ECONOMIC DEVELOPMENT IN THE ESTABLISHMENT OF INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTE*

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Abstract

The development of today's economy demands a favourable legal mechanism, one that is able to facilitate all matters in its development. In relation to economic cooperation between countries, especially in the field of investment to help developing countries, a suitable legal mechanism is required to settle disputes. For this reason, the World Bank established a special institution that handles foreign investment disputes, known as ICSID (the International Centre for Settlement of Investment Disputes) through its convention. However, a problem that arises from the convention is the refusal of ICSID jurisdiction due to certain issues, such as a vacuum of law. To resolve this issue, attention must be returned to the foundation of the convention, which aims to create 'Economic Development' for states. The concept of Economic Development has a profound impact to the contents of the convention and to the standing of ICSID itself. The writer would like to clarify the link between the concept of Economic Development to the practice of the application of the Convention regarding ICSID jurisdiction.

Intisari

Perkembangan ekonomi dewasa ini menuntut adanya suatu mekanisme hukum yang baik dan mampu memfasilitasi segala hal dalam perkembangannya. Berkenaan dengan hubungan kerjasama ekonomi antar negara khususnya dalam bidang investasi, dalam rangka membantu negara-negara berkembang diperlukan sekali suatu mekanisme hukum yang baik manakala terjadi sengketa in untuk diselesaikan. Atas dasar itulah Bank Dunia membentuk suatu badan yang khusus menangani sengketa penanaman modal asing yang dikenal dengan ICSID (International Centre for Settlement of Investment Disputes) beserta dengan konvensinya. Namun, masalah yang banyak muncul dari konvensi tersebut adalah penolakan jurisdiksi ICSID itu sendiri dikarenakan beberapa masalah, seperti kekosongan hukum di dalamnya. Akhirnya, jawabannya kembali kepada landasan konvensi tersebut, yang bertujuan untuk Perkembangan Ekonomi negara yang diinvestasikan. Konsep Perkembangan Ekonomi ini ternyata berdampak sangat besar terhadap isi dari konvensi tersebut dan status ICSID sendiri. Penulis ingin menjelaskan hubungan konsep Perkembangan Ekonomi tersebut dengan praktek pemberlakuan konvensi tersebut ditinjau dari masalah-masalah jurisdiksi ICSID.

Keywords: ICSID, investment, economic development, dispute settlement.

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A. Introduction

Foreign Direct Investment (FDI) is an important and reliable method in developing the economy and productivity of countries as it plays an extraordinary role in the growth of global business. However, conflicts of interest between parties and the conditions in the host State, particularly for developing countries, continuously raise problems in this particular area (Sornarajah, 2004). Thus, to develop a more favorable climate for international investment and to protect the host States' interest, it is necessary to foster their economic situation and provide a suitable legal system and settlement mechanism. Without a proper legal system, other aspects of a State such as its political and social factors would disrupt the process of investment in the host State.

The International Centre for Settlement of Investments Disputes ("the Centre") provides arbitration and conciliation as preferable means of dispute resolution through its convention. As in any international business dispute settlement, arbitration has always been the best alternative dispute resolution for its assured advantages such as confidentiality, flexibility and impartiality of the arbitrators (Margaret L. Moses, 2008).

However, parties often challenge the Centre's jurisdiction. In fact, as shown in many cases submitted before the court, the Centre still struggles to define its jurisdiction specifically in regards with its jurisdiction *ratione materiae,* where considerable ambiguity is present within its terms. Previous case law have shown frequent objections towards the Centre's jurisdiction by arguing from the description of the facts, unclear condition of the investment's existence, the position of the parties towards the case, and the holding of the Tribunal (Sule Akyuz, 2001). In this paper, the problem that will be discussed relates to a ground for jurisdiction *ratione materiae* of the Convention, which is the investment's existence, which according to ICSID's purpose should espouse a requirement for Economic Development. Such purpose is argued to be the primary background of the Centre, and this concept has a greater influence in interpretation than the mere words of the preamble (Zachary Douglas, 2009).

B. ICSID and The Convention: An Overview on Jurisdiction and Challenges

In disputes between host States and investors, cases would have been previously submitted to the domestic court of the host State. Obviously, it is a disadvantage for the investors as the court's decisions could potentially be partial to the homeland. Nevertheless, diplomatic protection is used as shelter for the investor. Unfortunately, diplomatic protection also has several disadvantages, as the investor must have exhausted all local remedies in the host country first. Moreover, diplomatic protection is discretionary and the investor has no right to invoke it on its own accord.

