

REVISTA LATINOAMERICANA DE DERECHO COMERCIAL INTERNACIONAL

LATIN AMERICAN JOURNAL OF INTERNATIONAL TRADE LAW

V. 2, NÚMERO 1, 2014

V. 2, ISSUE 1, 2014



SECOND PART

ENGLISH

CONTENTS

VOLUME 2, ISSUE 1, 2014

II First Part. Spanish

201 Second Part. English

205 Introduction to Volume 2, 2014

SECTION ON INTERNATIONAL ECONOMIC LAW

A. GENERAL ARTICLES

Inu Barbee & Simon Lester 207 The TPP and the Future of Trade Agreements

Elisabeth Bürgi Bonanomi 227 An enabling regulatory environment for sustainable investment: the example of trade law

Luciana Dutra de Oliveira Silveira & Ricardo Inglez de Souza 245 The public interest analysis in trade remedies investigations in Brazil

Eduardo Márquez Certucha 263 Social Entrepreneurship: bringing together impact investment, trade facilitation and regulatory reform

Ricardo García de la Rosa 281 Dichotomous evolution, regionalism and multilateralism: plurilateralism as a missing link

SECTION ON INTERNATIONAL ARBITRATION

A. GENERAL ARTICLES

Carlo Scheiternig 305 Sovereign bonds as investments under the ICSID convention

Pedro Arcoverde 327 Public policy and the recognition and enforcement of foreign arbitral awards in Brazil: an analysis against the backdrop of global governance

David Khachvani 349 Exclusion of right to challenge the arbitral award

B. CASE-LAW REVIEWS

- Carlos H. Reyes Díaz 365 BG GROUP v. Argentina. Investor state arbitration. Decision of the Supreme Court of the United States of America

INTRODUCTION TO VOLUME 2, 2014

With this number, the *Latin American Journal of International Trade Law (LATAM Journal)* proudly launches its 2nd volume. After one year of great experiences and tough work to achieve first volume standards, we release this second volume with the commitment to continue creating a space where young academics can express their ideas along with the always sharp point of views from renowned academics and practitioners in arbitration and international economic law areas.

Under this commitment, we present the first number of the 2nd volume of *LATAM Journal*, in which readers will find the opening essay embodying some personal perspectives of a leading scholar. This year, Simon Lester, Trade Policy Analyst at the Cato Institute and President of WorldTradeLaw.net, co-authoring with Inu Barbee, Graduate Associate at the Center for North American Studies at the American University, honor us with a manuscript reflecting on the current TPP negotiations and the future of trade agreements in a multilateral context.

A number of stimulating articles on varied subjects follow the opening article. In the section of International Economic Law, these articles include four extraordinary scholarly works. The first one from Elisabeth Bürgi Bonanomi, Professor at the Centre for Development and Environment and the World Trade Institute of the University of Berne, presents an overview on the regulatory framework for sustainable investment elaborating on the international agricultural trade regime. The second article by Ricardo Inglez de Souza and Luciana Dutra de Oliveira Silveira, Partner and Associate, respectively, of the international trade practice at DeVivo Whitaker e Castro Advogados, discusses on the public interest analysis in trade remedies investigations in Brazil. The third article by Eduardo Márquez Certucha, Foreign Associate in the Dallas office of Haynes and Boone, LLP, analyses the way that the investment climate of a country affects investors perception and how improving trade facilitation may enhance impact investment. Finally, the fourth article by Ricardo García De la Rosa, Professor and Researcher at the Instituto Tecnológico Autónomo de México, explains the dichotomous evolution of international trade relations in its two forms: regionalism and multilateralism, including plurilateralism as the missing link.

Following to the section of International Arbitration, we have three remarkable academic papers and a review about a trendy court's case. Firstly we will find the work

from Carlo Sheitering, an Associate in Munich office of Milbank, Tweed, Hadley & McCloy LLP, who analyses the treatment that sovereign bonds may have under the ICSID and how recent case law has impacted such treatment. Secondly, Pedro Arcoverde, a Brazilian lawyer and currently assistant professor at the L'Institut d'études politiques de Paris, examines the international standards for the recognition and enforcement of foreign awards towards public policy issues, setting-out special attention to Brazilian court's decision over the last years and its learning points thereto. Thirdly, David Khachvani, Hans Wilsdorf Scholar at the Master in International Dispute Settlement of the Université de Genève and Graduate Institute of International and Development Studies, exposes a general overview of several important jurisdictions' attitudes before the agreements to waive the right to challenge an arbitral award, giving some brightfull conclusions in such regard. At last but not least, an "in-house" work from Carlos Reyes, Co-editor-in-chief and Lecturer at the School of Law of the Universidad Nacional Autónoma de México, summarizes the recent ruling of the Supreme Court of the United States of America in the case *BG Group v. Argentina*, concluding on the questions that the mentioned ruling raised in regard to some arbitration matters involve therein.

We hope that our readers enjoy this new issue as much as we have enjoy it during the edition process, but more important, that it contributes highlighting some important topics and opinions for its discussion at this or other academic spaces or *fora*. *LATAM Journal* welcomes comments on the features included in this number as well as any suggestions for improvements. Comments should be sent to <journalit@derecho.unam.mx>.

Thank you for your interest in and support to *LATAM Journal*.

Ciudad Universitaria, Mexico City, May 2014

Carlos H. Reyes Díaz
Reynaldo Uriaga Escobar
Daniela Gómez-Altamirano
Raúl Aldana Argüelles

The Editors

OPENING ARTICLE

THE TPP AND THE FUTURE OF TRADE AGREEMENTS*

Inu Barbee** & Simon Lester***

* Thanks to Meredith Kolsky Lewis and Bryan Mercurio for comments. All errors remain are own.

** Graduate Associate, Center for North American Studies, American University.

*** Trade Policy Analyst, Cato Institute; President, WorldTradeLaw.net.

In recent years, the trade regime has been undergoing an existential crisis. Multilateral trade talks at the WTO have stalled, leading to much hand-wringing from the trade establishment. Although the exact starting point for the difficulties is hard to pinpoint, arguably it has been more than a decade since there was even a real hope for progress. The celebration of very minor developments at last year's Bali ministerial¹ serve only to emphasize how low the expectations are.

During this period, bilateral trade negotiations have fared better, with completed FTAs giving trade negotiators a feeling of success. However, there is a general recognition that the bilateral approach is inferior, and potentially has negative effects for the multilateral system.²

Recently, we have moved towards 'Mega-Regional' trade talks, and some see this as the way forward. In particular, the Trans Pacific Partnership (TPP), involving 12 nations in the Asia-Pacific region, and the Transatlantic Trade and Investment Partnership (TTIP), involving the United States and the European Union, have been offered as the solution to problems with the trade agenda. Proponents sell these negotiations as 'high standard' talks, or even the 'gold standard' of trade negotiations; the TPP is even said to be a 'docking station' that will eventually be open to all countries.³

¹ Uri Dadush, "How can world trade talks stay relevant?" World Economic Forum Blog (January 14, 2014) <<http://forumblog.org/2014/01/how-can-the-world-trade-organization-stay-relevant/>>.

² Jagdish Bhagwati offers the strongest version of this view. See, e.g., *Termites in the Trading System*, Oxford University Press (2008).

³ C. Fred Bergsten and Jeffrey J. Schott, "Submission to the USTR in Support of a Trans-Pacific Partnership Agreement," Peterson Institute for International Economics (January 25, 2010) <<http://www.iie.com/publications/papers/paper.cfm?ResearchID=1482>>.

In this paper, we focus our attention on the TPP and express doubts about its use as a model for future trade agreements. In terms of economic considerations, the U.S. ‘strategic agenda,’ and issues of global governance, we argue that the TPP is flawed. In this regard, we offer a number of specific concerns.

First, the economic arguments for the TPP rest on a number of assumptions that may not come to fruition. For instance, the gains from the TPP will be modest, and may not reach predicted levels, if the agreement does not expand beyond its current 12-country membership, to include China and others, in the form of a Free Trade Area of the Asia Pacific (FTAAP). The likelihood of an expansion to FTAAP remains slim. The exclusion of China from the current negotiating process may also become a major stumbling block to broader Asia Pacific liberalization, and the potential for the creation of competing trade blocs, embodied in the Regional Comprehensive Economic Partnership (RCEP), or separate Asian track negotiations, is a real possibility.

Second, the TPP is not a balanced partnership. One country, the United States, is using the talks to push its domestic policies and *values* on others,⁴ and to promote strategic alliances and foreign policy considerations more generally.⁵ This is the wrong approach to trade governance.

Lastly, the TPP’s expansive approach to global governance generates a great deal of opposition, and makes the simple and clear benefits of trade liberalization more difficult to achieve. The wide range of issues now included in trade agreements, including the environment, labor, and intellectual property, leads to a lack of focus on a core mission. Notably, it is on these issues where current disagreements among TPP negotiating parties are particularly strong.⁶

Given the lack of certainty at this stage over the ultimate outcome of the TPP, it is worthwhile to step back and examine the foundation of the agreement. To that end, we first set out a brief history of various models of trade agreements, explaining how it is we got to the TPP and the ‘Mega-Regionals.’ Next, we take a closer look at the TPP and evaluate it as a model for future trade agreements, in terms of the economic, strategic, and governance issues noted above. Finally, we conclude by asking whether the current approach is the best path for the global trading system.

⁴ Michael Froman, “A Values-Driven Trade Policy,” speech delivered at the Center for American Progress (February 18, 2014) <<http://www.americanprogress.org/wp-content/uploads/2014/02/Center-for-American-Progress-Remarks-Ambassador-Froman-2-18-14.pdf>>.

⁵ The TPP is part of a broader “pivot to Asia” in US foreign policy.

⁶ See, e.g., Henry Farrell, “The United States is isolated in the Trans-Pacific Partnership negotiations,” *The Monkey Cage*, November 18, 2013. <<http://www.washingtonpost.com/blogs/monkey-cage/wp/2013/11/18/the-united-states-is-isolated-in-the-trans-pacific-partnership-negotiations/>>.

I. MODELS OF TRADE AGREEMENTS

Over the years, trade institutions and rules have shifted direction many times. Bilateral trade agreements dominated in the late 19th century, but by the 1950s multilateralism had taken hold. Regionalism arose as a force around the same time. Today, bilateral agreements have reemerged, sharing space with multilateral and regional. This section briefly explores the existing models of trade agreements.

A. MULTILATERAL

The origins of the multilateral trading system lie with the League of Nations discussions of international economic policies in the 1920s and early 1930s. During this period, the major trading nations held a number of conferences on various issues related to trade barriers, developing ideas and concepts for how to promote economic integration. These early talks did not result in a multilateral trade treaty, but rather a number of bilateral trade agreements between the countries involved. After World War II, however, the principles in these agreements were multilateralized in the General Agreement on Tariffs and Trade (GATT).

The GATT had only 23 countries as original signatories. Over the years, however, membership expanded considerably. At the time the GATT became the WTO, in 1995, there were 128 members. Today, the WTO has 159 countries as members, including all the major economic powers. It also has a widely respected dispute settlement system, one of the most advanced legal systems that exist in the international arena.

For the most part, GATT/WTO integration has been of the ‘shallow’ kind.⁷ A core principle is non-discrimination, which reflects the idea of negative integration, in the sense that there is a prohibition on taking measures that discriminate against or among trading partners. An approach to economic integration that relies on non-discrimination is more limited than broader conceptions, such as a ‘single market’ for goods and services.

There are some aspects of WTO rules that go further than non-discrimination. For example, rules in the TBT Agreement and SPS Agreement that promote science-based measures, international standards, and measures that effectively contribute to their stated goals, all have broader implications. In addition, the WTO does make some effort to promote positive actions by governments, such as setting minimum standards for intellectual property protection. However, this aspect of the WTO regime has remained limited and bounded.

⁷ Robert Z. Lawrence, “Regionalism, Multilateralism, and Deeper Integration (Integrating National Economies),” Brookings Institute (1996).

The crisis within the WTO does not arise from the rules as they are now, but rather from the inability to negotiate additional trade liberalization. After the success of the Uruguay Round, the WTO has found itself in a long period of stagnation. While the noisy and creative protesters from the WTO ministerial in Seattle made the most headlines, the more important hurdle may be the differing views of certain developing countries and the traditional industrial powers. Everyone thinks they have liberalized enough, and now it is the others' turn. India, Brazil and China maintain that their developing country status means they should be given more flexibility in future liberalization, and that the rich world maintains excessive protectionism of its own. On the other side, the United States, the European Union, and Japan feel that the recent economic success of the larger developing economies means that it is time for them to step up their role as trade liberalizers.

The result has been deadlock. There is plenty of talk about trade issues at the WTO, and work is being done behind the scenes, but there has not been much success in terms of completed negotiations. Despite great effort from many people who would like to see the system succeed, trade liberalization in goods and services has barely occurred at the multilateral level since 1995. Whether the primary blame lies with the institution itself, its leadership, or the governments who make up this "member-driven" system is not clear. But the lack of results speaks for itself, and has caused people to turn away from the WTO for trade negotiations.

B. REGIONAL & BILATERAL TRADE AGREEMENTS

The multilateral system was never designed to be the exclusive form of trade liberalization. WTO rules anticipate that countries will negotiate both 'free trade areas' and 'customs unions'.⁸ Such agreements have been completed on both a regional and bilateral basis. In recent years, both of these approaches have emerged as a way to forge greater economic gains from close trading partners, and also to maintain momentum for trade liberalization in the absence of multilateral initiatives. According to the WTO, there have been 583 notifications of such trade agreements as of January 2014, 337 of which are in force.⁹ With these numbers, the implications of these agreements for the global trading system cannot, therefore, be understated.

The European Union is the most highly developed regional trading bloc, with 28 members. Ushered into existence through the Treaty of Rome in 1957, the original six members, France, Germany, Italy, Belgium, Luxembourg, and the Netherlands, sought to rebuild their war-torn economies and create a lasting peace on the continent.

⁸ GATT Article XXIV provides for these agreements in the context of trade in goods; GATS Article V refers more generally to "Economic Integration" agreements.

⁹ World Trade Organization, "Regional Trade Agreements," <http://www.wto.org/english/tratop_e/region_e/region_e.htm>.

Economic cooperation was the means to this end. As the member states have deepened their level of economic integration over time, the trading area has expanded from a FTA and customs union, to a single-market, limited membership monetary union, and is currently negotiating a limited membership fiscal union. This transition from one stage of integration to the next has not always been seamless. In fact, it took the EU well over 10 years to complete the customs union, even though it had declared *désarmement douanier* on July 1, 1968. Slow economic growth in the 1970s largely stalled the integration project, and it was not until the Commission White Paper on the Single Market in 1985, bringing together political and business elites, that the European integration project was revitalized. Its second attempt to free itself from economic decline was largely successful, and in turn spurred on a desire for regional integration elsewhere.

As a result of its complex structure of multi-level governance, the EU must often be treated as *sui generis* simply because the impetus for its creation and level of integration is so unique in the world. However, it is still highly illustrative of how complex initiatives can be tackled at the regional level, and a strong example of the many economic benefits of collaboration with states in close proximity.

A number of other regional agreements were also developed in response to economic stagnation in the 1970s, such as the Southern Common Market (MERCOSUR), the Association of Southeast Asian Nations (ASEAN), the South African Development Community (SADC), and the Economic Community of West African States (ECOWAS). These initiatives did not go nearly as far as the EU, but have served to create more regional economic cooperation and market liberalization.

The other major regional trade agreement of this era was the North American Free Trade Agreement (NAFTA), between the United States, Canada and Mexico, which was an initiative put forward by Mexico. Mexico was motivated by a desire to liberalize its economy and move away from the failed policies of import-substitution industrialization, and remedy its debt crisis. The U.S. was irritated by a lack of progress in the Uruguay Round, particularly by the EU's reluctance to eliminate agricultural market protections. Canada did not want Mexico to have a more favorable trade deal with the U.S., and took the NAFTA as an opportunity to update the Canada-U.S. Free Trade Agreement (CUSFTA), signed in 1988. In large part, NAFTA was a response to a lack of progress on trade liberalization at the multilateral level.

NAFTA is important for a number of reasons. First, it went beyond basic FTAs of the time and included a whole host of provisions on services, intellectual property, labor and the environment, as well as the first investor-state dispute mechanism in a trade agreement, the infamous Chapter 11. In addition, NAFTA was unique in that it brought together two highly developed countries with a developing economy. As a result, NAFTA was not seen as a standard FTA, and by some it was also viewed as a new model for development.¹⁰

¹⁰ See Richard S. Belous and Jonathan Lemco, *NAFTA as a Model of Development: The Benefits and Costs of Merging High and Low Wage Areas*, National Planning Association; Institute of the Americas (2000).

Second, it was very successful at removing trade barriers and improving economic exchange between the three countries. Currently, the U.S. trading relationship with Canada and Mexico amounts to over \$1 trillion a year – that’s \$3.4 billion a day, or \$2.4 million every minute.¹¹ This economic stimulus was considered a precursor to wider economic liberalization in the Americas, through the completion of the Free Trade Area of the Americas (FTAA). However, the misguided characterization of NAFTA as a big business initiative that would reduce standards to the lowest common denominator, and the demonization of the agreement for political gain, made future expansion of the agreement a political challenge.¹² This is one of the reasons the completion of the FTAA was next to impossible.¹³ Opponents also drew from the broader anti-globalization movement, which gained substantial momentum after the 1999 ‘Battle in Seattle’ protests over the WTO.

With the failure of the FTAA and growing opposition to trade from organized interests, the U.S. began negotiating more bilateral FTAs with smaller economies.¹⁴ This had been done a few times before, but now it was the focus of U.S. policy. Opposition to NAFTA had the residual effect of making the U.S. more cautious in proposing ‘ambitious’ trade agreements, especially where U.S. laws would have to be changed. The EU, suffering from enlargement fatigue, has also begun to take this approach as well. The past decade or so has seen an explosion of FTA negotiations all around the world. By contrast, regional integration has stalled. C. Fred Bergsten referred to this phenomenon ‘competitive liberalization,’ which he states is a response to the “increase of global interdependence [that] has forced all countries...to liberalize their trade (and usually investment) regimes.”¹⁵ Without this aggressive competition, says Bergsten, countries risk missing out on integration in global supply chains, and reaping the benefits associated with greater FDI.¹⁶

Despite its benefits, the global proliferation of FTAs has led to an ever increasing ‘spaghetti bowl’ effect from the various rules of origins provisions created by individual agreements, which results in trade discrimination and a complex system of preferences that is difficult to untangle. In addition, though the number of FTAs currently in effect

¹¹ Christopher Wilson and David Biette, eds., “Is Geography Destiny: A Primer on North American Relations,” Woodrow Wilson International Center for Scholars (February 2014) <http://www.wilsoncenter.org/sites/default/files/primer_north_american_relations.pdf>.

¹² See Generally, Robert Pastor, “A Piñata for Pandering Pundits and Politicians,” in *The North American Idea* (2011).

¹³ Jaime Zabłudovsky and Sergio Gómez Lora, “Beyond the FTAA: Perspectives for Hemispheric Integration,” in *Requiem or Revival?: The Promise of North American Integration I*, Eds. Isabel Studer and Carol Wise (Washington, DC: Brookings Institution Press, 2007): 101-107.

¹⁴ The only exception being the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) in 2004, which is plurilateral, albeit on a small scale.

¹⁵ C. Fred Bergsten, “Competitive Liberalization and Global Free Trade: A Vision for the Early 21st Century,” Peterson Institute for International Economics (Working Paper 96-15) <<http://www.iie.com/publications/wp/wp.cfm?ResearchID=171>>.

¹⁶ Ibid.

is vast, we have not been able to achieve the level of free trade globally that would yield the greatest benefits in overall welfare. These roadblocks have spurred a new approach to trade—not bilateral, and not quite multilateral, but instead, mega-regional.

C. MEGA-REGIONALS

The challenges presented by these overlapping (and at times conflicting) rules, in addition to the stalled Doha Round agenda, are a major reason for the more recent attempts at so-called Mega-Regionals. The first mega-regional was the TPP, which arose out of an effort by the Bush administration to expand the P-4 talks beyond four small Pacific countries, Brunei, Chile, New Zealand and Singapore. After some initial reluctance to address trade issues, the Obama administration began looking for trade initiatives to pursue, and decided to continue this effort, announcing participation in the TPP in 2009.¹⁷ The current talks include 12 countries from the Pacific region, with others thinking of joining.

The TTIP came about more recently, mostly at the urging of the Europeans, who were looking for new sources of economic growth. President Obama signaled his support for the TTIP in his 2013 State of the Union speech, and negotiations began in July of that year. In these talks, the emphasis has been on the potential gains from addressing so-called ‘regulatory trade barriers,’ although the precise scope of this issue is unclear.

In terms of substance, Mega-Regionals are expanding the scope of the traditional trade agenda. They are often said to go beyond negotiations on just tariffs and quotas, to a discussion of ‘beyond the border’ issues that have a significant impact on trade. In reality, such an expansion began decades ago. Nevertheless, it is true that more issues have been added. The list includes domestic regulations and the regulatory process, intellectual property, the environment, labor, state-owned enterprises (SOEs), and financial services, among others. For example, on the issue of regulatory coherence, there has been a new push to address issues in the domestic rulemaking process itself, such as notice and comment on proposed regulations, or developing an organizational structure of regulatory oversight.

In part, this bundling of issues that may have an impact on trade is employed as a strategy to have these topics addressed at the international level. Trade agreements tend to have strong enforcement mechanisms, so if environmental concerns, for instance, cannot be fully addressed at the multilateral level on their own, advocacy groups will try to have them included in trade agreements to ensure some form of commitment. Though this may provide a result of some sort, it also serves to complicate trade negotiations. There is a real danger here that disagreements over these trade-”plus” issues could lead to an

¹⁷ “Trans-Pacific Partnership Announcement,” Office of the United States Trade Representative (December 14, 2009) <<http://www.ustr.gov/about-us/press-office/press-releases/2009/december/trans-pacific-partnership-announcement>>.

impasse over negotiations, and also serve to weaken total gains by incentivizing countries to concede less in traditional trade areas.

In the end, the implications of the mega-regional approach, if successful, are not clear. Would success result in a world of competing mega-regions? Would they converge into a global agreement, or serve as the basis for multilateral talks? The effort being expended for these talks is enormous, but will they produce the desired benefits and produce a new 'high standard' model?¹⁸ The outcome remains to be seen.

II. CONCERNS WITH THE TPP MODEL

Though the TPP has been heralded by its proponents as the new '21st Century,' 'gold' or even 'platinum' standard agreement, it is worthwhile to step back and evaluate claims of its value to the global trading system. Many economic projections for the TPP, as will be discussed in greater detail below, rely on assumptions that may not play out as predicted. Estimates are, in fact, just that—an educated guess, but by no means a sure fact. In addition, the gains from the agreement may not be so clear cut, and will undoubtedly rely on future cooperation from China, which may be difficult to attain. In addition, there is a sense that the U.S. is pursuing a particular strategic agenda through the TPP, and is not solely concerned with trade liberalization per se. This focus will surely have an impact on the content of the agreement and its eventual outcome. And finally, there is the problem of using trade agreements as a general tool of global governance. This approach has been pushed quite far; it is not clear how much further it can go.

A. ECONOMICS

Supporters of the TPP are quick to point out its formidable economic benefits. For instance, the current twelve TPP countries make up 40% of world GDP, and proponents estimate that by 2025 it will lead to \$295 billion in annual global benefits.¹⁹ However, these gains need to be placed in context. Alan Deardorff has noted that a simple analysis of trade creation and trade diversion does not apply so neatly to the TPP because many TPP countries already have FTAs with other TPP member countries, and many Asian countries currently outside of the negotiations also have FTAs with a number of TPP

¹⁸ For a discussion on the rhetoric of 21st century trade agreements, and the potential for their successful adoption, see, C.L. Lim, Deborah Kay Elms, and Patrick Low, Eds., *The Trans-Pacific Partnership: A Quest for a Twenty-first-Century Trade Agreement* (Cambridge University Press, 2012).

¹⁹ Peter A. Petri and Michael J. Plummer, "The Trans-Pacific Partnership and Asia-Pacific Integration: Policy Implications," Peterson Institute for International Economics, Policy Brief (June 2012), 5. Available from: <<http://www.iie.com/publications/pb/pb12-16.pdf>>.

countries.²⁰ So what does this mean? Deardorff concludes that an agreement with as large a coverage as the TPP would normally be predicted to yield significant gains, but because of the preexisting agreements, the benefits will ultimately be less impressive.²¹ Couple this with the fact that the varying rules of origin requirements of each of the preexisting FTAs will still produce a ‘noodle bowl’ effect, albeit slightly smaller, and what you are left with is an agreement with some potential, but no guarantees of great success.

A frequently cited study on the TPP by Petri, Plummer and Zhai provides a quantitative assessment of the agreement.²² However, the positive results they put forward are estimates based on a number of underlying assumptions that should be taken with a dash of skepticism. The vast economic gains they project for the agreement will not be felt by the conclusion of the TPP itself, but rather if, and only if, a larger Asia-Pacific agreement is completed, such as the FTAAP. In fact, Petri, Plummer and Zhai, admit this is where the majority of welfare gains lie—not in the TPP, but in the FTAAP, especially so for the United States. By 2020, they conclude, the U.S. will see a predicted \$10 billion in welfare gains from the conclusion of the TPP, with a slight increase to approximately \$12-13 billion by 2025.²³ In comparison, the FTAAP would result in \$71 billion in welfare gains for the U.S. by 2025.²⁴

The reality is that it is premature to be speaking of the potential gains from the FTAAP, when we have not yet come close to completing the TPP. In fact, it seems we have been in the “endgame” stage of negotiations for quite some time.²⁵ Without fast-track legislation, and in the absence of a clear commitment on the part of the Obama administration to see this deal through,²⁶ it is not entirely certain that the TPP will be completed anytime soon.

Adding on a layer of complexity is Japan, which is the United States’ third largest trading partner in the TPP (second to Canada and Mexico). Japan’s entry into the TPP negotiations has had an impact on the dynamics of the talks because it is the TPP country with which the U.S. would benefit most from an economic opening.²⁷ At the same time,

²⁰ Alan V. Deardorff, “Trade Implications of the Trans-Pacific Partnership for ASEAN and Other Asian Countries,” Research Seminar in International Economics, The University of Michigan, Discussion Paper No. 638 (July 24, 2013), 10.

²¹ *Ibid.*

²² See Peter A. Petri, Michael G. Plummer, and Fan Zhai, “The Trans-Pacific Partnership and Asia-Pacific Integration: A Quantitative Assessment,” East-West Center Working Papers, No.119 (October 24, 2011).

²³ Petri, Plummer and Zhai, 44.

²⁴ An updated study also cites a comparably large figure, stating that the U.S. would see \$78 billion in annual income gains from the TPP. Peter A. Petri and Michael G. Plummer, “The Trans-Pacific Partnership and Asia Pacific Integration: Policy Implications,” Peterson Institute for International Economics, Policy Brief No. PB12-16 (June 2012).

²⁵ “Froman Says WTO Will Remain Valuable Dispute Forum If Bali Deal Fails,” *Inside U.S. Trade* (November 14, 2013).

²⁶ Daniel R. Pearson, “The Obama Administration’s Trade Agenda is Crumbling,” Cato Institute, Free Trade Bulletin No. 58 (March 19, 2014) <<http://object.cato.org/sites/cato.org/files/pubs/pdf/ftb58.pdf>>.

²⁷ Bryan Mercurio, “The Trans-Pacific Partnership: Potential Failure to Game Changer,” in *Pathways to the Same Destination? Free Trade Negotiations in the Asia-Pacific*, Australian Institute of International Affairs Policy Commentary,

projections of the benefits need to be approached with caution. Estimates of the benefits from the TPP tend to assume that Japan will be willing to negotiate and relax restrictions on its so-called 'sacred cows' (rice, wheat, beef and poultry, dairy products and sugar). However, if Japan negotiates exceptions to these sensitive sectors, the benefits of the TPP will be diminished.²⁸ As a result, it is absolutely imperative that if the TPP is to be successful, Japan must be willing to open up previously protected sectors; whether or not the U.S. is willing to sweeten the pot for Japan will likely play a large role in the eventual outcome.

Currently, U.S. business groups have been arguing that Japan's most recent tariff proposal is not enough, and it is unclear whether Japan will fully commit to the type of market opening that will allow for real competition.²⁹ U.S. Trade Representative Mike Froman, at a Hearing at the House Ways & Means Committee on April 3, 2014, reiterated that Japan is providing the largest obstacle to completion of the TPP, though its participation would be of greatest overall benefit. Rep. Dave Camp suggested that if Japan continued to be unwilling to negotiate on key areas such as agriculture or autos, its membership in the TPP should be put on hold as the negotiations with the other members move forward.³⁰ It is not hard to see why this path would not be the optimal choice for the U.S., since Japan is the largest economy in the TPP that the U.S. does not already have a FTA with.

In order for the FTAAP to ever become a reality, the parallel 'Asian-track' also must progress on time, which will require an FTA between China, Japan and Korea (not likely to be easy), and eventually grow to include the 10 members of ASEAN, or RCEP, to make the East Asia Free Trade Area (EAFTA). Even if this can ever be completed, there will be the additional problem of varying levels of commitments between the Asian track countries and members of the TPP. The Asian track is likely to include weaker disciplines than the TPP, though its overall welfare benefits will be much greater.³¹ This will certainly pose its own set of problems in the advent of an expansion to FTAAP, as the U.S. is pushing for such a 'high-standard' agreement. It is probable that this will isolate or disincentivize a number of countries, mainly China, from pursuing convergence with the TPP. As the U.S. pushes for more stringent standards, moving from "gold" to "platinum," the possibility of a future FTAAP may be further threatened. In fact, it has already been observed that the U.S. and Japan in particular are quite isolated in the TPP with regard to their negotiating

No. 14 (June 2013): 21-30.

²⁸ Petri, Plummer and Zhai, 50.

²⁹ "U.S. biz lobby says Japan's TPP proposal not enough," *Japan Times* (March 12, 2014) <<http://www.japantimes.co.jp/news/2014/03/12/business/u-s-biz-lobby-says-japans-tpp-proposal-not-enough/#.UyB0IIUzm-V>>.

³⁰ Len Bracken, "Froman Presses Japanese on Autos in TPP; Rep. Camp Sees Moving Ahead Without Japan," *Bloomberg BNA* (April 3, 2014).

³¹ Petri, Plummer and Zhai, 21.

positions, particularly on intellectual property.³² If equally strict provisions are also pushed for in the environment, labor, and regulatory coherence chapters, the appeal of the TPP model may fizzle over time.

The following section addresses two related issues—the overall strategic agenda of the U.S. to include more broad-ranging and stringent disciplines, and also the exclusion of China from the TPP, which may prove less innocuous than many commentators have suggested. In fact, if the TPP is concluded without China, it is not entirely clear that the evolution of Asia-Pacific economic integration would naturally progress to the FTAAP, and in fact, this pathway may be obstructed over the competition between two varying models of integration in the first place.

B. THE STRATEGIC AGENDA OF U.S. TRADE POLICY

The second critique of the TPP is that it is not a well-balanced agreement, featuring one dominant economy (the United States) pushing its ‘values’ on others.³³ In addition, there is a strong potential for the U.S., as the driver of these talks, to set the agenda, and to shape the content and trajectory of Asia-Pacific integration.³⁴ Three issues illustrate this well: the U.S. approach to regulatory trade barriers, its approach to intellectual property protection, as well as the exclusion of China from the TPP.

1. Regulatory Trade Barriers

As noted earlier, tariff levels have decreased over time and become less of the focus of international trade discussions. The new focus has been on so-called ‘beyond the border’ measures such as regulatory trade barriers. Though these types of barriers can be categorized in a number of ways, there are two basic categories that recent trade talks have sought to deal with: regulatory cooperation and regulatory reform.³⁵ Regulatory cooperation seeks to address divergences in regulatory outcomes through the use of mutual recognition agreements, recognizing equivalent standards, or harmonization. These

³² Henry Farrell, “The United States is isolated in the Trans-Pacific Partnership Negotiations,” *The Washington Post* (November 18, 2013) <<http://www.washingtonpost.com/blogs/monkey-cage/wp/2013/11/18/the-united-states-is-isolated-in-the-trans-pacific-partnership-negotiations/>>.

³³ Michael Froman, “A Values-Driven Trade Policy,” speech delivered at the Center for American Progress (February 18, 2014) <<http://www.americanprogress.org/wp-content/uploads/2014/02/Center-for-American-Progress-Remarks-Ambassador-Froman-2-18-14.pdf>>.

³⁴ Meredith Kolsky Lewis, *The Trans-Pacific Partnership: New Paradigm or Wolf in Sheep’s Clothing?*, 34 B.C. Int’l & Comp. L. Rev. 27 (2011): 39, <<http://lawdigitalcommons.bc.edu/iclr/vol34/iss1/3>>.

³⁵ For a more in depth discussion, see Simon Lester and Inu Barbee, “The Challenge of Cooperation: Regulatory Trade Barriers in the Transatlantic Trade and Investment Partnership,” *Journal of International Economic Law*, 2013 16: 847-867.

efforts can help reduce the costs of testing and certification, and help bring products to market in a more efficient manner. Regulatory reform, however, deals with changes to the regulatory process itself.

Both the TTIP and the TPP appear to be tackling both at the same time, though in the TTIP there has been ample resistance from the Europeans to addressing issues of regulatory reform.³⁶ As for the TPP, a leaked version of the chapter on this issue from March 2010 provides insight into the specific provisions currently being discussed.³⁷ Though this is an early draft, and much has likely changed since then, it is still useful in understanding the thinking of the negotiators on the issue.

The provisions in the leaked text appear to consider both regulatory reform and cooperation, which it refers to together as ‘regulatory coherence’—semantics aside, these are essentially the same. Much of the focus, however, is on the reform of domestic regulatory processes, through making legal or administrative documents publicly available; the authority to review regulatory measures to ensure they meet good regulatory practice requirements; transparency; strengthening coordination among government ministries and departments to avoid duplication and inconsistencies; the ability for systemic regulatory reform; and a periodic report on activities. To take one example of how this will be addressed in the TPP, one provision from the leaked draft encourages the coordination of regulatory efforts through the creation of a central regulatory oversight authority, similar to the role of OIRA in the United States. As things currently stand, most countries have numerous regulatory bodies developing regulations on a wide range of policy issues, and changing their domestic regulatory structure may be challenging, particularly given the fact that most TPP members are developing countries.

Aside from what the substance of these texts will be, it is also important to ask whether initiatives to address domestic reform through trade agreements are a good idea. As a general matter, reform of the domestic regulatory process can be of great value. The United States has been proactive in this area for decades, trying to make domestic regulations more sensible. Arguably, we are better off than we would have been without such efforts. But there are risks in this approach. One risk is that we apply our model to places that are not ready for it, which is a particular problem that could arise with the TPP countries. Developing the tools to implement sophisticated programs like those in place in the U.S. takes time.

In addition, this approach assumes that there is only one model for better regulation. But one size does not necessarily fit all. It would not be surprising if the model we have tinkered with over a period of four decades to fit our specific traditions and history cannot

³⁶ See “De Gucht Proposal For TTIP Regulatory Effort Contrasts With Froman’s,” *Inside U.S. Trade* (October 10, 2013), “CBI Exec Says U.S. Demand For EU Regulatory System Overhaul Is Unacceptable,” *Inside U.S. Trade* (March 12, 2014) and “European Business Down On U.S. Demand To Alter EU Legislative Process,” *Inside U.S. Trade* (March 10, 2014).

³⁷ Trans-Pacific Partnership, Regulatory Coherence (March 4, 2010) <http://insidetrade.com/iwppfile.html?file=oct2011%2Fwto2011_3025d.pdf>.

simply be imposed on, say, Viet Nam, without any adjustment. Viet Nam may be better off taking the time to develop its own approach. It is also possible that we could learn a few things about regulation from other countries, and the issue should be less of a one way street.³⁸ International discussion of how different countries regulate is probably a useful exercise. But a unilateral push to have everyone else adopt *our* model through an international legal instrument may not be appropriate.

2. Intellectual Property

Intellectual property protection has been a part of the trade regime for decades now, both through international agreements like the TRIPs Agreement, and through unilateral pressure by the United States (such as through the special 301 process, and GSP conditionality). In the TPP, the United States is taking these issues a step further, pushing its trading partners to adopt stronger protections in a number of areas. It is beyond the scope of this article to go into all the details, and we focus instead on one particular issue: the length of the copyright term.

The Electronic Frontier Foundation, an organization that is critical of excessive protections, explains how the TPP would affect copyright terms:

New Zealand, a party to the TPP negotiations, currently has a copyright term of the author's life and an additional 50 years for literary works. Another TPP member, Malaysia, has a copyright term of life plus 50 years for 'literary, musical or artistic work.' Canada, which is just entering negotiations, has an even shorter term of just 50 years for fixed sound recordings. Pursuant to the current TPP terms, all of these countries would be required to extend their terms and grant companies lengthy exclusive rights to works for no empirical reason.³⁹

Intellectual-property protection is an important policy area and its scope needs to be examined in a robust, public debate. The earliest time periods for copyright⁴⁰—twenty-

³⁸ While it may be best for domestic regulatory *reform* to remain primarily at the domestic level, international regulatory *cooperation* -- through information sharing, mutual recognition when necessary, and adoption of common standards where deemed appropriate -- can be very beneficial, and has fewer political sensitivities. International regulatory cooperation proposals seek to remedy inefficiencies, and to the extent that we can limit the impact on policy autonomy by focusing only on certain kinds of issues, such as arbitrary differences and minor policy disagreements, these should be pursued. Reducing barriers to trade is an important policy outcome, and if regulatory cooperation assists in that regard, then it is a worthy objective.

³⁹ Carolina Rossini and Yana Welinder, "All Nations Lose with TPP's Expansion of Copyright Terms," *Electronic Frontier Foundation* (August 8, 2012) <<https://www.eff.org/deeplinks/2012/08/all-nations-lose-tpps-expansion-copyright-terms>>.

⁴⁰ It is worth noting that in the United States, the copyright term has evolved over time. Terms for individual authors went from fourteen years (with the possibility of a fourteen-year renewal) as set by the first Congress, to twenty-eight years (with a twenty-eight-year renewal) in 1909, to life of the author plus fifty years in 1976, to life of

eight years total or fifty-six years total, taking into account renewal—seem reasonable. Even life of the author may be appropriate. But the continued extensions are pushing the bounds of rationality.

The reality is, that when the United States pushes for these longer terms, it is doing so not to support free trade, but in order to give its companies an edge. It feels more like economic nationalism than free trade.⁴¹ In a sense, the longer periods in U.S. law are a hidden subsidy to U.S. producers. By including these demands in the TPP, the U.S. position seems less about a good faith effort to reign in economic nationalism through an international agreement, and more about pushing the interests of a few U.S. corporations at the expense of everyone else. It is worth noting that, as things stand, the U.S. is isolated on this issue in the TPP talks.⁴²

3. China

The most obvious exclusion from the Asia-Pacific trade talks is, perhaps ironically, the largest Asian economy, China. This poses two problems: first, in leaving out the largest economy, the potential for the greatest market opening and gains from trade are limited; and second, it raises the question as to whether the U.S. is simply pursuing strategic alliances, and purposely keeping China on the sidelines for, in part, broader foreign-policy reasons.

To some extent, the agreement begins to look a lot less about free trade than it does about the U.S. strategically positioning itself in the Asia Pacific to compete with China and potentially complicate China's relationship with its neighbors through new rules of origin provisions that will undoubtedly discriminate against Chinese goods. This can be seen as a way to attempt to pressure China to adopt U.S. standards, by first compelling China's geographic neighbors to bend to U.S. demands on controversial subjects such as intellectual property, regulatory reform, and investor-state dispute settlement. In this sense, the TPP becomes a template for trade agreements that the U.S. can use to strategically push its vision of what international trade regulation should look like.

Some have argued that the TPP "aims to eventually develop an Asia-Pacific wide platform of economic integration, not to draw lines encircling China."⁴³ But even if the ultimate aim is for China to be included sometime down the road, via the FTAAP or

the author plus seventy years today. Based on the history of copyright, even the shorter terms used by our trading partners today seem a bit excessive.

⁴¹ For more on this, see Simon Lester, "Is the TPP about Free Trade or Economic Nationalism?" (December 26, 2013) <<http://www.cato.org/blog/confused-about-tpp-dont-worry-so-everyone-else>>.

⁴² Henry Farrell, "The United States is isolated in the Trans-Pacific Partnership Negotiations," *The Washington Post* (November 18, 2013) <<http://www.washingtonpost.com/blogs/monkey-cage/wp/2013/11/18/the-united-states-is-isolated-in-the-trans-pacific-partnership-negotiations/>>.

⁴³ Mireya Solis, "The Containment Fallacy: China and the TPP," Brookings Institution (May 24, 2013) <<http://www.brookings.edu/blogs/up-front/posts/2013/05/24-china-transpacific-partnership-solis>>.

otherwise, that does not solve the immediate problems the TPP may pose in terms of rules of origin requirements. Products are no longer made in just one country and sold to another, but rather are put together in various stages with inputs from numerous places, making up a value-chain. China, often as ‘final assembler,’ plays a key role in East Asian production networks.⁴⁴ If China is the last stop before a good reaches its final export destination, for instance, the U.S., that product, even if it has a significant amount of content from TPP partners, will not be given TPP tariff treatment. Since China is a net exporter to the U.S., it is not hard to see why this might pose a unique set of challenges, and also limit the potential gains from the TPP. It could, for instance, lead to divestment in China, and a shift in East Asian supply chains, perhaps leading to final assembly in Vietnam or Malaysia.⁴⁵ This would serve to isolate China or minimize its role in these supply chains.

China recognizes this possibility. In fact, it is worth noting that China showed a renewed interest in negotiations with Japan and Korea, in addition to the RCEP, once Japan announced it was to join the TPP.⁴⁶ RCEP includes all 10 members of the ASEAN and the six FTA partners – China, Japan, South Korea, India, New Zealand and Australia, accounting for 40% of world trade. RCEP would appeal to China as the preferred path in the immediate future for a few reasons. First, it could serve to further solidify and strengthen regional supply chains among its members,⁴⁷ alleviating a major concern of the TPP for China, which is the potential for a disruption in East Asian supply chains, or trade diversion. Second, the RCEP, in excluding the U.S., allows for a negotiation that will be more sensitive to these countries’ concerns. In addition, without the U.S. these countries may be able to pursue ‘soft regionalism,’ which is generally the preferred path for integration in Asia.⁴⁸

Chinese officials have recently noted that they have “an open attitude” to the TPP,⁴⁹ but it is important not to make too much of such statements. Strategically speaking, it makes sense for China to make such a statement, as it keeps open the possibility that the FTAAP is more than just fantasy. It also could imply that China may be willing to see some convergence in certain areas between the Asian track negotiations and the TPP. It has not said, however, that it is formally considering membership in the TPP.

In the end, the isolation of China will not be in the long-term economic interests of the United States, and it is worth considering whether an accession provision to the TPP is a sufficient mechanism to allow eventual inclusion. If the provisions in the TPP do, in fact,

⁴⁴ Evelyn S. Devadason, “The Trans-Pacific Partnership (TPP): The Chinese Perspective,” *Journal of Contemporary China*, 12.

⁴⁵ Conversation with Dan Ikenson, Director of Trade Policy Studies, Cato Institute, April 2, 2014.

⁴⁶ Bryan Mercurio, 26.

⁴⁷ Evelyn Devadason, 14.

⁴⁸ *Ibid.*, 12.

⁴⁹ “China Open to Trans-Pacific Partnership,” *China Daily* (April 10, 2014) <http://www.chinadaily.com.cn/business/2014-04/10/content_17424439.htm>.

reach a 'platinum standard,' it may be politically difficult for China to accept the terms of the agreement in the near future. Also, it seems highly unlikely that China would simply accept all the provisions of an agreement if it were not part of the negotiating process, making accession after the TPP's conclusion a less feasible scenario.

Petri, Plummer and Zhai estimate that by 2020 the FTAAP could be concluded, but given the current opposition to fast-track legislation in particular, and trade agreements in general, 2020 seems a bit of a stretch. In addition, even though a China-U.S. FTA may be beneficial to both countries, it is also unlikely that this would be a popular initiative in the United States. With lawmakers already calling for the inclusion of a currency manipulation provision in the TPP, as well as strict disciplines on labor and the environment, these political debates will weigh negatively on China's decision to push for convergence of the Asia and TPP tracks.

Furthermore, there is no certainty as to whether the 'Asia pivot' will remain a key priority in the U.S. once a new administration takes office in 2016. After TPP and the TTIP, will the U.S. suffer from trade liberalization fatigue? It is difficult to say, but given how hard a battle the current negotiations have shaped up to be, it would not be surprising.

C. TRADE AGREEMENTS AS GLOBAL GOVERNANCE

In their original form, trade agreements focused on reducing the impact of border measures, such as tariffs, quotas, tariff-rate quotas, customs procedures, and export restrictions. By the 1930s, however, governments had realized that internal laws and regulations could also affect trade, and discussed ways to address the problem. Since that time, there has been an expansion in the scope of trade agreement rules to cover more and more aspects of domestic policy.⁵⁰

In the early years of the trade regime, international trade rules related to domestic regulation focused on the non-discrimination principle. The idea was that governments could regulate however they wanted to, as long as they did not discriminate against foreign products in their regulation. Setting the precise boundaries of such rules was challenging, and the jurisprudence has undergone many refinements over the years in an effort to find the appropriate balance, but the idea has found general acceptance.

By the 1990s, international trade obligations began to push beyond the limited non-discrimination principle in a number of ways. In response to concerns that increased trade would have a negative impact on labor rights and the environment, positive rules were added to the trade regime, setting standards for domestic labor and environmental rules. These rules started as non-binding guidance, but eventually became enforceable obligations.

⁵⁰ Simon Lester, "The Role of the International Trade Regime in Global Governance," 16 *UCLA J. Int'l L. & For. Aff.* 209 (2011).

Intellectual property was also inserted into the trade regime, with traditional domestic issues such as patents, copyrights and trademarks now subject to international trade obligations. Minimum standards were set out very precisely and clearly, and were enforceable through the normal trade dispute mechanism.

More recent trade negotiations, both bilateral and mega-regional, have pushed the role of the trade regime in global governance even further. In the TTIP, there have been efforts by the United States to reform the EU regulatory process, for example by including a notice and comment period for draft regulations, akin to what occurs in the United States.⁵¹ And in the TPP, the United States has pushed for broader efforts to promote environmental protection, such as binding rules related to the practice of shark finning.⁵²

Taken together, the expansion of trade agreements to address so many new issues means that these agreements go far beyond the traditional issues of protectionism and economic integration. In effect, it makes trade agreements one of the main sources of global governance across all policy areas. While there is certainly nothing that exists today that could be called a ‘global government,’ *global governance* is expanding and it is doing so in the form of trade agreements.

Such a result is problematic both for trade liberalization and for global rule-making. First, putting these issues in trade agreements is a problem for trade agreements themselves. The trade debate has been muddled by the infusion of these additional issues, because objections now come from sources who have little interest in the free trade versus protectionism debate, and in many cases would actually be sympathetic to traditional free trade. By adding new opponents, governments have made reaching agreement on core trade liberalization issues more difficult.

In addition, when we disguise efforts to promote international cooperation and governing as merely ‘trade’ issues, we do not address these issues head on. Taking the example intellectual property, the length of the copyright term is an important issue in and of itself, regardless of its impact on trade. It is difficult to debate this issue when it is buried in the larger context of trade negotiations, and it might be better if governments addressed the issue directly outside the trade context.

III. THE FUTURE OF TRADE AGREEMENTS

The TPP is perhaps best looked at as an experiment with a new model of trade agreement. An agreement on multilateral trade liberalization has been elusive, and bilateral trade agreements have perhaps reached the limits of their success. As a result, governments

⁵¹ Inu Barbee and Simon Lester, “Will Regulations Sink EU-U.S. Free Trade?,” *National Interest*, October 15, 2013. <<http://nationalinterest.org/commentary/will-regulations-sink-eu-us-free-trade-9229>>.

⁵² USTR, “The United States and Environmental Protections in the TPP,” January 15, 2014. <<http://www.ustr.gov/about-us/press-office/blog/2014/January/The-US-and-Environmental-Protections-in-the-TPP>>.

have pushed forward with an alternative model that is loosely tied to regions, but is perhaps more accurately described as a strategic trade alliance. This model moves ahead with using trade agreements as global governance, tries to export U.S. values to trading partners, and expands trade relationships with some countries while excluding others.

The most obvious measure for whether the TPP can act as a future model is if an agreement can be reached. If the 12 countries that are currently negotiating the TPP, and any others who might join, can reach agreement amongst themselves, and then pass the completed agreement through their domestic political process, the TPP can declare victory. Where other trade negotiations have failed, the TPP would be a success. People can debate whether it has merit, based on one aspect or another, but simply achieving a deal gives the TPP international credibility.

