Do We Need Investment Arbitration?

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Investment protection in general and investment arbitration in particular are often portrayed as one-sided, serving the interests of investors who mostly represent big business. In actual fact, the procedural rights granted to foreign investors in the current system of investment law represent a balanced system that serves the interests of host States as well as investors.

For the investor, the risks of investing in a foreign country are considerable and quite different from those of a trader. Investment disputes, unlike trade disputes, are usually highly individualized. An investor typically must commit considerable resources before it can hope to reap the expected profits. In doing so, it makes itself dependent on the benevolence of the host State. This situation of dependence calls for strong legal protection.

After making the investment, the investor is exposed to a number of non-commercial risks at the hands of the host State. These include regime change, a change of general or sectorial economic policy, and economic or political emergencies in the host State (including public violence), to name just a few. While large multinational corporations may sometimes be in a position to pursue their claims through a variety of strategies, medium-sized and smaller investors are particularly vulnerable. For many, investment arbitration constitutes the only means of protection.

From the host State’s perspective, the most obvious advantage of investment protection is improvement of its investment climate. That climate consists of a variety of elements, economic and political. The legal framework for foreign investors is an important factor in determining the investment climate, and a key component of this legal framework is the impartial and effective settlement of disputes between host States and foreign investors.

The idea of investment arbitration as an incentive or at least a safety net for foreign investment inspired the ICSID Convention. The added security thus obtained was intended to translate into increased investment, which, in turn, would stimulate economic development.

In an early publication, Aron Broches, the spiritual father and principal architect of the ICSID Convention, explained the idea underlying the drafting of the Convention. He pointed to the importance of private foreign investment
for economic development and to the role of an orderly system of dispute settlement in the following terms:

[P]rivate foreign investment [...] is of great quantitative importance as a supplement to a necessarily limited volume of public development finance. . . .

It is beyond doubt that fear of political risks operates as a deterrent to the flow of private foreign capital to developing countries. The World Bank therefore considered it appropriate to explore whether it could make a contribution to an improvement in the investment climate, by reducing the likelihood of unresolved conflicts between host countries and investors, and in particular by doing so in a manner which would eliminate the risk of a confrontation of the host country and the national State of the investor.\(^1\)

The Convention was perceived by the directors of the World Bank as an instrument of international economic development. The link between orderly settlement of investment disputes, stimulation of private international investments and economic development is apparent from the Report of the Executive Directors on the Convention:

9. In submitting the attached Convention to governments, the Executive Directors are prompted by the desire to strengthen the partnership between countries in the cause of economic development. The creation of an institution designed to facilitate the settlement of disputes between States and foreign investors can be a major step toward promoting an atmosphere of mutual confidence and thus stimulating a larger flow of private international capital into those countries which wish to attract it.

. . . .

12. [A]dherence to the Convention by a country would provide additional inducement and stimulate a larger flow of private international investment into its territories, which is the primary purpose of the Convention.

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\(^1\) A. Broches, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 136 Recueil des Cours 331, 343 (1972 II) (*Convention on the Settlement of Investment Disputes*).