Considering such circumstances, and also following the growth of FDI disputes, it was necessary to have a suitable mechanism that enables the accommodation of settlements in international investment disputes. In 1950, the Organization for European Economic Cooperation made several agreements to create a framework to support and protect investments worldwide. This was then followed by proposals from the General Counsel of the International Bank for Reconstruction and Development ("the World Bank") to make a multilateral agreement in order to settle investment disputes on the basis of arbitration and conciliation. The Board of Directors of the World Bank then approved the final draft of the agreement, titled the Convention on

the Settlement of Investment Disputes between States and Nationals of Other States ("the Convention"). Following this event, on October 1966, the Convention came into force.

After the Convention came into force, a large number of signatory states followed suit and became members of ICSID. Those members are also members of the World Bank as the latter finances the ICSID Secretariat's expenses and all its establishment cost. The Centre was established to provide facilities for the arbitration and conciliation of investment disputes and to promote the flow of foreign investment between developed and developing countries. What is important to consider is that all of those transactions were made to create economic development.

There are differences between ICSID as an arbitration institution with other arbitration institutions:

1) unlike other arbitration institution, ICSID is an international organization established by the Washington Convention;
2) ICSID has a completely indistinguishable relationship with the World Bank;
3) ICSID proceedings could be performed in international law as implemented in the Convention. It is an independent mechanism;
4) the role of national litigation is to confirm and enforce the recognition of awards from ICSID tribunal; and
5) ICSID arbitration aims to maintain the balance of interest between investors and host states. It is a unique arbitration facility with a purpose that goes beyond the resolution of disputes between investors and states (Dolzer, 2008).

ICSID consists of two bodies, the Administrative Council and the Secretariat. The Administrative Council is the governing body of the Centre and its function consists of various administrative tasks such as approving ICSID's annual report and its administrative budget. The Secretary General meanwhile, heading the secretariat, appoints and dismisses staff members, registers requests for arbitration and conciliation, authenticates and certifies final arbitral awards, appoints a secretary for each arbitral tribunal, and various other tasks. ICSID maintains a panel of arbitrators and conciliators from which parties may select individuals to resolve the submitted dispute. Each of the Contracting States may designate 4 arbitrators and 4 conciliators of any nationality with the appropriate expertise (the Convention, Art. 13). Persons designated to serve on the panels shall be of high moral character and have recognized competence in the fields of law, commerce, industry or finance and may be relied upon to exercise independent judgment (the Convention, Art. 14). Compared to *ad hoc* arbitrations, the Convention offers considerable advantages; it offers a system for dispute settlement that contains not only standard clauses and rules of procedure, but also institutional support for the conduct of proceedings (ICSID 2.1. Overview, 2002).

In the Convention, Art. 25(1) regulates the Centre's jurisdiction by stating that:

> "the jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the

> dispute have given their consent, no party may withdraw its consent unilaterally"

Thus, the requisite elements for the competence of a tribunal under the Centre are: 1) the requirement of a legal dispute; 2) the requirement that the dispute arises directly out of underlying transaction; and 3) that such underlying transaction qualifies as an investment. Unfortunately the Convention has not clearly defined the terms 'legal dispute' and 'investment'. Thus jurisdiction *rationae materiae* became one of the distinctive points of contentions in ICSID. An example thereof is the meaning of the phrase 'out of an investment'. The vagueness of this term has led to jurisdiction *rationae materiae* becoming an issue in ICSID. To prove whether or not ICSID has jurisdiction, it is very important to seek jurisdiction *rationae materiae*.

It is found that case laws from the Tribunal have frequently displayed complications in defining the term 'investment', which would eventually lead towards objections to the Centre's jurisdiction. In the case of *Fedax v. Venezuela*, the Respondent challenged the Centre's jurisdiction by contending that the promissory notes given by the Claimant as the investor, is not a form of investment. Also in CSOB *v. Slovakia*, the Respondent also pleaded that the consolidation agreement made by both parties is also not a form of investment. The Respondent in the above cases argued that the arbitration proceedings were not legitimate as it does not arise from an investment and thus contrary to Art 25(1) of the Convention. In most cases, including the two cases above, the Tribunal rejected the Respondent States' challenge to jurisdiction. However the Commentary on the Convention expressly states that the requirement of directness requires a dispute to be reasonably closely connected to an investment (Schreuer, 2001). What happened in both cases was that the relevant legal documents between the parties were argued by respondents to be non-investment documents and thus not considered to be valid forms of investment carried out in the host state.

