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# ROLE OF BILATERAL INVESTMENT TREATIES IN ECONOMIC DEVELOPMENT: PAKISTAN'S PERSPECTIVE

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## Executive Summary

Bilateral Investment Treaties (“BITs”) have played a double-edged role in the economic development and progression of Pakistan. It is claimed that BITs have aided in attracting inward Foreign Direct Investment (“FDI”) in a variety of sectors in Pakistan. However, BITs have also narrowed down Pakistan’s policy-making space impacting the country’s domestic decision-making capabilities and shifting the balance of power in favour of foreign companies. In many clauses of the BITs, there are serious issues such as an expansive definition of “foreign investment” and the presence of “stabilisation clauses” which results in the leverage shifting towards foreign companies. In addition, a tailored approach towards the ratification of BITs with certain countries is the most plausible path for Pakistan.

Furthermore, investments under BITs in projects with high sunk costs and those which need greater political stability are most effective. For this purpose, the energy, manufacturing and mining sectors are extremely important. Investors are also attracted towards sectors with fewer chances of expropriation such as the ones which require advanced skills. It is also essential for the government to realize that the linchpin for attracting FDI is to focus on the institutional capacity of the government. BITs only serve to supplement the existing infrastructure and cannot act as sole guarantors of FDI. In summation, for creating conditions where FDI positively contributes to the growth of the Pakistani economy, a combination of revamping the structure of BITs as well as domestic reform is the need of the hour.

## Policy Recommendations

- **BIT Framework Amendment**

Key terminology such as “investors” should be expressly tailored to investing corporations and should specifically exclude shell companies. “Foreign Investments” must be “ideally” tailored to those sectors which have high sunk costs like electricity and infrastructural development. The ‘Fork in the Road’ clause need to be added within existing BITs and any future BITs with a special focus on drafting the clause.

- **Evaluation of Adjudication Framework**

The framework in place in the BITs signed by Pakistan can vastly improve in two respects. It needs to move beyond the International Centre for Settlement of Investment Disputes (“ICSID”) and revert to the Chinese BIT structure that is based on expropriation plus domestic arbitration. This will ensure that a dispute does not

automatically trigger international arbitration as Pakistan's track record suggests antagonistic decisions against the State in such cases.

- **Political and Economic Reforms**

The relationship between FDI and BITs is driven by *endogeneity*<sup>1</sup> and there is scant evidence supporting the assertion that BITs have a direct impact on FDI.<sup>2</sup> Pakistan needs to focus on the synchronized approach in which the basic infrastructure is built with BITs acting as a filler with other efforts in unison. BITs are more effective in attracting investment in sectors that have high sunk costs like electricity and infrastructural development as well as technology transfer and human resources.

- **Capacity Building Initiatives**

In light of Pakistan's volatile political climate and many other infrastructural shortcomings, BITs offer investors a guarantee of protection of their property rights. Pakistan must ensure political and judicial institutions are sufficiently empowered and trained to protect investors. BITs must be discussed democratically before the process of ratification is undertaken.

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<sup>1</sup> In statistics, *endogeneity* refers to the correlation between the independent variable and unexplained variation (or "error") in the dependent variable.

<sup>2</sup> Emma Aisbet, 'Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation', (2007) 2255 Munich Personal RePEc Archive, < [https://mpra.ub.uni-muenchen.de/2255/1/MPRA\\_paper\\_2255.pdf](https://mpra.ub.uni-muenchen.de/2255/1/MPRA_paper_2255.pdf) > accessed 1 June 2024

## Introduction

In 2022, FDI inflows equalled USD 1.3 trillion. Half of these FDI's were invested in developing countries. However, Pakistan received just a small fraction of this amount.<sup>3</sup> BITs are often considered to attract FDI's. After the end of Zia's regime, Pakistan adopted policies which allowed fiscal and trade incentives. For the first time in Pakistan, foreign investors were allowed to keep 100% of their share in the investment. Twelve BITs were signed in 1995 alone.<sup>4</sup> The collapse of the Soviet Union allowed many States in Eastern Europe to remove barriers to trade and investment which resulted in favourable tax policies for foreign investment. The idea to promote FDI from multinational firms ("MNCs") was to create employment and to transfer technology for the advancement of the host countries.<sup>5</sup>

However, BITs have also resulted in many financial penalties for Pakistan. In *Agility for Public Warehousing Company K.S.C v. Islamic Republic of Pakistan*, ICSID Case no. Arb/11/8, Kuwait's company filed an arbitration before the International Centre for Settlement of Investment Disputes ("ICSID") that the new software for customs clearance was built by Kuwait's software company. The compensation claimed was an astounding amount of USD 650 million against Pakistan.<sup>6</sup> Therefore, the impact of BITs must be perused comprehensively from all facets before their signing to assess their legal and economic impact. In addition, it is also important to reiterate some of the key conceptual points from a legal perspective to frame this policy brief.