But can it succeed in this way? As much as trade officials try to talk up the TPP as almost finished, describing the TPP as in the 'end game' late last year and early this year,⁵³ it appears that there is much still to be done. Based on recent reports and leaks, there are substantial gaps in the views of the parties on what the rules should say. The role of officials' positive public statements is clear: to keep people motivated to move towards the finish. However, after too many overly optimistic assessments, people begin to take any statement with an appropriate amount of skepticism. It is therefore imperative that we take a realistic and balanced approach to examining the benefits particular arrangements will yield, so as not to over or under sell an initiative. This is precisely why we urge caution in overly ambitious estimations of the TPP's gains, because if it does not succeed in bringing about the results the rhetoric claims, there will undoubtedly be a backlash towards the initiative. And, as we saw with the NAFTA, it could hamper any further expansion efforts to include China through the FTAAP.

If the TPP fails, on the other hand, then perhaps the trade community can begin to think more deeply about the best approach to economic integration. Many models have been tried over the years. There have been successes and there have been failures. What worked in the past, and why? What would work now?

In terms of economics, the multilateral and regional approaches are clearly the best. A broad principle of non-discrimination at the multilateral level, combined with deeper integration at the regional level, seem to make the most sense. The multilateral regime should remain open for all to participate in; at the regional level, a deeper opening of the borders, and a recognition that trade ties between neighbors are naturally stronger, can supplement the shallower multilateral approach. While trade blocs can be problematic, with appropriate multilateral oversight they can serve as an important part of the trade regime.

With regard to the strategic agenda of U.S. trade policy, trade negotiations should be about bringing countries together rather than separating them into alliances. When we pick and choose our trading partners based on foreign policy issues or other strategic

⁵³ See, e.g., Reuters, "Pacific trade partners in end-game of trade talks: U.S. official," January 22, 2014. <<http://in.reuters.com/article/2014/01/22/usa-trade-tpp-idINL2N0KW1LI20140122>>.

and political considerations, we sublimate the benefits of economic integration to the vagaries of whatever foreign policy we are pursuing at that moment. Whether we are ‘isolating China,’ or rewarding countries who supported particular military interventions, we undermine the trade regime when we base trade alliances on non-economic considerations. What is the benefit in claiming a ‘pivot to Asia’ without the involvement of the largest country on the Asian continent? What signal does this send, and is such a message in the best long-term interest of trade liberalization?

On a related note, we should be careful when pushing our ‘values’ on others. Such an approach is not conducive to cooperation and good international relations in general.

And finally, as to global governance issues, various interest groups have pushed hard for their pet issues to be included in trade agreements. We should be wary of using the trade regime as a general tool of global governance. It may be true that international rules on the environment, labor, or intellectual property would be useful. But even if that is the case, putting everything into the trade regime makes trade talks a target for all sides of the political spectrum, all around the world. The expansion of the trade regime over the years is almost surely one of the reasons for its recent stagnation.

Regardless of what happens with the TPP, a reconsideration of the trade regime, including its scope, its institutions, and its negotiating processes, would be of great value. The principles and issues described above could serve as a guide for such an effort. More generally, rather than simply push forward with the current model of economic integration, it would be of great value for trade officials and outside experts to take a step back and assess this approach.

One important question to ask is, with whom should we be negotiating trade agreements? Should it be everyone, a coalition of the willing, the region, our friends and allies? The relative merits of each approach should be discussed and debated. Another question is, what should we be negotiating? A diverse set of issues, including non-discrimination for goods and services, domestic regulations, intellectual property, the environment, and monetary and fiscal policy, have all been included to some extent. What is the appropriate way to address each of these in the international arena? Until these questions are properly answered, the trade regime may see less progress than many of us would like.

INTERNATIONAL ECONOMIC LAW



AN ENABLING REGULATORY ENVIRONMENT FOR SUSTAINABLE INVESTMENT: THE EXAMPLE OF TRADE LAW

Elisabeth Bürgi Bonanomi*

Abstract. There is broad international agreement that investment flows to the agricultural sector in developing countries need to be increased. But there is also agreement that such investments need to be sustainable. For being sustainable, they must not only be beneficial to the public economy, but also to rural households and to the environment in the short and the long run. Whether sustainable investments take place, not least depends on the legal framework within which these investments are situated. This is true for the domestic legal frameworks of both the home country and of the host country of the investment. But also the international legal frameworks in which home and host states are embedded set either positive or negative incentives for investments to be sustainable. The paper presents an overview on regulatory frameworks which come to focus in this regard. It then elaborates on international agricultural trade regulation, by assuming that sustainable investments in agriculture presume a 'sustainable trade regime'. By doing so, the paper presents parts of the debate about a sustainable agricultural trade regime, as it has been resumed and further developed by the author in recent years.

Key words. Agricultural sector, sustainable investment, regulatory environment, sustainable trade regime.

* The author lectures at both the Centre for Development and Environment (CDE) and the World Trade Institute (WTI) of the University of Bern. This paper follows up on the author's paper published with International Land Coalition ILC: Bürgi Bonanomi Elisabeth, Trade Law and Responsible Investment, in: ILC, Oxfam, Somo, WTI, International Instruments Influencing the Rights of People facing Investment in Agricultural Lands, 2011, p. 68-88. Some parts of the text have already been published in this paper.

I. SUSTAINABLE INVESTMENT IN AGRICULTURE: ENABLING DOMESTIC AND INTERNATIONAL REGULATORY ENVIRONMENT?

There is broad international agreement that investment flows to the agricultural sector in developing countries need to be increased.¹ But there is also agreement that such investments need to be sustainable. For being sustainable, they must not only be beneficial to the public economy, but also to (poor) rural households and to the environment in

¹ FAO, IFAD, UNCTAD, World Bank, *Roundtable. 2009: Promoting Responsible International Investment in Agriculture*. Chair's Summary.

the short and the long run. The discussion about which agricultural investments can be deemed sustainable is ongoing.²

In this context, whether sustainable investment are promoted or not, not least depends on the legal framework within which these investments take place. This is true for the domestic legal frameworks of both the home country and of the host country of the investment. But also the international legal frameworks in which home and host states are embedded set either positive or negative incentives for investments to be sustainable.

A. DOMESTIC REGULATION

Both the home country of the investment – the country in which the investment originates – and the host country – the country in which it is invested – influence kind and shape of the investment which is undertaken by their regulatory environment. This includes the way local land rights regarding ownership and use of land are protected or not protected, the way environmental and labour standards are implemented or not implemented, whether procedural rights are effectively ensured or not, and to what extent the investor is protected or bound to comply with economic, social and environmental duties both at home or abroad.³ The authors of the Land Matrix, one of the most prominent databases on large scale land acquisitions (LSLAs) in the global south (whose sustainability is often questioned), have concluded from their assessment that governance structures are a determining factor for foreign direct investment in agricultural production at a large scale. While in those countries, which are most targeted by LSLAs, investor protection is rather well established, land governance is rather weak. As a result, the authors have advanced the following hypothesis which still needs closer examination: “Investors are interested in countries that combine a strong general institutional framework, that protects their investment and allows them to smoothly operate their business, with low tenure security that gives them easy and possibly cheap access to land”.⁴ Such lopsided protection of the investor’s rights may occur both at the home and the host country level, primarily by failing to provide a comprehensive regulatory framework of balanced rights and duties which apply to the investor respectively to the investment.

² Committee on World Food Security, 2013. *Principles for responsible agricultural investment (RAI) in the food security and nutrition, Zero Draft*.

³ UN Guiding Principles on Business and Human Rights by John Ruggie, 2011: *Implementing the United Nations ‘Protect, Respect and Remedy’ Framework*, A/HRC/17/31.

⁴ Anseeuw, W., Breu T., Giger, M., Lay, J., Messerli, P., Nolte, K., 2012. *Transnational Land Deals for Agriculture in the Global South, Analytical Report Based on the Land Matrix Database*. CDE/CIRAD/GIGA, Bern/Montpellier/Hamburg. 2012, p. 11.

B. INTERNATIONAL REGULATION

In addition, policy space of both home and host countries – i.e. the space within which domestic regulation is located - is limited and shaped by international law. A range of human rights and environmental treaties, which most countries have ratified and to which they are bound, assist in ensuring a socially and environmentally careful treatment of land and land rights. Of particular relevance is the right to adequate food which is enshrined in Art. 11 of the International Covenant on Economic, Social and Cultural Rights (ICESCR).⁵ According to human rights theory, the right to food includes, *inter alia*, the obligation of the State to respect the ability of individuals and groups to feed themselves by access to land. According to the UN Special Rapporteur on the right to food, Olivier de Schutter:

...the State is obliged to refrain from infringing on the ability of individuals and groups to feed themselves where such an ability exists (respect), and to prevent others - in particular private actors such as firms - from encroaching on that ability (protect). Finally, the state is called upon to actively strengthen the ability of individuals to feed themselves...⁶

Also related to the protection of land is Art. 17 of the International Covenant on Civil and Political Rights (ICCPR)⁷ which specifically protects against ‘forced eviction’, while claiming that “no one shall be subjected to arbitrary or unlawful interference with his privacy, family, home or correspondence”.⁸ The respective “Eviction Guidelines”⁹ drafted by the UN Special Rapporteur on Adequate Housing Miloon Kothari, establish strong criteria. Accordingly, evictions shall only occur in exceptional circumstances and require full justification:

Any eviction must be (a) authorized by law; (b) carried out in accordance with international human rights law; (c) undertaken solely for the purpose of promoting the general welfare; (d) reasonable and proportional; (e) regulated so as to ensure full and fair compensation and rehabilitation; and (f) carried out in accordance with the present guidelines.¹⁰

⁵ International Covenant on Economic, Social and Cultural Rights of December 16, 1966, A/RES/2200 A (XXI) (ICESCR).

⁶ *UN Guiding Principles on human rights impact assessments of trade and investment agreements*, report of the Special Rapporteur on the right to food, Olivier de Schutter, 19 December 2011, A/HRC/19/59/Add.5., para 1(1).

⁷ International Covenant on Civil and Political Rights of December 16, 1966, A/RES/2200A (XXI). (cited: ICCPR)

⁸ Art. 17 of the ICCPR.

⁹ UN Special Rapporteur on adequate housing as a component of the right to an adequate standard of living, Miloon Kothari, Basic Principles and Guidelines on Development-Based Evictions and Displacement of February 5, 2007, A/HRC/4/18. (Eviction Guidelines).

¹⁰ Para 21 of the Eviction Guidelines.

Importantly, the ‘forced eviction framework’ applies to all persons, “irrespective of whether they hold title to home and property under domestic law.”¹¹

Similarly, the ‘Guiding Principles on Internal Displacement’ which were drafted by the UN Office for the Coordination of Humanitarian Affairs OCHA, point in the same direction.¹² Based upon international humanitarian and human rights law, these principles aim at protecting every human being from “being arbitrarily displaced from his or her home or place of habitual residence”.¹³ Thereby, the prohibition of arbitrary displacement includes displacement “in cases of large-scale development projects, which are not justified by compelling and overriding public interests”.¹⁴ Thus, the Guiding Principles on Internal Displacement present a further framework for protection of land owners, while promoting responsible investment.¹⁵

Environmental treaties, on their side, set environmental standards to which the investors should be bound, such as standards of biological resp. bio-cultural and landscape diversity protection, including the protection of soil quality.¹⁶ An interesting entry point, in this respect, provides for instance Art. 6 of the International Treaty on Plant Genetic Resources for Food and Agriculture (ITPGRFA)¹⁷ which calls for well-targeted agricultural policies which promotes “diverse farming systems”. The ITPGRFA upholds the duty to pursue

fair agricultural policies that promote, as appropriate, the development and maintenance of diverse farming systems that enhance the sustainable use of agricultural biological diversity and other natural resources.¹⁸

The climate regime sets different and to some extent contradictory incentives for agricultural investments. On the one hand, it promotes mitigation measures which

¹¹ *Idem.*

¹² UN Special Rapporteur on the Human Rights of Internally Displaced Persons (former), Francis M. Deng, Guiding Principles on Internal Displacement of February 11, 1998, E/CN.4/1998/53/Add. (Guiding Principles on Internal Displacement).

¹³ Principle 6(1) of the Guiding Principles on Internal Displacement.

¹⁴ *Ibidem* 6(2)(2).

¹⁵ For a nuanced interpretation of the Guiding Principles on Internal Displacement, see UN Representative of the Secretary-General on the Human Rights of Internally Displaced Persons (former), Walter Kälin, Annotations to the Guiding Principles on Internal Displacement, The Brookings Institution – University of Bern Project on Internal Displacement, The American Society of International Law, Studies in Transnational Legal Policy, No. 38, 2nd edition (Washington, 2008).

¹⁶ Buergi Bonanomi Elisabeth, forthcoming 2014, *Sustainable Development in International Law Making History, Concept, Processes, Normativity. The example of trade in agriculture.*

¹⁷ International Treaty on Plant Genetic Resources for Food and Agriculture of 3rd November 2001 (ITPGRFA; Seed Treaty)

¹⁸ Art. 6 of the ITPGRFA.

would assist in reducing on-farm greenhouse gas emissions and, hence, calls for climate friendly agricultural practices and hence promotes “the art of doing agriculture” by socially, economically and environmentally practices which are not only science, but also traditional knowledge based. On the other hand, it promotes reduction of greenhouse gas emissions, which implies remunerated tree planting through emission trading and the use of biofuels, both drivers of large scale land acquisitions.¹⁹

Further, the international economic regime, particularly trade and investment treaties and tax agreements, build the “channel through which investments flow” by providing an enabling environment for foreign direct investment in land which are mostly commodity export-oriented.²⁰ Since the lopsided nature of investment treaties has already been discussed in this context to some extent²¹ (whereby in-depth human rights resp. sustainability impact assessments have not yet been conducted), the trade angle has been neglected so far. As a consequence, this paper will have a closer look at the trade regime. It will be asked what kind of trade regime would best ensure that domestic and foreign direct investments in agriculture assist in promoting a sustainable development of the agricultural sector. Thereby, it will be derived from the ‘coherent trade regime’ debate.

IS A GIVEN INVESTMENT SUSTAINABLE? SWISS CASE ANALYSED BY CDE AND WTI OF THE UNIVERSITY OF BERN

In order to examine whether a given large scale investment is sustainable or not, it needs to be assessed how the investment impacts on the public economy, the environment and the society, including both individual and communal livelihoods. This is true for both short-term and long-term impacts. Such analysis, if being conducted systematically, includes an examination of the domestic and international legal settings in which the investment is embedded. This implies an assessment of whether accepted legal standards have been implemented during the investment phase and of whether those settings complement or contradict each other. The author is currently involved in an inter- and trans-disciplinary research project, hosted by both the Centre for Development and Environment CDE and the World Trade Institute WTI and supported by the Swiss National Fund, which seeks to capture the sustainability record of a large scale land investment which originates in Switzerland, and to define most optimal policy responses concerning the different

¹⁹ Bürgi forthcoming 2014.

²⁰ Anseeuw 2012, p. 12.

²¹ E.g. Smaller, Carin, Mann, Howard. 2009. *A Thirst for Distant Lands: Foreign investment in agricultural land and water*. IISD. 2009.

levels of governance, including the trade regime. Hence, this study will assess the legal embedding of the investment from a multi-layered governance perspective,¹ and analyse the settings by deriving from coherence theory.² It will then compare the identified benchmarks and deficits with the findings of the involved sociologists, geographers and agronomists.

¹ Cottier, Thomas, Hertig, Maya, The Prospects of 21st Century Constitutionalism, in: Max Planck UNYB, Band (2003), p. 261-328.

² See section 2.3.

II. THE EXAMPLE OF TRADE IN AGRICULTURE

A. SUSTAINABLE TRADE POLICY AS PRECONDITION FOR SUSTAINABLE INVESTMENT

As explained, international legal frameworks promote or discourage sustainable investments in agriculture, depending on their design. If it is assumed that sustainable agricultural investments presume a sustainable development of the agricultural sector, the respective legal frameworks should be shaped so as to most optimally promote such sustainable development. Regarding trade, it is assumed that sustainable investments in agriculture - and hence a sustainable development of the agricultural sector - presume a 'sustainable trade regime'. Hence, parts of the debate about a sustainable agricultural trade regime will be presented here, as it has been resumed and further developed by the author in recent years.²² This focus on the agricultural trade regime and related incoherencies shall assist in indicating trade related research questions which future interdisciplinary studies should examine.

The agricultural trade regime strongly contributes in shaping the markets within which farmers operate. Regarding these markets and the rush towards farmland in developing countries, the UN Special Rapporteur on the Right to Food Olivier de Schutter commented:

We have failed in the past to adequately invest into agriculture and rural development in developing countries [...]. We have failed to promote means of agricultural production which do not deplete soils and do not exhaust groundwater resources. And we are failing

²² Bürgi forthcoming 2014; Bürgi Bonanomi, Elisabeth, 2012, *Right to Food, Sustainable Development and Trade: All Faces of the Same Cube*, in: Rayfuse, Rosemary, Weisfelt, Nicole (eds.), *The Challenge of Food Security* (Cheltenham: Edward Elgar Publishing), pp. 70-91.

today to establish well-functioning and more reliable global markets for agricultural commodities.²³

But what would a well-functioning, more reliable global and local market for agricultural commodities look like? What instruments would contribute to a more equitable, reliable global market? Taking into account that international trade rules shape agricultural markets and influence investment practices, the following chapter will discuss how trade rules could provide an enabling environment for sustainable investment in agriculture.

B. SUSTAINABLE TRADE POLICY PROMOTES SUSTAINABLE DEVELOPMENT OF THE AGRICULTURAL SECTOR IN DEVELOPING COUNTRIES: SOME BASIC ASSUMPTIONS

A sustainable trade policy is a trade policy which promotes rather than hinders a sustainable development of the agricultural sector in developing countries. Such sustainable development of the agricultural sector requires that its economic viability is not undermined, that environmental assets are carefully dealt with, and that human needs are respected and fulfilled. The reflections in section 2.4. emanate from the following experience-based assumptions:

1. Need to include the small-scale sector and to take account of the care sector

As experience shows, sustainable agricultural development in developing countries necessitates that the small-scale farming sector is not left out, but is appropriately included in the process of raising agricultural productivity. Indeed, the process of development necessarily entails the movement of workers from low-productivity, low-income subsistence farming to higher-productivity, small- or large-scale agriculture, and requires an increase in work opportunities in sectors such as manufacturing and services in order to absorb excess agricultural labour.²⁴ However, “even under the most favourable domestic and international conditions, [...] moving large numbers of people from low-productivity farming to higher-productivity agriculture, manufacturing, and other occupations has taken decades”.²⁵ Taking account of this large employment effect of small-scale agriculture is a key element of poverty reduction.²⁶ As a result, adequate policies need to be in place to ensure that upgrading and inclusion of the small-scale

²³ De Schutter, 2009, p. 15.

²⁴ Polaski, Sandra., 2005. *Agricultural Negotiations at the WTO: First, Do No Harm*. Carnegie Endowment for International Peace (2005), p. 4.

²⁵ Idem.

²⁶ World Bank. 2008. *World Development Report 2008: Agriculture for Development*. World Bank.; ILC, Bürgi, 2012.

sector happens in a decent way. Hence, in order for investments to be sustainable, they should support small-scale farmers in their ability to produce and to gain weight in political processes by strengthening their economic weight and by improving knowledge about their contribution to society.²⁷

In this context, the phenomenon of feminisation of small-scale agriculture in poorer countries needs to be considered.²⁸ As a result of marginalisation of the sector, men tend to migrate in search of more lucrative jobs, while women stay with the family on the farm. This not only implicates more income opportunities, but also an increased workload for women who continue to provide most care work. Strategies that target economic efficiency of the agricultural sector therefore need to include an analysis of the sharing of the burden of work, in order to ensure that time poverty is not increased (as this constitutes an important element of individual wellbeing).²⁹

2. Engagement in international trade in agriculture is associated with less hunger (only) if the institutional environment is adequate

Engagement in trade in agriculture generally leads to higher rates of economic growth and is associated with less hunger: “The proportions of undernourished people and underweight children tend to be lower in countries where agricultural trade is large in proportion to agricultural production”.³⁰ However, there are many disparities, as not all developing countries with similar levels of trade experience the same amounts of hunger and poverty. This depends not least on the institutional environment upon which the trade policy is based: “If trade policy is to contribute to food security, it needs to be embedded in a coherent and well-sequenced national development strategy and complemented by appropriate pro-poor companion policies”.³¹ Thereby, sequencing is of particular importance, in the sense that trade reforms should only be implemented once the appropriate domestic policies are in place.

²⁷ De Schutter, 2012.

²⁸ Zammit, Ann, et al. 2008. *Social Justice and Gender Equality: Rethinking Development Strategies and Macroeconomic Policies*. UNRISD (2008); UNCTAD. 2004. *Trade and Gender: Opportunities and Challenges for Developing Countries*. UNCTAD: p. 77-117.

²⁹ Bieri, Sabin, Sancar, Annemarie, 2009. *Power and Poverty: Reducing Gender Inequality by ways of Rural Employment?* Paper presented at the FAO-IFAD-ILO Workshop on Gaps, trends and current research in gender dimensions of agricultural and rural employment: differentiated pathways out of poverty, Rome 2009 ; Razavi, Shahra. 2007. *The Political and Social Economy of Care in a Development Context: Conceptual Issues, Research Questions and Policy Options*. UNRISD; UN Special Rapporteur on the Right to Food, 2012 , Olivier de Schutter, *Women's rights and the right to food*, Report to the Human Rights Council of 24 December 2012 (A/HRC/22/50).

³⁰ Mechlem, Kerstin. 2006. *Harmonizing Trade in Agriculture and Human Rights: Options for the Integration of the Right to Food into the Agreement on Agriculture*. Max Planck Yearbook of United Nations Law, Volume 10. p. 132.

³¹ Idem.

3. Local markets need to be maintained since too intensive export orientation may increase vulnerability

This trade-friendly starting point is put into perspective by the recognition that intensive export orientation might increase vulnerability as a result of price volatility, and that reliable local or regional food markets are a key prerequisite of a viable small-scale farming sector.³² Such reasoning is prominently defended, for example, by the UN Special Rapporteur on the Right to Food who claims that states should avoid excessive reliance on international trade: “Their short-term interest in procuring from the international market the food which they cannot produce at lower prices should not lead them to sacrifice their long-term interest in building their capacity to produce the food they need to meet their consumption needs”.³³ This implies that local markets need to be strengthened since they provide for an important fall back option for small-scale farmers.

In order not to simply prolong the dependence of developing countries on low-productivity agriculture,³⁴ but instead to contribute to an increase in agricultural productivity, diversification of agricultural production and engagement in value adding processes are of key importance. Not only domestic, but also international economic policies must be shaped in such a way as to ensure that the rents that accrue along the value chain are distributed in an equitable way.

C. SUSTAINABLE TRADE POLICY PRESUMES A COHERENT DOMESTIC AND INTERNATIONAL TRADE REGIME

1. Coherent domestic trade regime

The trade strategy of a country or region indicates the direction in which the corresponding agricultural sector will develop. Ideally, the chosen strategy should complement the domestic food security strategy, that – according to the Rome Declaration 2009, principle 1³⁵ – should be country-owned and country-specific, and should constitute an integral part of the overall poverty reduction strategy.

Domestic trade strategies influence how investments are practiced. Ideally, they reflect the trade decisions of domestic government, by providing information about the intended degree of export orientation, the diversification and value adding policies that will be pursued, or the policy tools that will be chosen to protect and integrate the small-scale sector. The chosen approach can be more or less conducive to sustainable investment.

³² Eg. FAO. 2005. *The State of Food Insecurity in the World 2005, Eradication world hunger – key to achieving the Millenium Development Goals*.FAO, p. 27.

³³ UN Special Rapporteur on the Right to Food, De Schutter, Olivier. 2008. *Report on behalf of Human Rights Council, Mission to the World Trade Organization*, UN. p. 20

³⁴ Polaski, 2005, p. 9.

³⁵ FAO. 2009. *World Summit on Food Security. Declaration of the World Summit on Food Security*. FAO.

In order to find out what trade policy might best support a prudent and sustainable development of the agricultural sector, while taking the elements mentioned in section 2.2. into account, a deliberative process of decision making is needed. At the same time, this process needs to take into account the national and international social, economic and environmental legal principles and standards the country is bound to comply with.

2. Coherent international trade regime

The international trade regime, on the other hand, strongly influences domestic trade choices. International trade rules set the stage of each country's policy space ("what protective policy measures are allowed?"; "what trade incentives frame the remaining policy space?"). Importantly, international trade rules define to what extent developed countries' market policies are disciplined. As such, they have a significant impact on investment flows. The WTO Agreement on Agriculture (AoA) constitutes *the* multilateral legal framework in the field of agriculture, although a proliferation of bilateral and regional trade agreements can be observed. While the following reflections will be limited to the AoA and the classical trade instruments such as tariffs and subsidies, the arguments are also valid for both bilateral and plurilateral trade agreements. The line of argument can also be drawn further to other non-tariff barriers that influence trade flows.

The preamble to the Marrakesh Agreement establishing the World Trade Organization (WTO) states that international trade law shall be:

... in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of development.

With this, the WTO is committed to the Concept of Sustainable Development that encompasses the principle of coherence. This principle requires international trade law to be coherent with international human rights and environmental legal standards.³⁶

Such legal coherency is attained if a) the various international agreements do not formally contradict each other (formal coherence), and b) the *de facto* impact of one agreement does not undermine, but rather promotes the implementation of the other agreement (substantive coherence). Hence, in order to be "coherent", a trade agreement must not undermine but rather promote the implementation of international human rights and environmental obligations. Importantly, the dynamics that result from the implementation of a trade agreement, have to be taken into account.³⁷ This necessitates

³⁶ Gehne, Katja, 2011, *Nachhaltige Entwicklung als Rechtsprinzip* (Tübingen: Mohr Siebeck); Gehring, Markus W., CordonierSegger, Marie-Claire (eds.). 2005. *Sustainable Development in World Trade Law*. The Hague: Kluwer Law International; Bürgi, forthcoming 2014.

³⁷ Bürgi forthcoming 2014.

in-depth assessments of trade impacts. Not least, such assessments are also required by the human rights framework and its extraterritorial coverage.

Today, *ex ante* sustainability impact assessments, which examine the likely impacts of trade measures on various stakeholders and on the relevant social, environmental and economic assets, are undertaken in only a few cases,³⁸ and still come with many conceptual deficits.³⁹ Such proceedings imply a process of negotiation that is not driven by the short-term self-interest of the negotiating parties, but by the desire (or the obligation) to look for a trade framework that will come up with the optimal results in both the short- and the long-term.

D. SUSTAINABLE, COHERENT INTERNATIONAL TRADE REGIME: THE FOUR DUTIES

From such a perspective of sustainable development and coherence, two of the objectives of the international trade framework should be a) to promote investments in the agricultural sector in developing countries, and b) to be conducive to sustainable investment, while discouraging unsustainable or irresponsible investment. An in-depth study conducted by the author which uncovered respective legal incoherencies, concluded that the trade regime would need to comply with four duties in order to be sustainable. The four duties will be presented in the following.

1. The duty to discipline policy space, particularly for OECD countries

a) Tariffs

The still high trade barriers in Organisation for Economic Co-operation and Development (OECD) countries are imposed to discourage foreign investments from flowing into the agricultural sector of developing markets.⁴⁰ All these market barriers in developed countries have contributed to years of underinvestment in the agricultural sector of developing countries.⁴¹ A UNCTAD study highlights that a shift in the agricultural production towards

³⁸ UNEP. 2002. Integrated Assessment of Trade Liberalisation and Trade-Related Policies, UNEP Country Projects – Round II: A Synthesis Report, (2002e). UNEP; Kirkpatrick, Colin et al. 2006. *Sustainability Impact Assessment of Proposed WTO Negotiations, Final Global Overview Trade SLA of the Doha Development Agenda. Final Report*. Manchester.

³⁹ UN Guiding Principles on human rights impact assessments of trade and investment agreements, 2011; -Bürgi Bonanomi, Elisabeth, *EU Trade Agreements and Their Impacts on Human Rights*, Study commissioned by the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ) (including position paper) (Bern, 2014).

⁴⁰ See the Producer Support Estimates (PSE) of the OECD. *Agricultural Policies in OECD Countries: At a Glance*. OECD (OECD, 2004).

⁴¹ UNCTAD. 2009. *World Investment Report : Transnational Corporations, Agricultural Production and Development*. UN. p. 183.

developing countries would be accompanied by a shift in investment flows. According to this study, strategies to promote export-oriented FDI in the field of agricultural goods will be successful only if both export tariffs in export markets and import tariffs in export markets are kept low. Thereby, preferential treatment under non-reciprocal agreements (such as the Generalized System of Preferences) are of particular interest.⁴² For example, “investment in banana production in Angola and other African, Caribbean and Pacific (ACP) countries have been encouraged by the duty-free access of ACPs and LDCs to the EU”.⁴³ Hence, improved market access to developed countries’ markets for agricultural goods from developing countries remains an important issue. From this perspective, above all, particular emphasis should be laid upon improved market access for processed food. For the moment, investment in food processing for exports is discouraged by former or actual high tariffs⁴⁴ and non-tariff barriers imposed on processed products as opposed to those on raw materials. This phenomenon is known as “tariff escalation”.⁴⁵ Accompanying measures would have to make sure that the additional benefits are well distributed along the value chain.⁴⁶ Hence, to improve market access to OECD countries, import tariffs on products from developing countries need to be lowered in a reliable and well specified way.

While General Systems of Preferences (GSPs) come with important opportunities for producers from LDCs and often also other developing countries, it has not yet been sufficiently examined at what extent such GSPs promote large scale land acquisitions in the targeted countries. GSPs not only boost the development of the respective agricultural sector, but also may come with negative side effects. Much indicates that GSPs are a strong driver of LSLAs. As a result, the question arises how GSPs should be shaped in order to ensure that socially, environmentally and economically sustainable investments are promoted and unsustainable investments are hindered by them.

b) Subsidies

Also, subsidies provided to farmers in importing countries discourage investment flows to countries offering lower or no subsidies, since the subsidies provide a direct price-cost advantage for producers.⁴⁷ As all kinds of domestic or export subsidies may distort market prices and make market access more difficult, the distinction between distorting (e.g. export

⁴² Ibidem, p. 182.

⁴³ Idem.

⁴⁴ Even if many tariffs have been reduced in General Systems of Preferences, former tariff escalation still leaves tracks.

⁴⁵ UNCTAD, 2009, p. 182; Elamin, N., Khaira, H.. 2003. *Tariff Escalation in Agricultural Commodity Markets*. Commodity Market Review 2003-2004. FAO: 101 – 111.

⁴⁶ For a new approach s. eg. the proposal of Canada: WTO Committee on Agriculture. 2006/2. Proposed Approach for Addressing Tariff Escalation. Communication from Canada. JOB(06)/166. WTO.

⁴⁷ UNCTAD, 2009, p. 183.

subsidies and amber box subsidies) and non-distorting subsidies (e.g. decoupled green box subsidies) is problematic.⁴⁸ Hence, instead of thinking in boxes, transparency could be improved. Case by case, the subsidy programmes could be tested for proportionality. There could be a careful assessment of what aim is to be achieved by a specific subsidy, whether the targeted objectives are legitimate (in view of internationally agreed social or environmental standards), what the impact on developing countries' market access is, whether there would be effective measures with minor impact, and how the negative impacts could be offset or compensated for.

An issue, which arises with the suggestion of reducing subsidies, is that many developing countries are currently net importers of subsidised food. This results in cross-subsidisation of developing countries' food bills by developed countries. In consequence, a decrease in subsidies comes with higher food bills. Effective strategies would therefore be required to mitigate the adjustment costs, inter alia particular support for increasing the countries' own agricultural productivity, and also compensation.⁴⁹

2. The duty to allow for necessary policy space

Besides disciplining developed countries' markets, the international trade framework must also allow policy space to member countries where such policy space is needed for the implementation of human rights and environmental policies. Only an optimal balance of limiting and enabling policy space will ensure long-term legitimacy of the international trade system.

Taking the internationally recognized principle of common but differentiated responsibilities into account,⁵⁰ the policy space the member countries are entitled to could differ among countries and depend on their development needs.⁵¹ "Country-owned" development strategies will often not seldom depend on the possibility to choose (reliable) "country-owned" trade policies. The approaches that are currently being discussed, however, allow only for limited flexibility.

An issue that has often been raised in order to illustrate the incoherency of trade and investment regimes, is the question of export restrictions. While trade law allows for export restrictions when national food security is at risk (for instance, in the case of an

⁴⁸ IATP. 2007. *Still Not Confronting the Real Challenge*. IATP.

⁴⁹ See the "Marrakesh Decision of 1994 on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries" that still lacks effective implementation.

⁵⁰ International Law Association ILA. 2002. *New Delhi Declaration of Principles of International Law Relating to Sustainable Development*. ILA Report of the Seventieth Conference held in New Delhi 2-6 April 2002. London/Aberystwith.

⁵¹ See also above: 'developed countries'.

acute drought),⁵² investment treaties do not.⁵³ For example, the International Food Policy Research Institute IFPRI postulates that “when national food security is at risk, domestic supplies should have priority. Foreign investors should not have a right to export during an acute national food crisis”.⁵⁴

The WTO AoA already offers flexibilities. For example, AoA Art. 4 limits the use of tariffs, whereby Members agreed to bind their tariffs at a specific rate. However, in many cases, countries have chosen to set the applied tariffs below the bound rate. Such leeway between applied and bound rates can be made use of. This, however, requires that the respective countries are not otherwise compelled to give up such flexibility, e.g. by bilateral trade agreements or structural adjustments obligations that come with financial assistance. Also in the field of subsidies, the AoA offers considerable flexibilities⁵⁵ (eg. development box).

a) in particular: special products and special safeguard mechanisms

The safeguard provision of the AoA, that allows for protection against immediate import surges (AoA Art. 5), is only of restricted use to developing countries, as its application is limited to countries that underwent a tariffication process (AoA Art. 4 para 2).⁵⁶ This is why a special safeguard mechanism (SSM) with a broader scope has been seriously advocated in the Doha Round by the G33, consisting of developing countries with a still significant small-scale agricultural sector, such as India, Indonesia or Kenya.⁵⁷

The SSM shall be complemented by a specific ‘special product’ provision (SP) that would allow developing countries to refrain from reduction of tariffs on specific agricultural products that are particularly important for the small scale sector and rural livelihoods.

While opponents want to limit SP to only a few tariff lines and to narrow the scope of the SSM, human rights activists in particular have pointed out the necessity to keep the provisions broad in order to maintain political flexibility: “Developing countries should

⁵² Export restrictions have been very controversially debated in recent years, as they further increase food prices.

⁵³ Smaller, 2009, p. 12.

⁵⁴ Braun, Joachim von, Meinzen-Dick, Ruth. 2009. *Land Grabbing“ by Foreign Investors in Developing Countries: Risks and Opportunities*. IFPRI Policy Brief 13. p. 4; S. also Smaller, 2009, p. 18, who understands food export restrictions as a key policy tool for host states in the event of food shortages, a possibility that is limited by investment treaties: “The use of trade measures including export taxes and export restrictions, permissible under international trade law, can create problems for host governments if they negatively affect investor rights. This is particularly pertinent for contracts where agricultural production is for export to the home country only.”

⁵⁵ But not necessarily the most appropriate ones.

⁵⁶ ICTSD (International Centre for Trade and Sustainable Development). 2005. *Special Products and the Special Safeguard Mechanism. Strategic Options for Developing Countries*. Issue Paper No. 6. ICTSD.

⁵⁷ ICTSD (International Centre for Trade and Sustainable Development). 2008. *Implications of the July 2008 Draft Agricultural Modalities for Sensitive Products*. ICTSD.

be allowed to designate as ‘special products’ all crops that are cultivated by their small-scale farmers and farmworkers. These products should be exempted from any further reductions in tariffs or increases in import quotas. [...] There should be no numerical limit on the number of products that can be designated, provided they are cultivated by small-scale farmers and farmworkers”.⁵⁸

Such safeguard instruments might be important particularly for maintaining the viability of the domestic agricultural markets, a prerequisite for sustainable development of the agricultural sector. It has been argued that “investment agreements should include a clause providing that a certain minimum percentage of the crops produced shall be sold on local markets”, in order to mitigate the risk of food insecurity that might build up “as the result of increased dependence on international markets or food aid”.⁵⁹ Such clauses in investment agreements would, however, presume that the trade framework allows for commensurate restrictions.

However, some developing countries⁶⁰ have also raised objections to the inclusion of broad protective tools. They argue that such market protection would impede the ability of their small-scale farmers to export to the respective developing countries’ markets, and that it would thereby become harder for rural populations to make a livelihood in such previously exporting regions.⁶¹ UNCTAD points out the danger of safeguard measures reducing predictability of market access, which again might discourage FDI.

3. The duty to positively shape

a) Set incentives for sustainable agricultural production

Whereas market opening promotes investment flows, the trade framework should also contribute to investments happening in a sustainable manner, by not overrunning historically grown structures. This necessitates a trade regime that includes adequate market incentives.

Internationally, trade rules generally offer an incentive for the cheapest way of production. Much discussion has taken place on how to include sustainable incentives, whereas the debate has mainly centred on the inclusion of social and environmental standards, or on product differentiation according to the process and production methods (PPMs) concerned. Conditionalities have, so far, mainly entered the General System of

⁵⁸ Polaski, 2005: p. 8.

⁵⁹ UN Special Rapporteur on the Right to Food, De Schutter, Olivier. 2009. *Large-scale land acquisitions and leases: A set of core principles and measures to address the human rights challenge*. A/HRC/13/33/Add.2.

⁶⁰ Such as Thailand and Pakistan.

⁶¹ WTO Committee on Agriculture. 2006 /1. *Thailand Paper on Special Products*. JOB (06)/135. WTO; WTO Committee on Agriculture. 2007. *Modalities for the Selection and Treatment of Special Products (SPs) by Developing Countries*. *Communication from the Delegation of Pakistan*. JOB(07)/46. WTO.

Preferences.⁶² Further, product differentiation has been advanced by the use of labels or the promotion of geographical indications.

For many years, developing countries have been reluctant to accept the inclusion of social and environmental incentives into the trade regime, as such incentives might reverse achievements in market opportunities. Therefore, incentives need to be shaped carefully, taking all the various contexts into account, and must in no way hamper market access to the markets of developed countries, and thus remaining a core element of a responsible agricultural trade regime. Importantly, it is not up to the trade negotiators to set their own social or environmental standards. Rather, reference has to be made to existing standards of other international regimes.⁶³ Such approaches have been discussed in recent years referring to the concept of qualified market access.⁶⁴

b) duty to positively shape domestic governance

Trade rules may also influence state behaviour by requiring member countries to comply with certain criteria if they are participating in international trade. Such criteria may lie beyond domestic economic policy. For example, Art. VI of the WTO General Agreement on Trade in Services requires domestic policy to comply with procedural rules.⁶⁵ Hence, such procedural requirements could also be included in the AoA. Countries could be required to follow transparent and fair procedures while negotiating investments in agricultural assets, e.g. by promoting “alternative models of agricultural investment that do not involve transfers of land ownership”⁶⁶ and ensuring a fair sharing of the benefits.⁶⁷ One may also envisage references to International Labour Rights, or obligations to engage in responsive governance of land tenure.

⁶² Shaffer, Gregory, Apea, Yvonne. 2005. *GSP Programmes and Their Historical-Political-Institutional Context*. In: Cottier, Thomas, Pauwelyn, Joost, Buergi, Elisabeth, Human Rights and International Trade, New York: Oxford University Press: 488-503.

⁶³ Perez, Franz 2006. *The Mutual Supportiveness of Trade and Environment*. American Society of International Law: Proceedings of the 100th Annual Meeting, 26-19.

⁶⁴ Ecofair Trade Dialogue, Lorenzen Hannes. 2006. *Qualified Market Access, How to include environmental and social conditions in trade agreements*. Heinrich Böll Foundation et al.; European Commission, DG Trade. 2008. *Qualified Market Access*, Final Report. EC.

⁶⁵ S. eg. the obligation that “each member shall maintain [...] as soon as practicable judicial, arbitral or administrative tribunals” which shall provide for the prompt review of decisions affecting trade in services.

⁶⁶ Taylor, Michael, Bending, Tim. 2009. *Increasing commercial pressure on land: Building a coordinated response*, International Land Coalition, para. 4.

⁶⁷ Such references could draw from the evolving “Roundtable Principles” on responsible investment, according to which investments are considered responsible if a) they are based on investment treaties that recognize and respect existing rights to land and natural resources; b) they do not jeopardize, but rather strengthen food security; c) processes for accessing land are transparent, monitored, and ensure accountability; d) participation of those materially affected is ensured; e) the projects are economically viable; f) they generate desirable social and distributional impacts and do not increase vulnerability; g) they ensure sustainable use of resources (FAO, 2009).

Whereas the WTO framework includes an agreement for effective protection of intellectual property rights,⁶⁸ no legal framework has been established so far for the protection of local land property rights. As the protection of rights and obligations over land and resources constitutes a key pillar of responsible investment policy, an effective international legal framework might be supportive. The challenge, however, would be to focus primarily on the land rights of those who are most in need of protection, and to take adequately into account all forms of property systems.⁶⁹

c) duty to regard 'the other side of the coin': the package approach

The 'duty to regard the other side of the coin', finally, relates to the core aspect of sustainable development: the integration of interests. In the process of developing an optimal, sustainable Agreement on Agriculture, every conceivable policy which relates to the three duties mentioned above would need to be evaluated in relation to the other duties. Trade-offs would need to be made transparent, and the 'other side of the coin' uncovered.

Factually, there are always 'other sides of the coin'. For example, more open trade would imply a decrease in domestic subsidies which again would lower cross-subsidisation of developing countries' food bills by developed countries. Such would lead – at least temporarily – to higher food prices, also for poor net food consumers. Similarly, UNCTAD has pointed out that special safeguard measures risk discouraging much needed foreign direct investment. Likewise, provisions on export restrictions would come with positive and negative effects, depending on the perspective. Hence, in a sophisticated process of balancing all involved interests, middle courses as well as context based solutions must be looked for, while taking into account all existing economic interdependencies. The optimal AoA might most often be "somewhere in between".

4. A sustainable trade regime: further issues

If the issue of an unbalanced agricultural trade system was approached more comprehensively, many more areas would have to be touched upon. Competition rules might be introduced to deal with the issue of a highly concentrated intermediary sector,⁷⁰ regulations for commodity future markets would need to be strengthened,⁷¹ food

⁶⁸ WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

⁶⁹ Razavi, Shahra. 2003. *Introduction: Agrarian Change, Gender and Land Rights*. -Razavi, Shahra (ed.), *Agrarian Change, Gender and Land Rights*. Blackwell Publishing Ltd, Oxford: 2-32.

⁷⁰ South Centre. 2008. *Rebalancing the Supply Chain: buyer power, commodities and competition policy*, South Centre / Traidcraft.

⁷¹ E.g. Newman, Susan. 2008. *The role of international commodity exchanges in the formation and transmission of prices and price risk along international coffee chains*. NCCR Trade Regulation Working Paper No. 12/2008. World Trade Institute. Bern.

aid programmes be re-shaped,⁷² among others. The rules that regulate sanitary and phytosanitary measures and technical barriers to trade (in particular the WTO SPS⁷³ and TBT⁷⁴ Agreements, as well as the standards of the Codex Alimentarius) would need to be more seriously assessed in terms of their negative impact on developing countries' market access.

Further, from a comprehensive perspective, price volatility and instruments for its prevention would have to be dealt with. Past structural adjustment programmes have weakened the role of marketing boards and commodity stabilization funds.⁷⁵ Alternatives would need to be discussed, such as the establishment of shared public grain stocks, and further measures to mitigate the risks associated with price volatility.⁷⁶

III. URGENT RESEARCH QUESTIONS

The mentioned duties and related measures, which would allow to re-shape the trade regime, are derived from a preliminary coherence assessment of the trade framework and related experience and debate. However, in-depth impact assessment studies which would examine which trade regime would be most supportive to social, environmental and economic legal standards, and would most optimally promote sustainable investments in agriculture, are lacking. Certainly, such assessments depend upon a clear picture of what 'sustainable investments in agriculture' could be. But such undertaking would also require that researchers of LSLAs do not lose sight of the whole picture. They should understand the linkages between trade and investment policies and should be informed about the domestic and international trade debate. As a result, they should venture to tackle the complex question of how a sustainable trade regime would look like. Such can only be done in inter- and trans-disciplinary process where all involved stakeholders have a say. However, such search must also be guided by fundamental environmental, economic and social legal standards and principles, including human rights, which are valid for all actors. The above mentioned duties and measures may guide the direction of respective future research.

⁷² Heri, Simone, Häberli, Christian. 2009. *Can The World Trade Organisation Ensure that Food Aid is Genuine?* NCCR Trade Regulation Working Paper No. 19/2009. World Trade Institute. Bern.

⁷³ WTO Agreement on the Application of Sanitary and Phytosanitary Measures.

⁷⁴ WTO Agreement on Technical Barriers to Trade.

⁷⁵ UNCTAD, 2009, p. 183.

⁷⁶ Bürgi, 2009.

THE PUBLIC INTEREST ANALYSIS IN TRADE REMEDIES INVESTIGATIONS IN BRAZIL

Luciana Dutra de Oliveira Silveira*

Ricardo Inglez de Souza**

Abstract. Trade remedies and above all antidumping measures, are instruments widely used by Members of the World Trade Organization (WTO) in order to restrict access of foreign products into domestic markets. Even though the WTO has laid down the rules for the application of such measures, there is still wide discretion related to how WTO members impose them. In particular, it should be highlighted the analysis of the public interest (or national interest) surrounding the application of trade remedies. Taking into consideration the example of other WTO Members, Brazil seems to have moved towards a position to grant more space to the public interest debate with the creation of the Technical Group of Public Interest Assessment (GTIP). It is believed that such a debate is very productive, as well as a good mechanism to balance the benefits of trade remedies to the domestic industry and the burden to other parties affected by the measures.

Key words: Trade Remedies; Public Interest in Brazil, European Union and Canada; Technical Group of Public Interest Assessment (GTIP).

* Luciana D. O. Silveira is an international trade lawyer at DeVivo Whitaker e Castro Advogados in Brazil, holds a Bachelor of Laws degree from Pontifícia Universidade Católica de São Paulo – PUC-SP and a LL.M in International Economic Law and Policy (IELPO) from the University of Barcelona – Spain.

** Ricardo Inglez de Souza is partner of the international trade practice of DeVivo Whitaker e Castro Advogados in Brazil and holds a Bachelor of Laws degree from Faculdade de Direito da Pontifícia Universidade Católica de São Paulo – PUC-SP (2000)

I. INTRODUCTION

*T*rade remedies are instruments created in the ambit of the General Agreement of Trade and Tariffs (GATT) and developed further with the establishment of the World Trade Organization (WTO). These instruments enable countries, Members of the WTO, to investigate and apply corrective measures against certain trade practices. In this sense, the antidumping measure remedies the dumping, the countervailing measure compensates the subsidy and the safeguard restricts a surge in imports.¹

¹ For further information on the concepts of antidumping measures, countervailing measures and safeguards

Since the creation of the WTO, in 1995, over 90% of the trade remedies applied by Members were antidumping measures.² Thus, among the trade remedies, antidumping is the most frequently used instrument and most likely due to the lower political costs involved in the application of such a measure.³

According to the WTO, in 2012, Brazil initiated 47 antidumping investigations, one subsidy investigation and one safeguard investigation. Still, in this same period, Brazil imposed 14 antidumping measures and no countervailing measure or safeguard. In 2012, Brazil was the second country that most applied antidumping measures, preceded only by India that imposed 30 antidumping measures.⁴

The WTO Agreements related to trade remedies regulate the investigation procedure and the application of the measures.⁵ The procedure itself is conducted nationally by each WTO Member. In Brazil, the authority competent to conduct trade remedies investigations is the Department of Trade Remedies (*Departamento de Defesa Comercial – DECOM*),⁶ which is part of the Secretariat of Foreign Trade (*Secretaria de Comércio Exterior – SECEX*) of the Ministry of Development, Industry and Foreign Trade (*Ministério do Desenvolvimento, Indústria e Comércio Exterior – MDIC*).⁷ DECOM is responsible for analyzing all the technical requirements for the application of the trade remedies in one single

see VAN DEN BOSSCHE, Peter. *The Law and Policy of the World Trade Organization: Text, Cases and Materials*. Cambridge University Press, 2nd edition, 2006, p. 508-556/557-604/670-695; MATSUSHITA, Mitsuo; SCHOENBAUM, Thomas J; MAVROIDIS, Petros C. *The World Trade Organization: Law, practice, and policy*. The Oxford International Law Library, 2nd edition, 2006, p. 395-433/331-393/437-473.