Fedax and CSOB were cases where a state party was dragged to an incompetent tribunal, which should have had no jurisdiction *rationae materiae*. Besides, the distressing fact that mere documents without concrete investment following them up could lead to grounds for arbitration, there are also several disadvantages for the host state. Investor-state arbitration initiated by investors solely to pursue commercial interests often conflict with the policy goals of states. Investment arbitration, not subject to restraining considerations that apply to state to state dispute settlement; could expose parties to potentially costly international arbitration and awards. Furthermore, problems of regulatory chills associated with risk of claim being brought; the lack of accountability of investors; legitimacy and democracy concerns; and lack of familiarity of arbitrators with non-investment issues also riddles ICSID arbitration (Schill, 2009).

C. Economic Development as the Core Concept of ICSID

The term Economic Development refers to the deliberate effort to improve the economy of a specified geographic area, which can be as large as an entire nation-State or as limited as a city neighborhood (Centre for Community Enterprise, 2012). A general definition of this would be the process of raising the level of prosperity and material living in a society through increasing the productivity and efficiency of its economy. The Convention's primary aim is the promotion of Economic Development. The Convention is designed to facilitate private international investment through the creation

of favorable investment climate (Harahap, 2006), furthermore the World Bank's purpose of creating this convention is to reduce poverty in middle-income country by promoting sustainable development (World Bank, 2012). These purposes are intrinsic to the concept of investment in the Convention.

The Convention was born with the goal to pursue economic development as proven by its preamble which reads:

> "[the Contracting States] considering the need for international cooperation for economic development, [and the role of private international investment therein]..."

Moreover, the link between an orderly settlement of disputes, the stimulation of private international investments and economic development is explained in the Report of the Executive Directors on the Convention in the following term:

> "in submitting the attached Convention to governments, the Executive Directors are prompted by the desire to strengthen the partnership between countries in the cause of economic development"

That is one of the reasons why the tribunal in *Amco v. Indonesia* explained that ICSID tribunal is in the interest of not only investors, but also of host States (Amco 1983). There is also clear link between ICSID and the World Bank, which has strong developmental goals in its lending practices. For example the purpose of the World Bank according to the Article of Agreement in IBRD is, among others, to facilitate and encourage international investment for; a) productive purposes; b) for the development of the productive resources of countries to increase productivity, standards of living and conditions of labor.

Thus in regards to the problem of ambiguity of the term 'investment' in the Convention, it can only be fulfilled by the manifestation of the investment itself. No matter the definition given by the parties in the term "investment" it must always embody some sort of development for the host State. The objective meaning of every single word in the Convention is already present in the basis of the Convention. As Economic Development becomes the element that must be fulfilled, thus for acts or businesses to be considered as investments under the Convention, significant development for the host state must be effected. This issue of jurisdiction *ratione materiae* in the Convention of defining the term of investment becomes a one of the significant objection towards ICSID competency.

D. Economic Development Concept in its Impact to the Convention's Dynamic Changes

Most international investment law cases, when determining the existence of an investment, have been made in accordance with the concept of Economic Development. As the Convention does not define the term 'investment', tribunals have considered whether there are certain criteria that can be incorporated into its provision to determine when an investment has been made for the purpose of the Convention. However, the divergence of opinion on the extent to which contribution to Economic Development is determinative of an investment's entitlement seems to stem from the difficulties associated with how to define and measure economic development and ascertaining what constitutes relevant contribution towards it.

This absence of proper definition of 'investment' has given rise to issues where they have to determine the word 'investment' so that parties involved could prove jurisdiction *ratione materiae* to the Convention.The importance of economic

development for an ICSID protected investment cannot be underestimated. In the case of *Malaysia Historical Salvor v. Malaysia*, sole arbitrator Michael Hwang found that a positive and significant contribution to the economic development of the host state is a requirement for the investment to be ICSID protected (Bolivar, 2010). However,it is not easy, and sometimes impossible, to ascertain the existence of economic development. Furthermore in *Salini Costruttori SpA and Italstrade SpA v. Kingdom of Morocco*, the case established a test known as *the Salini test*, which proposed a combination of criteria in determining contributions towards economic development, these are namely: a) be made for public interest; b) to transfer know-how; c) enhance the Gross Domestic Product of the host state; d) make a positive impact on the host States development. The *Salini* testhas been followed by tribunals in many subsequent disputes, some in whole, some in part, and some with subtle changes.

