The Proliferation of International Trade and Investment Arrangements in the Arab World: Key Issues and Challenges

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Overview

The absence of a multilateral framework on investment accentuates, in part, the recourse to Bilateral Investment Treaties (BITs) and the inclusion of investment provisions in Free Trade Agreements (FTAs) as a way to regulate international investment relations[1]. Arab governments have been actively concluding such agreements with a view to attract foreign direct investment (FDI). The proliferation of bilateral trade and investment agreements in the Arab region reflects the desire of Arab governments to implement specific policy measures aimed at creating a stable and predictable international framework for FDI. This development mirrors their efforts at the domestic level to update their national laws on investment and by the simplification of legal procedures for the entry and establishment of transnational corporations, the reduction of corporate taxes, provisions of incentives and guarantees to the free transfer of capital, exclusion of nationalisation. In addition, new laws on intellectual property rights are being adopted.

This paper attempts to shed light on the international regulatory frameworks for investment in the Arab world, in particular, it aims to review the network of International Investment Agreements (IIAs) (both bilateral and regional) in Arab countries. The paper then analysis the criteria that govern the selection of an investment treaty partner before concluding with possible ways to enhance the development dimension of these treaties.

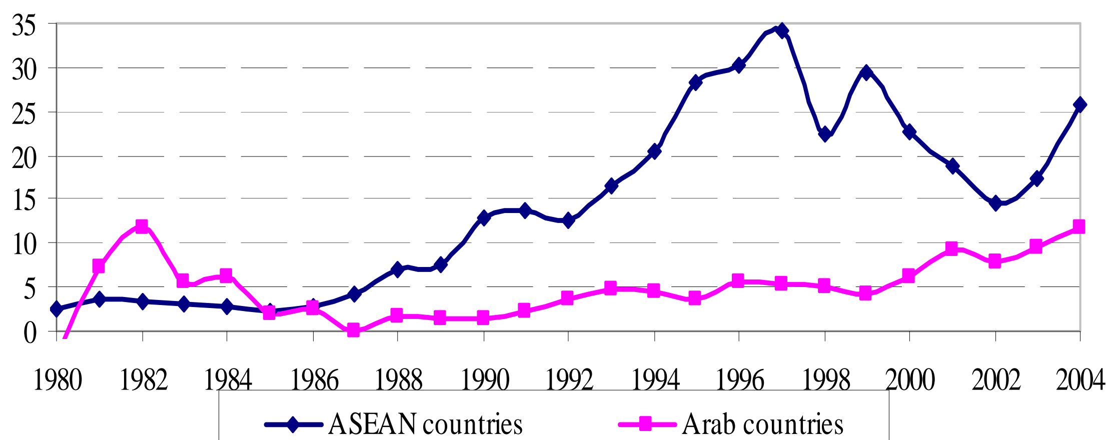
1. Regional investment frameworks

Some of the first initiatives to create regional frameworks for investment took place in the Arab world. As early as the 1950s and 1960s, Arab states had already concluded agreements aiming at encouraging intra-Arab investment flows. These initiatives were taking place in the context of rising pan-Arabism, a movement that aspired to a unified Arab nation. Under the auspices of the League of Arab States[2], several agreements were concluded, including the Agreement on Arab Economic Unity (1957) with the aim of fully liberalizing the movement of persons, capital and goods among the Arab League States , the Agreement on Investment and Free Movement of Arab Capital among Arab Countries (1970) was concluded to promote preferential investment treatment between Arab countries[3].