² See <http://www.wto.org/english/tratop_e/adp_e/adp_e.htm>, 07/01/13.

³ The party responsible for the trade practice in terms of dumping is always a private party. It is this party who will be investigated and eventually subjected to the antidumping measure. In turn, in a subsidy investigation the government of a WTO Member will be investigated together with the private parties that benefited from the subsidy. Lastly, regarding safeguards, the trade practice is not precisely unfair trade and for that reason the investigating Member may have to negotiate and provide compensation to the affected Members. Having said that, the imposition of antidumping measures is the only situation where the investigating country does not have to deal with public relations with other WTO Members.

⁴ Information on antidumping measures are available at <http://www.wto.org/english/tratop_e/adp_e/adp_e.htm>, information on countervailing measures are available at <http://www.wto.org/english/tratop_e/scm_e/scm_e.htm>, and information on safeguards are available <http://www.wto.org/english/tratop_e/safeg_e/safeg_e.htm>, 11/06/13.

⁵ See Agreement on Antidumping, Agreement on Subsidies and Countervailing Measures and Agreement on Safeguards.

⁶ The competence of DECOM is outlined on Decree No. 7096/2010 (initially outlined on Decree No. 3839/2001).

⁷ DECOM was created in 1995 as an internal restructuring in SECEX. According to Law No. 9019/1995 (later on modify by MP No. 2158-35/2001), SECEX is competent for conducting the administrative procedures for the application of trade remedies and CAMEX is competent for determining the value and the application of trade remedies (earlier in time, this competence was of the Ministry of Treasury, Industry, Commerce, Tourism – the change came with Decree No. 3756/2001, substituted by Decree No. 3981/2001. The current competence of CAMEX is outlined on Decree No. 4732/2003)

administrative procedure.⁸ Once the investigation is over, DECOM issues a final report based on which the Chamber of Foreign Trade (*Câmara de Comércio Exterior – CAMEX*) decides upon the application or not of trade remedies.⁹

This article focuses on the role of the public interest analysis concerning the application of trade remedies, particularly in Brazil. The first section describes the Brazilian legislation that regulates the public interest analysis, the procedural aspects and the topics that may be considered for this analysis. The second section draws a comparison of the Brazilian public interest analysis with those of other WTO Members, namely European Union and Canada. The third section addresses examples of the analysis undertaken by the competent Brazilian administrative body. And lastly, the conclusion expresses the final considerations respect to the public interest analysis in trade remedies investigations in Brazil.

II. THE PUBLIC INTEREST ANALYSIS IN BRAZIL

In general, DECOM conducts trade remedies investigations and issues a final report on which it recommends or not the imposition of the measure under debate. Nevertheless, despite DECOM's technical opinion, CAMEX may opt for the suspension or modification of the measure due to "public interest" reasons. This section will address the legal basis for the public interest analysis, the procedural aspects of such an analysis and the topics to be addressed as public interest.

A. LEGAL BASIS

In the multilateral arena, the WTO Agreements related to trade remedies do not provide for specific rules regarding a public interest analysis in the ambit of these investigations.¹⁰

⁸ For further information on DECOM please refer to <<http://mdic.gov.br/sitio/interna/interna.php?area=5&menu=228>>.

⁹ HEES, Felipe; VALLE, Marília Castañón Penha (org.). *Dumping, Subsidies and Safeguards: analysing technical aspects of the trade remedies instruments* (Dumping, Subsídios e Salvaguardas: revisitando aspectos técnicos dos instrumentos de defesa comercial). São Paulo: Editora Singular, 2012; BARRAL, Welber. *Dumping and international trade: the antidumping regulation after the Uruguay Round* (Dumping e comércio internacional: a regulamentação antidumping após a Rodada Uruguai). Rio de Janeiro: Editora Forense, 2000.

¹⁰ Despite the absence of such rules in the current agreements, during the negotiation history several proposals were discussed in the sense of including a public interest clause. See CORDOVIL, Leonor. *Antidumping: public interest and protectionism in international trade* (Antidumping: interesse público e protecionismo no comércio internacional). São Paulo: Editora Revista dos Tribunais, p.56-73, 2012; and STEWART, T. (editor). *The GATT Uruguay Round: A Negotiating History (1986 – 1992)*. Vol. II: Commentary, Kluwer Law and Taxation Publishers, Deventer, pp. 1689 – 1690, [in KOTSIUBSKA, Viktoriia. *Public Interest Consideration in Domestic and International Antidumping Disciplines*. MILE

In fact, the Agreement on Safeguard is the only to make explicit reference to the subject.¹¹ The Antidumping Agreement and the Agreement on Subsidies and Countervailing Measures mention that industrial users and consumer organizations shall have the opportunity to provide relevant information regarding the elements for the application of the trade remedy in question.¹² Moreover, these Agreements state:

It is desirable that the imposition should be permissive in the territory of all Members, that the duty be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry.

The Agreement on Subsidies and Countervailing Measures goes even further to say that it is desirable that procedures should be established so that authorities take due account of representations made by domestic interested parties whose interests might be adversely affected by the imposition of a countervailing duty.¹³ The important aspect of this provision is that footnote 50 of the Agreement on Subsidy and Countervailing Measures clarifies that, for the purpose of this paragraph, the term ‘domestic interested parties’ shall include consumers and industrial users of the imported product subject to investigation. In other words, although the WTO Agreements related to trade remedies do not have clear mandate on the public interest analysis, they all have particular indications that a balance should be pursued by authorities imposing trade remedies.

The WTO Agreements, including those related to trade remedies, were incorporated into the Brazilian domestic legislation¹⁴ by means of Decree No. 30/1994 and Decree No. 1355/1944. Moreover, Decree No. 1602/1995 regulates the administrative procedure of investigation and application of antidumping measures;¹⁵ Decree No. 1751/1995

¹¹ Thesis, September 2011, p. 12];

¹² Article 3 – Investigation

1. A Member may apply a safeguard measure only following an investigation by the competent authorities of that Member pursuant to procedures previously established and made public in consonance with Article X of GATT 1994. **This investigation shall include reasonable public notice to all interested parties and public hearings or other appropriate means in which importers, exporters and other interested parties could present evidence and their views, including the opportunity to respond to the presentations of other parties and to submit their views, inter alia, as to whether or not the application of a safeguard measure would be in the public interest.** The competent authorities shall publish a report setting forth their findings and reasoned conclusions reached on all pertinent issues of fact and law. (Emphasis added).

¹² See Article 6.12 of the Antidumping Agreement and Article 12.10 of the Subsidies and Countervailing Measures Agreement.

¹³ See Article 9.1 of the Antidumping Agreement and Article 19.2 of the Subsidies and Countervailing Measures Agreement.

¹⁴ Brazil adopts the dualist theory regarding the enforceability and effectiveness of international law in the domestic territory.

¹⁵ Decree 8058 /2013 was published at the end of July revoking Decree 1602/1995 as of October 2013. The new Decree stipulates more specific and detailed rules for the AD procedure, including a mandate for the Council

provides for similar rules in terms of subsidies and countervailing duties and, lastly, Decree No. 1488/1995 (with modifications provided by Decree No. 1936/1996) regulates the investigation and application of safeguards.

In contrast with the multilateral scenario, the Brazilian Decrees¹⁶ related to antidumping and countervailing measures both have provisions recognizing that, in exceptional circumstances, even though all the necessary elements for the application of the measure are present, the government may decide for the suspension or modification of the amount of such a measure in light of the national interest (public interest).¹⁷

Until 2012, the public interest analysis was a political discussion taken only within the Technical Group of Trade Remedies (*Grupo Técnico de Defesa Comercial – GTDC*) in the ambit of CAMEX. The GTDC was created in 2001¹⁸ and, similar to CAMEX, it is composed of one representative of each of the 7 Brazilian Ministries.¹⁹

With the purpose of formalizing the public interest analysis, Brazil created the Technical Group of Public Interest Assessment (GTIP), in the ambit of the Secretariat of Economic Monitoring (SEAE) of the Ministry of Treasury.²⁰ The GTIP is composed of representatives of the same Ministries that are present in CAMEX and they are responsible for analyzing the suspension, modification or revocation (non-application, in case the investigation is still on-going) of definitive antidumping measures and countervailing measures,²¹ as well as the non-application of provisional measures, due to public interest.

of Ministers of CAMEX to suspend, not to apply or to accept price undertakings due to public interest reasons (see Article 3).

¹⁶ Decree No. 1602/1995 (Antidumping), article 64, §3º; Decree No. 1751/1995 (Subsidies and Countervailing Measures), Article 73, §3º; Decree No. 1488/1995

¹⁷ For the purpose of this article the author shall consider “national interest” and “public interest” as synonyms. Some commentators argue that the terminology “national interest” refers to aspects related to national security while “public interest” refers to economic consequences of the measure (HEES, Felipe. *Public interest and the application of antidumping measures in Brazil* (Interesse público e a aplicação de medidas antidumping no Brasil). *Revista Brasileira de Comércio Exterior*, Ano XXVII, n. 114, janeiro/março de 2013, p. 6). Other commentators even point to the existence of different terminologies (CORDOVIL, Leonor. *Op. Cit.* 2012, p. 26).

¹⁸ The GTDC was created by means of the CAMEX Resolution No. 9/2001, which was substituted by CAMEX Resolution No. 30/2006 and lastly by CAMEX Resolution No. 82/2011.

¹⁹ Ministry of Development, Industry and Foreign Trade (*Ministério do Desenvolvimento, Indústria e Comércio Exterior – MDIC*), Ministry of Foreign Relations (*Ministério das Relações Exteriores*), Civil House of the Presidency of the Republic (*Casa Civil da Presidência da República*), Ministry of Treasury (*Ministério da Fazenda*), Ministry of Agriculture, Livestock and Supply (*Ministério da Agricultura, Pecuária e Abastecimento*), Ministry of Planning, Budget and Management (*Ministério do Planejamento, Orçamento e Gestão*) and Ministry of Agrarian Development (*Ministério do Desenvolvimento Agrário*).

²⁰ The GTIP was created by means of the CAMEX Resolution No. 13/2012 (with modifications provided by CAMEX Resolution No. 38/2012).

²¹ Important to note that the public interest analysis for safeguards continues not to be formalized. The mandate of GTIP does not include the analysis of public interest in safeguard measures.

B. PROCEDURAL ASPECTS

The public interest analysis of GTIP is separate from the trade remedies investigation. If the investigation is still ongoing, the conclusion of GTIP's analysis will only reach CAMEX after DECOM finishes its technical analysis and issues its final report. In general, once the procedure for analysis of the public interest is registered, GTIP has 4 months to present its conclusions to the Executive Committee of CAMEX (GECEX) and later on to the Council of Ministries of CAMEX. The Council is the administrative body responsible for taking the final decision on the matter. The suspension, modification or revocation (non-application) due to public interest is published through a CAMEX Resolution.²²

The requests for suspension, modification or revocation (non-application) due to public interest may be formulated by any interested party (company or representative entity), any Member of GTIP or any administrative governmental body. The requests, however, must follow a specific form that requires information on the product/chain affected by the trade remedy (although not directly subject to the measure), the specific conditions of the market of the product subject to the trade remedy (national production, main national producers, structure of the production, imports, exports, costs, etc.), the conditions to purchase the product subject to the trade remedy (taxes applicable, preferential trade agreements, non-tariff barriers and costs of importation) and the price history of the product, both nationally and internationally.²³

So far, GTIP has not yet laid down specific procedural rules respect to, for example, time line for submissions and responses to submissions, access to the files submitted, confidentiality treatment, publication of the technical note of GTIP to the interested parties, hearings and others. Nonetheless, the debate in this area is very much in progress.²⁴

C. TOPICS TO BE ADDRESSED AS PUBLIC INTEREST

The Brazilian regulations regarding the public interest analysis do not clearly indicate the topics to be addressed as public interest. In fact, they do not clearly define public interest.

²² See Articles 7 and 8 of CAMEX Resolution No. 13/2012.

²³ See CAMEX Resolution No. 50/2012.

²⁴ See MACERA, Andrea Pereira. *The interaction between antitrust and antidumping: problem or solution?* (A Interação entre Antitruste e Antidumping: problema ou solução?), SEAE/MF Working Document (Documento de Trabalho) No. 36/2006, MONTEIRO, Carmen Diva Beltrão; GALVÃO, Letícia Andreoli. *Public Interest: Criteria for consideration in antidumping procedures* (Interesse Público: Critérios Para Consideração Em Processos De Investigação Antidumping), SEAE/MF Working Document (Documento de Trabalho) No. 44/2006 and Bulletin of the Brazilian National Confederation of Industry, Trade Remedies Observatory, Ano 1, Número 1, August 2012 (available at <<http://www.cinpr.org.br/uploadAddress/Observatorio%20Agosto%202012%5B36739%5D.pdf>>, 07/28/13).

Finger and Slate suggest that public interest should be regarded as the sum of all the private interests affected. That is, the impact of the unfair trade practice should be measured to the same extent as the effects of the restrictions or burden imposed on all the other domestic interest by means of a trade remedy.²⁵

Trade remedies are destined to offset the injury suffered by the domestic industry of an importing country. However, within the domestic context, these measures have a widespread effect on other sectors and parties. In fact, they have a negative effect on intermediary users (industrial users) and consumers of the product under investigation, on competition, on wholesale and retail services, on allocation of resources, on purchase and consumption decisions and on trade flow between importing and exporting countries. In other words, while the trade remedies address the concern of the domestic industry, the costs of these measures are borne by the rest of the economy.²⁶ Economically speaking, when trade remedies or any other trade restriction is imposed, there is an increase (gain) in the surplus of the domestic industry and of the government, but a decrease (loss) in the surplus of the consumers. In certain cases such as of Brazil, a country that has minimum influence on the world price of the vast majority (if not all) products,²⁷ the application of trade remedies shall lead to economic welfare loss.²⁸

In this sense, Aradhana Aggawal suggests that the public interest analysis is (i) a means of achieving social-economic justice to parties adversely affected by trade remedies (i.e. a way of balancing the producers' interests with consumers' (intermediary or final) interest; (ii) a means of guarantying that authorities consider trade remedies in a wider context, taking into account not only the interests of the domestic industry who seeks for relief, but also the costs of the government intervention to the national economy in its entirety – in other words, there is an argument of economic welfare that demands a net gain for the application of trade remedies; and (iii) a means of imposing due restraint in the imposition of trade remedies by allowing different stakeholders to affect the outcome of a trade remedy investigation.²⁹

²⁵ FINGER, J. Michael; ZLATE, Andrei. *Antidumping: prospects for discipline from the Doha negotiations*. Boston College: Working Papers in Economics n. 632, November 2005, p.18. Available at <<http://fmwww.bc.edu/ec-p/wp632.pdf>>, 02/07/2013. This Author refers to antidumping measure; however, it is believed that the rationale applies likewise to trade remedies in general.

²⁶ See Paper on 'Public Interest', TN/RL/W/174/Rev.1, p.1

²⁷ Brazil's share of the world merchandise among the exporters is 1,7% and among the importers is 1,6%, excluding intra-EU trade. The top 3 exporters are European Union (14.7%), China (13.9%) and United States (10.5%) and the top 3 importers are United States (15.6%), European Union (15.4%) and China (12.2%). See <http://www.wto.org/english/news_e/pr688_e.htm>, 07/02/13.

²⁸ FEENSTRA, R.; TAYLOR, A. *International Economics*. Chapter 9 – Import Tariffs and Quotas under imperfect competition. Worth Publishers, 2008, p. 343-348.

²⁹ AGGARWAL, Arahdna. *The WTO Antidumping Agreement: possible reform through the inclusion of a public interest clause*. Indian Council for Research on International Economic Relations (ICRIER): Working Paper n.142, September 2004, p. 5-6. Available at <<http://www.icrier.org/pdf/wp142.pdf>>, 07/02/13. This Author refers to antidumping measure; however, it is believed that the rationale applies likewise to trade remedies in general.

Leonor Cordovil succinctly explains the concept of public interest along the same lines. This Author states that the public interest is the justification for not applying trade remedies when it is understood that the benefits created by these measures to the domestic industry are lower than the costs created to parties adversely affected (*i.e.* consumers, industrial users, importers, society in general).³⁰

Felipe Hees, Director of DECOM (Brazilian authority responsible for conducting trade remedy investigations), stated that the public interest analysis mingles two universes of interests inevitably conflicting. On one hand, it is of the national industry's interest to have a trade remedy imposed so as to prevent unfair trade practices. On the other hand, the rest of the economy and consumers will face the effects of the measures, most of the times with higher prices.³¹ Yet, Felipe Hees further concludes that to address only specific topics, such as the competition effects of trade remedies, within the public interest analysis, would ultimately rule out the application of these measures. Given that this will hardly be the case, to resume the public interest analysis to competition aspects would not be sufficient and would lead to an insuperable debate.

Based on GTIP's regulations, Brazil seems to have moved towards an approach that would permit a thorough public interest analysis, including competition and other important economic aspects. In light of the specific form to request a public interest analysis, Andrea Pereira Macera, Coordinator of the SEAE-MF and current Executive Secretary of GTIP, acknowledges that:

Initially, there is the concern of identifying the stages of the production chain allegedly affected by the trade remedy, as well as defining the conditions of the market. Moreover, it is requested information that enable the evaluation of the accessibility to the product subject to the trade remedy, that is, if there are like or substitutable products from origins not investigated and, if there is, if there would be additional costs for the importation. Finally, it is requested information related to the price, which allows the analysis of its evolution as well as the causal relationship with the measure adopted.³²

At last, it should be mentioned that, although not mandatory as in other countries, the public interest analysis in Brazil seems to strike for a balance among the domestic interests affected by trade remedies and is in line with the proposal of the *Friends of Antidumping Negotiations* (FANs),³³ a group of WTO Members including Brazil, that wish trade remedies application to have a proper consideration of public interest topics. In fact,

³⁰ CORDOVIL, Leonor. Op. Cit. 2012, p. 55-56. Free translation.

³¹ HEES, Felipe. Op. Cit. 2013, p. 5.

³² MACERA, Andrea Pereira. *Public Interest and trade remedies: general considerations* (Interesse público e defesa comercial: considerações gerais). Revista Brasileira de Comércio Exterior, Ano XXVII, n. 114, janeiro/março de 2013, p. 19.

³³ Brazil, Chile, Colombia, Costa Rica, Hong Kong (China), Israel, Japan, Korea, Mexico, Norway, Singapore, Switzerland, Thailand and Turkey. The Group has later on included some other WTO Members.

several proposals have been submitted to the WTO with comments concerning the public interest analysis surrounding the application of trade remedies.

In 2002, the FANs proposed that the Antidumping Agreement (i) strengthen rules in order to ensure that relevant information pertaining to public interest is taken into account in a more substantive manner and (ii) discuss whether authorities should take into account the interests of the other economic sectors affected by the anti-dumping measure. This communication was the first to suggest the implementation of public interest provisions in the Antidumping Agreement.³⁴ The European Union followed the initiative and submitted a suggestion in 2002,³⁵ which discussed the establishment of a public interest test (in terms of an examination of the impact on economic operators) as an additional condition before measures can be imposed. Also, in 2003, Canada identified the public interest as a topic that could be negotiated so as to enhance the effectiveness of legitimate antidumping measures and to limit the inconsistent, sometimes unwarranted, application of these measures:

In Canada's view, efforts to improve the ADA should include an examination of the unintended effects of anti-dumping action and efforts to strengthen existing provisions of the Agreement so as to fully consider the consequences of anti-dumping duties for broader economic, trade and competition policy concerns.³⁶

In 2005, eleven Members (Chile, Costa Rica, China, Israel, Japan, Republic of Korea, Norway, Singapore, Switzerland, Taiwan – Penghu, Kinmen and Matsu – and Thailand) submitted a communication³⁷ to the Negotiating Group on Rules proposing a framework of four elements: a public interest provision, minimum factors for consideration, right for interested parties to present information and transparency. Later on the same year, this Group of Members (except for Chile and Costa Rica) presented a communication so as to extend their suggestions made in the context of the Group regarding the inclusion of a public interest provision in the Antidumping Agreement. This provision would force authorities to “provide full opportunity for persons who may be affected by the measure to comment on the matter”. Concerning the possible topics to be addressed, the Members outlined:

³⁴ See Antidumping: Illustrative major issues, TN/RL/W/6. Before that, Canada had already flagged that, among other topics, public interest would be one of the areas that would benefit greatly from improvements and clarifications to the rules governing dumping and subsidy investigations and the application of such measures.

³⁵ See Submission From The European Communities Concerning The Agreement on Implementation of Article VI of GATT 1994 (Anti-Dumping Agreement), TN/RL/W/13.

³⁶ See Submission From Canada Respecting The Agreement on Implementation of Article VI of the GATT 1994 (The Anti-Dumping Agreement), TN/RL/W/47.

³⁷ See Public Interest, TN/RL/W/174/Rev. 1.

(i) The costs for the industrial users, consumers, importers, wholesalers and retailers of the product under consideration; (ii) competition in the market of the product under consideration in the importing member; (iii) choice or availability of like products at competitive prices for industrial users and consumers; (iv) profitability and competitiveness of industrial users, importers, wholesalers and retailers of the product under consideration, among others.³⁸

Still in 2005, China and Canada also presented their concerns to the Negotiating Group on Rules. China expressed that a public interest analysis would be in line with the existing provisions of the Antidumping Agreement; however, highlighted that this analysis should focus on the economic effects of the measures only. China mentioned that non-economic effects should be dealt with under other WTO provisions (e.g. Article XX or XXI of the GATT). Canada, in turn, submitted a paper concerning the guiding principles for a more effective public interest analysis, as well as a text proposal for amending the Antidumping Agreement and the Agreement on Subsidies and Countervailing Measures. According to Canada, the public interest is vital to the context of trade remedies and relevant persons should be afforded the opportunity to comment on the imposition of such measures as soon as they are able to provide useful comments. Yet, Canada believes that:

Any new obligations on public interest [must] afford sufficient flexibility as to the method of their implementation so as to accommodate the different approaches of Members to this issue and the domestic legal systems of Members; and domestic public interest decisions, as the sovereign prerogative of each Member, be recognized as falling outside the reach of WTO dispute settlement proceedings.³⁹

Jamaica shares a similar point of view but makes more reservations. According to its paper submitted in 2005,

Incorporating a public interest component into the ADA [Antidumping Agreement] should *not automatically* translate into requiring the Investigating Authority to refrain from imposing an anti-dumping duty where the enquiry reveals that the imposition of the measure is not in accordance with the national economic interest.⁴⁰

³⁸ See Further Submission on Public Interest, TN/RL/GEN/53. In 2006, China and the Separate Customs Territory of Taiwan (Penghu, Kinmen and Matsu) submitted an update to the proposals made on TN/RL/GEN/53. For this submission see Economic Effects of Antidumping Measures, TN/RL/GEN/142.

³⁹ See Public Interest, TN/RL/GEN/85.

⁴⁰ See Comments by Jamaica on Proposals to the Negotiating Group on Rules (AD and SCM, Including Fisheries Subsidies) Discussed At The Group's Meeting on 26-30 September 2005, TN/RL/W/188.

On a more extreme view, South Africa disagrees with the abovementioned communications. In 2006, South Africa submitted a paper⁴¹ whereby it recognized the importance of including a public interest provision in the Antidumping Agreement; however, South Africa alleged that this matter is predominantly a national issue that should be better dealt with through national legislations.

In 2008, Colombia, China, Israel, Japan, Norway, Singapore, Switzerland, the Separate Customs Territory of Taiwan (Penghu, Kinmen and Matsu) and Thailand presented their comments to the text circulated by the Chair of the Negotiation Group on Rules. The Members suggested some modifications to the public interest provision, mainly with the purpose to confer further clarity to the text and inclusions of topics discussed in previous meetings.⁴²

In sum, from an international perspective, the proposals and communications submitted to the WTO regarding the presence of public interest provisions in the Antidumping Agreement or Agreement on Subsidies and Countervailing Measures reveal a growing concern with the topic. As a rule, the discussion in the WTO demonstrate the idea of guaranteeing that nations who are considering implementing trade remedies weight the benefits of the matter beforehand and listen to different segments of their national industries. The right for all relevant areas of the society to opine over the implementation of antidumping and countervailing measures is agreed on by most of the Members; however, controversy remains as to how far the WTO Agreements should rule upon the matter or should it be better handled by national authorities.

III. COMPARISON WITH OTHER WTO MEMBERS

A formal public interest analysis within the context of trade remedies is not widely common. Apart from Brazil, only few WTO Members conduct a public interest analysis, each of them in their own particular ways.⁴³

This section is dedicated to an examination of the public interest analysis performed by the European Union and Canada, two countries with concrete space for such a debate.⁴⁴

⁴¹ See Proposals on Issues Relating to the Antidumping Agreement, TN/RL/GEN/137.

⁴² See Public Interest, TN/RL/W/222.

⁴³ For further information on the public interest analysis in some WTO Members please see MONTEIRO, Carmen Diva Beltrão; GALVÃO, Letícia Andreoli. Op. Cit. 2006; CORDOVIL, Leonor. Op. Cit. 2012; WELLHAUSEN, Marc. *The Community Interest Test in Antidumping Proceedings of the European Union*. American University International Law Review, Volume 16, Issue 4, 2001.

⁴⁴ It should be noted that the examination of European Union and Canada in this section does not intend to suggest that these are the only systems that perform the public interest analysis, neither that these are the best ways to perform such an analysis.

A. EUROPEAN UNION

In the European Union, the antidumping and countervailing measures regulations have specific provisions concerning the Community⁴⁵ interest analysis.⁴⁶ In contrast, the safeguard regulation mentions this interest for several times throughout the provisions; yet, no particular article deals with it exclusively.⁴⁷

In short, and based on the antidumping and countervailing measure regulations, the Community interest analysis considers the various interests taken as a whole, including those of the domestic industry, users and consumers. After the proper consideration of all the information submitted, trade remedies (antidumping and countervailing measures) may not be applied if the authorities can clearly conclude that it is not in the Community interest to apply such measures.

Already in the initiation notice, a time limit is established for interested parties to present their argument to the European Commission concerning the Community interest. Such parties are considered to be the complainants, the importers and their representative associations, the representative users and the representative consumer organizations. All information submitted is made available for consult to other parties and they are entitled to respond.⁴⁸ Within the given time limit, parties may also request for hearings, when duly justified based on the Community interest.⁴⁹

The European Commission is responsible for analyzing the information submitted and issuing a technical opinion about the matter, which must be forwarded to the appreciation of the Advisory Committees. The discussion taken in the ambit of the Advisory Committees respect to the Community interest must be taken into consideration by the European Commission for its final decision on the application or not of trade remedies (antidumping and countervailing measures).⁵⁰

⁴⁵ The European Union was formally established by means of the Maastricht Treaty in 1993. Before that, however, the customs union was firstly referred to as the European Economic Community (ECC, Treaty of Rome, 1957) and later on as European Community (EC, Merger Treaty, 1967). Given that the current regulations on trade defense are based on regulations issued before the establishment of the European Union, the current regulations often refer to the Community interest as the Union interest.

⁴⁶ See Article 21 of the Council Regulation No. 1225/09 (Antidumping) and Article 31 of the Council Regulation No. 597/09 (Countervailing Measure). The Regulations were initially adopted in 1995 (Council Regulation No. 384/96 and 2026/97) following the conclusion of the Uruguay Round. Due to several amendments made to the Regulations since then, the Council decided, in 2009, to codify the regulations in the interest of clarity and rationality.

⁴⁷ See recital 11 and Articles 11, 16, 17 and 23 of the Council Regulation No. 260/09.

⁴⁸ See Article 21.2 of the Council Regulation No. 1225/09 (Antidumping) and Article 31.2 of the Council Regulation No. 597/09 (Countervailing Measure).

⁴⁹ See Article 21.3 of the Council Regulation No. 1225/09 (Antidumping) and Article 31.3 of the Council Regulation No. 597/09 (Countervailing Measure).

⁵⁰ See article 21.5 of the Council Regulation No. 384/96 (Antidumping) and Article 31.5 of the Council

At last, this final decision shall make public, to the extent possible, the considerations of the Authorities regarding the Community interest.⁵¹

In few occasions antidumping and countervailing measures were not imposed or modified due to the Community interest. In other words, such a non-imposition or modification based on public interest analysis appears to be an exception to rule.⁵²

It is important to stress that the European Commission has recently proposed a series of changes to modernize the European Union's trade defense instruments, including legislative and non-legislative proposals. Among the changes, the provisions in the Council Regulation No. 1225/09 (Antidumping) and Council Regulation No. 597/09 (Countervailing Measure) respect to the Community Interest would be amended so as to consider as an interest party all the European Union's producers and not only the complainants who filed the trade defense request.⁵³ Moreover, it is expected new guidelines on a Union interest (Community interest) test.⁵⁴

The legislative proposal is under analysis by the competent authorities and may become effective as of 2014. The Staff Working Documents setting out the draft guidelines, in turn, shall be subject to a public consultation, opportunity when stakeholders may submit their point of views within a certain period of time. At the end of that period the Commission will analyze the comments and organize the final version of the draft guideline, to be adopted and published by the Commission.⁵⁵

B. CANADA

The public interest analysis in Canada seems to be more complex and detailed.

As oppose to Brazil and European Union, but similar to United States, for example, Canada has a dual analysis for trade remedies investigations. The Canada Border Services Agency (CBSA) is responsible for analyzing the dumping and the subsidy. On the other hand, the Canadian International Trade Tribunal (CITT) is responsible for examining the injury, the casual link and the safeguards requests.⁵⁶

Regulation No. 2026/97 (Countervailing Measure).

⁵¹ See article 21.6 of the Council Regulation No. 384/96 (Antidumping) and Article 31.6 of the Council Regulation No. 2026/97 (Countervailing Measure).

⁵² SINNAEVE, Adinda. *The 'Community Interest Test' in Anti-dumping Investigations: Time for Reform?*. Global Trade and Customs Journal, (2007) 2, Issue 4, p. 158.

⁵³ See <http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_150838.pdf>, 08/22/13.

⁵⁴ See <http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_150837.pdf>, 08/22/13.

⁵⁵ See <http://europa.eu/rapid/press-release_MEMO-13-319_en.htm>, 08/22/13.

⁵⁶ See <<http://www.cbsa-asfc.gc.ca/sima-lmsi/brochure-eng.html>> and <http://www.citt.gc.ca/mandate/index_e.asp>, 07/28/13>

The Special Import Measures Act (SIMA) provides that in cases where the CITT makes an injury finding arising from a dumping or a subsidy investigation⁵⁷ the Tribunal shall, on its own initiative or upon the request of an interested person, initiate a public interest inquiry if it has reasonable grounds to believe that the application of the antidumping or countervailing measure, or the measure in its full amount, would not or might not be in the Canadian public interest.⁵⁸

According to the Guidelines on Public Interest Inquiries, the ones entitled to submit a request are any party to the regular injury inquiry or any other group or person affected by the regular injury finding. Moreover, the request must be submitted within 45 (forty five) days of the regular injury finding.⁵⁹

If information provided is sufficient, the CITT will notify the commencement of the public interest inquiry and invite all parties that received the Tribunal's injury finding to respond to the interested person's request, if they wish so. After the initiation of the inquiry, parties will have the opportunity to present their arguments (orally and/or in writing) and a public hearing is normally held. The time frame for the public interest inquiry may vary depending on the number of parties involved and the complexity of the arguments presented. Still, nearly 100 days from the commencement of the inquiry, the CITT will issue a report⁶⁰ to the Minister of Finance recommending that the measures are not imposed or that the measures be reduced and by how much.⁶¹

As opposed to Brazil and the current situation in the European Union, Canada has some guideline on the topics to be addressed as public interest. Despite any factor that the CITT considers relevant, Annex 2 of the Guidelines on Public Interest Inquiries expresses that the Tribunal should take into account the following factors in the public interest inquiry:⁶²

1. whether goods of the same description are readily available from countries or exporters to which the order or finding does not apply;
2. whether imposition of the full duties has had or is likely to have the following effects:
 - (a) substantially lessen competition in the domestic market in respect of like goods,

⁵⁷ Similar as in Brazil, the Canadian public interest inquiry does not embrace safeguard measures.

⁵⁸ SIMA, section 45(1).

⁵⁹ Interested persons may notify the CITT of their public interest concerns already when the notice of commencement of an injury inquiry is published. However, the Tribunal does not expect public interest issues to be discussed during that inquiry. Such an analysis will be conducted after the injury inquiry is finished. See <http://www.citt.gc.ca/publicat/pubint_e.asp>, 07/28/13.

⁶⁰ SIMA, section 45(4) and (5).

⁶¹ See <http://www.citt.gc.ca/publicat/pubint_e.asp>, 07/28/13.

⁶² See <http://www.citt.gc.ca/publicat/pubint_e.asp>, 07/28/13.

- (b) cause significant damage to producers in Canada that use the goods as inputs in the production of other goods and in the provision of services,
 - (c) significantly impair competitiveness by limiting access to:
 - (i) goods that are used as inputs in the production of other goods and in the provision of services, or
 - (ii) technology,
 - (d) significantly restrict the choice or availability of goods at competitive prices for consumers or otherwise cause them significant harm;
3. whether a reduction or elimination of the antidumping or countervailing duty is likely to cause significant damage to domestic producers of inputs, including primary commodities, used in the domestic production of like goods; and
4. any other factors that are relevant in the circumstances.

Similar to the European Union, few public interest inquiries resulted in revocation or modification of the antidumping or countervailing measures.⁶³

IV. CASE LAW ON PUBLIC INTEREST ANALYSIS IN BRAZIL

The institutionalized public interest analysis in Brazil performed by GTIP is very recent. GTIP itself was created on February, 2012. Notwithstanding this, such an analysis was already conducted by GTDC.

In this sense, prior to GTIP there were numerous antidumping cases where the public interest played an important role. In fact, from 1998 to 2011, 12 cases had the antidumping measure revoked or modified due to public interest. See below a list of these measures:⁶⁴

- Disodium carbonate – the measure was suspended for unlimited period because it would negatively affect the glass and cleaning products industry, which were the users of the investigated product (Ordinance MICT/MF No. 13 of 1998; SECEX Ordinance No. 23 of 1998).
- Preserved peach – the measure was suspended as long as the product remained in the List of Exception to the Common External Tariff of Mercosur, because the tariff rate of 55% was already a protection to the domestic industry (CAMEX Resolution No. 11 of 2002).

⁶³ For further information on the cases with public interest inquiries see <http://www.citt.gc.ca/dumping/interest/index_e.asp>, 07/28/13.

⁶⁴ Free translation of list elaborated by the Brazilian National Confederation of Industry and based on CAMEX Resolutions (See Bulletin of the Brazilian National Confederation of Industry, Trade Remedies Observatory, Ano 1, Número 1, August 2012 (available at <<http://www.cinpr.org.br/uploadAddress/Observatorio%20Agosto%202012%5B36739%5D.pdf>>, 07/28/13)

- New tyres for bicycles – the measure was suspended for unlimited period because the injury to the domestic industry tended to be lower than the injury cause to the country's interest to expand trade relations with India and China (CAMEX Resolution No. 02 of 2004).
- Ferro alloys (high carbon content) – the measure was suspended for unlimited period because of the country's interest to preserve the price stability in the metal sector (CAMEX Resolution No. 36 of 2004).
- Ammonium nitrate destined to the fertilizing industry – the measure was suspended for unlimited period because of the country's interest to preserve the price stability of the product as well as due to the importance of this product to the main agriculture business in Brazil (CAMEX Resolution No. 71 of 2008).
- Portland Cement – the measure was suspended for unlimited time for imports cleared in Roraima because of the country's interest to preserve price stability of the Portland cement in the State of Roraima (CAMEX Resolution No. 36 of 2006).
- Footwear – the measure had the method of calculation modified due to public interest reasons, among them, the increase in the import tariff rate for products affected by the measure during the investigation and the intention to reduce the burden on users with lower purchase power (CAMEX Resolution No. 48/2009).
- New tyres for automobile vehicles – the measure was suspended for 6 months due to the national policy to foster the purchase of popular automobile vehicles through the reduction of internal tax (IPI) (CAMEX Resolution No. 49 of 2009).
- Ball point pen – the measure was modified to an *ad rem* (specific) duty due to public interest reasons, among them, the necessity to avoid the burden on school-material mentioned in Article 70, VIII, of Law 9.394 of 1996 (CAMEX Resolution No. 24 of 2010).
- Glyphosate – the measure was modified due to public interest reasons, among them the importance of the product to the agriculture sector the maintenance of agriculture production in Brazil. (CAMEX Resolution No. 41 of 2010).
- Portland Cement - the measure was suspended for unlimited period for imports destined to Acre, Amazonas, Roraima and some areas of Pará because of the country's interest to preserve price stability of the Portland cement in these States (CAMEX Resolution No. 64 of 2010).
- Poly vinyl chloride resin – the measure was modified to an *ad valorem* duty due to the necessity to restore the effectiveness of the measure (CAMEX Resolution No. 66 of 2011).

After the creation of GTIP and until this moment,⁶⁵ 5 (five) procedures were formally initiated and no measure was revoked or modified yet. See below a list of GTIP's procedures:⁶⁶

- Long fibers blanket – Proceeding SEAE/MF 18101.000745/2012-48 and CAMEX Resolution No. 92 of December, 2012 (at the time of the initiation of this proceeding the specific form had not yet been released)
- Polymeric Methylene diphenyl diisocyanate (MDI) – CAMEX Resolution No. 50 of July, 2012 (initiation notice), Proceeding SEAE/MF 18101.000349/2012-11 and CAMEX Resolution No. 28 of April, 2013 (termination notice)
- Lightweight coated (LWC) paper – CAMEX Resolution No. 50 of July, 2012 (initiation notice), Proceeding SEAE/MF 18101.000362/2012-70 and CAMEX Resolution No. 29 of April, 2013 (termination notice)
- Flat rolled stainless steel products – CAMEX Resolution No. 58 of July, 2013 (initiation notice) and Proceeding SEAE/MF 18101.000334/2013-33 (ongoing proceeding).

Unfortunately, it is not possible to draw a comparison of efficiency between the previous and the current system given that no particular procedure was established for the former public interest analysis. In other words, the comparison is not feasible because it is not possible to know how many requests were denied by GTDC and on what basis. Anyhow, it is believed that the current system is a substantial improvement to the Brazilian public interest analysis, not only in the material substance of the cases but also in procedural aspects.

V. FINAL CONSIDERATIONS

The public interest analysis in Brazil has developed considerably with the creation of GTIP. Similar to other WTO Members such as European Union and Canada, Brazil seems to be granting more room to the public interest debate within trade remedies context.

Moreover, even though none of the Brazilian applicable regulations outline topics to be addressed as public interest, the information required in the form for requesting the registration of a GTIP analysis indicate that this assessment should focus on the economic effects of a trade remedy (antidumping and countervailing measures).

⁶⁵ July, 2013.

⁶⁶ List elaborated based on CAMEX Resolutions.

Despite the little time of existence, GTIP has conducted important public interest analyses and parties involved in trade remedies procedures are becoming gradually aware of this mechanism.

In sum, it is believed that the public interest analysis is and will continue being an essential tool so as to balance the benefits to the domestic industry and the burden to other private parties affected by antidumping and countervailing measures.

SOCIAL ENTREPRENEURSHIP: BRINGING TOGETHER IMPACT INVESTMENT, TRADE FACILITATION AND REGULATORY REFORM

Eduardo Márquez Certucha*

Abstract. The social and economic evolution of the world has come to recognize that boundaries between the private sector, governments and non-profits have started to overlap. In this context, social entrepreneurship has found in Impact Investment (investments made with the intention to generate a social impact) a new asset class that could be the corner stone of the equilibrium of public and private investments in social projects. This paper will urge the need for a holistic approach between impact investment and regulatory business reform in order to provide the investment climate needed for social entrepreneurship to reach their development goals, while proving the profitability of their business model. The first part of this paper outlines the nature, challenges and industry evolution of impact investments. The second part analyzes the way that the investment climate of a country affects investor perception, and specifically, how improving trade facilitation may enhance the possibility of lowering the cost for producers and enhance impact investment. The third part of the paper proposes the use of Social Impact Bonds as a mechanism to align the interest of governments, non-profits and the private sector in projects with a social impact.

Keywords: Economic Law; Trade; Trade Facilitation; Impact Investment; Social Entrepreneurship; Social Impact Bonds; Regulatory Reform; Business Reform; Investment Climate; Social Projects; Development.

* Foreign Associate in the Dallas office of Haynes and Boone, LLP. Master of Laws in International Business and Economic Law, with distinction, Georgetown University Law Center. Law Degree at Instituto Tecnológico y de Estudios Superiores de Monterrey.

We've used our creative power to focus on making money — and we've done it like it's the only game in town. It's not. There's a more exciting game in town (social entrepreneurship)."

MUHAMMAD YUNUS¹

I. INTRODUCTION

*t*he social and economic evolution of the world has come to recognize that boundaries between the private sector, governments and non-profits have started to overlap.² In

¹ David Bornstein, *Beyond Profit: A Talk With Muhammad Yunus*, The New York Times, April 17, 2013, available at <<http://opinionator.blogs.nytimes.com/2013/04/17/beyond-profit-a-talk-with-muhammad-yunus/>>

² Andrew M. Wolk, *Social Entrepreneurship and Government: A New Breed of Entrepreneurs Developing*

the need to efficiently address social problems, and due to the limited resources of the public sector and insufficient development of philanthropy, governments of all ideological trends³ have turned to the private sector as an alternative to face social problems by using large-scale private capital.⁴ As the role of these three sectors start to converge, a new sector has defined the path in which social and economic interests are to be tied: social entrepreneurship.⁵

In this context, Social Entrepreneurship intends to provide market-based solutions to reduce poverty and improve the social conditions of the so-called Base of the Pyramid (BoP)⁶ and proposes a new way to create shared value⁷ through a new investment model called impact investment.⁸ Impact investment, a term coined in 2007,⁹ refers to investments made with the intention to generate a social impact along with financial returns, and in which the social impact must be measured and quantified.¹⁰

As this emerging industry starts to develop, recent reports show optimistic results, taking into consideration that impact investment accounted a total of USD\$8 billion in 2012 and in which investors plan to commit USD\$9 billion in 2013. However, the challenges of investing in a BoP environment means that due to the philanthropic nature of the business, there is a great exposure to low and volatile margins, where the greatest challenge of this business model is to actually prove that it is sustainable.¹¹ Thus, as this

Solutions to Social Problems, U.S. Small Business Administration's 2007 The Small Business Economy: A Report to the President, 2007, at 156.

³ Goldsmith, Stephen, and William D. Eggers, *Governing by Network: The New Shape of the Public Sector*. Washington, DC: Brookings Institution Press, 2004, at 23

⁴ J.P. Morgan et al, *Impact Investment: An emerging asset class*, J.P. Morgan Global Research, November 29, 2010, at 5

⁵ "Social Entrepreneurship and Government: A New Breed of Entrepreneurs Developing Solutions to Social Problems," in the U.S. Small Business Administration's 2007 The Small Business Economy: A Report to the President. P. 163

⁶ The "Base of the pyramid" describes groups of people in emerging markets who earn less than \$3,000 a year (2002 PPP) World Resource Institute.

⁷ "The principle of shared value, which involves creating economic value in a way that also creates value for society by addressing its needs and challenges. Businesses must reconnect company success with social progress." Michael E. Porter and Mark R. Kramer, *Creating Shared Value*, Harvard Business Review, January-February 2011 at 4

⁸ Ashish Karamachandi et al, *From Blue Print to Scale, The Case for Philanthropy in Impact Investing*, Executive Summary, April 2012, at 1

⁹ The Rockefeller Foundation, *Accelerating Impact, Achievements, Challenges and What's Next in Building the Impact Investing Industry*, New York, July 2012, at ix

¹⁰ As defined by the Global Impact Investing Network (GIIN), Impact Investments are "investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return. They can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending upon the circumstances." Global Impact Investing Network (GIIN), *About Impact Investing*, available at <<http://www.thegiin.org/cgi-bin/iowa/resources/about/index.html>>

¹¹ Ashish Karamachandi et al *supra* note 8 at 6.

paper will attempt to prove, it is important to recognize that impact capital by itself is deemed to fail if it is not coupled with joint efforts between the government, the non-profit sector and the private sector.

Therefore, the greatest challenge that social entrepreneurship faces today is to be proven worth it. Impact investors have turned to social entrepreneurship as an alternate business model to address social issues. This paper will urge the need for a holistic approach between impact investment and regulatory business reform in order to provide the investment climate needed for social enterprises to reach their development goals, while proving the profitability of their business model. The first part of this paper outlines the nature, challenges and industry evolution of impact investment. The second part analyzes the way that the investment climate of a country affects investor perception, and specifically, how improving trade facilitation may enhance the possibility of lowering the cost for producers and enhance impact investment. The third part of the paper proposes the use of Social Impact Bonds to align the interest of governments, non-profits and the private sector, as an example of how governments may use trade facilitation as a hook or pitch for impact investors.

II. IMPACT INVESTMENT

A. BREEDING A NEW ASSET CLASS

Even though the term ‘impact investment’ is relatively new, the practice of investing to generate social and environmental impact is not.¹² In 1948 the Commonwealth Development Corporation (“CDC”) was created in the United Kingdom (“UK”) as the world’s oldest Development Financial Institution (“DFI”).¹³ The CDC provides support in building businesses and investing in a commercially sustainable fashion in Africa and South Asia.¹⁴ Similarly, in 1956 the International Finance Corporation (“IFC”), the private sector driven entity of the World Bank, and the largest development institution focused on private sector development in developing countries, was created in order to foster development, generate jobs and contribute to local communities in emerging markets.¹⁵ Other examples in the private sector include financial institutions such as Prudential, which formally established a social investment program in 1976 and has

¹² The Rockefeller Foundation, *supra* note 9 at 4.

¹³ CDC, Who We Are, available at <<http://www.cdcgroup.com/who-we-are.aspx>>

¹⁴ CDC group Who We Are <<http://www.cdcgroup.com/who-we-are.aspx>>

¹⁵ International Finance Corporation (IFC), The World Bank Group, About IFC, available at <http://www1.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/about+ifc>

invested more than USD\$1 billion since.¹⁶ Also, one of the most well-known and successful examples of an innovative social business is the Grameen Bank,¹⁷ a world leader and pioneer in microfinance that provides financial services to the rural poor in Bangladesh.¹⁸ Another relevant example is the creation of the Acumen fund in 2001, a non-profit entity that raises capital in order to invest in companies, leaders and ideas to fight poverty.¹⁹

Accordingly, while these private-driven, socially-focused practices started to develop, governments around the world started to enact legislation that could stimulate the growth of these and other social initiatives. Examples of this type of legislation and policies that have enhanced the growth of impact investment include the Community Reinvestment Act²⁰ in the United States, Brazil's Clean Development Mechanism,²¹ Kenya's Microfinance Act,²² Malaysia's Corporate Social Responsibility Disclosure Rule²³ and the Mexican Law of Common Savings and Credits.²⁴ Therefore, in order to attract the private and the non-profit sectors into partnerships in which social issues are to be tackled, governments have started to develop social investment initiatives as an ongoing trend in which public and private capital meet. The UK government has established Big Society Capital as an impact investor with around USD\$960 million;²⁵ in 2012, the Overseas Private Investment Corporation, the US government DFI, committed USD\$285 million to invest in emerging markets through several impact investment funds.²⁶

¹⁶ J.P. Morgan et al, *supra* note 4 at 15.

¹⁷ Nowadays owned 90% by borrowers of the bank, and 10% by the Government. Grameen Bank, About us, A history of Grameen Bank, available at <http://www.grameen-info.org/index.php?option=com_content&task=view&id=19&Itemid=114>

¹⁸ Grameen Bank, About Us, <http://www.grameen-info.org/index.php?option=com_content&task=view&id=792&Itemid=759>

¹⁹ Acumen, About, available at <<http://acumen.org/about/>>

²⁰ CRA, Pub L. 95-128, title VIII of the Housing and Community Development Act of 1977, 91 Stat. 1147, 12 U.S.C. § 2901 *et seq.*

²¹ The Rockefeller Foundation, *supra* note 9 at xvii.

²² *Id.*

²³ *Id.*

²⁴ Ley de ahorro y crédito popular, Law of savings and popular credit, Mexico, 5 of June of 2001, *Diario Oficial de la Federación*, Mx, 2001.

²⁵ J.P. Morgan, Insights into Impact Investment Market, An in-depth analysis of investor perspectives and over 2,200 transactions, J.P. Morgan Social Finance Research, December 14, 2011, at 8.

