The Role of Bilateral Investment Treties in Global Trade: Case Study of Iraq

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ABSTRACT

In this paper, several international investment treaties have been researched, in addition to other resources from organizations such as the (OECD) and the (UNCTAD). Through the comments, suggestions and recommendations that have been presents for investment institution (mostly the National Investment Commission in Baghdad and the Ministry of Investment in KRG) to draft a sound Model Bilateral Investment Treaties BITs which will express the issues that any government has to consider and define clearly the objectives and intent on investment agreements, and which will protect the government interests in the future. I will come over the dispute resolution clause in the BITs and their role in economic development and the interaction between increased protection and the rate of capital accumulation because, in the absence of capital flows, investment is determined by the amount of domestic savings out of total income. This will drive me later to talk about the benefits of expanded FDI flows under globalization and its effect on international trade the World Trade Organization WTO. Expanded FDI flows under globalization, which is encouraged by BITs, could have benefits to international trade but under few restrictions which I came to explain in this paper which includes Low value-added, Weak linkages, Erosion of local capacity, Merger and acquisition, Environmental damage and displacement.

Keywords: Iraqi Bilateral Investment Treaties, International Trade, World Trade Organization

1. Background

During the work in the National Investment Commission (NIC) in the last two years, I had the possibility to review number of bilateral investment agreements presented to the commission by number of foreign governments and the draft Government of Iraq’s (GOI) model Bilateral Investment Treaty (BIT) document. To do so, I have researched several international investment treaties and other resources from organizations such as the Organization for Economic Cooperation and Development (OECD) and the United Nations Conference on Trade and Development (UNCTAD).

This study addresses comments, suggestions and recommendations for any investment institution to draft a sound Model BIT which will express the GOI’s objectives and intent on
investment agreements, and which will protect the government interests in the future. I will discuss issues that any government has to consider in defining key terms such as “investor,” “investment,” and determining whether the government wishes to include an “umbrella clause” in its model BIT or not.

This study is designed to prove that the BITs which are signed or is under the negotiation process by the GOI has been designed in the benefit of both the contracting states and their investors and will not work in favor of international trade and economic development. These treaties need more comprehensive discussion and review of the government’s objectives and strategy for signing with specific nations that serves more the mutual interests of both parties.

While I hope that this study will provide a good foundation for interested countries in drafting model for BIT, which can be improved through additional time for a more in-depth and comprehensive discussion and review of the government’s objectives and strategy for signing BITs with specific nations.

2. Introduction

BITs are an instrument that states use to encourage foreign investments by granting broad rights and guarantees to investors of one contracting state in the territory of the other, which typically include fair and equitable treatment, protection from expropriation, free transfer of means and full protection and security (Reisman, 2004). One of the most significant features of many BITs is that they grant investors who are covered under the BIT the right to use international arbitration proceedings against the host state, in the event that the investor’s rights have been violated under the BIT, rather than suing the host state in its own courts.

As of 2007, there is a total of 2608 signed BITs in the World, involving 179 different countries (UNCTAD, 2008a:2). Therefore, the government should take great care in crafting the terms of the government’s model BIT to ensure that it minimizes any potential future conflicts with investors as a result of unclear terms and concepts in the BIT. Regardless of whether the government uses its model BIT, some terms will change based on negotiations and the objectives of the particular states the government will be engaging to establish formal investment relationships. Therefore, we will discuss the interpretation of some of these terms and definitions in the sections below to better prepare the government in understanding and negotiating these terms with other states.

There is no such thing as a single definitive definition for most of the terms such as “investment” and “investor” because it will depend largely on the objectives and interpretation of the contracting states. For example, some states may want to include investors who are not citizens, but are permanent residents and living in their territories. Nevertheless, states use commonly used formats and definitions as a starting point, and then they transform them as necessary (OECD, 2008).

These definitions will be critical to determine the desired scope of application of rights and responsibilities of Contracting States and investors in the BIT, and establish the jurisdiction of
the international arbitration tribunals included in the BIT and under the International Center for the Settlement of Investment Disputes (ICSID), if using its auspices (OECD, 2008:7). Therefore, only such investors and investments defined in the BIT will be able to benefit from its protection and be eligible to make a claim to settle an investment dispute.

Something else to keep in mind is that the majority of BITS are negotiated and signed between a developed state and a developing state, although the number of BITs between developing states are growing (UNCTAD, 20044). Therefore the government should prepare a negotiation strategy to leverage its strengths and minimize its weaknesses before sitting across the table from the other state.

In general, the government will be faced with two main issues when drafting the specific criteria for the BIT: 1) the scope, variety, and number of investment promotion provisions it wants to incorporate into the BIT; 2) it has to make a decision on the intensity of the commitment undertaken, including the issue of posterior implementation and follow-up procedures. If the government can draft precise and binding provisions in its BIT, which are directly linked to specific follow-up procedures, then it will be more likely to obtain results that will have a positive and visible impact in promoting foreign investment in Iraq (UNCTAD, 2008b).

For example, will the emphasis of signing BITs be on improving the general policy framework for foreign investment in Iraq, or on supporting micro-level foreign investment through financial, fiscal, and regulatory incentives to individual enterprises or specific industries? The answer to this and other similar questions will determine the final language of the terms required in the BITs.


In general, BITs define two categories of investors: natural persons and legal persons (UNCTAD, (n.d):109). While the first category is the easier one to define, the second requires additional analysis to ensure that the government’s definition addresses its objectives.

