



MEETING REPORT

Investment Treaties and Economic Development: Growing conflicts and options for coherence

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Executive Summary

The Eighth Annual Forum of Developing Country Investment Negotiators (Forum) was held in Montreux, Switzerland, from November 5 to 7, 2014. It was co-organized by the Government of Liberia, the International Institute for Sustainable Development (IISD) and the South Centre. This year's Forum was attended by 99 participants from 54 countries from Africa, Asia, Eastern Europe, and Latin America and the Caribbean, as well as international organizations. In keeping with this year's theme "Investment Treaties and Economic Development: Growing Conflicts and Options for Coherence," the Forum examined the challenges arising in the relationships between investment treaties and economic development, with particular focus on industrial policy, investment liberalization and performance requirements (PRs). The agenda and background materials for the Forum can be found on the IISD website: http://www.iisd.org/investment/dci/dci_forum_2014.aspx

- Recognizing the "winds of change" in both developing and developed countries regarding investment issues and rules within the context of economic development, the initial presentations of the Forum questioned some of the foundations of the existing international investment agreement (IIA) regime and discussed the need to look at options for reform or alternatives.
- In this context, the participants saw the need to legitimize the decision of some governments to opt for the termination or non-renewal of investment treaties to transition to a new system and framework, including reviewing and modernizing their domestic laws and frameworks relating to investment.
- The participants also recognized the need of governments to make informed choices based on thorough evaluation and experiences shared from around the world relating to investment treaty cases and negotiations.
- The need was expressed for each country to adopt a coherent and single investment strategy applicable at all levels of government, based on an overall investment plan with strategic objectives, defining sectors to open or keep closed.
- It was generally accepted that industrial policy and PRs are essential to the host state's sustainable development. Participants shared the benefits and challenges of PRs and other industrial policy tools used in their countries and discussed various types of PRs that have been successfully adopted by countries around the world, noting that not only developing countries, but also developed countries are using PRs. On the other hand, participants recognized that the effectiveness of PRs depends on many factors and should be sector-specific, especially considering the fact that PRs, as conditions for providing incentives, are a



key part of government policy space, which unfortunately is increasingly restricted by IIAs and by interpretations of those IIAs as rendered by arbitrators.

- Presentations and discussions focused on a series of questions relating to the structure and nature of investment liberalization commitments while raising a number of associated high risks in the context of investment liberalization and PR prohibitions. Participants formed a clear consensus on the important role of economic policy space for development—sustainable development in particular—and on the need for states to preserve a range of economic policy tools. Nevertheless, participants also acknowledged that, due to a variety of internal and external reasons and pressures, a number of governments continued to engage in negotiations of IIAs with investment liberalization and related commitments, despite the risks.
- With these two competing realities as background, the participants engaged in dialogues about workable solutions for governments, while recognizing each country's differences. Among other things, they agreed that:
 - In order to define the scope of liberalization, governments should look to local capacity within each particular sector and the importance of the sectors within the national economy.
 - Liberalization could be effectively achieved through domestic laws and policies.
 - Liberalization commitments should not be permanent, and that a mechanism should be developed to allow the review, renegotiation and withdrawal of an agreement while maintaining the stability of the investment environment.
 - It is important to reserve future policy flexibility for “new sectors” for developing countries, and that the term should be carefully defined within the treaty.
 - There were no close relations between PRs and liberalization, and that a country could liberalize while still adopting PRs to create linkages between foreign investment and the local economy.
 - Sustainable development should be a precondition for investment in the country.
- At the end of the Forum, the participants took stock of the issues and concerns raised during the Forum and recognized the importance of establishing action plans at the national, regional and international levels. Overall, the participants considered the discussion to be fruitful and beneficial. The participants saw a continuing important role for the Forum with respect to information sharing and raising concerns of developing country investment negotiators.



Introduction

The Eighth Annual Forum of Developing Country Investment Negotiators (Forum) was held in Montreux, Switzerland, from November 5 to 7, 2014. It was co-organized by the Government of Liberia, the International Institute for Sustainable Development (IISD) and the South Centre. This year's Forum was attended by 99 participants from 54 countries from Africa, Asia, Eastern Europe, and Latin America and the Caribbean, as well as international organizations, including the Caribbean Community and Common Market (CARICOM), the United Nations Conference on Trade and Development (UNCTAD), the United Nations Economic and Social Commission for Western Asia (ESCWA) and the United Nations Food and Agriculture Organization (FAO).

The Forum builds upon the successes of the seven previous forums, held in Singapore (2007), Morocco (2008), Ecuador (2009), India (2010), Uganda (2011), Trinidad and Tobago (2012), and Indonesia (2013). In light of current developments and of requests by many developing countries at the previous event, the Forum examined the challenging conceptions in the relationships between investment treaties and economic development, with particular focus on industrial policy, investment liberalization and performance requirements (PRs).

DAY 1: NOVEMBER 5, 2014

Opening Ceremony

Ms. Nathalie Bernasconi-Osterwalder (Group Director, Economic Law and Policy, IISD) welcomed the participants to the Forum. She thanked the co-hosts of the Forum, and noted that, although the organizers had originally planned to convene the Forum in Monrovia, Liberia, the venue was ultimately moved to Montreux, Switzerland, due to the unexpected and unforeseeable Ebola outbreak. Ms. Bernasconi expressed her regrets regarding the Liberian participants' inability to travel due to the epidemic in the region, and welcomed their participation via videoconference.

Mr. George Gyude Wisner (Director, National Investment Commission, Liberia) addressed the participants via videoconference. On behalf of H.E. Ms. Ellen Johnson Sirleaf, President of the Republic of Liberia, Mr. Wisner conveyed the sentiments and best wishes to the participants and expressed Liberia's gratitude for the understanding, cooperation and solidarity demonstrated by all. Mr. Wisner briefed the participants on the recent progress Liberia has made in combating the epidemic. He also provided an update on recent economic and investment developments in Liberia, noting the importance of balancing the quest of multinational corporations for market access and the need for developing countries to achieve sustainable development. Mr. Wisner noted the paradigm shift from multilateral investment agreements to bilateral investment treaties



(BITs), and noted that the inadequate safeguards for direct intervention in developing the domestic private sector—coupled with the current practice of the investor–state arbitrations—had constrained the ability of developing countries to adapt to emerging internal imperatives through policy innovation. In this context, Mr. Wisner called for the development of more pragmatic BITs that would prioritize the interest of developing countries in more inclusive growth, while recognizing the interest of foreign investors in the protection of their capital and investment. Noting that, since the first Annual Forum in 2007, this platform had offered many unique opportunities to strengthen South–South cooperation as well as South–North dialogue, Mr. Wisner finally extended his best wishes to the participants for fruitful deliberations in Montreux.

Following Mr. Wisner’s intervention, **Mr. Senera Sar** (Cambodia), **Ms. Naa Lamle Orleans-Linsay** (Ghana) and **Ms. Afroza Khan** (Bangladesh), on behalf of the participants, gave their statements of solidarity, followed by a moment of silence by all, to reflect on the terrible health crisis in West Africa.

Mr. Martin Khor (Director, South Centre) welcomed the participants and thanked Mr. Wisner and the government of Republic of Liberia for their support to the Forum. Recalling the rapid changes in thinking and in practice of investment treaties during the past several years, Mr. Khor affirmed that the Forum would begin by discussing the winds of change regarding investment issues and rules within the context of economic development. From there, the Forum would then move on to the issue of formulating industrial policy, and would end with a brainstorming session on the way forward.

Keynote Speech: Foreign Direct Investment and Development

Mr. Yilmaz Akyüz (Chief Economist, South Centre) presented his Keynote speech to officially open the Forum.

Mr. Akyüz addressed several issues at stake in terms of foreign direct investment (FDI) and development: a growing concern on the impact on policy space and development by BITs designed from and governed by a corporate perspective; a lack of clear linkage between FDI inflows and BITs; and a lack of correlation between recorded FDI inflows and socially productive investment. After exploring each of the issues in detail, Mr. Akyüz summarized some lessons learned from successful FDI policies, including paying attention to the long-term balance-of-payment impact; never using FDI to meet foreign exchange shortfalls; selectively encouraging greenfield investment; requiring joint ownership with local firms and paying attention to the crowding-out impact on domestic investment; refraining from providing incentives unless there are clear spillovers for domestic industry; encouraging domestic firms to compete with transnational corporations; refraining from relying on international production networks; and embedding FDI policy in overall industrial strategy.



Finally, Mr. Akyüz noted that although policy space might be somewhat constrained by the World Trade Organization (WTO) Agreement on Trade-Related Investment Measures (TRIMs), it is still possible for developing countries to encourage positive spillovers without violating their WTO commitments. However, many of the constraints are in practice self-inflicted through BITs and free trade agreements (FTAs) that impose tighter restrictions and commitments. As a result, Mr. Akyüz noted that developing countries have a strong reason to avoid BITs and to withdraw from the ones already signed, even if incurring some immediate costs to do so.

Session 1A: Recent Developments in Treaty Negotiation, Renegotiation, Termination, Dispute Settlement

Chair: **Ms. Angela Dau-Pretorius** (Deputy Director, Investor Services, Namibia Investment Centre, Ministry of Trade and Industry, Namibia).