This agreement was followed in 1971 by the conclusion of the Convention Establishing the Inter-Arab Investment Guarantee Corporation further creating an enabling framework for investment flows within the region[4]. In 1980, the Agreement for the Investment of Arab Capital in the Arab States was signed. It permits the free transfer of funds and requires the parties to protect Arab investors and their revenues. The agreement also prohibits the nationalization of Arab investments unless it is for the public benefit, in a non-discriminatory manner and accompanied by fair compensation. Moreover, the agreement entitles Arab investors to unimpeded entry and residence within the territory of the Arab State in which the investment is made. The agreement also includes a chapter on dispute settlement that refers the disputing parties to the Arab Investment Court. The Arab Court is referred to in Chapter VI of Agreement; a first ruling has been rendered recently in a case involving Tunisia and an investor from Saudi Arabia[5]. The Court was set up to arbitrate disputes involving States that are members of the Arab League and investors that are nationals of other member States of the Arab League. As illustrated below, some BITs concluded by Arab countries refer to the Arab court as an arbitration mechanism in the investor-State dispute settlement provisions.

Another regional agreement is the Unified Economic Agreement between the Countries of the Gulf Cooperation Council (GCC) created by Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates in 1981. The primary objective of the agreement is to deepen economic relations between the members, but provisions on investment and services were only of trivial importance, the agreement called, in Article 21, for the unification of investment rules and the achievement of a joint investment policy; however, no specific implementation steps were stipulated.

More recently, the Arab League decided to initiate the Arab Free Trade Area (AFTA) in an effort to revive previously unsuccessful attempts at regional integration. In 2002, the 69th meeting of the Economic and Social Council of the Arab League, held in Cairo, decided to accelerate the establishment of AFTA, setting 2005 instead of 2007 as deadline for its launch. If successful, this new initiative should form a bigger and more homogenous Arab market



and thus attract more foreign direct investments (regional and international) and strengthen the member countries' negotiating power when dealing with powerful economic blocs in international arenas such as the WTO. However, the AFTA is primarily a trade liberalization initiative, which may not suffice to create conditions conducive to a deeper integration comparable to other developing integration blocs. It should be noted that regional integration in Southeast Asia (ASEAN) and in Latin America (MERCOSUR) were not confined to the liberalization of trade in goods. Other issues such as investment and services were also included in the integration process of these blocs. As illustrated in Figure 1, since 1985, total FDI inflows to the ten ASEAN member countries[6] have been consistently higher than the total FDI inflows to 18 Arab countries[7].

Another free trade initiative is the Agreement for the Establishment of a Free Trade Zone between the Arabic Mediterranean Nations (*The Agadir Agreement*) which was signed between Jordan, Tunisia, Egypt and Morocco in 2004. The creation of a free trade zone between these countries could strengthen the Barcelona process (see below) and build on the already existing association agreements between these countries and the EU. The agreement could also be perceived as a building block towards a greater Arab Free Trade Area. The Agadir Agreement provides for a pan-Mediterranean cumulation of origin, however, the agreement does not cover investment, and only reaffirms the commitment of the member parties with respect to the multilateral WTO agreements on intellectual property (TRIPS) and on services (GATS). Again, a deep integration among the members of the agreement would require substantive disciplines on a number of issues in addition to trade in goods, these issues could include for example, the liberalization and protection of investment and services within the region, which would encourage the establishment of Arab companies and the development of linkages with local market forces and thus foster integration at a higher level than mere free trade. Moreover, a successful economic integration among the members of the Agadir Agreement would require more coordination in terms of exchange rate and macroeconomic policies[8].

2 Bilateral investment frameworks

2.1 Arab countries' involvement in bilateral investment treaties (BITs)

Bilateral investment treaties (BITs) constitute one of the most important international policy tools used by Arab countries to attract foreign direct investment (FDI). By signing these treaties – which provide protection and favorable treatment to foreign investment and foreign investors under international law – signatory countries are signaling their commitment to provide a stable, transparent and predictable investment climate[9]. The parties to a BIT commit themselves to providing national treatment and most-favored nation treatment (MFN) to the investors of the other contracting party. Under BITs foreign investors are also protected against nationalization and expropriation, have the right to transfer funds and profits back to their home country. BITs also include a provision which allows the foreign investors to take the host country to international arbitration if any provision is

perceived by the foreign investor to be violated. BITs usually give investors a choice between the International Centre for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL). Some BITs also refer to other institutions such as the International Chamber of Commerce (ICC) or the Stockholm Chamber of Commerce (SCC). There are also other regional arbitration centers such as the Arab Investment Court and the Cairo Regional Center for International Commercial Arbitration which are referred to in some BITs concluded by Arab states. The BIT between Jordan and Syria (2001) for example, states that:

