A Cotonou Investment Agreement

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Executive Summary

Foreign direct investment is central to the attainment of the goals of the Cotonou Partnership Agreement (CPA). A Cotonou Investment Agreement is needed to amplify investment provisions of the CPA to identify the full range of issues that need to be addressed to ensure that a Cotonou Investment Agreement promotes the objectives of the CPA.

Existing international investment agreements provide limited guidance for the development of a Cotonou Investment Agreement. Their focus is too narrow, limited primarily to investor protection, which is but one item on the investment agenda. Moreover there is no empirical evidence that such limited agreements have generated benefits for developing countries.

A Cotonou Investment Agreement must explicitly identify its objectives: to increase long term foreign investment into the ACP countries for activities that promote the sustainable development goals of the host country, consistent with the CPA.

A Cotonou Investment Agreement must incorporate the essential principles of investment policy:

- Balance between investor rights, development objectives and the protection of public goods
- Legitimacy;
- Transparency;
- Accountability.

These principles apply at the domestic and international levels alike. The Agreement must provide specific rewards for actions that are consistent with these principles.

A Cotonou Investment Agreement must address host state rights and obligations, home state rights and obligations, and investor rights and obligations. It must create a
framework within which these rights and obligations can be balanced in a manner that is legitimate, transparent, and accountable.

Results of a Cotonou Investment Agreement must be monitored on a continuing basis in relation to its objectives. The Agreement must develop criteria for monitoring and include commitments from all parties to take the necessary measures to improve performance if necessary. To this end it will need to create an Observatory for ACP Investment, which reports to the Council of Ministers and the Joint Parliamentary Committee.

The agenda of good governance that is incorporated into the CPA represents a significant asset for a Cotonou Investment Agreement. It needs to be further developed to meet the requirements of investment. In countries with proven governance investors must exhaust domestic remedies before turning to international institutions. International dispute settlement must show proper deference to goals of public policy that have been arrived at in accordance with the principles of the Agreement.

The Investment Agreement must address the problems of small and vulnerable economies (SVEs), in particular through the Cotonou Investment Fund mentioned below.

The Cotonou Investment Agreement must be rooted in the regional institutions envisaged by the CPA. Regional markets can improve the conditions for investment and regional institutions, for example for competition, environmental management, or judicial review can represent a more effective use of limited financial and human resources. The Investment Agreement must include a commitment on the part of the European Union and Member states to contribute actively to this process by providing financial support and capacity building.

An Investment Agreement needs dispute settlement that conforms to the above principles. Current models of arbitration do not meet these criteria. The Investment Agreement must create the necessary institutions.
The Partners of the CPA are parties to numerous bilateral investment treaties (BITs). The Cotonou Investment Agreement must replace these BITs or ensure that they are consistent with the Agreement and its objectives and principles.

A Cotonou Investment Fund will be needed to ensure that the goals of an Investment Agreement are met. The Fund will provide direct and indirect funding for investment projects giving priority to small and medium enterprise likely to contribute to the development goals of the ACP countries.

A Cotonou Investment Agreement must advance the sustainable development goals of the CPA in an effective manner. The CPA is in many ways the ideal environment for the conclusion of such an innovative investment agreement because it includes all the key actors on both sides and has already taken steps towards the creation of a facilitating institutional environment.
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1. Investment in the Cotonou Agreement

Foreign direct investment (FDI) is central to the attainment of the goals of the Cotonou Partnership Agreement (CPA). Yet little is known about what is necessary to ensure FDI. At one level, investment decisions are a matter of the relationship between risk and return, given the constraints of capital, which is in limited supply in most developing countries. Governments can act to create perfect institutional conditions for FDI, and no FDI flows, for lack of infrastructure, markets or needed private institutions. Infrastructure may be constructed and no FDI flows. International Financial Institutions can provide support to improve the risk/return relationships, and no FDI flows. Bilateral investment agreements may have been concluded, and no FDI flows. Skilled labor may be available at modest cost, and still no FDI flows. At the same time, FDI may flow towards countries with problematic institutions and limited infrastructure. It would appear that the desire to attract FDI is marked by numerous necessary conditions, none of which are sufficient in themselves to attract FDI, making the conclusion of investment agreements a problematic undertaking from the perspective of developing countries1.

A Cotonou Investment Agreement must create the institutional framework to address all these conditions, and must be sufficiently flexible to be able to learn from experience and to pursue its objectives in light of changing circumstances.

Art. 75 and 76 CPA cover Investment Promotion, Art. 77 concerns Investment Guarantees, and Art. 78 covers Investment Protection2. Art 78 states: The Parties “affirm the importance of concluding, in their mutual interest, investment promotion and protection agreements3 which could also provide the basis for insurance and guarantee schemes.” This is the only mention of “investment agreements” in the CPA.

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2 The provisions of Art 78 are further elaborated in Annex II, Art. 15 (see below the discussion on BITs)
3 The use of the plural leaves the relationship between multilateral, regional, and universal agreements within the Cotonou framework intentionally ambiguous.
Much of the detail concerning investment financing is transferred into Annex II, including provisions for an Investment Facility. Strangely neither the Agreement nor its Annexes actually contain any explicit text establishing this facility nor do they specify the Facility’s purpose. The Facility simply exists and Annex II Chapter 1 Article 2 then addresses the “Resources of the Investment Facility” and enumerates uses that are permitted. This rather cavalier approach suggests that the Facility is a body controlled by the EU and its Member States and not a joint enterprise of the Cotonou partners.

All of this suggests that the CPA retains some ambiguities on the issue of investment that need clarification—for example through an Investment Agreement. To help achieve the development goals of the CPA, such an Agreement must be properly integrated with all parts of the CPA that relate to investment, and not only those addressed in Art 78.

Large parts of the CPA text are derived from its predecessor, the Lomé IVbis Agreement. This is not the place to undertake an analysis of the evolution from Lomé IVbis to Cotonou but it is worth noting some of the salient points:

- The provisions on investment promotion have evolved noticeably. In this area the addition of the EU Member States has significantly enlarged the domain that can be covered, as reflected by the reference to the “respective competences” of the partners. The text presumably reflects significant drafting effort

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4 Annex I on Financing allocates 2,200 million euros to the Investment Facility, referring back to Annex II for terms and conditions.
6 The inclusion of the Member states in CPA is particularly significant for the issue of investment. The EU Treaties do not assign competence for international investment negotiations to the Union. Indeed, negotiations for a Multilateral Agreement on Investment initially did not include the European commission. During the negotiations for the Nice Treaty (the most recent amendment of the EU Treaties, the commission proposed the inclusion of investment in Art. 133, which governs trade and trade negotiations. That proposal was not adopted, yet the pursuit of investment negotiations in the WTO is likely to have the same ultimate effect. For now, however, the participation of the Member states is essential if a Cotonou Investment Agreement is to have the required coverage.
- In general, the investment promotion efforts listed in Art. 75 CPA are couched in facilitating language, using terms such as “encourage,” “help,” “facilitate,” “support,” “disseminate,” and “promote.”

- Lomé IVbis included a commitment on the part of the Community to provide certain assistance\(^7\). This commitment has been dropped in Cotonou, presumably because it reflected a conception of investment that was essentially identical to development projects.

- The provisions on investment financing have been moved to an Annex.\(^8\) The creation of the Investment Facility is the most significant innovation—yet without any proper definition of the Facility’s governance or mandate, other than that the ACP-EC Development Finance Committee “shall examine the operations deployed within the framework of this Agreement to attain the objectives of promoting private sector development\(^9\) and investment and the operations of the Investment Facility.”

When it comes to Title I (Development Strategies), Investment and Private Sector Development is the first substantive issue raised. The relevant Article 21 is an initial road map for an investment agreement. Yet in the section devoted to Economic and Trade Cooperation, investment does not find a clear location in the text. This Section is structured to promote conformity between CPA and the World Trade Organisation (WTO). It reflects continuing lack of clarity concerning the status and extent of investment negotiations in the World Trade Organisation (WTO). On the one hand,

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\(^7\) Art. 259:
(f) provide assistance to ACP States in:
  i. creating or strengthening the ACP States’ capacity to improve the quality of feasibility studies and the preparation of projects in order that appropriate economic and financial conclusions might be drawn,
  ii. producing integrated project management mechanisms covering the entire project development cycle within the framework of the development programme of the State.”