Ms. Elisabeth Tuerk (Chief, International Investment Agreements Section, Division on Investment and Enterprise, UNCTAD).

Ms. Tuerk delivered four key messages in terms of recent developments in international investment agreements (IIAs). First, she noted that there had been an increasing dichotomy in the making of IIAs. On the one hand, there had been an upscaling in terms of the participation rate, negotiation process and the substance of the agreements; on the other, there had also been a trend toward disengagement from the system, exemplified by a number of unilateral terminations of treaties or denunciations from multilateral conventions such as the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention). Second, in terms of the investor-state dispute settlement (ISDS) process, there had been a trend of continuation, both in terms of the use of the system by investors, and also in terms of investor challenges to public policy measures taken by the host state. Third, Ms. Tuerk pointed to the continuation of the underlying challenges of the current IIA regime that had been faced by policy-makers before, particularly in terms of policy space. Finally, Ms. Tuerk noted that it is necessary to look at the reform of the IIA regime and to identify concrete solutions. She referred to the World Investment Report 2014, which identified four paths of actions taken by developing countries in the recent years in their approaches to address the issues, and noted a systematic reform would be needed to effectively establish an IIA regime in line with sustainable development imperatives. Ms. Tuerk also shared the conclusions and feedback from the recent IIA Conference that took place during the 2014 World Investment Forum, which also confirmed this understanding.

Mr. Martin Khor (South Centre) reviewed the historical context in which industrial policies and PRs were developed and implemented by governments to maximize the use of foreign investment while minimizing risks for local businesses. Unfortunately, governments were largely constrained and limited by the existing IIA regime. Mr. Khor further noted that most countries had realized the



problem and had been taking different approaches in addressing the issues. For instance, Ecuador had taken the initiative to form an alliance of countries affected by situation and was establishing an observational group to research the cases and to assist developing countries. In addition, Namibia and South Africa had been discontinuing and terminating treaties as they expire and started introducing domestic law as a substitute. Meanwhile, many more countries are reviewing and observing the experiences of other countries. Mr. Khor urged the participants to take the opportunity of the Forum to share their experiences and knowledge in this regard to develop better regime.

Ms. Nathalie Bernasconi-Osterwalder (IISD) drew the attention of the participants to recent developments in Europe, noting it is important for developing countries to know where the European Union stands regarding IIA negotiations, which would give an indication of how developed countries might approach other negotiations, and what leverages developing countries might have. Ms. Bernasconi observed that the earlier generation of IIAs focusing on investment protection had evolved in the EU context to include investment liberalization clauses and the prohibition of PRs, resulting in a far-reaching liberalization and market access obligations combined with investment protections. Meanwhile, Ms. Bernasconi also noted recent texts of IIAs concluded by the European Union and other parties saw the inclusion of certain investor obligations. In addition, there had been significant public participation in the recent negotiations, both in terms of the press and media attentions in following up on the negotiations as well as the public consultations and commenting process. She also discussed some of the EU members' positions against the inclusion of ISDS clauses in IIAs. Finally, Ms. Bernasconi again emphasized the significance of following developments in the recent negotiations between the European Union and the United States, and concluded her presentation with a recent quote by U.S. Trade Representative Michael Froman, indicating that the Transatlantic Trade and Investment Partnership (TTIP) Agreement between the European Union and the United States was intended to be a model agreement for the rest of the world and that, given this attitude, other countries needed to be prepared and should assess the proposed model.

Discussions

A discussion followed the session regarding the European Court of Justice's pending decision on the nature of the EU-Singapore FTA, to determine whether the parliaments of individual member states would play a role in the agreement's approval process. The decision would also have implications for other IIAs the European Union is negotiating or had recently concluded with other parties.

Another discussion concerned an issue addressed by Mr. Akyüz in the keynote speech, namely, how to properly define and monitor FDI. It was suggested that it was important to distinguish all capital inflows with those investments contributing to the development and social productive capital. In terms of monitoring, it was suggested that mere voluntary standards would not be



enough. Instead, a multilateral disciplinary and binding system or institution would be necessary to impose certain minimum obligations of conduct on transnational corporations.

Discussions also addressed the issue of survival clauses being an obstacle for effectively reforming the existing IIA regime. One of the approaches suggested was negotiating with friendly counterparts to remove survival clauses from existing BITs before initiating the termination process.

Session 1B: Experience Sharing Round Table: What has happened over the last year in treaty negotiation, renegotiation, terminations, dispute settlement

Chair: **Ms. Champika P. Malalgoda** (Director of the Research and Policy Advocacy Department, Board of Investment, Ministry of Economic Development, Sri Lanka).

Update on South Africa's Process to Modernize its Investment Protection Regime

Ambassador Xavier Carim (Ambassador and Permanent Representative of South Africa to the WTO) shared South Africa's experience and gave an update on its efforts to reform its foreign investment regime.

Ambassador Carim recalled that, from 2007 to 2010, South Africa conducted an intensive review of its BITs, with the participation of a wide range of stakeholders. Among many other issues identified as a result of the review, there were two core lessons learned: there had been no clear link between signing BITs and increases in FDI inflows; and BITs had posed a range of risks to the country's economic development and could thus undermine or overturn the country's democratic policy-making process.

On the basis of the recommendations from the review, in July 2010 the Cabinet decided to terminate all existing BITs and negotiate new treaties only if there were compelling economic reasons to do so, and if such negotiations and the resulting new treaties were based on a new model that mitigates identified risks. In addition, the Cabinet decided to prepare a new investment act under the supervision of an Inter-Ministerial Committee.

At the time of the Cabinet decision, South Africa had approximately 20 BITs in force, and 13 of them had been terminated or marked for termination at the time of the Forum. During the process, South Africa had successfully negotiated with Cuba and Argentina to remove survival clauses before termination of their respective BITs.

Ambassador Carim also noted that, in Africa, a discussion on a future approach to IIAs had opened up in the African Union (AU) and the Southern Africa Development Community (SADC). Dialogues



had been initiated to assess whether IIAs would support Africa's sustainable development. In addition, at the regional level, with the assistance of IISD, ministers of SADC member states have adopted a new model BIT and are renegotiating the provisions of the investment annex.

In terms of the preparation of the Promotion and Protection of Investment Act, the new investment act, Ambassador Carim shared with participants the policy and principles behind the drafting of the bill, and the approaches taken in the draft texts to accommodate core provisions ordinarily found in BITs, while bringing them in line with South Africa's Constitution and its existing legal framework. In terms of the drafting process, the Ambassador said that the draft bill had undergone a public comment period and was being updated for a second iteration by Cabinet in the final quarter of 2014. If the Cabinet decided to endorse the bill, it could be tabled for parliamentary ratification in early 2015.

Finally, Ambassador Carim noted that, throughout the process of modernizing South Africa's investment protection regime, there had not been a decline of investment activities into South Africa. Instead, the 2014 World Investment Report indicated that 2013 had witnessed "record-high flows" of FDI to South Africa.

Ecuador Round-up: Negotiation, renegotiation, termination and dispute settlement

Mr. Andrés Arauz (General Undersecretary of Planning for Well-being, National Secretariat of Planning and Development, Ecuador) recalled that Ecuador's reform of its investment regime began with denouncing the ICSID Convention in 2008. Since then, Ecuador had terminated 10 BITs and initiated a process for the termination of an additional 16 BITs, all of which were declared unconstitutional by Ecuador's domestic courts.

Mr. Arauz noted that Ecuador was still negotiating new investment agreements, but based only on its model BIT, designed to attract investment for development, and protected only investors who had signed contracts with the government. In addition, Ecuador had been relying on its domestic legal framework, especially its Investment Code, to regulate foreign investments. Mr. Arauz also introduced the recently adopted UN Resolution on the Elaboration of an International Legally Binding Instrument on Transnational Corporations and Other Business Enterprises with Respect to Human Rights. In addition, he announced that Ecuador had decided to create an international observational group to monitor and analyze investment cases to promote coordination amongst developing countries. Assisted by other organizations, the observational group would advise governments of developing countries on their negotiations with transnational corporations.

Finally, Mr. Arauz shared the recent development of Ecuador's Audit Commission, established in 2013 to determine, among other issues, whether the BITs violated Ecuador's sovereignty, whether previous arbitral tribunals had misinterpreted the BITs, and whether the BITs were beneficial for the country. Mr. Arauz said that the preliminary conclusions of the Audit Commission had found ratification irregularities, evidence of conflicts of interest and bias of arbitrators and experts, and



the lack of a linkage between the signing of BITs and FDI inflows. The Audit Commission's preliminary recommendations included the nullification or termination of BITs and the improvement of investment contracts. Mr. Arauz shared with the participants that the Audit Commission's final report is in the drafting process and would become publicly available once ready.

Indonesia's Experience in its BIT Review

Mr. Ronald Eberhard (Treaty Legal Advisor; Directorate for Treaties of Economic, Social and Cultural Affairs; Directorate General of Legal Affairs and Treaties; Ministry of Foreign Affairs; Indonesia) shared with the participants Indonesia's developments in the past year in the area of reforming its foreign investment regime.

He noted that, after thorough review and analysis in consultation with academics and lawyers, Indonesia had discontinued 11 BITs over the past year and is in the process of discontinuing nine more. Indonesia's discontinuation of the BITs was sparked by recent international developments and trends in the IIA regime, especially the failure to prove the assumption that BITs help attract FDI inflows.