"All disputes related to different aspects of investments and activities…shall be settled through conciliation, arbitration, or by competent judicial authority in the hosting country of investment or by ***the Arab Investment Court in accordance with the provisions of chapter 6 of the Agreement of Unifying of Investing Arab Capitals in Arab countries****…"* (Emphasize added).

The Cairo Regional Centre for International Commercial Arbitration is referred to in a number of BITs concluded by Egypt, including the BIT between Egypt and Nigeria (2000) and the BIT between Egypt and Pakistan (2000) [10] which states that:

"If the dispute is not settled…within six months from the date of the written notification…it may be submitted upon request of the investor (his choice will be final) either to:

A. The International Centre for the Settlement of Investment Disputes (ICSID)…

B. Ad-hoc Court of Arbitration established under the arbitration rules of procedures of the United Nations Commission for International Trade Law.

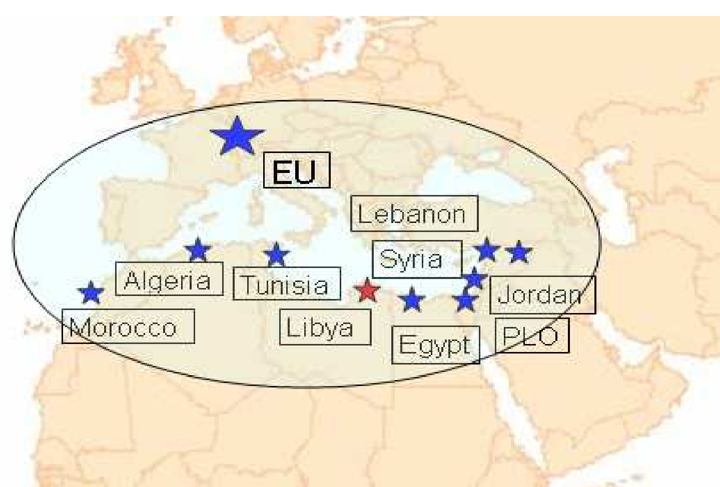
C. ***The Regional Center for International Commercial Arbitration in Cairo.****"* (Emphasize added).

The investor-State dispute settlement clause in BITs is of critical importance as it ensures that the provisions of the agreement are effectively enforced. In this respect, BITs limit the sovereignty of the host state in providing preferential treatment to its own investors, and limits the rights to regulate foreign investment.

Despite a certain loss of policy space entailed in these agreements, the number of BITs has increased significantly in the Arab world, reaching over 520 BITs, constituting about 20 percent of the total BITs network. Moreover, while the effectiveness of these legally binding international treaties to protect the foreign investors under international law is unquestionable, their role in actually attracting foreign investments remains inconclusive[11].

Arab Countries conclude these agreements with the belief that on balance, the legally binding provisions found in BITs would encourage foreign companies to invest in their territories, and thus offset the loss of sovereignty over certain areas related to the regulation of foreign investment. In terms of the number of BITs concluded, Egypt, Lebanon, Tunisia and Morocco have been the most active in the region. In terms of intra-Arab BITs, over 80 such agreements have been concluded. As far as the geographical scope is concerned, Arab countries concluded most of their agreements with

Figure 1. The Euro-Mediterranean association agreements, June 2006[a/]



a/Libya has observer status

capital exporting Western European countries[12].