\(^8\) Te Velde and Bilal p.3:“The main reason for relegating some investment provisions in Annex II rests on the issue of competence, investment falling also under the competence of the EU member states and not only the European Commission. This therefore limits the scope of the Commission to initiate investment related programmes, which depend on the member states too”

\(^9\) “Private sector development and investment” are not mentioned explicitly as objectives in Article 1 nor as Principles in Article 2 of the CPA. Rather Article 1 identifies them as means when it states “The partnership shall provide a coherent support framework for the development strategies adopted by each
investment is viewed as integral to trade policy so that reference to “trade” may have been perceived as encompassing “investment.” On the other it represents a significant area of law and policy in its own right, requiring extensive development beyond the framework created by trade in goods (or trade in services for that matter). From the latter perspective, investment could readily be viewed as a “trade-related” area—like intellectual property rights, competition, environment, labour rights, or consumer policy and protection. In the end, the issue is largely absent from Title II (Economic and Trade Cooperation), perhaps reflecting the diversity of views between the parties on the issue of investment in the WTO at the time of concluding the CPA.

The overarching objective of the Cotonou Partnership Agreement (CPA), set out in Article 1, is described as follows: “The partnership (of the European Community and its Member States and the ACP States) shall be centered on the objective of reducing and eventually eradicating poverty consistent with the objectives of sustainable development and the gradual integration of the ACP countries into the world economy.” In practice policies to promote this integration—including measures concerning investment—are the principal tools to achieve the two first objectives.

The CPA also is highly explicit on the issue of good governance, a matter of vital concern from the perspective of investment and a fundamental condition of any Cotonou Investment Agreement. This renders the CPA uniquely appropriate for the conclusion of an investment agreement—provided this agreement reflects all the goals of the CPA in an appropriate manner.

Among the Articles that explicitly mention good governance are:

ACP State. Sustained economic growth, developing the private sector, increasing employment and improving access to productive resources shall all be part of this framework.”


11 See page 25ff. below
Preamble: ACKNOWLEDGING that a political environment guaranteeing peace, security and stability, respect for human rights, democratic principles and the rule of law, and good governance is part and parcel of long term development; acknowledging that responsibility for establishing such an environment rests primarily with the countries concerned…

Article 8 (Political Dialogue): “The dialogue shall focus on specific political issues of mutual concern of general significance for the attainment of the objectives of this Agreement, such as the arms trade, excessive military expenditure, drugs and organised crime, or ethnic, religious or racial discrimination. The dialogue shall also encompass a regular assessment of the developments concerning the respect for human rights, democratic principles, the rule of law and good governance.”

Article 9 (Essential Elements and Fundamental Element): “3. In the context of a political and institutional environment that upholds human rights, democratic principles and the rule of law, good governance is the transparent and accountable management of human, natural, economic and financial resources for the purposes of equitable and sustainable development. It entails clear decision-making procedures at the level of public authorities, transparent and accountable institutions, the primacy of law in the management and distribution of resources and capacity building for elaborating and implementing measures aimed in particular at preventing and combating corruption.

Good governance, which underpins the ACP-EU Partnership, shall underpin the domestic and international policies of the Parties and constitute a fundamental element of this Agreement. The Parties agree that only serious cases of corruption, including acts of bribery leading to such corruption, as defined in Article 97 constitute a violation of that element.

4. The Partnership shall actively support the promotion of human rights, processes of democratisation, consolidation of the rule of law, and good governance. These areas will be an important subject for the political dialogue. In the context of this dialogue, the Parties shall attach particular importance to the changes
under way and to the continuity of the progress achieved. This regular assessment shall take into account each country’s economic, social, cultural and historical context.
These areas shall be the focus of support for development strategies. The Community shall provide support for political, institutional and legal reforms and for building capacity of public and private actors and civil society in the framework of strategies agreed jointly between the State concerned and the Community.”

Article 20 (The Approach): “The objectives of ACP-EC development cooperation shall be pursued through integrated strategies that incorporate social, cultural, environmental and institutional elements that must be locally owned. Cooperation shall thus provide a coherent enabling framework of support to the ACP’s own development strategies, ensuring complementarity and interaction between the various elements. In this context and within the framework of development policies and reforms pursued by the ACP States, ACP-EC cooperation strategies shall aim at:
(a) achieving rapid and sustained job-creating economic growth, developing the private sector, increasing employment, improving access to productive economic activities and resources, and fostering regional cooperation and integration
(b) promoting human and social development to ensure that the fruits of growth are widely and equitably shared and promoting gender equality;
(c) promoting cultural values of communities and specific interactions with economic, political and social elements;
(d) promoting institutional reforms and development, strengthening the institutions necessary for the consolidation of democracy, good governance and for efficient and competitive market economies; and building capacity for development and partnership; and
(e) promoting environmental sustainability, regeneration and best practices, and the preservation of [the] natural resource base.”
This should provide a strong framework for any investment agreement, provided the partners actually meant what they signed. In particular the definition of “good governance” to be found in Article 9.3 is as clear an articulation of the principles that must govern any international investment agreement as can be found in any current international treaty.

2. International Investment Agreements

2.1. Existing Agreements. For many years, investment has been part of the international negotiating agenda, and for many years it has proven difficult to negotiate agreements on investment. The attempt to forge international investment agreements gave rise to two of the most controversial economic negotiations to date, the UN Center for Transnational Corporations (UNCTNC) Code of Conduct on Transnational Corporations and the Multilateral Agreement on Investment (MAI). Both negotiations had to be abandoned following the emergence of significant opposition. The difficulties encountered in negotiating any global investment agreements suggest that the task is more difficult than most negotiators expected. As a result existing investment agreements are widely dispersed.

Some international investment agreements were negotiated to meet a specific need. Some appear to have been concluded with no real purpose in mind, simply because a senior politician visited a developing country and an investment agreement seemed like a harmless thing to do. Initially, developed countries sought to protect investments of their nationals, in particular in recently decolonized countries. The resulting bilateral investment treaties (BITs) focussed on investor protection. The UNCTNC effort sought to counterbalance this single focus by developing a global agreement on investor

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responsibilities. It is by now widely recognized that a binding global agreement on investor responsibility is impossible because the range of issues that must be covered is very large and some of these issues require highly specific local adaptation. A universal agreement thus runs the risk of drowning in specifics or remaining at a relatively meaningless level of generality. Nevertheless the issue of investor responsibility remains an important part of any balanced investment negotiation. The issue of investor responsibilities is a serious one, and even if it is not amenable to traditional treaty approaches it still needs to be addressed. The current debate is shifting towards a balance between voluntary measures and the need to create a facilitative environment by means of legally binding instruments.

Several regional agreements include investment provisions. The EU Treaties cover investment in numerous ways, but never as a singular topic, suggesting that the complexity of the issue requires a much more differentiated approach than is possible in most agreements. The North American Free Trade Agreement (NAFTA) contains the highly developed investment provisions in its Chapter 11. These provisions have given rise to significant difficulties of implementation\(^\text{16}\). The Mercosur Treaty establishing the common market of the Southern cone countries of South America also includes a chapter on investment but this appears to have been drafted so as to have little discernible effect since it has not been put into effect for lack of the necessary ratifications.

Several agreements include investment provisions because these are essential for the accomplishment of their goals. The Energy Charter Treaty is designed to create a framework for investment in the energy sector of the countries of Central and Eastern Europe. It contains investor protection provisions that are modeled on the BITs. The General Agreement on Trade in Services (GATS)—one of the agreements that make up the WTO—also covers investments that are necessary, in particular for the delivery of services in the host country. The GATS is a “bottom up” agreement, that is it covers only services that have been explicitly listed by the respective countries (rather than “top

\(^{15}\) Personal communication from a Canadian diplomat.

