

## BOOK REVIEW – August 2000

**A Review of "NAFTA AND THE ENERGY CHARTER TREATY" by Mirian K Omalu, Kluwer Law International, The Hague, 1999 ISBN 90-411-1076-3**

The Forth Bridge which straddles the Firth of Forth in Southern Scotland is a tribute to Scottish engineering excellence. Amongst other things, it provides efficient access for bankers from Edinburgh to visit their agricultural customers in the fertile meadows of Fife, their tourism industry customers in the golfing precincts of St Andrews and their North Sea oil and gas customers operating out of the port city of Aberdeen. Almost equidistant between Edinburgh and Aberdeen is the city of Dundee, famed for its university and the Centre for Energy Petroleum and Mineral Law and Policy (CEPMLP), established a little over 20 years ago in the aftermath of the OPEC crisis.

Like a facility such as the Forth Bridge, the CEPMLP is a form of public infrastructure in the sense that, as an institution of educational excellence, it underpins the intellect, skills and other qualities of the population. To me, however, what most distinguishes the CEPMLP from other centres of educational excellence is its special focus of interest on "legal infrastructure", that is on the body of legal rules concerned with the conduct of economic activity. This book is actually a manifestation of that special focus.

In 1992, the World Bank and the International Monetary Fund published the World Bank Guidelines on the Treatment of Foreign Direct Investment. These guidelines endorsed national treatment, non-discrimination among foreign investors, fair and equitable treatment, protection and security. Although the Guidelines did not clarify international law or lay down rules on foreign investment, they nonetheless influenced the fundamental provisions on investment which have now appeared in the North American Free Trade Agreement (NAFTA) and the Energy Charter Treaty (ECT), the two international treaties which are the subject of this book.

In the contemporary world of global investment, no nation-state can be a unitary player. State sovereignty has entered a new era. As Omalu sees this:

*"The idea of real sovereignty is substantially undermined by the actual effect of world economic interdependence which can cause billions of dollars to move across boundaries with a flick of a computer key, and creates speedy cross-boundary impacts of interest rate fluctuations, tax and fiscal policy, deregulation, and the like."*

To be a player in the international economic system, the state must actualise and exhibit its sovereignty by participating in the international regimes that not only regulate international trade but also now regulate international investment. International investment regimes have been created to handle the collective suboptimality that would otherwise emerge from individual state behaviour. In part, this is a consequence of realisation of the excesses and shortsightedness of the nationalisation policies of host countries in the 1970s. Today, isolation is tantamount to a failure to realise the state's potential for economic development and political influence.

Both NAFTA and the ECT are the offspring of market reform in the post-communist world, NAFTA having come into force in 1984 and the ECT in 1998. Their impact, perhaps underwhelming at first, is having an increasingly pervasive effect. The NAFTA is a trilateral treaty that brought Canada, Mexico and the US into the North-American free trade area. The ECT is a unique multilateral treaty, limited in scope to the energy sector, which establishes rights relating to both trade and investment within that sector. The ECT breaks away from the mould of other treaties by making governments accountable directly to aggrieved investors before arbitral tribunals for breaches of the Treaty.

The importance of host states attracting investors by offering them the security of market-based economic systems — underpinned by market-oriented legal systems — cannot be overemphasised. The purpose of market-oriented legal systems is to define and protect the rights of the private sector against encroachment by government, to remove special privileges accorded to state-owned enterprises and support fundamental business relationships between private parties — by reducing risk and transaction costs between parties. Both NAFTA and the ECT seek to do this. They also seek to establish a global level playing field for investors.

Omalu's research indicates that NAFTA and the ECT seem to be having a positive influence on the rate of inflow of foreign investment although she emphasises that the two treaties are only one of many factors that influence this. She reminds us that the effects of such treaties should not be overshadowed by more fundamental factors such as geological potential, political stability, macro-economic policy, exchange rate volatility and the like. However, although a decision to invest is usually based on technical merit, the rate of return has to be sufficient to offset risk factors and Omalu convincingly explains how treaties such as the NAFTA and the ECT serve to reduce risk. Thus they are likely to become the way forward in expanding international investment and trade.

Omalu emphasises that the two treaties should be seen as a process or a continuous mechanism rather than a static, two-dimensional picture. She points out that the two treaties have resulted in a proliferation of contacts between the participating states:

*“The long-term significance of NAFTA and the ECT, as a whole, stretches out beyond the investment, or even economic, sphere. They both increase economic links. Consequently, they draw diverse nations into closer contacts. This results in a dramatic upsurge in the number and range of formal and informal transactions between citizens of the participating states.”*

In the Asia-Pacific region, APEC, although falling short of treaty status, is conducive of a similar proliferation of contacts. It may be speculated that the economic payoffs would increase if APEC had more teeth.

As a lawyer practising in the energy industry, my natural concern is with practicalities as distinct from theories, with solving day to day problems and with minimising investment risk without being distracted by intellectual or academic concerns. As I have written elsewhere, the control of variables is the greatest single concern of investors and their lawyers. Generally, however, I think practising lawyers and their clients traditionally have placed too high a value on the tight wording of carefully negotiated investment agreements in order to minimise risk. This can create a false sense of security for investors. Greater efforts should in my opinion be made by governments on creating market-oriented legal systems. As a generalisation, I believe that the time has already arrived when many private investors will place at least equal emphasis on the macro aspects of investment security as they do on the micro. What this means is that each country's investment flows will be largely determined by an aggregation of highly idiosyncratic investment decisions by investors who are increasingly influenced by whether the country in question offers a market-oriented legal system or it doesn't.

Omalu is a Nigerian law graduate who, having been awarded a Foreign and Commonwealth Office scholarship, came to Dundee to enter the CEPMLP's PhD program under the supervision of Professor Thomas Walde. This book is a product of her doing so. With it, Omalu has made an important and insightful contribution to the advancement of international knowledge and understanding in a field which is of increasingly critical importance to world economic development. This book is well researched, well written and in my opinion should be very well read by both government officials and lawyers.

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