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The Internalisation of Investment Treaties and the Rule of Law Promise

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1.1 Introduction

Over the past thirty years, international treaties for the promotion and protection of investment have proliferated, with over 3,000 such treaties concluded. The bulk of these treaties were concluded in the 1990s and 2000s, largely between developed and developing states.

In general structure, investment treaties provide special protections to foreign investors in host states, such as protections against discrimination, arbitrary treatment and uncompensated expropriation, as well as guarantees of fair and equitable treatment. The scope of coverage of these protections is broad. Generally speaking, the disciplines imposed by these treaties are applicable in respect of any measure attributable to the state in respect of a covered investment or investor, regardless of the subject matter of the measure (e.g. environment, public health, energy policy, etc.), regardless of the responsible organ of government and regardless of the sector of the investment. In addition, investment treaties establish specialised dispute settlement mechanisms. Under the treaties, foreign investors may bring claims for breach of the treaty against the host state before an international arbitration tribunal, generally without having to go first through the host state’s domestic courts.

Traditionally, two theories have been advanced for how host states might benefit from entering into investment treaties. The first theory is that – by offering special protections to foreign investors – investment treaties help developing states attract foreign investment.¹

¹ For an early statement of the justification, see Earl Snyder, 'Protection of Private Foreign Investment: Examination and Appraisal' (1961) 10 International and Comparative Law Quarterly 469, 92 (quoting Hartley Shawcross, one of the originators of the ill-fated Organisation for Economic Co-operation and Development [OECD] Draft Convention on the Protection of Foreign Property: 'The quid pro quo for the States’ undertaking is, in fact, in the English vernacular, the provision of the quids, that the capital importing countries, in
The second theory is that – by way of additional effect – investment treaties have positive effects on national governance in the host state. On this latter theory, because of a desire to avoid liability for breaches of investment treaties, developing states will internalise consideration of their international legal obligations into their governmental decision making, reform their decision-making processes, and thereby, over time, improve the rule of law not just for foreign investors but also for all those within their territories.\(^2\) As Roberto Echandi has put it, the fear of arbitration by foreign investors should act as ‘a deterrent mechanism’ against short-term policy reversals and ‘assist developing countries in promoting greater effectiveness of the rule of law at the domestic level’.\(^3\) Or, as Stephan Schill has asserted, “[d]amages as a remedy sufficiently pressure States into complying with and incorporating the normative guidelines of investment treaties into their domestic legal order”.\(^4\)


proponents of this theory have based their views upon the content of the obligations in investment treaties and assumptions about state behaviour. Kingsbury and Schill, for example, have argued that the obligation to provide fair and equitable treatment – found in almost all investment treaties – ‘ought to prompt States to adapt their domestic legal orders to standards that are internationally accepted as conforming to the rule of law’. Thus, they predict that the obligations contained in investment treaties will ‘have effects over time on specific law and administrative practices within states’, and that these improvements in governance will not only inure to the benefit of foreign investors but also ‘indeed to others under national law’. In other words, as a result of incorporating their investment treaty obligations into their dealings with foreign investors, host states can be expected to experience positive ‘rule of law’ spillover effects with regard to governance in the host state generally, such that improvements to the rule of law will be felt by all within the host state, not only covered foreign investors. We refer, henceforth, to this theory of the possible effects of investment treaties on national governance as the ‘rule of law thesis’. 

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7 See also Michael Reisman and Robert D. Sloane, ‘Indirect Expropriation and Its Valuation in the BIT Generation’ (2004) 75 British Yearbook of International Law 115, 117 (arguing that investment treaties will compel states with weak regulatory capacity to develop ‘an effective normative framework’ which includes, inter alia, ‘impartial courts, an efficient and legally restrained bureaucracy, and the measure of transparency in decision’); Celine Tan, ‘Reviving the Emperor’s Old Clothes: The Good Governance Agenda, Development and International Investment Law’, in Stephan W. Schill et al. (eds.), International Investment Law and Development: Bridging the Gap (Edward Elgar, 2015), 147–58 (saying, inter alia, that the ‘language of good governance, its associated rule of law narrative and their relationship to development outcomes have been used to justify the normative and institutional evolution of law and policy in [the area of international investment law]’). José Alvarez, ‘Are Corporations “Subjects” of International Law?’ (2011) 9 Santa Clara Journal of International Law 15–16 (providing an overview of the argument underlying the rule of law thesis).