²⁶ Mitchell L. Strauss, Six questions on Impact Investing, OPIC, The Opic Blog, June 05, 2012, available at <<http://www.opic.gov/blog/impact-investing/six-questions-about-impact-investing>>

B. SECTOR FOCUS AND INDUSTRY BUILDING

Impact investment emerges as an innovative asset class²⁷ with the potential to revolutionize the asset management industry in the following years.²⁸ The general scope of the definition of impact investment is considered to include a two-prong test: (i) the investment must have the intention to generate social impact; and (ii) there must be evidence that the social impact was met in the intended target area.²⁹ As a result, impact investments operate around different sectors, but most commonly through agriculture, water, housing, education, health, energy and financial services.³⁰ Among these sectors, and as it is expected with all types of investments, there is a sector exposure risk that must be taken in consideration. Because impact investors try to leverage their investments with competitive advantages that a certain region or developing country may offer, a survey conducted by JP Morgan in 2011, showed that the sectors with more impact investment representation were (1) financial services (through microfinance), (2) food and agriculture, and (3) clean energy and technology.³¹ However, the 2013 survey conducted by JP Morgan, showed, that investors, in a forward-looking response, believed that the sectors where more focus would be placed in the following year were (1) food and agriculture, (2) healthcare, (3) financial services (excluding microfinance), (4) microfinance and (5) education.³²

As the impact investment industry starts to progress, investors acknowledge how the industry has evolved from the ‘uncoordinated innovation’ stage, to the ‘market building’ stage.³³ In this ‘market building’ stage, the investment really starts to develop, but in order to capture the value of the market place, legal and material infrastructure is needed to reduce transaction costs and optimize resources.³⁴ Once the value of the marketplace is captured, then impact investment will reach its ‘maturity’ stage, which is the stage where the track record and consolidation of investments will reach a steady growth.³⁵ Therefore, in generating the legal and material infrastructure needed, governments must continue (if started) to promote impact investments through multiple mechanisms such as public-private partnerships and other legal reliefs such as guarantees, subsidies or procurement, and most importantly by providing the investments, and the investors, with

²⁷ J.P. Morgan et al, *supra* note 4 at 5.

²⁸ J.P. Morgan et al, *supra* note 4 at 13.

²⁹ The Rockefeller Foundation, *supra* note 9 at 8.

³⁰ J.P. Morgan et al, *supra* note 4 at 7.

³¹ J.P. Morgan, *supra* note 25 at 12.

³² J.P. Morgan, *Perspective on Progress, The Impact Investor Survey*, J.P. Morgan Social Finance Research, January 7, 2013, at 6

³³ The Rockefeller Foundation, *supra* note 9 at x.

³⁴ *Id.*

³⁵ *Id.*

an adequate investment climate that may be accomplished through regulatory reforms. As investors decide the market where they are going to place their investments, some of the key indicators that are taken into consideration, for obvious reasons are: the country's treatment to foreign investors, access to finance and trade facilitation.

C. CHALLENGES FACED BY IMPACT INVESTMENT

Naturally, impact investment faces the great challenge of delivering profitable social services to the BoP, while proving that its business model is financially sustainable.³⁶ As an asset class, impact investments are usually averagely small deal sizes that represent a high cost of due diligence for institutional investors.³⁷ Similarly, top challenges faced by investors and the industry itself are the 'lack of appropriate capital across the risk/return spectrum' and the 'shortage of high quality investment opportunities with a track record'.³⁸ The JP Morgan survey on impact investors identified the following as the most important investor's risks: the 'business model execution & management risk', 'country & currency risks', and 'macroeconomic risk'.³⁹ Therefore, this paper suggests that governments and policymakers should engage and partially own these risks and challenges by improving the investment climate in order to attract investors by reducing operational costs and improving the host country trade facilitation.

Finally, it is important to note that at the core of impact investment is its evaluation, where the measurement of social impact is found to be a challenge that has been addressed by important organizations and promoters of the impact investment industry. Such organizations include the Rockefeller Foundation, the Acumen Fund and B Lab, which in 2008, in collaboration with USAID, Hitachi, PricewaterhouseCoopers, and Deloitte created the Impact Reporting and Investment Standards⁴⁰ (IRIS).⁴¹ Thus, as the impact investment industry starts to develop and position itself as a new asset class with an enormous potential, governments must understand the role they play in enhancing and promoting foreign and private capital on impact investment. To do so, government policies must improve the investment climate so that the cost and risk of investments becomes lower, while providing the legal certainty needed for this business model to grow steadily. The involvement of governments through guaranties and credit enhancement

³⁶ J.P. Morgan et al, *supra* note 4 at 12.

³⁷ *Id.* at 35.

³⁸ J.P. Morgan *supra* note 32 at 9.

³⁹ *Id.* at 13.

⁴⁰ The Rockefeller Foundation, *supra* note 9 at 31.

⁴¹ "IRIS is a set of standardized metrics that can be used to describe an organization's social, environmental, and financial performance. IRIS' independent and credible performance measures help organizations assess and report on their social performance." Impact Reporting Investment Standards, <<http://iris.thegiin.org/>>

is also an important variable that impact investors will look for when structuring their business and deciding the country and sector in which they will want to invest.

III. INVESTMENT CLIMATE AND TRADE FACILITATION

A. IMPROVING THE INVESTMENT CLIMATE

When creating an enabling environment for impact investment, government policies to attract foreign capital must be initially focused in improving the investment climate. In this section, the paper will focus on how improving a country's trade facilitation positively affects the investment climate and may foster impact investment by enabling producers and investors to reduce operational costs, facilitate export and import of products and services, and increase productivity.

Trade challenges in developing countries affect the way these countries compete with products and services from developed countries.⁴² Trade facilitation means the efficient and simple use of export and import policies that provide a fast response to a product supply chain.⁴³ Therefore, improving the investment climate in which impact investors will want to invest means to provide trade facilitation by improving the "full set of policies designed to reduce trade transaction costs".⁴⁴ Embedded in trade facilitation is the desire to liberalize the market in order to promote competition.⁴⁵ Consequently, emerging markets must understand that whether corrupt or bureaucratic their country is, in order to effectively promote investment and address social issues through impact investment with private (foreign or domestic) capital, a reduction of time and procedures in trade must be made in order to reduce costs which would facilitate the implementation of trade-related impact investment models.

For example, in the US it takes 6 days to export a 20-foot container,⁴⁶ while in Mexico it takes 12 days⁴⁷ and in Chad it takes 75 days.⁴⁸ The effect that time has on trade has been measured by different studies, providing remarkable results, such as

⁴² Uma Subramanian, Trade Logistics Reform, Linking Business to Global Markets, The World Bank Group, View Point Note Number 335, December 2012, at 1

⁴³ *Id.*

⁴⁴ Jean-Christophe Maur and Ben Shepherd, Regional Integration and Trade Facilitation, WTO Publications, Discussion Forum, June 7, 2011 available at <http://www.wto.org/english/res_e/publications_e/wtr11_forum_e/wtr11_jun11_e.htm>

⁴⁵ Andrew Grainger, Customs and Trade Facilitation, *World Custom Journal*, Volume 2, Number 1, 2008 at 4

⁴⁶ World Bank, *Doing Business 2013*, 10th edition, Washington D.C., at 203.

⁴⁷ *Id.* at 181.

⁴⁸ *Id.* at 156.

the fact that reducing 1% the time it takes to export a product could have a potential increase in bilateral trade ranging from 0.64% for Sub-Saharan Africa to 0.18% for OECD countries.⁴⁹ Similarly, a reduction of the same 1% in the time for exports could potentially have an increase in exports of 0.37%.⁵⁰ Now, imagine reducing the time it takes to export a product and clear customs by 10%, the results would be astounding. With respect to time-sensitive products that are important for agriculture, such as fruit and vegetables, a study found that an increase in time for each day of transit of these products, translates to a 0.9% price reduction of such product,⁵¹ but a reduction of trade of 1%.⁵² This means that for every day a time-sensitive product is delayed, its price may be reduced in almost 1% (due to its perishable nature), but because the product was delayed, the conditions of the shipment and terms of the contract, and general obligations acquired between the parties, cause a reduction in trade of almost 1%. Therefore, when assessing the country that impact investors will want to invest, for example in the agricultural sector, for a product say coffee, the investment climate, specifically trade facilitation, would be an important indicator to consider in order to optimize time and cost, but also to assess a product and market viability in fulfilling contractual terms and estimated times for delivery of a product.

Trade facilitation is often referred to as trade logistics. Among the international organizations that have moved towards the analysis and study of trade facilitation is the World Bank through their Logistics Performance Index (“LPI”) initiative. The LPI initiative rates economies depending on the performance and assessment of logistics. In general, countries with a low score tend to spend more days to export and import goods.⁵³ However, trade logistics is not only about reducing time, but also an important performance indicator is the reliability and predictability of the supply chain.⁵⁴ Producers will have to spend time and money in mechanisms to mitigate reliability and predictability of the supply chain, which would end up burdening the price of a product. This unreliability on logistics may be represented through extensive bureaucratic paperwork, excessive physical inspections, and even discretionary inspections that could cause variations and modification in a product clearance time.⁵⁵ Therefore, LPI focuses their research on 6

⁴⁹ Subramanian, Uma, William Anderson, and Kihoon Lee, *Less Time, More Trade: Results from an Export Logistics Model*, Draft, Investment Climate Department, World Bank Group, Washington, DC.

⁵⁰ Hausman, Warren H., Hau L. Lee, and Uma Subramanian. 2012. “The Impact of Logistics Performance on Trade.” *Production and Operations Management Journal*. First published online January 18. DOI: 10.1111/j.1937-5956.2011.01312.x.

⁵¹ David Hummels, *Calculating Tariff Equivalents for Time in Trade*.” Nathan Associates for U.S. Agency for International Development, Washington, D.C., 2007 at iii

⁵² See Djankov et al, *Trading on Time*, *The Review of Economics and Statistics* 92 (1) at 166–73.

⁵³ World Bank, *Connecting to Compete, Trade Logistics in the Global Economy*, *Logistic Performance Indicators (LPI)*, Washington, D.C., 2010 at 1.

⁵⁴ *Id.*

⁵⁵ *Id.* at 2.

specific indicators, which are (1) customs, (2) infrastructure, (3) international shipment, (4) logistics competence, (5) tracking & tracing, and (6) timeliness.⁵⁶

Studies have shown that in developing countries, transport and logistics account for 20-60% of delivered food prices.⁵⁷ One example is the fact that transport and logistics make up 48% of the cost of Nicaraguan corn imported in the US.⁵⁸ For logistic performance, the LPI initiative has determined that the most important indicator is the reliability on the supply chain.⁵⁹ Mitigating the unreliability of the supply chain may move exporters or producers, to have a high level of inventory which represents, depending on the commodity, larger costs than direct costs of freight.⁶⁰ Malawian sugar exporters for example, choose to save money and use an unreliable railway to an intermediate storage in a small port, rather than paying high costs in transport such as the ones paid by garment manufacturers that participate in a preferential African Growth and Opportunity Act program with the US, to use efficient transportation (from 2,000 km to 5,000 km) to reach the ports of Durban or Cape, but at a higher cost.⁶¹ For this reason, governments should address the sources of under performance, time delays, and take cost-effective measures to redeem such unreliability on supply chains. It is important to note, that most of the reforms suggested, are administrative and executive (branch) in nature rather than legislative, in the understanding that governments may provide such regulatory measures usually through easier procedures and directives rather than through legislative procedures or enactment of new laws.

B. ENHANCING TRADE FACILITATION

In regards to the cost-effectiveness that trade facilitation enhances, in 2004 the General Council of the World Trade Organization (“WTO”) launched, as part of the “July Package”,⁶² an explicit consensus to begin negotiations on trade facilitation.⁶³ Despite the

⁵⁶ World Bank, Logistics Performance Index, Global Ranking 2012, available at <<http://lpi.survey.worldbank.org/international/global>>

⁵⁷ World Bank, Global Trade Logistics Performance Slows Down Amid Recession and Major Events, Press Release No:2012/446/PREM, May 15, 2012, Washington D.C. <<http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:23196035~pagePK:64257043~piPK:437376~theSitePK:4607,00.html>>

⁵⁸ Id.

⁵⁹ World Bank, *supra* note 53 at 20.

⁶⁰ Id.

⁶¹ Id.

⁶² The “July Package” refers to the text of the General Council, agreed on August 1, 2004, on the Doha Agenda. WTO, DOHA development agenda, text of the “July Package”, <http://www.wto.org/english/tratop_e/dda_e/draft_text_gc_dg_31july04_e.htm>

⁶³ WTO, Trade Facilitation, Negotiations, The launching of negotiations on trade facilitation, available at <http://www.wto.org/english/tratop_e/tradfa_e/tradfa_negoti_e.htm>

stall that the disagreement with some imports on agricultural issues caused in the Doha round, in recent years, WTO member countries found a common ground in regards to trade facilitation, where, quoting the chairman of the committee:

there was a collective acknowledgement of its win-win potential for all Members, with work here in Geneva moving forward and of course provided technical assistance and capacity building for developing countries and in particular the least-developed countries is adequately provided.⁶⁴

In such negotiations, the idea was to expand Trade Related Technical Assistance (“TRTA”) to developing countries not only to facilitate the implementation of WTO rules, but also to provide capacity building.⁶⁵ Furthermore, in November 2012, the “Seoul Symposium on Trade Facilitation and the Doha Development Agenda” reaffirmed the need to reach a prompt agreement on the implementation of trade facilitation measures, primarily for developing countries.⁶⁶

Some of the examples given to improve trade facilitation for developing countries have been the implementation of single window systems and substantiating risk management.⁶⁷ Other alternatives proposed for the implementation of such mechanisms, include the implementation of Public Private Partnerships (“PPP”) to allow the approach of financing agencies for the establishment and installation of such mechanisms.⁶⁸ However, in order to achieve positive results, academics and the private sector have emphasized the need of ‘political will’ to effectively implement new trade facilitation policies.⁶⁹ At this point, trade facilitation has made a call for coordination between governments and the private and non-profit sectors to join efforts to provide effective tools, such as capacity building, technical assistance, and public private ventures in order to successfully address this issue.

Traditionally, government efforts and improvements in trade facilitation has come from support in infrastructure and the modernization of customs through information technology,⁷⁰ however, policymakers should also pay attention to other sectors such as logistics, coordination of government programs such as the optimization of government subsidies and joint cross-border initiatives such as coordination of border management

⁶⁴ WTO, News Item, Report by the chairman of the trade Negotiations Committee, May 1 and 2, 2012, available at <http://www.wto.org/english/news_e/news12_e/gc_rpt_01may12_e.htm>

⁶⁵ WTO *supra* note 53.

⁶⁶ WTO, Summary on “Seoul Symposium on Trade Facilitation and the Doha Development Agenda”, November 27-28, 2012, available at <http://www.wto.org/english/tratop_e/tradfa_e/seoul_symp_nov12_e/seoul_symp_nov12_e.htm>

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ World Bank, *supra* note 53 at 23.

and technical assistance as supported by the TRTA of the WTO. Another policy approach that should be address is the government cooperation in product clearance. By providing cooperation with other agencies (national and foreign), easing clearance mechanisms (without overlooking product sanitary standards) governments might be able to improve the investing climate and provide higher certainty in trade facilitation and logistics reliability.

It is also important to mention that while it is true that these measures that improve trade facilitation would be generalized, the idea of the government policy would actually be to find, for each specific country, in each specific case, the competitive advantage in which trade facilitation could foster a specific sector, which should be of course, tied with the impact investors' enthusiasm in a specific program, sector or product. That being said, trade facilitation, for impact investment purposes, could be translated to a consensus of a particular need of a country, in which the government, instead of waiting for external sources of funding, would allow challenged social models to have an opportunity for success. In the event that the general policy of trade facilitation applied to a specific program, sector or product increases importantly the margin of profits, and thus, attracts a bulk of investors, now then, the government policy would be successful in building its own market and fostering a specific program, sector or product, without the need of social investors. However, the government policy should be really aggressive in order to attract investors outside the impact investors (or impact investment as an asset class), or charitable investors sphere, and therefore such aggressive measure could raise other trade related issues.

C. GOVERNMENT INCENTIVES TO PROMOTE TRADE FACILITATION

With regard to the role of developed nations in fostering and promoting trade facilitation, it is important to note that in 2012, countries like Sweden, the US, Norway and even the European Union have made donations to the Trade Facilitation Negotiation Group Fund. However, such donations do not add up to even USD\$1.5 million.⁷¹ This fact may lead us to think that either the issue has not been given the sufficient importance, or a lack of true transformational political will exists. Developing countries must be encouraged to copy, or improve better practices of trade facilitation. Also, the WTO has urged developing countries, including landlocked countries, to play an active role in the negotiations and implementation of trade facilitation.⁷²

⁷¹ WTO, Trade Facilitation News Archive, available at <http://www.wto.org/english/news_e/archive_e/fac_arc_e.htm>

⁷² WTO, Arancha Gonzalez urges landlocked poor countries to play active role in trade facilitation talks, LLDCs and International Trade and Trade Facilitation Conference, New York, March 20, 2013, available at <http://www.wto.org/english/news_e/news13_e/lldc_20mar13_e.htm>

But how could countries be incentivized to promote the development of trade facilitation and the implementation of technical assistance? One answer to this question is through impact investment. As noted before, impact investment brings together profit and social awareness, which is translated into private and public efforts working together towards one same goal. Thus, through impact investment, new forms and mechanisms of capacity building, technical assistance and even negotiation, may be reached through the engagement and combination of public and private funds, or public funds and private expertise, in which the implementation of a government policy, related to trade facilitation, would be tied to the investment of private or public (national or foreign) capital in technical assistance to impact investment projects for exporters.

Governments should see the opportunity of enhancing trade facilitation as a holistic approach towards the development not only of trade-related infrastructure or management institutions, but as a direct impact that these measures will have on the cost of products, the income of producers, and the increase of investment. If we are as strong as our weakest link, then governments will have to understand the need of partnering with the private sector but most importantly, to partner with the social and non-profit sector as well. While the private sector may provide capital and expertise, the non-profits usually have focused on understanding the need of the forgotten communities, which by including them and providing sustainable conditions of work and life, will start to play an active role in the economy of a country.

Also it is important to take into consideration that improving trade facilitation will most likely not trigger any Trade-Related Investment Measures, taking into consideration that the proposed policy changes in trade facilitation, actually translate into reciprocal trade liberalization, this is, the benefits that a country gets by providing better access to trade facilitation work for exporters as well as importers. Also, the policies discussed in this paper which in general include the improvement of the investment climate, do not require a change or modification of limits to balancing requirements, local content requirements, foreign exchange restrictions or exports restriction among others. The main idea behind trade facilitation to improve the investment climate is to attract investors, especially social impact investors, which, as evidenced in the first part of the paper, take into consideration, and need, to reduce their risks in order to prove the profitability of their business models, which usually take place in emerging markets. However, specific circumstances on this case should be evaluated by governments in the understanding that the trigger of TRIMs measures when implementing trade facilitation policies is actually a topic for another research.

The next section of this paper provides a model through which the needs of capacity building and technical assistance for product exporters could be met through the implementation of an impact investment model called Social Impact Bond ("SIB"). Similarly, this last part of the paper proposes another alternative, which is to use SIB in the implementation of private-initiative social programs to unsustainable subsidies, which

would include government support in the enhancing of trade reliability and logistics as part of the overall schematic of the deal.

IV. SOCIAL IMPACT BONDS

A. SIBs

Whereas technical assistance has been identified by investors as the main way in which government policies may improve the investment climate for impact investors;⁷³ and whereas the role of governments, with respect to technical assistance, has been limited (at some point) to the disbursement of funds, and a lack of unitary approach to reach rural (and marginal) export producers; and whereas non-profits have been limited by the lack of human and capital resources; now therefore, bringing social entrepreneurship and an impact investment model, such as the implementation of SIBs, could mean an innovative alternative to solve important social issues related to rural producers.

SIBs, also referred to as ‘pay for success contracts’,⁷⁴ are a new innovative mechanism in which the interests of governments, the private sector and non-profits are aligned for a common purpose: to generate a tangible and measurable social impact. This new approach to face social problems has given the opportunity for governments to expand social programs, where a partnership between impact investors and non-profits (or philanthropic foundations) assume the risk of the success of a determined project, and the government pays for such projects only if it has the social impact and success agreed upon by all, or if the success threshold is not met, then the fee is adjusted.⁷⁵ The evaluation of the social impact is done by an independent evaluator, who determines whether the program meets the previously defined outcome.⁷⁶ The great benefits of this model includes the transfer of risk of funding social services from the government to the private sector, while the private sector provides the expertise and technical resources needed to evaluate and offer a price-risk model with financial and social returns,⁷⁷ and the non-profit benefits from a stable revenue stream that allows them to increase their potential.⁷⁸ In 2010, Social Finance, a UK NGO, launched the first project of this type,

⁷³ J.P. Morgan *supra* note 32 at 11.

⁷⁴ Social Finance, Social Impact Bonds, available at <<http://www.socialfinanceus.org/work/sibs>>

⁷⁵ McKinsey&Company, *From Potential to Action: Bringin social impact bonds to the US*. May 2012, at 4.

⁷⁶ Social Finance, *supra* note 64.

⁷⁷ Notwithstanding the expectation of some investors to get a financial return, some people like Muhammad Yunus argue that the investment should be pure philanthropy, and that no return should be expected but for the sustainability of the project.

⁷⁸ Social Finance, *supra* note 64.

where the SIBs model is being used to rehabilitate the social reinsertion of 3,000 prisoners in the Peterborough Prison.⁷⁹ Other SIBs pilot projects have been implemented by other countries, for example in 2012 the state of Massachusetts launched the first SIBs model in the US in an attempt to fight homelessness.⁸⁰

B. SIBs, TRADE FACILITATION AND REGULATORY REFORM

Under this proposed idea, the main scheme would be that a bank (or institutional investors), partnered with a non-profit, would invest in a project focused on improving technical assistance and capacity building for rural producers, and in which the government would be in charge to pay for the project, only if such project brings the expected impact. Under this model, the government would not need to put money upfront, investors will be able to enter the export-import market and will have a great deal of leverage with host countries for customs reliefs, tax reliefs, subsidies or procurement. In an ideal successful and optimistic picture, government cooperation could even grant statutory or reciprocal reliefs to such projects that involve impact investors, which may be categorized through specific corporate forms such as the LC3s and Benefit Corporations that have been established in the US or the *Société d'Impact* as developed by certain European nations.

Therefore, SIBs may be an alternative for non-profits to increase their capital, in order to help the organization reach further in their development programs, and improve, modernize, and implement their best practices. Similarly, foreign countries, international organizations and institutional investors will want to fund such projects due to the influence that they could gain to incentivize host countries to improve their trade facilitation and further benefit by being supplied with technical assistance and capacity building of rural producers. Impact investors, whatever their intention may be, will receive the impact desired and the financial return promised. Governments will be able to channel social issues, while having a further spillover effect that will improve the investment climate, attract private investors and improve social conditions.

The big challenge this idea faces is the capacity of private investors to reduce the cost of production and supply chain of a product, while providing the same quality. In order to achieve this, 'government will' must be translated into a different type of support, which could range from economic and legal reliefs such as tax reliefs, subsidies or procurement, to procedural and administrative support for specific products or projects. For this reasons, impact investors, as well as interested parties, will approach governments that are able to understand the benefit of impact investment, and most specifically of SIBs. Governments could also provide important guarantees such as political risk guarantees that reduce the

⁷⁹ McKinsey&Company, *supra* note 65 at 20.

⁸⁰ *Id.* at 21.

risk of syndicated deals of non-profit and private investors.⁸¹ For their part, international organizations, interested foreign governments and DFIs (such as the IFC and CDC) may also be part of such projects through guarantees and also as co-investors.⁸² The participation of international agents will enhance the possibility to improve negotiations and settle the ground for host governments to improve their trade facilitation, while providing tangible social impact for their citizens.

C. SIBs, SUBSIDIES AND GOVERNMENT COOPERATION

Another alternative in which SIBs could be used to generate a social impact and enhance government cooperation within the regulatory framework of trade facilitation would be through a model focused in optimizing unsustainable government subsidies. Unsustainable government subsidies are expensive for governments, and tend to have negative effects on the long-run towards subsidized parties.⁸³ These types of subsidies are often found in the agricultural sector, where governments grant non-recoverable subsidies in order to help the production in the short term, or as some people claim, to directly modify the current situation of certain farmers. Generally, a well-established subsidy program has a macro-economic effect of providing efficiency and productivity impact, while having also an impact on the balance of payments.⁸⁴ In the micro level, there is a direct impact on price that has a social impact on producers' income, and a change in consumer behavior.⁸⁵ The social effects of subsidies tend to have a negative impact on communities, households and farmers to "respond to change without moving significantly from its equilibrium".⁸⁶

Because unsustainable subsidies is by itself a subject of a whole other investigation, this paper will not provide a specific case of unsustainable subsidy, but rather, raise the question on how, once an unsustainable subsidy is identified, it might be alternatively addressed. Critics to subsidies in general tend to question if subsidies is the best policy instrument to fight poverty and enhance agricultural production.⁸⁷ In this regard, critics

⁸¹ The Rockefeller Foundation, *supra* note 9 at 48.

⁸² *Id.*

⁸³ OECD, Sustainable Development Studies, Subsidy reform and sustainable development: political economy aspects, 2007, available at <<http://www.cbd.int/doc/case-studies/inc/cs-inc-oecd-SubsidyReform-PoliticalEconomy-en.pdf>>

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ OECD, *supra* note 86 at 36.

⁸⁷ Food and Agriculture Organization of the UN, Agricultural input subsidies and the green economy: fertilizer subsidies in sub-saharan Africa, presented at FAO at Rio +20, Rio de Janeiro, 2011, available at: <<http://www.imf.org/external/np/seminars/eng/2012/rio/pdf/ksll.pdf>>

question the fact of using public funds for private goods, as well as the large fiscal cost that subsidies represent for governments, which, in some cases, is at an unaffordable cost.⁸⁸ Another major critic rests upon the poorly implemented programs that governments offer and end up having lower economic, social and environmental benefits for all participants.⁸⁹ An example of poorly designed subsidy programs in agriculture are those in which the lack of information, preparation, and technical assistance to farmers, ends up generating a misuse of subsidies itself, such as an excess use of fertilizers not absorbed by crops that may pollute waterways.⁹⁰

Therefore, a new emerging idea for the optimization of government economic resources would be the implementation of a pay for success contract, a SIB, in which through social entrepreneurship and private initiative, the use of market-based solutions, such as the implementation of private-initiative programs for the distribution of funds and further technical assistance from NGOs or private organizations, would allocate the resources needed to optimize the use of funds in a supply chain. Evidently, the success of the program would be measured, and, if successful, the government would pay for such contract at the agreed fee. In order to incentivize the private sector, the SIB may be divided in different contracts and success fees itself, where there can be different impact measurements such as payments based on area planted, payments based on input use, payments based on input constraints and payments based on overall farming income. The overall benefit of this idea is the initial fiscal relief for governments, as well as the access to private initiatives in social programs with an economic return.

However, in order for these programs to have a direct or indirect impact on trade facilitation, government support should also be translated in milestone objectives in which governments commit themselves to reduce the cost that surround the supply chain of a product in order to obtain larger economic benefit on the reduced amount of funds that they would pay instead of the subsidy. Therefore, the idea assumes that private initiative programs should provide a more efficient way to address the implementation of funds to producers, but as the government role in this venture is supplanted, then the government would commit through government support agreements to provide tangible results to investors. Government cooperation could come from general ease on clearance and excessive inspections, to the provision or concession of infrastructure. A default from the government in fulfilling the milestone of its commitments would be remedied through compensation. As it is, this idea only provides a further debate on the type of business models that may be implemented, however it does sets a proposal to get access to finance and the counter benefits that governments, private actors, and social welfare could gain.

⁸⁸ Id.

⁸⁹ Id.

⁹⁰ Id.

V. CONCLUSION

Impact investments have grown in recent years to the point of creating a new asset class. As an emerging asset class, impact investments have called upon a sector of investors that were usually pushed to give away money without a measurable certainty of the social impact that their charity could generate. Another catch for impact investors is the way that impact investment provides a sustainable way to generate social impact in which funds are not lost, but rather provide a continuous flow of revenue. As such, impact investment relies on the capacity of social entrepreneurs to generate sustainable ideas that not only generate the social impact needed, but that have an economic return, and even emancipation and sustainability.

Among the intrinsic challenge that presenting these types of ideas represent to social entrepreneurs, impact investments have reached out to governments, not necessarily for help, but to react to this new investment tendency. The role of governments in this type of investments has evolved from a passive role to an active role. Governments have sought to be part of impact investment to alternate legal and investment mechanisms such as SIBs. SIBs might as well be the corner stone of the coordination of public, private and social ventures. Through this type of mechanisms, government interest and private interest merge to find a social solution.

It is through this type of investment that this paper has proposed to evaluate the approach in which governments, through private sector initiatives, may be actively involved in regulatory reform, specifically in improving the investment climate and specifically trade facilitation as one regulatory issue that is of great importance for investors as a whole. By involving the government in programs where trade facilitation has a direct impact, the commitment of the government rises to get a stake on projects, and a stake on the social welfare of its people. For these reasons, this paper has defined the areas in which investors have called for government assistance in order to develop successful impact investments. The second part of the paper has demonstrated the impact that trade facilitation has on exports, growth and trade, and has established the way that governments could possibly address this issue through the cooperation with the private sector. The last part of the paper has proposed two alternate models in which through SIBs and non-profits or through social programs (such as unsustainable subsidies), social investments may be capitalized economically and technically through the private sector, to reach the desired social impact.

While it is true that this paper does not offer a financial and business proposition to address these issues, it does promote the development of a new alternative to get access to finance, as well as a way in which PPPs may be accomplished not only in the economic and business side of a transaction, but in a way that private and social actors may enhance regulatory reform in a specific area such as trade. If governments are able to gather the best of the private, public and social sector, a holistic approach towards

the development of a country may be reached through the enhancement of regulatory reform, in this specific case, trade facilitation and the inclusion in the economy of long forgotten producers.

DICHOTOMOUS EVOLUTION, REGIONALISM AND MULTILATERALISM: PLURITERALISM AS A MISSING LINK

Ricardo García de la Rosa*

Abstract. The relationship between regionalism and multilateralism has resulted in numerous studies and discussions on the subject. There are several reasons, mainly in Asia and America, explaining the increase of preferential trade agreements starting in the nineties. The complex reality of these agreements is that they are not entirely good or bad; they can contribute positively to increase economic opportunities, or may be characterized by their exclusivity, discrimination or distortion. The design and intent are essential to become a propeller element of the multilateral trading system.

Keywords: Regional trade agreements, GATT, Regionalism, Multilateralism, OECD, WTO, Multilateral trading system, NAFTA.

* Researcher and professor at the Instituto Tecnológico Autónomo de México (ITAM).

¶ Translation by Jaime Gary López

I. INTRODUCTION

The analysis of international trade relations is traditionally based on a dichotomous conception: multilateralism and regionalism. Multilateralism is concretized through the establishment of trade agreements with global vocation -even if not all the countries are involved in this process-, by *ad hoc* international institutions, such as the “GATT” and the “WTO”. The multilateral system prefers the principle of “non-discrimination” through the most important instruments such as the clause of Most Favored Nation clause (“MFN”) and National Treatment (“NT”)¹. Meanwhile, regional economic integration based on the idea of preference can not appear as derogatory against the fundamental principle of multilateralism; however, the multilateral framework has shown, at the level of the negotiations, considerable blocs. This is due to the number of negotiators, decision making through *single undertaking*, as well as divergent interests among member States,

¹ See FloryThiébaud, *Le G.A.T.T. Droit international et commerce mondial* (L.D.J.D. 1968) 8 ; Dominique Carreau y Patrick Juillard, *Droit International Économique* (4a. Ed. Dalloz 2010) 189-190.

among other reasons. Therefore, it is not surprising the paralysis faced by the negotiations of the Doha Round, almost thirteen years after its launch.²

Some authors such as Christian Deblock,³ say that the multilateral trading system (“MTS”) is no longer adapted to the new realities of globalization, as the mandate of the WTO is limited to deal with new issues as regulatory standards, force of emerging economies, protection of rights and climate change, among others. This is corroborated by the recent “Report Abu-Ghazaleh”, in which it is demonstrated the urgent need to reform the MTS and the WTO rules in order to adapt them to an increasingly integrated world, where nations seek to maximize and position their exports in goods and services as well as their “know-how”.⁴

Under this scenario, some countries have chosen to agree to certain reciprocal concessions without extension to other partner countries; thus, under Article XXIV of the GATT, it is authorized, under certain conditions, the formation of regional free trade areas or customs unions introducing discriminatory trade for the benefit of the member States and to the detriment of the rest of the world. This, at first glance would seem contradictory, based on the fundamental principles outlined above, this means, the possibility of creating Preferential Agreements concluded under the rules of Article XXIV of GATT; however, the original drafters of the GATT established specific exceptions to the MFN clause for existing preferential schemes in 1947, as it was the case of the British Imperial System of Preferences (Ottawa agreements of 1932), as well as agreements on tariffs between the United States, Cuba and the Philippines (GATT Article I: 2), and customs unions and free trade areas (GATT Article XXIV).

The objective of this article is to examine,⁵ in the light of the different theories of international trade, the evolution of the economic regionalism and its relationship with the multilateral trading system, which, and in this case we share the increasingly widespread view, that it is a permanent and complementary interaction.⁶ It is proposed as a missing

² See Jeffrey J. Schott, “The future of the multilateral trading system in a multi-polar world” (2008) Discussion Paper/Deutsches Institut für Entwicklungspolitik 8.

³ Christian Deblock, «Régionalisme économique et mondialisation : Que nous apprennent les théories ? », (2005) Cahier de recherche CEIM 05-07, Continentalisation, 3.

⁴ Talal Abu-Ghazaleh, “WTO at the Crossroads, A report on the Imperative of a WTO Reform Agenda” (2012) Report Paper, <http://www.wto.org/spanish/thewto_s/dg_s/dft_panel_s/dft_s.htm>.

⁵ The basis of our analysis are basically the classical and neoclassical theories of regional integration processes, without ignoring existing -and heterodox positions themselves deserve a full study- that have addressed the issue from a different perspective. Our approach will be then from the liberal economic perspective, taking into account the neoliberal policies of the nineties and the current post-liberal regional processes in Latin America.

⁶ See, Antoni Esteve de Ordal, Matthew Shearer y Kati Suominen, Multilateralizing RTAs in the Americas: State of Play and Ways forward (WTO/HEI/NCCR Trade/CEPR Conference “Multilateralizing Regionalism” September de 2007); Jeffrey J. Schott, Free trade Agreements: US Strategies and Priorities (IIE 2004); Emanuel Ornelas, “Trade creating free trade areas and the undermining of multilateralism” (2004) EER 49 (7) 1717; and, Dominique Van Mensbrughe, Richard Newfarmer and Martha Denisse Pierola, “Regionalism vs. Multilateralism? at Richard Newfarmer (ed) Trade, Doha and Development: A Window into the Issues” (World Bank 2005).

link in the classic dichotomy of international trade, the concept of “plurilateralism” also understood as “trans-continentalism”.⁷

Reflection and analysis of economic regionalism emerged then immediately after the signing of the GATT. In this event, a number of economic and theoretical studies will aim to explain the effects of regionalism on the MTS. These studies have evolved over the years, and have been adapting to the different “waves of regionalization” that arose after the entry into force of the GATT and later with the creation of the WTO (II). Now a days we can not deny that regionalism and economic multilateralism are in constant interaction, there are many studies that attempt to explain these two visions of trade liberalization, sometimes considered antinomian, sometimes complementary, but always with a common goal of the liberalization of world trade (III).

II. A THEORETICAL APPROACH OF ECONOMIC REGIONALISM

In international relations, regionalism represents all forms of institutionalized cooperation between two or more countries. We are in the presence of a form of “orderly pluralism”⁸ that is indistinguishable from the concept of multilateralism rather than the number of actors and the scope of the rules.⁹ This concept, initially of limited use, was widespread until the early eighties when it began to progressively replace the concept of “regional integration”. This is certainly the definition retained by the WTO, which has a restrictive nature as it does not take in count cases of liberalization of trade and does not answer the question of why two or more countries are motivated to seek a deeper integration of their economies.¹⁰

In fact, if trade liberalization is its rationale, regionalism emerges before all from the order of political construction.¹¹ The commitment assumed by this way is always result of a strategic choice that rests on the conviction of the actors -founded or not-, that their interests will be defended in a better way and that the results will be more easily achieved inside the group than outside. Three elements are involved in this commitment:¹² i) a body of ideas, values and goals in view of creating greater security, wealth or other purposes in a given region; ii) a formal program aimed at building institutions which may

⁷ Cf. Antoni Esteveordal, Matthew Shearer y Kati Suominen, *op. cit.*

⁸ Mireille Delmas-Marty, *Trois défis pour un droit mondial*, (Seuil 1998) 173-174.

⁹ John-Gerard Ruggie, “Multilateralism: Anatomy of an Institution”(1992)Vol. 46, International Organization, 561.

¹⁰ Christian Deblock, *Régionalisme économique et mondialisation : Que nous apprennent les théories ?* (n 3).

¹¹ Peter J. Katzenstein, “Regionalism in Comparative Perspective” (1996) *ARENA* Working Paper n°1, University of Oslo 46 <<http://cac.sagepub.com/content/31/2/123.short>>date accessed May 2013.

¹² Andrew Hurrell, “Regionalism in a Theoretical Perspective”, en Louise Fawcett y Andrew Hurrell (eds), *Regionalism in World Politics: Regional Organization and International Order*, (OUP 1995).

be supranational as the European case, *ad hoc* institutions as the case of Regional Trade Agreements (“RTA”)¹³ among the countries of Latin America or the vast majority of RTAs notified to the WTO; and iii) a strategy of regionalization that will be followed by both public and private actors.

In order to clearly understand the issues of economic regionalism that arise, we will develop a brief analysis on the scientific studies of regional integration (A); and we will enunciate the current typologies of economic regionalism, which have evolved at various levels (B).

A. THE ECONOMIC LITERATURE ON REGIONAL INTEGRATION

For Fritz Machlup,¹⁴ economic integration is associated primarily with the labor division, involving the movement of goods and/or factors. This is linked to discrimination or non-discrimination of the regime of goods and factors of production, particular their origin and destination. Peter Robson,¹⁵ adopts a similar definition: “economic integration is mainly related to the efficiency of the resources used with particular reference to the spatial aspect. The necessary conditions their creation are the free movement of goods and factors of production, as well as the absence of discrimination between group members.”

The above definitions imply that economic integration is characterized by an optimum utilization of resources. In the classical theory of international trade, the main motivation for trade integration is to exploit existing differences between countries. From these differences results the concept of “comparative advantage” that allows the optimal use of resources through specialization in production and diversification of consumption.¹⁶ However, the integration leads to homogenization which is not only a mechanical result of trade, as proposes for example the theorem of the price equalization of the factors,¹⁷ but of the will to eliminate certain differences in regulatory or institutional matters. Items

¹³ RTA is the generic term used for practical purposes, and encompass the diversity of trade agreements that grant preferential treatment to the contracting parties (preferential agreements, customs unions and free trade areas).

¹⁴ Fritz Machlup, *A History of Thought on Economic Integration*(Macmillan 1977).

¹⁵ Peter Robson, *The economics of international integration* (Routledge 1998).

¹⁶ The founders of economic analysis, Smith and Ricardo, important studies devoted to the development of the international economy. The theory of comparative advantage is the basis of all economic analysis (cost-benefit theory and the concept of opportunity cost), and it is in the center of all subsequent studies to Ricardo. See Jaime De Melo and Jean-Marie Grether, *Commerce international, Théories et applications* (Université Deboeck Balises 1997) 73, Paul R. Krugman and Maurice Obstfeld, *Economie internationale* (De Boeck 2001) 13; Henri-F. Henner, *Commerce international* (Montchrestien 1997) 37.

¹⁷ The model developed by Swedish Eli Heckscher, Bertil Ohlin and American Paul Samuelson (Model “HOS”) joins the comparative availability of factors of production (labor, capital, land, etc.). Advantages and consequently, the irrelative price indifferent countries. See *ibid* 190-235, *ibid* 77-98, 81-1.

as pricing and regulatory frameworks are homogenized, but the fundamental differences that promote trade such as resources and preferences are maintained.

The theory of regional trade integration emerged under its modern conception in the fifties,¹⁸ shortly after the entry into force of the GATT accompanied by a wave of RTAs, highlighting the large area of integration in Western Europe. It showed not only that the RTAs would be harmful to the rest of the world, which GATT negotiators had already perceived, but also that the improvements in its own area of integration were not entirely clear.

This position will change from the early eighties, for this reason, it is necessary to analyze it from the point of view of the first wave of regionalization of the sixties (1), and the last two waves of regionalization of the seventies and nineties (2) which by the way resulted in a new conception of economic regionalism (3).

1. First wave of regionalization

The first wave of regional integration in the post-war history appeared in the sixties, a few years after the creation of the European Economic Community ("EEC") in 1957. South-South cooperation, particularly in Africa and Latin America, was intensified by the fact that developing countries wanted to regroup their import substitution industries within larger economic markets.¹⁹ It was from this first wave of integration that economists began to study the effects of RTAs in the non-discriminatory system established by the GATT.

Preferential, regional, and non-regional agreements had already been criticized by the GATT negotiators because of the terrible experience of the thirties.²⁰ Jacob Viner's model, published in 1950, allowed the study of the resolutions of the first wave of regionalization.²¹ It showed, in effect, that if regional trade agreements were generators of trade inside the area, they were also harmful with respect to the outside; the final result for the area was therefore not assured, contrary to what most of the polarized economists supposed on the effects of the creation of these areas. From this contrast, it follows that the RTAs do not always have a positive net effect for its members.²² Viner's model rests

¹⁸ While studies on the effects of regional integration gained importance with the study of Viner (1950), Peter Robson explained that there were already significant contributions on this subject, mainly with studies of DeBeers in *Tariffs Aspects of a Federal Union* and DeBye in *national eset données douanières Unions*. See supra (n15)7.

¹⁹ Nations Unies Conseil Economique et Social, « Zones de libre-échange dans le cadre du multilatéralisme en Asie et dans le Pacifique: Progrès, Difficultés et Perspectives », note from the Secretariat (E/ESCAP/SCITI/1, 1 September 2004).

²⁰ In particular the wave of protectionist thirties, where the great economic powers of that time retreated in themselves and in their former colonies on the basis of bilateral preferential agreements with discriminatory.

²¹ Jacob Viner, *The Customs Union Issue*, (Carnegie Foundation for International 1950).

²² Here we should make two comments: 1.The costs of trade diversion are not limited to the outside of the settlement area, and the benefits of trade creation nor to members of that zone (ie. greater efficiency that can export cheaper products out of the area limited) 2.Trade diversion is bad because it means we are importing goods relatively

on the conventional theory of comparative advantages which justifies free trade because of the gains it attempts for the consumer under the frame of dynamic economies where production factors are easily redistributed. Thus, the ability freely import what they require allows economies to specialize and concentrate their -scarce- resources in sectors where they are comparatively more efficient. The decrease in the relative price of imported goods improves the situation of countries that open to the trade of goods and services; the more primary resources are diversified, economies will have greater opportunity to specialize and thus improve their situation.

From this general model, the scenario proposed by Viner fits the post-war situation. Certainly, countries retained high levels of protection, due to the early thirties, but at the same time the Bretton Woods²³ agreements and the entry into force of the GATT, guide the western economies to trade liberalization. A regional agreement allows the reduction, even the elimination, of tariffs on the benefit of a limited number of countries, but multilateral negotiations conducted within the GATT, aim to reduce, towards all parties involved, what appears to be mostly beneficial in terms of economic efficiency. Jacob Viner highlights the contradictory effects of the customs union: the effect of trade creation on the one hand, and on the other of deviation; the first improves the situation of the importing country, the latter deteriorates it. The effect is thus uncertain.

2. Second and third waves of regionalization

At the end of the decade of the seventies it was clear that the agreements previously concluded were ineffective, with the exception of the EEC. These had contributed to the industrial development in a marginal way, and combined with the accumulation of external debt of developing countries, this led to more confusion between them giving little or no results in their economic integration efforts.²⁴ Thus, it is imposed a change in strategy as globalization was accelerating by the fast technological advances; as the fall of central planning of certain States gave the “North-South” relations a new reason for being in a globally interdependent economy, motivated by private profits. It is then that a second wave of regionalism appears when countries were reorienting their development strategies towards exports.

Adhering to the principle of non-discrimination gaining ground to the extent that the number of participants in the GATT/WTO system increased rapidly; while the

less efficient country because we have a trade agreement, as may be the case that there are better providers outside the free trade area.

²³ See Philippe Moreau Defarges, *La Mondialisation* (PUF 2005) 87.

²⁴ Their success or failure is linked to the viability of the model of import substitution. There were cases of partial success, for example in Central regional trade increased much with the Central American Common Market (CACM), although from the seventies the political situation in the region is out of control. See Jagdish Bhagwati, “Regionalism and Multilateralism, an Overview”, in Jaime De Melo and Arvind Panagariya (eds), *New Dimensions in Regional Integration*, (CUP1993).

industrialized and developing countries pledged to liberalize trade by the accelerated conclusion of preferential agreements or RTAs. This brought a golden era of trade liberalization in which multilateralism and regionalism are mutually reinforcing.²⁵

This stage reached its apogee in the early nineties with the establishment of the Asia-Pacific Economic Cooperation Forum (“APEC”). This forum embodied the so-called “open regionalism” and non-discriminatory liberalization, rather than preferential, in the strict sense of the word, leading to the so-called “third wave of regionalization” whose instigator element was the financial crisis of 1997.²⁶ However, the liberalization process established by the APEC was slowed at the time that some forum members were unwilling to liberalize sensitive products.²⁷ Indeed, this would not be verified if it was not through mutual negotiations and legally binding within the WTO, or possibly through preferential regional trade arrangements.²⁸ This led unconditional countries of multilateral trade liberalization, as Japan and Korea, to abandon its resistance base to base RTAs and begin a new era of economic partnership.²⁹

3. Towards a new concept of economic regionalism

In this context, what do the new theories of regional economic integration tell us? On the one hand, the original preposition of Jacob Viner rests on questionable methodological assumptions (partial equilibrium, small economies, elasticity of import offers, comparative statistics, etc.),³⁰ on the other hand, the analysis inspired by Ricardo or by Herckcher-Ohlin-Samuelson gives a narrow picture of the success and extension of the EEC, now European Union (“EU”). The comparative advantages of member countries appear, *a priori* and even *a posteriori*, lightly marked. Of course, the factors of production in Spain and Germany are not exactly in the same proportions, but the differences between these two countries are obviously lower than those that they may have regarding Spain with Morocco, or Nicaragua; countries with which trade is less developed. In another context, the specialization of the neoclassical model becomes an “intra-branch specialization”: cars with tomatoes, for example. In Europe, and to a certain extent in the area of the North American Free Trade Agreement (“NAFTA”), specialization is rather symmetric: cars with cars; tomatoes with tomatoes, etc. The exchange is then based between goods and

²⁵ Nations Unies Conseil (n 12) 3.

²⁶ See Yves Gounin y Sébastien Vivier Lirimont, *La crise asiatique: aspects économiques et politiques* (PUF1999).

²⁷ Forestry and fishery resources.

²⁸ Nations Unies Conseil (n 19) 4.

²⁹ Japan signed a free trade agreement with Mexico on September 17, 2004, which came into force on April 1, 2005. Meanwhile South Korea signed an agreement with Chile on February 15, 2003.

³⁰ Jean-Marc Siroën, *La régionalisation est-elle une hérésie économique ?* (6° Congrès de l’Association française de Sciences Politiques, Rennes, Octobre de 1999).

differentiated services, sometimes of varying quality incorporating factors of production in very similar proportions. This difference between theory and reality has arisen, since the sixties, a multitude of theoretical and empirical studies.³¹

After many studies, the “new global economy”³² proposes a new systematic analysis of the effects of economic integration, which will be taken into account both in the academic environment and in the government level. A new feature of these models, *a priori* criticized was that they led more than reassess the scale gains with a larger variety of products offered to consumers, to a rethinking of national monopolies and oligopolies.³³

The approach does not minimize trade deviation,, only justifies that such deviation could be lower than the previously thought. That is, if there are cases of preferential agreements between geographically distant countries (eg. Mexico-Israel), most RTAs are formed between neighboring countries; precisely one of the successes of the EU comes from the compactness of its borders.³⁴ Another element that plays in favor of the flows of bilateral trade is the level of development: models called “gravitational” take as a hypothesis that bilateral trade volumes are determined by variables such as GDP of the respective countries (gravitational effect),³⁵ and by the economic distance (eg. differences in GDP per capita).³⁶

If preferential integration zones match the “natural” areas, trade deviation effects are reduced by definition. As Paul Krugman³⁷ says, in a natural area,³⁸ potential losses related to trade deviation are limited and the potential profits on trade creation are important.