\(^{16}\) International Institute for Sustainable Development, Private Rights
down” like the MAI, involving a universal agreement that permits countries to register exceptions).

Whether to negotiate a broad multilateral agreement on investment was already a contentious issue during the Uruguay Round. The resulting texts represented, much like the rest of the Uruguay Round agreements, a compromise. Two of the Uruguay Round agreements deal with investment issues, the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related Investment Measures (TRIMS). While they do not represent a coherent or a comprehensive approach to investment issues they are a bridgehead for investment issues within the WTO.

The GATS incorporates rules on investment because it is impossible to deal with trade in services without addressing related issues of investment. The TRIMS agreement is intended as a first step towards a much more comprehensive agreement on investment. This difference of approach reflects differences in the relationship between investment rules and trade in services on the one hand and trade in goods on the other. Certain aspects of the trade in services cannot be adequately addressed without including some rules on investments related to those services, in other words the investment rules of the GATS are there because they are needed. The relationship between investment and trade in goods is much more tenuous. Clearly foreign direct investment (FDI) and trade in goods are related: much FDI is undertaken to facilitate trade, or to replace trade. Yet for forty years, the GATT/WTO addressed trade in goods without dealing with investment matters. This suggests powerfully that dealing with investment matters is not a necessary condition for accomplishing the goals of trade liberalization. The GATS investment rules and the TRIMS reflect these differences in their relationship to the underlying liberalization objectives.

The word “investment” occurs but twice in the GATS: in Article XVI on (Market Access), a provision prohibiting limitations, in sectors where market-access commitments

are undertaken, on the participation of foreign capital in terms of aggregate foreign investment and again in an annex on financial services and in a definition of asset management contained in an annex on financial services. In other words the investment provisions of the GATS are subsidiary to its provisions liberalizing trade in services and are designed to avoid hidden protectionism and to protect investments that are an integral part of a service such as banking or transport. As such these investment provisions are also subject to Article XII (Restrictions to Safeguard the Balance of Payments) and Article XIV (General Exceptions), which have no equivalent in most investment agreements. The investment implications of the GATS are largely derived from the key definition of Article I.2, which identifies the “modes” of supply of services. Several of these imply a significant presence in the country where the service is provided and consequently provide the basic protections of the GATS to the investments that are an integral part of this presence. Consequently the investment provisions of GATS bear little or no resemblance to the provisions that are typically found in investment agreements and in the TRIMS agreement in particular. Indeed, an argument can be made that the investment provisions of GATS, embedded as they are in a broader context providing for a considered balancing of rights and obligations represent a more appropriate form of investment agreement than most bilateral investment treaties. CPA Article 41 (Trade in Services) explicitly references the GATS Agreement and consequently includes an implicit commitment on investment. But this aspect of investment in the CPA does not need to be addressed in a Cotonou Investment Agreement since it is liable to be negotiated as the various parties move to augment their respective schedules of covered services under the GATS, a process that has no independent equivalent in the CPA.

The TRIMS Agreement is a fairly obscure document, resulting from the desire of some countries to go much further in the direction of a multilateral\(^{18}\) agreement on investment and the resistance of other countries to any agreement on investment within the framework of the WTO. The TRIMS Agreement is not an independent agreement, such as GATS, or the Agreement on Trade Related Property Rights (TRIPS), but forms part of

\(^{18}\) The term “multilateral” is used in the sense of the trade regime, where it is taken as synonymous with “global” or “universal,” rather than in its strict sense, which means “more than two countries.”
the GATT, like the Agreement on Agriculture. Its operative provisions are contained in a single sentence of Art 2.1: “Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent the provisions of Article III or Article XI of GATT 1994.” The TRIMS Agreement is also explicitly subject to the exceptions of GATT Art. XX (TRIMS Art. 3). The TRIMS Agreement can be read as stating that investment measures may not be used to circumvent national treatment or the ban on quantitative measures. It can also be read more broadly as establishing an independent obligation upon Members concerning their treatment of investment that happens to be defined with reference to the text of the GATT. The TRIMS Agreement is notable for its lack of any reference to most-favored nation treatment (MFN) and by the lack of any definition of either “investment” or “trade-related investment.” An Annex provide an “illustrative list” of TRIMS that are inconsistent with Article III or Article XI of the GATT. In the terminology of international investment agreements, the measures that are listed in the Annex are “performance requirements.”

This is not the place to discuss the appropriateness of further negotiations on investment in the WTO. The essential point is that the CPA with its focus on development and its comprehensive approach to institutional development and good governance provides an ideal environment for negotiating an investment agreement that contributes to its goals. What is currently proposed for the WTO is a sparse agreement of uncertain significance in terms of economic growth and development, let alone sustainable development.

Following the collapse of the MAI negotiations in 1998 there has been renewed activity on investment negotiations in other fora. The number of BITs has increased rapidly and a significant number of on-going negotiations include investment provisions. There are consequently more than two thousand investment agreements that have been concluded and at least ten distinct negotiations on investment (other than BITs) that can be identified. The resulting picture is ambiguous at best. While there appears to be interest in negotiating investment agreements there is still no consensus as to the provisions that should be included in such agreements. Most of the existing agreements are built around
the protection of investor rights. There is no evidence that this provides benefits from the perspective of development. Consequently agreements that are designed to support development—for example a Cotonou Investment Agreement—will need to be constructed along lines that are markedly different from those of most existing investment agreements.

Economic assessments of investment agreements are hard to come by. All that can be done is to look at investment flows and to attempt to relate these to investment agreements, and vice versa. The evidence in this regard is striking. No empirical evidence has thus far been found to suggest that existing investment agreements have economic benefits for the developing country. Indeed, two of the three developing countries that attract most foreign direct investment—Brazil, and Mexico—happen to be the countries with the fewest investment agreements, in the case of Brazil none. China, the leader in FDI among developing countries, has bilateral investment treaties but they are not known to have played any role in attracting investment to China. Not coincidentally these three countries also offer a large and dynamic market for goods and services. The case of Mexico is particularly striking. NAFTA led to a dramatic increase in foreign direct investment in Mexico, but much of this increase was attributable to investment from non-NAFTA countries whose investors did not benefit from NAFTA Chapter 11. It must be assumed that because of NAFTA these investors viewed Mexico as a desirable platform from which to supply the North American market—and that NAFTA as a whole signaled Mexico’s intent to back off from practices expressing hostility to foreign investment. It appears that a combination of factors are at play in attracting foreign investment: an accessible market for the goods and services that are to be produced; traditional advantages in terms of the production of these goods, such as access to inputs, availability and price of labor relative to its productivity, communications and transport infrastructure; transparent rules governing investment and institutions to implement them in a fair and equitable manner. An international investment agreement like the BITs or such as envisaged by the MAI is not normally identified as a key requirement for the attraction of foreign investment. The promotion of foreign direct investment consequently requires a combination of traditional economic and reputational factors.
2.2. **Current International Negotiations on Investment.**

For more than fifteen years, efforts have been under way to include an agreement on investment in the Uruguay Round agreements and subsequently in the WTO. These efforts encountered opposition at the first Ministerial meeting of the WTO, held in Singapore. The Doha Ministerial, however, appears to have moved towards inclusion of investment in the agenda for a new round. The language of the Doha declaration is somewhat ambiguous, stating “we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations.” Apart from the unusual turn of phrase “by explicit consensus,” which had no precedent in GATT/WTO usage\(^{19}\), this reads like a decision to go ahead with negotiations. Negotiations about “modalities,” in WTO parlance decisions on the extent and format of an agreement, are currently ongoing. The positions that have been articulated thus far are quite modest, seeking to establish a general framework on investment. The link between investment and development has been emphasized and may become the focus of serious attention in any subsequent negotiations. In truth, however, it is impossible to predict how far WTO negotiations on investment will go. Once launched, such negotiations can take many unexpected turns, just as the comprehensive Agreement on Trade Related Intellectual Property Rights (TRIPS) emerged from the Uruguay Round based on a fairly narrow mandate to address problems of piracy of intellectual property rights.