3.1 Natural Persons

Under international law, it is widely recognized that the nationality of an “investor as a natural person is determined by the national law of the state whose nationality is claimed.” (OECD, 2008:11). The definition is usually simple, but the NIC should consider whether it wants to include permanent residents as “nationals” for purposes of benefiting from the BIT, and how to address the issue of dual citizenship.
3.1.1 Permanent Residents and Dual Citizens

The current definition of investor in the draft government model BIT does not address permanent residents or dual citizens. The following are examples of how other countries and organizations address these two issues.

Although the ICSID Convention does not grant jurisdiction to permanent residents to use its international arbitration auspices under a BIT, several countries include them within the definition of “investor” for purposes of benefiting from the BIT (OECD, 2008:15). For example, Canada defines investor in their BITs as:

“Any natural person possessing the citizenship of or permanently residing in Canada in accordance with its laws” (UNCTAD, (n.d):109-110)

Similarly, the US-Uruguay BIT defines a national person to mean:

a. For the United States, a natural person who is a national of the United States as defined in Title III of the immigration and Nationality Act [which includes permanent residents].

b. For Uruguay, a natural person possessing the citizenship of Uruguay, in accordance with its laws (OECD, 2008:13)

Another example is Article 201 of NAFTA where it includes permanent residents of a party to the agreement (OECD, 2008:14).

3.2 Benefits And Drawbacks

Iraq could benefit from including foreign permanent residents or Iraqi permanent residents in the other state in their definition of investor because it would attract Iraqi and third-state citizens who have taken permanent residency in other states and who would like to invest in Iraq under the protections of the BITs. However, the drawback is that if permanent residents are included in the definition of investor, then they could also bring claim against the contracting state for international arbitration under the BIT.

Although not many BITs address the issue of dual citizenship of natural persons, the GOI should nevertheless consider it in its definition of investor (OECD, 2008:23). The following scenario illustrates this issue:

An Iraqi citizen who migrates to the USA and after a few years obtains U.S. citizenship through naturalization. Thus he becomes a dual citizen. If Iraq and the US ratify their BIT which does not address the issue of dual citizenship of investors, and the dual citizen invests in Iraq using his American nationality, and then he decides to file a claim against Iraq for alleged violation of the BIT, then the international tribunal would have to use general principles of international law to determine which “effective” nationality of the dual citizen would apply and whether he would be covered under the BIT to bring such an international arbitration claim against Iraq.

To avoid such problems, the ICSID Convention excludes dual citizens (nationals) from its jurisdiction if one of the nationalities is that of the host state in the BIT (OECD, 2008:15).
Likewise, Canada excludes natural persons who are citizens of both parties from the definition of “investor” to prevent facing this issue (UNCTAD, (n.d):110).

Therefore, the GOI should determine whether it wants to specify the dual citizenship issue in its definition of investor, or not address it altogether like in the current definition in the GOI model BIT.

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3.2 Legal Persons

The majority of BITs tend to adopt a comprehensive approach that includes various types of entities regardless of legal form, nature of company (private or state-owned), purpose, control, and ownership within the definition of legal entities as investors for purposes of the BIT(UNCTAD,(n.d):110).

However, the issues related to the nationality of legal persons are far more complicated and numerous than those related to natural persons because the way companies are structured and operate today makes it very difficult to determine nationality for purposes of the BIT(OECD,2008:17).

For example, it is standard practice for a company to be established under the laws of one country, have its center of control in a second country, and do its main business in a third country; furthermore, this company can be owned and controlled by a layer of shareholders, both
natural and legal persons themselves, operating from and in different countries (OECD, 2008:17-18).

Although there is no single “correct” definition that addresses all potential future issues between legal persons and states under the BIT, it is worthwhile to consider the following main issues when finalizing the definition of legal persons as investor in the GOI model BIT.

3.2.1 Defining Objective Criteria That Defines A Legal Person As “National” Or “Investor”

According to OECD, it is standard practice in drafting BITs to “specifically define the objective criteria which make a legal person a national, or investor of a Party, for purpose of the agreements, rather than to simply rely on the term “nationality” and international law.” (OECD, 2008:18).

The objective criteria used by the GOI may include investors to whom the GOI would not want to extend the treaty protection. If this is the case, then the GOI should include a “denial of benefits” clause to list the exclusion of investors in certain categories of the BIT (OECD, 2008:18).

3.2.2 Four Tests Used To Determine Nationality Of Legal Persons

International law has no single test that can be used for all BITs to define the required link between a legal person seeking protection under the BIT and the contracting state under whose BIT the investor asks for protection. (OECD, 2008:18-9) States have mainly relied on a combination of the following four tests to determine the nationality of legal persons for purposes of receiving protection under the BIT:

3.2.2.1 No. 1: Place Of Constitution In Accordance With The Law In Force In The State

Some BITs adopted this test and simply make reference to national law provisions of each of the contracting states to establish the legal persons covered under the BIT (OECD, 2008:19). The current GOI model BIT uses this test;

3.2.2.2 No. 2: Place Of Incorporation Or Where The Office Is Registered

Other BITs combine test 1 with the place of incorporation test. When doing so, they also include a “denial of benefits” clause which allows a contracting state concerned to deny treaty protection to an investor, under certain circumstances, which is controlled by nationals of a non-party state (OECD, 2008:19).
Some BITs qualify the exclusion by excluding companies that are established in one of the contracting states of the BIT, but that are controlled by nationals of third countries if such entities do not engage in substantial business activity in the territory of the country in which they are organized (UNCTAD, (n.d):112).

The UK uses the place of incorporation test as its sole test in most of its BITs; for example, the UK-Yugoslavia BIT defines investor as:

“i) In respect to the United Kingdom: […] corporations, firms, and associations incorporated or constituted under the law in force in any part of the United Kingdom or in any territory to which this agreement is extended […].” (OECD, 2008:20)

3.2.2.3 No. 3: The Country Of The Seat (Place Of Administration)

This test has been used by some states in BITs to narrow the definition of qualifying investors and to prevent some creative investors from “treaty shopping” by acquiring or establishing a “paper” company in a jurisdiction where a relevant BIT applies. This test would require the entity not only to be established or incorporated in the host country, but also have its seat and/or main place of administration (OECD, 2008:20).