8 The scholarship advancing the ‘rule of law’ thesis uses the term without definition, although, as noted in the text, some have stressed notions of due process, effectiveness, transparency, non-arbitrariness and accountability. The general literature on the rule of law is vast. For an overview of different definitional approaches to the rule of law, see, for example, Rachel Kleinfeld, ‘Competing Definitions of the Rule of Law’, in Thomas Carothers (ed.), Promoting the Rule of Law Abroad: In Search of Knowledge (Brookings Institution Press, 2010), 31; Kevin E. Davis and Michael J. Trebilcock, ‘The Relationship between Law and
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Over the past fifteen years, there has been a significant amount of empirical research on the impact of investment treaties on foreign direct investment (the findings of which have yielded little consensus).\(^9\) In contrast, we still know little about the effects of investment treaties on governance. Despite the rule of law thesis implicitly underlying much of the investment treaty discourse, and despite anecdotal indications that ‘the signature of international investment agreements by states was generally not followed by regulatory or institutional changes at the domestic level to enable states to meet their newly acquired commitments’,\(^10\) empirical studies examining the veracity of this claim have been rare. Mavluda

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Footnotes:


Sattorova’s work on the impact of investment treaties on host state governance is a notable exception.11 The purpose of this book is to contribute towards filling this gap.

Three assumptions about state behaviour underlie the rule of law thesis. The first assumption is that states make policy choices to seek to comply with their international treaty obligations. The second assumption is that – out of this desire to comply – states internalise their international investment obligations and that these obligations are taken into account in governmental decision making. The third assumption is that this desire to comply with investment treaty obligations ultimately will become operationalised in the host state’s general dealings with all addresssees of its legal and regulatory system.

The rule of law thesis, moreover, is rooted in a traditional view about the way in which the international legal order functions. On this view, states affirmatively seek to comply with their international treaty obligations12 either because it is in their self-interest to do so (they would not have consented to the treaty otherwise)13 or because they benefit from the reciprocity of compliance.14 Further, when states are tempted not to comply, the argument goes, they face the threat of sanctions, which in

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International relations literature explains this traditional international law approach through a ‘rational choice’ theory of the state. Rational choice theory considers the state to be rational, which is understood to mean that when setting policies and taking decisions, the state undertakes a cost–benefit analysis of alternative actions and their consequences, and that it chooses the action which maximises its preferences. Given the benefits of compliance and the costs of violation alluded to above, a rational choice model predicts that states, on balance, gain more from compliance, and as such, expects them, for the most part, to internalise their obligations and comply with them.

There are good reasons to be sceptical of the assumptions underlying the rule of law thesis. First, the rational choice theory on which it is based simply does not reflect the complexities of governance. Indeed, empirical studies on compliance with international law carried out in recent years illustrate how inconsistent compliance is and highlight the many domestic and international factors that can impede it. Such impediments are amplified in developing countries, where, as established in the law and development literature, low regulatory capacity, and/or the absence of a well-developed regulatory governance model, serve as a further hindrance to the internalisation of international obligations into governmental decision making.

Second, internalising international investment obligations into the myriad processes of government is markedly demanding. The pervasive presence of foreign investment throughout national economies is such that a wide range of entities and persons for whom the state is internationally responsible may take measures of one kind or another with respect to a foreign investment or investor. This wide range of entities and persons is reflected in the wide range of actors that have taken measures giving rise to investment treaty arbitrations. According to a study of investor–state agreements.