As mentioned above, in addition to BITs, some free trade agreements concluded by Arab countries include provisions on investment promotion and protection. These free trade agreements therefore form a part of the international regulatory framework for investment in the Arab world and deserve attention. Two schemes in particular are worth mentioning, first are the Euro-Mediterranean association agreements between the European Union and its southern Mediterranean neighbours, and the second are the free trade agreements between the United States and some Arab countries as part of the proposed Middle East Free Trade Area (MEFTA)[13].

2.2. Investment-related provisions in the Euro-Mediterranean association agreements

The Euro-Mediterranean Partnership initiative (or the Barcelona Process)[14] started in 1995 with the ambitious objective of creating a Mediterranean Free Trade Area by 2010. As part of this effort, eight Arab countries have concluded bilateral association agreements with the EU (figure 1)[15].

The association agreements with the EU constitute the legal basis of the EU-Arab Mediterranean countries relationship. The Euro-Mediterranean association agreements are comprehensive agreements covering economic, social and political issues. Investment provisions are also included, with the aim of facilitating and increasing the free circulation of capital for direct investments, as well as expertise and the transfer of technology from European to Arab countries; the agreements also call for:

- ⇒ the simplification and harmonization of procedures relating to the admission of investments;
- ⇒ the exchange of information on investment opportunities;
- ⇒ the creation of joint ventures (especially for small and medium-sized enterprises);
- ⇒ the encouragement of the conclusion of bilateral investment treaties (BITs) and double taxation treaties to improve the legal framework for investment.

These agreements also provide for consultations and deeper co-operation on the right of establishment of firms, and the effective protection of intellectual property rights.

As far as the right of establishment of firms is concerned, there are different approaches. In some agreements, the contracting parties agree to consider granting in the future the right of establishment of one party's firms in the territory of the other and assign the Association Council to make recommendations for achieving this objective. See for example Article 30 of the EU-Egypt Association Agreement, which states that:[16]

"1. The Parties will consider extending the scope of the Agreement to include the right of establishment of companies of one Party in the territory of another Party and the liberalisation of the supply of services by companies of one Party to service consumers in another Party.

2. The Association Council shall make the necessary recommendations for the implementation of the objective set out in paragraph 1."

A second approach consists of granting the right of establishment articulated through the granting of MFN and/or national treatment upon entry. As illustrated in Article 30 of the EU-Jordan Association Agreement:

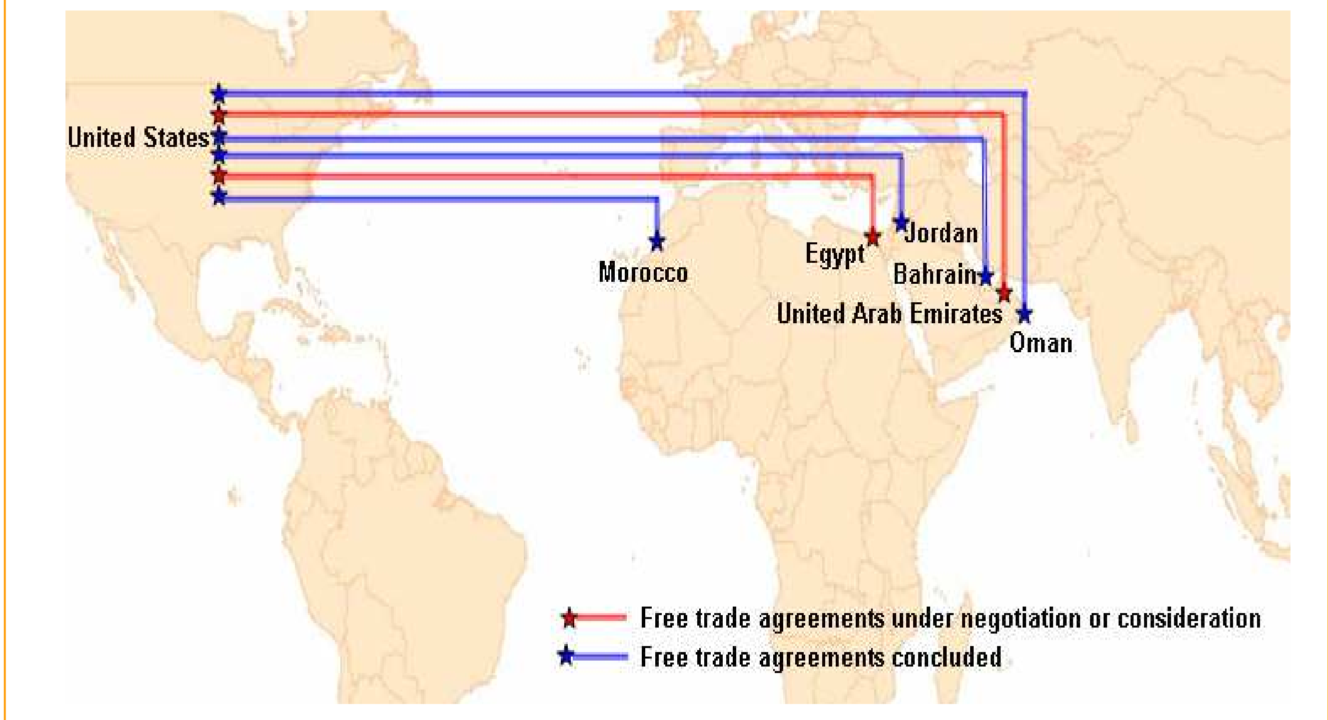
1 (a) " the Community and its Member States shall grant for the establishment of Jordanian companies treatment no less favourable than that accorded to like companies of any third country;...

2 (b) Jordan shall grant to subsidiaries and branches of Community companies, established in its territory, in respect of their operations, treatment no less favourable than that accorded to its own companies or branches, or to Jordanian subsidiaries or branches of companies of any third country, whichever is the better."

Furthermore, the agreements aim at strengthening scientific and technological cooperation (strengthening research capacity in the Arab countries, stimulating technological innovation, transfer of new technologies, dissemination of know-how and access to Community R&D programmes).

However, the investment provisions of the association agreements do not go as far as the provisions found in BITs or in other agreements concluded by the EU, such as, for example, the partnership and co-operation agreements with eastern European countries. Investment protection provisions concerning the post-establishment phase are not included in EU agreements because, according to the EU Treaty, the European Commission does not have competence on investment protection matters. An important exception re-

Figure 2. The network of U.S. free trade agreements with Arab countries, concluded and under discussion, June 2006



lates to provisions on the free transfer of capital relating to direct investments, which are included in all the association agreements.

From a European perspective, the association agreements are hoped to generate employment in the Arab Mediterranean countries so as to reduce the flow of labor migration into the Union. Another objective is to create favorable conditions to encourage European companies to invest in the southern Mediterranean countries.

The important question that arises here is whether and to what extent these agreements will help to reduce the prosperity gap between the EU and its Arab neighbours. The association agreements will open Arab markets to European goods and will make it easier for European companies to invest in the region. In return, Arab countries expect dynamic gains and economic growth through greater access to the EU market as well as larger FDI inflows and technology transfer. However, the actual benefits of these association agreements have yet to be proven. The tariff margins afforded to the Arab Mediterranean countries may not be significant enough to offset the competitive advantages of major manufacturing exporters like China and India. Moreover, European agricultural subsidies and high tariffs constrain the Arab ability to compete and export to the EU and world markets. In addition, even preferential imports are subject to anti-dumping and other protection measures such as quality and health standards and restricting rules of origin.

The countries of the Gulf Cooperation Council (GCC), which are outside of the scope of this initiative, are currently negotiating a separate free trade agreement with the EU. Negotiations on the EU-GCC FTA were opened in 1990 and re-launched in 2001. The delay in concluding the FTA is partially the result of high taxes levied by the EU on refined oil products of GCC countries and of issues related to the liberalization of the services sector in the GCC countries.