## What is a BIT?

A BIT is an instrument ratified between two countries laying out fundamental principles regarding dispute settlement mechanisms as well as core tenets on investor protection and activity in each respective State party. The first-ever BIT was signed in 1959 between Pakistan and Germany and the number continued to exceed 2,500 globally as of 2024.<sup>7</sup> As for Pakistan,

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<sup>3</sup> Mahnaz Malik, 'International Law Protections for Foreign Investment in Pakistan' (Overseas Investors Chamber of Commerce and Industry, December 2010).

<sup>4</sup> Rekha Rangachari, Fatima Aslam, Kabir Duggal, Adeel Wahid, 'It Is Not a BIT Race, It Is a BIT Marathon: Comparing Pakistan's and India's Evolving Approach to Investment Policy', (2022) 39:5 [Journal of International Arbitration](#) 631

<sup>5</sup> The Role of Bilateral Investment Treaties in Promotion of Foreign Direct Investment Inflows: Evidence from Small Open Economy, *Pakistan Languages and Humanities Review* April-June, 2022, Vol. 6, No. 2, 1137, 1139

<sup>6</sup> Rashida Abbas, Muhammad Akif Rashid, Fazal Elahi Bilal, 'Disputes Arising out of Foreign Direct Investments in Pakistan: A New Look at Legal and Political Issues', *Pak. Journal of Int'l Affairs*, Vol 5, Issue 2 (2022) 1066, 1076

<sup>7</sup> OECD, 'The Future of Investment Treaties' < [www.oecd.org/investment/investment-treaties.html](http://www.oecd.org/investment/investment-treaties.html) > accessed 27 May 2024

the number of BITs signed and enforced stands at 31.<sup>8</sup> As a developing nation, Pakistan has many key benefits to accord from signing BITs with developed countries.

Conceptually, FDI serves two primary purposes in developing economies. First, it helps finance the development of infrastructure. Secondly, it generates employment for local workers. BITs, in turn, serve two key purposes in attracting FDI. Most importantly, the treaties offer a safety net to foreign investors regarding their property rights in the host state.<sup>9</sup> BITs also tend to redress discrimination against foreign investors by giving preferential access to international arbitration as a dispute resolution mechanism. This ensures preferential legal and regulatory treatment of all investors and encourages them to expand, especially where protection accorded via domestic laws, is insufficient.<sup>10</sup>

### **Evolutionary Framework of BITs in Pakistan**

Pak-German BIT was the first BIT which Pakistan signed. Initially, It did not allow the parties to directly seek any international adjudicative platform for investor-state disputes. With the French and Kuwaiti BITs signed in 1978 and 1983 respectively, Pakistan finally recognized ICSID's jurisdiction for the first time for dispute settlement.<sup>11</sup> This provided a channel for both the States and their investors to now approach an international tribunal directly.

However, there appeared to be a different approach by Pakistan in 1989 after signing its BIT with China.<sup>12</sup> Articles 4 and 10 of BIT with China provide that the investor can only claim compensation in cases of expropriation. When expropriation occurs, the investor can then either challenge its legality or bring it to the host country's appellate tribunal. It is only after a certain period has expired that the investor is then granted the right to approach an international tribunal.

This approach was slightly modified in the Free Trade Agreement ('FTA'), signed between Pakistan and China in 2006. In this FTA, the investor was provided an option to initiate proceedings before ICSID or a domestic tribunal after six months of negotiations.<sup>13</sup> This was

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<sup>8</sup> UNCTAD Investment Policy Hub, 'International Investment Agreements Navigator' <[www.investmentpolicy.unctad.org/international-investment-agreements/countries/160/Pakistan.html](http://www.investmentpolicy.unctad.org/international-investment-agreements/countries/160/Pakistan.html)> accessed 27 May 2024.