Investment is also an important part of the negotiations for a Free Trade Area of the Americas (FTAA), with NAFTA as the starting template. The investment provisions have already proven controversial even though it is too early to determine the likely outcome of this process.

A number of bilateral negotiations have also included investment, most notably the EU/Mercosur negotiations as well as all recent bilateral negotiations involving the United States or Canada (with Jordan, Chile, Singapore, and South Africa). While none of these

\(^{19}\) By contrast the term “consensus” is indeed defined in the WTO Agreement. Article IX.1, fn. 1.
negotiations appears to break new ground concerning the purpose and content of the agreements they do represent a slow evolution of the formulations on some of the key issues such as national treatment, most favored nation treatment, measures equivalent to expropriation, and international standards of treatment. There is widespread recognition that the dispute settlement institutions that have been used in most existing investment agreements represent a number of serious issues that will have to be attended to, even though none of the agreements actually takes a decisive step in that direction. Some of the most recent bilateral trade agreements involving the United States (with Chile and Singapore), neither of which have yet entered into force, include provisions for adaptation in case of new institutional developments in investor-state dispute settlement, such as the establishment of an Appellate Body.

The principal lesson to be drawn from the numerous existing investment agreements and the continuing negotiations on the subject is that no obvious template has emerged for these agreements. For many years, investment agreements were essentially agreements to protect foreign investors. Unlike trade in goods, which does not usually involve major issues of governance, investment deals with some of the most important goals of public policy: the process of economic development, community development, and the use of natural resources and environmental protection. In a more open world, the ability to attract investment has become one of the key determinants of economic success or failure. Constraints on the movement of capital have largely been lifted so that investment agreements now need to focus on the conditions of investment, taking into account the requirements of investors and the needs of host countries. The challenge is to identify measures that are suitable for inclusion in investment agreements that will help to achieve the development goals of the countries concerned.

3. What is the Purpose of an Investment Agreement in the Cotonou Framework?
Many existing investment agreements do not explicitly define the purpose that they seek to achieve.

The Multilateral Agreement on Investment identified no objective and contained no statement of purpose.

The Colonia Protocol to the Mercosur Treaty states that investment between the parties intensifies economic cooperation and accelerates the process of integration, implying that this is the objective of the Protocol.

The North American Free Trade Agreement states as an objective “to increase substantially investment opportunities in the three parties.” (Art. 102.1c), This language is also to be found in the Canada-Chile Free Trade Agreement.

Presumably the drafters of these agreements viewed their purpose as so self-evident as to not require specification. In many instances they were convinced that according to trade theory the process of liberalization itself generates growth. Yet investment is quite unlike trade (whether in goods or services). An investor acquires rights on the host country and presumably also assumes obligations, becoming an “economic citizen.” The investor seeks return on the investment; the host country seeks to increase its capital stock and to promote sustainable development by attracting investment. None of these outcomes flow automatically from international agreements designed only to liberalize capital flows and to protect foreign investors.

The practice of identifying the objective of an international agreement explicitly has a long and proud tradition. Without a statement of purpose it is obviously impossible to determine subsequently whether the agreement is achieving its goals. Moreover the lack of a clear identification of the objectives of an agreement leaves scope for

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20 This reflects widespread practice in liberalization agreements that tend to assume that desirable outcomes will flow from an agreement because of the economic benefits associated with liberalization. While such agreements may indeed promote aggregate economic growth, distributional issues become
misunderstanding. Such scope may be a creative drafting device in negotiations where one or more parties have an interest in obscuring the actual outcome. In an economic negotiation that is presumably designed to benefit all parties, such a practice is hard to justify.

The purpose of international investment agreements is not the liberalization of foreign direct investment. Unlike trade in goods or services, the international movement of capital is relatively unimpeded—and investment agreements are not designed to lift such obstacles, for example exchange rate controls, as may exist. Indeed, they may contain an exception that relates to changes in the capital markets\(^{21}\). The effect of such an exception is, however, to emphasize that no other exceptions have been included.

There has been some discussion about the type of investment to be covered by an investment agreement. “Portfolio” investment involves the acquisition of legal documents: derivative instruments such as shares, bonds, or more complex financial instruments, that represent rights that can be bought and sold without any change of ownership in the underlying economic activity. “Productive” investments involve facilities and enterprises that actually produce and sell goods or services. NAFTA has a particularly comprehensive definition of investment, and the case law has expanded this by creating a number of associated protected interests and assets with the result that many forms of trading activity may fall under its terms\(^{22}\). The Doha Agreement speaks of “long term” investments, grouping together most productive investments and a few portfolio investments that must be held for an extended period, that is are not negotiable within certain time limits. In practice portfolio investments and productive investments are significantly different, even though both can provide benefits to the host country. This report will focus on productive investments because of their particular importance from the perspective of development policy.

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more important as the issues covered become more complex. They are critical in an investment agreement that is designed to promote development.

21 NAFTA Art. 1102.  
Investors in productive investments acquire rights in the host country. In addition to property rights, they frequently require the right to hire and fire employees, to utilize public infrastructure, rights of access to the administrative services and courts of the host country, rights to use natural resources, and rights to discharge into the environment. It is in the nature of such rights that they entail certain obligations—to respect the laws governing employment, to pay taxes and charges, to obey administrative regulations and to operate within the framework of licenses that may have been obtained. In other words, foreign investors become economic citizens of the host country, raising the obvious questions concerning the conditions of such citizenship. It is the definition of these rights and the attendant obligations that has posed the greatest challenge to drafters of investment agreements since ultimately they impact the balance that has been struck in the host country between private rights and public goods, a balance that is often the result of many years of discussion, dispute, conflict, trial and error.

An investment agreement in the Cotonou context must contribute to the objectives of the CPA itself. Article 1 identifies the goals of the CPA as:
- to promote and expedite the economic, social and cultural development of the ACP states, with a view to contributing to peace and security and to promoting a stable and democratic political environment, and
- The Partnership shall be centered on the objective of reducing and eventually eradicating poverty consistent with the objective of sustainable development and the gradual integration of the ACP countries into the world economy.

An Investment Agreement must obviously conform to these objectives. Article 79 on investment does not further elaborate on this ambitious objective but an Investment Agreement needs to be significantly more explicit in how it will promote the core development objectives of the CPA, and must identify verifiable criteria to determine whether its objectives have been met. In this regard, a Cotonou Investment Agreement is likely to explore new ground, but in practice it may simply be addressing a range of
issues that any multilateral investment agreement must cover. Because of the specific characteristics of the CPA it represents a particularly suitable environment in which to undertake such a task.

It is hard to overstate the importance of investment in the attainment of the objectives of the CPA. Investment determines the future of any economy. Most ACP countries are characterized by low levels of investment and by negligible levels of foreign investment, which is frequently concentrated in one or two sectors, effectively contributing to an imbalance of the economy. The reasons for this are complex and require continuous monitoring and assessment. The first task of an Investment Agreement is to create a process that will reliably determine the causes of low investment and identify measures and policies (domestic, regional and within the Cotonou Partnership) that may contribute to paliating this situation. The Investment Agreement must contain a general commitment of the Parties to implement such measures and policies as they are identified. Indeed, such an undertaking is consistent with the letter and spirit of the Agreement.

A major challenge is the identification of criteria to establish whether the specific objectives of an Investment Agreement are being met. There are four core objectives: economic and cultural development, reduction of poverty, sustainable development, and integration of the ACP countries into the global economy. Each of these requires investment, and together they clearly require an increase in investment from current levels. Measures to ensure the quality of that investment is a matter to be considered in subsequent sections of this report. For the overall purposes of the Agreement, the key criterion is a demonstrable increase in investment, either domestic or foreign but attributable to policies adopted pursuant to the Agreement. Consequently the Agreement requires continuous monitoring of investment activity in ACP countries and a specific commitment by the Parties to measurable increases, presumably expressed in percentages and tied to the overall economic growth and development of all Parties.