Finally, Mr. Eberhard shared with the participants the three most prominent issues that had come up during Indonesia's BITs review process: the ISDS clause, most-favoured-nation (MFN) clause, and the definition of "investment." In terms of the ISDS clause, Mr. Eberhard suggested that it is better to exclude such clauses altogether rather than include a modified version of the clause, as it has been shown in practice that arbitrators have broad power in interpreting and deciding jurisdictional matters. Mr. Eberhard also suggested trying to avoid MFN clauses in BITs. In terms of the definition of "investment," Mr. Eberhard noted that Indonesia is still debating whether to adopt an enterprise-based or an asset-based definition. But the more fundamental questions to ask, according to him, were whether to have BITs, and, if so, what kind of BITs to have.

Brazil's New Model BIT

Mr. Erivaldo Alfredo Gomes (General Coordinator of the Trade Policy Secretariat for International Affairs, Ministry of Finance, Brazil) first provided the participants with a quick profile of Brazil, noting that the country had an open FDI regime with generally no pre-establishment screening process discriminating among various types of foreign investment. Brazil had so far signed 14 BITs, but none of them had been ratified. Although Brazil did not have BITs in force, its investment regime is constrained by other international commitments such as the WTO Agreement on TRIMs.

Mr. Gomes said that Brazil is exploring a new approach on the IIA regime by developing a new model BIT focusing on measures of regulation and risk mitigation, institutional governance and dispute prevention, and a thematic agenda for further investment cooperation and facilitation. He then introduced some approaches adopted by the new model BIT. Mr. Gomes also shared with



participants that Brazil is working with other member states of the Union of South American Nations (UNASUR) to establish a UNASUR Regional Dispute Settlement Body as an alternative to the International Centre for Settlement of Investment Disputes (ICSID). He believed that this new mechanism would provide innovative solutions to address some of the issues under the existing IIA regime.

Discussions

Discussion followed the presentations regarding current FDI trends and issues in BRICS countries (Brazil, Russia, India, China and South Africa). In terms of Brazil, it was noted that, after the government's focus on inflation stabilization in the 1980s, attention was later shifted to addressing the social issues, resulting in a consumption-driven economy and leading to a new wave of investment inflows. However, the government has recognized the limits of a consumption-driven economy, and began to implement policies to promote a shift toward an infrastructure-driven economy.

Participants also noted that capital inflows tended to increase as the host state's legal and financial framework was strengthened, and that the proportion of FDI in those inflows would diminish over time. For instance, there was a high level of FDI stock in South Africa. The issues were not the country's ability to attract new FDI, but the quality and social benefit of the FDI. Many of the investors in South Africa had failed to reinvest in productive capacity or expansion, despite the large reserves they had. This was partly because they could receive higher returns when investing in short-term capital markets, but more importantly because of currency volatility in South Africa. As a result, the government of South Africa is planning to increase the fixed capital spending from 15 to 30 per cent of the country's GDP.

Other discussions concerned the pressures countries face when terminating BITs. Some countries did not face significant pressures, as they were successful in persuading their counterparts that investors would be sufficiently protected under the domestic legal framework. Other countries did not face pressure at the time they announced the termination, but did face pressure when the BITs were actually terminated, mostly from representatives of counterpart countries. It was noted that, an increasing number of stakeholders, including some developed countries, had begun to question the effectiveness of existing IIA regime, and developing countries should seize the opportunity to detach from a flawed system to replace it with a better-functioning investment framework.



Session 2: Setting Out The Problématique: The return of economic development policies as a major element of sustainable development in developing and emerging economies versus the evolution of the investment treaty model, as seen in recent negotiations

Chair: **Ambassador Xavier Carim** (South Africa). This session presented an introduction to the central theme, showing general trends that may come into conflict. It focused on structural transformation policy and the growing role of industrial policy in economic planning, and on the growth in scope of treaty provisions relating to these.

Trade and Development Challenges in the 21st Century

Mr. Richard Kozul-Wright (Director of Division on Globalization and Development Strategies, UNCTAD), based on extensive research he and his colleagues at UNCTAD had conducted, focused on the trade and development challenges facing developing countries in the coming decades, particularly in the area of structural transformation.

Mr. Kozul-Wright pointed out the difference between growth and development. He noted that, although countries might benefit from trade, and although those countries that sustained faster growth generally experienced a rising share of trade in GDP, it would be incorrect to conclude that the countries should rapidly reduce tariffs or open markets to foreign firms. Mr. Kozul-Wright pointed out that the real world is more complicated than the model posed by economists. In reality, economic development did not hinge on specialization, which is the core of the classical argument supporting free trade, but on diversification, which is a major challenge most developing countries face. Research shows that most successful economies are successful because they had been able to diversify their economic structures. Mr. Kozul-Wright further pointed out that, although trade is a critical part of the sustainable growth process, it is not a stand-alone process. Successful trade does not emerge spontaneously: countries tend to become successful domestically before they begin to succeed in international trade. History shows that all successful trading economies, such as Germany, Japan and China, had underpinned their successful trade performance on a very rapid pace of capital formation linked to a process of structural transformation.

Mr. Kozul-Wright noted that one of the current challenges facing developing countries during their process of structural transformation is the less-favourable international environment compared to that of decades ago, primarily due to the centuries-long stagnation of the developed economies. As a result, UNCTAD insisted that developing countries needed to adapt to a different kind of international economy; in particular, they will have to focus much more intensely on developing their own markets and generating regional growth dynamics. While developed countries might adopt alternative strategies to restart their growth, developing countries need to look at new



growth drivers to achieve inclusive and sustainable growth, to commence structural transformation and, in particular, achieve strong industrialization.

However, Mr. Kozul-Wright did acknowledge that industrial catch-up is difficult for developing countries, quoting a recent publication by the Organisation for Economic Co-operation and Development (OECD) on boosting productivity to meet the middle-income challenge. According to the publication, many developing countries remain specialized in low-value-added sectors, and there is a particular worry in the field of labour productivity, where catch-up had stalled in a number of middle-income countries, including Mexico and Turkey, and some had even fallen further behind. In addition, Mr. Kozul-Wright noted other challenges to structural transformation, including more restrictive international agreements reducing the policy space available to developing countries; limits to export-led growth; financialization of the real economy; and the rise of global value chains and uncommitted corporations.

Addressing these challenges, Mr. Kozul-Wright commented that no country had made the arduous journey from widespread rural poverty to post-industrial wealth without proactive government policies to alter the economic structure and dynamism of the economy. The economic conversation had changed from whether to have an industrial policy to the question of how to properly use an industrial policy to succeed in specific country conditions. Practical lessons and principles illustrated by country case studies indicated that, among other things, institution building is very important. Mr. Kozul-Wright suggested that developing countries should develop the mindset of addressing the issues from a systemic, long-term and public interest perspective; experiment and be flexible to manage the transformation; and monitor the beneficiaries of the transformation, to ensure they achieve the development goals.

Finally, Mr. Kozul-Wright commented that developing countries needed to use skilfully the policy space remaining under existing international commitments to pursue proactive trade and industrial policies with a view to rebalancing their growth strategies toward allowing a greater role for domestic and regional demand. He noted that the IIAs implemented during the past two decades have not only failed to provide necessary space to use proper policies to effect the structural transformation, but had actually limited that space. He cautioned that developing countries should consider carefully before entering into new IIAs, and should take every opportunity to exit and redefine investment agreements to make them more conducive to a strategic development agenda, which would be critical to ensuring sustainable and inclusive development in the coming decades.

Setting Out the Problématique: The legal dimensions

Mr. Howard Mann (Senior International Law Advisor, IISD) followed up on Mr. Kozul-Wright's remarks and gave his thoughts on the legal perspective of the same issue. He noted that, from a social and legal perspective, "policy space" refers to ensuring that the obligations on states in a treaty did not inhibit the state's ability to enhance its social, economic and environmental



development through new rules or policies, as it saw fit. Mr. Mann also noted that all international treaties, to some extent and by nature, would limit policy space. Thus, the issue is whether limits on good-faith government measures are consistent with—or constraints to—the capacity to regulate by means of sound sustainable development policies.

Mr. Mann recognized some divided trends in the scope for policy space in recent investment treaties. In principle, there is an increase in terms of understanding of the need for governments' policy space, and a clear trend to ensure the protection of policy space in the social and environmental area. However, in terms of economic policy space, there had been an opposite trend and increased regulation. For instance, the recently finalized Canada–EU Comprehensive Economic Trade Agreement (CETA), while it pays some attention to environmental objectives, contains powerful, comprehensive restrictions on policy space for industrial policy.

Mr. Mann noted that for investment to effectively promote development, a robust regulatory framework is necessary. Although customary international law allowed states to regulate investment as they saw fit, there seemed to be a trend to legitimize certain types of measures impacting businesses (the social and environmental ones, for example) and to delegitimize others (such as measures regulating economic development).

Comparing investment treaties concluded in 1990s, early 2000s with more recent ones such as the CETA and the EU–Singapore treaty, Mr. Mann noted that there had been a growth in the limitations on both scope and content of the economic regulations. He commented that the key lessons learned from successful economic planning examples as summarized by previous speakers would be rendered practically irreplicable by those prohibitions on available economic tools.