For example, the language in Article 1 (1) (b) of Switzerland’s model BIT language illustrates this test by stating that legal person “investor” means:

“legal entities, including companies, corporations, business associations and other organizations, which are constituted or otherwise duly organized under the law of that Contracting Party and have their seat, together with real economic activities, in the territory of that same Contracting Party.” (UNCTAD, (n.d):112)

No. 4: The country of control

An additional criterion that states use is the nationality of the investor entity’s controlling interest. For example, an American company may be the majority and controlling entity of a subsidiary company established in the United Arab Emirates. However, this is a difficult concept to define because there is no established universal meaning and it varies from case to case.

Some organizations, like the OECD, take the quantitative approach and focuses on the percentage of ownership or voting power in the concerned investor company:

“To classify an enterprise within a country on the basis of the presence or absence of effective foreign control [emphasis in original text], the criterion recommended for use is whether or not a majority of ordinary shares or voting power (more than 50% of the capital) is held by a single foreign direct investor or by a group of associated investors acting in concert Application of this criterion avoids the use of subjective concepts or case by case review. (OECD, 2008:24).”

Other states combine the test of control with other formal criteria such as the incorporation and seat to justify coverage of an investor in the BIT; for example the French model BIT defines “investor” as: in b) Any legal person constituted on the territory of one Contracting Party in
accordance with the legislation of that Party and having its head office on the territory of that Party, or controlled directly or indirectly by the nationals of one Contracting Party, or by legal persons having their head office in the territory of one Contracting Party and constituted in accordance with the legislation of that Party.” (APPI, 2006:27).

3.2.3 Denial Of Benefits Clause

As discussed briefly above, some BITs contain a denial of benefits clause that enable the signatory states to deny the protection to investors incorporated in one of the signatory states, but under control of investors of a third country not signatory to the BIT or when the investors do not have any substantial activity in the country of incorporation (OECD, 2008:28).

This provision gives the host country the authority to exclude “shell” or “paper” companies owned by nationals of a third-country or the host state and companies owned by certain third-country aliens from the protection of the BIT (OECD, 2008:29).

The Austria-Libya and Austria-Lebanon BITs include the following denial of benefits clause: “A Contracting Party may deny the benefits of this Agreement to an investor of the other Contracting Party and to its investments, if investors of a Non-Contracting Party own or control the first mentioned investor and that investor has no substantial business activity in the territory of the Contracting Party under whose law it is constituted or organized.” (OECD, 2008:32).

Note that by using the word “may” in the first sentence, the countries have decided to have the discretion of denying these benefits to certain investors, or of including them in the BIT even if they do not comply with the denial of benefits clause. The use of “may” opens a lot of potential issues, such as the criteria for including otherwise excludable investors, the requirement of the State to notify the investor that it is excluded, etc. Therefore, if the states do not foresee granting exceptions to this clause, then they should use the word “shall.” This makes it clear and absolute that the state has no discretion for inclusion of investors which do not meet the definition criteria in the BIT.

Another example is Article 17 of the US Model BIT:

“1. A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if persons of a non-Party own or control the enterprise and the denying Party:
   a) Does not maintain diplomatic relations with the non-Party; or
   b) Adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Treaty were accorded to the enterprise or to its investments.

2. A Party may deny the benefits of this Treaty to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise.” (OECD, 2008:30).
3.2.4 Nature of Investor (Private or State-Owned/Controlled?)

The GOI should also determine whether it wants both private and public (state owned or controlled) entities to be included in its definition of “investor” for purposes of the model BIT. ICSID’s definition is not clear as to whether investor companies could be state owned or controlled companies; as a result, its tribunal was confronted with this issue in one of its cases and decided that “a legal person could have access as an investor to proceedings under ICSID unless it acts as a state agent or undertakes a governmental function.” (OECD, 2008:38).

However, states usually have included state entities in their definition under their BITs, such as the 2004 US Model BIT, the Canada Model FIPA, and the Convention Establishing the Multilateral Investment Agency, which defines eligible investors to include a legal person “whether or not is privately owned.” (OECD, 2008:39).

Some even include governments themselves in addition to state entities as eligible investors, such as the 1996 Czech Republic-Kuwait BIT and in the 2001 Belgium-Saudi Arabia BIT. (OECD, 2008:39)

Including state entities and governments as qualified investors requires the GOI to take careful consideration of potential repercussions, such as take-over, influence and control of certain industries by foreign governments through investments.

3.2.5 Rights Of Shareholders To Bring Claims Under Bits

Like the GOI’s draft model BIT, other BITs often include shares or participation in companies as forms of investment; for example, the US-Argentina BIT includes “a company or shares of stock or other interests in a company or interests in the assets thereof” in its definition of “investor.” (OECD, 2008:40)

The GOI should be ready to address issues concerning shareholders in the future under the BIT because an investment may have controlling or non-controlling shareholders, minority or majority shareholders, or it may be direct or indirect through another company (foreign or domestic) (OECD,2008:40). Jurisprudence on recent investor-state disputes favors the right of shareholders to be accepted as claimants with respect to the portion of shares they own or control in an investment covered by the BIT (OECD, 2008:42). Also, as long as the BIT includes indirect ownership or control of shares, then an investor can claim for damages inflicted to a company of which it owns shares only indirectly through an intermediary company or subsidiary (OECD, 2008:44). Consequently, these provisions provide a wider scope of investors who are protected under the BIT and would motivate more foreign investment.
4. Defining “Investment”

4.1 Two Standard Approaches To Defining “Investment”

There is no single common definition for the term “foreign investment.” OECD states that “the absence of a common legal definition is due to the fact that the meaning of the term investment varies according to the object and purpose of different investment instruments which contain it.” (OECD, 2008:46).