2.3 Free Trade Agreements with the United States

In 2003, the United States proposed a plan to increase trade and investment with Middle Eastern countries. The ultimate objective of this plan is the creation of a Middle East Free Trade Area (MEFTA) by 2013. This is to be achieved through a step-by-step approach beginning with actively supporting World Trade Organization (WTO) membership for the Arab countries that are yet to become full members. A second step is to improve and strengthen the regulatory framework governing FDI in Arab countries by encouraging the conclusion of trade and investment framework agreements (TIFAs) and BITs with individual Arab countries. The main objective of a TIFA is to establish an institutional body (a council) composed of representatives of both parties to hold consultations on specific trade and investment matters and to identify possible areas of trade and investment cooperation. The conclusion of a TIFA is often seen as a prerequisite to the beginning

of official negotiations for a more comprehensive FTA. In recent years, the United States has concluded many TIFAs, including with Saudi Arabia, Algeria, Egypt, Bahrain, Qatar, the United Arab Emirates, Kuwait, Yemen, Tunisia and Oman. TIFAs have no legally binding provisions on investment protection, but they do nonetheless send an important signal to U.S. investors and companies as to the willingness of the host Arab country to create a favourable climate for their investments.

Finally, the U.S. will conclude high-standard comprehensive FTAs with Arab countries addressing such issues as transparency, the rule of law, anticorruption, intellectual property protection and investment. Unlike the association agreements with the EU (which only provides for steps to encourage and to promote investment), the FTAs with the U.S. provide for more substantive investment protection provisions, similar to those found in BITs. The United States has so far concluded four comprehensive FTAs with Arab countries (Figure 2).

The conclusion of trade and investment agreements could be stirred by political variables, rather than economic ones. The politicization of FTAs is particularly evident in the case of the U.S. - Arab states agreements, which are in fact part of a wider geo-strategic plan that attempts to stabilize the region through economic interdependence.

'The political importance of the Middle East to the United States is evident from the willingness of the United States to wage a war in Iraq, the political capital some US administrations have invested in resolving the Palestinian-Israeli conflict, and the amount of aid extend to such countries as Egypt and Israel. It is not surprising, therefore, that political rather economic considerations have driven US free trade agreements (FTAs) in the Middle East'.[17]

Another example is the conclusion of the US-Bahrain FTA which was made possible only after Bahrain made it clear that it would no longer support a boycott of Israeli goods.

The net effects of such trade agreements on the U.S. economy are expected to be minimal due to the small size of the Arab economies relative to that of the U.S. Clearly, to the U.S., the importance of these FTAs goes well beyond increased trade and investment flows with Arab countries. The benefits the U.S. expects from these free trade agreements are mainly on the foreign policy level. Indeed the U.S. wants to build on the privileged relationship it enjoys with most Arab Governments through the preferential terms the FTAs stipulate. This is especially true today as support for the U.S. among Arab populations has significantly declined as a result of the political situation in the region. The security dimension is also an issue of concern for the U.S. By improving the standard of living in the Arab countries, the U.S. hopes to curb the rise of religious extremism in the Arab and Islamic world. Arab countries on the other hand, see real economic opportunities such as securing access to U.S. markets and attracting U.S. investors.

The U.S. has also been encouraging the creation of Qualified Industrial Zones (QIZs) such as the ones in place in Jordan and Egypt which provide for the establishment of free trade zones in special areas in Egypt and Jordan, where goods made with a minimum level of Israeli input gain preferential entry to the U.S. Again, the political factor in the creation of the QIZs is of great importance. It is hoped that these QIZs will boost exports while drawing foreign investment from businesses that want access to the American market. Moreover, Creating trade and investment linkages between the Arab countries and Israel could, on the long run, diffuse political tensions and create a more stable and economically prosperous Middle East.