<sup>9</sup> Mary Hallward-Driemeier, 'Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite' (World Bank, DECRG, June 2003).

<sup>10</sup> Jonathan Bonnitcha, 'Assessing the Impacts of Investment Treaties: Overview of the evidence' (IISD Report, September 2017).

<sup>11</sup> UNCTAD Investment Policy Hub, 'International Investment Agreements Navigator' <[www.investmentpolicy.unctad.org/international-investment-agreements/countries/160/Pakistan.html](http://www.investmentpolicy.unctad.org/international-investment-agreements/countries/160/Pakistan.html)> accessed 30 May 2024.

<sup>12</sup> 'Agreement Between The Government of The People's Republic of China And The Government of The Islamic Republic of Pakistan Concerning The Promotion and Protection of Investments' (1989).

<sup>13</sup> Article 9, China – Pakistan Free Trade Agreement

not in Pakistan's best interests, as the most beneficial route for Pakistan was to opt for a "mutually accepted tribunal" rather than ICSID. It must be noted that almost all BITs concluded by Pakistan referred explicitly to either ICSID or some other form of an *ad-hoc* tribunal as a way of dispute settlement.

However, Pakistan has encountered great difficulty in subsequent BITs, particularly the one signed with Australia in 1998 which resulted in the *Reko Diq* dispute.

### **Impact of BITs on Pakistan**

Economic models have depicted some positive impacts of BITs to attract FDI. For countries like Pakistan, BITs have significantly increased vertical FDI inflows. The primary reason for this model is the need for cheap labour and raw materials for the supply chains of Western markets for an increase in vertical FDI inflows.<sup>14</sup>

It is argued that BITs signed with key economic partners play an essential role in attracting inward FDI in Pakistan. For instance, the BIT signed with Japan in 1998 contains an express provision in Article 12 specifying that each party is to bear its costs of appointing their arbitrator(s).<sup>15</sup> This ensures two key things. Firstly, each party can remain assured that the arbitrator would remain neutral since they are responsible for individual costs. Secondly, high-quality arbitrators can be appointed in a cost-manageable manner with the parties being aware of their obligations from the outset. Therefore, such BITs do provide a substitute for poor legal adjudication to attract FDI.<sup>16</sup>

One of the main elements of the BITs is embedded in the signalling approach. The liberal economic system of the world values the consistency and credibility of institutions. Therefore, when a country consistently ratifies BITs with other countries, it represents a commitment to the international economic system.<sup>17</sup>

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<sup>14</sup> The Role of Bilateral Investment Treaties in Promotion of Foreign Direct Investment Inflows: Evidence from Small Open Economy, Pakistan Languages and Humanities Review April-June, 2022, Vol. 6, No. 2, 1137, 1140

<sup>15</sup> 'Agreement between Japan and the Islamic Republic of Pakistan Concerning The Promotion and Protection of Investment' (1998), (n2).

<sup>16</sup> Niemeyer, Eric & Spess, Laura, 'Do bilateral investment treaties increase foreign direct investment to developing countries?' (LSE, Feb 2006) <<https://eprints.lse.ac.uk/627/>>

<sup>17</sup> Michael N. Jacobs, 'Do Bilateral Investment Treaties Attract Foreign Direct Investment to Developing Countries? A Review of the Empirical Literature', International Relations and Diplomacy, October 2017, Vol. 5, No. 10, 583, 586

## Tailored Impact of BITs

There is a growing literature in support of the proposition that BITs are not necessary to attract FDI. It is no surprise that Brazil, with over USD 86 billion in inward FDI in 2022, has only signed and enforced 3 BITs relative to Pakistan's inward FDI of USD 1.3 billion and 31 BITs.<sup>18</sup> Therefore, it is often postulated that other factors are essential for attracting FDI and BITs only serve in a complementary fashion.

One of the main factors which assist in attracting FDI is the political stability complemented with an increase in the governance index. The governance index requires a very robust system in which there is very little government intervention to artificially control economic situations; less red tape in bureaucracy and a very secure conception of property rights. This depicts that factors other than the mere signing of BITs are important to attract FDI.