Nevertheless, there are two main approaches used in defining investment: a- asset-based and b- enterprise and transaction-based definitions of investment (UNCTAD, 2004:93). Most BITs define “investment” as comprising a broad range of assets, much like the definition in the draft GOI model BIT (UNCTAD, 2004:93). This asset-based definition does not require that an investor have a controlling interest in companies and includes both debt and equity interests, to include portfolio and direct investment (UNCTAD, 2004:93).

OECD states that “most BITs take four basic definitional dimensions into consideration: a- the form of the investment; b- the area of the investment’s economic activity; c- the time when the investment is made; and d- the investor’s connection with the other contracting state.” (OECD, 2008:50)

However, like in the GOI model BIT, the scope of this definition can be limited to those assets that have been approved and authorized by the host countries laws and regulations.

Furthermore, the scope of this definition can also be limited as to the nature and/or sector of economic activity of the investment. For example, the 1994 Energy Charter Treaty states:

“[…] ‘Investment’ refers to any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as a ‘Charter efficiency projects’ and so notified to the Secretariat.” (UNCTAD, (n.d):95)

The other common approach is the enterprise-based and transaction-based definitions of investment, where it focuses on foreign investment as the establishment of a new enterprise, or the acquisition of a controlling interest in an existing enterprise, in the territory of another state (UNCTAD,(n.d): 96). For example, NAFTA, the Canada-Philippines BIT, and the US BITs adopt this approach; NAFTA defines investment as:

a) The establishment of a new business enterprise, or
b) The acquisition of a business enterprise; and includes:
c) As carried on, the new business enterprise so established or the business enterprise so acquired, and controlled by the investor who has made the investment; and

d) The share or other investment interest in such business enterprise which owned by the investor provide that such business enterprise continues to be controlled by such investor.” (UNCTAD, (n. d):96-7)
4.2 “Investment” For Jurisdictional Purposes

The definition of “investment” the GOI decides to use will be critical to determine and establish the jurisdiction of the international arbitral tribunals that Iraq and its counterpart to the BIT will agree to use. The dispute resolution clause in the BITs usually provides more than one option of dispute settlement mechanisms, such as ICSID, the International Chamber of Commerce (ICC), United Nations Commission on International Trade (UNCITRAL), etc. (OECD, 2008:53)

However, according to OECD, “[j]urisdictional questions relating to the scope of arbitral investment disputes may arise, no matter which forum of arbitration is selected, since the jurisdiction of an arbitral tribunal under the applicable BIT relies on a showing of the existence of an ‘investment’.” (OECD, 2008:56)

A major recent issue contested in BIT cases has been whether rights granted by contract can be considered as “investments” under the BIT (OECD, 2008:54). The decision of these cases will heavily rely on the definition of “investment” in the BIT. Therefore, the GOI should consider whether it wants to include international contracts for the sale of goods in the definition of “investment” even if does not involve any transfer of money or property as capital in a business.

If the GOI decides to include such transactions in the definition under the BITs, the parties will not be able to utilize ICSID and UNCITRAL as these organisms decline jurisdiction to disputes arising out of contracts and transactions covering only the sale of goods. (OECD, 2008:58) Also, if the GOI decides to sign the ICSID Convention, or the other country is an ICSID Convention member and the BIT includes ICSID dispute resolution mechanism as one of its options, the GOI should note that once a claim has been submitted to an ICSID tribunal and it decides to deny the case based on lack of jurisdiction due to basis of the “investment” definition by ICSID for jurisdictional purposes, “the same dispute could be resubmitted to one of the other available fora [in the BIT]. But if the ICSID tribunal rejects its jurisdiction under both Art. 25 and the BIT, claimants would have no alternative options on the basis of Art 53 of the ICSID Convention, according to which the award shall be binding on the parties.” (OECD, 2008:78)

The current GOI model BIT definition of investment seems to include contracts and transactions involving the sale of goods under Section 1 (e): “Any right that is granted by law or by contract, additionally any authorizations or permits valid per law or per special agreements…”

One other major issue for the GOI to consider is the relevance and effect of the “in accordance with the laws and regulations of the host state” language to limit the scope of the “investment” definition in the BIT. International arbitration tribunals have interpreted this provision as referring to the validity of the investment in question, and not the definition of investment in accordance to the host country’s law. (OECD, 2008:76) As one ICSID tribunal opined, “more specifically, it seeks to prevent the BIT from protecting investments that should not be protected, particularly because they would be illegal.” (OECD, 2008:56; ICSID, 2003:12).
In conclusion, although the current GOI model BIT contains standard definitions, the NIC and GOI should conduct comprehensive analysis of its laws and its investment strategy to determine the best combination for its definitions of “investor” and “investment” and achieve maximum effect in fostering foreign investment activity in Iraq through the BITs.

5. Understanding The “Umbrella Clause”

Umbrella clauses are now common in BITs and are included to provide additional protection to investors by protecting the contractual obligations in investment agreements between the foreign investors and the host state (OECD, 2008:101). However, the meaning of the umbrella clause remains a controversial issue in international arbitration tribunals because it obligates the host state under the BIT to honor investor-state contracts, which may otherwise be resolved in administrative or civil courts in accordance with the terms and conditions of the contract itself.