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4. Issues in Framing an Investment Agreement

4.1. The Relationship Between an International Investment Agreement and Domestic Institutions.

Investment is of critical importance to all countries. Yet striking a balance between investor rights and public goods in a manner that is legitimate, transparent and accountable is a daunting task. Countries that have achieved a measure of equality before the law (“non-discrimination” in the language of international investment agreements) have also discovered just how difficult a task this is. In practice it requires all the institutions of governance to ensure that this crucial balance is struck in a fair and equitable manner. For productive investments, this frequently involves several licensing and permitting procedures as well as adequate safeguards for contracts between employers and employees, as well as the provision of infrastructure that may be needed for the successful operation of an investment. In most instances quite elaborate structures for citizen participation in decisions, for transparency, monitoring, reporting, and assessment are needed to ensure that all relevant points of view are taken into account. These countries have also found that a judiciary (“dispute settlement” in the language of international investment agreements) capable of ensuring fair and equitable treatment is essential to correct mistakes in the interpretation and application of the rules that will inevitably happen.

No country has been able to provide a safe and open environment for investment without a significant investment in domestic institutional capability. In a few, relatively rare, instances countries have been able to attract investment in the absence of such institutions, generally because of the prospect of extraordinary profits that justify the attendant risks or because investors perceive a need to position themselves for the future.

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24 This is of course also an issue in relation to the CPA itself, but the narrower focus of an Investment Agreement lends itself much more readily to the identification of objectives and related criteria.
development of the domestic economy and are willing to accept risks that would be unacceptable elsewhere.

The relationship between an international investment agreement that seeks to promote non-discrimination and the institutions that guarantee equality before the law is a complex one. On the one hand the existence of such domestic institutions is widely perceived as a necessary—but often not sufficient—condition for foreign direct investment. On the other hand, the provisions of an international investment agreement are liable to interact with the relevant domestic institutions in ways that must be anticipated and carefully considered as part of any negotiation.

The dilemma that the CPA faces is that some countries have met the requirements outlined above but still fail to attract significant levels of investment, often on account of their size and location. This is particularly the case for small and vulnerable economies (SVE).25

The institutional requirements outlined here—and that could be expected to become the subject of a Cotonou Investment Agreement—are not the same as so-called “home country measures (HCM)” that are also envisaged under both Lomé and CPA. The latter are more informational in nature and have tended to focus on the private institutions that are needed for investment, some of which could be provided at a regional level, and some of which could themselves be the object of investments within the Cotonou framework.26 HCMs include the provision of information on investment opportunities in host countries, provision of investment guarantees and insurance, provision of risk and venture capital, support to linkage promotion programmes and technical assistance to local firms, and aid to improve the economic fundamentals of host countries. These HCMs are covered by Articles 75-77 of the CPA. An Investment Agreement needs to supplement these provisions.

26 Te Velde and Bilal.
The CPA includes numerous Articles that envisage the development of the kind of institutions that are required to successfully manage productive investment. These are not, however, explicitly linked to investment but are rather part of the agenda of “good governance” that is just under the surface of the CPA.

“Good governance” is a front end issue, covered quite extensively in the early, more general articles of the CPA and not explicitly mentioned in the latter part and the annexes, which are more operational in nature. Nevertheless the emphasis on good governance is unambiguous and there have been a number of political declarations indicating an intent to link the actual flows of resources to demonstrations of performance in this area.

The existence of these provisions creates the possibility of an Investment Agreement that is appropriately rooted in the domestic institutional dimensions of investment. In this respect, the CPA represents a unique opportunity. No other international regime—except the European Union itself—does as much as the CPA to support the development of domestic conditions and institutions for investment. Consequently the CPA represents an ideal environment for an Investment Agreement, provided it is properly integrated with the goals and institutions of the CPA itself.

An Investment Agreement should, however, contribute to the further specification and operationalization of the relatively general provisions of the CPA itself. Indeed, the emphasis of the provisions of Article 21 are on enabling ACP countries to participate at the international level in the institutional framework that is typically created by investment agreements. Art. 21.1(d) emphasizes the development of mediation and arbitration institutions, but fails to identify the central importance of the judiciary in any investment regime.

It is striking to note that many of the provisions of Art. 22 (Macroeconomic and structural reforms and policies) will also support an effective domestic investment regime. This
underlines the extent to which investment touches upon all aspects of a country’s
development—and requires the active involvement of virtually all institutions of
governance.

The CPA also is characterized by its emphasis on good governance, itself a condition of
attracting significant and diversified foreign investment. In this manner, the CPA itself
creates a beneficial framework for an investment agreement, provided that these linkages
are recognized and acknowledged in the investment agreement and efforts are made to
ensure the full integration of the Investment Agreement with the CPA itself.

4.2. The Contribution of a Cotonou Investment Agreement.
A Cotonou Investment agreement can promote the development of domestic institutions
needed to address the public policy issues associated with investment—or it can serve to
undermine them. In addition to the provision of appropriate technical assistance and
capacity building, two principles are vital to ensure that international agreements do not
undermine domestic institutions: exhaustion of remedies and deference. This is one of the
areas where the partners face the challenge of operationalizing their proud words about
good governance. It needs to be recognized that this is one of the more difficult issues for
an investment negotiation agenda. Yet the emphasis of the CPA on good governance, as
well as the current attempts to develop criteria for the operationalization of this aspect of
the CPA again create opportunities in the CPA context that are much less likely to exist
elsewhere.

Exhaustion of Remedies. The principle of exhaustion of remedies assumes that domestic
institutions are capable of undertaking a fair and equitable balancing of the interests of
foreign investors against public goods. It does not provide an investor access to
international remedies until domestic options have been pursued. This assumes that such
domestic options will be fair and equitable and available in a timely manner. One of the
challenges to drafters of a Cotonou Investment Agreement is to develop criteria for the
capability of domestic institutions and to calibrate international remedies to this
capability. This challenge has already been identified in Article 9.4 CPA\textsuperscript{27}. In other words the requirements of an Investment Agreement mesh with those of the CPA itself. Where countries have proven institutions, investors should be required to take complaints to those institutions first. International remedies should only be available when domestic institutions have failed to act in a fair and equitable manner. The basic principle must be that the Investment Agreement serves to certify institutions that have a record of good performance and to create incentives to upgrade performance that has lagged.

The criteria for the existence of capable domestic institutions should presumably reflect historical experience, that is whether there is evidence of the performance of institutional functions, for example in licensing and permitting or in adjudication, in combination with a factor that reflects the expeditiousness of action\textsuperscript{28}. In other words, persistent delay should lower the barrier against the use of international remedies. It may be desirable to incorporate broadly available indicators for country level performance, for example concerning transparency and corruption, as part of the metric that is utilized in an Investment Agreement. The development of such criteria is a significant challenge—but it would also begin a process whereby commitments to “development” are subjected to standards reflecting substantive outcomes rather than remaining commitments of “best efforts,” with outcomes left indeterminate.

The dilemma faced by all countries is the fact that even the best institutions are fallible. The traditional response has been to introduce a sufficient number of review processes to reduce the error quotient to an acceptable minimum. International investment agreements have sought to add a further layer that addresses the special case of discrimination against foreign investors, on the assumption that domestic institutions will be more prone to error in this area and less capable of correcting mistakes once made. Yet the introduction of international review also creates a new set of issues of equity. Domestic investors do not have access to these international institutions, even when they have been wronged, and the need to deal with international institutions may result in the reallocation of scarce

\textsuperscript{27} See above.
resources towards the needs of foreign investors and away from domestic needs, where they might actually generate greater benefits. The principle of exhaustion of remedies helps to rebalance these relationships.

*Deference.* The principle of deference imposes a burden of proof on international actions that may interfere with the proper functioning of domestic institutions. It is recognition of good governance. It will, however, again be necessary to establish criteria to identify domestic institutions that enjoy widespread credibility as compared to institutions that are candidates for improvement.

It should be clear that an international agreement that does not incorporate the principles of exhaustion of remedies and deference has the likely effect of undermining domestic institutions and thereby reducing their effectiveness and removing incentives for upgrading them. In particular an international agreement that does not meet basic standards of legitimacy, transparency and accountability will also set the wrong example for the development of national (or regional) institutions.