Merely signing a BIT attracts FDI in the short run. Therefore, BITs were primarily successful in developed countries where there was better rule of law, good energy infrastructure and strong public institutions.<sup>19</sup> BITs have increased investment only if there are strong domestic institutions.<sup>20</sup> Similarly, measures such as ratification of a tax treaty can also weaken FDI especially if they are ratified at the same time as a BIT.<sup>21</sup>

A liberal economy is a prerequisite for reaping the benefits of BITs. It is contended that trade openness has a direct corollary with an increase in FDI. Protectionist policies do not result in favourable outcomes for generating FDI or positive signalling to the investors. Market size also has a significant impact on attracting FDI as investors find higher sales and better economies of scale in bigger markets.<sup>22</sup> Most importantly, it is the increase in purchasing power and labour productivity, rather than low labour costs, which increases the inflows of foreign investment.<sup>23</sup>

It is also observed that foreign investors who come from countries with delayed trials do not alter their investment decisions due to the termination of applicable BITs. This was different for investors who come from countries with more robust justice systems. Therefore, the link

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<sup>18</sup> UNCTAD World Investment Report, 'Global foreign direct investment flows over the last 30 years' (May 2023).

<sup>19</sup> The Role of Bilateral Investment Treaties in Promotion of Foreign Direct Investment Inflows: Evidence from Small Open Economy, Pakistan Languages and Humanities Review April-June, 2022, Vol. 6, No. 2, 1137, 1147

<sup>20</sup> Hallward-Driemeier, Mary, Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a BIT and They Could Bite (June 2003). Available at SSRN: <https://ssrn.com/abstract=636541>

<sup>21</sup> Hallward-Driemeier, Mary, Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a BIT and They Could Bite (June 2003). Available at SSRN: <https://ssrn.com/abstract=636541>

<sup>22</sup> The Role of Bilateral Investment Treaties in Promotion of Foreign Direct Investment Inflows: Evidence from Small Open Economy, Pakistan Languages and Humanities Review April-June, 2022, Vol. 6, No. 2, 1137, 1148

<sup>23</sup> Liesbeth Colen, Damiaan Persyn, Andrea Guariso, 'Bilateral Investment Treaties and FDI: Does the Sector Matter?', World Development Vol. 83, pp. 193, 197, 199-200



between the termination of BITs and FDI was dependent on the host state's justice system and the overall legal and corporate structure in which the investor was operating.

### **Industrial Niche and FDI**

It is extremely important to analyse the impact of BIT on FDI about the type of investment. Projects involving large sunk costs with a higher degree of irreversibility become more attractive if a country has signed BITs with the origin country of the investing company. Similarly, politically sensitive investments also benefit from the presence of BITs. These areas primarily include mineral extraction, excavation and infrastructure projects.<sup>24</sup>

The risk of expropriation is lower in sectors which have a higher number of non-transferable assets. Investors are attracted to sectors which have lower risks of expropriation such as manufacturing and service industries where there is a large degree of firm-specific knowledge. In comparison, sectors which are considered strategic such as utilities, railways or mining are at a high risk of expropriation.<sup>25</sup>

### **Developing Countries and BITs**

To attract investments, developing countries often bargain for the prospect of economic growth and development. In return, they often compromise economic sovereignty in the form that their ability to “regulate and extract from MNCs” becomes limited. In addition, developing States offer foreign investors special treatment while domestic investment is placed at a competitive disadvantage. This often pushes out domestic investment.

In addition, dispute settlement provisions containing a referral to ICSID result in a reputational crisis for the host country which causes additional damage. The result is that these BITs tie the hands of developing States, especially in relation to the MNCs, and the activities of these corporations go unchecked. For instance, even in South Africa’s post-apartheid property re-

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<sup>24</sup> Liesbeth Colen, Damiaan Persyn, Andrea Guariso, ‘Bilateral Investment Treaties and FDI: Does the Sector Matter?’, World Development Vol. 83, pp. 193, 194

<sup>25</sup> Liesbeth Colen, Damiaan Persyn, Andrea Guariso, ‘Bilateral Investment Treaties and FDI: Does the Sector Matter?’, World Development Vol. 83, pp. 193, 197, 199-200



distribution, MNCs covered under the BITs were allotted more favourable treatment, as compared to the ones not covered under a BIT.<sup>26</sup>

The claim that BITs can be homogenous is also a myth. The balance of power between States dictates the fine details of BITs even if the overall structure of the treaty seems homogeneous. For instance, if there is a provision for the transfer of money back to the MNC's home State in the BIT or the allowance for the MNC to bring its management team, this can result in a better quantum of FDIs.<sup>27</sup>

Further, increasing inward FDI has been linked to natural resource depletion in developing countries through generating money from unsustainable business practices. Developing countries are used as "supply depots".<sup>28</sup> This causes FDI to increase, which leads to financial dependence and resource depletion, enhancing FDI as the sector grows albeit unsustainably. Eventually, this forces the nation to shape its economic policy in a convenient direction for the investing nation.