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treaty disputes by Zoe Williams, examining 584 arbitration cases from 1990 to 2014, 61 per cent of cases were triggered primarily by administrative measures; 26 per cent were triggered by legislative measures alone; and 11 per cent were related to judicial decisions.\(^{20}\) Moreover, the economic sectors of the underlying investments in these disputes ranged across all aspects of the host economies, from investments in extractive industries to banking to construction to agriculture to the provision of public services (energy, water services, etc.) to manufacturing, transport and telecommunications.\(^{21}\)

In this introductory chapter, we develop a framework for thinking about the internalisation of international treaty obligations in governmental decision making that attempts to take account of the complexities of governance. In so doing, we lay out a typology of processes whereby international investment treaty obligations may be internalised and identify factors that may affect whether and to what extent international investment law is internalised by the state. This framework serves as the background for the main body of the book in which we present case studies addressing whether and how a select group of governments in Asia internalise international investment treaty obligations in their decision-making processes: India, Indonesia, Myanmar, Republic of Korea, Singapore, Sri Lanka, Thailand and Viet Nam.\(^{22}\) These case studies serve as a foundation for testing our theoretical framework by empirically examining whether and to what extent these governments take investment treaty obligations into account in their governmental decision-making processes and whether such internalisation has had spillover effects on governance in the state more generally.

The organisation of this introduction is as follows. Section 1.2 begins by setting out the principal research questions with which we are concerned


\(^{21}\) Ibid., at 40–41. Using the World Bank sectoral classification system, Williams noted disputes across at least fifteen different sectors: oil, gas and mining (25%); electric power and other energy (14%); construction (7%); banking and finance (6%); manufacturing (6%); agricultural, forest and fisheries (6%); telecommunications (6%); transportation (5%); water and waste management (4%); food and beverage (3%); other services (3%); real estate (3%); hospitality/tourism (3%); healthcare and pharmaceuticals (2%); media (2%); other (3%); and unknown (2%).

\(^{22}\) The authors of these country-specific case studies are Dafüna Atanasova (Singapore), Jonathan Bonnitcha (Myanmar), Sachinta Dias (Sri Lanka), Younsik Kim (South Korea), John Lumbantobing (Indonesia), Prabhash Ranjan (India), Tran Viet Dung (Viet Nam) and Teerawat Wongkaew (Thailand).
in order to clarify the scope of our inquiry. We additionally set forth a definition of ‘internalisation’ in the context of our thinking about the role of investment treaties in governmental decision making. Section 1.3 situates the project in the existing theoretical and empirical literature on the role of international law in state behaviour. Section 1.4 builds on the literature to set out a framework for exploring the internalisation of international investment treaties by governments. In Section 1.4, we operationalise the concept of internalisation and offer a typology of the kinds of internalisation processes that states may adopt. In Section 1.5, we consider factors that may impact the internalisation of investment treaty obligations and the extent to which governments take those obligations into account in their decision making. Section 1.6 provides an introduction to the case studies that make up the core of this volume, addressing the issues of case selection and methodology.

1.2 Definitions, Research Questions and Scope

For investment treaties to improve governmental administration, the obligations contained within them must have an effect on the decision-making processes of government. They must be ‘internalised’ into the domestic regulatory system. Such internalisation is a foundational assumption to the claim of the rule of law thesis that investment treaties will improve domestic governance. Yet, as mentioned earlier, there are reasons to be sceptical about the degree of internalisation actually present in government and the role of international obligations in governmental decision making.

We define ‘internalisation’ as referring to the formal and informal processes by which the state’s international legal obligations are taken into account in governmental decision making. Our focus, within government, is on the executive, the public bureaucracy and the legislature. In setting this definition, we note two main decision-making situations in which governments may take international law into account. The first situation is when the government implements international law as a domestic law or regulation. In this situation, the government naturally considers international law because the international obligation forms the subject matter of the governmental measure. The second situation is when the government adopts a measure on a matter of domestic law or regulation, which is itself not directly related to international law. In this circumstance, while the government may take into consideration whether the adopted measure is in line or in tension with its international legal obligations, such