The current GOI model BIT does not seem to contain an umbrella clause. According to OECD, an estimated 40% of more than 2500 BITs contain an umbrella clause (OECD, 2008:105). The range of use of the umbrella clause varies depending on the particular state. For example, Switzerland, the Netherlands, the UK, and Germany often include umbrella clauses in their BITs, while France, Australia and Japan only include it in a minority of their BITs (OECD, 2008:105). For example, Germany usually places the umbrella clause in Article 8 and reads:

“Each Contracting State shall observe any other obligation it has assumed with regard to investments in its territory by investors of the other Contracting State.” (OECD, 2008:127; DFG, n.d): 21

Some commentators have expressed concern that umbrella clauses in BITs may protect the investors even against minor breaches of contract between the investor and the host country (OECD, 2008:105-7). Scholar F.A. Mann states that the umbrella clause is “a provision of particular importance in that it protects the investor against any interference with its contractual rights, whether it results from a mere breach of contract or a legislative or administrative act, and independently of the question whether or not such interference amounts to expropriation….”(OECD, 2008:107). Therefore, the BIT would render the following actions by the host state wrongful: changing the terms of contract or license by legislative measures, the termination of the contract or the failure to perform any of its terms, for example, by failing to pay, and the dissolution of the local company with which the investor may have contracted with and transferred its assets (OECD, 2008:107).

International tribunals have generally viewed the umbrella clause with common sense and have not held the host state responsible for contractual breaches that could be addressed in accordance with the terms and conditions of the contract itself. However, the language defining the scope of the umbrella clause is a critical issue that could bind a host state to all contractual obligations with a protected foreign investor (OECD, 2008:111). For example, the use of mandatory language such as in the German BIT “each Contracting state shall observe any other obligation…” provides a wide scope of obligations and commitments on behalf of the
Contracting State (OECD, 2008:109). Also, arbitral tribunals have interpreted the phrase, “any obligation,” to mean “not only obligations of a certain type, but ‘any’ – that is to say, all obligations.” (OECD, 2008:111).

Other BITs provide more narrow and specific umbrella clause, such as the Italy-Jordan BIT where “each Contracting Party shall maintain in its territory a legal framework apt to guarantee to investors the continuity of legal treatment, including the compliance, in good faith of all undertakings assumed with regards to each specific investor;” (OECD, 2008:112) or Mexico’s model BIT language stating that “disputes arising from such obligations shall be settled under the terms of the contract underlying the obligation.” (OECD, 2008:112)

In conclusion, because there is no standard interpretation of the language in the umbrella clauses, the proper desired interpretations will greatly depend on the specific wording of the particular BIT, its ordinary meaning, context, objective and purpose of the BIT, and negotiation history of the contracting states (OECD, 2008:125).

6. Subrogation Clause

According to UNCTAD, “subrogation is a term originating in insurance law and referring to the substitution of one person for another with respect to a claim. Subrogation clauses, which appear in most BIT’s, provide that, if a party or an agency of a party makes a payment to one of its investors pursuant to an investment insurance scheme, the other party shall recognize the assignment of the rights of that investor to the party or its agency.” (UNCTAD, (n.d):141) The GOI model BIT template contains a subrogation clause labeled “Assignees.”

Another example of a subrogation clause is Article 6 of the un-ratified BIT between Iraq and Germany:

"If either Contracting State makes a payment to any of its investors under a guarantee it has assumed in respect of an investment in the territory of the other Contracting State, the latter Contracting State shall; without prejudice to the rights of the former Contracting State under Article 10, recognize the assignment, whether under a law or pursuant to a legal transaction, of any right or claim of such investor to the former Contracting State. The latter Contracting State shall also recognize the subrogation of the former Contracting State to any such right or claim (assigned claims) which that Contracting State shall be entitled to assert to the same extent as its predecessor in title. As regards the transfer of payments made by virtue of such a signed claims, Article 4 (2) and (3) as well as Article 5 shall apply mutatis mutandis."

Although subrogation clauses are common in BITs to address common industry practices in the international business and insurance world, the NIC and GOI should consult an Iraqi insurance expert to discuss the limitations that relevant laws and regulations may have on this clause under the BIT.
7. **Governing Language**

The current GOI model BIT does not contain a “governing language” clause. Including this clause will prevent conflict and disagreements as to which shall be the governing version of the BIT. Since one of the most important objectives of the BIT is to be widely read in a familiar international business language, English is typically a good choice to select as the governing language for a BIT because it tends to be the most common business language used around the world and can provide some neutrality between two countries that do not use English as their official language.

8. **The Role Of Investment**

Attracting foreign investment is crucial from a number of standpoints and of course, there is never shortage of theoretical arguments (Chete, 1998:289-336): First, consistent and regulated inflow of foreign investment provides an important source of foreign exchange earnings needed to supplement domestic savings and raise investment levels. Second, import substituting investment would serve to reduce the import bills as investment in export industries will directly increase the country's foreign exchange earnings.

Some other benefits might also accrue from increased foreign investment. These include the creation or rather expansion of local industries to supply inputs to the newly established plants; a rise in the overall level of domestic demand to boost incomes and, through taxation, state revenues; and the transference of labor (human capital) skills and technology. Yet another set of benefits arises from the forecasting of efficiency in the domestic economy, an effect that might even occur prior to the anticipated investment flows (Chete, 1998:298).

Agarwal (1980:30-64), clarifies the determinants of foreign direct investments using two political factors of political stability and the threat of nationalization, in conjunction with a variety of economic factors such as investment incentives, the size and growth of the recipient's market, its degree of economic development proxies by infrastructure, market distance and economic stability in terms of inflation, growth and balance of payments. In his extensive survey of the literature on the determinants of foreign direct investment, he finds mixed evidence with respect to the impact of political instability.