As was observed in the *Reko Diq* case, for instance, the domestic policy had to accommodate the foreign investor by the extra mile. Petitions were submitted to the Baluchistan High Court contesting the constitutionality of the amendments to the *Chagai Hills Exploration Joint Venture Agreement* ("CHEJVA") which had granted the investor a share, as much as 75%, in the mines exploration. The petitions argued that the agreements were illegal due to corruption in the mineral rights granting process. Additionally, they claimed that the mining companies, ineligible for licenses, lobbied for the relaxation of domestic rules. Cumulatively, this was against the vital interests of the people of Baluchistan and Pakistan.<sup>29</sup>

One of the main issues with BITs is the potential loss of policy space in the host country. As a developing country, Pakistan, compared to its more developed counterpart nations, has lower levels of legal capacity to understand and evaluate the legal implications of treaty jargon.<sup>30</sup> In such circumstances, FDI derived from BITs, not only creates long-lasting legal battles, as in the *Reko Diq* case, but also adversely impacts national governance. For instance, in the first *Vattenfall* case, Germany eased the environmental regulations linked to a coal power plant to

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<sup>26</sup> Michael N. Jacobs, 'Do Bilateral Investment Treaties Attract Foreign Direct Investment to Developing Countries? A Review of the Empirical Literature', *International Relations and Diplomacy*, October 2017, Vol. 5, No. 10, 583, 586-588

<sup>27</sup> Michael N. Jacobs, 'Do Bilateral Investment Treaties Attract Foreign Direct Investment to Developing Countries? A Review of the Empirical Literature', *International Relations and Diplomacy*, October 2017, Vol. 5, No. 10, 583, 591

<sup>28</sup> Sofia Caycedo, 'foreign direct investment in developing countries: A blessing or a curse?' (*Yale Environmental Review*, 2018).

<sup>29</sup> Abdul Rafay Siddiqui, 'Pakistan's Need for Amicable Resolutions Concerning Foreign Investment Disputes: The *Reko Diq* Case' (*LUMS Law Journal* 2017: 4(1)).

<sup>30</sup> Jonathan Bonnitcha, 'Assessing the Impacts of Investment Treaties: Overview of the evidence' (IISD Report, September 2017).

resolve an investment treaty dispute.<sup>31</sup> This settlement also brought an end to ongoing domestic court proceedings, in essence, affecting how domestic policy might have been shaped otherwise.

### Issues with the Legalese in BITs

BITs require an investor to be registered as a foreign investor with “substantial business operations”. As a result, there is a concept of treaty shopping which allows corporations to establish hollow companies and acquire the benefits of a BIT with specific countries.<sup>32</sup> Thus, it is no surprise that in the case of *Philip Morris vs. Australia*, the Permanent Court of Arbitration assumed its jurisdiction in the host State, although the host State only imposed conditions for cigarette packaging under its domestic laws.<sup>33</sup>

Under the UK-Pak BIT of 1995, an investor can be a foreign person based on nationality and a legal person based on incorporation. In these BITs, the major beneficiaries of the BITs are the foreign investors although they are not party to the treaty themselves. As a result, MNCs have power in comparison to sovereign States and they can initiate proceedings without even permission of the host state.<sup>34</sup> In the case of BITs between countries like Pakistan and the USA, the USA even incorporates clauses which ensure that all disputes are settled under US laws and the protections are accorded even if the US companies invest via third parties.<sup>35</sup>

Transfer of Funds is one of the most important clauses within BITs. These clauses allow the provision of transfer easily. These are controversial provisions and are considered to be detrimental to the economy. The European Court of Justice has also actively responded to such provisions deeming them as incompatible with the Treaty on the Functioning of the European Union (“TEFU”). As a result, even Pakistan’s updated BIT with Germany declared, in Article 5(7), that the provisions, “shall not be constructed as to prevent a Contracting State from

