality. By employing low-order sources of international law such as decisions of arbitrators and the writings of 'highly qualified publicists', it is possible to employ vast private resources to ensure that a body of law favourable to multinational corporations is created. This, again, is a phenomenon that international lawyers have been reluctant to explore lest it shakes the hoary foundations on which their discipline is built.

There will be entirely new types of multinational corporations entering the scene. The state-owned oil corporations of China and India are aggressively entering the field and seeking mergers with existing multinational corporations. The investment funds of many rich, smaller states like those in Singapore and Dubai as well as those newly industrialising

[10] C. Duggan, D. Wallace, N. Rubins and B. Sabahi, *Investor–State Arbitration* (2008), suggest that the United States, which had opposed the Calvo doctrine that international law has no relevance to foreign investment and only national laws have competence, may now be adopting that doctrine. They observe, at p. 488: 'It is indeed ironic that the United States – long the leading opponent of the Calvo Doctrine – may now be considered its proponent, at least in regard to national treatment and indirect expropriation.'

[11] It has been pointed out that multinational corporations exist in developing states as well. But, they are nowhere near as large as US and European multinational corporations and cannot wield the same degree of influence.

[12] Writers on international relations, however, concede the power of these corporations to affect the course of international relations. Their behaviour, as a consequence, is extensively studied in that field. It is unfortunate that there are no parallel studies in international law. There are, however, efforts being made to grapple with the problem in international law. Jennifer Zerk, *Multinationals and Corporate Social Responsibility* (2006).

[13] C. Cutler, *Private Power and Global Authority: Transnational Global Law in the Political Economy* (2003).

states which have excess capital will enter the scene as actors who will shape the rules of the game. The very states which wanted strong rules in the area may baulk at the prospect of these rules being used in a manner favourable to these new actors.[14]

The rapid changes in this subject area call for an understanding not only of the role of states and multinational corporations but also of the role of NGOs. In addition, since much of the exploitation of natural resources takes place on the land of minorities and tribal and aboriginal groups, the interests of these groups also have to be taken into account in the development of the law. It is an area in which international law is clearly moving away from the old positivist notion that international law is shaped entirely by the activities of states. Even as techniques to protect foreign investment are coming to be explored more fully through the creation of standing for multinational corporations, so, at the same time, by contrast, there is pressure to ensure that the subject reflects the concerns of human rights and environmental interests through the imposition of liability on these corporations. These emphasise, not the protection of the investments of multinational corporations, but their social and corporate responsibility to the host communities in which they operate. These concerns are reflected in the increasing volume of literature that is devoted to the new directions that foreign investment law has taken.[15]

The interplay of various economic, political and historical factors shaped, and continues to shape, the development of the international law on foreign investment. If international law is generated by the eventual resolution of conflicting national, business and social interests, the international law of foreign investment provides an illustration of these processes of intense conflicts and their resolution at work. It is an area in which the interests of the capital-exporting states have clashed with the interests of capital-importing states. The resultant resolution of the conflict, if any resolution is indeed achieved, indicates how international law is made and how open-ended the formulation of its principles are in the face of intense conflicts of views among states as to the law. These conflicts become accentuated when other actors in the field are divided in their views and support the contesting norms that each camp espouses. Positivist studies of the subject which emphasise the rules in treaties and arbitral awards fail to capture the rich policy implications behind the shaping of these rules through a constant clash of interests.

As a result of such clashes, the field provides for the study of international law as an interdisciplinary subject in which ideas in the sphere of economics, political science and related areas have helped to shape the arguments. Yet, for all its richness, the field has

[14] An instructive situation is the effort of the Chinese state oil company, Sinopec, seeking to buy into the American oil company, Unocal. The matter created considerable concern and the offer fell through. In the United States, national security and other concerns were cited as reasons for opposing the merger.