Finally, Mr. Mann reminded the participants that governments did not need treaties to liberalize their investment regimes; rather, liberalization could come from domestic law and policy. Treaties would create a lock-in effect and a floor from which a country could not retreat. As a result, developing countries need to consider very carefully before entering into new treaties.

Discussions

Questions were raised regarding how to diversify and whether diversification for developing countries would mean focusing on manufacturing and industry. Participants commented that diversification for most developing countries would mean moving away from natural resource-focused activities into high-skill, high-tech, value-added activities, both inter- and intra-sectoral. Although there is a special role for manufacturing and industry in that process, it is not exclusively about shifting to manufacturing and industry. On the relationship between diversification and liberalization, participants noted that liberalization should be implemented in a strategic fashion. The right time to liberalize the economy comes only when a country has established the kind of capacity that will allow it to compete internationally. In terms of successful economic



development, FDI might follow and contribute to success, but does not generate success itself. This would be the same in terms of productive capabilities. FDI does not by itself generate the desired productive capabilities; instead, accompanying policy is essential to that process.

Other discussions following the speeches focused on external and internal pressures experienced by developing countries in IIA negotiations. Questions were raised whether developing countries should leverage the pressure imposed by counterparts regarding investment provisions against other trade-related provisions, for instance, negotiating market access for goods against the counterpart's demand for market access for investment. Participants commented that this would be a very dangerous approach, as it would most likely result in developing countries giving up control of the production processes that generate the capacity to produce the goods to be traded. This would negate all the opportunities for development that can be generated from trade market access, as the benefit of producing those goods would be largely controlled by foreign investors. In terms of internal pressures from the domestic private sector for entering into IIAs emphasizing investor protections, participants recognized but challenged the logic of the emerging argument that developing countries should adopt the same protection for their capital exporters as for foreign investors already in their countries, noting that a pure cost-benefit analysis could easily rebut the argument. Participants also noted that it is a legal fact that developing countries did not need IIAs to liberalize their economies, and that equality on paper and in negotiations would not necessarily be able to translate into real benefits for developing countries in the long term.

Session 3: Industrial Policy and Performance Requirements: Friends or foes of sustainable development?

Chair: **Ms. Keganele Malikongwa** (Director of Department of Industrial Affairs, Ministry of Trade and Industry, Botswana). Separating slogans from effective development strategies, this session engaged in some economic and development analysis. It reviewed the role of industrial policy in developing countries post-decolonization, the range and types of more specific tools today, approaches to structural transformation, and examples of industrial policy decision making at the national level.

Industrial Policy and Performance Requirements: Friend or foe of sustainable development?

Mr. Aaron Cosbey (Senior Associate, IISD) said that industrial policy had been defined as government policies aimed at accelerating structural change toward more competitive and higher-value activities. There are two basic types of industrial policy: horizontal and vertical. The former creates a welcoming investment climate across the board, without intentionally discriminating amongst the sectors. There are no economic controversies as to the effectiveness of this type of policy. On the other hand, vertical industrial policy targets specific sectors, and is used to promote the economy by targeting the strategic sectors in which the government would



like to advance economy activities. There is no consensus as to the desirability of these tools, though there is a growing understanding that they can be successful if used wisely.

Mr. Cosby introduced PRs as a specific type of industrial policy tools, which are requirements for certain actions as a condition of receipt of some benefit. Examples of PRs included local-content requirements, technology transfer requirements and joint-venture requirements, etc. Mr. Cosby noted that these tools were developed as a reaction to the observation that much FDI has very few backward or forward linkages to the economy. The purpose of these tools is thus to increase the linkages of a given investment to the host economy.

Mr. Cosby noted, however, that the history of industrial policy is full of failures. As a result, the Washington Consensus says that governments should not use industrial policy because it cannot be used well. That paradigm gave rise to TRIMs, and provisions in IIAs prohibiting the use of PRs. Nevertheless, recent evidence clearly shows that those countries that followed the Washington Consensus did not do particularly well, while those that ignored it, such as China and Korea, did very well. Furthermore, in the wake of financial crisis in 2008, even developed countries flooded their countries with stimulus spending, which was in large part directed to what they saw as strategic sectors. So the question now is not whether to use industrial policy, but how to use it properly.

There are legal barriers to implementing industrial policy. Modern IIAs, for example, often prohibit the use of certain specific tools. In addition, the WTO TRIMs Agreement also prohibited local-content requirements and export requirements. General Agreement on Trade in Services (GATS) commitments might also prevent restriction of foreign entrants. There were also other non-investment law barriers, such as restrictions on the use of tariff protection, government procurement measures, subsidies, etc. However, Mr. Cosby pointed out that there were successful cases in implementing industrial policy. He summarized the successful cases of using industrial policy and found six common criteria: meritocratic bureaucracy, healthy communication between the business sector and government, checks and balances in government, objective performance criteria for continued support, mandatory sunset clauses to protect infant industries, and the right choice of sectors.

Mr. Cosby concluded that it does not make sense for the law to prohibit a tool on the grounds that it might be misused, as the market will eventually punish those who use it ineffectively. It does, however, make sense for the law to reflect the lessons learned from the history, for instance, the introduction and use of sunset clauses in the proper deployment of industrial policy.

Sustainable Development, Policy Space and Performance Requirements

Mr. Manuel F. Montes (Senior Advisor on Finance and Development, South Centre) concurred with Mr. Akyüz, and noted that a country should not invite FDI unless it is regulated as a part of the country's industrial policy, and unless FDI filled a gap that country needed to fill. Mr. Montes



addressed the importance of having an industrial policy and noted that it could be used to scale up a country's economic, social and environmental development as well as its community capability upgrading. In addition, industry policy is needed because private sector players tended to underinvest in (and were reluctant to enter in the first place) new areas, or require state subsidies because of high risk. In this context, industry policy can be used to build, channel, and discipline private sector actors.

Mr. Montes introduced various types of PRs that have been successfully adopted by countries around the world, noting that both developing and developed countries are using PRs. Mr. Montes also concurred with Mr. Cosby that the effectiveness of PRs depended on many factors and should be sector-specific. Finally, he cautioned that PRs, as conditions for providing incentives, are a key part of government's policy space, which unfortunately is increasingly restricted by IIAs and by interpretations of those IIAs as rendered by arbitrators.

Industrial Policy and Performance Requirements in Nigeria's Oil Sector

Ms. Omotese Rianat Eva (Assistant Director, International and Comparative Law Department, Ministry of Justice, Nigeria) reviewed the role that industrial policy played in decolonization processes in developing countries, and introduced Nigeria's effort in developing industrial policy for its oil sector.

She noted that the discovery of oil in Nigeria in the 1950s had resulted in a paradigm shift in the country's economic structure. Currently, the country's economy was almost entirely dependent on oil exports. Recognizing the issue, the Nigerian government tried to transform its economy by adopting various industry policy tools. During the process, Nigeria adopted a Local Content Act, despite the threats from developed countries alleging Nigeria's breach of its TRIMs commitments. In addition, Nigeria is in the process of reviewing its existing BITs and is developing its own model BIT. Ms. Eva further noted that Nigeria is in the process of passing its Petroleum Industry Bill, and addressed four key principles of the proposed new bill, including creating a conducive business environment for petroleum operators; enhancing exploration and exploitation of petroleum resources in Nigeria for the benefit of Nigerian people; promoting transparency and openness of the administration of petroleum resources of Nigeria; and promoting a viable and sustainable petroleum industry in Nigeria. Finally, Ms. Eva emphasized that industrial policy is a strong tool for sustainable development, and that developing countries do not need treaties to liberalize their economies; rather they could achieve that by building up a proper domestic policy and legal framework.

The Mining Law and Investment Treaties

Mr. Ronald Eberhard (Indonesia) addressed industry policy tools adopted by Indonesia within the context of its 2009 Mining Law, which prescribes two key measures regulating its mining sector: divestment requirement and raw mineral export ban. In addition, Mr. Eberhard noted that one significant change of the 2009 Mining Law compared to its predecessor was the shift from a



contract-based system to a permit-based approach, which made it easier for the government to impose and enforce obligations on the investors.

Mr. Eberhard continued by introducing the content of the PRs prescribed by the 2009 Mining Law, as well as the underlying rationales used by the government to impose those PRs. He acknowledged that the PRs might be seen by some to constitute a breach of relevant international obligations, and indicated that it is important for developing countries to consider carefully before entering into IIAs, so that they can reserve necessary policy space for measures that might need to be taken in the future.

Discussions

Discussions following the presentations mainly focused on the kind of impact PRs might have on FDI inflows and on how to balance the host country's need to impose PRs with its need to attract investors. Some participants noted that their countries had witnessed a decline in FDI inflows after the promulgation of certain PRs. Nevertheless, the decline in FDI inflows did not create any significant impact on the country's economy, as the measures resulted in new business opportunities for domestic investors. Consequently, government revenue kept growing even after the PRs went into force. In addition, those participants noted that, years after those PRs went into force, there were still many foreign investors operating in those regulated sectors in their countries and continuing to make profits. Other participants commented that a country should only accept foreign investors that would abide by its rules and benefit its sustainable development. Participants also discussed the importance of and difficulty in properly designing PRs that would suit the country's development needs, and acknowledged that it would demand a great deal of knowledge and capacity from the government.