Lewis (1979: 59-68), lays emphasis, to some extent, on political factors too. He tested the dual hypotheses that economic considerations are the prime determinants of foreign investment flows and that political variables are of secondary importance. His model uses a step-by-step regression for 25 developing countries from three continents: Africa, Asia and Latin America to establish that economic variables are more important than the political ones. All the above studies except, Dunning (1981:30-64), were pre-occupied with the determinants of foreign direct investment in developing countries. A respectable number of studies have also been conducted for developed countries particularly for the United States and the European Community (Scapelanda, 1988:381-390; Lunn, 1980: 93-101). The authors established similar findings.
Keynes (1936), pioneered the discovery of an independent investment in the economy, in contrast to, the widespread belief that all available saving is automatically invested so far as the interest rate is attractive. Keynes' main contention was that investment is a function of the prospective marginal efficiency of capital relative to some interest rate which reflects the shadow cost of the invested funds. According to Keynes, because of incomplete and uncertain information about private investment volatility in the future, potential investors would depend on their "animal spirits" in making their investment decisions rather than a rational calculation of an inherently intermediate distant future (Chete, 1998:346).

Investment theories that followed the tradition of the Harod Domar growth models emerged in the 1950s and 1960s. This was the precursor to the familiar accelerator theory. This theory posits investment as a linear function of changes in output derived from a fixed proportion of production technology. Thus, given an incremental capital-output ratio, it is easy to compute the investment requirements needed to achieve a given output growth target. In his model, profitability expectations and cost of capital considerations are ignored in the determination of investment.

The Neo Classical Approach to investment was next in line. Mainly spurred by the desire to obviate the shortcomings of the Harod Domar formulation, particularly in its simplistic assumptions, this approach introduces factor substitution in the derivation of the demand for capital from the firm's cost minimization problems. Consequently, the desired capital stock is shown to depend on the rental cost of capital (which, in turn, depends on the price of capital goods, the real interest rate and the depreciation rate) and the level of output. This approach too has been attacked on account of inconsistency of the assumptions of perfect competition and exogenous output, the inappropriateness of static expectations and the introduction of delivery lags in an ad hoc manner.

Tobin's "Q" theory of investment of 1969 is an alternate formulation of the investment function. The theory postulates that the ratio of the market value of the existing stock of capital to its replacement cost (otherwise termed Q ratio) is the force driving investment. Tobin subsequently elaborated two reasons why Q may differ from unity which include delivery lags and increasing marginal costs of investment.

Abel (1984: 43-65) and Hayashi (1982: 34), both, in separate studies, attempt a reconciliation of the Neo-Classical and Q approaches to investment. By showing that the latter follows from the firm's optimal capital accumulation problems under adjustment costs, they proved that what drives investment is marginal Q, that is, the ratio between the increase in the value of the firm due to the installation of an additional unit of capital and its replacement costs. However, marginal Q may not be observable as it will generally diverge from the observed average Q (which essentially is the market value of existing capital in terms of new capital), except under competitive equilibrium and constant returns to scale. Both will also diverge if firms confront quantity constraints in real asset or financial markets. In such a situation, average Q will, at best, provide some and not all of the information required to make investment decisions.
This disequilibrium approach to investment is associated with Malinvaud (1980: 52) and Sneessens (1987: 43-71). In this respect, investment is a function of both profitability and output demand considerations. Malinvaud splits investment decision into two stages: the decision to expand the level of productive capacity, and the decision about the capital intensity of that additional capacity. The latter depends on profitability variables like the relative cost of capital and labor. By contrast, the capacity decision relates to the degree of capacity utilization in the economy as an indicator of demand conditions. In Sneessens, net investment is a positive function of the gap between actual and long-run equilibrium capacities. This, in turn, is a reflection of differences between actual an equilibrium rates of capacity utilization and between actual and equilibrium mark-up rates. Therefore, investment depends on both profitability (discrepancies between actual and equilibrium mark-up rates) and on sales constraints (discrepancies in rates of capacity utilization). By implication, investment decisions may be reached in a setting in which some firms confront current and expected future sales constraints, a crucial departure from both the Neo-Classical and the Q (Tobin) models.

There exists an expanding literature on the effects of financial constraints on investment (Fazzari et al., 1988:52; Olopoenia, 1983: 221-234). The central argument here is that internal finance (retained earnings) and external finance (bonds, equity or bank credit) are not perfect substitutes. The discrepancy in the cost of different sources of financing is due to asymmetric information where bankers in the capital market cannot evaluate accurately the quality of firm's investment opportunities; thereby leading to existence of opportunity cost of internal finance generated from cash flows and retained earnings. According to this view, investment will be very sensitive to financial factors such as the availability of internal finance or the access to capital markets (Chete, 1998:372).

Finally, another feature of investment in developing countries of sub-Saharan Africa (SSA) is the high import content of capital goods. This buttresses the contention in the two gap model (Chenery and Bruno, 1962: 72; Bacha, 1984:13), that the lack of foreign exchange may constitute a major constraint to sustain high rates of investment and growth in developing economies. Therefore in countries like Nigeria where domestic and foreign capital goods are highly complementary, the lack of foreign resource to import machinery and equipment will always constitute an impediment to growth. In other word, foreign exchange is a crucial determinant factor in capital formation among developing countries of Africa. This is a serious issue when viewed from the current perspective of our study.