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<sup>31</sup> *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12

<sup>32</sup> Muhammad Khalid and Tansif Ur Rehman, ‘Investment Protection Under Bilateral Investment Treaties of Pakistan’, (2000) 11: 4 International Journal of Asian Business and Information Management, 44, 46

<sup>33</sup> Ali Nawaz Khan, Bakht Munir, Naveed Ahmad, ‘Critical Analysis of Bilateral Investment Treaties in Pakistan’ (2020) 57:2 Journal of Research Society of Pakistan 163,167

<sup>34</sup> Ali Nawaz Khan, Bakht Munir, Naveed Ahmad, ‘Critical Analysis of Bilateral Investment Treaties in Pakistan’ (2020) 57:2 Journal of Research Society of Pakistan 163,167

<sup>35</sup> ‘Pakistan US Bilateral Trade Agreement’ (Pakistan Business Council) < [https://www.pbc.org.pk/wp-content/uploads/pakistan\\_us\\_bilateral\\_trade\\_agreement.pdf](https://www.pbc.org.pk/wp-content/uploads/pakistan_us_bilateral_trade_agreement.pdf)> accessed 01 June 2024

fulfilling in good faith its obligations as a member of an economic and monetary union”.<sup>36</sup> Pakistan is usually under pressure to include Transfer of Funds clauses in its BITs.

Pakistan has introduced a new BIT template which focuses more on arbitration under the Investment Policy 2013. Under this template, there is a specific period for domestic resolution before either party can initiate international arbitration. However, even this provision can cause issues. In 1996, the Pakistan government cancelled a contract executed with *Societe General de Surveillance* (“SGS”). As a result, multiple legal proceedings began in Pakistan and Switzerland which ended unsatisfactorily for the investor. After five years, Pakistan received a letter to pay USD 110 million to SGS, although domestic litigations had been unsuccessful.<sup>37</sup>

Domestic laws of Pakistan such as the Foreign Private Investment (Promotion and Protection) Act 1976, provide less expansive interpretations as compared to the BIT regimes that Pakistan has signed. For instance, Article 2 of the Foreign Private Investment (Promotion and Protection) Act 1976, defines investment to include traditional investment such as in mining, services or establishment of undertakings such as industry. However, most of the BITs signed by Pakistan have a negative definition excluding certain assets such as commercial transactions and intellectual property rights but allowing space for other kinds of assets.<sup>38</sup>

There are also stabilization clauses in BITs which can freeze the impact of the domestic laws on the investment for more than a decade.<sup>39</sup> Essentially, a stabilization clause is usually entered into where there is a prospect of a long-term investment, as was the case with the *Tethyan Copper Company* (“TCC”), in the *Reko Diq* dispute. These clauses are also a problem because they meddle with the host nation’s domestic laws and policymaking.

### **Fork – in - the – Road Clauses**

An important step for Pakistan is to inculcate the Fork – in – the – Road (“FIIR”) clause in the BITs which Pakistan signs with other countries. The FIIR clause shall ensure that there are no domestic or international arbitral proceedings if a foreign company initiates proceedings in

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<sup>36</sup> Ghouri, Ahmad Ali and Mahmood, Deciphering Pakistan’s Foreign Investment Policy: A Review of Pakistani BITs (October 1, 2012). The Journal of World Investment & Trade, Vol. 13, pp. 812–873, 2012, Available at SSRN: <https://ssrn.com/abstract=2165739>

<sup>37</sup> Muhammad Khalid and Tansif Ur Rehman, ‘Investment Protection Under Bilateral Investment Treaties of Pakistan’, (2000) 11: 4 International Journal of Asian Business and Information Management, 44,45-46

<sup>38</sup> Muhammad Khalid and Tansif Ur Rehman, ‘Investment Protection Under Bilateral Investment Treaties of Pakistan’, (2000) 11: 4 International Journal of Asian Business and Information Management, 44, 46

<sup>39</sup> Ali Nawaz Khan, Bakht Munir, Naveed Ahmad, ‘Critical Analysis of Bilateral Investment Treaties in Pakistan’ (2020) 57:2 Journal of Research Society of Pakistan 163,167

ICSID.<sup>40</sup> If such a provision is not added within BITs, there is a chance that foreign companies shall exploit various legal avenues to extract penalties from Pakistan.