Questions were also raised as to the risk of developing countries breaching WTO obligations. Some participants commented that TRIMs only established a very narrow set of prohibitions on PRs, and only covered trade-related measures. It left large room for the governments to use other types of PRs and instruments. However, IIAs might impose significantly more constraints than WTO agreements. Therefore, countries should reserve enough policy space for future development when negotiating IIAs. Participants also shared experiences on WTO disputes and international arbitrations arising out of new domestic legislations with PRs, but noted that this was a necessary step for their countries' sustainable development, and that their government chose to take that step sooner than later.



Breakout Session 1: Industrial Policy and Performance Requirement Tools: How are they used by governments today?

Participants broke into groups to identify some of the industrial policy tools or PRs used in their countries, and to discuss the importance and the risks of using those tools. They identified the following tools:

- Local-purchasing requirements or similar requirements promoting local linkages.
- Technology transfer requirements.
- Raw material export bans in natural resources.
- More targeted and limited domestic use requirements.
- National ownership and equity requirements such as joint-venture requirements.
- Research and development requirements.
- Tax incentives for value-added activities, employment levels, depressed regions, improved competitiveness.
- Export incentives.

It was generally accepted that industrial policy and PRs are essential to the host state's sustainable development. However, it was also acknowledged that it is very challenging for developing countries to properly implement those PRs and accurately monitor their implementation, due to a lack of capital and technical resources.

DAY 2: NOVEMBER 6, 2014

Session 4: Examining Different Approaches to Investment Liberalization in Investment Treaties and Chapters

Chair: **Mr. Ahmed Ishthiyaque** (Director, Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, India). This session covered the range of options in liberalization and the role of domestic law. It examined different approaches in IIAs, as formulated in "traditional" EU-style treaties, the North American and Japan models, as well as the newer models, as seen in the Canada–China and Canada–European Union agreements.

Before giving the floor to the panellists, the chair made a few observations regarding some of the issues already discussed in the Forum. He noted there is a need for adequate policy space for the host country, targeting disadvantaged groups and sectors, while creating an environment that can ensure profitable investments. Improving approvals and licence procedure and assisting in the



establishment of an investment might generate more results than typical BIT protections. Instead of ISDS, the reliance on a fair and transparent judicial system would be more effective.

Examining Different Approaches to Investment Liberalization in Investment Treaties and Chapters

Ms. Nathalie Bernasconi-Osterwalder (IISD) focused on the different approaches to liberalization and to the listing of commitments, and made additional comments on dispute settlement and MFN treatment. A summary of the key points of her presentation follows.

The starting point is that states have the sovereign right to control the entry of foreign investors and investments into their territories. Sometimes, when negotiating with certain parties, a country may have the impression that there is an obligation to be open. However, in principle, under public international law there is complete sovereignty; customary international law does not impose any limitations to the state's ability to regulate foreign investment.

Unless specifically limited in a treaty, a state may limit admission of foreign investment into designated sectors or activities, set quantitative thresholds, prescribe modes of entry or business forms, or establish conditions such as performance or screening requirements. None of these measures is required, but all of them can be regarded as legal options that can be scrutinized for their usefulness for the country's economy.

Traditional BITs are generally silent on the issue of liberalization, but sometimes include a clause on admission of foreign investment in accordance with domestic law. While retaining the right to regulate the admission of foreign investment through its own domestic laws, the host state promises not to treat foreign investments arbitrarily or capriciously, by applying and following domestic law. This approach was adopted in older treaties and is still currently used.

Another approach was used by the United States in its investment treaties in the 1980s and was then incorporated in the North American Free Trade Agreement (NAFTA) in 1994. Under the NAFTA-type approach, a pre-establishment right is created through the national treatment (NT) and MFN provisions. It is a relative right, in that a foreign investor only has the right of establishment insofar as the nationals have the same right. Once a state opens up its economy, it needs to grant the same or no less-favourable treatment to the foreign investor wanting to come in.

This approach appears in the U.S. and Canada model BITs of 2004 and 2012, as well as in their treaties, and is now included in a number of other treaties as well, including those negotiated by Japan and, more recently, the European Union.

Liberalization as part of the non-discrimination clauses has been widely pushed by the United States and Canada. This has proven to be a problem, as some developing countries in the past did not always recognize that national treatment and MFN extended to cover the establishment,



acquisition and expansion of an investment, meaning that they were granting pre-establishment rights to foreign investment.

The third type of investment liberalization is by means of absolute market access commitments, by which the state promises to allow foreign individuals and entities to enter its markets. This prevents the state from maintaining or adopting certain types of measures on admission. This approach is becoming known through the practice of the European Union, but it is not as recent as one might think: it has existed since as early as the 1957 Treaty of Rome of the European Economic Community. The approach has become dominant with the FTAs negotiated by the European Union, such as the 2001 EU–Korea FTA. This approach forbids limitations or requirements on:

- The number of investments.
- The total value of transactions or assets.
- The total number of operations of the total quantity of output.
- The participation of foreign capital.
- The total number of persons that may be employed.
- The specific type of legal entity or joint venture to structure the investment.

These are very far-reaching commitments. Canada agreed to this with the European Union in the CETA; Singapore too, but only to a certain extent and using a somewhat different approach. It is a fairly new development that could become part of the “global model” the U.S. Trade Representative wishes to shape through TTIP.

Regardless of the investment liberalization approach adopted, most countries will want to limit liberalization to some extent, as they are normally not willing to liberalize the entire economy. This can be done through a listing approach which can be carried out using negative or positive lists. The negative-list approach appears in NAFTA as well as the treaties negotiated by the U.S. and Canada and other treaties; the positive list approach, in the GATS and traditional EU treaties. Ms. Bernasconi noted that the margin for error is greater in the negative-list approach: if a sector is not listed out, it is liberalized. Nonetheless, in both cases there is a need for public debate, and for studies on what to liberalize and not to liberalize, and on what measures or laws to safeguard or grandfather.

Finally, Ms. Bernasconi pointed to the fact that in some treaties, like the CETA, liberalization commitments were carved out from ISDS. As regards MFN, tribunals might admit the importation of pre-establishment rights in one agreement through the MFN clause in another, though this has not yet been tested.



Approaches to Investment Liberalization in Investment Treaties and Chapters: The experience of CARICOM countries

Ms. Chantal Ononaiwu (Trade Policy & Legal Specialist, Office of Trade Negotiations, CARICOM Secretariat) indicated that most CARICOM countries had signed BITs and trade agreements with investment provisions, and that the right of establishment was generally absent from the treaties. However, there were a few treaties guaranteeing market access for investors. The Revised Treaty of Chaguaramas, seeking to establish a common regional market, guaranteed market access for CARICOM investors; it relied on a negative list, and included a freeze on existing restrictions, and a program for countries to gradually remove them. BITs that CARICOM countries had concluded with Canada and the United States also took the approach of granting pre-establishment rights, by extending NT and MFN treatment to prospective investors. A negative-list approach was used, with listed exceptions. Some treaties included standstill mechanisms (measures could not be made more restrictive) and ratchet mechanisms (liberalization could not be rolled back). The CARIFORUM–EU Economic Partnership Agreement included liberalization, but limited to commercial presence, with several listed exceptions. The CARIFORUM States separately listed commitments on commercial presence in non-services activities (through only reservations for non-conforming measures) and commitments on commercial presence in services (using the GATS Template). In recognition of the intensive and time-consuming nature of this exercise, the CARIFORUM States reserved the right to schedule, within two years of entry into force of the Agreement, any existing non-conforming measures relating to commercial presence in non-services activities which had not been listed.

Ms. Ononaiwu provided an overview of some of the challenges faced by CARICOM countries in negotiations of FTAs with comprehensive Services and Investment Chapters, particularly where the Parties have different approaches to the treatment of a commercial presence in services, the liberalization of trade in services (including a commercial presence in services), pre-establishment commitments on investment and the availability of ISDS for pre-establishment claims. In the use of negative lists, the CARICOM countries had found it difficult to identify comprehensively at the time of scheduling all of the existing measures the countries wanted to grandfather. The countries were also concerned about the ratchet mechanism, in terms of its limits on their ability to experiment with and adapt policies, their uncertainty about all the sectors for which future policy flexibility should be reserved and automatic liberalization of sectors yet to be developed. Ms. Ononaiwu further pointed that the ultimate challenge to investment liberalization arises where countries are working through what economic development tools work for them. She emphasized the importance of consistency between any liberalization commitments undertaken by a country and that country's development policies.



Pre-establishment obligations under IIAs: Challenges and implications for developing countries

Mr. Hamed El-Kady (International Investment Policy Analyst, Division on Investment and Enterprise, UNCTAD) highlighted that pre-establishment obligations under IIAs not only restrict the policy space of developing countries, but also affect their development strategies, as they might open up sectors that governments do not wish to liberalize. Mr. El-Kady illustrated how pre-establishment obligations in a treaty could interfere with existing domestic measures such as those responsible for reviewing and approving foreign investments. He listed several examples of conflicts between existing domestic laws and international obligations under IIAs with liberalization commitments. For example, if domestic laws limit foreign ownership in certain sectors, a treaty with pre-establishment obligations—if not drafted carefully—may render the policy unviable; furthermore, governments could be prevented from regulating sectors that might come into existence after the treaty entered into force.