Many reasons why trade liberalization might encourage investment are illuminated in the literature. Corden (1974:58) pointed out that protection could reduce the rate of capital accumulation because, in the absence of capital flows, investment is determined by the amount of domestic savings out of total income. Hence, as long as protection lowers real income, especially for small countries that lack international market power, investment and the rate of
capital accumulation will decline. The new literature on economic growth argues that countries that take advantage of international trade might enjoy higher growth because of faster absorption of foreign technical knowledge (Grossman and Helpman, 1991: 145-63; Aizenman and Marion, 1993: 145-63; Aizenman 1992: 163-87; Romer, 1994: 5-38).

In other words, if investment is linked to changes in output (say through the accelerator effect) any policy measure that promotes growth will be a stimulus for an increase in capital accumulation. In an indirect manner, it is argued that in as much as economic growth is linked to faster capital accumulation and growth is associated with openness, then effective trade policy reform will be investment inducing (OECD, 2001). There is a preponderance of cross-country evidence that trade liberalization and openness to trade increases capital accumulation, the growth rate of income and output. In addition, numerous individual country studies over the past three decades suggest that “trade does seem to create, even sustain higher growth” (Bhagwati and Srinivasan, 1999:82).

It is generally agreed, however, that a country’s trade policy is the key link in the transmission of price signals from the world market to the national economy. The literature suggests that the existence of uncertainty regarding the sustainability of trade liberalization might discourage investment and deter resource (re-)allocation. This is usually the case when investors are risk-averse (Arellano, 1990; Dixit and Pindyck, 1994: 372-93; Collier and Gunning, 1999: 64-111). More recently, it has been shown that risk-aversion is not the only way to generate this conclusion: an alternative is provided by the literature on irreversible investment and hysteresis, which shows that the existence of sunk costs, in combination with price uncertainty, might frustrate the use of relative prices as a guide for investment decisions. This lack of credibility regarding the durability of policy reforms on the one hand, and insofar as physical capital is partly or fully irreversible on the other, even if investors are risk-neutral, they tend to favor a “wait-and-see” attitude in the early stages of a reform program.

Given this irreversibility of physical capital, it may pay the investor to delay investments until uncertainty is reduced, even though the postponement option carries a premium. This premium, which gives the investor the right but not obligation to enter the market sometime in the future – akin to a financial call option – is either implicit in terms of loss of market share and/or forsaking other advantages of being a market pioneer, or explicit in terms of initial sunk costs to preserve the advantages it may have from early entrance. Thus, as Metcalf and Rosenthal (Metcalf and Donald, 1995: 521) state, “part of the cost of making an investment is the value of the option that is lost when the option is killed”.

That is, from the firms’ point of view, it might be optimal to delay expansion of productive capacity even if the actual price exceeds the long-run average cost—that is there is an option value in holding back investment decisions (Dixit and Pindyck , 1994: 396).The reason is that when investment decisions are irreversible and relative prices are uncertain, waiting represents an opportunity cost that should be compared with the currently available profit in order to determine the optimal timing of investment. For developing countries, Rodrik (1990:933-47) used this framework to show that private investment can fail to take place after the introduction of an
economic policy reform if the survival of the policy is uncertain or perceived to be unsustainable by private economic agents.

In essence, there are two fundamental reasons for the observed link between trade and overall economic performance. The first is that both depend on the policies and institutions in place in the transition country and its major trading partners. The second is that increased openness to the world appears to have a strong impact on rates of economic growth (Frankel and Romer, 1999:379-400). The first source of the observed correlation highlights the importance of reforming trade policy as part of a more comprehensive package of reforms aimed at achieving economic development. The second highlights the importance of reforming trade policies if the reforms are to succeed in raising living standards and alleviating poverty.

While firms obviously face many more complicated conditions and trade-offs, expectations and perceptions of policy uncertainty do lead them to exercise some real options in their decision making processes. Taking the discussion above to its logical end leads one to conclude that at the extreme, uncertainty about future policy reversals, by “crippling animal spirits” of the private investors (Rodrik, 1990:933-47), May – through the multiplier-accelerator mechanism – leave the economy trapped in “low investment equilibrium”. Recognizing this, Rodrik (1990:933-47) has concluded that from the viewpoint of investment, “liberalization may often need to take a back seat when it places the sustainability of policies... into question”.

10. Foreign Direct Investment And The World Trade Organization (WTO)

The benefits of expanded FDI flows under globalization should not be under-stated. But neither should the problems. To mention five:

10.1 Low value-added. Large amounts of foreign investment are directed towards simple assembly activity. Domestic value-added in, say, the garment sectors of Bangladesh and Honduras, or even the maquiladora sector of Mexico, is exceptionally low.

10.2 Weak linkages. Low value-added is partly a consequence of weak linkages to the local economy. For example, local inputs account for only around 2 per cent of the value of Mexican maquila exports. This is a marked contrast to the more successful firms in East Asia.

10.3 Erosion of local capacity. FDI can be associated with a decline of technological capacity. For instance, the take-over of Brazilian auto-part companies through FDI in the mid-1990s was followed by the downgrading of their research and development facilities. In some cases, this included their transfer to industrialized countries. The same process has been recorded in telecommunications.

10.4 Merger and acquisition. Greenfield investment is likely to be the most beneficial source of FDI for developing countries. Merger and acquisition activity is first and foremost about changing ownership patterns. Yet this activity has been one of the main driving forces behind FDI growth, accounting for around one half of all inflows into Latin America at the end of the 1990s and one-quarter of the global total.
10.5 Environmental damage and displacement. FDI is frequently associated with problems in both of these areas, notably in countries with weak institutional structures. The sheer economic size of the companies involved often makes effective regulation difficult, especially in the extractives sector.

It is difficult to assess the implications of current proposals at the WTO for action in these areas. However, the principles of MFN and NT could seriously constrain governments seeking to harness FDI to national development priorities, reinforcing other WTO limits on the policy space available to governments.