In the drafting of FIIR, it must be explicitly mentioned that FIIR shall not apply if the “fundamental basis of claim” in ICSID is separate from a claim in any local court or arbitral forum. In other words, there shall be no separation or “semantic labelling” to distinguish contractual and treaty claims. In addition, for the inapplicability of the FIIR, the claims need to possess no similar “essential bases”. The claims should also not have the same “factual predicates and request the same relief”.<sup>41</sup>

## FDI and Energy Sector

Since 2009, deteriorating security conditions in Pakistan have resulted in reduced FDI inflows. This is particularly true for the energy sector owing to attacks on electricity installations. After 2013, the energy investment policy was introduced to increase energy investments. The trend observed was that an increase in global FDI does increase the energy inflows.

The energy sector is a high-risk – high return sector and foreign investors are willing to take risks when the international climate is positive as the energy sector requires high capital outlays. However, investments in cheap energy, improvements in energy transmission and restructuring of companies are essential so that FDI in energy generation is efficiently channelled.<sup>42</sup> In such situations, BITs have the potential to play a positive role.

## Recommendations

- **BIT Framework Amendments**

The term ‘investor’ should be applied to the nationality of the investing shareholders rather than under a shell company registered in a third country. In addition, ‘applicable laws’ must be either Pakistan or a third party or never the investing States.

Clauses such as ‘Stabilization Clauses’ need to be never accepted within the framework of BITs.

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<sup>40</sup> ‘Fork in the Road Clauses’ (Norton Rose Fulbright, October 2015)

<<https://www.nortonrosefulbright.com/en/knowledge/publications/0bd10ad8/fork-in-the-road-clauses#:~:text=In%20Fork%20in%20the,for%20in%20the%20relevant%20contractual> > accessed 7<sup>th</sup> July 2024

<sup>41</sup> *Pantechniki SA Contractors & Engineers (Greece) v The Republic of Albania* (ICSID Case No ARB/07/21), Para 61

<sup>42</sup> Sakina Lavingia, ‘Attracting Foreign Direct Investment in Pakistan: The Role of Governance, National Security and Global Investment Trends’, (Thesis, Oberlin College) pp.50-60

The ‘Fork in the Road’ clause needs to be added within existing BITs and any future BITs. The FIIR clause should import test within its drafting that there shall be no similar ‘factual predicates and similar request of the relief’ if any party believes that the FIIR clause must not apply.

‘Transfer of Funds’ clauses need to be subject to the emergency laws in Pakistan. It is essential to consider that BITs are a consistent ingredient of the liberal market policy and work well under a liberal system. However, the perils of an entirely free market on the autonomy of a country cannot be ignored. It must also be mentioned that if domestic arbitration or litigation is mutually accepted, foreign arbitration should not allowed to be initiated.

- **Evaluation of Adjudication Framework**

The Pakistani BIT framework can vastly improve. First, it needs to move beyond ICSID and could revert to the Chinese BIT structure of sticking to expropriation plus domestic arbitration. This will ensure that a dispute does not automatically trigger international arbitration, as our track record shows antagonistic decisions against Pakistan. Rather, the dispute would first go to a domestic appellate tribunal and if unresolved, the aggrieved party can choose to go to international arbitration before a mutually accepted tribunal.

- **Political and Economic Reforms**

There is a requirement to tailor the definition of “foreign investments” within BITs to specifically include and list the activities covered. The focus must be on sectors that have high sunk costs like electricity and infrastructural development as well as technology transfer and human resources. In this regard, protectionism needs to be encouraged to protect the already developed sectors while liberalization for less developed sectors should be encouraged.

There is little support for the effectiveness of BITs to attract FDI. At a point, it was considered desirable for countries with weak institutions to ratify BITs as they protected any unforeseeable political change to foreign investors. A higher growth rate under a better investment policy leads to an increase in the probability of ratification of BITs. Therefore, it is plausible to assume that the relationship between FDI and BITs is driven by *endogeneity* and there is scant evidence to assume that BITs have a direct impact on FDI. However, States are now preferring FTAs over BITs because they boost trade by giving concessions on tariffs while also including chapters on investment protection.

To enforce the aforementioned recommendations, Pakistan is in dire need of political and judicial stability. No technical reform to the BITs or investment policy would produce results as long as there is domestic institutional instability, which reduces the foreign investor's confidence as they contemplate investing in Pakistan. Implementation of practical reforms shall be the key.