Mr. El-Kady further discussed some challenges facing developing countries. Due to the complexity of the issues, Mr. El-Kady recognized the need for knowledge, awareness of technical issues, and internal coordination within the government. He noted that negotiators must be fully aware of the details in order not to miss anything in a negative-list approach. He suggested that subjecting liberalization to domestic laws (using language such as “in accordance with domestic laws”) might be a safer option as governments must seek coherence between the IIA and national investment policy. Mr. El-Kady also noted that most developing countries lack experience in negotiating pre-establishment liberalization agreements, and must deal with internal and external pressures. In conclusion, Mr. El-Kady highlighted the serious impacts of pre-establishment obligations in IIAs in national development policy, and emphasized the recommendations of UNCTAD’s Investment Policy Framework for Sustainable Development (IPFSD) on the issue.

Discussions

After the session, there were discussions on the importance, from a negotiating perspective, of defining the country’s offensive interests and making an assessment: whether or not the country would have a good chance of getting what it wanted, and what the cost would be. Participants also recognized the importance of preparing in advance for negotiations. It was noted that countries should not rush to conclude any negotiations nor should they give in to pressures.

It was also noted that learning during negotiations and from past negotiations is important. For example, discussants indicated that time-consuming research carried out for the negative listing under a specific negotiation can be seen as a positive exercise to gain knowledge and experience. Other discussants highlighted that the negotiators must give feedback to ministers of trade and heads of government, who could revise their instructions based on that feedback.



Other discussions stressed that countries should question whether to lock themselves in an international instrument. It was mentioned that countries should be reminded that, to signal its openness to foreign investment, they might do it through its domestic law, without a treaty.

The discussants also noted that even if liberalization commitments were to be adopted in a treaty, one should avoid the idea that they must be permanent. One suggestion was to allow the liberalization schedules to be unilaterally changed, with the condition that any investment made while the earlier schedule was in force would be regulated by the earlier liberalization provision. Another suggestion was that, if pre-establishment commitments are to be taken, it is not necessary to adopt a lock-in, but simply to list sectors open for liberalization, especially if the parties were not prepared to negotiate pre-establishment, but wanted to use the agreement to provide a signal in that direction.

Finally, discussions touched upon the spillover of liberalization provisions from one IIA to others through the application of the MFN clause, effectively resulting in the multilateralization of investment liberalization. It was noted that the application of the MFN clause could and should be limited only to agreements entering into force after the agreement in question, as was the case for most of Canada's FTAs and BITs, for example.

Session 5: Prohibitions on Performance Requirements in Investment Treaties and Chapters

Chair: **Ms. Catalina Barberi Torres** (Advisor, Directorate of Foreign Investment and Services, Colombia). This session provided a more detailed focus on provisions that prohibit PRs. It recapped what they were and provided an overview of their scope in TRIMs and IIAs.

Overview of Performance Requirement Prohibitions in IIAs

Ms. Suzy Henrique Nikièma (International Law Advisor, IISD) emphasized that each country is free to establish the conditions of admission and operation of investments on its own territory unless it has signed a treaty by which it renounced some of its policy space. Most treaties do not include clauses on PRs. In such cases, states might apply PRs as long as they were not included in the short list of prohibitions under the TRIMs Agreement (assuming they were bound by WTO agreements). Even if a PR violates the TRIMs, it would not be subject to ISDS unless the state expressly chose to do so by including similar prohibitions under an IIA and subject it to ISDS, whether in the form of clauses expressly prohibiting PRs or some other clauses with similar effects such as pre-establishment and market access liberalization clauses and MFN clauses.

Ms. Nikièma noted, however, there had been an increasing number of IIAs expressly prohibiting PRs. For example, some IIAs had included the so-called "TRIMs clauses," where the parties imported WTO TRIMs obligations into those IIAs. Consequently, under those IIAs, disputes



involving PRs prohibited by the TRIMs would be subject to ISDS, unless expressly excluded. Some IIAs had included so-called “post-establishment TRIMs+ clauses,” where only PRs adopted after the establishment of the investment are prohibited. Other IIAs had included so-called “Pre and post-establishment TRIMs+ clauses,” and prohibited PRs adopted either before or after the establishment of the investment, whether they were mandatory (i.e., a requirement for establishing the investment) or not (i.e., a requirement for the investor to have access to an incentive). Other examples of PR prohibitions included “non-binding clauses,” where the parties agree to make an effort not to impose PRs on foreign investments.

In conclusion, Ms. Nikièma suggested that the most cautious approach would be to not include PR-prohibition clauses in IIAs. Yet, if they are included, it is important to avoid broad and vague clauses. She suggested that countries should resort as much as possible to exceptions and exclusions, grandfather existing PRs, prepare the annexes carefully, exclude PR-related disputes from the scope of ISDS, and pay attention to the “unexpected” effect of other clauses in the IIA, which could indirectly prohibit or limit the ability to use PRs.

Prohibitions on Performance Requirements: A brief note on ASEAN

Mr. Howard Mann (IISD) noted that the Association of Southeast Asian Nations (ASEAN) Comprehensive Investment Agreement (ACIA) reaffirmed the parties’ obligations under the WTO TRIMs, and directed the parties to review existing PRs and to consider the need for additional prohibitions no later than two years from the date of entry into force of the ACIA. The review process started in 2013 and is currently considering keeping the provision as it was, including hortatory provisions on measures not covered by the TRIMs Agreement, making cross-references to provisions in other agreements, restricting certain additional PRs while allowing exceptions, and prohibiting certain PRs not covered by the TRIMs Agreement.

Mr. Mann noted that PRs are used across ASEAN member states. They are recognized as supportive of industrial policy development, economic diversification, and sustainable development. They are used to allow states to better harness inward FDI, to attract the “right” type of investment, to leverage investment in the domestic market, and to address market or policy failures.

Mr. Mann mentioned a study by Prof. Julien Chaisse on the impact of TRIMs PRs on trade. The study demonstrates that, whether under a neoclassical or “new trade” framework of analysis, no empirical evidence was found that PRs under TRIMs inevitably result in trade distortions, or that they have an impact on investment flows.

Finally, Mr. Mann highlighted that the Model Mining Development Agreement (MMDA) developed by the International Bar Association (IBA) includes a host of PRs aimed at ensuring the achievement of development benefits and of a positive contribution of mining to sustainable



development. The MMDA demonstrates that there is not an inherent contradiction between doing good business and PRs.

Restrictions on Performance Requirements in the TPP

Ms. Sanya Reid Smith (Senior Researcher, South Centre) discussed restrictions on PRs, generally, and presented some included in the leaked draft of the Trans-Pacific Partnership (TPP) agreement. She started by indicating some reasons to have PRs: increasing forward and backward linkages, increasing domestic value addition, increasing employment or training of locals, developing new industries, promoting technology transfer, etc. She noted that governments often wish to avoid the closing of local businesses due to liberalization, and to encourage joint ventures and local purchasing. She further noted many examples of successful PRs that resulted in foreign companies helping local companies improve their processes and products.

Ms. Smith then emphasized reasons not to commit to liberalization in an IIA. First, she discussed the difficulty of reverting the commitment, especially in cases where a country might not have full knowledge of the sector and might have to reverse. Second, she noted that according to WTO studies, binding investment liberalization did not increase FDI inflows. Third, she proposed that if liberalization occurred in sectors that the government had not intended to open, but is forced to open by an IIA, increased FDI inflows would be a failure rather than a success. Ms. Smith also addressed the importance of defining the investment to be liberalized, in particular, whether the definition should include portfolio investment, greenfield investment, mergers and acquisitions, etc.

Finally, Ms. Smith pointed out that, under the state-to-state dispute settlement mechanism of the WTO, if a government is sued over a prohibited PR and found to be in non-compliance of its commitments, the most damaging consequence is that it would need to change its law, but in the meantime it would still be able to enjoy the benefits of the prohibited PR. The United States used this strategy. However, if WTO language was replicated in an IIA, a foreign investor might bring proceedings against the state, which might be subject to the payment of damages.

Discussions

Discussions concerned preliminary questions that must be asked before entering into any IIA negotiation: Is it in the interest of the country to negotiate an IIA? If so, why? Does the country need the treaty to get inflows of FDI? It was pointed out that, in most cases, the answer to these questions might indicate that the country should not enter into negotiations.

It was also indicated that foreign investment would generally flow into countries rich with natural resources even in the absence of an IIA with investment liberalization obligations. Furthermore, if an investor had already been established in a country to exploit natural resources, it was a sign that the investment was perceived as economically viable; entering into a treaty afterwards to offer more advantages to the investor would be unlikely to change the situation.



Others commented that it did not make sense to include PR-prohibition clauses from the TRIMs in an IIA, as the parties to that IIA would already have been bound to those rules under the WTO. In addition, TRIMs had granted certain low-income countries special exemptions in terms of their compliance with those PR prohibitions; however, IIAs incorporating those prohibitions would not automatically extend those exemptions to those countries.