B. MODERN TYPOLOGY OF ECONOMIC REGIONALISM

During the first regionalization wave, the analysis will be based essentially on the EEC. This is logical because up to the nineties, Europe is the only true regional “success story”,

³¹ Jean-Marc Siroën, *La régionalisation de l'économie mondiale* (La découverte 2004) 35.

³² It is of Anglo-Saxon inspiration and appeared in the late seventies in order to respond to empirical challenges posed development intra-branch and “re found” the theory of international trade from models industrial economy trade and game theory.

³³ Siroën, *La régionalisation est-elle une hérésie économique ?* (n 30) 4.

³⁴ You might even think that one of the countries that have apparently enjoyed less integration is precisely Greece, being furthest from the political heart of the EU (Brussels) or financial (London). But this question is ruled not only the financial support received by this country's infrastructure and organization of the Olympic Games, but with the recent financial crisis in 2010.

³⁵ Transposition of physical laws on the attraction of bodies: two major economies are more likely to attract two small one.

³⁶ Siroën, *La régionalisation de l'économie mondiale* (n 31) 4-5.

³⁷ Paul Krugman, “The Move Toward Free Trade Zones” en Federal Reserve Bank of Kansas City Economic Review (1991) 5.

³⁸ For Krugman a “natural area” is defined as the area within which, in the absence of barriers to trade and preferential agreements, the trade is with greater intensity than in the rest of the world.

with strong intra-regional trade development of their economies. Most of the regional agreements notified to the GATT, and until the creation of the WTO they were “good intentions” agreements with no real impact in terms of economic integration, and performed mostly by developing countries.³⁹

In the nineties, there will emerge a new form of regionalism or hybrid regionalism: the so called zones of North-South free trade being NAFTA the first example; Europe will continue this trend by signing in 1999 a preferential agreement with Tunisia and in 2000 with Morocco. The Euro-Mediterranean free trade is generalized with successive RTAs that firms reached with countries of the Maghreb, covering the southern and eastern Mediterranean perimeter except Syria and Libya.⁴⁰ In the Americas, Canada signed with Chile in 1997, a hemispheric negotiation is carried out in view of creating a Free Trade Agreement of the Americas (“FTAA”). In December 2002, the United States and Chile signed an FTA, among other examples. At the end of the nineties also witnessed the transatlantic free trade agreement: EU-South Africa in 1999, EU-Mexico in 2000, EU-Chile in 2002, the United States signed in 2000 with Jordan and in January 2003 with Singapore.

From the proliferation of North-South agreements that characterized the nineties -countries with very marked asymmetries-, the first concern that arises is framing such agreements with other international agreements, in particular with regional agreements that were known until then. However, in the early twenty-first century, the emergence of new political leadership and the influence of social movements and leftist and center-left parties, along with the exhaustion of an economic cycle marked by the idea of market liberalization and the new strengthening of national sovereignty and interest, resulted in South American countries beginning to focus on other alternatives to the model proposed until then in the region.

Under this scenario, the problem of typology of regional forms is then presented, either dichotomous (1), triangular (2) or post-liberal (3).

1. Dichotomous typologies

With the revival of economic regionalism in the context of globalization, there arises an analytical renewal. Unlike the concept of the fifties, archetypal theory of customs unions (Viner), the new regional integration is not restricted to trade. This entails capital flows, free movement of a specific class of skilled labor, introduction of a common institutional environment and policy coordination that enables convergence between economies. Thus,

³⁹ It is the remarkable case of the Latin American Free Trade Association, direct antecedent of Latin American Integration Association.

⁴⁰ Libya has never had a special agreement with the EU, even before regional preferences within the framework of the global Mediterranean policy introduced in the seventies period.

the regional space is presented as a place of restructuring of public and private powers and strategies of national and international context of globalized actors.⁴¹

So, some innovative side of the above concepts arise, by opposing the integration planned by States -voluntarist conception- by integration through market -Liberal conceptions- (b); integration linked to the rules -institutional conception against a more spontaneous integration (a); as well as a deep integration against a surfaced integration (c).⁴²

a) *Economic regionalism according to its shape*

- Regionalism *de iure* or institutional. The idea of regional integration is usually associated with an agreement concluded in accordance with law by notifying the international trade institutions for its review in accordance with existing multilateral rules.⁴³ Institutional regionalism is based on agreements that reduce in the short term -eliminates- barriers and rules on the exchange of goods, services and other factors. This regionalism imposes regulatory harmonization to ensure minimum viability of reciprocal trade liberalization.⁴⁴ Typical examples of regionalism are the EU, NAFTA and MERCOSUR, regardless that their content, objectives and implementation modalities are profoundly different.
- *De facto* or spontaneous regionalism. Regional integration can be characterized independently from formal agreements by more interdependence of national economies (the consolidation of regional markets and the intensification of trade flows). Regionalism is considered *de facto* if it is not explained by formal agreements negotiated under the discriminatory nature and reciprocal basis.⁴⁵ Charles Oman,⁴⁶ clarifies that regionalization is not always a political phenomenon, ie, a *de jure*

⁴¹ Direction Générale de la Coopération Internationale et du Développement, accessed 21/05/2013, «Analyse comparative des processus d'intégration économique régionale», <www.diplomatie.gouv.fr>, (Website at PDF format. Address) <http://www.diplomatie.gouv.fr/fr/ministere_817/publications_827/cooperation-internationale-developpement_3030/series-etudes_3195/serie-etudes-annee-2002_3217/analyse-comparative-processus-integration-economique-regionale_4614/index.html>.

⁴² *Ibid.*

⁴³ Henri Regnault, «Libre-échange Nord-Sud et typologies des formes d'internationalisation des économies», (Séminaire EMMA-RINOS (Réseau Intégration Nord Sud), Maison des Sciences Economiques et CEPREMAP Paris Mayo 2003).

⁴⁴ Institut Orléanais de Finance, accessed 21/05/2013, « L'intégration entre pays inégalement développés dans la régionalisation de l'économie mondiale. Une analyse comparative », website: <www.dauphine.fr> (At PDF format), Address: <<http://www.dauphine.fr/ceresa/siroen/Plan1.pdf>>, p. 11.

⁴⁵ *Ibid.*

⁴⁶ Charles Oman, Globalisation et régionalisation: quels enjeux pour les pays en développement?, (OCDE, 1994) 37.

process resulting from the checks and balances in the political negotiations. This may be a natural economic phenomenon driven by the same micro economic forces of the economies involved. Or as states Larbi Jaidi,⁴⁷ it may be the result of the practices of certain actors (usually South-South agreements) which are commercial, financial, cultural and technological networks in regional areas. Such is the case of the East-Asian or African reticular border trade regionalization.

b) The economic regionalism as the voluntarist or liberal character of the State

- Closed regionalism. The first developments of regionalism in the Asia-Pacific (development of APEC), led to a vague concept of open regionalism, suggesting simultaneously that the old regionalism was closed. The voluntarist character of closed regionalism seeks an integration process which is not left to the discretion of market forces, but is subject to greater political coordination created through regional institutions.⁴⁸ According to this voluntarist view, regional integration is a state of “disconnection” that protects the economies from globalization. This type of regionalism implies protection, spatial planning policies, building a more or less outdated system of world prices. The basis of analysis is that of the subsidiaries, introverted and disjointed societies that cannot build their industry from a national base. For this reason, regional integration is on track to reduce extraversion; create a market and offset regional imbalances. It’s instruments are a managed and regulated economy, protecting regional industries and creating projects whose final effect is polarization.⁴⁹
- Open regionalism. This form of integration rejects any idea of exclusivity, being fully respectful of multilateral principles, ensuring the creation and trade deviation of traffic through the logic of the market ensuring the benefits of comparative advantage. According to the liberal conception, the inverse of the voluntarist conception, open regionalism is mixed with the liberalization of trade and factors of production. This is normally founded on the concept of a free trade area whose ultimate aim will be the “multilateral” exchanges and generalized free trade.⁵⁰ An example is the NAFTA and the truncated project FTAA aimed at extending free trade to

⁴⁷ Jaidi Larbi, “The South-South regional integration: a multiform regionalism” (2010), Yearbook IEDMed Mediterranean, 126.

⁴⁸ Renault, « Libre-échange Nord-Sud et typologies des formes d’internationalisation des économies » (n 43) 4.

⁴⁹ Cf. Jean-Marie Boisson, « Comment gérer la Globalisation ? Etats, Régions ou Organisations Internationales ? », (Coloquio internacional C.E.D.E.C.E., La Dynamique de la démarche communautaire dans la construction européenne, Poitiers October 2000).

⁵⁰ *Ibid.*

all the American continent (from Alaska to Tierra del Fuego). This would then open the way for “multilateration” and the globalization of trade in the area. Importantly, open regionalism, as stated by Fred Bergsten⁵¹, should serve the cause of multilateralism and not be a substitute for that; this should not be the means through which participants dump their commitments and responsibilities multilaterally.⁵²

c) The economic regionalism by operating mode

- Surface Integration. Also known as shallow integration, which is limited to a single elimination or removal of border barriers on trade. The Euro-Mediterranean agreements are an excellent example where the elimination of tariff barriers is limited on certain goods. The RTA of the European Free Trade Association (“EFTA”) for its acronym in English, completely exclude agricultural issues.
- Deep integration. Involves the introduction of liberalization measures that go beyond the mere protection of borders, dealing in particular; investment, competition, services, sales of the public sector, etc.. Europe is the archetype of this kind of deep integration, however, NAFTA is emblematic because it’s characterized by its north-south asymmetry.⁵³

2. The triangular typology

This is a proposal made by Professors Christian Deblock, Dorval Brunell and Michèle Rioux.⁵⁴ who clutching to a logic of international political economy, propose a new typology established in terms of a “triangle of incompatibility” between three characteristics, requirements or potential targets in the framework of a regional construction: i) the autonomy of markets (the top of the triangle), ii) the sovereignty of States, and iii) institutional cooperation among members.

According to these authors, no regional form can fully reconcile these three features, only two can be fully respected being defined fully only three pure forms of regionalism:

⁵¹ Fred Bergsten, Open Regionalism, Institute for International Economics, Working Paper 3/1997, 1 <<http://www.iie.com/publications/wp/wp.cfm?ResearchID=152>>.

⁵² See “El regionalismo abierto en América Latina y el Caribe. La integración económica en servicio de la transformación productiva con equidad”, books CEPAL, N°39 (1994); “El regionalismo abierto y la integración económica” magazine CEPAL N°53 (1994) 81-89.

⁵³ Regnault « Libre-échange Nord-Sud et typologies des formes d’internationalisation des économies» (n 43) 4.

⁵⁴ Christian Deblock, Brunelle Dorval y Michèle Rioux, “Globalización, competencia y gobernanza: el surgimiento de un espacio jurídico transnacional en las Américas” (2004) vol. XLIV, in the international forum 92.

- A Regionalism of “regulation and punishment” founded on the autonomy of markets and institutional cooperation between participating States, articulated about multilateral rules of law and supranational institutions (EU). This regionalism eventually creates an international law on investment and antitrust modeled on the common good, which is the one adopted so far by the States. On the basis of consensus regarding the degree of autonomy that States are willing to lose, and the degree of freedom that they are willing to take to markets and private actors, then it will try to resolve the breach of the rules committed by State unfair competition and anti-competitive business practices and dominant positions - through appropriate supranational institutions.
- A Regionalism of “risk management” founded on the autonomy of markets and respect for the sovereignty of States; articulated this around codes of conduct and dispute settlement mechanisms whose example is NAFTA. In this particular case, States must achieve a minimum consensus on rules and mechanisms for risk management, which must be supplied to markets and relations between States; at all time preserving the autonomy of markets, private actors and States in accordance with the principle of national sovereignty. It seems that the Trans-Pacific Partnership Agreement (TPP) is this way too.⁵⁵
- A Regionalism of “regulated markets and organized exchanges,” reconciling sovereignty and cooperation at the expense of free markets. Henri Regnault⁵⁶, proposed as an example the Council for Mutual Economic Assistance between the former Soviet Union and Central and Eastern Europe Countries (“CEEC”), to the extent that, in reality, cooperation was structurally asymmetric and sovereignty of CEEC extremely small.

C. THE POST-LIBERAL TYPE

The notion of open regionalism climaxed in Latin America and the Caribbean in the early to mid-nineties and the first decade of this century. This notion is based on the perspective of trade as a central element of regional integration, ceased to be the main driving force of the current trends of integration and cooperation among the countries

⁵⁵ The Trans-Pacific Partnership is an initiative of negotiations for the liberalization of trade and investment among countries born of the Asia-Pacific. It is currently the most important and ambitious internationally for product coverage and disciplines including plurilateral trade negotiations, as well as the economic importance of participating members.

⁵⁶ Regnault, *Libre-échange Nord-Sud et typologies des formes d'internationalisation des économies* (n 43) 5

of the region going to have a new approach in which some authors call it “post-liberal”, “post-hegemonic regionalism” or even “post-neoliberal”⁵⁷ regionalism.

This new approach is characterized by the displacement of issues for trade liberalization and deregulation policy agenda clearly marked by a return to a leading role of the State in the formulation and implementation of various public policies and a revitalization of the traditional principle of national sovereignty.⁵⁸ This, however, does not mean a full break with open regionalism as a institutionalized process in the region since the nineties, but both coexist and complement with their own experiences.⁵⁹

There are exogenous and endogenous factors that explain the new regionalist trend:⁶⁰ i) following the attacks of September 11 and the subsequent war on terrorism, U.S. attention was focused primarily on the Middle East and Central Asia, consequently losing influence in Latin America and allowing the latter to have an edge and wider autonomy ii) the “predominant left” of the region with the relative ideological convergence of Latin American leaders, and iii) the sustained leadership that Brazil has developed in recent years, which has earned him the recognition of power in the region.

Under this platform, we have built in Latin America regional initiatives such as the South American Community of Nations, to its consolidation in 2008 of the Union of South American Nations (“UNASUR”) and in 2004, the Bolivarian Alliance for the Americas (“ALBA”) as a notable side project against the FTAA. Regional feat, since 2011, an ambitious scheme called joint political and economic Community of Latin American and Caribbean (“CELAC”). All these initiatives, as stated Andrés Serbin, unlike the American system established around the Organization of American States (“OAS”) and the FTAA initiative hemispheric explicitly exclude the United States and Canada from the negotiations.⁶¹

We have so far made a count of the different stages of economic regionalization, as well as a critical analysis of the literature on the subject. It will be necessary then to analyze the implications of economic regionalism versus multilateral trading system.

III. ARE ECONOMIC REGIONALISM AND MULTILATERALISM

⁵⁷ The concept of post-liberal regionalism was originally proposed by Sergio da Motta and Sandra Rivers. About terminological concepts see Gian Luca Gardini, “Unity and Diversity in Latin America Visions of Regional Integration” en *Latin American Foreign Policies: Between Ideology and Pragmatism*, (2011) Palgrave Macmillan 235-254; Pedro da Motta Veiga y Sandra P. Ríos, “O Regionalismo pós-liberal na América do Sul: origens, iniciativas e dilemas” (2007) CEPAL N°62 Serie Comercio Internacional.

⁵⁸ Andrés Serbin, “Regionalismo y soberanía nacional en América Latina: lecciones aprendidas y nuevos desafíos” (2011-2012) *Anuario CEIPAZ*, 138.

⁵⁹ Cristobal Bywaters y otros, “UNASUR y la integración latinoamericana: propuesta de un nuevo modelo del regionalismo post-liberal” (2009) *Revista Encrucijada Americana* Año 3 N°1, 6.

⁶⁰ *Ibid.*

⁶¹ Andrés Serbin, Laneydi Martínez y Haroldo Ramanzini Júnior, *El Regionalismo “post-liberal” en América Latina y el Caribe: Nuevos actores, nuevos temas, nuevos desafíos*, (2012) CRIES.

DIAMETRICALLY OPPOSED?

Today we are certain that the open regionalism is here to stay and that it interacts with the multilateral trading system. We can say that this has slowly become the rule and not the exception, contrary to what the GATT contracting parties had anticipated. The erosion of the principle of non-discrimination is a phenomenon that occurs constantly and now the WTO is aware of this. Paradoxically, as a result of what the WTO calls hank or entanglement of customs unions, free trade areas, unique markets, and unlimited array of agreements of all kinds (investment, complementation, partial, etc.). The MFN clause has become an exception treatment rather than the rule. Even the famous “Sutherland Report”, in a tone somewhat ironic, mentioned that it would be better to speak today of the clause in the less-favored nation.⁶²

The GATT, born on January 1, 1948 by the conclusion of 123 bilateral agreements grouping 23 contracting parties gathering in Geneva in October, 1947. Adopting the basic principle of non-discrimination, the form is manifested through the MFN clause, GATT founders hoped that the international trading system should be organized without excluding those members who did not have the bargaining power to obtain the advantages granted to other members. In other words, the founders of the GATT had adopted a multilateral approach to trade liberalization, however, in a parallel way the founding members adopted derogatory rules of the MFN clause, ie, the introduction of the provisions of Article XXIV of GATT authorizing establishment of customs unions and free trade areas, giving them entry to the regional approach to trade liberalization. Since then we can ask whether these two approaches to trade liberalization that coexist within the global economic system are diametrically opposed.

To give some partial answers, we will analyze from a strictly systemic point of view,⁶³ the interaction of RTAs in the multilateral trading system (A) in order to arrive at a possible reconciliation between these two visions of economic liberalization (B).

A. THE RELATIONSHIP BETWEEN RTAs AND THE MULTILATERAL TRADING SYSTEM

The multilateral trading system and RTAs have undergone numerous changes since the late fifties and in particular, in the eighties. With rounds of negotiations within the GATT/

⁶² OMC, *L'avenir de l'OMC, Relever les défis institutionnels du nouveau millénaire*, (Reporte del Consejo Consultativo de Supachai Panitchpakdi Genève 2004) 21.

⁶³ See Paul Krugman, *Is Bilateralism Bad?* en Helpman y Razin (eds), *International Trade and Trade Policy* (MIT press 1991) 9; Jagdish Bhagwati y Arvind Panagariya, *The Theory of Preferential Trade Agreements: Historical Evolution and Current Trends* (1996) vol. 86 at *American Economic Review* 82 and Anne O Krueger, *Free Trade Agreements Versus Customs Unions* (1995) National Bureau of Economic Research NBER, working paper n° W5084, <<http://www.nber.org/papers/w5084>> consulting date 2 July 2013.

WTO trade liberalization progressed substantially, while multilateral trade disciplines deepened considerably reaching aspects that have far surpassed the initial rules of the GATT 1947.

In parallel, the number of RTAs has increased in recent years, representing today fifty percent of world trade and involving a more extensive range of trade policy issues.⁶⁴ The new generation of regional agreements aimed not only the liberalization of trade in goods and services but also cover other aspects also regulated by the WTO as such are the rules and aspects of intellectual property or sales to the public sector. The scope in some of these agreements may even exceed the WTO rules and include aspects that until today had been excluded from the multilateral negotiations, or partially analyzed in the same-to name some examples we have sales to the public sector; investments, competition policy, etc.

The number of RTAs in which each WTO member is part -EU counting as one member- has doubled in the last ten years, ie, five in average per member since some are part of ten or more RTAs. Until January 15, 2013,⁶⁵ there have been notified to the WTO about 546 RTAs, counting separately notices relating to goods and services. Of these, 390 were notified under Article XXIV of the GATT, 38 based on the enabling clause, and 118 in accordance with Article V of the GATS. On the same date, according to the WTO, 354 RTAs were in force, and according to their estimates, the trend will grow with the numerous agreements that are being negotiated, of which ninety percent are free trade agreements or partial agreements, and ten percent are customs unions.⁶⁶

Adopting a systemic approach, the debate centers on two positions: one, represented by the economist Lawrence Summers,⁶⁷ for whom any initiative to trade liberalization whether unilateral, bilateral, plurilateral or multilateral level, it is a step towards liberalization Global trade, the other represented by Professor Jagdish Bhagwati⁶⁸ who believes in contrast, the proliferation of regional unions is a challenge for the multilateral trading system⁶⁹. The question that arises is whether or not the RTAs facilitate the development of the multilateral trading system. A yes or no answer would be a bit reductionist; the fact is that there are elements that favor their convergence (1), and others, their differences (2).

⁶⁴ Comité des Accords Commerciaux Régionaux, Synopsis des «questions systémiques» relatives aux accords commerciaux régionaux - Note du Secrétariat (2000) WT/REG/W/37.

⁶⁵ OMC, consult 12/07/2013, « Acuerdos comerciales regionales », internet site: <www.wto.org>, (available online), <http://www.wto.org/spanish/tratop_s/region_s/region_s.htm>.

⁶⁶ *ibid.*

⁶⁷ Lawrence Summers, "Regionalism and the World Trading System", in Federal Reserve Bank of Kansas City, Policy implications of trade and currency zones, (FRB Kansas City 1991) 295.

⁶⁸ Jagdish Bhagwati, "The watering of trade", (1997) in JIE42, 239.

⁶⁹ About the tensions between the MTS and RTA see Roberto V. Fiorentino, Luis Verdeja y Christelle Toqueboeuf, The Changing Landscape of Regional Trade Agreements:2006 Update (WTO Discussion Paper n°12 2007).

1. Elements of convergence

RTAs can contribute to the harmony by three ways:⁷⁰ i) drawing of the matters discussed by the WTO or even copying them; ii) inspired in other existing international agreements and, in some cases, iii) helping to develop model agreements that could be subsequently adopted by the WTO. RTAs can likewise complete the objectives of the multilateral trading system encouraging cooperation and technical assistance between regional partners. Even if RTAs contain provisions that go beyond those covered by the WTO, these are generally based on existing provisions and principles within the WTO.⁷¹ In the following way:

- RTAs are very similar from the point of view of the catalog of disciplines aimed at facilitating the gradual opening up of services markets, even if the load differs in terms of obligations;
- In terms of sales to the public sector, RTAs, even if beyond the provisions of the Government Procurement Agreement (“GPA”), generally follow the provisions proposed by this agreement or, in most cases copy the provisions;
- Similarly, RTAs reproduce the provisions of the Agreement on Trade-Related Investment Measures (“TRIMs Agreement”) and the WTO Agreement on Intellectual Property (“TRIPS”) either referring explicitly or well, reproducing part of the content;
- The provisions of RTAs on the environment largely reflect the approach taken in the WTO agreements. Lots of RTAs recognize in its preamble the need to preserve the environment and the scope of sustainable development. Other RTAs contain general exception clauses similar to those contained in Article XX of the GATT, constantly using the formula according to which the provisions of Article XX (b) of the GATT 1994, they include environmental measures necessary to protect life, human, animal and plant health.⁷²

To the extent that regional initiatives build on international agreements, these serve to a greater and better harmonization. This is the case when the RTA, in the aspects of trade in goods, make constant reference to the Arusha Declaration issued by the World

⁷⁰ Syntheses OCDE, *Le régionalisme et le système commercial multilatéral*, (L’Observateur OCDE, 2003) 5.

⁷¹ *Ibid.*

⁷² The NAFTA negotiated by President George HW Bush, does not contain a specific chapter devoted to the environment. This lack of interest and dispersion offended many environmentalists as “*Public Citizen*”. For his part, Bill Clinton during his 1992 campaign, promised NAFTA to fill the gaps in this area and in labor. Once elected, President Clinton proceeded to the negotiation of two side agreements to NAFTA: *The North American Agreement on Environmental Cooperation*, *Mexico-United States Border Environmental Cooperation Agreement* y el *North American Agreement on Labor Cooperation*.

Customs Organization, as well as the Revised Kyoto Convention on the simplification and harmonization of customs regimes.

According to the WTO, RTAs generally evolve faster than the MTS and are sometimes ways to strengthen it. A study by the WTO Secretariat in 1998, showed that RTAs demonstrate a faster liberalization and access to the markets regarding non-tariff measures than the MTS.⁷³ In fact, several WTO members have stressed the beneficial effects of RTAs in the integration of developing countries into the world economy.⁷⁴

2. Divergence elements

The proliferation of RTAs is still source of divergence, ie, that the afore mentioned convergence does not always translate into a harmonized approach to the international level. We have the example of intellectual property rights, where there is evidence that if these are reinforced from the regional level, their content may vary according to the interests of each regional junction. On the other hand, among the main regional agreements, there are currently two divergent views between the relationship that occurs in the economic competition policy and antidumping action: in one case, the reciprocal abolition of antidumping measures foreseen in the framework of the economic competition policy; on the other, the strong right of a party to apply antidumping measures.⁷⁵

In practice, the differences according to approach contained in RTAs, results in a considerable increase in transaction costs for businesses. This increase is particularly evident in the area of rules of origin. Under this logic is not strange that a country should apply different rules in accordance with the specific provisions of each RTA to which it belongs. This certainly complicates decisions of production and procurement of established businesses or planning to settle in that country.

The heterogeneity of regional initiatives⁷⁶ can also be a source of systemic frictions. For example, efforts to strengthen multilateral disciplines on trade defense are usually not

⁷³ WTO, *L'avenir de l'OMC, Relever les défis institutionnels du nouveau millénaire*, (n 62) 72.

⁷⁴ Shortly after the entry into force of NAFTA, Mexico joined the OECD May 18, 1994.

⁷⁵ *Syntheses OCDE, Le régionalisme et le système commercial multilatéral* (n 70) 7.

Several studies have noted that the removal of antidumping on free trade area is a desirable policy, and that concerns about unfair business practices can be addressed by using competition policy, as the EU has done which abolished the use of antidumping measures into the EEC in 1969, after the tariffs were removed without waiting for the unified marketing program 1993, or the completion of monetary union marked by the Treaty of Maastricht in 1999. In contrast, the NAFTA region retains use of antidumping measures which do not always coincide and are far from being harmonized between NAFTA members. See Murray G. Smith "The evolution of laws against unfair trade practices in the free trade in North America (NAFTA)" in Sergio Lopez Ayllon and Gustavo Vega Canovas (eds), *Unfair trade practices in the process of trade integration in the Americas: the experience of Chile and North America* (UNAM, SECOFI 2001) 57.

⁷⁶ *Syntheses OCDE, Le régionalisme et le système commercial multilatéral* (n 70) 7.

provided because of the existence of varied criteria at the regional level in the moment that:⁷⁷

- Some RTAs eliminate the recourse to antidumping or countervailing duties, instead authorizing the use of safeguard measures among members of the regional junction;
- Other RTAs eliminate the recourse to antidumping or safeguard measures but retain the ability to use countervailing duties;
- Others maintain recourse to antidumping and countervailing duties but suppress the use of safeguard measures.

In other fields, regional approaches can lead not to systemic friction -at the absence of direct tension with the development of the rules of the WTO-, but a systemic overload (for example the area of investment where the proliferation of agreements caused a significant increase in the number of cases to resolve through the various dispute resolution mechanisms). With the rapid proliferation of bilateral investment treaties (“BITs”), we have that disputes under the jurisdiction of the International Centre for Settlement of Investment Disputes, by the way, one of dispute settlement agencies that makes more reference to the BIT, have greatly increased in recent years. Taking into account the overhead involved in the dispute settlement mechanism of the WTO, and the increase of resources in alternative dispute settlement means, there is a lot to be done from the point of view of the disciplines on investment at the WTO.⁷⁸

B. TOWARDS RECONCILING TWO VIEWS OF ECONOMIC LIBERALIZATION

A new interest in the analysis of RTAs appears in the early nineties, and it arises at the time when the negotiations of the Uruguay Round were paralyzed by lack of agreement between the negotiators. The major industrialized countries (EU and U.S.) reflected their fickleness to negotiate bilateral agreements -a more or less acceptable alternative for this countries en case of failure of the multilateral negotiations-. In this context, the Uruguay Round reached a more or less acceptable result to the members of the now WTO, but the misadventures of the Ministerial Conferences in Seattle (1999) and Cancun (2003) prompted this new trend to negotiate bilaterally which was understandable as most

⁷⁷ The difficulties in negotiating dumping and subsidies in the WTO, have little to do with the RTA and yes to the heterogeneity in trade defense systems of WTO members. Mexico and the United States have very different systems and have often been in conflict despite sharing a FTA. Special disciplines in RTAs have not come into conflict with multilateral rules and with the negotiations.

⁷⁸ *Ibid.*

of bilateral negotiations address topics and issues beyond what was negotiated at the multilateral level, some authors even speak of agreements “WTO plus”.⁷⁹

Paul Krugman⁸⁰ proposes four reasons to explain this phenomenon: i) the increase in the number of participants in the process of WTO negotiations has been such that it is quite difficult to control the phenomenon of free rider⁸¹ ii) the protectionist nature of some Members has evolved in such a way that the mechanisms of safeguards, antidumping and other forms of protectionism, considerably complicate negotiations iii) the decline in economic hegemony of the United States has complicated the continuity in the implementation of the system and iv) the institutional differences between the larger countries have complicated negotiations.

However, we cannot lose sight that the WTO⁸² Declaration issued at the end of the 4th Ministerial Conference in Doha, Qatar, in November 2001, clearly emphasizes the importance of regionalism:

- Recognizing that RTAs can play an important role in regard to the promotion of liberalization and expansion of trade in promoting development;
- Accepting negotiations aimed at clarifying and improving disciplines and procedures provided by the existing WTO provisions applying to RTAs;
- Agreeing that the work of the working group on the relationship between trade and investment of the WTO, should take into account, as appropriate, bilateral and regional arrangements on investment.

So some WTO members consider it necessary, in the present situation, redefining the links between RTAs and the multilateral trading system to achieve better synergy between two visions of economic liberalization. The guiding principle of this redefinition should be to facilitate trade between the parties and not to raise barriers to trading parties with such territories.⁸³

The Organization for Economic Cooperation and Development (“OECD”) has concluded that RTAs are compatible with WTO rules. In general the OECD studies

⁷⁹ Jean-Marc Siroën, *Evolution récente des accords régionaux* (2004) *Les Rencontres Economiques*, 2.

⁸⁰ Paul Krugman, *Regionalism versus Multilateralism*, *Analytical Notes en Jaime De Melo y Arvind Panagariya* (eds), *New dimensions in Regional Integration*, (CUP 1993) 58.

⁸¹ It is an expression that a country that does not make any trade concessions but, under a most-favored-nation benefits from tariff reductions and other concessions offered by the negotiating countries designated. View Dominique Carreau and Patrick Juillard, *Droit international économique* (Daloz 2005) 189.

⁸² The Declaration is available online at the Internet address: <http://www.wto.org/spanish/thewto_s/minist_s/min01_s/mindecl_s.htm>.

⁸³ This principle is enshrined in Article XXIV: 4 of the GATT; in the preamble of the Memorandum of Understanding on the Interpretation of Article XXIV of the GATT 1994, in paragraph 3) of the 1979 Decision on Differential and More Favourable Treatment, reciprocity and Fuller Participation of developing countries, and finally, in Article V: 4 of the General Agreement on Trade in Services (GATS).

claim that RTAs can complement, but not replace coherent multilateral rules and progressive multilateral openness (1), perhaps a new element could give some clarity to the current situation that not necessarily fits into the classic dichotomy regionalism-multilateralism (2).

1. Regionalism: an ongoing interaction and necessary complement to the multilateral trading system

Two lessons can say of at the time antagonistic at the time complementary relation. The first lesson is that all the consequences that have resulted from the implementation of RTAs confirm the need to strengthen the multilateral framework. This observation applies in particular to the contribution of regionalism in the divergences to develop the rules, to the effect that the heterogeneity of regional agreements can have on countries that are not members of those agreements, and the role of regionalism in increasing transaction costs for businesses. These effects are severe by the fact that regionalism, in most cases, does not solve the most complex problems.

In the most sensitive cases, regional initiatives have not yielded the best results, -and in some cases have not even been effective- , when compared with multilateral rules,⁸⁴ but Ken Heydon,⁸⁵ specialist of the OECD recognizes that even if multilateral disciplines were reinforced, the RTAs and the provisions thereof would not disappear. The question raised then is: how to overlap and make coexist multilateral disciplines and regional agreements? This issue directly affects the meaning of Article XXIV of the GATT/WTO and GATS Article V and the activities of the Committee on Regional Trade Agreements.

The Committee on Trade and Development has considered other agreements between developing countries notified under the Enabling Clause. For example, for the field of investment, current WTO provisions concerning the examination of RTAs contemplate it only to the extent that Article V of the GATS covers trade in services, as long as the requirements are met established the same, but the RTAs provide a more extensive coverage on investment, coverage that goes beyond investment in services.⁸⁶

The second lesson is derived from the experience gained in regionalism through the years. While some consequences of development of RTAs confirm the need to strengthen

⁸⁴ For example, the RTA have made little progress in terms of the interface in terms of rulemaking between internal regulation and trade in services, and in some cases, they contain narrower than the provisions contained in the GATS; rare exceptions RTAs have not been very helpful to solve the main issues “Unfinished” relating to rulemaking in the GATS, particularly in relation to the disciplines that address urgent safeguard measures and subsidies for services.

⁸⁵ Ken Heydon, *Le régionalisme peut compléter mais non remplacer le système commercial multilatéral*, en *Le Régionalisme et le Système Commercial Multilatéral* (OCDE 2003) 16.

⁸⁶ In the case of NAFTA are not given a specific conceptual and what is meant by definition foreign investment, by contrast, lists a number of activities for the purposes of NAFTA, when undertaken, will fall under the concept of foreign investment. Examples such as debt instruments when the enterprise is an affiliate of the investor, or benefits from allocating capital and other resources for the development of an economic activity (concessions, construction contracts and turnkey, etc.) Fall within the catalog investment of Chapter 11 of NAFTA.

the multilateral framework, also some criteria contained in RTAs can fill that need of reinforcement and provide a basis for the development of stronger multilateral rules. RTAs can complete the multilateral framework to the extent that they contribute to the harmonization of multilateral rules, these can be the basis for strengthening multilateral rules insofar that its provisions exceed those contained in the WTO provisions.⁸⁷ Meeting these two elements, very effective synergies between regional and multilateral approaches will be created.

2. The “plurilateralism” as the missing link between the dichotomy of regionalism-multilateralism

The classical theory of economic integration given by the Hungarian economist Bela Balassa, states that integration is not an event but a growing process that consists of the following steps:⁸⁸ i) partnerships and cooperation forums; ii) non-reciprocal preferential agreements; iii) FTA; iv) customs unions; v) common market; and vi) monetary union.⁸⁹

However, free trade hardly described as increased stage in Balassa’s typology explains the concrete reality of the forms of internationalization of economies today. Take for example the NAFTA, where regardless that the treaty takes the form of free trade area, the deregulation rules established therein includes not only goods but also services of all kinds: intellectual property rights, sales to public industry and, especially, organizes considerably at chapter XI the free movement of capital. NAFTA is undoubtedly a hybrid form of free trade.

Henri Regnault,⁹⁰ reflects on the idea of whether free trade of conventional type designed by Balassa still sets a first level of regionalism as it did until the early eighties. We might ask under this base if, does the free trade agreement between the UE and Mexico constitutes a regional agreement? The total absence of geographical proximity provides a first obstacle without doubt. To what extent the concepts of international economy can ignore geography? Maybe this break of geographical continuity could be admitted if the relationship between the parties was exclusive, but it is clear that the provisions of GATT/WTO authorize “multi-partnership” between Member States and between Member countries. Thus the evolution of the reality of free trade makes obsolete the current typology of Balassa as regionally.

The “plurilateralism” is presented as a separate form of internationalization of economies, as the missing link between the classic dichotomy of regionalism-multilateralism with a broader and selective geographic field, as well as agreements with varying degrees of

⁸⁷ For example, in the field of labor mobility, different RTAs contain dispositions surpass the ones in GATS because it foresees an integral national treatment and a full access to the providers of services and preferment to a certain category of people.

⁸⁸ Bela Balassa, *The Theory of Economic Integration*, (George Allen and Unwin LTD1961) 2.

⁸⁹ Bela Balassa, *Economic Union speech itself and economic integration as later stages*.

⁹⁰ Regnault, « Libre-échange Nord-Sud et typologies des formes d’internationalisation des économies » (n 43) 7.

demand that the classical dichotomy. In the moment that multilateralism is not sufficient for the global deployment of the most dynamic and influential economic actors, a plurilateral system among the most dynamic and influential economic spaces, ready to accelerate the pace of international trade liberalization is then started.⁹¹ Plurilateralism adopts the path of bilateralism through multiplication and juxtaposition of bilateral agreements between commercial entities of a geographic sub-space with various asymmetries.⁹²

In the international economic system today are then three inescapable dimensions:

- The multilateral trading system that responds to the need for rules of common law or standard rules in international trade relations. The multilateral network with 159 members is very far from the GATT of 23 contracting parties in 1947. The plurilateral tissue is formed by each member keeps ties with others, represented by the Organization who serves as an intermediary between its members;
- The plurilateral trading system forefront of free trade today. This reflects the need for specific relationships, variable geometry, carried out by a number of selected partners willing to go further than multilateral agreements, without this meaning enclosed in an exclusive relationship, unable to engage in a process of deep integration, away from the statements of intent of the texts, the geographical distance and the multiplicity of agreements;
- The regional trading system that responds to the need to form close relationships whose objective is the construction of a block within the global economy, involving a commitment of a deep integration process; rather than geographical proximity, the exclusivity of the relationship involves the will to coexist in order to form a global geopolitical project without reducing to one economic interest.

The second half of the last century was determined by the regionalism-multilateralism dichotomy; today will be apparently characterized by the tripartite trade regime described above.⁹³

⁹¹ Take the case of plurilateral agreements or “codes” of the WTO agreements between interested members club without geographical basis and with certain issues specific disciplines (ie government procurement). Speaks itself of economic union and economic integration as later stages.

⁹² One of the strategies of the United States to negotiate the proposed Free Trade Agreement of the Americas (FTAA), was to conclude bilateral free trade agreements with Central American subregions, the Andean countries or countries like Chile.

⁹³ Authors like Antoni Esteveordal, Matthew Shearer and Kati Suominen distinguish four main groups: i. Intra blocks, ii. Bilateral intra blocks, iii. Continental megablocks and iv. Regional agreements Transcontinentales Esteveordal cf. Antoni, Matthew Shearer and Kati Suominen, *Multilateralizing RTAs in the Americas: State of Play and Ways Forward* (n 6) 2.

IV. CONCLUSION

The study of the classical dichotomy between regionalism and multilateralism has evolved over the years, namely, from the first study by Jacob Viner. The evolution, since then has been such, that today we cannot understand the economic regionalism as in 1947.

The objective and purpose of the present study was, first, to explain the different “waves of regionalization” that emerged shortly after the creation of the GATT and the diverse typological founded in the economic literature. Of course, the proposal may be criticized, but the intention was to study the subject from an evolutionary perspective and present it as a critical review. In many works, the study is lineal, as if the study of economic regionalism was static and not dynamic as we note throughout the first part of this article. Second, having clear the current regionalism, we can analyze the implications of this with the MTS, their divergent and convergent arguments. We join the trend, in appearance false, that economic regionalism, understood as “plurilateralism”, “transcontinentalism” or “megaregional RTAs”, contributes to complementing and strengthening the MTS. It is, from our point of view, the missing link of the classical dichotomy.

Definitely, our study leaves several doors open to reflection. We consider the issue of regionalism fundamental for the viability and sustainability of the MTS, issue that has not been fully reflected in the latest WTO Ministerial Conferences. We do not mean by this that the Hong Kong ministerial in 2005 and Geneva 2009-2011 have been a failure, on the contrary, there have been outcomes on membership accession, dispute resolution, public sector sales and trade policy review; however, we think that from the Bali ministerial 2013, it will be the great opportunity to achieve the objective stated by the academic Jeffrey J. Schott, that is; 1. Multilateralizing multilateralism (attenuate the exceptions that the system provides for itself); 2. Multilateralizing regionalism (getting projects like the TTP, TTIP or Transatlantic Alliance among others, being proponents of the multilateral trading system); and 3. Modernizing Multilateralism (institutional reengineering of the WTO, its program and role in global governance).

All this is urgent, since otherwise there is a risk of loss of trade governance of the WTO and the fragmentation of the world economy.

SECTION ON INTERNATIONAL ARBITRATION



SOVEREIGN BONDS AS INVESTMENTS UNDER THE ICSID CONVENTION

Carlo Scheiternig*

Resume. In *Abaclat et al. v. The Argentine Republic* and *Ambiente Ufficio S.p.A. and Others v. The Argentine Republic*, two ICSID tribunals upheld their jurisdiction over claims of holders of sovereign bonds against Argentina. This seemingly opened the door to ICSID as a forum for disputes between states in financial distress and their creditors. However, the decisions were subject to strong criticism. It is therefore debatable to what extent the decisions provide guidance for future bondholder claims. This article examines the key question underlying the decisions of whether bonds can qualify as investments for the purposes of ICSID arbitration.

Keywords: Investment Arbitration; ICSID; Sovereign Debt; Sovereign Bonds; *Abaclat*; *Ambiente Ufficio*.

* Obtained the Law Degree at the Ludwig-Maximilians-University of Munich and an LL.M. in International Dispute Settlement from The Graduate Institute Geneva and the University of Geneva. Is currently working as an associate in the Munich office of Milbank, Tweed, Hadley & McCloy LLP.

I. INTRODUCTION

When Greece had to restructure its debt in 2011, holders of Greek bonds were asked to exchange their old bonds for new bonds, thereby agreeing to significant write-downs.¹ After the deadline for acceptance of the offer had passed, and collective action clauses had been activated, the participation rate reached 96.9 percent, equaling about €199.2 billion in debt.² This was the largest debt restructuring in history.³

In the midst of this turmoil, an ICSID⁴ tribunal upheld its jurisdiction over a claim of thousands of Italian bondholders which had rejected Argentina's bond exchange offers after it had defaulted on its debt in late 2001.⁵ In the case now known as *Abaclat*

¹ Gulati/Trebesch/Zettermeyer, *The Greek Debt Exchange: An Autopsy* (2012), 5.

² *Ibidem*, at 9.

³ *Ibidem*, at 16.

⁴ The term *ICSID* refers to the *International Center for Settlement of Investment Disputes*.

⁵ *Abaclat and Others v. The Republic of Argentina*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (hereinafter: *Abaclat*).

and Others v. The Argentine Republic, the tribunal decided that bonds were investments in terms of the ICSID Convention⁶ and the applicable BIT, and that some of Argentina's measures to restructure its debt amounted *prima facie* to a breach of the latter.⁷ Less than two years later, another tribunal issued its decision on jurisdiction and admissibility in the related case *Ambiente Ufficio S.p.A. and Others v. The Argentine Republic* which also concerned claims of Italian bondholders against Argentina.⁸ The tribunal essentially followed the *Abaclat* decision in holding that bonds were covered by the ICSID Convention and the applicable BIT which Argentina had *prima facie* violated.⁹ In both cases, dissents were issued.

In light of recent developments, the importance of these two decisions cannot be overstated. The above-mentioned cases were the first two instances in which ICSID tribunals had to decide on this issue; another related case is still pending.¹⁰ And with regard to Greece, there is likely more to come. A Slovak and a Cypriot investor have already commenced ICSID proceedings.¹¹ Apparently, sovereign bondholders increasingly regard ICSID arbitration as a viable alternative to litigation in state courts. One may speculate over the reasons, but the high compliance rate of ICSID awards is certainly appealing.¹² This is not to say that bondholder claims will necessarily succeed on the merits, but the mere existence of ICSID arbitration as a potential forum for sovereign debt disputes might already pose a challenge to states in financial distress, and hamper their ability to resolve the crisis.¹³ Therefore, the issue deserves careful consideration.

II. BONDS AS INVESTMENTS

Bonds must qualify as investments for bondholders to have access to ICSID arbitration. The definition of investment in the context of ICSID is highly controversial. But before entering into this discussion, it might be useful to consider the issue in economic terms.

⁶ The term *ICSID Convention* refers to the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*.

⁷ *Abaclat*, para. 311 et seq., and 333 et seq.

⁸ *Ambiente Ufficio S.p.A. and Others v. The Argentine Republic*, ICSID Case No. ARB/09/8, Decision on Jurisdiction and Admissibility (hereinafter: *Ambiente Ufficio*).

⁹ *Ibidem*, at para. 355 et seq. and 521 et seq.

¹⁰ *Giovanni Alemanni and Others v. Argentine Republic*, ICSID Case No. ARB/07/8.

¹¹ *Poštová banka, a.s. and ISTROKAPITAL SE v. Hellenic Republic*, ICSID Case No. ARB/13/8.

¹² Cross, *Arbitration as a Means of Resolving Sovereign Debt Disputes*, American Review of International Arbitration 335 [361]; Waibel, *Opening Pandora's Box: Sovereign Bonds in International Arbitration*, 101 American Journal of International Law 711 [715].

¹³ *Ibidem*, at 713 et seq.

A World Bank publication defines an investment as “outlays made by individuals, firms, or governments to add to their capital”.¹⁴ Foreign investment is defined as “investment in an enterprise that operates outside the investor’s country”¹⁵ and further subdivided into foreign direct investment which is “foreign investment that establishes a lasting interest in or effective management control over an enterprise”,¹⁶ and portfolio investments which are “[s]tock and bond purchases that, unlike direct investment, do not create a lasting interest in or effective management control over an enterprise”.¹⁷ These definitions are of course neither binding, nor authoritative for tribunals. An investment may be something different in the legal context. Yet one should keep them in mind, especially when referring to an inherent meaning of the term as is often done.

A. THE NOTION OF INVESTMENT UNDER THE ICSID CONVENTION

States employ many different interpretations of the notion of investment in their bilateral and multilateral investments treaties, and they are generally free to do so. In the context of ICSID, however, the threshold question is if and to what extent the ICSID Convention itself restricts the type of disputes that can be subject of arbitration. The views expressed thereto by tribunals vary greatly. While some tribunals have shown great deference, others quite actively curtailed the states’ discretion to define an investment for the purposes of ICSID arbitration. Yet all of them seem to agree that there are at least some outer limits that cannot be exceeded.¹⁸ Interpretations¹⁹ pursuant to which the term means whatever the legal instrument carrying the consent of the parties says it means, rarely find support anymore.²⁰ But this is about as far as the agreement goes.

¹⁴ Soubbotina, *Beyond Economic Growth: An Introduction to Sustainable Development*, 2nd edition, World Bank Publications, Washington, D.C. (2004), 138.

¹⁵ Ibidem, at 135.

¹⁶ Ibidem, at 134.

¹⁷ Ibidem, at 141.

¹⁸ *Ambiente Ufficio*, para. 438; *Malaysian Historical Savors SDN BHD v. The Government of Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment, para. 69.

¹⁹ *Phillipe Grustlin v. The State of Malaysia*, ICSID Case No. ARB/99/3, Award, para. 13.6; *Lanco International, Inc. v. The Argentine Republic*, ICSID Case No. ARB/97/6, Preliminary Decision on Jurisdiction, para. 48; *M.C.I. Power Group L.C. and New Turbine, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/03/6, Award, para. 159.

²⁰ Schreuer, *The ICSID Convention: A Commentary*, 2nd edition, Cambridge University Press (2009), Article 25, para. 125; Gaillard, *Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice*, in *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer*, Oxford University Press (2009), 403 [411].

1) The Subjective Approach

The most liberal approach in defining the term investment largely relies on what the parties have deemed to constitute an investment for the purposes of ICSID arbitration. It is therefore also referred to as the “subjective approach”.²¹ It works like an inverted assumption. Generally, every economic activity covered by the parties’ consent is presumed to constitute an investment for the purposes of ICSID, except in truly extraordinary circumstances.²² The standard example for such exceptional circumstances is where the parties define ordinary commercial transactions as investments.²³ In *Asia Express v. Greater Colombo Economic Commission*, the Secretary General of ICSID even refused to register a case that dealt with a dispute arising out of a mere sales contract.²⁴ Absent such exceptional circumstances, tribunals following this approach will simply turn to the instrument conferring jurisdiction upon them, and assess whether the asset or enterprise falls under that instrument. As stated by the *Ambiente Ufficio* tribunal:

[T]he very fact that BITs regularly combine (...) a detailed definition of the term “investment” with explicit authorization for the investor to resort to ICSID arbitration, should be given great weight in deciding whether or not the transaction in question is an investment for the purposes of Art. 25 of the ICSID Convention.²⁵

The approach is predicated upon the drafting history of the ICSID Convention. The drafters debated heavily about the appropriate definition of an investment, but were unable to reach an agreement.²⁶ Several proposals were discussed but none of them made it into the Convention.²⁷ The states argued *inter alia* over the precise wording, the property rights to be covered, time elements, thresholds regarding the value of the claim, or the investment and issues of economic development.²⁸ Since the only thing they eventually could agree on was the fact that they did not agree, they decided to leave the definition of investment open for subsequent determination by the

²¹ Stern, *Are There New Limits on Access to International Arbitration*, 25 ICSID Review – Foreign Investment Law Journal 1 [3].