The CPA presents what might be described as an ideal environment to tackle these issues, which have been widely neglected in the international investment debate. With its emphasis on good governance and institutional development as well as its commitment to making trade and investment a cornerstone of development efforts, the CPA already has both explicit and implicit elements that support this kind of performance-based approach to an Investment Agreement.

The ultimate dilemma that a Cotonou Investment Agreement must address is that of countries with good institutions, which still do not attract the foreign investment they need. A comparable problem exists in developed countries, where remote regions or those with limited infrastructure and services do not attract investment, creating a spiral of stagnation. The response within developed countries has been the development of a

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28 "Expeditiousness" is a relative standard. It can take several years to resolve litigious issues in many jurisdictions that are recognized as representing high standards of governance.
range of investment incentives to promote a better allocation of available investment in accordance with priorities of public policy. Most developing countries do not have the resources to fund such incentives—and in some instances entire countries find themselves in such a situation of marginalization—so a Cotonou Investment Agreement needs to initiate a process designed to produce the necessary system of incentives.

4.3. The Balance of Rights and Obligations.
The ultimate purpose of a Cotonou Investment Agreement is to increase investment to ACP countries, including some SVE countries that are currently at a significant disadvantage when it comes to attracting investment. This goal is to be achieved by creating a legal framework that ensures that investor rights and public goods are balanced in a legitimate, non-discriminatory way that is transparent and accountable. In addition a Cotonou Investment Fund needs to be created to undertake actions that are needed to ensure that actual outcomes match the objectives of the CPA, since experience has shown that the existence of an appropriate legal framework is not always sufficient to engender the required investment flows.

Existing investment agreements are highly developed with respect to investor rights. While these certainly form an essential part of a Cotonou Investment Agreement, significant negotiating effort will be needed to properly shape the rules that apply to other parts of the international investment process that have not received comparable attention.

5. The Role of Regional Institutions

The CPA includes an extraordinary emphasis on regional cooperation between ACP countries. This particular dimension of the CPA pervades the entire agreement, with

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29 Michael Davenport, ed., Investment Incentives in Commonwealth Developed Countries and the WTO Investment Negotiations. (Draft s.d.)
30 For suggestions on issues that may need to be considered see: konrad von Moltke, A Road Map for Cotonou Investment Negotiations.
hundreds of references to regional approaches. The resultant dynamic will prove significant from the perspective of investment and this needs to be reflected in a Cotonou Investment Agreement. There are essentially two aspects to this particular issue: the development of regional markets and their implications for investment, and the prospects for addressing some of the institutional needs for investment at the regional level.

5.1. **The Prospects for Regional Markets.** To a much larger extent than is generally acknowledged international trade is local trade. That is actually not surprising since trading with neighbors is easier than trading with remote and impersonal partners. Trade has flourished wherever borders between neighboring countries have been opened. Even within the European Union, a large proportion of all trade between countries actually occurs along the borders, at distances of 100km or less. Moreover small and medium enterprises, the most dynamic sector of any economy and the lifeblood of most developing countries, are more likely to enter international markets in a regional context than at the global level. This fact is recognized by the CPA’s emphasis on regional association.

Regional markets are sometimes even more difficult to liberalize than global ones. Relations between neighboring countries carry the burden of history, in some cases a burden so heavy as to render liberalization almost impossible. Moreover inequalities are more apparent close up, so that small countries may hesitate to open their markets to large and powerful neighbors and large countries may not perceive the advantage in opening to small neighbors. It took the disaster of World War II and its aftermath of the Cold War to convince Europeans of the benefits of economic liberalization and political integration on a continental scale.

Economic theory has also created obstacles to the development of regional trade agreements. All economic models largely disregard geography. Countries are considered as single points, remote regions—those close to borders with other countries—appearing no further from a port of entry than a coastal location. As long

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distance transport becomes more efficient distance between countries is seen as being of less importance. Yet everybody knows that the cost of transport from port to a remote interior location may be many times the cost from that port to any other port in the world—and vice versa, of course. Seen from the perspective of economic theory, regional trade is an inefficient phenomenon and global approaches always appear more efficient in economic models than regional ones, often in defiance of reality. This is one of several reasons why the economic gains from the Uruguay Round of trade agreements have proven elusive for more countries than expected, benefiting large countries with highly developed infrastructure disproportionately.

Business and governments are beginning to recognize the importance of regional trade. In some cases, the promotion of regional trade offers economic benefits that far outstrip those that can realistically be expected from global measures. Just as important, these benefits are likely to be shared more evenly between large, medium and small enterprises. The patterns of regional trade come to resemble more closely the internal structure of the economy, where it is well established that a strong SME sector is a necessary condition for a dynamic economy.

The CPA is the first of its kind to take these factors seriously. Yet it leaves the implementation of these principles in a relative void. Not much is said about the kinds of measures that are needed, nor of the contribution that may be expected from the European Union and its Member states to this process. European experience suggests just how much effort the development of regional associations will require. Without a strong commitment from the countries directly involved, little is liable to happen. The principal source of this commitment is unlikely to be the CPA—which can at best provide support to an autonomous regional dynamic—but the recognition of affected economic interests that regional association offers tangible benefits.

The consequences of even modest levels of regional association can be quite dramatic. Much evidence suggests that the availability of substantial markets for goods and services is one of the critical determinants of FDI (together with effective institutions and infrastructure). Regional trading arrangements offer the prospects of increasing the effective size of the participating countries’ markets, presumably attracting investment to most of them. European experience has shown this process to be particularly significant for smaller countries and for border regions where a “foreign” market may prove to be more readily accessible than the markets in the metropolitan areas of one’s own country.

A Cotonou Investment Agreement can help to activate some of the implied promises of the CPA in relation to regional association. It can also incorporate specific rewards and incentives—for example in support for infrastructure measures to promote cross-border trade or in enhanced efforts to promote investment from the EU and Member states.

5.2. Regional Institutions.

The institutional demands of foreign direct investment are onerous. Countries must create and maintain institutions that are demonstrably capable of balancing private rights and public goods in a manner that is legitimate, transparent, and accountable. For many smaller ACP countries the cost of such institutions, both in financial terms and as a drain on scarce human resources, may prove excessive. Such countries may wish to work together with the regional association to create the necessary framework. Moreover, regional institutions for investment may also prove more efficient in terms of resource allocation for many larger ACP countries.

The exact scope for the development of regional institutions for investment remains to be determined. An indication of the kind of steps that could be adopted follows.

Administrative Measures. Developing international administrative institutions is among the most challenging tasks, as the European Union can attest. Yet there are a range of functions relating to the review of investment and the various licensing and permitting procedures that can readily be shared if they have not yet been established in individual
countries. This is particularly true of the range of environmental reviews that need to accompany any major productive investment. These require an assessment of environmental conditions, frequently a formal environmental impact assessment, and subsequent reporting by the investor and monitoring by the authorities. All of these functions can in principle be shared without serious losses of sovereignty but with a much more efficient use of limited resources, human resources in particular. Moreover the European Union should have a lively interest in the establishment of effective regional environmental institutions as a means to ensure that its commitments to sustainable development are appropriately implemented. In many ways a regional environmental agency that supports national environmental administrations is in the interests of the European Union.

Another area that lends itself to regional organizations is the establishment of competition authorities. As regional markets develop, considerations concerning competition need to reflect the actual structure of the markets that are being protected. The experience of the European Union is emblematic in this regard. Consequently smaller countries may find it preferable to move directly to the establishment of regional competition authorities, even though this is liable to pose certain challenges, for example when one country seeks to attract productive investment but resistance comes from market participants in other countries. Provision must be made to deal with such eventualities.

The conduct of hearings and public participation procedures is a much more sensitive aspect of the licensing process but even here regional institutions can be of material assistance, in particular for small countries that do not have frequent need of the technical expertise involved in such matters.