[15] There is a concentration in the new literature on foreign investment arbitration. For the literature, see C. McLachlan, L. Shore and M. Weiniger, *International Investment Arbitration: Substantive Principles* (2007); C. Duggan, D. Wallace, N. Rubin and B. Sabahi, *Investor–State Arbitration* (2008). These works are a result of increasing practitioner interest in the area. There is also a second edition of C. Schreuer, *The ICSID Convention: A Commentary* (2nd edn, 2009). A. Newcombe and L. Pradell, *Law and Practice of Investment Treaties* (2009) is an excellent book developing the law on the basis of investment treaties. There are works which deal with the impact of external forces on the law. See, for example, J. Zerk, *Multinational Corporations and Corporate Social Responsibility* (2006); J. Dine, *Companies, International Trade and Human Rights* (2005); D. Kinley, *Human Rights and Corporations* (2009).

seldom been looked at as a whole, until recently.[16] It is necessary to carve out a niche for the subject within international law so that the manner in which the norms of international law are affected by the seemingly irreconcilable interests that operate in this area could be studied more intensively.[17]

Interest in the area also arises from the fact that the trends in this field cannot be explained on the basis of any existing theory of international law. Most theories of international law are rooted in positivism and are aimed at explaining law as an existing, static phenomenon, unaffected by political and other trends. These theories are incapable of being applied to a situation where the existing principles of law, formulated at a time when they were kept in place by hegemonic control and dominance, are under attack. Other theories are idealistic, seeking to achieve objectives based on morality and conscience. These theories are also inadequate to explain a situation in which different value systems of somewhat equal moral validity are in collision. Where existing rules supported by the established group of nations are subject to attack by relatively new members of the international community,[18] they become feeble and, until they are replaced, a situation of chaos or normlessness will exist. The task of decision-makers and scholars will be to examine the conflicts in the norms in the area and ensure that adjustments are made to bring about some acceptable norms so that the situation of normlessness may be ended. This book is a contribution to this process in an area of abundant normative conflicts. The identification of the conflicts in norms will itself facilitate the process of a future settlement of the conflicts and bring about a clearer set of rules on the international law of foreign investment.

[16] After the first edition of this book, a spate of new books on this and related areas appeared. R. Dolzer and C. Schreuer, *International Investment Law* (2008) concentrates on rules of investment treaties and arbitration under them. P. Muchlinksi, F. Fortino and C. Schreuer, *Handbook of International Investment Law* (2008), is an edited book which lacks a coherent theme, but collects together chapters on distinct aspects of the law. P. Muchlinksi, *Multinational Corporations Law* (2007), approaches the subject from the perspective of multinational corporations. One result of the profusion of arbitral awards has been a spate of books on the subject, as indicated in the previous footnote. Many of them have been written from the perspective of practitioners in the field, and are often papers presented at conferences, commenting on recent awards. There are older works: R. Pritchard (ed.), *Economic Development, Foreign Investment and the Law* (1996); and D. D. Bradlow and A. Escher (eds.), *Legal Aspects of Foreign Investment* (1999). For even earlier studies, see I. Delupis, *Finance and Protection of Foreign Investment in Developing Countries* (1987); Z. A. Kronfol, *Protection of Foreign Investment* (1972); and G. Schwarzenberger, *Foreign Investment and International Law* (1969). There are now specialist journals: *Foreign Investment Law Journal*, published by the World Bank; and the *Journal of World Investment* (Geneva). For a French study, see P. Laviec, *Protection et Promotion des Investissements: Etude de Droit International Economique* (1985). Specific areas of the law on foreign investment have also attracted book-length studies. See, for example, R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (1996); M. Sornarajah, *The Settlement of Foreign Investment Disputes* (2000); and C. Schreuer, *The ICSID Convention: A Commentary* (2nd edn, 2009). The newer works on investment arbitration have been indicated in the previous footnote.

[17] The creation of new subjects within international law must be addressed with caution, as the charge is made that these are studied without any foundation in the major discipline of international law. This is a legitimate criticism. An unfortunate facet of this area of the law is that many arbitrators who have made awards in the area have no grounding in international law and approach issues from an entirely commercial perspective, without regard to the public law elements in the disputes or to the public international law doctrines that may apply. Specialisation, within international law, helps to enhance the law. Also, often in modern times, the law has to be explained to persons who may not have the inclination to study the whole area of international law. The fact is that the areas of international law are burgeoning so rapidly that they cannot be addressed by a generalist with sufficient depth. There is a need for specialist works, well grounded in basic principles of international law. As indicated in the previous footnote, there are studies on more specialised aspects of this area of international law.

[18] The European origins of international law have been extensively commented on. One view is that new nations are born into the world of existing law and are bound by it. See D. P. O'Connell, 'Independence and State Succession', in W. V. Brian (ed.), *New States in International Law and Diplomacy* (1965). The opposing view is that they may seek revision of existing principles of international law, as they are not bound by these rules. This dispute takes an acute form in many areas of international law. For general descriptions of the disputes, see R. P. Anand, *The Afro-Asian States and International Law* (1978). The attack on Eurocentric international law is more evident in this field, as the conflict is between the erstwhile colonial powers which are now the principal exporters of capital and the newly independent nations which are the recipients of such capital.