3. Benefiting from international investment agreements

Most international investment agreements are influenced by two models (the U.S. model or the European model of IIAs). These models have been developed during the 1960s, an era of political, economic and social tensions when foreign investors felt threatened and vulnerable by the possibility of the nationalization of their assets in newly independent countries, or in countries that opted for the socialist state-owned economic system. In such a climate, it was only normal that the provisions of investment agreements focused exclusively on the protection of foreign investors and their assets. Today, the risk of sudden expropriation of foreign assets has diminished considerably, and FDI is widely recognized as an important engine of economic growth. The world is changing, and with it our perception of foreign investors. The foreign investor is now seen as an essential actor in the economic development of host states. The change in the perception of foreign investors in developing countries, i.e. from caution to enthusiasm was not echoed or reflected in the provisions of international investment agreements. Indeed, most IIAs still focus on the legal protection and favourable treatment accorded to foreign investors.

A number of issues need to be addressed in order to improve the overall development dimension of IIAs. For example, IIAs can be drafted in a manner as to admit and protect only those investments that the host country

wishes to promote for development purposes, thus providing more policy space for host countries to ensure the beneficial impact of the investments on its territory. As far as the treatment of established investment is concerned, it needs to be underlined that most investment agreements leave considerable flexibility for the host country to regulate investment activities. In addition, the contracting parties could lodge reservations, safeguard measures and exceptions with regard to the protection of sensitive areas such as health and the environment. Investment agreements can also provide for flexible timeframes for the implementation of specific provisions, based on the levels of economic development of the Parties, or on difficulties that can arise, such as those related to the balance of payments for example. It is also important to explore the possibility of introducing new development-oriented provisions in IIAs that are currently lacking; these can include a corporate commitment to invest in a socially and environmentally responsible way, to foster linkages with local investors, and a commitment to transfer technology. Such provisions in IIAs (alongside investor's protection provisions) would further encourage developing countries to conclude such treaties, and would at the same time, ensure the positive contribution of the foreign investors in the societies in which they operate.

Host Arab governments should try, as much as possible to give priority to admitting and protecting investments that will have a long-term positive economic impact (infrastructure projects for example) on the host country. The quality of the foreign investment should be scrutinized. More specifically, the *spillover* effects of the investment should be taken into account, for example will the investment project bring new technology, capital and managerial skills? Will it create jobs? Will it create joint ventures and linkages with medium size Arab companies? Which sectors are targeted – are they sectors that can generate exports, develop infrastructure? Will the investment help reduce the host country's reliance on imported goods? Some of these questions need to be examined and based on the results, it should be decided whether the conclusion of an investment agreement and the subsequent favourable treatment and protection granted to the foreign investor under international law would serve the development objectives of the host country. At the same time, too many obligations and requirements on the foreign investor (the imposition of performance requirements for example)[18] could defeat the purpose of the agreement which is to encourage investment flows. Foreign investors could perceive such obligations as a burden, and could decide to invest in other countries that impose fewer restrictions on their operations.

Conducting feasibility studies and establishing study groups prior to the beginning of formal negotiations on an investment agreement is of crucial importance, especially to the developing country partner. Such pre-negotiations research can for example estimate the impact of the investment agreement, determine the potential for increased trade and investment between the parties, provide recommendations to the negotiators on how best to serve specific areas of national interests; and identify potential overlaps and inconsistencies with other international agreements. The study group could consist of international trade and investment experts from the relevant ministries, but should also as far as possible involve members of the private sectors and academia. There should also be as far as possible an open debate and public scrutiny on how best to address the development dimension of these treaties. Transparency in international investment rule-making is crucial in order to gather the necessary public support, especially that such agreements can have an impact on issues such as labour standards, health and the environment.