- **Capacity Building Initiatives**

It is argued that Pakistan needs to offer investors certain safeguards for greater inward FDI, which can only be achieved through BITs. In light of Pakistan's volatile political climate, sporadic energy shortages, inefficient judiciary and bureaucracy and many other domestic shortcomings, BITs offer investors an essential guarantee of protection of their property rights and interests. BITs are more effective in developing countries with weak institutions. Therefore, Pakistan should not actively dismantle the BIT framework and keep engaging with the BIT framework selectively in a tailored manner. For this purpose, Pakistan must ensure political and judicial institutions are sufficiently empowered and trained to protect investors. Pakistani officials must be aware of the basis of legalese and potential legal issues arising from their decisions.

BITs must be discussed democratically before the process of ratification is undertaken. If Pakistan signs a BIT with powerful countries such as the USA, there must be due diligence for each provision with input from all stakeholders. For instance, the BIT between the USA and Korea was signed after intense negotiations for five years. Additionally, there is research that indicates that including certain sectors within BITs shall benefit Pakistan in the long run. For this purpose, the first step shall be to initiate a treaty with basic provisions with a clause to renegotiate a treaty in the next 3-5 years to outline the structure. In these five years, a council should be established to negotiate and jointly research opportunities for trade and investment.

## Action Matrix

### Legal Options for Government

Recommendations	Pathways to Solution	Implementation of Solution	Actors Responsible	Implementation Timelines
<b>Evaluation of Adjudication Framework</b>	Pakistan needs to ensure that the dispute goes first to a domestic appellate tribunal and, if unresolved, the aggrieved party can choose to go to international arbitration before a mutually accepted tribunal.	Pakistan needs to move beyond ICSID and needs to revert to the Chinese BIT structure of sticking to expropriation plus domestic arbitration.	<ul style="list-style-type: none"> <li>• Board of Investment</li> <li>• Ministry of Law and Justice</li> <li>• Office of the Attorney General</li> <li>• Ministry of Foreign Affairs</li> </ul>	<p>3-6 Months for the Study and Re-Evaluation of BITs</p> <p>Ongoing Process-Renegotiation of BITs</p>
<b>BIT Framework Amendments</b>	Pakistan must eliminate, add and rephrase certain clauses which have cost the country a great deal. Clauses to view include FIIR and stabilization clauses.	The FIIR clause should import test within its drafting that there shall be no similar ‘factual predicates and similar request of the relief’. Transfer of Funds clauses need to be subject to the emergency laws in Pakistan while the stabilization clause needs to be never accepted within a BIT.	<ul style="list-style-type: none"> <li>• Board of Investment</li> <li>• Ministry of Law and Justice</li> <li>• Office of the Attorney General</li> </ul>	<p>6 Months for the Study and Re-Evaluation of BITs</p> <p>Ongoing process of re-evaluation</p>
<b>Economic Policy Reform</b>	Pakistan must produce tailored economic policy, to attract foreign investment, specifically for sectors which have high sunk costs like electricity and infrastructural development.	Protectionism needs to be encouraged to protect already developed sectors while liberalization should be undertaken for less developed sectors. This will ensure investors’ confidence and retain domestic policy-making ability.	<ul style="list-style-type: none"> <li>• Ministry of Finance</li> <li>• Ministry of Commerce</li> <li>• Ministry of Economic Affairs</li> <li>• Board of Investment</li> </ul>	<p>2-6 Months for consultation and research</p> <p>6-12 Months for policy and legislative reform</p>
<b>Capacity Building Initiatives</b>	Pakistan must ensure political and judicial institutions are sufficiently empowered and trained to protect investors. Officials must be aware of the basis of legalese and potential legal	Legislative and non-legislative provisions must be drafted that give greater independence to these institutions to ensure safety and security, as well as just decision-making. Sufficient consultation.	<ul style="list-style-type: none"> <li>• Office of the Attorney General</li> <li>• Ministry of Law and Justice</li> <li>• Ministry of Commerce</li> <li>• Ministry of Foreign Affairs</li> </ul>	<p>Ongoing Process</p> <p>Capacity building and training of Pakistan’s international legal obligations</p>



	issues arising from their decisions.		<ul style="list-style-type: none"><li>• Board of Investment</li></ul>	
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