The normative conflicts are accentuated by the fact that parties interested in this area of the law have become diverse. NGOs engaged in the promotion of single issues such as the protection of the environment from the hazardous activities of multinational corporations or the protection of human rights from violation by elites of states in association with multinational corporations have entered the fray. Large law firms see the area as a lucrative field of practice. They may seek to promote rules that cater to their interests in maintaining volatility in the area, ensuring wide bases of liability and a continuation of arbitration as the means of settlement of investment disputes. Arbitrators have agendas in that the field is one that provides scope for the lucrative pursuit of their profession. These interests often collide, increasing the fragility of the law.

1. The definition of foreign investment

Foreign investment involves the transfer of tangible or intangible assets from one country to another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets.[19] There can be no doubt that the transfer of physical property such as equipment, or physical property that is bought or constructed such as plantations or manufacturing plants, constitute foreign direct investment. Such investment may be contrasted with portfolio investment. Portfolio investment is normally represented by a movement of money for the purpose of buying shares in a company formed or functioning in another country. It could also include other security instruments through which capital is raised for ventures. The distinguishing element is that, in portfolio investment, there is a separation between, on the one hand, management and control of the company and, on the other, the share of ownership in it.[20] Investment treaties also define the nature of the foreign investment that is protected through their provisions. As a result, definitions differ according to the purpose for which they are used. It is emphasised that this work is not confined solely to the law created by treaties.[21]

1.1 The distinction between portfolio investment and foreign direct investment

In the case of portfolio investment, it is generally accepted that the investor takes upon himself the risks involved in the making of such investments. He cannot sue the domestic

[19] Compare the definition of foreign investment in the *Encyclopaedia of Public International Law* (vol. 8, p. 246), where foreign investment is defined as 'a transfer of funds or materials from one country (called capital-exporting country) to another country (called host country) in return for a direct or indirect participation in the earnings of that enterprise'. The difficulty with this definition is that it is broad enough to include portfolio investment. The IMF, *Balance of Payments Manual* (1980), para. 408, used a narrower definition which excluded portfolio investment. It defined foreign investment as 'investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of an investor, the investor's purpose being to have an effective choice in the management of the enterprise'. A definition that includes portfolio investment should demonstrate that its inclusion for the purposes of the international law on foreign investment is justified.

[20] Such a distinction is drawn in the texts on economics, and is also a sound basis for distinguishing direct and portfolio investment in the law. Thus, control is stressed in the following definition in E. Graham and P. Krugman, *Foreign Direct Investment in the United States* (1991) p. 7: 'Foreign direct investment is formally defined as ownership of assets by foreign residents for purposes of controlling the use of those assets.'

[21] Because of the extensive practitioner-oriented interest in treaty-based investment arbitration, there is an over-concentration on the law under investment treaties in the literature, despite the fact that contract-based arbitration continues and the roots of the law are also in other sources, such as customary practice on diplomatic responsibility.

stock exchange or the public entity which runs it if he were to suffer loss. Likewise, if he were to suffer loss by buying foreign shares, bonds or other instruments, there would be no basis on which he could seek a remedy.[22] Portfolio investment was not protected by customary international law. Such investment was attended by ordinary commercial risks which the investor ought to have been aware of. But, customary international law protected the physical property of the foreign investor and other assets directly invested through principles of diplomatic protection and state responsibility.