²² Mortenson, *The Meaning of “Investment”: ICSID’s Travaux and the Meaning of International Investment Law*, 51 Harvard International Law Journal 257 [269].

²³ Idem.

²⁴ Shihata/Parra, *The Experience of the International Centre for Settlement of Investment Disputes*, 14 ICSID Review – Foreign Investment Law Journal 299 [308].

²⁵ *Ambiente Ufficio*, para. 462.

²⁶ Ibidem, at para. 448 et seq.; *MHS v. Malaysia*, supra note 18, para. 63 et seq.

²⁷ Idem; Schreuer, supra note 20, Article 25, para. 113 et seq.

²⁸ Idem.

states in the legal instruments subjecting disputes to ICSID.²⁹ This rather broad solution is counterbalanced by the possibility of states to notify ICSID of the class or classes of disputes which they would or would not consider submitting to the jurisdiction of ICSID pursuant to Article 25(4) ICSID Convention.³⁰ The *Report of the Executive Directors* provides in the pertinent part:

No attempt was made to define the term “investment” given the essential requirement of consent by the parties, and the mechanism through which the Contracting States can make known in advance, if they so desire, the classes of disputes which they would or would not consider submitting to the Center (Article 25(4)).³¹

2) *The Objective Approach*

This can be distinguished from what is referred to as the “objective approach”.³² This approach regards the term “investment” in Article 25(1) ICSID Convention as an independent qualification of the disputes that may be submitted to ICSID, and hence it must be interpreted autonomously. It effectively limits the states’ ability to subject certain types of disputes to ICSID.³³ This is justified by the multilateral character of the ICSID Convention and the favorable arbitration framework it establishes. Tribunals following this approach assess whether the disputed asset is covered by the parties’ consent and, cumulatively, the notion of investment in terms of the ICSID Convention. If it fails to meet one of these two tests, the tribunal will decline jurisdiction. This is sometimes described as a “double-barreled test”.³⁴

Under this approach, the important question is how the notion of investment is to be defined. The broader the definition, the less significant is the difference to the subjective approach and vice versa. This is illustrated by the definition employed by the tribunal in *Abaclat*. Even though adhering to the “double-barreled test”, the interpretation adopted by the tribunal was so broad that it hardly imposed any limits on the states’ determination of an investment. It held that “the only requirement regarding the contribution is that it be apt to create the value that is protected under the BIT.”³⁵

However, most tribunals favoring the objective approach adopted narrower definitions.

²⁹ Idem.

³⁰ Idem.

³¹ *Report of the Executive Directors of the International Bank for Reconstruction and Development on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, para. 27.

³² Stern, *supra* note 21, 2.

³³ Schreuer, *supra* note 20, Article 25, para. 122 et seq.

³⁴ *MHS v. Malaysia*, *supra* note 18, Award on Jurisdiction, para. 55; *Abaclat*, para. 344.

³⁵ *Abaclat*, para. 365.

a) The Salini Test

The starting point was set in *Salini v. Morocco*³⁶ where the tribunal had to decide whether it had jurisdiction over a dispute about a contract concerning the construction of a highway. It held that in terms of Article 25(1) ICSID Convention an:

Investment infers: contributions, a certain duration of performance of the contract and a participation in the risks of the transaction (...). In reading the Convention's preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition.³⁷

The tribunal arrived at this conclusion not by following the rules of treaty interpretation, but by a descriptive analysis of what had been identified as typical characteristics of an investment in the doctrine.³⁸ Nonetheless, many subsequent tribunals followed these criteria which became known as the *Salini* test.³⁹

The first three requirements are usually pretty straightforward. The requisite contribution can usually consist of any transfer of capital in cash, kind or labor.⁴⁰ At the drafting stage of the ICSID Convention, it has been debated whether the contribution must meet a minimum threshold, i.e. whether it must be substantial.⁴¹ But eventually, this was rejected.⁴² So far, the requirement has not played a decisive role.⁴³ The contemplated minimum duration of the investment ranges from two to five years.⁴⁴ In any case, tribunals handle it rather flexibly.⁴⁵ Also, the presence of some form of risk is usually inherent in any economic activity. The mere existence of a dispute can be seen as proof of that.⁴⁶

³⁶ *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction.

³⁷ Ibidem. at para. 52.

³⁸ Idem.

³⁹ Schreuer, supra note 20, Article 25, para. 156.

⁴⁰ *Salini v. Morocco*, supra note 36, para. 53; *Romak S.A. v. the Republic of Uzbekistan*, UNCITRAL Arbitration, PCA Case No. AA280, Award, para. 214; Schreuer, supra note 20, Article 25, para. 161.

⁴¹ Mortenson, supra note 22, 297.

⁴² Idem.

⁴³ Schreuer, supra note 20, Article 25, para. 161.

⁴⁴ Ibidem. at Article 25, para. 162; *Salini v. Morocco*, supra note 36, para. 54; *MHS v. Malaysia*, supra note 18, Decision on Jurisdiction, para. 110/111.

⁴⁵ Schreuer, id.

⁴⁶ *Fedax N.V. v. The Republic of Venezuela*, ICSID Case No. ARB/96/3, Decisions of the Tribunal on Objections to Jurisdiction, para. 40.

However, some tribunals held that the ordinary commercial risk would not sufficient to fulfill the risk requirement.⁴⁷

The requirement of a contribution to the economic development of the host state is more controversial. It is hence useful to briefly consider the concept of economic development. The above-mentioned World Bank publication defines it as:

[q]ualitative change and restructuring in a country's economy in connection with technological and social progress. The main indicator of economic development is increasing GNP per capita (...), reflecting an increase in the economic productivity and average material well being of a country's population.⁴⁸

It further explains that economic development is closely linked to, but not identical with economic growth.⁴⁹ Economies can grow extensively by using more resources, or intensively by using resources more efficiently.⁵⁰ Only in the latter case does economic growth also result in economic development.⁵¹ Investment in the above-cited economic sense is a precondition for both.⁵² If tribunals want to exclude investments that do not contribute to economic development from the purview of ICSID, they consequently have to verify that the investment in dispute resulted in the more productive use of resources within the host states economy. However, such determinations are rather difficult with regard to an individual investment. Tribunals have thus been careful in the application of this criterion;⁵³ some even omitted it.⁵⁴

Other requirements contemplated by tribunals are a regularity of profit and return,⁵⁵ and that the investment must have been made *bona fide*.⁵⁶ However, none of them seems to have found much support.

⁴⁷ *Joy Mining Machinery Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction, para. 57; *MHS v. Malaysia*, supra note 18, Decision on Jurisdiction, para. 112.

⁴⁸ Soubotina, supra note 14, para. 133.

⁴⁹ Idem.

⁵⁰ Idem.

⁵¹ Idem.

⁵² Ibidem at para. 138.

⁵³ *Fedax*, supra note 46, para. 43; *Salini v. Morocco*, supra note 36, 57; *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction, para. 80, 64 and 88.

⁵⁴ *Consortium Groupement L.E.S.I.- DIPENTA v. République algérienne démocratique et populaire*, ICSID Case No. ARB/03/08, Award, para. 13; *L.E.S.I. S.p.A. et Astaldi S.p.A. c. République algérienne démocratique et populaire*, ICSID Case No. ARB/05/3, Decision, para. 72; *Victor Pey Casado and President Allende Foundation v Republic of Chile*, ICSID Case No. ARB/98/2, Award, para. 232.

⁵⁵ *Helnan International Hotels A/S v. Arab Republic of Egypt*, ICSID Case No. ARB/05/19, Decision of the Tribunal on Objection to Jurisdiction, para. 77.

⁵⁶ *Phoenix Action, Ltd. v. the Czech Republic*, ICSID Case No. ARB/06/05, Award, para. 106 et seq.

Among the proponents of the objective approach, there is further disagreement on how these different criteria should be applied. The *Salini* tribunal suggested that:

...these various elements may be interdependent. Thus, the risks of the transaction may depend on the contributions and the duration of performance of the contract. As a result, these various criteria should be assessed globally even if, for the sake of reasoning, the Tribunal considers them individually here.⁵⁷

From there, two methods of assessment evolved. The first one tries to identify an investment by using the *Salini* requirements as typical characteristics.⁵⁸ Not all of them have to be fulfilled cumulatively for an asset or transaction to qualify as an investment. They rather provide some guidance for a holistic assessment of whether there is an investment. The second method treats the requirements as a definition.⁵⁹ If one of them is not fulfilled, jurisdiction must be declined. Both methods see the requirements as normative rather than descriptive, but only the latter considers them to be mandatory.

b) Additional Requirements

In scholarly literature, additional requirements have been contemplated. Two of them have expressly been proposed for the purpose of excluding bondholder disputes from ICSID: the existence of a territorial link between the purported investment and the host country, and a reasonably close association with a commercial undertaking.

(i) The Need for a Territorial Nexus

This criterion purportedly requires that there is at least some physical presence in the territory of the host state, even though the investment must not be located therein entirely.⁶⁰ A mere flow of capital, however, would not be sufficient.⁶¹ It is important to highlight that this does not concern the territoriality requirement found in investment treaties which will be discussed below, but the notion of investment under Article 25(1) ICSID Convention.

The requirement of a territorial nexus is allegedly found in the drafting history of the ICSID Convention. And indeed, the *Report of the Executive Directors* makes several references in that regard, stipulating that the ICSID Convention “can be a major step

⁵⁷ *Salini v. Morocco*, supra note 36, para. 52.

⁵⁸ Gaillard, supra note 20, para. 407 et seq.

⁵⁹ Ibidem, at 410 et seq.

⁶⁰ Waibel, supra note 12, 727; Waibel, *Sovereign Defaults before International Courts and Tribunals*, Cambridge University Press (2011), 242 et seq.; Douglas, *The International Law of Investment Claims*, Cambridge University Press (2009), 343; *Abaclat*, Dissenting Opinion, para. 73 et seq.

⁶¹ Idem.

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”,^{62v} and that “the Executive Directors believe that private capital will continue to flow to countries offering a favorable climate for attractive and sound investments”.⁶³

It is further argued that the object and purpose of the ICSID Convention to promote economic development is served best by investments physically present in the territory of the host state.⁶⁴ Otherwise, contributions to economic development would be highly unlikely.⁶⁵ Another argument that is advanced is that the investment regime intends to counterbalance the states’ regulatory power within their territory.⁶⁶ Or, as one author put it:

The territorial nexus between the claimant’s contribution of capital and the economy of the host state is also a fundamental aspect of the economic materialization of the investment; indeed it is the realization of the prime objective for the contracting state parties to enter into an investment treaty in the first place. (...) In other words, the territorial connection between the claimant’s contribution of capital and an investment enterprise in the host state must be direct rather than indirect or consequential.⁶⁷

The answer to whether the ICSID Convention requires a territorial nexus must come from the ICSID Convention itself. Its wording does not support it. The term investment in itself is geographically neutral and the context of Article 25(1) ICSID Convention is inconclusive.

What could militate in favor of a territoriality requirement is the object and purpose of the ICSID Convention as evidenced by the *Report of the Executive Directors*. Yet while there are indeed references to the territory of the host state, none of them concerns specific capital flows into a specific territory. Quite to the contrary, the above-cited passages take a much broader stance. Their aim is to create an overall favorable investment climate in order to stimulate investment activity in general. Encouraging specific capital flows between individual countries is a matter to be dealt with by the states through separate legal instruments such as investment treaties. The ICSID Convention only establishes a platform that they can build on. It is a framework agreement for the settlement of investment disputes. Neither does it provide any substantive investment protection, nor does it subject states to arbitration. Promoting additional capital flows into specific territories is not among its objects and should therefore also not be deemed to be a requirement for its application.

⁶² *Report of the Executive Directors of the ICSID Convention*, para. 9

⁶³ *Ibidem*, at para. 12.

⁶⁴ Waibel, *supra* note 60, 238; Waibel, *supra* note 12, 727.

⁶⁵ *Idem*.

⁶⁶ *Ibidem*; *Abacat*, Dissenting Opinion, para. 53.

⁶⁷ Douglas, *supra* note 60, para. 404.

It is further not convincing to justify a territoriality requirement with the purported intention of the ICSID Convention to counterbalance the states' regulatory power within their territory. It is undisputed that the primary intention of the ICSID Convention is to mitigate sovereign risk by providing a forum for the adjudication of international investment disputes. Yet there is no reason why this intention should be limited to the territory of the host state. Domestic regulation may very well have extra-territorial effects. A prime example is the law enacted by Argentina in support of its debt restructuring program in 2005.⁶⁸ Even though directed at Argentina's own executive, it directly affected foreign bondholders. Measures of this kind can equally deter future capital flows and should thus be part of the sovereign risk addressed by the ICSID Convention.

The case law put forward in support of a territoriality requirement is also inconclusive. While some decisions make reference to a territorial link between the investment and the host state, none of them expressly designate it to be a requirement under the ICSID Convention. The only known case where a tribunal declined jurisdiction for lack of a territorial nexus was *Bayview v. Mexico*.⁶⁹ However, this was based on an interpretation of NAFTA Chapter Eleven, and not the ICSID Convention.⁷⁰ With regard to Article 25(1) ICSID Convention, the tribunal in *L.E.S.I.-DIPENTA v. Algeria* only held that investments are often effected in the host country, but expressly stated that this is not an absolute condition.⁷¹ In *CSOB v. Slovakia*, the tribunal even said that "a transaction can qualify as an investment even in the absence of a physical transfer of funds".⁷² State practice does not support a general territoriality requirement either. Many investment treaties carrying the consent to ICSID arbitration expressly require a territorial nexus. This would be redundant if it was already implicit in the ICSID Convention.

Finally, excluding bonds for lack of a territorial nexus would be inconsistent with the practice regarding shares. Shares are securitized equity capital; bonds are securitized debt capital. Both of them are tradable in secondary markets. But this does not warrant the conclusion that shareholders have a territorial nexus with the host state and bondholders do not. It would be a misconception of shareholding if one were to assume a physical connection between the shareholder and the host state through the physical location of the company. Shareholders neither own the company's assets, nor are they entitled to it. They hold entitlements in the company which owns the assets as a separate legal entity. This is particularly evident in the case of indirect shareholding where the ownership of the company is mediated through several corporate layers. If one were to exclude bonds from the purview of ICSID for lack of a territorial nexus, one would consequently have to apply the same reasoning to shares. Either both are in or both are out. Treating them

⁶⁸ *Abacat*, para. 78.

⁶⁹ *Bayview Irrigation District et al. v. United Mexican States*, ICSID Case No. ARB(AF)/05/1, Award, para. 102 et seq.

⁷⁰ *Idem*.

⁷¹ *L.E.S.I.-DIPENTA v. Algeria*, supra note 54, para. 14(i).

⁷² *CSOB*, supra note 53, para. 78

differently would lead to inconsistencies which are highly undesirable if one wants to sustain investor confidence.

(ii) Association with a Commercial Risk

Another requirement that has repeatedly been suggested is the association with a commercial risk. Waibel contends that:

...a final typical element of an ‘investment’, inherent in Article 25, is the operation of, or a reasonably close relation with, a commercial undertaking. The meaning of investment in international investment case law comprises equity holdings in private or public owned entities whose main goal is commercial.⁷³

From that, he infers that sovereign bonds do not fall under the ICSID Convention as they serve general budgetary purposes and are not associated with commercial undertakings.⁷⁴ He contrasts bonds with shares, contending that the latter would always qualify as investments because they represent part of a company and shareholders thus have a voice in the management of a commercial enterprise.⁷⁵ Finally, he stipulates that sovereign bonds may exceptionally fall under the ICSID Convention if they are tied to specific projects such as railway or power plant constructions.⁷⁶

Apart from being postulated as an inherent feature of Article 25(1) ICSID Convention, it remains obscure where this requirement really comes from. The case law is also inconclusive. Prior ICSID cases dealt with equity holdings and debt instruments alike.⁷⁷

The comparison to shares is not entirely convincing either. Not every shareholder participates in the management of the company and thus engages in a commercial operation. Depending on the composition of the shareholders, quite the opposite may be true. Such an assumption also neglects the different forms of stock that there are such as common stock, preferred stock and any hybrid forms. It also forgets about indirect shareholding which is an accepted form of investment in terms of Article 25(1) ICSID Convention. Indirect shareholders have frequently been claimants in international investment disputes and it may be doubted that all of them were actively engaged in the commercial operations of the held companies, particularly in cases where there are many corporate layers.⁷⁸ Requiring an association with a commercial undertaking would thus

⁷³ Waibel, *supra* note 12, 728; and *supra* note 60, 242 et seq., quote taken from the article.

⁷⁴ *Idem.*

⁷⁵ *Idem.*

⁷⁶ *Idem.*

⁷⁷ For debt instruments see e.g. *Fedax*, *supra* note 46; *CSOB*, *supra* note 53.

⁷⁸ Valasek/Dumberry, *Developments in the Legal Standing of Shareholders and Holding Corporations in Investor-State Disputes* 26 ICSID Review – Foreign Investment Law Journal 34 [51 et seq.].

not only exclude sovereign bonds from the purview of ICSID, it would also have a limiting effect on of shareholding and thus again lead to inconsistencies.

B. DO SOVEREIGN BONDS QUALIFY AS INVESTMENTS UNDER THE ICSID CONVENTION?

Having outlined the notion of investment as developed in ICSID jurisprudence, one must now examine whether (sovereign) bonds fall under it. But before doing so, it is useful to recall the structure of bonds and bond markets as well as the modalities of their issuance and trading.

1) The Structure of Bonds and Bond Markets

A bond is a security evidencing a debt. It is used for debts with a maturity of more than one year.⁷⁹ The issuer usually undertakes to pay the holder of the bond a fixed principal amount upon maturity and make periodic interest payments. There are many different types of bonds and they vary greatly in respect of their conditions and issuers. Sovereign bonds are bonds issued by a state typically through its central bank, ministry of finance, or a debt agency.⁸⁰ The global bond market consists of the international bond market which is commonly referred to as the Eurobond market, and the various domestic bond markets which are usually open to domestic and foreign issuers alike.⁸¹ The regulatory environment of domestic bond markets may differ greatly, while the Eurobond market is not governed by any particular jurisdiction, and only subject to self-imposed standards of practice.⁸² Sovereign bonds may be issued in any of these markets.

Bonds are usually issued in a multistep process that typically involves financial institutions from various jurisdictions. The process is organized by a so called lead manager or book runner which is typically an investment bank. The lead manager is in charge of putting together a management group of a small number of other banks which is to prepare the issue of the bond, set the final conditions, and select the underwriters and the selling group. The underwriters are a group of financial institutions that provide a purchase guarantee for the newly issued bonds at a fixed price. The selling group comprises financial institutions that offer to assist in the placement of the bond in the market. Unlike underwriters, they do not assume any risk in the placement of the bond. Together, the participating financial institutions form the issue syndicate. Each of them may be a manager, underwriter and seller at the same time.

⁷⁹ Moles/Terry, *The Handbook of International Financial Terms*, Oxford University Press (1997), 50.

⁸⁰ Valdez/Molyneux, *An Introduction to Global Financial Markets*, 6th edition, Palgrave MacMillan (2010), 151.

⁸¹ Solnik/McLeavey, *International Investments*, 6th edition, Pearson Addison Wesley (2009), 260 et seq.

⁸² Smith/Walter, *Global Banking*, Oxford University Press (1997), 248.

The issue process begins with a meeting of the lead manager and the issuer to discuss the terms of the bond. After its assembly, the management group prepares all necessary documents, including a preliminary prospectus for prospective underwriters. Then, the bond issuance is announced and other financial institutions are invited to join the issue syndicate as underwriters or sellers. Once the issue syndicate is complete, the final terms of the bond are set and a final prospectus is prepared. The issue syndicate then purchases the bond and makes a public offer for a certain placement period. At the end of this period, the subscription is closed and the bond is delivered by the issuer in exchange for the cash. It is important to highlight that the issuer, i.e. the sovereign in case of sovereign bonds, receives the money in a lump sum on the closing day. The placement risk is solely borne by the underwriters.⁸³

In order to cope with certain regulatory impediments and to facilitate the trading of bonds in modern secondary markets, the structure of bonds has gradually been dematerialized. Instead of producing a large number of small, separate bond notes which circulate at retail level, the borrower only issues one giant global note that represents the entire sum of the bond issue. This note is deposited in the vault of a commercial bank which will typically declare to hold the note on behalf a clearing house. Potential buyers maintain accounts with these clearing houses through which they can purchase and trade entitlements in the bond. These accounts show the individual security entitlements of each market participant and also serve as platform for handling the payments. That way, all trades can be processed and settled electronically through the clearing houses without any need for individual bond notes to change hands physically. To make the regular interest payments and repay the principal upon maturity, the bond issuer appoints a paying agent which is often a branch of the bank acting as a depository. The paying agent pays the clearing houses which distribute the money to the individual accounts correspondent to their participation in the bond. The account holders, however, will often not be acting for themselves, but as an intermediary and accordingly pass the payments on to their clients. These clients may themselves be intermediaries, and hence they have to pass the money on to somebody else, and so on.⁸⁴

The structure of modern bonds is thus somewhat different from traditional debt instruments such as loans or physically tradable promissory notes. There is only one giant bond note that is locked away in a bank vault. All that bondholders own are entitlements therein. However, this does not change the nature of bonds as debt instruments. The structural changes only serve practicality reasons.

⁸³ The two foregoing paragraphs are based on id. 266 et seq. and Ianotta, *Investment Banking, A Guide to Underwriting and Advisory Services*, Springer Verlag (2010), 100 et seq.

⁸⁴ The foregoing paragraph is based on Bamford, *Principles of International Financial Law*, Oxford University Press (2011), para. 6.01 et seq.

2) *What Must Qualify as Investment?*

The modern structure of bonds is certainly convenient for market participants. From a legal perspective, however, they are quite the opposite. There now is a complex web of transactions and other legal relationships, stretching across various jurisdictions.⁸⁵ Before answering the question whether bonds qualify as investments in terms of Article 25(1) ICSID Convention, one must therefore first determine whether the various transactions can be treated holistically, or whether they have to be disentangled. There are two basic options: One can either rely on any of the individual transactions involved, from the underwriting of the bond to the purchase of the entitlements in secondary markets, or one can look at them as one economic operation.

The case law is in favor of the latter. In *Fedax v. Venezuela*,⁸⁶ the tribunal decided that it had jurisdiction over a dispute concerning six promissory notes issued by Venezuela for the performance of certain services.⁸⁷ Even though the case only concerned promissory notes and not bonds, it provides a first point of reference. Venezuela argued that the promissory notes did not constitute investments in terms of the ICSID Convention, because their purchase in the secondary market did not involve a long term transfer of capital for the purpose of acquiring interests in or shares of a corporation.⁸⁸ The tribunal, however, did not follow this argument. It did not deal with the purchase of the promissory notes in isolation, but rather looked at the entire operation as a whole. In the pertinent part it held:

A promissory note is by definition an instrument of credit, a written recognition that a loan has been made. In this particular case the six promissory notes in question were issued by the Republic of Venezuela in order to acknowledge its debt for the provision of services under a contract (...); Venezuela had simply received a loan for the amount of the notes for the time period specified therein and with the corresponding obligation to pay interest.⁸⁹

Abaclat is the first known case to deal with bonds directly. The tribunal also refused to disentangle the various transactions and rather treated them as one economic operation.⁹⁰ It reasoned that the issue of the bonds, their distribution and subsequent trading in secondary markets only made sense together as none of them would have taken place individually.⁹¹ Most importantly, the underwriter would never have engaged in the issue process if it would not have been able to resell the bonds.⁹² The

⁸⁵ Ibidem, at para. 6.06.

⁸⁶ *Fedax*, supra note 46.

⁸⁷ Idem.

⁸⁸ Ibidem, at para. 19.

⁸⁹ Ibidem, at para. 37.

⁹⁰ *Abaclat*, para. 358 et seq.

⁹¹ Ibidem, at para. 358.

⁹² Idem.

tribunal saw its assumption of an economic unity confirmed by the fact that Argentina's exchange offers in the restructuring of its debt addressed the individual bondholders and not the underwriters.⁹³ It concluded that "bonds and security entitlements therein cannot be regarded as two separate investments relating to different rights or values"⁹⁴.

The tribunal in *Ambiente Ufficio* followed the same approach.⁹⁵ It seconded the reasoning of *Abaclat* and invoked a *doctrine of general unity of an investment operation* which it inferred from existing case law.⁹⁶ It concluded that the operation was:

...correctly characterized (...) as the overall loans which made funds available to finance the Respondent's budgetary needs, with each Claimant holding a proportionate share of that investment (...). To seek to split up bonds and security entitlements into different, only loosely and indirectly connected operations would ignore the economic realities, and the very function, of the bond issuing process.⁹⁷

The respective dissents expressly reject the assumption of an economic unity.⁹⁸ They rather distinguished between the individual legal transactions, especially between the issuance of the bond and the purchase of the entitlements therein.⁹⁹ They pointed to the fact that the underwriter bears the placement risk, and that the purchase price paid for the entitlements is not paid to the issuer, but to the prior holder of the entitlement.¹⁰⁰ As the dissent in *Ambiente Ufficio* stated "bonds" and "security entitlements" are materially and legally different "financial products" issued at different moments of time, in different markets and by *two different juridical persons*".¹⁰¹

Especially the latter point seems to stick out. Generally, there is nothing peculiar about an economic operation comprising several legal acts. In most jurisdictions, even a simple purchase of land involves more than just one legal act, not to mention the setting up of a business. It is also not unusual that these legal acts are disconnected in place and time. Yet what is certainly noteworthy in the case of bonds is the myriad of actors who typically have no closer connection with each other. The borrower only gets active at the very beginning when the bond is issued in the primary market. Once it is dispersed, it is traded independently. The issuer services the debt irrespective of the person entitled to it. Especially longer running bonds, *i.e.* the entitlements therein, may change hands numerous times before they mature.

⁹³ Ibidem, at para. 360.

⁹⁴ Ibidem, at para. 359.

⁹⁵ *Ambiente Ufficio*, para. 327 and 422 et seq.

⁹⁶ Ibidem, at para. 422 et seq.

⁹⁷ Ibidem, at para. 425.

⁹⁸ *Abaclat*, Dissenting Opinion at para. 69 et seq.; *Ambiente Ufficio*, Dissenting Opinion, para. 151 et seq.

⁹⁹ Idem.

¹⁰⁰ Idem.

¹⁰¹ *Ambiente Ufficio*, Dissenting Opinion, para. 155.

But does this prohibit a holistic assessment of the legal transactions as an economic unity? The ICSID Convention itself does not warrant such a conclusion. It simply states that there must be a legal dispute between the claimant and the respondent arising directly out of an investment. It does not require any personal links beyond the existence of a disagreement regarding an investment. It further says nothing about how a claimant must have acquired the purported rights in the investment. There is nothing to suggest that a potential claimant must have made the disputed investment *in personam*.¹⁰² The funds bound by the investment must not come directly from the claimant's pocket. Otherwise, any transfer of an investment would result in the loss of protection under the ICSID Convention.

This is in line with the object and purpose of the ICSID Convention. If international investment is to be stimulated, the ICSID Convention must cover the entire economic operation and not just the initial allocation of funds by a foreigner. The protection of an investment becomes moot if it fades away after it has been made. If an investor fears to lose its investment down the road, it might not make it in the first place. The same rationale applies where the investment is tradable. If assets are unattractive in the secondary market due to their exposure to sovereign risk, their protection in the primary market does not help much. Primary market actors will refrain from making the investment in the first place if they are unsure about whether they can adequately monetize it.

Further, it would again be inconsistent with the practice regarding shares if one were to split up bonds in their issuance and secondary market trading. Shares are also traded in secondary markets and can hence change hands frequently. The purchase price does also not flow to the issuing company, but to the prior holder. If the bondholding is broken up in the issuance of the bond in the primary market and the subsequent trades in the secondary market, one could request the same with regard to shareholding. The issuance of the shares could be separated from their purchase. However, this is not what tribunals do. And for the sake of consistency, they should not do so with regard to bonds either.

3) *Analysis*

So do bonds and the entitlements therein qualify as investments in terms of Article 25(1) ICSID Convention? For tribunals following the subjective approach the answer largely depends on the underlying legal instrument which in most cases is an investment treaty. If the underlying legal instrument covers financial instruments such as bonds, then the tribunal will assume jurisdiction over the case. As stated by the Tribunal in *Ambiente Ufficio*:

[T]he Tribunal can see no reason why sovereign bonds/security entitlements should be excluded from the jurisdiction of the Centre and, for that matter, from the competence

¹⁰² See in that sense also *Amco Asia Corp. v. The Republic of Indonesia*, ICSID Case No. ARB/81/I, Award on Jurisdiction, para. 31/32.

of this Tribunal, if and to the extent that there is evidence that the States parties (...) considered those to be investments to be protected.¹⁰³

But also tribunals employing the objective approach are likely to accept bonds as investments in terms of Article 25(1) ICSID Convention, regardless of how many *Salini* criteria they apply.

The contribution is the money paid in the primary market in return for the issuance of the bond. It is this money that constitutes the investment and it also is the intended source of profits. The principal of the bond is the basis for the calculation of the interest and it is the amount to be repaid upon maturity. From the perspective of the issuing state, this is the capital flow that matters as it is the only one it receives directly. The purchase prices paid in the secondary market only serve to acquire the entitlements in the bond. Neither do they change the terms of the bond, nor do they affect the issuer. Even if transferred free of charge, e.g. through inheritance, the terms of the bond remain the same. It is hence the capital embodied in the bond that must be the object of investment protection and not the money paid to purchase the entitlement therein. This does not pose any problems with regard to the standing of the claimants either. It has already been established above that the ICSID Convention does not require that the investment was made *in personam*. The tribunals in *Abaclat* and *Ambiente Ufficio*, however, followed a different approach. They considered the aggregate amount of the money paid by the individual bondholders in the secondary market to constitute the contribution.¹⁰⁴

The duration requirement will usually be met, even though there is no agreed minimum duration that all tribunals adhere to. Bonds serve to raise medium to long term capital, whereas short term capital is raised through money market operations. Bonds have by definition a maturity of at least one year, but typically more. The holding time of the individual bondholders is not indicative as the funds are contributed to the issuing sovereign for the entire time until maturity and not just for the time during that the claiming bondholders have held it. Again, the bond operation should be seen in its entirety and may not be reduced to the purchase of the individual entitlement. The circulation of bonds in financial markets is independent of their actual duration. This is the main feature of the modern bond structure.

The main risk associated with sovereign bonds is the potential inability or unwillingness of the sovereign to regularly pay the interest or to repay the principal at maturity of the bond. The perceived probability of such a credit event is typically reflected in the payable interest rate. Other risks are potential changes in the applicable tax regime or fluctuations of the currency in which the interest rates and/or the principal are denominated. These risks will be accepted by most tribunals. However, for tribunals requiring the presence of a special investment risk that goes beyond ordinary commercial risks, this will most likely not suffice. By providing funds to a sovereign, lenders do not assume any specific risk

¹⁰³ *Ambiente Ufficio*, para. 472.

¹⁰⁴ *Abaclat*, para. 366; *Ambiente Ufficio*, para. 394.

regarding the successful application of these funds. Also, it will be close to impossible to associate the funds with any particular usage, and to assess the financial success thereof.

The contribution of sovereign bonds to the economic development of the host state is contested, because they differ from foreign direct investments which some consider to be the “ideal type” of investment for the purposes of ICSID.¹⁰⁵ And certainly, the economic impact of foreign direct investment is the most visible. But that does not mean that other forms of investments cannot contribute to the economic development as well. Funds provided to sovereigns may, for example, be used to improve the infrastructure and the educational system. State aid may be granted to build up infant industries, or temporarily buffer economic downturns. Even military expenses, often mentioned as negative example for government spending, may benefit the economy if used to protect important trade routes. In that regard, it makes no difference whether the capital raised through the bond is dedicated specifically to one of these purposes, or if it simply enters the general budget of the host state. Through their budgetary planning, states assess and allocate the available funds. The less money is available, the less money can be used for economically beneficial purposes. The availability of outside funds by itself thus contributes to the economic development of the host state. It is further irrelevant whether the financial instrument used to raise the capital allows for secondary market trading. All that matters is the availability of the funds to the sovereign. If anything, the tradability increases the attractiveness of the state’s bonds in primary markets, and thus drives down borrowing costs. It is hence not inconsiderate for states to extend investment protection to tradable financial instruments such as bonds.

Finally, the requirement of regular profit and return will also be met in most cases, since bonds typically provide for annual or semi-annual interest payments. It is further hard to think of cases in which a bond is issued or traded in bad faith.

C. BONDS AS INVESTMENTS UNDER INVESTMENT TREATIES

In most cases, the legal instrument conferring jurisdiction to ICSID will be an investment treaty. Whether bonds qualify as protected investments under such a treaty largely depends on its wording and cannot be answered in the abstract. Yet one issue that is likely to arise with regard bondholder claims is, again, the existence of a territorial nexus.

1) The Territoriality Requirement in Investment Treaties

Unlike the ICSID Convention, many investment treaties contain express references to the territory of the respondent state by requiring that an investment must be made therein. Hence, the key question is not whether there is a territoriality requirement, but what it

¹⁰⁵ *Abaclat*, Dissenting Opinion, para. 55.

takes to satisfy it. This is again a matter of interpretation. As noted above, the object and purpose of investment treaties is to build up mutual confidence among the contracting states to stimulate capital flows between them. So unlike the ICSID Convention, investment treaties are concerned with specific capital flows to individual countries. Therefore, territorial references in those treaties can and should be interpreted so as to require an investment to create a capital flow to the respondent state's territory in order to benefit from investment protection.

However, this requirement should not be interpreted narrowly by demanding the direct and physical materialization of the investment within the territory of the host state. As noted above, non-materializing types of investments such as bonds are equally apt to contribute to economic development. Their tradability benefits the state at best. With regard to investment treaties, it would be particularly odd to exclude certain types of investments for lack of a territorial nexus, while they are included in the treaty's illustrative list of protected investments. If an investment treaty covers bonds, the territoriality requirement must be interpreted accordingly. Otherwise, their protection would be moot. This would in turn violate the interpretative principle of effectiveness. Or as Schreuer puts it:

Where the document providing the basis of consent refers to investment in the territory of a State, a certain degree of flexibility is appropriate. Not all investment activities are physically located in the host State. This is particularly true of financial instruments. (...) If a treaty includes loans and claims to money in its definition of investment, it would be unrealistic to require a physical presence in or a transfer of funds into the host State (...) In cases involving financial obligations the locus of the investment can often be determined by reference to the debtor and its location. In this way financial instruments issued by States have their situs in that State.¹⁰⁶

This latter point might be the reason why commentators favoring a narrow interpretation insist on the territoriality requirement to belong to the notion of investment under the ICSID Convention. It can only credibly limit the jurisdiction of an ICSID tribunal if it forms part of the ICSID Convention's outer limits.

Based on the foregoing considerations, the question whether the territoriality requirement is met largely depends on whether the bond issuance and the secondary market purchases are regarded as self-standing transactions, or as economic unity. If they are treated separately, it is unlikely that the requisite territorial nexus will be found. The purchase of entitlements in bonds in itself has little to no connection with the territory of the respondent state. The entitlements have usually no physical location and their trading may take place under any random jurisdiction or, in the case of Eurobonds, under no jurisdiction at all. The bonds themselves are mostly governed by the law of one of the major financial centers and subjected to the respective courts. The secondary market

¹⁰⁶ Schreuer, *supra* note 20, Article 25, para. 197/198.

purchases may be carried out in any currency and the proceeds do not go to the issuing state, but to the seller and the intermediaries.¹⁰⁷

Tribunals treating the issuance of bonds and their subsequent trading in secondary markets as an economic unity will not look to the individual security entitlements, but rather assess the investment operation as a whole.¹⁰⁸ Bonds are then essentially treated like loans.¹⁰⁹ The decisive criterion for establishing the requisite territorial nexus consequently is the location of the ultimate beneficiary of the raised capital.¹¹⁰ As the *Abaclat* tribunal put it:

With regard to investments of a purely financial nature, the relevant criteria should be where and/or for the benefit of whom the funds are ultimately used, and not the place where the funds were paid out or transferred. Thus, the relevant question is where the invested funds ultimately made available to the Host State and did they support the latter's economic development?¹¹¹

Under this method of assessment, sovereign bonds will generally fulfill the territoriality requirement. The capital raised through the issuance of a bond goes directly to the borrowing state which by its very nature is the legal embodiment of its territory. Investments that make funds available to them must therefore be deemed to have been made within their territory.

As already outlined above, the holistic method is preferable. Primary and secondary market transactions are economically inseparable. It is useful to recall that under the present bond structure, the debt obligation of the bond issuer is entirely represented by the global note, while the security entitlements only represent the individual entitlements therein. The global note by itself is incomplete, because it only shows the debtor and its debt but not the present creditors. Treating it as a self-standing financial instrument would almost inevitably require to regard the depository bank as the physical holder of the global note as the beneficial owner of the entire debt. But this is not how the global note is designed to function. The security entitlements in themselves are also incomplete because they only represent the entitlements of the individual creditors but not what they are entitled in, i.e. the debt. Taken in isolation, they are practically worthless. To adequately reflect legal and economic realities, one must therefore look at the bond as a whole and assess the territorial connection accordingly.

¹⁰⁷ See also *Abaclat*, Dissenting Opinion, para. 80 et seq.

¹⁰⁸ *Abaclat*, para. 377/378; *Ambiente Ufficio*, para. 500.

¹⁰⁹ *Idem.*

¹¹⁰ *Idem.*

¹¹¹ *Abaclat*, para. 374.

2) *Territoriality as a Matter of Private International Law?*

In addition to this analysis, one must also mention another form of a territoriality requirement proposed in scholarly literature. It has been suggested that the property rights protected by an investment treaty must be interpreted exclusively according to the laws of the host state.¹¹² Therefore, the investment at stake must fall under the domestic jurisdiction of the host state pursuant to its rules of private international law.¹¹³ This is purportedly warranted by the territoriality requirement in the investment treaty.¹¹⁴ Douglas sums this up as follows:

The legal materialization of an investment is the acquisition of a bundle of rights in property that has the characteristics of one or more of the categories of an investment defined by the applicable investment treaty where such property is situated in the territory of the host state or is recognized by the rules of the host state's private international law to be situated in the host state or is created by the municipal law of the host state.¹¹⁵

Even in cases where the applicable investment treaty expressly lists bonds as protected investments, a tribunal following this approach would most likely have to decline jurisdiction over disputes involving bonds. The legal instruments underlying a bond issuance, especially the global note embodying the debt, are usually – though not always¹¹⁶ – subjected to the jurisdiction of a major financial center such as London, New York, Zurich or Frankfurt. If the bond issuer does not accidentally happen to be the sovereign of the law chosen to govern that particular bond, there will be no jurisdictional link.

This also shows the practical weakness of this approach. Where the investment comprises more than just the acquisition or physical relocation of tangible property, the localization of an investment may become somewhat arbitrary. Investments involving intangible property such as bonds are often structured by various legal instruments containing choice of law provisions, each of which possibly pointing to another jurisdiction. There may be a multiplicity of *siti*, possibly none of them pointing to the jurisdiction of the territory where the investment and the associated contributions are factually located. The rules of private international law serve the purpose of delimiting competing domestic laws. This may sometimes require the use of legal fiction. They are hence not always adequate for determining the territorial links of an investment.

¹¹² Douglas, *supra* note 60, para. 101 et seq. and 347 et seq.

¹¹³ *Ibidem*, at para. 349 et seq.

¹¹⁴ *Ibidem*, at para. 109.

¹¹⁵ *Ibidem*, Rule 22.

¹¹⁶ Remarkably, 85.9% of Greek bonds were governed by Greek law before the restructuring, see Sandrock, *Emerging Issues in International Arbitration: The Case for More Arbitration When Sovereign Debt is to be Restructured: Greece as an Example*, 23 *American Review of International Arbitration* 507 [513].

Moreover, converting the territorial into a private international law requirement will usually contradict the investment treaty itself. Investment treaties typically require that the investment was made in the territory of the host state, not that it falls under its jurisdiction. One may presume that states are capable of distinguishing between the factual determination of where an investment was made, and the determination of its legal *situs*. If the drafting state parties of an investment treaty would have wanted to include a private international law requirement, they could have done so. Their intentions seem to be different though. They seem to be less concerned with the legal structures surrounding inflowing capital than with attracting it in the first place.

There is also nothing to suggest that the illustrative list of protected investments must in itself be interpreted exclusively by reference to the law of the particular host state. The list is part of an international treaty and its terms should be interpreted accordingly. It is undisputed that the property rights comprising the investment must legally exist and will therefore necessarily be rooted in some domestic legal order; but this must not necessarily be legal order of the host state. There is nothing nonsensical about an investment treaty protecting investments governed by a foreign jurisdiction as long as economic benefits accrue to the contracting states.

III. CONCLUSION

Sovereign bonds constitute investments in terms of Article 25(1) ICSID Convention, regardless of the definition employed by the tribunal. They must be understood holistically as financial instruments that cannot be split up in their issuance and their subsequent trading in secondary markets. However, the fact that sovereign bondholder disputes under ICSID are possible does not mean that they are desirable. States should be aware that sovereign bonds may be treated as investments in terms of the ICSID Convention when *committing themselves to ICSID arbitration or considering any restructuring measures to resolve financial crises*.

PUBLIC POLICY AND THE RECOGNITION AND ENFORCEMENT OF FOREIGN ARBITRAL AWARDS IN BRAZIL: AN ANALYSIS AGAINST THE BACKDROP OF GLOBAL GOVERNANCE

Pedro Arcoverde*

Abstract. Arbitration is the standard means of dispute resolution in the field of international commerce. Thanks to the scheme set up by the widely accepted 1958 New York Convention, foreign arbitral awards can circulate easily around the globe. However, one of the grounds to refuse recognition and enforcement often seems to constitute a significant barrier: public policy. A concept notoriously hard to define, public policy provides national courts with a large margin of appreciation in assessing whether the foreign award is in conformance with the forum's most fundamental values. This article, focusing on the practice of Brazilian courts, enquires into the role of public policy in today's global economic governance and examines the consequences that can arise from the weakening of such an exception to bar the recognition and enforcement of foreign arbitral awards.

Keywords: Recognition. Enforcement. Arbitral awards. Public policy. Brazil. Global governance.

* LL.B. (UFPE, Brazil), Lawyer admitted to practice in Brazil, Master's degree in International Economic Law from Sciences Po Law School, Paris (with honors). Assistant professor at the L'Institut d'Etudes Politiques de Paris.

I. INTRODUCTION

*t*he importance of international arbitration to global governance is beyond doubt. As arbitration has become the default means of dispute resolution in international trade,¹ arbitrators are called upon to solve conflicts that often involve millions of dollars, all this protected by the confidentiality obligations that govern the arbitral proceedings. Moreover, the impossibility of appealing the awards, the international legal framework facilitating their recognition and enforcement and the pro-enforcement bias of most national courts² have created a scenario where international arbitral awards are virtually free to circulate without the interference of any regulatory forces.

¹ Horatia Muir Watt, "Party Autonomy" in international contracts: from the makings of a myth to the requirements of global governance, *European Review of Contract Law*, n. 3, 2010, p. 23.

² Dirk Otto and Omaia Elwan, "Article V(2)", in Herbert Kronke, Patricia Nacimiento *et al.* (eds.), "Recognition and Enforcement of Foreign Arbitral Awards: A Global Commentary on the New York Convention" (Kluwer Law International, 2010), p. 366.

Not by coincidence, private actors have gradually issued their own norms – of *soft law* nature – with a view to exercising some sort of control over critical points of the arbitral proceedings, without, however, putting at risk the freedom and the flexibility that are the trademarks of this alternative method of dispute resolution. By way of example, one can cite the IBA Guidelines on Conflicts of Interest in International Arbitration,³ the IBA Rules on the Taking of Evidence in International Arbitration,⁴ the ILA Recommendations on *Lis Pendens* and *Res Judicata* and Arbitration⁵ and the recommendations issued by arbitral institutions on how to draft arbitration clauses.⁶

The boom in the use of international arbitration has raised several interesting questions, one of the most frequent being the importance of a consolidated body of case law in arbitration. An author has gone as far as saying that the question “do we need an arbitral case law?” could sound unnecessarily provocative as “a negative answer would be almost inconceivable.”⁷ Another learned commentator has raised the question of the importance of an arbitral case law to global governance, especially now that arbitration has become “the distributive factory of justice in the great private disputes.”⁸ In this regard, it has been said that “if arbitration is to be considered as having a significant role in regulating cross-border economic transactions, then coherence in the legal regime of awards is surely part of governance requirements of accountability and transparency.”⁹

Nevertheless, a point that seems to have been somewhat neglected so far is the one pertaining to the important role of public policy during the recognition and enforcement of foreign arbitral awards to global governance.

Indeed, by force of the principle of party autonomy, recognized to a greater or lesser extent by all legal systems, parties are entitled to “contract out” of the courts and resort to arbitration to solve their conflicts. Thanks to the scheme set up by the New York Convention and to its extremely wide acceptance, arbitral awards are increasingly able to circulate freely within the 149 jurisdictions that are part of the UN Convention system.¹⁰

³ IBA Guidelines on Conflicts of Interest in International Arbitration (2004). Available at: <http://www.ibanet.org/Publications/publications_IBA_guides_and_free_materials.aspx#conflictsofinterest>.

⁴ IBA Rules on the Taking of Evidence in International Arbitration (2010). Available at: <http://www.ibanet.org/Publications/publications_IBA_guides_and_free_materials.aspx#takingevidence>.

⁵ Filip de Ly and Audley Sheppard, ‘ILA Recommendations on *Lis Pendens* and *Res Judicata* and Arbitration’, *Arbitration International*, Volume 25, Issue 1, 2009, p. 83–86.

⁶ For the ICC, for example: <<http://www.iccwbo.org/Products-and-Services/Arbitration-and-ADR/Arbitration/Standard-ICC-Arbitration-Clauses/>>.

⁷ Jean-Michel Jacquet, ‘Avons-nous besoin d’une jurisprudence arbitrale?’, *Revue de l’Arbitrage*, Volume 2010, Issue 3, 2010, p. 445-467.

⁸ Diego P. Fernández Arroyo, “Los precedentes y la formación de una jurisprudencia arbitral” in Emmanuel Gaillard and Diego P. Fernández Arroyo, “Cuestiones claves del arbitraje internacional” (Bogotá: CEDEP, 2013), p. 226.

⁹ Horatia Muir Watt, *Op. cit.* (2010), p. 23.

¹⁰ This number can be even higher and encompass every jurisdiction in the world if taken into account the fact that almost half of the Contracting States did not make the “reciprocity reservation” provided for in Article I(3) of the Convention.

Hence, in this context of extreme liberalization, it appears that only one important barrier still lingers: the exception of public policy. In effect, “fifty years on, public policy remains the most significant aspect of the Convention in respect of which such discrepancies might still exist.”¹¹

Hence, the analysis that will follow will first inquire into the relevant role reserved to the public policy defence in the context of global governance (II). It will then examine the consequences to global governance of the stance adopted by Brazilian courts with regard to public policy, without however discussing the decisions in detail due to space constraints (III). Finally, a standard of court review of arbitral awards will be proposed (IV).

II. THE RELEVANCE OF PUBLIC POLICY AS A GROUND TO REFUSE RECOGNITION AND ENFORCEMENT

The extremely liberal paradigm in force today, aggravated by globalization and by the speed at which business relations are conducted, has led to the “flexibilization” of private international legal relations. Parties are now free to choose not only the law that will govern their contract, but also the jurisdiction that will settle any eventual disputes arising out of their contractual relationship. What is more, they can opt to submit their dispute not to a specific national judge, but to a private adjudicator, who in addition may apply any given set of a-national legal rules chosen by the parties (the UNIDROIT Principles or the *lex mercatoria*, for instance), in lieu of the laws of a given country.

In view of the binding nature of the arbitral award and the exclusion of any possible appeals generally provided for in the arbitration agreements,¹² the award debtor is forced to comply with the dictum of the tribunal. In effect, according to the available statistics, voluntary compliance by the losing party is said to happen in most of the cases.¹³ In any case, if the award creditor is forced to seek recognition and enforcement of the award by the courts, the New York Convention guarantees that only in very exceptional circumstances the award’s recognition will be denied. A possible motion to set aside an award would be subject to the same strict requirements.¹⁴

¹¹ International Law Association, “Final Report on Public Policy as a Bar to Enforcement of International Arbitral Awards” (New Delhi Conference, 2002), p. 5-6.

¹² Most arbitration clauses provide that the award will be “final and binding” on the parties, or that all disputes arising between the parties shall be “finally settled” by arbitration. The Standard ICC Arbitration Clause for instance reads: “All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.”

¹³ One survey found that there is a rate of around 90% of voluntary compliance with international arbitral awards. See Queen Mary, School of International Arbitration and PriceWaterhouseCoopers, “International Arbitration: Corporate attitudes and practices, 2008”, Available at: <www.arbitrationonline.org/research/Corpattitempirical/2008.html> (accessed on 17 September 2013), p. 2-3.