In the *Salini* test, the term investment implies a contribution towards the Host State's development, this judgment is followed by other tribunals, such as in *Saipem v. Bangladesh*, where it upheld the relevance of economic development as a prominent requirement for the existence of investment, and further implied that the contribution to the Host State development should be significant. Heavy reliance on the existence of economic development as a defining characteristic could be seen as ignorance towards the legal terms consented by both parties, which might not require development. To cover that ignorance, the Tribunal in *Bayindir v. Pakistan* had adjusted that determination would depend on the circumstances of each case, even though *the Salini test* has been applied in the first place.

However, ICSID Tribunals are currently minimizing the relevance of economic development as the prominent element and often dismiss host State's objection to jurisdiction that the so called 'investments' brought to arbitration have not contributed to their development. This condition is also supported by the decision of several tribunals. In *LESI S.p.A. v. Algeria* for example, the Tribunal overruled *the Salini* test by dismissing the need for Economic Development as primary objective of the Convention's terms. Though the Tribunal held that the *Salini* test is only applicable in a given context, it held that it cannot be applied as a general rule, but on a case-by-case basis. The Tribunal found that specific elements in the concept of investment, i.e. duration of the investment, assets contribution, a certain risk, and a significant contribution to the economic development, would prevail over Economic Development because those elements are objective in nature and provide certainty, unlike the term 'Economic Development' which is hard to be determined.

Further, in *PSEG v. Turkey*, the Tribunal did not even consider the issue of development at all because the existence of an investment was so real to it that it was not even worth going through the *Salini* test. Regarding the connection between economic development and its contribution to the definition of investment, the arbitrator in *Malaysian Historical Salvors* found a yardstick to such object. The arbitrator highlighted the element of "significance" of the contribution to the host State's development and based his decision to decline jurisdiction (Mortenson, 2010). Sole arbitrator Hwang found that a positive and significant contribution to the economic development of the host State was a requirement for the investment to come under the protection of the Convention. Significantly, the Tribunal held that enhancing the Gross Domestic Product of the local economy was the factor that

determined the criterion of economic development.

E. Closing

Economic development as a fundamental legal requirement indeed is far too wide and subjective to offer solid ground to argue lack of jurisdiction before an ICSID Tribunal. What is extracted from both doctrine and case law is that the law does not allow too much hope for a Host State to argue thus. However, it should be noted that the main purpose of ICSID is still to foster Economic Development. Its absence would turn the Convention inapplicable and the Tribunals incompetent.

ICSID does not recognize *stare decisis* (Waldron, 2011),as international investment law does not incorporate such concept (Schill, 2009),hence Tribunals are not bound by precedents such as those rejecting the proposed argument. This makes the defense technically possible for an attempt by Host States if the facts of the case so allow. Nevertheless, taking into account the ambiguity of the concept of economic development together with the international community's investor friendly position, means an almost certain refusal by an ICSID Tribunal of such an argument.

Consequently, it would be advisable for a Host State raising an objection to the jurisdiction of the Centre based on the absence of economic development in its territory to prove, however difficult, that not even a hint of development arouse out of the claimant's investment. The Host State could also argue, even if there had indeed been some contribution to its development by the claimant, if none of the other elements of *the Salini test* had been met, that the contribution to its development had not been significant enough to sustain itself. These objections would result in a matter of a soft proof. For this reason a party relying on them should set up the most complete and convincing plea as possible.

In simple conclusive term, the concept of Economic Development is expressly stated both in the Preamble to the Convention and in the Report of the Executive Directors. Based on those facts and supporting arguments from case to case, if the investment does not encourage the Host State's development, then it would fall outside the scope of the Convention. Unfortunately, ICSID cases are not that simple since ICSID Tribunals are not bound by *stare decisis*, thus, it should be feasible for a state to challenge to the jurisdiction of the Centre on that basis.

Seeing that parties always have the freedom to choose the forum, it is advisable for the investor not to choose ICSID as the exclusive forum, but to set it as an option among other institutions or courts.

Economic development is certainly a concept that can be very broad and can encompass many disparate elements. However, through a review of the relevant documents and cases, several factors have emerged that point to certain criteria which are not exclusive, for determining when an investment has made a contribution to the economic development of the host state.

Although it is still very much a controversial and debatable area of international investment law, it is clear that several factors need to be satisfied under the test of whether an 'investment' has contributed to the economic development of the host state. If an investment is contrary to the public interest, has not transferred any knowledge to the host state, has not developed the economy, it almost certainly not made a proper contribution as required by the Convention.

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