One view maintains that there should be no distinction between portfolio investments and foreign direct investments as to the protection given to either by international law. This view is based on the assumption that there is no distinction between the risks taken by either type of investor, both being voluntarily assumed.[23] But, this view is not accepted generally in international law, where it is clear that foreign direct investment alone is subject to the protection of customary international law. Several reasons are given for this difference in treatment. The foreign investor takes out of his home state resources which could otherwise have been used to advance the economy of the home state.[24] The home state is said to be justified in ensuring that these resources are protected.[25] Portfolio investments, on the other hand, can be made on stock exchanges virtually anywhere in the world. Since the host state cannot know to whom linkages are created through the sale of shares on these stock exchanges, there can be no concrete relationship creating a responsibility. This is not so in the case of foreign direct investment where the foreigner enters the host state with the express consent of the host state. Nevertheless, the trend of the law in the area may be to create responsibility towards those who hold portfolio investments through treaties. This is a trend associated with the liberalisation of the movement of assets. Opinions are found in some publications that portfolio investments are now to be included in foreign direct investments. To a large extent, such opinions are influenced by the fact that treaties defining investments include shares in the definition of foreign investment. But, as will be demonstrated, shares in this context mean the shares of a joint venture company in which the foreigner present in the host state has invested, and is not meant to include shares held by a non-resident and purchased entirely outside the host state. There will be continued uncertainty attached to the question whether portfolio investment is protected in the same manner as foreign direct investment in international law. The better view is that portfolio investment is not protected unless specifically included in the definition of foreign investment in the

22 Unless, as *Fedax* v. *Venezuela* (1998) 37 *ILM* 1378, would have it, an investment treaty could be interpreted as extending to portfolio investments.

23 I. Brownlie, 'Treatment of Aliens: Assumption of Risk and International Law', in W. Flume, H. J. Hain, G. Kegel and K. R. Simmond (eds.), *International Law and Economic Order: Essays in Honour of F. A. Mann* (1997), p. 309 at p. 311.

24 This is not much of a reason, as portfolio investment also constitutes resources within the state which could have been used within the state if not committed to a company overseas. But, sums of money that are used in portfolio investments are often small, shares being bought by individuals on stock exchanges.

25 But, again, the reason breaks down. The home state itself takes a risk in allowing these resources to leave the state. The question is why should it not have to bear the consequences of its own risk if the resources were to be harmed. Obviously, there is no answer to this logical issue, other than the pragmatic one that powerful states have conferred protection on the person and the property of its citizens who work or invest abroad.

relevant treaty.[26] The issue is considered later in this volume when dealing with investment treaties and their extension to cover portfolio investments.

1.2 Definition of foreign investment in investment treaties

The tendency of many treaties in the area of foreign investment, particularly the model treaties drafted by the United States and other capital-exporting states, has been to broaden the scope of the definition of foreign investment.[27] The objective behind this is to ensure that treaty protection could be given to a wide variety of activities associated with foreign direct investment. This objective has to a large extent been facilitated by the attitudes taken by arbitral tribunals and writers in the area. It is important for those who negotiate treaties to understand the purpose behind the making of these extensions.[28]

Several arbitration awards have been concerned with the issue as to whether the transactions that gave rise to the disputes could be characterised as investments. They are dealt with in the chapter on investment treaties. All of them contain definitions of foreign investment. But, these definitions apply only in the context of the protection given by the treaties. The notion of foreign investment may be wider than that contained in the treaty definitions, though these definitions also seek to capture a complete range of the types of foreign investments. But, for the moment, it is sufficient to indicate that one technique has been to identify foreign direct investment as having distinct criteria such as commitment of assets into a project with the object of profit and permanence and with a view to the risks arising from legal, political and economic changes. Controversy has centred on whether economic development is a criterion that marks foreign investment protected by international law. Certainly, one policy justification for the protection of foreign investment through the mechanism of international law has been the argument that it promotes economic development. It is interesting to note that, in early arbitrations in the field, a distinction was made between, on the one hand, foreign investments in developed countries which were subject to the host state's domestic law and, on the other, investments in developing countries which were subject to a supranational or international legal system on the basis that the agreements in the developing countries involved high risk but were made to promote economic development. Indeed, the contracts made in developing countries were designated 'economic development agreements' so as to reflect this distinction.[29] The controversy has continued under investment treaties which, their preambles suggest, are made in order to promote economic development through the flows of foreign investment. This controversy is dealt with in greater detail in Chapter 5 below.

[26] There are treaties, such as the ASEAN Framework Agreement on Investment, which specifically exclude portfolio investments from the scope of the treaty.

[27] Vandevelde has explained the concerns behind the definition of foreign investment in US bilateral investment treaties. See K. Vandevelde, *United States Investment Treaties* (1992), p. 261.

[28] Sometimes, a distinction is made between an asset-based definition, which simply lists the types of property which amount to protected investments, and a corporation-based definition, which lists the assets which are owned by the corporation which makes the investment. No material difference flows from this distinction.

[29] J. Hyde, 'Economic Development Agreements' (1962) 105 *Hague Recueil* 271.