Furthermore, Arab countries need to ensure coherence between their various international investment commitments and their national laws governing foreign investment. The harmonization of these rules and the formulation of a coherent national strategy on investment are essential to maintain a stable and predictable investment climate. Overlapping commitments on investment rules can occur for example between BITs, regional integration agreements, free trade agreements and national investment laws. These obligations result in a complex 'spaghetti bowl', which are difficult to navigate. Provisions such as the MFN clause add to the complexity in this regard[19].

Finally, the present inter-Arab regional investment agreements concluded between the 1950s and 1980s have become to a large extent obsolete; in this respect, the time is ripe to consider a new Arab regional agreement to promote and to protect investments within the region. Such an agreement could take into account the recent developments in international investment rule-making, ensure the interests of Arab countries to create a more dynamic and integrated approach to inter-regional FDI, and could potentially supersede a large number of inter-Arab BITs; this would in turn simplify and harmonize investment rules in the region

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Notes

1. It could be argued that free trade agreements (FTAs) have also proliferated rapidly despite the existence of the WTO and the GATT Agreement; however the number of bilateral investment treaties (BITs) alone is almost 10 times higher than the number of FTAs.

2. The Agreement on Arab Economic Unity was signed on 3 June 1957 and came into force on 30 April 1964. The original signatory States were Iraq, Jordan, Kuwait, Lebanon, Libyan Arab Jamahiriya, Morocco, Saudi Arabia, Sudan, Syrian Arab Republic, Tunisia, United Arab Republic, and the Arab Republic of Yemen. Mauritania, Palestine and Somalia subsequently also became signatories to the Agreement.

3. The Agreement on Investment and Free Movement of Arab Capital Among Arab Countries was signed on 29 August 1970 by the States members of the Agreement of Arab Economic Unity. It entered into force on 29 August 1970.

4. The Convention Establishing the Inter-Arab Investment Guarantee Corporation was opened for signature in May 1971. It entered into force in April 1974.

5. For more details on the Arab Investment Court and its first decision, see Ben Hamida, Walid, “The First Arab Investment Court Decision”, in *The Journal of World Investment and Trade* Vol. 7 No. 5 October 2006 and El-Ghitany, Magda, Al-Ahram Weekly, 27 October 2004, (Issue No.713).

6. Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

7. Algeria, Egypt, Libya, Morocco, Sudan, Tunisia, Bahrain, Iraq, Jordan, Kuwait, Lebanon, Oman, Palestinian Territory, Qatar, Saudi Arabia, Syria, United Arab Emirates and Yemen.

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10. The full text of these BITs are available at (www.unctad.org/iia).

11. For more details on whether BITs attract FDI, see for example, Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract FDI? Only a bit... and they could bite*, June 2003 and Eric Neumayer and Laura Spess, *Do bilateral investment treaties increase foreign direct investment to developing countries?* May 2005.

12. UNCTAD's online BITs database (www.unctad.org/iia).

13. Arab countries have concluded a number of bilateral FTAs among themselves, but none included investment provisions.

14. For more details on the Barcelona Process, and for the full texts of the Association Agreements, visit: (http://ec.europa.eu/comm/external_relations/euromed/med_ass_agreements.htm)

15. The EU has concluded association agreements with Algeria, Egypt, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria and Tunisia; Libya has observer status since 1999.

16. See also Article 31 of the EU-Morocco agreement, available at (www.unctad.org/iia).

17. Ahmed Galal and Robert Z. Lawrence (2004). "Egypt, Morocco, and the United States", in Free Trade Agreements: US Strategies and Priorities, edited by Jeffrey J. Schott, Institute for International Economics, Washington DC.

18. For more details on performance requirements, see UNCTAD, Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries, 2003.

19. See for example, Mann, Howard. *'Who Owns "Your" Water? Reclaiming Water as a Public Good Under International Trade and Investment Law'*, paper presented at the Seminario Latino-Americano de Politicas Publicas em Recursos Hidricos, Brasilia, Brazil, 22 September 2004, available at (http://www.iisd.org/pdf/2004/investment_water_economic_law.pdf).