¹⁴ E.g., the UNCITRAL Model Law, Articles 34 and 36.

In sum, the entire process – from the moment the parties agree to arbitrate future or already existing disputes to the moment the losing party complies with the order of the arbitral tribunal – can today take place within the private sphere, dispensing with any intervention from public lawmakers. The implementation of justice in the sphere of international commerce has, so to say, been privatized, and State courts have consequently been deprived of their regulatory role:¹⁵ “The transfer of international commercial adjudication to the private sector is synonymous with private appropriation of the regulatory function of the courts, of which States are progressively divested.”¹⁶

An author has stressed that “the importance of state law in governing business relations is thought to be receding, as transnational business networks lift off from the terrain of state systems, governed by a mix of alternative forms of norms and processes.” Commenting on the rapid rise of international commercial arbitration and the construction of this “new order”, he added:

[...] transnational business relations in which disputes are resolved by international commercial arbitration and *lex mercatoria* are a primary example of systems which “break the frame” of national laws. [...] The results is “global law without a state”, in which systems of transnational commerce and multinational corporations, as well as transnational systems of human rights and labor actors, challenge the supremacy of state-based legal systems for pre-eminence in the production of social norms.¹⁷

Indeed, “the progressive liberalization of requirements for the cross-border movement of the chosen court’s decision may empower private actors to cross jurisdictional boundaries and benefit from a *quasi*-immunity from the constraints of state law.”¹⁸ Consequently, “arbitrators have more and more powers. The development of the law is now left in their hands. The regulation of society is left in their hands. The regulation of transnational activities is also left in their hands.”¹⁹

In other words, the system of international commercial arbitration is now marked by what has been described in the context of international law as the principle of “role

¹⁵ For but one example of such regulatory role, see W. Kip Viscusi (ed.), “Regulation through Litigation” (Washington, D.C.: AEI-Brookings Joint Center for Regulatory Studies, 2002).

¹⁶ Horatia Muir Watt, ‘Économie de la Justice et Arbitrage International (Réflexions sur la Gouvernance Privée dans la Globalisation)’, *Revue de l’Arbitrage*, Volume 2008, Issue 3, 2008, p. 389.

¹⁷ Robert Wai, “Transnational Liftoff and Juridical Touchdown: The Regulatory Function of Private International Law in an Era of Globalization”, *Columbia Journal of Transnational Law*, Vol. 40, 2002, p. 216-217. Available at SSRN: <<http://ssrn.com/abstract=1596732>>.

¹⁸ Dominique Bureau and Horatia Muir Watt, ‘L’impérativité désactivée?’, *Revue critique de droit international privé*, 2009, p. 1.

¹⁹ Catherine Kessedjian, “Transnational Public Policy”, in Albert Jan van den Berg (ed.), *International Arbitration 2006: Back to Basics?* (Montreal: ICCA Congress Series, Volume 13, 2006, Kluwer Law International, 2007), p. 862.

splitting” or “double-function” (*dédoublement fonctionnel*²⁰): in public international law, the nations that are *subject* to international law are themselves the *creators* of those norms. They are, to some extent, at once the legislature, the sheriff and the potential offenders. Likewise, in international arbitration, the “international community of merchants” is itself the law maker (e.g., the UNIDROIT Principles and the *lex mercatoria*), the adjudicator (arbitrators), and the subject (since arbitration is based on consent and thus is exercised through party autonomy).

In the words of a renowned professor, international commercial arbitration has now established itself as a “largely auto-poietic, parallel, world of private justice, supposedly secreted by a self-regulating transnational merchant community.”²¹ In other words, “as social systems such as these transnational networks achieve autonomy from state laws, the norms and rules of these networks become reflexive and self-reinforcing. The dominant norms are found within the system itself.”²²

However, the risk of permitting private adjudication to be exercised freely is that, to some extent, “a privatized justice is not apt to produce efficient social norms.”²³ Some warn that “transnational business networks which use arbitration and *lex mercatoria* take on a law-making and law-generating character and engage participants to look only to values from within that system as their binding laws.”²⁴ A commentator, comparing the standard method of norm creation through legislature with that arising out of private adjudication, asserted:

Contrast this polycentric and information-rich process with three arbitrators, deciding a bilateral international commercial dispute in a process which is closed to the participation of all outsiders and could well be unknown to them. This arbitral process benefits from none of the advantages enjoyed by the modern lawmaker. Hence arbitral efforts to play the role of Solon are likely to produce bad law, unenforceable law or both.²⁵

Bestowing on private actors the power to resolve conflicts without the interference, at any level, of public instances raises serious questions regarding the legitimacy and accountability of such adjudicators. Arbitration may indeed suffer from a “democracy

²⁰ For a detailed explanation of the theory, cf. Antonio Cassese, “Remarks on [Georges] Scelle’s Theory of “Role Splitting” (*dédoublement fonctionnel*) in International Law”, *European Journal of International Law*, volume 1, 1990, p. 210-231.

²¹ Horatia Muir Watt, *Op. cit.* (2010), p. 5.

²² Robert Wai, *Op. cit.*, p. 258.

²³ Horatia Muir Watt, *Op. cit.* (2008), p. 394.

²⁴ Robert Wai, *Op. cit.*, p. 258.

²⁵ Michael W. Reisman, “Law, International Public Policy (So-called) and Arbitral Choice in International Commercial Arbitration”, in Albert Jan van den Berg (ed.), *International Arbitration 2006: Back to Basics?* (Montreal: ICCA Congress Series, Volume 13, 2006, Kluwer Law International, 2007), p. 851.

deficit”.²⁶ “privately designated (and financed) arbitrators lack both the legitimacy and the incentive to take account of societal interests in their decision-making process.”²⁷

Moreover, it inevitably leads to the debate about the nature of justice itself. Some commentators have thus inquired whether it is possible to conceive justice (or adjudication) as a private good,²⁸ thereby suggesting the existence of a global market for judicial services²⁹ as an outcome of the competition to provide such services.

It is precisely because of the liberalization of private international law and of the empowerment of private actors that public policy plays a key role in today’s global governance.

It has been repeated to exhaustion that the system set up by the New York Convention (and by virtually all other international instruments that seek to regulate the enforcement of arbitral awards) aims at restricting at a maximum the possibility of refusing recognition and enforcement or of challenging an award. Moreover, the situations set out in Article V(1) (a) to (e) and V(2)(a) of the Convention seem to have been more harmoniously interpreted by courts worldwide. It is therefore on Article V(2)(b) of the New York Convention that the possibility of exercising great control of foreign arbitral award relies.

As very well summarized by a commentator:

Today, international arbitration has escaped from the States’ control. Only public policy still reveals their minimum and irreducible presence. Public policy is, in some way, the sole pocket of resistance to the autonomy of international arbitration. Thanks to the defence of public policy, international arbitration is not completely out of control. Public policy is thus a limit, the ultimate limit, to the autonomy of international arbitration.³⁰

It is for no other reason that public policy has been termed a “safeguard clause”³¹ and the “guardian angel of the legal system of a given society”.³² It represents a safety net national judges can resort to in order to protect the national legal systems.

The fact that great discrepancies still exist in regard to public policy shall also not be overlooked: it evidences precisely the wide variety of situations in which State courts can have recourse to it with a view to protecting their national legal order, leading some to

²⁶ Robert Wai, *Op. cit.*, 263.

²⁷ William Landes and Richard Posner *apud* Horatia Muir Watt, *Op. cit.* (2010), p. 31.

²⁸ William Landes and Richard Posner, “Adjudication as a Private Good”, NBER Working Paper Series, Working Paper No. 263, July 1978.

²⁹ Jens Dammann and Henry Hansmann, “A Global Market for Judicial Services”, Yale Law & Economics Research Paper No. 347, 15 March 2007. Available at SSRN: <<http://ssrn.com/abstract=976115>>.

³⁰ Jean-Baptiste Racine, ‘L’arbitrage commercial international et l’ordre public’ (Paris: LGDJ, 1999), p. 6.

³¹ Berthold Goldman, ‘Les conflits de lois dans l’arbitrage international de droit privé’ (Collected Courses of The Hague Academy of International Law, 1963, vol. 109, p. 347-486), p. 430.

³² Jacob Dolinger, “A evolução da ordem pública no direito internacional privado” (Rio de Janeiro: Renovar, 1979), p. 41.

depict it negatively as “an escape device, which allows Contracting States exceptionally to rely on local law.”³³

As well described by a commentator, “public policy is a legal standard. It is thus an ‘open texture’ norm which ensures the global coherence of the legal system.”³⁴ Public policy is therefore the key element that enables national courts to guarantee the soundness of their legal order and to avoid the interference of extraneous elements that could harm this coherence. In short, it is the last resort courts can avail themselves of in order to maintain the orderliness of the national legal system when dealing with international matters. Hence the affirmation that “if courts are unable to annul arbitral awards that contravene public policy [...], arbitration is not only superior to the judiciary, but is seemingly beyond legislative control.”³⁵

Therefore, as the last element granting national judges with the possibility of somehow controlling the arbitral proceedings and hence allowing States to have a say in the quasi-autonomous field of private adjudication, the exception of public policy as a ground for refusing recognition and enforcement of foreign arbitral awards should not be underestimated. It is a key element for securing the States’ internal legal system and, likewise, it is a key element to global governance.

In this sense, French courts, always an inspiring source for international arbitration practice, have subscribed to a very narrow standard of court review of awards, both at the recognition and enforcement stage and during the annulment proceedings. Such a “minimalist” approach has reduced the concept of international public policy within international arbitration to a very limited set of situations, and only when the violation of public policy is said to be blatant, effective and concrete will the recognition of the award be refused.³⁶ A telling example has been given by the Court of Appeal of Paris:

The recourse to the international public policy exception contained in Article [1520(5)] of the French Code of Civil Procedure is only conceivable when the enforcement of the award would violate in an unacceptable way the French legal order, such violation having to affect in a manifest manner an essential rule of law or a principle of fundamental importance.³⁷

³³ Gary B. Born, “International Commercial Arbitration” (The Hague: Kluwer Law International, 2009), p. 2827.

³⁴ Jean-Baptiste Racine, *Op. cit.*, p. 7.

³⁵ Jean-Baptiste Racine, *Op. cit.*, p. 567.

³⁶ *Verhoeft v. Moreau*, Cour de Cassation (1st Civil Chamber), 21 March 2000. Reported in: *Revue de l’Arbitrage*, Volume 2001, Issue 4, 2001, p. 805-810.

³⁷ *SA Thalès Air Défense v. GIE Euromissile*, Court of Appeal of Paris (1st Civil Chamber), 18 November 2004. Reported in: *Revue de l’Arbitrage*, Volume 2005, Issue 3, 2005, p. 751-760.

This position is strongly praised by part of the doctrine³⁸ and is not completely devoid of reason. It is not uncommon for arguments like the trust in international arbitration and the respect for party autonomy to be raised in its support:

In reality, the position of the [French] case law deserves approval. The starting point must be the idea that the State courts are not the judges of the case that was precisely taken away from them by the arbitration agreement. [...] With the arbitration agreement, the parties took the risk of erroneous decisions by the arbitrator, risk which by the way is embodied in every judicial system.³⁹

Others make reference to “the objectives of facilitating international commerce, promoting international cooperation, or ensuring cosmopolitan fairness” to endorse the view that a “liberal internationalist” attitude should be privileged.⁴⁰

Nonetheless, such approach undermines the true utility of public policy as it leads to a mere illusionary control by the courts, limited to the sole *appearance* of conformity of the award with international public policy. In reality, as argued by a commentator, the true difference between “a deliberate absence of control and the control effectively carried out by the French courts is more apparent than real.”⁴¹ Such approach might in effect be closer than expected to a pure and simple withdrawal of any sort of control of the award’s conformity. What is more, there is strong evidence to believe that the reasons behind such deliberate abstention are not the most noble.⁴²

Indeed, the deliberate abstention of the courts’ supervisory function over arbitral awards has reinforced the idea of justice as a private good – something made *by* private actors *for* private actors. With the State courts’ blessing, individuals behave almost

³⁸ Cf. for instance Alexis Mourre, ‘Note sous Cour de cassation (1ère chambre civile)’, 4 juin 2008, *Journal de droit international* (Clunet), n. 4, 2008, p. 1107; Luca G. Radicati Di Brozolo, ‘L’illicéité « qui crève les yeux »: critère de contrôle des sentences au regard de l’ordre public international (à propos de l’arrêt Thalès de la Cour d’appel de Paris)’, *Revue de l’Arbitrage*, Volume 2005, Issue 3, 2005, p. 529-560; Yves Derains and Laurence Kiffer, ‘National Report from France (2013)’ in Jan Paulsson (ed.), *International Handbook on Commercial Arbitration* (Kluwer Law Arbitration, 1984, Updated: 2013, Supplement n. 74), p. 1.

³⁹ Ibrahim Fadlallah, ‘L’ordre public dans les sentences arbitrales’ (Collected Courses of The Hague Academy of International Law, 1994, vol. 249), p. 390.

⁴⁰ Robert Wai, *Op. cit.*, p. 225.

⁴¹ Louis Christophe Delanoy, ‘Le contrôle de l’ordre public au fond par le juge de l’annulation: trois constats, trois propositions’, *Revue de l’Arbitrage*, Volume 2007, Issue 2, 2007, p. 179.

⁴² An author refers to studies that show that “some states’ motivation for supporting arbitration may have been to gain narrow pecuniary advantages associated with involvement in arbitration, rather than to consider the broader regulatory implications of the decision to promote arbitration. [...] [Prof. W. Michael] Reisman argues that a number of jurisdictions loosened such controls [of national courts over international arbitrations] not because of a genuine belief that international commercial arbitration is the best system for dispute resolution, but rather in an effort to attract the ‘business’ of international commercial arbitration to their state.” Robert Wai, *Op. cit.*, p. 257.

autonomously in the field of commercial law. The ultimate result of such trend would be the privatization of norm production at the international level.

Hence, the position of the French courts is too extreme. In the name of the prohibition of the courts' review of the merits of the awards, judges have truly resigned from their task of ensuring the respect, by the arbitrators, of the policies considered as essential by the State.⁴³ To require that the enforcement of foreign arbitral awards be not only "effectively" and "concretely" against public policy but also "flagrantly" is to require that the infringement of the forum's fundamental notions of morality and justice be crystal clear. Such vital elements of any legal order, however, deserve a better protection than one that relies solely on the *appearance* of conformity.

As proposed by a commentator, the requirement of a "flagrant" violation should give way to that of a "serious" violation, so as to authorize a profound analysis of the award that would go past a mere *prima facie* look focused only on impressions: "the adjective 'flagrant' could be usefully replaced by the adjectives 'serious' or 'grave', which would avoid the confusion between *gravity* [of the violation] and *obviousness*."⁴⁴

It must be noted that French courts have already demonstrated that at times they are ready to consider public policy seriously. In effect, one of the rare cases where the French judges found that there had been a violation of public policy serves to show how the courts' work can contribute to effectively regulate international arbitration with the support of private actors.

In the famous *Dutco*⁴⁵ case, the arbitral award rendered under the auspices of the ICC was annulled by the Cour de Cassation by reason of an unbalanced appointment of arbitrators in a multiparty case, as the two respondents had had their co-arbitrator appointed by the institution whereas the claimant had appointed his own. The court held that "the principle of the equality of the parties in the appointment of arbitrators is a matter of public policy (*ordre public*) which can be waived only after a dispute has arisen", which had not been the case. Accordingly, the award was annulled.

The annulment by the Cour de Cassation established the "cornerstone in the process of establishing rules for multiparty arbitration"⁴⁶ and led to many institutions changing their rules so as to conform to the dictum of the court.⁴⁷ Indeed, the ICC itself was "forced to reconsider its practices",⁴⁸ what resulted in the revised 1998 ICC Rules of

⁴³ Louis Christophe Delanoy, *Op. cit.*, p. 186.

⁴⁴ Christophe Seraglini, 'Le contrôle de la sentence au regard de l'ordre public international par le juge étatique : mythes et réalités', *Gazette du Palais*, 21 mars 2009, n° 80, p. 11.

⁴⁵ *Sociétés BKMI et Siemens v. société Dutco*, Cour de Cassation (1st Civil Chamber), 7 January 1992. Reported in: *Revue de l'Arbitrage*, Volume 1992, Issue 3, 1992, p. 470-472.

⁴⁶ Jean-Louis Delvolvé, 'Multipartism: The Dutco Decision of the French Cour de cassation', *Arbitration International*, Volume 9, Issue 2, 1993, p. 196.

⁴⁷ Jeff Waincymer, 'Procedure and Evidence in International Arbitration' (Kluwer Law International, 2012), p. 271.

⁴⁸ Yves Derains and Eric A. Schwartz, "Guide to the ICC Rules of Arbitration" (2nd edition, Kluwer Law

Arbitration. Such case clearly shows that the arbitral institutions – and more generally the private actors – can and should adapt to the practices of the courts, and not the other way around.

Other examples where, in our opinion, a correct standard of revision was laid out can be cited.⁴⁹ However, such decisions constitute a minority and, given their dates, might now be said to have been overruled.⁵⁰ In any case, the position here is that the French courts should not restrain themselves to a merely formal analysis of the alleged violation and, in line with those decisions, should proceed to a deeper examination of the facts of the case bearing always in mind the notion of international public policy.⁵¹

Bearing these concepts in mind, the next section will focus on the practice of the Brazilian courts and accordingly will analyse whether the decisions rendered by them have the potential of boosting the use of international arbitration in Brazil.

III. BRAZILIAN CASE LAW AGAINST THE BACKDROP OF GLOBAL GOVERNANCE

Brazilian courts have not (yet?) subscribed to the same extremely constraining view of public policy as the French, perhaps to the disappointment of some. Be it an overt and conscious choice or rather the yet immature state of the case law on the issue, the fact is that Brazilian courts are still cautious when dealing with the issue of public policy in international arbitration, to the point of resorting to *ordre public* when the court decision could very well repose on other, less provocative, grounds (for instance, Article V(1)(a) of the New York Convention).

Indeed, the overall practice of the Superior Court of Justice (STJ, in its Portuguese acronym) remains rather inconsistent. Firstly, some decisions go well into the details of the notion of public policy, citing renowned scholars and, to some, implicitly acknowledging the existence of an international public policy.⁵²

A good example is the case *Thales Geosolutions v. FARCO*.⁵³ In this case, for the first time in the STJ's history, the Reporting Judge addressed the public policy issue at reasonable

International, 2005), p. 176.

⁴⁹ Cour de Cassation (1st Civil Chamber), 6 January 1987. Reported in: *Revue de l'Arbitrage*, Volume 1987, 1979, p. 469, note Ph. Leboulanger; JDI 1987, p. 638, note B. Goldman; and *European Gas Turbines SA v. Westman International Ltd.*, Court of Appeal of Paris (1st Civil Chamber), 30 September 1993. Reported in: *Revue de l'Arbitrage*, Volume 1994, Issue 2, 1994, p. 359-370.

⁵⁰ Ibrahim Fadlallah, *Op. cit.*, p. 389.

⁵¹ Rather than transnational public policy.

⁵² Arnaldo Wald, 'Les récents progrès de la jurisprudence brésilienne en matière d'arbitrage commercial international', ASA Bulletin, Kluwer Law International, Volume 24, Issue 2, 2006, p. 206-215.

⁵³ *Thales Geosolutions v. FARCO*, STJ, SEC n. 802, Judge-Rapporteur José Delgado, Special Court, judged on

length. Attempting to draw a picture of the concept from the private international law standpoint, Judge José Delgado cited Article 17 of the Introductory Act to the Rules of Brazilian Law and national doctrine on the issue. After presenting a few definitions of public policy proposed by renowned authors, the judge drew attention to the “difficulties encountered by doctrine when clarifying the meaning of public policy”.⁵⁴ He then asserted, again based on national literature:

It is accepted, however, that the following laws are laws of public policy:

- (a) constitutional laws;
 - (b) administrative laws;
 - (c) procedural laws;
 - (d) criminal laws;
 - (e) laws on the organization of the judiciary;
 - (f) tax laws;
 - (g) *lois de police*;
 - (h) laws on the protection of persons lacking legal capacity;
 - (i) laws concerning the organization of the family;
 - (j) laws establishing conditions and formalities for certain acts;
 - (k) laws of economic organization (concerning salaries, currency, regime of goods).
- [...]. It must be noted that abuse of the law [*fraus legis*] is also considered part of public policy.⁵⁵

The Reporting Judge noted however that “[i]n the case at hand, the allegation of the respondent that it did not pay the amounts owed to applicant on the ground of art. 1092 of the 1916 Brazilian Civil Code does not fall within the concept of violation of public policy.”⁵⁶ This conclusion was supported by Judge Carlos Alberto Menezes Direito in his concurring opinion, where he noted that in the case at issue “there cannot be said to be a violation of public policy or of national sovereignty, to the extent that the arbitral award examined, in reality, a debt recovery action without offence to what the Brazilian legislation provides.”⁵⁷

More recently, in the case *Keytrade v. Ferticitrus*,⁵⁸ Reporting Judge Nancy Andrichi wrote that it was not for the court to analyse in depth the merits of the award. The recognition proceedings aimed solely at assessing whether the formal requirements were met in order for the *exequatur* to be granted, and in this specific point there was no violation

17.08.2005, DJ dated 19.09.2005.

⁵⁴ *Thales Geosolutions v. FARCO*, STJ, SEC n. 802/2005, p. 10.

⁵⁵ *Thales Geosolutions v. FARCO*, STJ, SEC n. 802/2005, p. 11.

⁵⁶ *Thales Geosolutions v. FARCO*, STJ, SEC n. 802/2005, p. 11.

⁵⁷ *Thales Geosolutions v. FARCO*, STJ, SEC n. 802/2005, p. 14.

⁵⁸ *Keytrade v. Ferticitrus*, SEC 4.024, Judge-Rapporteur Nancy Andrichi, Special Court, judged on 07.08.2013, DJ dated 13.09.2013.

of public policy (given that compound interest was also accepted under Brazilian law). Most remarkably, quoting her opinion in the case *SEC n. 2.410* (not yet published), she held:

Public policy reflects the fundamental values of our legal culture, and everything that might be deemed contrary to this moral construction shall not be endorsed by the STJ. [...] In the context of a request for recognition of a foreign award, the analysis carried out on the alleged violation of public policy is not destined to verify the fairness of the decision in the light of our legal system, but to examine whether it is in conformance with the set of principles and rules considered essential to national cohesion.

Other decisions, however, hardly mention public policy at all, although invoking Article 39, II, of the Brazilian Arbitration Act to deny recognition. For example, the court has once stated, without further explanation:

The discussion is centred on the absence of a voluntary statement, in written form, by the defendant accepting the arbitral clause. It is therefore offensive to public policy for going against a principle enshrined in our legal order which requires express acceptance by the parties to submit the settlement of disputes arising out of private contractual legal relations to arbitration.⁵⁹

In another decision, it was held that:

In the absence of any proof, in the file, of the manifest and autonomous declaration of the respondent's intention to waive its right to court proceedings in favour of arbitration, the request [for recognition] amounts to a violation of Article 4, paragraph 2, of Law n. 9.307/96, of the principle of party autonomy and of Brazilian public policy, thereby rendering impossible the homologation.⁶⁰

These decisions are nonetheless inconsistent with the one in *L'Aiglon v. Têxtil União*,⁶¹ the first one rendered by the STJ after it became competent to hear applications for recognition and enforcement of foreign arbitral awards.⁶² In *L'Aiglon*, even though

⁵⁹ E.g., *Plexus v. Santana*, STJ, SEC n. 967, Judge-Rapporteur José Delgado, Special Court, judged on 15.02.2006, DJ dated 20.03.2006. Also reported in Albert Jan van den Berg (ed.), *Yearbook Commercial Arbitration*, Kluwer Law International, Volume XXXVII, 2012, p. 169-170.

⁶⁰ *Indutech v. Algocentro*, STJ, SEC n. 978, Judge-Rapporteur Hamilton Carvalhido, Special Court, judged on 17.12.2008, DJ dated 05.03.2009. Also reported in Albert Jan van den Berg (ed.), *Yearbook Commercial Arbitration*, Kluwer Law International, Volume XXXIV, 2008, p. 424-429.

⁶¹ *L'Aiglon v. Têxtil União*, STJ, SEC n. 856, Judge-Rapporteur Carlos Alberto Menezes Direito, Special Court, judged on 18.05.2005, DJ dated 27.06.2005. Also reported in Albert Jan van den Berg (ed.), *Yearbook Commercial Arbitration*, Kluwer Law International, Volume XXX, 2005, p. 437-439.

⁶² By virtue of the Constitutional Amendment n. 45/2004, which came into force on 31 December 2004, the

there was no evidence in the file of the parties' agreement to submit future disputes to arbitration, the court held that: "[t]he defendant's participation in the arbitration, by presenting arguments and stating the express intention to appoint an arbitrator, indicates an unequivocal acceptance of the existence of the arbitration clause."

In the STJ's view, it was an obligation of the party, stemming from good faith and the principles of due process, to contest the validity of the arbitration agreement at the very first opportunity it had of presenting its defence in the arbitral proceedings. Since the party resisting enforcement had not done so, it had impliedly and tacitly accepted the existence of the arbitration clause.

Other decisions rendered by the STJ briefly allude to the notion of public policy but repel it immediately thereafter, granting recognition on the basis that "all requirements [for recognition] were duly met".⁶³ Finally, a few decisions are completely silent on the issue, even if the argument is raised by the party resisting recognition.⁶⁴ It is therefore clear that the decisions of the court are inconsistent not only in respect of the finding of a violation of public policy, but also with regard to the depth of the analysis carried out.

In sum, in the cases that the STJ resorted to public policy to refuse the recognition and enforcement of an award (interestingly, all concerning procedural issues⁶⁵), such references were superfluous, as the matter was not tackled in sufficient detail.

It is also interesting to note that an explicit distinction between domestic and international public policy is still missing, as well as a clear picture of what public policy represents in the specific context of international arbitration. Indeed,

The case law of the tribunals has not been very helpful, as one can notice a reluctance from the courts to define the content of national public policy or trace the contours of the distinction between internal public policy and Brazilian international public policy. [...] In the lack of such distinction and given the absence of a definition of "national public policy" under Article 39, II, of the Law 9.307/1996, [Brazilian] judges content themselves with enunciating that the parties' tacit or implicit consent to arbitrate violates public policy.⁶⁶

competence to hear requests for recognition and enforcement of foreign arbitral awards was shifted from the Federal Supreme Court ("STF" in its Portuguese acronym) to the Superior Court of Justice ("STJ").

⁶³ E.g., *ICT v. Odil Pereira*, STJ, SEC n. 1.210, Judge-Rapporteur Fernando Gonçalves, Special Court, judged on 20.06.2007.

⁶⁴ E.g., *Litsa v. SV Engenharia e Inepar*, STJ, SEC n. 894, Judge-Rapporteur Nancy Andrighi, Special Court, judged on 20.08.2008, DJ dated 09.10.2008.

⁶⁵ *Plexus v. Santana*, STF, SEC n. 6.753-7/2002, *Plexus v. Santana*, STJ, SEC n. 967/2006, *Oleaginosa v. Moinho Paulista*, STJ, SEC n. 866/2006, *Indutech v. Algocentro*, STJ, SEC n. 978/2009.

⁶⁶ Marina Mendes Costa, 'Ofensa à ordem publica nacional decorrente de ausência de assinatura de cláusula compromissória – Comentários à SEC 978/STJ', *Revista de Arbitragem e Mediação*, Year 7, Volume 24, January-March 2010, p. 234-235.

The STJ has however reiterated several times that, as a general rule, recognition proceedings are subject to strict limits of examination.⁶⁷ It is now settled case law that the “judicial control over a foreign arbitral award is limited to formal aspects; the merits of the arbitration may not be reviewed.”⁶⁸ Likewise, it has held that the simple dissatisfaction with the result of the arbitration does not equate to a violation to public policy or national sovereignty. In its view,

The simple judgment contrary to the interests of one of the parties does not constitute, *per se*, violation of national sovereignty or public policy. Besides, it must be noted that the homologation of foreign awards comprises solely an “assessment of formal requirements”,⁶⁹ to the exclusion of any analysis of the aspects pertaining to the merits of the judgment.⁷⁰

One can infer from this analysis that for the moment Brazilian courts are somewhat reluctant to liberalize the recognition and enforcement of foreign arbitral awards too much. Even if their practice is not yet fully technical and if the rationale underlying the decisions is not always clear, in Brazil the public policy defence still plays a key role in protecting the forum’s most fundamental notions of morality and justice.

However, in its struggle to develop a strong arbitral practice (and also aiming to attract foreign investors), Brazil may in a few years follow the same path as France. Indeed, the STJ seems to be well aware of the importance of its role to international arbitration, and thus to economic governance – another element that might indicate in which direction it intends to go.

A member of the STJ, for instance, has asserted that “arbitration, as an alternative means of dispute resolution, must be seen in its most relevant role, that of propitiating investment, creating jobs and boosting the economy.” He added: “arbitration is a tool that facilitates the realization of great business deals, in which companies and users alike can count on a quick and efficient solution.”⁷¹ Another STJ judge has, for his part, affirmed: “[t]he judiciary is very conscious of the importance of arbitration and of the need to preserve and protect this precious instrument in order to provide good justice and avoid

⁶⁷ For instance, *ATECS v. Rodrimax*, STJ, SEC n. 3.035, Judge-Rapporteur Fernando Gonçalves, Special Court, judged on 19.08.2009, DJ dated 31.08.2009.

⁶⁸ *Tremont Alloys v. Metaltubos*, STJ, SEC n. 760, Judge-Rapporteur Felix Fischer, Special Court, judged on 19.06.2006, DJ dated 28.08.2006. Also reported in Albert Jan van den Berg (ed.), *Yearbook Commercial Arbitration*, Kluwer Law International, Volume XXXVII, 2012, p. 175-176.

⁶⁹ In Portuguese, “juízo de delibação”. From the Latin “*delibatioonis*”, meaning “to touch slightly upon”, “to examine”, “to prove”. Courts are thus not allowed to embark on an analysis of the merits of the decision.

⁷⁰ *Western Bulk Carriers v. A. P. Oxidos*, SEC 4.439, Judge-Rapporteur Teori Albino Zavascki, Special Court, judged on 24.11.2011, DJ dated 19.12.2011, p. 7.

⁷¹ João Otávio de Noronha, speech given at the International Seminar on Arbitration, held at the STJ in Brasília on 3 December 2012. Available at: <http://www.stj.jus.br/portal_stj/publicacao/engine.wsp?tmp.area=398&tmp.texto=107941>, (accessed on 19 October 2013).

unnecessary litigation.”⁷² Such declarations are clear evidence of the judges’ awareness of the responsibility lying in their hands.

Within the case law of the STJ itself there have been displays of this preoccupation. In the leading case of *L’Aiglon v. Têxtil União*, the judge Gilson Dipp affirmed in his concurring opinion:

Mr. President, I would like to stress that the expression of the doctrine, of the practitioners and of the judiciary has been highly positive in respect of the procedure adopted by this Superior Court of Justice for the homologation of foreign decisions [...], meeting the expectations that arose after the Constitutional Amendment n. 45/04. I believe that this Tribunal has, from this moment and from this opinion of Mr. Reporting Judge, a great responsibility in updating, modernizing, [and] aerating the matter under this perspective. I concur with the opinion of Mr. Reporting Judge to grant the request for recognition of the foreign arbitral award.⁷³

It is hence clear from the words of the members of the Superior Court of Justice that their intention is to foster the development of international arbitration and allow foreign awards to circulate easily in the country. Whether and how such intention will actually materialize is not yet certain, but one might legitimately infer from the foregoing elements that the liberalization of the requirements for recognition tends to soar. In the words of leading practitioners, “[t]he STJ’s recent judgments demonstrate the Court’s unequivocal contribution to arbitration in Brazil [...], which is key to Brazil’s economic progress and its reputation as ‘belle of the ball’ of international arbitration.”⁷⁴

Finally, it is interesting to note that the proposal of a new Brazilian arbitration law (in reality, an amendment to the present Act), drafted by well-known specialists in the field, was recently unveiled.⁷⁵ The bill does not represent a great shift, seeking rather to ratify the latest development of the case law. It confirms the possibility for the arbitrators to render partial awards, reiterates that Brazilian courts have jurisdiction to issue provisional and interim measures until the constitutional of the arbitral tribunal (which can then confirm, modify or reverse the measures), and broadens the arbitrability of consumer matters. The thorny issue of public policy, however, was left untouched.

In sum, the text corroborates the courts’ trend to foster the practice of arbitration in the country without provoking a revolution – which, indeed, would not be necessary at

⁷² Sidnei Beneti *apud* Alisson Ross, *In praise of Brazilian enforcement*, Global Arbitration Review, 3 April 2012. Available at: <<http://www.newyorkconvention.org/news/in-praise-of-brazilian-enforcement>>, (accessed on 19 October 2013).

⁷³ Concurring Opinion of Judge Gilson Dipp in *L’Aiglon v. Têxtil União*, p. 18.

⁷⁴ Arnaldo Wald, Ana Gerda de Borja and Maira de Melo Vieira, ‘Brazil as “Belle of the Ball”’: The Brazilian Courts Pro-Arbitration Stance (2011-2012)’, *Cahiers de l’arbitrage*, 1 April 2013, n° 2, p. 392.

⁷⁵ Tadeu Rover, ‘Leia os anteprojetos de arbitragem e de mediação’, *CONJUR* (published on 2 October 2013). Available at: <<http://www.conjur.com.br/2013-out-02/leia-anteprojetos-arbitragem-mediacao-comissao-senado>>, (accessed on 2 February 2014).

the present stage. With the already satisfactory legislative framework in force, the duty of promoting arbitration without overly liberalizing the judicial control of foreign awards is now the courts' responsibility.

Having looked at the practice in Brazil, it is now time to turn to what we believe should be considered by national judges when assessing whether the recognition and enforcement of foreign arbitral awards violate the forum's public policy.

IV. THE USE BY THE NATIONAL JUDGES OF THE PUBLIC POLICY GROUND

In the very memorable words of a renowned professor:

It continues no doubt to serve powerful economic interest to maintain the illusion that private actors are subject to limits corresponding to a (albeit nebulous) public interest. Be that as it may, beneath its smooth surface, this illusion is increasingly undermined by the growing empowerment of economic actors, who attain 'regulatory lift off' in face of the receding authority of states.⁷⁶

Indeed, one may invoke in support of this phenomenon the fact that today's *economic* rather than *institutional* regulation pushes towards a more liberal stance by the courts. According to a professor, some States, essentially European, which constitute the major arbitration centres, have engaged in a "fierce fight to attract arbitration to their territory"⁷⁷ with all the economic benefits that ensue.⁷⁸ Naturally, in that struggle, they are encouraged to adopt a very liberal attitude towards arbitration:

In fact, the spectacular liberalization of the conditions of circulation of arbitral awards means in reality that all economic actors, irrespective of their status with regard to State law, can obtain a private settlement apt for recognition, subject only to the reserve of a 'blindingly obvious' illegality.⁷⁹

⁷⁶ Horatia Muir Watt, *Op. cit.* (2010), p. 15.

⁷⁷ Christophe Seraglini and Jérôme Ortscheidt, 'Droit de l'arbitrage interne et international' (Paris: Montchrestien, 2013), p. 895.

⁷⁸ In effect, the first public report relating to any arbitration seat worldwide on the city of Toronto, Canada, informed that in 2012 Toronto should host approximately 425 arbitrations, bringing C\$256 million to the city's economy and growing to C\$273.3 million in 2013. Kimberley Stewart, CEO and founder of a local arbitral institution, noted that the news were good "not only for Toronto's legal and financial sectors but its hotel, restaurant, transport, retail and airport and airline industries." See: Charles River Associates, *Arbitration in Toronto: An Economic Study*, 6 September 2012.

⁷⁹ Horatia Muir Watt, *Op. cit.* (2008), p. 406.

Another professor has written that such restrictive conception of public policy aims at liberalizing the review of awards “in order to meet the needs of international trade.”⁸⁰ According to him, the notion of *international* public policy would serve to foster the development of international arbitration: “[i]t is the needs of international trade that impose a limitation on the content of public policy.”⁸¹ In sum, owing to the effects of economic globalization, the international community would be witnessing a “privatization of normative production” that would in turn necessarily lead to deregulation.⁸²

However, it must be remembered that ideological choices are there to be made. It is perhaps too convenient to argue that the “forces of the market” impose any given solution whilst in reality States are clearly free to choose the path they want to follow. The way of implementing such choice lies in the hands of national judges.

Indeed, there is no doubt that national judges are the ultimate guardians of the legal order to which they belong: they are in effect the keepers of the integrity of both their legal order and of their public order (*ordre public*).⁸³ Consequently, the duty is upon them to protect their legal system against potential violations embodied in foreign decisions seeking recognition. The judges, as part of the judicial branch and thus as an extension of the national sovereign, are in charge of implementing the policies of the State.

It follows from this responsibility that, when asked to give effect to a foreign decision, a judge cannot blindly allow the parties’ will to prevail over the interests that his or her State considers as superior to party autonomy and that constitute a limit to this autonomy.⁸⁴ In the words of a professor, “[a]fter all, national jurisdictions exist to protect the legitimate interests of the community concerned, which is the *raison d’être* both of the state and of the international law of jurisdiction.”⁸⁵

The defence of public policy is precisely a way of protecting those policies and mandatory rules from violations committed by foreign acts, laws or decisions. “The public policy exception to enforcement is an acknowledgment of the right of the State and its courts to exercise ultimate control over the arbitral process.”⁸⁶ They might as well make use of that right. In this context, and in conformance with Article V(2)(b) of the New York Convention,⁸⁷ it is the *international* public policy of the State in question that shall be applied by the judge.

⁸⁰ Jean-Baptiste Racine, *Op. cit.*, p. 475.

⁸¹ Jean-Baptiste Racine, *Op. cit.*, p. 476.

⁸² Horatia Muir Watt, *Op. cit.* (2008), p. 395.

⁸³ Christophe Seraglini, *Op. cit.* (2009), p. 7.

⁸⁴ Christophe Seraglini, *Op. cit.* (2009), p. 7.

⁸⁵ Michael W. Reisman, *Op. cit.*, p. 850.

⁸⁶ International Law Association, *Interim Report on Public Policy as a Bar to Enforcement of International Arbitral Awards* (London Conference, 2000), p. 2.

⁸⁷ Which refers to “the public policy of *that country*.” Emphasis added.

Furthermore, when assessing whether the recognition and enforcement of a foreign decision will infringe the forum's most basic notions of morality and justice, a judge shall be entitled to look carefully into the decision's findings. The scope of review, as per the notion of international public policy, shall indeed be narrow; the degree of review, however, must be deep. "The sovereignty of the arbitrators stops when public policy is at stake. [...] [I]f the judge really wants to check whether the result of the award is contrary to public policy, he or she must take hold of the entire dispute, i.e. assess both the fact and the law."⁸⁸

In other words, at this stage, the cognition carried out by the judge shall be limited in its extension, that is, horizontally, as it will focus solely on the few elements required by the forum's legislation to grant recognition to a foreign decision. In a vertical perspective, however, the assessment of those requirements shall not be superficial or brief; it shall be deep and exhaustive, conducting a profound analysis of the matters at issue.⁸⁹

In this regard, as cleverly suggested by a commentator, the control by State courts over foreign arbitral awards, with a view to ascertaining whether their enforcement would violate the forum's public policy, should be *real* but *measured*: the content of the public policy must be limited; the degree of violation must be high; and the intensity of the control carried out by the judge must be significant.⁹⁰

Such position is consistent with the Recommendations on the Application of Public Policy as a Ground for Refusing Recognition or Enforcement of International Arbitral Awards of the International Law Association, which state:

Recommendation 3(c):

When the violation of a public policy rule of the forum alleged by a party cannot be established from a mere review of the award and could only become apparent upon a scrutiny of the facts of the case, the court should be allowed to undertake such reassessment of the facts.

It is worth noting that the Committee on International Commercial Arbitration of such Association provided the following commentary on the Recommendation cited above:

The majority of the Committee concluded that the court, when enforcement is resisted on grounds of *lois de police*, should be entitled to review the underlying evidence presented to the tribunal and, in exceptional cases, any new evidence. However, the court should undertake a reassessment of the facts only when there is a strong *prima facie* argument of violation of international public policy.⁹¹

⁸⁸ Jean-Baptiste Racine, *Op. cit.*, p. 565.

⁸⁹ André de Albuquerque Cavalcanti Abbud, "Homologação de Sentenças Arbitrais Estrangeiras" (São Paulo: Atlas, 2008), p. 125.

⁹⁰ Christophe Seraglini, *Op. cit.* (2009), p. 9 *et seq.*

⁹¹ International Law Association, *Op. cit.* (2002), p. 11.

Moreover, it is relevant to recall that in this context, the notion of *transnational* public policy is of no use to a State court. Insofar as transnational public policy consists of the “fundamental moral or legal principles recognized by all civilized nations”, its core will also be part of the forum’s *international* public policy. Issues commonly said as forming part of transnational public policy, such as bribery and corruption, are most likely also fought against by the forum’s legislation. This explains the affirmation made above that only international arbitrators and international judges are indeed concerned with transnational public policy.

In this sense, a commentator has written that “enforcement States are not obliged to consider supranational public policy when deciding to recognize or enforce an international arbitral award.”⁹² Another learned professor and practitioner has affirmed that it would seem futile to prevent a State from defining, itself, what it considered as part of its public policy.⁹³ He summarized: “it is up to each State to define the content of its public policy, and it is this public policy that it will oppose to the introduction, in its legal order, of a foreign arbitral award.”⁹⁴ In the words of another author:

We cannot restrain the exception of public policy to a transnational concept. It is indeed for each State and its judges, within the context of the control of foreign awards, to define and implement their own international public policy. [...] If we can ask a State to make a moderate use of its exception of public policy, we cannot ask a State or its judges to assure the protection of *only* what is *universally accepted* as constituting public policy.⁹⁵

It is hence the position here that when confronted with such a situation, nothing more natural for a judge than to look to his or her own domestic policies applicable in international situations, so as to correctly ground the refusal of recognition or the leave for enforcement.

That an arbitrator refers to the notion of truly international public policy is one thing. But it is difficult for a national judge to follow it. The mission of the judge is to control the award to verify that its integration into the domestic legal order is indeed possible and acceptable. It is hence logical that this control be exercised with regard to such legal order.⁹⁶

⁹² James Fry, “Désordre Public International under the New York Convention: Wither Truly International Public Policy”, *Chinese Journal of International Law*, Volume 8, n. 1, 2009, p. 133.

⁹³ Pierre Mayer, ‘Recommandation de l’association de droit international sur le recours à l’ordre public en tant que motif de refus de reconnaissance ou d’exécution des sentences arbitrales internationales (Présentation)’, *Revue de l’Arbitrage*, Volume 2002, Issue 4, 2002, p. 1061.

⁹⁴ Pierre Mayer, *Op. cit.* (2002), p. 1061.

⁹⁵ Christophe Seraglini, *Op. cit.* (2009), p. 10. Emphasis added.

⁹⁶ Laurence Idot, ‘Note - Cour de cassation (1^{re} Chambre civile) 15 mars 1988, *Revue de l’Arbitrage*’, Volume 1990, Issue 1, 1990, p. 129.

In fact, it is hardly conceivable that a national judge can be prevented from verifying that the enforcement of an award will or will not infringe the public policy of which he or she is the legitimate and genuine protector. As has been exposed, that in no way implies that the judge's office does not itself have limits.

Therefore, it is submitted that it is only by taking into account the preceding statements that international arbitration can be correctly placed within the scheme of global economic governance: a method of dispute resolution fundamentally based on party autonomy and largely auto-poietic, commonly used in international trade, but whose deviations and eventual abuses can be duly remedied by the States through – if no other ground is left – the “last resort” of public policy.

A commentator, writing in 2006, warned:

A few years ago, we might have argued that, after all, the award would be subsequently examined by a national judge, either at the review or enforcement level, and that the most important violations would be condemned under the exception of public policy which is the one exception always invoked by the parties and present in all the *lex arbitrii* around the world and in international conventions. This may have been true before but is no longer the case. Indeed, studies have shown that judges are very reluctant to use the public policy exception and that among all the cases where a party has tried to use it, very few have succeeded.⁹⁷

We therefore invite courts, arbitrators and practitioners alike to reassess such statement and recognize that the position of “a few years ago” was indeed desirable. As the “guardian angel” of any given legal system, public policy shall remain an important tool in the hands of national judges to, without detracting from its originally intended purpose, protect the national legal order from any misuse of party autonomy.

V. CONCLUSION

Public policy is an extremely powerful tool in the hands of national judges. By granting State courts with a broad margin of appreciation to determine its content, public policy can be used to align the judicial practice with the interests of the forum: loosely read, the exception contained in Article V(2)(b) of the New York Convention can permit the introduction into the forum's legal order of foreign awards that would otherwise not be enforceable. If too strictly applied, public policy is liable to undermine party autonomy and frustrate the interests of those resorting to arbitration precisely to avoid national courts, which can sometimes be disconnected from the reality of international trade.

⁹⁷ Catherine Kessedjian, *Op. cit.*, p. 862.

Nonetheless, this tool has a task to fulfil, namely guaranteeing the coherence of the legal order of the place of enforcement. If it is true that judicial courts, even in their own interest, must ensure that arbitration as an alternative means of dispute resolution remain efficient, it is no less true that their biggest concern and most important task is to respect the legal order that is the very source of their power. In short, national judges are ultimately accountable to the members of their society, whilst arbitrators must firstly pay regard to the interests of the parties to the arbitration and secondly to those of the international community of merchants.

It follows that it is natural that national judges invoke international public policy (domestic by nature, in spite of the apparent terminological incongruence) when refusing to recognize a foreign arbitral award, whereas it is legitimate that arbitrators, detached from any specific national legal order, rely on transnational (or truly international) public policy, precisely to fulfil their mandate and guarantee that the awards they render be enforceable anywhere.

With regard specifically to the way Brazilian courts have been using public policy to deny recognition and enforcement, the analysis reveals intriguing conclusions. Brazilian case law, still in its youth but quickly evolving, has shown that it is ready to embrace a liberal stance, but has thus far failed to do so. The latest developments show however that the way is paved and that in the near future the scenario may change.

In any case, what is expected from such courts is that, more important than changing their approach, they modify the way of looking at the issue. In view of the liberalization of international private economic activity and of the consequent empowerment of private individuals, national courts have a fundamental role in today's global economic governance. Given that parties are increasingly free to contract out of the national courts, it is through the mechanism of public policy that these courts may still regulate the international commercial activity. Therefore, it is on public policy that they shall concentrate their efforts.

Accordingly, an extremely liberal approach based on the sole appearance of conformity of the foreign award with public policy will do nothing but ratify the parties' ability to remain immune from State regulation. The standard called for here is one that would consider the true importance of public policy and, when necessary, delve into the details of the award to ensure that no violation took place. Needless to say, that is in no way incompatible with the general principle of no review of the merits of the awards, which is still the foundation of the control exercised by the courts over foreign arbitral awards. It is by that means that international arbitration, increased party autonomy and effective global governance can best coexist. There, we argue, is where lies the *optimum* between the essential right to freedom and the necessity of some sort of control.

EXCLUSION OF RIGHT TO CHALLENGE THE ARBITRAL AWARD

David Khachvani*

Abstract. Parties to international arbitration proceedings are generally given opportunity to request the annulment of the award at the courts of the seat of arbitration. However, for variety of practical reasons parties may agree to opt out from annulment review. Certain States give effect to such arrangements of the parties, commonly known as Exclusion Agreements, but set specific validity requirements. It has been argued that by giving effect to the Exclusion Agreements States breach their human rights obligation to guarantee observance of minimum standard of procedural fairness. However, relevant case law shows that the State responsibility can be engaged only at the stage where the arbitral award is given coercive effect. States giving effect to the waiver of annulment action still retain control over the enforcement of the awards. Thus, in majority of instances they remain in compliance with their human rights obligation.

Keywords. Waive; exclusion; annulment; set aside; validity; procedural fairness; fair trial; human rights; non-waivable standards; ECHR.

* *LLM in International Dispute Settlement (Université de Genève and Graduate Institute of International and Development Studies) (Hans Wilsdorf Scholarship).*

I. INTRODUCTION

An arbitration award bears the nationality of the State where it is made (the ‘Seat State’).¹ This very feature renders the award enforceable almost everywhere in the world.² In exchange of giving such effect to arbitration, Seat States retain power to exercise certain degree of control over arbitral proceedings. Most importantly, the parties are given opportunity to seek annulment (also called setting aside or vacation) of the arbitral award in the Seat State’s courts, on the grounds set out by relevant legislation. The arbitration statutes of the most jurisdictions allow annulment only under very limited grounds.

