An Empire of Capital? Transatlantic Investment Protection as the Protection of Illegitimate Investor Privileges

Mattias Kumm

Summary: In relations between capital-exporting developed countries and capital-importing developing countries, the investor-state dispute settlement mechanism has a specific if sometimes ambivalent role to play as an element in bilateral investment treaties. In relations between the European Union and the United States or Canada – and between liberal constitutional democracies more generally – such arbitration tribunals are not only unnecessary: they tend to privilege investors illegitimately.

The planned free trade agreement between the European Union and Canada (Comprehensive Economic and Trade Agreement, CETA) includes rules on investment protection (Investor-State Dispute Settlement, ISDS). A similar mechanism had originally been envisaged for the free trade agreement between the EU and the United States (Transatlantic Trade and Investment Partnership, TTIP). This mechanism has provoked fierce reactions, to the surprise of many experts. In the past, after all, European countries—notably Germany—have concluded more than 1,400 bilateral investment agreements (BITs). As a rule, BITs were entered into between an industrial country and a developing country. Industrial countries export capital; developing countries import capital. Investment protection agreements are designed to help solve two problems: to guarantee legal certainty for foreign investors and to offer foreign investors incentives to place their money in the given developing country. But such issues play practically no role between developed, liberal constitutional democracies. Nevertheless, the concentration on these aims explains the structure and culture of present-day investment arbitration procedures.

Many developing countries have had unstable, corrupt, or dysfunctional systems of government and legal systems. Furthermore, the developing countries that had just emerged from colonial tutelage became a battleground for the opposing ideologies and interests of the Cold War. There was fear of socialist revolutions bringing expropriation without compensation and fear of unjust treatment if new governments failed to honour the commitments of their predecessors. In times of mass national movements and populist uprisings, foreign investors are never welcome; all the less so if such movements embrace socialist ideologies. Foreign investors could not necessarily expect fair and non-discriminatory protection.

This problem hardly exists between developed liberal constitutional democracies with an independent and impartial judiciary. But this is nevertheless the main reason for including rules on investment protection in the CETA and TTIP. For national courts entrusted with the protection of constitutional and human rights, disputes about compliance with fair procedures and about protection against unequal treatment and expropriation are the order of the day. European investors may well be sceptical about the constitutional infrastructure and political framework conditions in some states in the U.S., but do they really have to fear that their interests will not receive due attention from the ultimately competent federal courts? Vice versa, American investors may well have not completely unjustified doubts about the legal and political infrastructure in some EU countries; can Romanian or Bulgarian courts really be trusted? But are reservations really justified about the practices of the Court of Justice of the European Union or the European Court of Human Rights, which generally provide protection if called for? If all that is at stake is equal treatment and legal certainty for foreign investors, there appear to be no grounds for concern: American federal courts and the European judicial system offer investors all the guarantees they could wish for. It is therefore no surprise that the proponents of investment protection clauses in the CETA and TTIP are unable to cite convincing examples of investors being disadvantaged by American or European courts which would make investment protection mechanisms necessary. Suspicions that something else is in play are therefore not unfounded.

What spoke in favor of earlier investment protection agreements over and above the reasons mentioned was indeed something else: in the view of many, including the World Bank and the International Monetary Fund, offering an attractive environment for foreign investors was of crucial importance for successful economic development. Importing foreign capital and the concomitant foreign know-how would support a capital-importing developing country on its way to progress and prosperity. The function of BITS was that the capital-importing country gave potential investors credible guarantees in order to attract investment from the capital-exporting country.

But there is a dark side to the matter, as well. For a less kindly disposed observer, bilateral agreements appear to facilitate complicity between corrupt and despotic governments of developing countries and Western countries along with their industrial interests. Foreign investments generated revenues in the form of tax income, licence fees for the capital-importing country, which filled the public purse and could be used by those in power to consolidate their positions, be it through personal enrichment or by influencing important groups of supporters. In such a context, bilateral agreements gave Western investors safe access to, for example, the exploitation of natural resources in capital-importing countries while helping maintain authoritarian and kleptocratic regimes.

These partly legitimate, partly dubious reasons for concluding bilateral agreements to protect investment in the post-colonial context provide good arguments for treating foreign investors not only fairly but also for granting them further privileges as investment incentives. Historically, bilateral investment protection agreements have laid down not only the basic principles of fair treatment and non-discrimination and the relevant procedures for protecting them: such agreements are traditionally worded to signal top priority for the protection of investment and that such protection is not subject to the considerations reasonably taken into account in democratic constitutional states in the pursuit of justified public purposes.

Even if some agreements do not specifically override these considerations unilaterally, many include most-favored nation clauses, which permit arbitrators to refer to other rules explicitly more favorable to investors under other bilateral agreements to which the capital-importing country is party. Anyway, there is far-reaching consensus among investment arbitrators, often backed by corresponding preambles, that strong protection for investment is the purpose of such agreements. In turn, this understanding influences courts to interpret general clauses in these agreements to the advantage of investors.

If economically developed, established liberal constitutional democracies grant foreign investors privileges to immunize them against the financial implications of changes in the law, this merely furthers downward competition in de/regulation. Some may well find such competition politically attractive and conducive to prosperity, but as an explicitly formulated political policy, such a proposal would in many countries meet with resistance and fail. It is therefore no wonder that the advocates of investment protection clauses in the CETA and TTIP never tire of repeating that it is not a matter of granting privileges to investors but only of ensuring fairness and effective legal protection.