Consider the argument that strengthened investor protection will act as a catalyst for increased FDI. If this were true one might expect to find a positive correlation between investment flows and bilateral investment treaties (BITs). After all, BITs now cover about one half of all investment to developing countries. Yet cross-country research has consistently failed to discover significant before-and-after effects. Other factors – such as location, the wider policy framework, and investor perceptions of stability – seem to be far more important. What matters here is the predictability and transparency of host-country policy, not the scope for recourse to cumbersome WTO adjudication processes.

This relates to a wider point: namely, the dispersal effects of any WTO agreement. Both the quantity and quality of investment attracted by developing countries is a function of wider factors. These include human capital, market location, infrastructure, institutional behavior and so on.

Moreover, existing BITs and regional agreements already provide high levels of protection. Given that the protection envisaged in the WTO is unlikely to exceed that provided for under these arrangements, it is difficult to see what additional protection the EU has in mind.

The claim that a multilateral agreement will constrain the tendency towards BITs and regional agreements deserves to be taken seriously – but not too seriously. It is clearly the case that bilateral and regional agreements are being used by the US in particular to push developing countries into WTO-plus arrangements (WTO, 2003). Recent bilateral agreements between the US and Chile, Singapore and Jordan are examples. There is an equally clear danger that these arrangements will be used to ‘ratchet up’ any WTO agreement. The US Trade Representative Robert Zoellick openly cites the Singapore agreement – with its zero tariff provisions and open door for US investors – as a model for others to follow.

Yet there is no evidence that the WTO will set a ceiling on rich country demands. On the contrary, it is likely to set a floor to be negotiated in an upward direction through bilateral arrangements. US officials openly state that, whatever the outcome at the WTO, regional and bilateral priorities will remain important.

The same problem, it might be added, applies to the EU’s positive list approach. The danger here is that pressure will be brought to bear on developing countries to apply the MFN liberalization principle across the board. Several developing countries have already complained that this is happening in the service sector, where progress in Mode 4 negotiations (movement of
persons) has been linked to offers in other areas (such as the right of establishment for TNC investors).

11. The Case For BIT

Any move towards a binding multilateral investment agreement would threaten to lock developing countries into a policy framework that is bad for poverty reduction, integration into global markets, and national development. Such a move would raise further questions about the tensions between rich country trade policies on the one side, and their commitment to the Millennium Development Goals on the other. But there are two further reasons for rejecting a WTO agreement.

First, it threatens to overload an already desperately overcrowded agenda. It has the potential to become the straw that breaks the camel’s back. Negotiations on investment would divert time and energy from other areas of vital concern to developing countries, such as market access, phasing out agricultural subsidies, delivering on the Doha public health declaration and so on.

Second, an agreement that gives unprecedented rights to foreign investors will be seen by the developing world for what it is: the product of an unbalanced, undemocratic system, in which rich countries devise rules to advance their own interests.

Doubtless northern governments will reject such an assessment. Yet the same governments would doubtless fly into a frenzy of denunciation were Africa to insist on placing the crisis in global commodity markets on the Doha agenda. And unlike investment, this is self-evidently a trade issue that ought to be at the centre of any ‘development round’. The fact that it is not, while investment is, speaks volumes about the WTO’s ongoing crisis of legitimacy across much of the developing world.

12. Conclusion

Hopefully this study will provide the GOI with a good starting point for drafting a final model BIT and dedicate additional time for a more in-depth and comprehensive study and review of the GOI’s objectives and strategy for signing BITs with specific nations and emphasize the role of BITs in enhancing international trade.

The entire BITs that have been designed in Iraq were Targeting:

- Creating favorable conditions to promote further economic cooperation between both Contracting Parties specifically in fields of Mutual Investment.
- Revitalizing the economic initiatives and promoting prosperity in the territories of both Contracting Parties.
- Encouraging and providing mutual protection for investments, as such to support efforts for revitalizing the economic initiatives in this field and to work on providing free movement of capital and persons between both Contracting Parties and to remove any problems or obstacles hindering the aforementioned.
Iraq signed a trade agreement with the United States on August 11, 2008, designed among many other aims to improve trade and investment flows between the two countries. Iraq is a party to the Multi Investment Guarantee Agreement (MIGA), and currently serves as an observer in the World Trade Organization (WTO). In addition, Iraq is currently party to nine separate multiparty agreements within the Arab League, as well as 32 other bilateral agreements worldwide. Additionally, negotiations for investment agreements are underway with Egypt, France, Germany, Italy, Jordan, Lebanon, Oman, Romania, Syria, Turkey, and United Kingdom. Numbers of them are signed by the initials and send to the Iraqi Council of Ministers for approval. All of BITs played a big role in encouraging foreign investors to enter Iraqi Economy, in 2008; foreign investment in Iraq surged by nearly 1,500% year-on-year from 2007, increasing from $2.7bn in 2007 to $42.9bn in 2008.

The investment outlook in Iraq was temporarily altered by the collapse in the price of oil, which created a $9.5 billion fiscal deficit for the central government after several years of surpluses, as well as a general tightening of credit for many companies that had hoped to break ground on new projects. As a result of such difficulties raising capital, at least two previously announced mega3 real estate projects faced major delays or cancellations. The al-Rasheed Development District, a $20 billion project in east Baghdad led by Dubai-based Bonyan International Investment Group has been delayed. In addition, Damac Properties canceled its $15 billion Tarin Hills Development, which had been the largest real estate project in Iraq to date (Dunia, 2009).

This study was based on international principles to recommend a global and balanced approach that will benefit both the contracting states and their investors. The large increase in the volume of international trade and FDI over the past 20 years has increased the attention paid to the impact of international integration on productivity and welfare across plants and industries.

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