Judicial Institutions. There is scope for the establishment of judicial review institutions at a regional level. This could even limit the need for further dispute settlement at the global level. The presumed advantages concern the efficient use of limited resources and the likelihood of increased independence of a regional judicial body. Steps need to be taken, however, to ensure that the decisions of such a body are based on a well-defined body of
law, that is are seen to be legitimate, and its proceedings transparent. A structure of accountability must be in place to balance the need for independence of such institutions.

*Private Sector Institutions.* Foreign productive investments require a range of service institutions to support their activities—banks, insurance companies, auditors, engineers for example. To a certain extent the development of such institutions is presumed to be a consequence of the processes of market opening and liberalization: if a market is sufficiently attractive, institutional development is liable to develop. Yet there is evidence that the process is not quite as smooth as anticipated, not unlike the process of promoting foreign investment itself. Careful consideration must be given to ways in which a Cotonou Investment Agreement could support the development of the necessary institutions. Once again, the logic of efficient use of limited (human) resources leads fairly directly to the proposition that regional institutions may be a better approach.

*Infrastructure.* In some ways, infrastructure—transport, energy, water supply, waste water treatment—is the most important prerequisite to productive foreign investment. At the same time such infrastructure investments hold some promise of attracting foreign investors. In some instances, foreign investors have been willing to include (public) infrastructure investment as part of their own project. This is, however, rarely a satisfactory solution. The infrastructure is typically geared towards a single user and the cost is factored into the cost-benefit analysis of the project anyhow, that is the host country pays indirectly. On the other hand, the provision of necessary infrastructure can rapidly overwhelm the capacity of individual countries, in particular financially weak ones. Regional solutions can be explored, provided the distribution of costs and benefits is appropriately addressed.

Similarly, the development of regional markets that is one of the goals of regional association is liable to change the infrastructure needs of the countries concerned. In most countries, border regions are remote from the population centers that are the center of economic activity, even in rural and agricultural societies—at least formal economic activity, which is after all the object of an investment agreement. These regions can
sometimes be more readily linked to the infrastructure of their neighbors, or at least at lesser cost—provided there are not historic barriers to cooperation, but these barriers are liable to limit cooperation in all forms.

6. The Problem of Dispute Settlement

The most pressing problem of international investment agreements is the inadequacy of the investor/state dispute settlement process, yet investment agreements require some forum to permit investors to present complaints against host countries. The argument in support of investor/state dispute settlement is actually quite simple. States do not invest, and they certainly do not invest in other states: individuals invest. Investment disputes almost always involve a specific investment and not a class of investors. While the latter may properly be represented by a state, just as the class of importers or exporters of certain goods are, when the dispute revolves around an individual investment it is not appropriate for a state to handle the dispute. The national government is not a law firm for wronged investors. Moreover access to the national government for investors is liable to be highly unequal: small investors will not get much of a hearing. The solution to all of these problems is the creation of an investor/state process.

The institutions utilized in other investment agreements—primarily The International Center for the Settlement of Investment Disputes (ICSID) and the United National Commission on Trade Law (UNCITRAL)—are not suitable for an EU/Cotonou investment agreement. In fact they are not suitable for any investment disputes for the simple reason that they are not institutionally equipped to undertake a balancing of private rights and public goods in a manner that is legitimate, transparent and accountable.

There is a need to develop the necessary institutions for a Cotonou Investment Agreement. It is worth keeping in mind the principles of exhaustion of remedies and deference outlined above. It is appropriate to ensure that this dispute settlement institution is staffed by persons from both ACP and EU countries and that a person from
the relevant region that includes the host country must be part of every dispute settlement process. Above all, the Agreement must create the legal framework that ensures that the actions of the dispute settlement process are legitimate, its proceedings must be transparent, and those involved in the process must be held accountable in some appropriate fashion. All of these issues can be solved if there is a desire to do so.

Finally experience with the dispute settlement processes of the GATT/WTO suggest just how vulnerable ad hoc panels are to error. The number of interventions from the Appellate Body created by the Uruguay Round is not surprising, since most governments are likely to appeal an adverse decision out of political necessity, to show that they have exhausted all remedies. What is surprising is the number of times the Appellate Body has had to correct the interpretation of WTO law by the ad hoc panels, sometimes even in ways that suggest that the panels were circumventing the law, as for example in the shrimp/turtle case. While the WTO Appellate Body has not yet overturned the outcome of a panel proceeding, the kind of interpretative adjustments that typically occur are liable to be particularly significant were public goods are at issue and where panel awards can involve very large sums.

Annex II Art.15.2(j) suggests that particular attention shall be given to “international arbitration in the event of disputes between investor and Host States. While this text does not explicitly refer to ICSID or UNCITRAL it clearly assumes that the practice of existing investment agreements is acceptable. In this regard it does not adequately reflect more recent analysis showing this not to be the case. As a practical matter, however, Annex II Art. 15.2(j) only calls for some form of investor/state arbitration—which this paper argues is indeed appropriate—but is silent as to the institutional requirements of such a process, leaving a Cotonou Investment Agreement free to develop acceptable solutions.

Negotiators will also have to decide whether to create an Appellate Body that is specifically geared to the CPA or to take a first step towards creating a review institution
that can be available to a larger class of investment disputes.\textsuperscript{33} Unlike the state/state dispute settlement procedures of the WTO there should be no assumption of a widespread need for appellate review. In other words, any dispute settlement procedure must be constructed so as to ensure that decisions are right first time most of the time. Appeals should be the exception rather than the rule—as in the WTO dispute settlement system. Yet some form of review is essential to ensure that results are balanced—and seen to be balanced.

7. **The Status of BITs under a Cotonou Investment Agreement**

A large proportion of existing bilateral investment treaties (BITs) are between EU Member and ACP countries. Some of these BITs are quite old, dating back to the era of decolonization, and some are quite recent, having been negotiated following the collapse of the MAI negotiations. None of the BITs involve the European Union as such, in other words they have been concluded between ACP countries and individual EU Member states. Their problematic nature is well illustrated by the tensions that have arisen over the requirement that countries acceding to the European Union will need to abrogate their BIT with the United States.

There is no specific analysis of the patchwork of BITs that exist between ACP countries and EU Member states. Some ACP countries may have BITs with most or all EU Member states; some may have only a few, typically with the former colonial power first because of the preponderance of investment from there towards the relevant ACP country. Some ACP countries may have BITs that were negotiated over a long period of time and that consequently contain a variety of specific provisions. They may cover different issues or they may use different language to cover the same issues. There has been no analysis whether the MFN provisions that are to be found in most BITs mean that investors from any country that has a BIT with an ACP country may in practice

\textsuperscript{33} A recent US-Singapore free trade agreement explicitly acknowledges the possibility of appellate procedures in the future.
cherry pick among the legal provisions of all the BITs of that country. This would be the most intuitive assumption but it is one that has not yet been tested.

The CPA covers “Investment Protection Agreements” in Article 15 of Annex II “Terms and Conditions of Financing.” This gives rise to a number of observations. Annex II Art. 15 is presented as implementing Article 78 of the Agreement itself, which deals with investment promotion and protection, yet it covers—by admission of its title—only investment protection. For no apparent reason, Annex II.15 assumes that implementation of Article 78 will take the form of bilateral agreements. Either the negotiators did not consider the possibility of an investment agreement that includes all parties to the CPA, or there was a willful desire to perpetuate the imbalance that is implicit in BITs.
Annex II Art. 15 is a strange text\textsuperscript{34} It shows signs of hasty drafting and careless amendment\textsuperscript{35}. Article 15 1(a)-(e) is taken directly from Article 261 of Lomé IV, but it has been elevated to the status of “principle.” Article 15.2 is new to the CPA. There can be little doubt as to the intent. While speaking of investment promotion and protection Article 15 is concerned exclusively with investment protection and views bilateral agreements as the instrument of choice. In principle Article 15.1 is prescriptive (“shall take into account the following principles”) yet Art. 15.1(a), which is the trigger of the anticipated process is only facilitative (“may request where appropriate”). The two prescriptive principles are contained in Article 15.1(b) and (c). The import of these