So what are we to think of the argument that—at least nowadays, in the interpretation of more modern BITs—investor interests are no longer structurally privileged? The question raises complex methodological issues in both directions. For our present purposes, it must suffice to point out the obvious: imagine that, contrary to the facts, legal action has been taken against the national security authorities by individual citizens who claim that anti-terrorist measures have violated their basic rights. Imagine that these disputes are heard by tribunals headed by arbitrators who have had a successful career in the military, the police force, or the national secret services, or are leading scholars in the field of security studies. Imagine then, vice versa, that the same cases are heard before tribunals presided over by leading personalities from human rights organizations like Amnesty International or Human Rights Watch, flanked by leading scholars in the domain of human rights. Can it be doubted that the composition of these tribunals would have a structural impact on their rulings? There is clearly good reason for such legal disputes to be heard by courts headed by judges who can more easily be expected to achieve a plausible balance between competing interests.

There is accordingly also good reason for not allowing disputes between investors and states to be decided by members of a small epistemic community of investment protection experts from large law firms specialized in economic law whose regular clients are business enterprises and by academic experts closely associated with these enterprises. Furthermore, the fact that only 40 to 50 per cent of the cases in which investors take action against the host country end with victory or partial victory for the private investor is hardly evidence that there is no structural bias. Before German administrative courts, for example, the rate is generally between 20 and 30 per cent. Although this does not prove much—there can be many explanations for differing success rates—these statistics are certainly no valid evidence that investment arbitration tribunals are not structurally biased. Citing individual examples of arbitral awards that appear overly favorably to investors may not suffice to prove that they are structurally privileged, but it is worth noting the remarkable lack of counter examples in which arbitration tribunals have been overzealous in their defence of state interests against investor interests.

In the post-colonial context of the second half of the twentieth century, investment protection regimes could to some extent be described as the continuation of Western imperialism under modern conditions: the protection of investment, it was claimed, was in the interest of justice or development policy goals; in practice, however, it often amounted to complicity between Western economic interests and authoritarian and/or despotic, kleptocratic governments. What was new in the 1990s was that there were no longer any geographical limits to the empire. NAFTA (North American Free Trade Agreement) and the European Energy Charter (and in all likelihood CETA and TTIP) enable foreign investors increasingly to impose their positions on developed Western constitutional democracies, as well. They are protected not only against the whims of underdeveloped and corrupt government in the underdeveloped marginal regions of the empire but also against the laws and democratic processes of traditional, highly developed core countries. Investors and the professional caste of those who serve their interests thus increasingly acquire the privilege to insulate themselves against the normal procedures of democratic politics and constitutionally entrenched legal protection.

There are remarkable parallels between investment protection regimes and a notorious institution of colonial tradition: "consular jurisdiction." Even if details varied from period to period and from context to context, the basic concept of consular jurisdiction as laid down under an unequal bilateral agreement was that citizens of a given state enjoyed almost complete immunity from the jurisdiction of the host country. They were instead subject to the jurisdiction of civil servants more sympathetic to their interests, often consular officials of their country of origin. There were also mixed tribunals in which representatives of the host country participated. The basic idea was that "barbarian" countries were not to be trusted and that one's own citizens ought not to be subject to their authority.

In contrast to classical consular jurisdiction, post-colonial investment protection formally recognizes reciprocity. If, for example, Germany and Pakistan conclude a bilateral investment agreement, Pakistani investors in Germany in principle benefit from the guarantees under the agreement just as much as German investors in Pakistan. But this recognition is only formal. In a world clearly divided between capital-importing countries and capital-exporting countries, the formal recognition of reciprocity merely hides the fact that investors from capital-exporting countries enjoy privileges. New to investment protection in the twenty-first century is that the geographical disequilibrium is disappearing. Liberal constitutional democracies now see themselves confronted by claims of foreign investors under investment protection clauses—investors from other liberal constitutional democracies as well as investors from developing coun-

Mattias Kumm is managing head of the WZB Center for Global Constitutionalism and holds the research chair in Global Public Law. *[Photo: Ksenya Kumm]*
mattias.kumm@wzb.eu

tries, which as newly industrialized countries have themselves developed into capital exporters. If we describe the rules on investment protection, like the old consular jurisdiction, as an imperial institution, the present-day empire would not be France, Britain, or the United States; not even "the West." It would be the global empire of capital. In this empire, the beneficiaries would not be the citizens of this country or that but foreign investors. And the colonized would be the citizens of traditional Western core countries, who face the unintended, path-dependent consequences of their own imperial history.

References

Dezelay, Yves/Garth, Bryant G.: Dealing in Virtue. International Commercial Arbitration and the Construction of the Transnational Legal Order. Chicago: The University of Chicago Press 1998.

Puig, Sergio: "Social Capital in the Arbitration Market." In: The European Journal of International Law, 2014, Vol. 25, No. 2, pp. 387–424.

Roberts, Anthea: "Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System." In: The American Journal of International Law, 2013, Vol. 107, No. 1, pp. 44–94.