¹ Nigel Blackaby, Konstantine Partasides *et al*, “Redfern and Hunter on International Arbitration” (Oxford University Press, 2009) 1.17.

² The New York convention (1958) Article 1.1 requires that the award be made on the territory of foreign State in order to benefit from the enforcement regime set out in the convention.

The reason why the Seat States do not entirely abandon such control is their inherent function to protect public policy, encompassing the minimum standard of procedural fairness. Approach may change if parties agree to waive their access to the annulment proceedings.

Parties may want to enter into an Exclusion Agreement for some practical reasons. They may wish to avoid a step of review at the annulment level, knowing that the award will, in any event be reviewed at the enforcement stage. It is however, worth noting from the outset, that there are numerous practical disadvantages associated with entering into an Exclusion Agreement. Namely, if the claim is unduly dismissed by the irregular decision of the arbitral tribunal, the claimant is left without remedy, there being obviously no enforcement for the dismissed claim. On the other hand, if respondent loses, it risks to be in the position to oppose the enforcement in multiple jurisdictions, with no chance to request annulment at the source of the award. An Exclusion Agreement thus can be described as beneficial only for the winning party. However, at the time of conclusion of the contract the parties have no definite knowledge of their chances of success in case of any future dispute. Hence, they may still opt to jointly waive their right to seek the annulment of the prospective award.

Some States give effect to such Exclusion Agreements. The Courts of those States refrain from entertaining the set aside applications, where they find that the parties have validly excluded the set aside action. It is at this instance when public policy considerations arise. It can be argued, that by giving effect to an Exclusion Agreement, the State abandons its inherent duty to supervise the compliance with minimum standard of procedural fairness. It has been claimed to also constitute a breach of a State's human rights obligation to guarantee the fair trial.

This article will first analyse the effect and interpretation of Exclusion Agreements under Swiss, Swedish, French, Belgian, English and US arbitration laws and some institutional arbitration rules (I). It will thereafter explore the possible conflict between an Exclusion Agreement and a States' duty to respect the minimum standard of procedural fairness (II).

II. EFFECT AND INTERPRETATION OF EXCLUSION AGREEMENTS³

Arbitration laws and institutional rules give increasing effect to party autonomy. This trend is also reflected on the application and interpretation of Exclusion Agreements.

This first part of the article will consider three main aspects of Exclusion Agreements: First, it will overview the effect given to the Exclusion Agreements by above States'

³ The article focuses on Exclusion Agreements in international commercial arbitration. The ICSID arbitration system will not be discussed for obvious reasons. Namely, annulment of the ICSID award is governed by article 52 of the ICSID Convention. Parties to ICSID proceedings (Investor and State) are by no means empowered to waive mandatory provisions of the multilateral treaty.

arbitration laws (A); Secondly, the focus will be made on the validity requirements set for Exclusion Agreements under these laws (B); Thirdly, it will examine the degree of control over arbitral proceedings, retained by the States recognizing the validity and effect of Exclusion Agreements (C).

A. EFFECT GIVEN TO THE EXCLUSION AGREEMENTS BY ARBITRATION LAWS

Due to the emergent nature of the Exclusion Agreements in practice, the vast majority of States have yet to express their position with regard to its validity and enforceability. However, there are several laws that have given effect to the Exclusion Agreements. Switzerland, France, Sweden and Belgium are the most significant representatives (the ‘Recognizing States’). On the other hand some jurisdictions like the US, have refused to give effect to Exclusion Agreements (the ‘Non-Recognizing States’).⁴

The UNCITRAL Model Law on International Commercial Arbitration (the ‘Model Law’) is silent on this matter. However, in practice, some Model Law jurisdictions have allowed or refused to allow the waivers of the annulment grounds listed in their Model Law based statutes.

The particular approaches towards Exclusion Agreements employed under those arbitration laws are due to be reviewed.

1. Recognizing States

(i) Switzerland

Article 192.1 of Swiss Private International Law Act (the ‘PILA’) reads as follows:

If none of the parties have their domicile, their habitual residence, or a business establishment in Switzerland, they may, by an express Statement in the arbitration agreement or by a subsequent written agreement, waive fully the action for annulment.

Important requirement set by the provision is that none of the parties to the proceedings are domiciled in Switzerland. The Swiss Federal Tribunal interprets such requirement to be in line with public policy considerations.⁵

⁴ Gary Born, “International Arbitration: Law and Practice” (Kluwer Law International 2012), 334.

⁵ Spoorenberg, Bürgenmeier, “The Swiss Law Provision Allowing Foreign Parties to Waive Their Right to Seek the Annulment of International Arbitration Awards is Compatible with the Fair Trial Guarantees” (26 April 2012) Mondaq, 2.

The annulment grounds are enlisted in Article 190.2. Those grounds relate to: (a) Improper constitution of the arbitral tribunal; (b) Lack of jurisdiction of the arbitral tribunal; (c) Ultra petita or infra petita decision-making; (d) Violation of equality of the parties and/or their right to be heard; or (e) violation of public policy. Swiss legislator does not draw any difference between those grounds in terms of Exclusion Agreements and expressly allows opting out from annulment action irrespective of the grounds to be relied upon by the challenging party.

It is also worth noting that the given provision of PILA allows the conclusion of the Exclusion Agreement both before and after the dispute has arisen. The level of parties' awareness of the possible need for challenge is likely to be higher after the dispute arises than at the time of conclusion of the contract. Swiss legislator however, does not draw any difference between those two stages, as long as the Exclusion Agreement is expressly stipulated.

In practice, the Swiss Federal Tribunal has dismissed numerous applications of annulment on the basis of the existence of an Exclusion Agreement under Article 192.1 PILA.⁶ The Swiss Federal Tribunal usually applies the literary interpretation of the statute. So long as the parties are not domiciled in Switzerland and the Exclusion Agreement is express, the court has not found it difficult to affirm the possibility of opting out from the annulment action.

(ii) France

The first sentence of Article 1522 of French Code of Civil Procedure (the 'French CCP') stipulates that:

By way of a specific agreement the parties may, at any time, expressly waive their right to bring an action to set aside.⁷

Unlike the Swiss provision, the above article does not set an overseas domicile or residence requirement. Thus, even if one of the parties is domiciled in France, the Exclusion Agreement will be valid. Moreover, article 1522 of the French CCP provides that Exclusion Agreements may be concluded 'at any time'. This, much like the Swiss PILA, empowers the parties to waive the annulment action before, as well as after the dispute arises.

⁶ *X v. Z*, Swiss Federal Tribunal 4A_238 (2013); *X v. Y*, Swiss Federal Tribunal 4A_486 (2011), 3.1, available at <<http://www.swissarbitrationdecisions.com/>>.

⁷ English Translation by Emmanuel Gaillard, Nanou Leleu-Knobil and Daniela Pellarini of Shearman & Sterling LLP.

(iii) Sweden

The relevant part of Section 51 of Swedish Arbitration Act (the ‘SFS’) provides that:

Where none of the parties is domiciled or has its place of business in Sweden, such parties may in a commercial relationship through an express written agreement exclude or limit the application of the grounds for setting aside an award as are set forth in section 34.⁸

The wording of article 51 of SFS limits the possibility of concluding the Exclusion Agreement exclusively to parties with a domicile or place of business abroad.

The provision is also clear with respect to the possibility of excluding any and all annulment grounds under Article 34 SFS. The latter provides the exclusive list of annulment grounds that are essentially similar to the ones enlisted in Swiss PILA. Article 51 SFS does not provide any clarification as to the permissibility of concluding Exclusion Agreement before or after the dispute arises. Hence, it is to be assumed that there are no limitations in this regard.

(iv) Belgium

According to article 1718 of Belgian Judicial Code:

By an explicit declaration in the arbitration agreement or by a later agreement, the parties may exclude any application for the setting aside of an arbitral award, where none of them have (...) registered office, its main place of business or a branch office in Belgium.⁹

Much like in Switzerland and Sweden, Belgium permits Exclusion Agreements exclusively for parties with places of business abroad. The provision also sets forth with the possibility to exclude all the grounds of annulment before or after the dispute arises. It is worth noting that Belgium adopted the Model Law in 2013. However, the legislator still retained the mentioned provision of the Judicial Code. Hence, unlike in other purely Model Law jurisdictions, in Belgium the Exclusion Agreement is statutorily allowed.

2. Non-Recognizing States

Certain States have refused to give effect to Exclusion Agreements. This has rather been expressed in case law than in legislative enactments.

⁸ English Translation by Stockholm Chamber of Commerce.

⁹ English Translation by Belgian Centre for Mediation and Arbitration.

(i) *United States*

US Federal Arbitration Act (the 'FAA') is silent on the issue of Exclusion Agreements. In prior cases the US courts recognized the waiver of the annulment proceedings by explicit agreement.¹⁰ By the same token, some decisions allowed the parties to agree on expansive or full-scale appeal on the substance of the dispute at the annulment stage.¹¹ In contrast, in *Hoelt v. MVL Group* the US Court of Appeals held that the annulment action provided by FAA might not be altered by party agreement.¹² As case law of the lower courts has been contradictory over the years, the US Supreme Court stepped in to finally settle this discrepancy. It held in *Hall Street* case that the grounds for annulment are mandatorily enlisted and may not be modified by party agreement.¹³ Since then, the US courts do not give effect to any modification (i.e. exclusion or expansion) of the set aside action.

(ii) *England*

The situation in England is somewhat more complex. Section 68 of the English Arbitration Act 1996 mandates the supervising courts to set aside the arbitral award for the grounds essentially similar to the ones provided by Swiss PILA (as described above). Apart from those generally recognized grounds for annulment of awards, Section 69 of the Arbitration Act provides for the appeal of the award that may lead to latter's annulment, variation or remittal on the basis of arbitral tribunal's error on a point of English law. English courts have allowed the exclusion by agreement of this right of appeal under Section 69.¹⁴ Schedule I of the Arbitration Act, which exhaustively enlists the mandatory (non-waivable) provisions of the statute, includes section 68, but not section 69. Thus, parties are allowed to opt out from the appeal only for the substantive error on a point of English law. This approach is substantiated by the text of section 69, starting with words: 'unless otherwise agreed by the parties'. In contrast, English courts will mandatorily review the compliance with grounds enlisted in section 68 irrespective of any contrary agreement of the parties. Thus, England does not allow the Exclusion Agreement on most commonly accepted annulment grounds. For this reason it shall be deemed as Non-Recognizing State.

¹⁰ *Aerojet Corporation v. AAA* (1973) US 9th Circuit 478-F.2d, 248; *Payne v. SS-Tropic Breeze* (2008) US Court of 1st Circuit 423 F.2d, 236.

¹¹ Gary Born, "International Arbitration: Law and Practice" (Kluwer Law International 2012), 336.

¹² *Hoelt v. MVL Group* (2003) US 2nd Circuit 343-F.3d, 60.

¹³ *Hall Street Associates LLC v. Mattel Inc.* (2008) US Supreme Court 128-1396.

¹⁴ *Shell Egypt West Manzala GMBH, Shell Egypt West Qantara GMBH v Dana Gas Egypt Limited*, Queens Bench Division Commercial Court 2097 (2009).

Notably, Singapore has adopted the similar approach. The substantive review under Section 49.1 of the Arbitration Act is capable of being excluded by virtue of party agreement, while the non-substantive grounds of challenge are deemed to be non-waivable.¹⁵

3. Model Law Jurisdictions

Article 34 of the Model Law enlists annulment grounds. The law does not itself contain any provision as to the possibility of excluding the application of Article 34. The judicial practice developed in relevant Model Law jurisdictions shows existing discrepancies on this matter.

In 1998, the court of Ontario (a Canadian province having adopted the Model Law) had to deal with the challenge of the arbitral award rendered in Canada between a Hong-Kong corporation and a Canadian company.¹⁶ The arbitration clause contained the waiver of possibility of recourse to any form of challenge of the award. The court stressed that the party agreement should be given full effect, unless it contradicts any mandatory provision of the procedural law of arbitration. After analysing the language of article 34 of Ontario arbitration statute, mirroring the article 34 of the Model Law, the court came to the conclusion that the provision was not mandatory and could have been excluded by party agreement. By this decision the court allowed the Exclusion Agreement without having specific enabling provision in the statute.

Some other Model Law States, like Russia¹⁷ and Tunisia¹⁸ have recently followed this approach.

Courts of other Model Law jurisdictions have reached diametrically opposite conclusion while interpreting the same provision. In 2004, a New Zealand court found that the parties were not allowed to waive or limit annulment action provided for by article 34, as there was no statutory provision enabling them to do so. The court carefully analysed the wording of Article 34 and stressed that it does not allow modifications by party agreement.¹⁹

As Model Law States adopt distinct interpretations of article 34, some of them shall be considered as Recognizing States, while others - as non-Recognizing States.

¹⁵ *Daimler South East Asia Pte Ltd v. Front Row Investment Holdings (Singapore) Pte Ltd*, Singapore High Court 157 (2012).

¹⁶ *Noble China Inc. v Lei*, Ontario Court 42.3d (1998), 69.

¹⁷ Federal Arbitrazh (Commercial) Court of Moscow District, case No. A40-124999/12-50-1261 (2013); See also Case No. A40-124996/12-143-588 (2013) Cited at Debevoise & Plimpton Arbitration Quarterly (September 2013), 15.

¹⁸ Chalghoum, 'The Judicial Annulment of the Arbitral Award in Light of Islamic Law', *Kluwer Arbitration, International Journal of Arab Arbitration* Volume 4, Issue 1 (2012), 10.

¹⁹ *Methanex Motonui v. Joseph Spellman* (2004) NZ Court of Appeal 171/03.

B. VALIDITY AND FORM OF EXCLUSION AGREEMENTS

Recognizing States set validity requirements for Exclusion Agreements. Firstly, the requirement of explicitness is due to be discussed (1); secondly, the approach of the Recognizing States towards the Exclusion Agreements contained in various institutional arbitration rules shall be examined (2).

1. Requirement of Explicitness

Most Recognizing States require the Exclusion Agreement to be unequivocally stipulated. Swiss Federal Tribunal has refused to give effect to the alleged Exclusion Agreement merely indicating that the award shall be final.²⁰ The Tribunal held that arbitral awards are final in the sense that they are not subject to ordinary appeal on substance. Thus, according to the Swiss Federal Tribunal, reference to finality does not bar the annulment review.

In contrast, the Swiss Federal Tribunal gave effect to the Exclusion Agreement put before it in another case. The agreement read as follows:

Neither party shall have any right to appeal award to any court of law. Neither party shall submit to any court of law any dispute arising out of this agreement, except for the enforcement of the arbitral award.²¹

According to the Swiss Federal Tribunal, the parties had put sufficiently clear emphasis on exclusion of the involvement of the court into any proceedings, including annulment action. The similar requirement of explicitness has been adopted by some other Recognizing States, such as Australia.²²

As noted above, England allows the Exclusion Agreements only on the substantive appeal of arbitral awards. Interestingly enough, English courts do not require the same level of explicitness for assuming the waiver of such an appeal. English courts would refrain from supervising the arbitral tribunal's substantive errors on the point of English law if parties simply agree that the arbitral award is to be final.²³ Such approach is to be explained by the ordinary meaning of word 'final'. As stressed by the Swiss Federal

²⁰ *X v. AY - Holding BV*, Swiss Federal Tribunal 4A_256/2009 (2010), 2.2, available at <<http://www.swissarbitrationdecisions.com/>>.

²¹ *X v. Z*, Swiss Federal Tribunal 4A_238 (2013), 2.2, available at <<http://www.swissarbitrationdecisions.com/>>.

²² See: *Am Diagnostica Inc. v. Gradipore Ltd* (1999) Supreme Court of NSW, at XXIVa Yearbook of Commercial Arbitration 574.

²³ *Sanghi Polyesters Ltd v. KCFC* (2001) 1 Lloyd's Report 480; *Lesotho Highlands Development Authority v. Impreglio SpA* (2005) UKLH, 43.

Tribunal, indication on finality entails no recourse on substance. Hence, the indication on final nature of the award indeed bars the English courts from supervising the tribunal's error on points of English law.

However, as far as the annulment on ordinary non-substantive grounds are concerned the rule is to require the Exclusion Agreement to be more specifically stipulated. Thus, the dominant approach of majority of Recognizing States is to adhere solely to the express indication of excluding the supervisory role of the annulment court.

2. Institutional Rules Incorporating Exclusion Agreement

Some institutional rules incorporate Exclusion Agreements. ICC 2012 Rules are representative. Article 34.6 provides that

By submitting the dispute to arbitration under the Rules, the parties undertake to carry out any award without delay and shall be deemed to have waived their right to any form of recourse insofar as such waiver can validly be made.

Similarly, article 26.9 of LCIA Rules stipulates that 'by agreeing to arbitration under these Rules, the parties undertake to carry out any award immediately and without any delay; (...) and the parties also waive irrevocably their right to any form of appeal, review or recourse to any State court or other judicial authority, insofar as such waiver may be validly made.'²⁴

Other non-major institutional rules also incorporate provisions to similar effect.²⁵

The wording of the said provisions is explicit enough to be interpreted as Exclusion Agreement. However, the courts of most Recognizing States still have to assess whether mere reference to such institutional rules demonstrates the clear intent of the parties to waive their right to annulment action. It has been reported that the Swiss Federal Tribunal recently refused to deem the reference to ICC Rules as valid Exclusion Agreement.²⁶ It is worth noting that the same provision was present in earlier 1998 ICC Rules. Through the years, the courts of the major Recognizing States, such as Switzerland or France have never interpreted the mere reference to the ICC Rules as a valid proof of parties' intent to conclude the Exclusion Agreement.

²⁴ In the recent proposal of amendment of the LCIA Rules this provision is slightly modified. Namely, the modification affects the last phrase of article 26.8 (current article 26.9), which now reads as follows: 'insofar as such waiver shall not be prohibited under applicable law'. Presumably, such formulation is intended to encompass the jurisdictions, which neither restrict nor expressly allow the Exclusion Agreements. The text of the proposed amendment is available at: <<http://www.lcia.org//media/download.aspx?MediaId=336>>.

²⁵ See: CEPANI Rules, Article 24.2.

²⁶ Strik, 'Growing number of countries allowing exclusion agreements with respect to annulment warrants greater scrutiny of the arbitration clauses' (2013) Linklaters LLP, 3.

Exceptionally, Russian Federal Arbitrazh recently found the indication of finality of the award in the Arbitration Rules of the International Commercial Arbitration Court (the 'ICAC') to be sufficient to demonstrate intention of the parties to exclude the annulment action.²⁷ Article 44 of the ICAC rules reads as follows: 'An award made by the ICAC shall be final and binding from the date thereof.' However, the mentioned case of Russian Arbitrazh, does not express the finally settled position in Russian jurisprudence. This exact provision of ICAC rules has not been interpreted similarly in numerous other decisions of the Federal Arbitrazh. The wording of article 44 of the ICAC Rules is even softer than the one contained in ICC or LCIA Rules. It does not clearly stipulate the waiver of recourse to the courts, but merely includes the indication on finality of the award. According to the reasoned opinion of the Swiss Federal Tribunal, finality is simply a regular characteristic of the arbitral award and it by no means denotes the parties' intent to exclude the essentially non-substantive annulment action.²⁸ Consequently, the said approach recently developed by Russian courts is somewhat idiosyncratic and should not be favoured.

It should be concluded that, predominantly, the Recognizing States are reluctant to give effect to the Exclusion Agreements incorporated into institutional rules of arbitration.

On the other hand, it is no surprise that the Non-Recognizing States, which give effect only to waiver of the substantive review, (like England²⁹ and Singapore³⁰) deem the mere reference to such institutional rules sufficient to refrain from reviewing the award on the point of law. This is explained by significantly softer validity requirements posed for the waiver in those jurisdictions in comparison with the criteria of explicitness statutorily enshrined in the Recognizing States.

C. THE DEGREE OF CONTROL RETAINED BY RECOGNIZING STATES

The Recognizing States still retain control over arbitral proceedings in two aspects. First, the courts check the existence and validity of Exclusion Agreements; and second, they review the arbitral awards on enforcement stage (in an unlikely case where party seeks to enforce the award on the territory of the Seat State³¹).

²⁷ Federal *Arbitrazh* (Commercial) Court of Moscow District, case No. A40-124999/12-50-1261 (7 February 2013).

²⁸ *X v. AF Holding BV*, Swiss Federal Tribunal 4A_256/2009 (2010), 2.2, available at <<http://www.swissarbitrationdecisions.com/>>.

²⁹ *Lesotho Highlands Development Authority v. Impregilo SpA & Others*, House of Lords 43 (2005).

³⁰ *Daimler South East Asia Pte Ltd v. Front Row Investment Holdings (Singapore) Pte Ltd*, Singapore High Court 157 (2012).

³¹ Enforcement in the seat State remains unlikely because the parties to international arbitration usually choose the neutral seat, where they do not conduct business. Thus, it is less likely that the enforceable assets will be located in the Seat State.

As shown above, Courts of the Recognizing States have refused to give effect to unclearly drafted Exclusion Agreements. While deciding whether or not to dismiss the annulment application on the ground of existence of Exclusion Agreement the courts will need to satisfy themselves that such agreement is validly concluded. At this stage they will employ the full-scale standard of review, as opposed to *prima facie* review undertaken by some courts at the primary stage of determining the validity of the arbitration agreement itself.³²

Moreover, as recently decided by Swiss Federal Tribunal *ratione personae* scope of the Exclusion Agreement is also to be ascertained by the court, when the award rendered involves non-signatories.³³ This will incidentally involve the control over the scope of the arbitration agreement as well. However, this does not imply that the court refuses to give effect to the Exclusion Agreement. Rather, the review is undertaken for the sole purpose of ascertaining whether the Exclusion Agreement binds the non-signatory.

Second important feature of control is that arbitration laws of the Recognizing States introduce the special regime of enforcement for the awards rendered in the arbitral proceedings where Exclusion Agreement has been present. Article 192.2 of the Swiss PILA stipulates that:

If the parties have waived fully the action for annulment against the awards and if the awards are to be enforced in Switzerland, the New York Convention of June 10, 1958 on the Recognition and Enforcement of Foreign Arbitral Awards applies by analogy.

Provisions to the similar effect are present in French and Swedish arbitration statutes.³⁴ Even though the award is rendered on the territory of the Recognizing State, the courts will treat it as foreign award for enforcement purposes. Thus, the compliance with the grounds mirroring New York Convention will be examined before enforcing the award. Similarly, in Belgium, the award is in any event checked under the grounds similar to the ones of the New York Convention, irrespective whether the award is rendered in Belgium or abroad.³⁵ This feature makes the existence of an Exclusion Agreement irrelevant for the enforcement purposes.

As a consequence, in all enlisted Recognizing States awards will attain coercive power only after examined on the grounds similar to the ones provided in New York Convention. As it will be discussed bellow ('Section II.B') such control at the enforcement stage can

³² *Foundation M. v. Banque X*, Swiss Federal Tribunal 122_III (1996), 139; Gaillard, Banifatemi, 'Negative Effect of Competence-Competence: The Rule of Priority in Favour of the Arbitrators', in *Enforcement of Arbitration Agreements and International Arbitral Awards: The New York Convention in Practice* (Edited by Gaillard, Di Pietro) Cameron May, 257 (2008), 261.

³³ *A.Xav. By.*, Swiss Federal Tribunal 4A-631 (2011), available at <<http://www.swissarbitrationdecisions.com/>>.

³⁴ French Code of Civil Procedure, Article 1522; SFS, Section 51.

³⁵ Belgian Judicial Code, Article 1719.1.

play an important role in avoiding the responsibility of Recognizing States in terms of procedural fairness standards.

III. POSSIBLE CONFLICT WITH PROCEDURAL FAIRNESS

States supervise proceedings taking place on their territory as part of their duty to warrant procedural fairness. It can be argued that by upholding Exclusion Agreements and thus renouncing their supervisory role over arbitral proceedings, the Recognizing States compromise access to fair justice.

This second part of the article will first examine the standards of procedural fairness applicable in international arbitration proceedings (A). Second, it will analyse whether a State may be held responsible for failure to guarantee the compliance with the procedural fairness standards at arbitral proceedings (B).

A. PROCEDURAL FAIRNESS STANDARDS IN ARBITRATION

Application of procedural fairness standards in international arbitration derives from the New York Convention and national legislations. Where the former sets minimum standard below which the enforcement of the award may be refused, the latter provides for the requirements imposed as a matter of domestic standard. It is outside the ambit of the present article to engage into comparative analysis of approaches taken by different jurisdictions. It would suffice to mention that, generally, the following non-exhaustive list of principles form part of procedural fairness standard:

Equality of arms - denotes the equal treatment of the parties by the arbitral tribunal. Both parties must be afforded with equal opportunity to present their case and the tribunal shall not take decisions in even-handed manner;

Right to be heard – closely tied to the previous standard, this is an essential guarantee for the parties to present their case. The tribunal is obliged to give opportunity to the parties to comment on the issues raised at the proceedings by another party or by the tribunal itself. An example of the grave violation of the right to be heard would be the negligent failure of the tribunal to notify the party about the date or place of the scheduled proceedings.

Independence and Impartiality – protects parties from the tribunal, which is biased and/or lacks independence.³⁶ The most obvious implication of the standard is the principle that no one shall be a judge of his/her own cause.

³⁶ *IBA Guidelines on Conflict of Interests in International Arbitration*, Council of the International Bar Association (22 May 2004).

No Ultra/Infra Petita Decisions – by virtue of this standard the tribunal is not allowed to decide on claims not posed by any of the parties or to leave any of the claims untouched.

Those procedural fairness standards often entail mandatory procedural guarantees, which exist irrespective of party agreement.³⁷

B. POSSIBILITY OF INVOKING STATE RESPONSIBILITY

By entering into Exclusion Agreement parties do not waive the application of procedural fairness standards. They merely exclude the control of the Seat State over the compliance with those standards. The question arises, whether Recognizing States breach their duty to guarantee procedural fairness by giving effect to Exclusion Agreements. In order to answer this question it should be first examined to what extent, if at all, is a State responsible to guarantee the procedural fairness standards in arbitral proceedings (1); and next, it should be discussed whether the Recognizing States, in fact, comply with such duty (2).

1. State's duty to guarantee procedural fairness in arbitration

States have numerous human rights obligations related to the access to justice. The European Convention on Human Rights (the 'ECHR') system provides the most comprehensive practice in this regard. Article 6.1 ECHR dictates that in determination of 'civil rights and obligations', everyone is entitled to a fair hearing within a reasonable time, by independent and impartial tribunal.

Generally, an ECHR Contracting State is responsible to guarantee fulfilment of this standard in its domestic courts. It is also true that the conduct of the arbitral tribunal is not attributable to the State.³⁸ However, the European Commission of Human Rights (the 'Commission') has outlined that:

Account must be taken of the legislative framework, in order to determine whether the domestic courts retained some measure of control of the arbitration proceedings and whether the control was properly exercised in concrete case.³⁹

European Court of Human Rights (the 'Strasbourg Court') reached the similar conclusion in the Suovaniemi case⁴⁰. The applicant (Mr Suovaniemi) argued that Finland

³⁷ Gary Born, *International Arbitration: Law and Practice* (Kluwer Law International 2012), 318.

³⁸ Kuijer, Applicability of Article 6 ECHR at *The Blindfold of Lady Justice – Judicial Independence and Impartiality in Light of Requirements of Article 6 ECHR* (2004) Wolf Legal Publishers, 29.

³⁹ *Nordstrom-Janzon v. The Netherlands* European Commission of Human Rights (Application No 28101), 95.

⁴⁰ *Suovaniemi v. Finland* (1999) ECHR 31737/96.

had breached article 6.1 ECHR, by refusing to set aside the arbitral award rendered by an allegedly biased tribunal. Finland responded that the procedural irregularities at arbitral hearings could not have engaged responsibility of the Seat State. The Strasbourg Court rejected this reasoning and stressed that before giving coercive power to the arbitral award States have to make sure that the award is produced as a result of proceedings, which comply with non-waivable mandatory standards of procedure.⁴¹

Those non-waivable standards have been identified case-by-case by the Strasbourg Court. However, the ECHR case law is primarily aimed at the general public. In contrast, the most prominent users of international arbitration are business corporations. Where in the agreement between businessmen there is an express waiver of the right to seek the annulment of the prospective arbitral award, it is most likely that the parties have well prevised all possible consequences.⁴² Thus, what is non-waivable standard for general public can be considered perfectly waivable for informed businessmen. In any event, this factor does not abolish the State's duty to overlook the compliance of arbitral proceedings with minimum standards of procedural fairness. It merely calls for setting a lower threshold for triggering such duty.

Thus, before giving the coercive effect to an arbitral award the States have to ensure that the award has been obtained through proceedings conducted in compliance with basic procedural fairness standards.⁴³

2. Compliance with the duty to guarantee procedural fairness

It might be argued that by giving effect to Exclusion Agreements and thus refusing to check the compliance with mandatory procedural standards, the Recognizing States breach article 6 of ECHR. This would be certainly true had the Recognizing States not retained a very important instrument of control. Namely, as discussed above (Section I.C), the legislation of the Recognizing States equates the award rendered in the proceedings, where Exclusion Agreement is present, to a foreign award. Thus, before it is enforced on the territory of the Recognizing State the award will undergo control under the New York Convention grounds for refusal of recognition and enforcement of arbitral awards. The New York Convention grounds effectively encompass those minimum standards of procedural fairness that have to be observed by the State within the framework of its human rights obligations.

⁴¹ Landrove, 'European Convention on Human Rights' Impact on Consensual Arbitration' (2006), 84.

⁴² See: Thomas Schultz, 'Human rights: a speed bump for arbitral procedures? An Exploration of Safeguards in the acceleration of Justice,' (2006) IALR 9(1), 8-23.

⁴³ David Harris, Michael O'Boyle, *Law of the European Convention on Human Rights* (Oxford University Press, Second Edition 2009), 203.

The Swiss Federal Tribunal recently had to rule on the compatibility of article 192.1 PILA with ECHR Standards.⁴⁴ The tribunal stressed that it was indeed required to guarantee the fulfilment of non-waivable standards of the ECHR before giving coercive effect to the arbitral award. However, according to the Swiss Federal Tribunal, the PILA still provides sufficient degree of control over the proceedings by ensuring that the award produced in such proceedings will be checked against the New York Convention grounds before being enforced. Hence, the Swiss Federal Tribunal rejected allegation on incompatibility with article 6 ECHR.

Thus, the control over the arbitral awards on the enforcement stage retained by the Recognizing States has been considered to be an essential factor for avoiding international responsibility for violation of the fundamental right to procedural fairness. However, there are instances when the enforcement of the award is not at stake. As described above, if the claimant's claims are dismissed by the arbitral tribunal in violation of fundamental rules of procedural fairness (e.g. conducting hearing without sending the notice to the claimant, engaging into corruption, etc.) the only option for the claimant is to challenge the decision at Seat State's courts in annulment proceedings. In case the parties have concluded the Exclusion Agreement it becomes impossible for such claimant to effectively defend itself from grave violations of its fair trial rights. There will be obviously no enforcement action available for the dismissed claims. The award will acquire the *res judicata* effect and the claimant will be compelled to abandon its claims, without having opportunity to properly present its case. This narrow situation creates the risk for Recognizing States to be in violation of their duty to guarantee minimum standard of procedural fairness. In all other instances, the Recognizing States remain in compliance with their international human rights obligations, by retaining essential tool of control over enforcement of arbitral awards.

IV. CONCLUSIONS

Following conclusions can be drawn as the summary of the present article:

1. Several key arbitration jurisdictions recognize and give effect to Exclusion Agreements;
2. Such Recognizing States still retain degree of control over arbitral proceedings at least in two aspects:
 - (a) The courts check existence and validity of the Exclusion Agreement;
 - (b) The award produced as a result of such proceedings is treated as a foreign award and will be reviewed under New York Convention before being given coercive effect;

⁴⁴ *X v. Y*, Swiss Federal Tribunal 4A_238 (2013), 2.2, available at <<http://www.swissarbitrationdecisions.com/>>.

3. Generally, States can be held responsible under their human rights obligations if they give coercive effect to the arbitration award produced as a result of unfair proceedings – i.e. the proceedings in breach of fundamental standards of procedural fairness;
4. Due to the degree of control over enforcement of the arbitral awards retained by the Recognizing States, they generally remain in compliance with the human rights obligations as well as with their possible public policy considerations.
5. However, in the narrow case, where the arbitral tribunal dismisses the claimant's claims in violation of fundamental rules of fairness, the Recognizing States leave such claimant without any proper remedy. At this instance the State's international responsibility to guarantee the right to fair trial can be invoked.

CASE-LAW REVIEWS

BG GROUP V. ARGENTINA. INVESTOR STATE ARBITRATION. DECISION OF THE SUPREME COURT OF THE UNITED STATES OF AMERICA¹

Carlos H. Reyes Díaz*

Abstract: The United States Supreme Court ruled on March 5th of 2014, at the last legal stage, the dispute arising between Argentina and the gas company *BG Group* of British nationality, originally raised in an investment arbitration under the Arbitration Rules of the United Nations Conference on International Trade Law (“UNCITRAL”). The decision from the U.S. Supreme Court shows, among others, some lessons for the treatment of consent to arbitration by the host State.

Keywords: Investment arbitration, consent to arbitration, treaty interpretation, award recognition, UNCITRAL.

* PhD in Law (Universidad Nacional Autónoma de México “UNAM”). Lecturer at the Law School of the UNAM. Chief Co-editor of the Latin American Journal of International Trade Law.

¶ Translation by Paola Sabina Soto Sánchez

I. INTRODUCTION

Investment arbitration started having its rise at the seventies and eighties, although its peak was more clearly expressed at the nineties and nowadays, is one of the most widely used mechanism within the broad universe of dispute settlement mechanisms.² Recently, on March, 5, the Supreme Court of the United States ruled (with a concurring opinion and a dissenting opinion) on the validity of the UNCITRAL arbitration award on the dispute of a London gas company with operations in Argentina.

The objective of this work is the analysis of the dispute in its different stages and continue the ongoing debate about the validity and effectiveness of investment arbitration and its permanent conflict with domestic jurisdictions, with special attention on Latin America.

¹ At: <<http://www.italaw.com/sites/default/files/case-documents/italaw3115.pdf>> Retrieved April 12, 2014.

² See: UNCTAD. *Recent developments in investor-State dispute Settlement (ISDS)*, April, 2014. At: <www.unctad.org/diae> in which is mentioned a number of 274 solved cases to date, derived of an approximately total of 568 treaties. For its part, the International Center for Settlement of Investment Disputes (ICSID), of the World Bank, in its most recent 2014 report, with data through December 31, 2013, recorded 459 cases submitted to the Agency. Cf <<https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=CaseLoadStatistics>>. Retrieved April 12, 2014.

II. BACKGROUND

A. ORIGIN OF THE DISPUTE

The Argentine crisis, one of the most shocking in its story, was also a crisis that inaugurated the XXI Century and even today continues to show its effects. In years 2001 and 2002, as a result of this crisis, the Argentine government enacted some domestic laws to address and seek alternatives to mitigate the economic and financial disaster that was coming and that, ultimately, could not be avoided. The content of these laws (at least in regard to this work) affected the investment rights of foreign companies, including *BG Group* (Metrogas, its Argentine subsidiary), since the rules to calculate gas tariffs from dollars to Argentine pesos were changed, with an unfair exchange rate, as it was established a rate of one Argentine peso per U.S. dollar, when the rate at that time was tree Argentine pesos per dollar. This lead to a great economic loss for the company from London.

To this situation it must be added that Argentine President decreed (2002) suspending, for a period of 18 months, the enforcement of court's rulings resulting from damage claims as a consequence of governmental economic decisions.

An additional effect to the former was that the Argentine government established a "renegotiation process" of public services contracts, in order to give relief to the negative impact of the implemented economic measures, but prevented the companies who have begun litigation proceedings before local courts or arbitration from participating in this process, situation in which *BG Group* was already, who had relied on article 8 (request for arbitration) of the Bilateral Investment Treaty agreed by the United Kingdom and Argentina since 1990 ("BIT"), and that was the cause that discriminated against the claimant to benefit from the renegotiation process referred to above.

The obstacle to go to the national authorities to resist the measures taken by Argentina drove *BG Group* to begin an arbitration process under article 8 of the BIT before UNCITRAL.³

B. CLAIMS OF BG GROUP

The British company claimed that the measures of the Argentine government (legal and administrative-regulatory) breached the provisions of the BIT and ignored Argentina's

³ One should recall that Argentina is not a subscriber of the Washington Convention establishing ICSID arbitration, of the World Bank.

obligation to provide treatment in accordance to international law and *de facto* expropriate their rights as an investor, guaranteed by the Treaty itself.

In particular, *BG Group* argued that Argentina breached the fair and equitable treatment that was required to provide, as well as of the legitimate expectations it yearned to obtain from its investment which led to a lack of protection and security of its rights and the erosion of its investment rights constituting an indirect or *de facto* expropriation of its investment.

The obstacle established by the Argentine's measures to exhaust the domestic remedies, as its proceedings were suspended for 18 months, left *BG Group* without any option, finding in investment arbitration the only alternative to remedy the damage caused by the Argentina's intern measures.

C. ARGUMENTS OF ARGENTINE

Argentina's defense was based on denying the investor claims, but did not recognize the jurisdiction of the arbitral tribunal to resolve this dispute in particular.

For Argentina, *BG Group* should have exhausted domestic remedies before initiating arbitration. The decision of the company from London did not involve Argentina in the process, as the government never agreed to arbitration under the Arbitration Rules of UNCITRAL.

III. THE ARBITRAL DECISION

B. DEPLETION OF NATIONAL INSTANCE

The arbitral tribunal issued its award in 2007. Briefly, the tribunal ruled as follows:

- a) Admitted jurisdiction over the dispute; and
- b) Decided that *BG Group* was an investor under the BIT and their interests could be considered as investments, also based in the BIT.

In the opinion of the arbitral tribunal, the Argentine argument to exhaust domestic instances prior the request of arbitration, when there was a prohibition to recourse to the Argentine courts for a period of 18 months, was itself an unsound, as well as forcing *BG Group* to do so would have been an irrational decision.

For the arbitral tribunal, Argentina did not indirectly expropriated the investment rights of claimant, although Argentina denied fair and equitable treatment, reason enough to condemn Argentina to pay \$185 million to *BG Group* for damages.

IV. UNITED STATES TRIBUNALS

A. RECOGNITION AND ENFORCEMENT. FEDERAL COURTS

The United States federal courts had knowledge of the controversy in 2008, since the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards, provides that the parties in arbitration proceedings may apply at any signatory State to enforce the award validly issued by an arbitral tribunal, as it is also provided by the *United States Federal Arbitration Act*. Article 1 paragraph 1 of the New York Convention provides:

Article 1

1. This convention shall apply to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought, and arising out of differences between persons, whether physical or legal. It shall also apply to arbitral awards not considered as domestic awards in the State where the recognition and enforcement are sought.

BG Group sought to confirm the decision in arbitration, while Argentina sought to withdraw the decision made by the arbitration for the same previously reasons.

The Columbia District Court denied the claim of Argentina and confirmed the arbitration award, but the Court of Appeals of the Circuit of Colombia reversed the decision of the District Court.

The the Court of Appeals ruled that the interpretation and application of Article 8 of the BIT was a matter that concerned to Argentina's local courts to solve *de novo*, and was not a matter that arbitral tribunals should had solved "by deference". For the Court of Appeals, *BG Group* should have exhausted the domestic instance and wait for 18 months to initiate arbitration; meaning that, the special circumstances of the situation in Argentina did not exclude the requirement to exhaust the local instance.

B. SUPREME COURT OF THE UNITED STATES. MAJORITY OPINION

The Supreme Court of the United States assumed jurisdiction to define very specific issues of the dispute, but not before taking into account that the merits belongs to the arbitral tribunal.

The question was: should the Court analyze the decision of the arbitral tribunal as a matter *de novo*, or should apply the deference principle towards the tribunal?

To answer, the Court identifies the BIT with private contractual relations (which in itself is controversial from the perspective of the law of treaties, but being an ancillary matter it is not part of this analysis), arguing that if the controversy were about a contract, the merits of the dispute would correspond to the arbitral tribunal, situation that does not change in essence speaking about an international treaty.

As consequence of this first analysis, the Court asks whether the parties are bound by an arbitration clause, or if this clause is in the BIT itself. To bolster its argument the Court went to previous cases in which it was ruled that Court is competent to find whether the parties had decided to arbitrate or not when that was not apparently clear and unmistakable from the agreement. Being a matter of procedure rather than substance, the matter should be resolved by the Court and never by the arbitral tribunal itself.

This is precisely the substance of the dispute. For the Court, Article 8 of the BIT provides that only the merits of the dispute are matter of arbitration, not the submission to arbitration, because it is a procedural provision.

Although the Court agreed that consent to arbitration is a sovereign decision from the States, it is also true that this consent may be given since the signature of the BIT. But for practical purposes of this case, interpretation must be within the meaning that the parties, regardless of their sovereignty, tried to give full authority to the arbitral tribunal to rule on the contract provisions giving rise to arbitration, *i.e.* the BIT.

According to the opinion of the Court, the arbitral tribunal decided three important issues:

- a) Article 8 of the BIT cannot constitute an impediment to submit to arbitration;
- b) By enacting some laws, Argentina hindered the use of local courts by those affected in their business or investment rights by the emergency measures that tried to prevent judicial interference; and
- c) For all the foregoing, it would be flawed and unreasonable to interpret Article 8 of the BIT requiring to go to local procedures before applying for arbitration. If so, it could be understood that Argentina could even prohibit arbitration by enacting laws that would prevent recourse to the local courts under certain circumstances or prohibiting that foreign investors use their local courts systems.

For Argentina, no circumstance is enough for investors to avoid submitting to the national courts before initiating arbitration, as it is a requirement under Article 8 of the BIT.

C. CONCURRING OPINION

Justice Sotomayor issued a concurring opinion with the formal decision of the Court. According to her, arbitration is a matter of “consent”, which must be expressed in a manner that there is no doubt about it.

For Justice Sotomayor, the BIT is not an express agreement to arbitration previously determined by parties, but an open offer to arbitration by the host State towards an undetermined entity. The reason for this is that the parties could not give, using a silent or tacit mechanism, a submission to arbitration under the BIT because that would imply that the Treaty is hierarchically subordinated to the decision of a local court that determines this submission.

She agrees with the majority opinion, however, differs on the precondition that going to local courts before initiating arbitration is a matter that must be interpreted by the arbitrator (as deference) and not by a local court (*de novo*).

D. DISSENTING OPINION

Two justices (Roberts and Kennedy) presented their dissenting opinion, based on the following arguments:

For them, the majority is wrong for starting the discussion equating the relationship giving rise to the dispute to a contract between individuals, when it is about a treaty between “sovereign nations”: United Kingdom and Argentina. No individual participated in signing the Treaty, signed since 1990.

The BIT, by itself cannot be regarded as an agreement to arbitration for the simple reason that there were no investors involved in the execution of this agreement. In the absence of an express agreement to arbitration, *BG Group* should have resorted to local courts after waiting the 18 months provide by the Argentine measures and only if the circumstances of the claim persisted.

Article 8 of the BIT is a unilateral offer to arbitration, which could be accepted by the investor if it meets the requirements established in this provision. Not interpreting it this way, would mean that Argentina had entered into an arbitration agreement with any potential investor in the United Kingdom, in addition to *BG Group*.

This would be an erroneous interpretation of Article 8 because it would be like assuming that a sovereign nation is permanently subject to the will of individuals attempting to sue in international courts that can be seated anywhere in the world.

The submission to arbitration, in accordance with this dissenting opinion, can occur if you take any of the options set forth in Article 8 of the BIT, which incorporates a settlement procedure more complex than a simple arbitration clause. According to this

article, to go to arbitration the investor should have waited: a) 18 months after the claim filing before the host State courts had elapsed and the court had not decided in a final manner; or b) once the domestic court have ruled and the parties continue in dispute. In either case, the domestic route is unavoidable. There is a third way that does not requires to recourse to domestic courts, but requires the express agreement to arbitration from the host State and the investor, which is not relevant to this case.

Arbitration, in their view, is a process by which States' public policies are reviewed and arbitral decision may annul acts of authority derived from any law, from an administrative act and from a court ruling, which cannot be taken lightly.

Moreover, the dissenting opinion considers that the requirement to attend the local courts is not a mere formality, but a fundamental issue that shall be interpreted by a local court *de novo*. If it were not so, the parties in arbitration would submit to the decision of an arbitral tribunal if they are subject to arbitration or not, which never happens. It reinforces the argument, if we add that arbitrators cannot be considered more expert to settle a dispute than national judges.

V. ANALYSIS

The Supreme Court of the United States of America in its majority opinion, as in its concurrent and dissident opinions established criteria that contribute to the discussion of several controversial issues in the investment arbitration world. On the one hand, the consent to arbitration as matter that belongs to national courts to decide *de novo*, but without losing the precedence that is owed to the arbitral tribunal to rule on merits of the dispute.

The substantive discussion is whether the States, when subscribing a free trade agreement or a bilateral investment treaty (BIT), agree by the same act the submission to arbitration, or if a subsequent act is required to formalize that submission. The majority opinion supports this submission from the same moment of signing the treaty, but the dissident opinion has an argument that has been supported by many States for long time. The formalization of this consent would need to be as clear as possible, as required by arbitration in its origin, the inclusion of an arbitration clause in a treaty cannot be regarded as a dead letter in the treaty, but a manifest intention of the subscribing parties to submit their disputes to an institution independent from domestic courts and tribunals. The debate on this issue does not end with this analysis, but rather, revives the conflict positions on the issue.

Another relevant aspect of Court's analysis and conclusion was about the impossibility *de iure* and *de facto* that a government impede access to arbitration by enacting laws and administrative decisions. To conclude otherwise would tantamount to reversing the spirit of arbitration as an alternative mechanism to States' settlement of disputes procedures.

The court decided to determine a limit over the arbitrability of a dispute. The Court ruled that the submission to arbitration cannot be an arbitrable issue (the substance of the dispute is arbitrable, and that is an indisputable fact) because it is a contradiction in itself. This shall not be confused with the power of the court to decide on its own jurisdiction (*kompetenz-kompetenz*), which is not in debate.

What stands out of the argument is the fact that if there is submission to arbitration or not, is something beyond arbitral jurisdiction, because it would be absurd that a tribunal, of which its valid existence is under dispute, had in its hands this decision. In this matter is different to discuss about jurisdiction than about competence. The arbitrator can decide his own competence in a dispute only when arbitration has formally begun, therefore the Court assumes that the local courts are the only indicated to resolve this issue (*de novo*) and the arbitral tribunal will have to decide on the merits of the dispute (precedence).

In Court's dissident opinion, over the former's accessory issue, goes in the same direction of the United States general opinion over arbitration. For the dissenters, arbitrators are not qualified enough (as experts) to leave on their hands the decision in which a sovereign State is involved, at least not as qualified as judges may be.

VI. CONCLUSION

This decision, besides solving the over validity of their decisions, it raises serious questions about the desirability of arbitration as an alternative protection against governmental violation acts. First, there is little to say about the speed of arbitration. Thirteen years after the first damages to *BG Group* a ruling in their favor is issued. Prompt and expeditious justice? It is doubtful, at least. If to this is added that, even worse, it is still necessary that Argentina complies with the ruling.

Putting aside the above, the majority decision clearly strengthens the investment rights and hits the State's sovereign freedom to react politically and legally before a (economic, in this case) crisis. Investment rights, protected by a BIT or by a free trade agreement, remain as the best way to attract the confidence of foreign investors to other countries, although they have not a guarantee against violations of their rights, nor are insurance policies for its investments.

The support given by the United States Supreme Court to investment arbitration is, at the same time, a way to strengthen the domestic jurisdiction and demonstrates a less local justice before global problems. A dispute between an English investor and a sovereign State, which is resolved in three different courts of of a third State, is a clear example of the effects of legal globalization.

The argument that the Court makes should not be understood as a form to handover States' sovereignty to a foreign court, but it is precisely with the intervention of the local court that the administration of justice, objectivity, independence and the protection of legal, economic and financial values can be strengthen.

Consent to arbitration has found, as a result of this decision, new ways to define its limits, especially in regard to clauses at the BIT's.

International treaties are not contracts, as initially the Court tried to explain, and this unfortunate comparison can tempt to criticize the entire work of the Court, which would be a mistake. The comparison was intended to highlight the expression of consent in a legal transaction, but never sought to equate the two legal relationships in the same hierarchical level.

What is certain, after analyzing this decision, is that the debate on access to and effectiveness of arbitration decisions, are issues that will continue to be discussed in these and other forums. For now, this decision must be taken as another element that contributes to the debate on arbitration, fair and equitable treatment of investors and investments and, in general, the global dispute settlement mechanism.