Breakout Session 2: The Political Push for Market Access and Investment Liberalization in Bilateral and Regional Relations

Participants broke into groups to discuss where the demands for expanded liberalization and markets access are coming from: whether they are internal, regional, or inter-regional. They also identified the underlying reasons for and objectives of any existing pressures. Some groups also shared their responses to these liberalization pressures. A summary of the participants' contributions follows.

Origin of the pressures for liberalization

- Bilateral partners, including Canada, China, Japan, the European Union, the United States, and South Africa; in most of the cases, they try to impose their perspectives.
- Regional partners, in Africa (including the Economic Community of West African States [ECOWAS] and SADC), Asia (including ASEAN) and Latin America, as investment liberalization is, to some extent, part of regional economic integration.
- Multilateral economic organizations, including the World Bank and the International Monetary Fund (IMF), imposing investment liberalization as a condition for lending or providing development aid.
- Internal: including from diplomatic missions willing to show results by signing treaties, domestic companies, transnational corporations (TNCs) based in the country, and other private sector actors.
- TNCs interested in increased access to developing country markets.

*Objectives of the push for liberalization coming from **within** developing countries*

- Facilitating the negotiations of mega-regional IIAs, such as the TPP.
- Attracting more FDI inflows as an instrument of economic development.
- Improving the balance of payments by exporting more products and services.
- Promoting technology transfer.
- Fostering regional economic integration.
- Creating jobs and employment opportunities.
- Introducing new products into the market.
- Creating new international investment routines.



- Advancing a stronger, high-tech industry.
- Host state businesspeople willing to obtain visas from capital-exporting developed countries more easily.

*Objectives of the push for liberalization coming from **outside** the developing countries*

- Conditioning the conclusion of an FTA to the inclusion of an investment chapter.
- Capital-exporting states conditioning investment promotion to liberalization.
- Gaining access to rich, unexplored natural resources.
- Accessing new markets or expanding access to existing ones.
- Expanding businesses and maximizing profits.
- Protecting private sector investment from capital-exporting developed country states.
- Securing access to international arbitration against developing countries.
- Locking in investment conditions in countries that are already liberalized, but where investors are concerned about changes in the status quo.
- Prohibiting PRs in certain sectors.

Responses to the push for liberalization

- Excluding PR-prohibition clauses from the negotiations.
- If PR prohibitions are negotiated, excluding them from the scope of ISDS.
- Creating regional alliances of countries with similar interests or development levels.
- Employing efforts to make IIAs more balanced.

Session 6: Investment Liberalization and Prohibitions on Performance Requirements: A review of treaty arbitrations and related WTO disputes

Chair: **Ms. Kinda Mohamadih** (Policy Advisor, South Centre). This session provided a review of arbitrations and WTO disputes relating to PRs and investment liberalization, as well as the relationship between the different dispute settlement mechanisms. It also examined the role of permanent sovereignty over natural resources.

What is the Relation Between PRs, Investment Treaty and WTO Agreements?

Mr. Ronald Eberhard (Indonesia) began by explaining that even in absence of provisions prohibiting the use of PRs in a treaty, tribunals might find the introduction of a new government measure imposing such a requirement in violation of the rules on indirect expropriation or the fair and equitable treatment (FET) standard. Mr. Eberhard further commented on the relations between PR and the WTO agreements. He noted that Article 2 of the TRIMs Agreement prohibited TRIMs that violated the obligations under the General Agreement on Tariffs and Trade (GATT) with respect to national treatment (NT) and the elimination of quantitative restrictions (QRs). The



TRIMs Agreement also included an annex with an illustrative list of prohibited PRs. Article 3 of the TRIMs Agreements brought in all exceptions under the GATT. Finally, under the GATT, export prohibitions can only be maintained when all of the following conditions were met: there was a critical shortage of products; the restriction was temporary; the product was essential for the exporting country; and there should be a restriction on domestic consumption.

Finally, Mr. Eberhard discussed the relationship between ISDS and the WTO dispute settlement mechanism. Under the WTO Dispute Settlement Understanding (DSU), WTO member states might initiate dispute settlement proceedings concerning obligations under WTO, and private investors could not initiate proceedings against a state. Under ISDS, an investor might bring a claim against a state, based on investment treaty obligations (NT, MFN, FET, PR prohibitions, expropriation clauses etc.). Furthermore, if the treaty contained an umbrella clause, it could link WTO obligations to investment treaty obligations.

PR Prohibitions in BITs: Overview of investor–state arbitrations

Ms. Suzy Nikièma (IISD) began her presentation by noting that there have been very few investor–state arbitration cases under BITs dealing with PRs. All of the existing cases involved Canada or the United States as either respondent state or home state of the investor, and the majority of them were based on NAFTA. She then commented on two cases that resulted in opposite conclusions. In *Lemire v. Ukraine* (under the Ukraine–United States BIT, which prohibits local-purchase PRs), a Ukrainian law requiring reserving 50 per cent of radio broadcasting to music “produced in Ukraine” was challenged. Based on a literal interpretation, the tribunal found that the law was not a prohibited PR, as it did not require that the music was produced locally; the intention was not to protect local companies, but to promote Ukraine’s cultural heritage. In *Mobil Oil v. Canada* (under NAFTA), the challenged measures were 2004 provincial directives determining a minimum spending on research and development (R&D) and local-purchasing requirements. While NAFTA prohibited PRs, the federal law under which the R&D directives were enacted was in Canada’s list of reservations. The tribunal concluded that the directives did in fact impose a prohibited PR, that their objective was irrelevant, and that they were not excluded under Canada’s reservations, as the 2004 revisions reduced the level of conformity of the non-conforming measure.

Ms. Nikièma concluded that these divergent decisions illustrated how the unpredictability and incoherence of the decisions rarely benefited the states, and that the exceptions and exclusions of the Canadian and U.S. model BITs did not effectively protect the states’ right to regulate.

IIAs and Prohibitions on Performance Requirements: A review of treaty arbitrations and WTO dispute settlement

Mr. Aaron Cosby (IISD) first highlighted that WTO dispute settlement was different from IIA arbitration in many aspects. He noted that the WTO had case law and consistent interpretations; WTO law is subject to definitive interpretation by WTO members; furthermore, the WTO had an



appellate process, and a standing roster of panellists and Appellate Body members. He then noted that WTO TRIMs Agreement prohibited measures that required the purchase of products with some level of local content, and commented on two WTO cases. In *Indonesia–Autos* (1997), a measure by Indonesia granting preferential tax treatment and low input tariffs to national car producers was challenged as a local-content requirement prohibited by the TRIMs Agreement. The panel found that it was a breach of the agreement, and Indonesia did not appeal. *Canada–Renewables* (2011–12), a measure by the province of Ontario granting premium rates to local producers of renewable energy was challenged. The panel found that the measure was in breach of the TRIMs Agreement. Canada appealed the case, but on other grounds.

Mr. Cosby concluded that, while there had only been two WTO complaints, most countries were using PRs in violation of their TRIMs obligations. Countries tended to challenge PRs in violation of the TRIMs only when the matter at hand was very important economically. The TRIMs Agreement may be used more to prevent legislation than to take countries to dispute settlement. Many PR measures did not see the light of day because of the mere threat of a TRIMs challenge. Finally, given the narrow scope of the TRIMs agreement, it covered only an important part of industrial policy, but not all of it. Many other PRs were allowed under TRIMs.

DAY 3: NOVEMBER 7, 2014

Session 7: Relation of Industrial Policy Issues to Other Parts of Investment Treaties, FTAs, and the WTO

Chair: **Mr. Andres Arauz** (Ecuador). This session looked at how other parts of IIAs and WTO law relate to economic development policy and the use of other economic development tools. It also examined how different rules were interrelated, including the definition of investment, TRIMs and GATS; the role of intellectual property rights (IPR)–related issues, services chapters, financial services chapters, and mutual recognition chapters.

The Relation of Industrial Policy Issues to Services and Financial Services Chapters in FTAs

Ms. Chantal Ononaiwu (CARICOM Secretariat) examined the relation of industrial policy to the services and financial services chapters in FTAs. She noted that FTAs were increasingly addressing a broad range of issues beyond tariff liberalization. Further, provisions in FTAs other than investment rules, such as those concerning services and financial services, are relevant for economic development policy and tools, both in terms of their constraints on policy choices of governments and the flexibilities they afford. Services chapters in FTAs are closely related to their investment chapters, as commercial presence in services is an issue that can straddle both parts



of the FTAs. For example, a measure that a government takes to regulate a service sector, such as tourism, could affect both cross-border trade in that service and investment in that sector.

Ms. Ononaiwu continued to explore different approaches some FTAs have taken in this regard. She noted that some FTAs have differentiated between the scope of the services and investment chapters with the services chapter applicable to cross-border trade in services (CBTS) and investment chapters applicable to all types of investment (including a commercial presence in services). Some FTAs also recognize that a commercial presence in services is also a mode of supplying a service resulting in certain obligations in the services chapter (e.g., market access and domestic regulation) applicable to the supply of services by a covered investment. Other FTAs have dual coverage of a commercial presence in services under the services chapter and the investment chapter.

Within this context, Ms. Ononaiwu observed that disciplines in services chapters might be relevant for certain economic development policy and tools, in particular those prohibiting certain market access restrictions, requiring non-discriminatory treatment of foreign service suppliers, and prohibiting restrictions on capital transactions that are inconsistent with liberalization commitments. Further, governments may retain certain flexibilities to use economic development tools under service chapters in FTAs. These include the exclusion of services supplied in the exercise of governmental authority, exclusion of government procurement and subsidies, scheduling of reservations to market access and NT, modification or withdrawal of specific commitments, as well as restrictions to safeguard the balance of payments.