\textsuperscript{34} Chapter 5
INVESTMENT PROTECTION AGREEMENTS
ARTICLE 15

1. When implementing the provisions of Article 78 of this Agreement, the Parties \textbf{shall} take into account the following principles:
   (a) a Contracting State \textbf{may} request where appropriate, the negotiation of an investment promotion and protection agreement with another Contracting State;
   (b) the States part to such agreements \textbf{shall} practise no discrimination between Contracting States party to this Agreement or against each other in relation to third countries \textbf{when opening} negotiations for concluding, applying \textbf{and} interpreting bilateral or multilateral investment promotion and protection agreements;
   (c) the Contracting States \textbf{shall} have the right to request a modification or adaptation of the nondiscriminatory treatment referred to above when international obligations or changed circumstances so necessitate;
   (d) the application of the principles referred to above \textbf{does not} purport to and cannot in practice infringe the sovereignty of any Contracting Party to th Agreement; andd
   (e) the relation between the date of entry into force of any agreement negotiated, provisions for the settlement of disputes and the date of the investments concerned will be set out in the said agreement, account being taken of the provisions set out above. The Contracting Parties confirm that retroactivity shall not apply as a general principle unless the Contracting States stipulate otherwise.

2. With a view to facilitating the negotiation of bilateral investment agreements on promotion and protection, the Contracting Parties agree to study the main clauses of a model protection agreement. The study, drawing on the provisions of the existing bilateral agreements between the States Parties, will give particular attention to the following issues:
   (f) legal guarantees to ensure fair and equitable treatment and protection of foreign investors;
   (g) the most-favoured investor clause;
   (h) protection in the event of expropriation and nationalisation;
   (i) the transfer of capital and profits, and
   (j) international arbitration in the event of disputes between investor and host State.

3. The Parties agree to study the capacity of thee guarantee systems to give a positive answer to the specific needs of small and medium-sized enterprises of insuring their investments in ACP States. The studies referred to above shall be started as soon as possible after the signing of the Agreement. The result if these studies shall be submitted, (sic!) upon completion to the ACP-EC Development Finance Committee for consideration and appropriate action. \textbf{[emphasis added]}

\textsuperscript{35} Obviously Article 1 and 2 were originally part of a single Article—when this was split in two, the drafters forgot to restart at 2(a) but simply continued right through with 2(f), or to be more exact Microsoft Word did, as I discovered while copying the text of the Article.
provisions is not entirely clear. It refers to opening negotiations while the intent appears to be to determine the result of negotiations without so stating. It would seem to ensure that all provisions of all investment agreements, whether bilateral or multilateral, will be available to all Parties without discrimination. The sense of unease that seems to have accompanied the drafting of this strange text at the time of Lomé IVbis is manifested by the following salvatory provisions that concern international obligations or changed circumstances and an emphasis that this “does not purport to and cannot in practice infringe the sovereignty of any Contracting Party to the Agreement” where that is most obviously the intent. Why else go to the trouble of formulating the principles in the first place? The kindest thing that can be said about Article 15 is that it was drafted without much thought and the negotiators paid it not much attention, presumably because it was considered self-evident. One must wonder whether the lessons of the MAI had been absorbed. Because of the defects in drafting the legal significance of Art. 15.1 is presumably limited; it is little more than a political declaration, and one that the drafters felt sufficient uneasiness about to hide in a cloud of ambiguity.

It makes little sense to add another layer of complexity to the existing BITs. In other words, one key goal of a Cotonou Investment Agreement must be to do precisely what Annex II Article 15 sought to avoid, namely to replace the BITs with a single, balanced, institutionally capable investment agreement that would cover all ACP states, the European Union and its Member states in a way that ensure a proper distribution of burdens and benefits. Since there is no evidence that ACP states have actually benefited from the BITs and only uncertain evidence whether the BITs are important in practice or EU investors—primarily in the form of political declarations defending rights that have once been obtained—the replacement of the BITs would seem a reasonable goal. A Cotonou Investment Agreement would presumably address the reputational risk that any ACP country might reasonably be expected to face if it seeks to abrogate a BIT unilaterally.

Annex II Article 15.2(f)-(j) lists the core provisions of most BITs. All the listed issues are appropriate for negotiation in a Cotonou Investment Agreement—and Annex II
presumably creates a general obligation to do so—but it would be wrong to suggest that they form an adequate framework for an Investment Agreement or that they contribute to investment promotion although that appears to be the implication of Art. 15. The multiple inadequacies of BITs precludes using them as a template for a Cotonou Investment Agreement. Yet it is certainly appropriate, even necessary, to ensure that the legitimate rights secured by BITs are also secured by the Cotonou Investment Agreement in a manner that is balanced and ensures the legitimacy of the overall process.

8. A Cotonou Investment Fund

If the goal of a Cotonou investment agreement is to increase the flow of investments to ACP countries it appears likely that an agency will be required to promote this process. It remains to be seen whether such an agency would also be responsible for the management and updating of the Cotonou Investment Agreement as experience is acquired and the issues have become better understood and properly framed for negotiation. But such an agency must have the resources to promote institutional development, in particular regional institutional development and must be in a position to take at risk equity stakes or to provide at risk financing in other forms to ventures that appear to be in the joint interest of the parties but where markets are not (yet) responding in an appropriate manner.

It is critical that the governance structure of such an institution reflect the interests of all parties involved. A possible model is the European Bank for Reconstruction and Development (EBRD) that has acquired particular experience supporting private investment and working with small and medium sized investors in the countries of Central and Eastern Europe. The EBRD appear to have learned some of the lessons from the World Bank where past loans are now creating tensions. Countries find that they are repaying loans that were made many years ago to fund projects that were either inappropriate for the country or did not generate the necessary (and calculated) returns. The problem of moral hazard means that the World Bank pays no penalty for past
mistakes. Indeed, in the absence of capital replenishments, which have long ceased at the World Bank, the money that is being lent out derives entirely from repayments from earlier borrowing (by developing countries), as does the Bank’s operating budget and profit. That is a situation that must be avoided at all costs.

Both EU and ACP countries must have ownership of such an agency. Such an agency could be modeled on the European Bank for Reconstruction and Development, and in particular its private market activities in support of small and medium enterprises. The funds must be able to contract with national institutions for intermediation so as to be able to reach SMEs in both EU and ACP countries.

It is certainly worth considering whether the Investment Facility established by the Cotonou Agreement provides an appropriate starting point for the Fund that is being proposed here. The creation of the Facility was one of the major innovations of the Agreement, acknowledging that creating an appropriate legal and institutional environment was both costly and not by itself a sufficient condition to ensure that investments will actually flow. Nevertheless the rather backhanded manner, in which the Facility is created in the Agreement leaves a number of critical questions that have not been addressed, not least the clear articulation of objectives, means, criteria for success and governance structures to increase the chance of success. It is conceivable that a Cotonou Investment Agreement could supplement the Cotonou Agreement’s lack of clear definition of objectives, means and criteria for success. It appears highly unlikely that it would be in a position to bring about a change of governance of the Facility, which is currently constituted as an EIB institution. The provision for review of the Facility by the ACP-EC Development Finance Committee is not sufficient to ensure proper governance, which must include continuing participation in the administration and oversight functions of the Fund by both EC Member States and ACP States.

9. Conclusion: Balance, Legitimacy, Transparency, Accountability, Rights and Obligations
Balance is the key to a Cotonou Investment Agreement. It will need to address host state rights and obligations, home state rights and obligations, and investor rights and obligations. And it will need to create a framework within which these rights and obligations can be balanced in a manner that is legitimate, transparent, and accountable. An Investment Agreement must create an institutional structure capable of addressing some of the most serious market failures and include criteria to determine whether it is succeeding as well as obligations on all parties to identify the reasons for lack of success and to act to remedy them.

The CPA is in many ways the ideal environment for the conclusion of such an innovative investment agreement because it includes all the key actors on both sides, it already has taken steps towards the creation of a facilitating institutional environment and has some of the institutional elements that are likely to be needed.