In addition, Ms. Ononaiwu noted that some FTAs featured distinct chapters regulating financial services in recognition of the special nature of the sector. In some agreements, financial services fell under the same framework for liberalization as other services sectors. However, the financial services chapter could set out the principles of the regulatory framework for financial services to ensure that the commitments would not undermine the regulatory capacity of governments, or to include obligations concerning the regulatory framework for financial services. Some of the specific exceptions or exclusions for financial services include the prudential carve-out, exclusion of activities conducted by a public entity in pursuit of monetary or exchange rate policies, and allowing governments to exclusively conduct activities forming part of a public retirement plan or statutory system of social security. Obligations concerning the regulatory framework for financial services that have been included in some FTAs include the obligation to permit the supply of new financial services similar to those domestic firms can supply under domestic law, an obligation to allow the cross-border transfer of information required for data processing required in the ordinary course of business and disciplines on the behaviour of self-regulatory organizations. Ms. Ononaiwu further noted that the NAFTA-model financial services chapter goes further and prescribes distinct rules for liberalization of the sector, creating a different framework for protection of investments than that of the investment chapter, and contains distinct provisions on investor–state and state–state dispute settlement on financial services.



In conclusion, Ms. Ononaiwu said that in FTA negotiations, investment negotiators must appreciate fully the relationship between investment rules and other parts of the FTA and need to understand the relevance of those other parts of FTAs to economic development policy and tools. Given the relationship of investment rules and rules in services and financial services chapters, there is a need for collaboration between negotiators of these subjects.

Impact of Some Other BIT Provisions on Industrial Policy

Ms. Sanya Reid Smith (South Centre) spoke about the impact of other investment chapter provisions on industrial policy, noting that evidence had shown that the costs of agreeing to those investment chapter provisions could not be offset by gains in other FTA chapters. Provisions touched on by Ms. Smith included the definition of “investment,” the definition of “investor,” the scope and coverage, market access, NT, MFN treatment, FET, expropriation, umbrella clauses, exceptions, and the survival clause. Ms. Smith concluded her presentation with a cautionary note to the participants that the existing ISDS process in most BITs would only allow investors to sue the government, but the government would not be able to raise counterclaims challenging the investor’s breach of its responsibilities.

Relation of Industrial Policy Issues to Other Parts of Investment Treaties, FTAs and the WTO

Mr. Aaron Cosby (IISD) spoke about the relation of industry policy to WTO agreements. He noted that, in the GATS context, industry policy becomes relevant in its mode 3 supply for the delivery of services in cross-border trade—commercial presence. Mr. Cosby noted that it is particularly important to regulate some service sectors with industrial policy, including in the areas of telecommunications, financial service and tourism. Some of the benefits of properly implementing industrial policy in those sectors could include increased localization and the strengthening of the supplier industry to build up the supplier sector for more viable and exportable services. In addition, Mr. Cosby also briefly discussed the TRIMs provisions that impose restrictions on governments adopting some of industry policy tools, including certain measures on local-content requirements and certain export requirements. Mr. Cosby also addressed some disciplines on subsidies within the WTO regime, including the prohibited and actionable subsidies under the WTO Agreement on Subsidies and Countervailing Measures. Subsidies, he noted, are one of the most commonly used forms of industrial policy.

Breakout Session 3: Discussion on the Integration of Investment Provisions in Comprehensive Agreements and on the Inclusion of Investment Liberalization and Performance Requirement Prohibitions

Two competing messages were revealed during the past two days of the Forum: on one hand, participants had formed a clear consensus on the role of economic policy space in development and sustainable development in particular, and on the need to preserve such tools as an option.



On the other hand, participants also noted that, for a variety of internal and external reasons, many governments negotiated in good faith and would continue to engage in negotiations of IIAs with investment liberalization commitments, even while being aware of the risks.

In order to help all governments while recognizing each country's differences, participants were asked to break into groups to discuss the options and their associated issues to reconcile those two competing messages. Below is a summary of the result of the breakout discussions.

In the breakout session participants generally recognized the need for a structured review of existing agreements, the need for getting more information to top levels of governments, the need for linking the discussion to other parts of governments and the development of the national strategies, as well as the need for presenting different scenarios for review and building a proper roadmap for review of decision making in this area.

Participants called for the development of a coherent development strategy in each country. Such a development strategy should identify sectors where FDI was needed and should provide the starting point for negotiations, with benchmarking processes for strategy, broad public consultations, and cost-benefit analysis.

In terms of scope for liberalization (defined as reducing barriers to investment to provide a flexible climate for investment through market access with more (appropriate) regulations to ensure these investments will support the development of the host state), the development plans should identify sectors where FDI is needed for development, and it is important for negotiators to be informed by this. In addition, the scope of liberalization should be based on national investment capacities and areas of need for FDI benefits. Generally, positive lists would be much preferred with no ratchet mechanism. The importance of public and private consultations was addressed, as was the importance of exploring options of gradual liberalization with capacity building to support regulation making.

Participants recognized the need for flexibility and adaptability of the treaties and rejected the permanence of treaties. In terms of defining "new sectors," participants noted that it could be defined in the treaties but negotiators should be careful in excluding new sectors from the application of some provisions, such as NT, MFN treatment and FET.

Finally, participants recognized the importance of including in treaties the goals and objectives of using PRs, linking incentives to PRs, and making sure they were allowed under the treaty. In addition, participants noted that PRs could be legitimized in treaties as part of investor obligations when signing a contract or obtaining a permit or license.



Session 8: The Way Ahead for Developing Countries: Promoting positive relationships between investment, investment treaties and sustainable development

Chair: **Ms. Chantal Ononaiwu** (CARICOM Secretariat). This session was conducted in a format of a moderated plenary discussion.

Mr. Martin Khor (South Centre) discussed the considerations governments should go through during the entire cycle of IIA negotiations, focusing on some immediate issues regarding arbitration and some long-term issues. In terms of the immediate issues, Mr. Khor noted that, when a developing country is faced with international arbitrations initiated by investors, it would be important to have a strategic advisor look at public relations and economic issues along with legal issues. It would also be important to share experiences with other countries in a similar situation. Also, to minimize similar problems in the future, developing countries should amend, terminate or withdraw from existing treaties, and should not enter into negotiations for any new BITs or FTAs with inappropriate investment chapters. In terms of the long-term issues, Mr. Khor noted that developing countries could formulate a national bill on balancing investor protection with investor obligations and national sovereignty and policy space. At the international level, reforms of the IIA regime are necessary. Developing countries should be proactive in pushing forward the reform agenda by advancing binding treaties on investor obligations. Mr. Khor finally noted that although it might take some time, the optimal situation would be to have a global framework with legitimate investor protection clauses avoiding “toxic” elements while balanced with investor obligations and national sovereignty and policy space.

Discussions

Additional reflections by participants during the session are summarized below:

- In terms of terminating BITs, evidence showed that the task could be achieved without facing any catastrophic consequences.
- Before terminating BITs, it was important to perform a thorough assessment and develop alternative tools to replace BITs.
- Developing countries should focus more on developing domestic policy and legal frameworks to advance their business environments, peace and stability, rather than signing more BITs.
- There is a need to increase the profile of institutions such as IISD and the South Centre, in terms of making their presence more known by decision makers at the national level.
- It is important to establish action plans at the national, regional and international levels. At the national level, balanced national rules and regulation are needed to attract investment and address peoples’ rights. At the regional level, a more balanced regional integration among partners with same level of development is needed. Coordination of a

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common model and approach amongst regions of developing and emerging economies would also be useful.

- The relevance of initiatives such as the observational group for IIAs was highlighted, and the need to coordinate the initiatives with intergovernmental institutions and NGOs stressed.

Participants also suggested following topics to be discussed at next year's Forum:

- Outflows from a country and their impacts.
- Alternatives to existing IIAs.
- How to reform domestic frameworks in countries facing the challenges posed by existing BITs.
- Experience and tools on promoting investments.
- How to avoid toxic provisions and how to develop healthy ones.

Ms. Ononaiwu concluded the session urging participants to earmark budgets for attendance of the next forum, which has been scheduled for late October 2015 or early November 2015. Countries and organizations considering co-hosting the next Forum were also encouraged to informally express their interest to IISD as soon as possible.

Closing Ceremony

Ms. Nathalie Bernasconi-Osterwalder (IISD) thanked all speakers and participants for their contributions to the Forum. She reminded the participants that their remarks at the Forum would be governed by the Chatham House Rules, and therefore would not be personally attributed to them or their governments, except for the speeches and comments made by the speakers at their respective sessions. Commenting on some of the remarks made by participants during the previous session, Ms. Bernasconi noted that IISD had been working on developing alternatives to the ISDS process, including a recently convened expert meeting for an in-depth exploration of different ways to settle investment-related disputes. She thanked co-hosts South Centre and the Government of Liberia. Again, she expressed her regrets that participants from Liberia could not attend the Forum. Finally, she encouraged participants to volunteer for the steering committee for next year's Forum.