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Foreign Investment Protection in Cyprus: Should I Stay or Should I Go?

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Opinion Article

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Foreign Investment Protection in Cyprus: Should I Stay, or Should I Go?

In recent years, it has become increasingly difficult to justify Bilateral Investment Treaties. Several states have begun a conscientious effort to ensure that Bilateral Investment treaties achieve their desired ends, while other states have decided to terminate them. These developments should keep the Republic of Cyprus vigilant, since it has concluded several of these treaties in the past. In this spirit, the policy paper first discusses the reasons behind the reaction against these treaties, and then examines the extent to which these concerns are relevant to Cyprus. Finally, the policy paper outlines a few policy recommendations.



Despite the popularity of this system, Bilateral Investment Treaties (BITs) are currently facing international backlash.

1. The Backlash Against Bilateral Investment Treaties

A popular method used by states for the protection and attraction of Foreign Direct Investments (FDIs) is the signing and ratification of Bilateral Investment Treaties (BITs). According to the prevailing theory, the legal protection provided by BITs to foreign investors, as well as the robust mechanism of dispute settlement and enforcement included in these treaties, creates an investment-friendly environment.¹ Moreover, it has been suggested that BITs have contributed to the 'depoliticization' of investment disputes by transferring the burden of dispute resolution and enforcement to arbitration venues, instead of resorting to gunboat diplomacy.² On this basis, over the last two decades, more than three thousand BITs have been concluded between states.³

¹ J. Bonnitcha et al., *The Political Economy of the Investment Treaty Regime* (Oxford University Press, 2017), pp. 8-10.

² K. Miles, *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital*, (Cambridge University Press, 2013), p. 33

³ United Nations Conference on Trade and Development, *World Investment Report* (2018), p. 88.

Several States have either chosen to abandon this system of investment protection or made steps to seek alternative frameworks for FDIs.

Despite the popularity of this system, BITs are currently facing an international backlash.⁴ This is due to concerns that BITs do not fulfil their stated purpose and that they have become detrimental to the interests of states. It is suggested on this front that there is little evidence supporting the assumption that BITs attract FDIs.⁵ In the same vein, it has also been suggested that most successful claims have concerned measures that would anyway have been inconsistent with the domestic law of developed states.⁶ Recent examples further indicate that investment disputes impose a heavy financial burden on states.⁷

Most importantly, it has been argued that BITs excessively constrain the regulatory power of states.⁸ As Salacuse and Sullivan argue, BITs impose costs on states, which 'constrain their sovereignty by entering into treaties that

specifically limit their ability to take necessary legislative and administrative actions to advance and protect their national interests.'⁹ In addition to this, an investment dispute damages the reputation of a host state and possibly its relationship with the other contracting party.¹⁰

Considering the argument that BITs bear high risk without any significant positive impact, several States have either chosen to abandon this system of investment protection or made steps to seek an alternative framework for attracting and protecting

⁴ See Michael Waibel et al. (eds.), *The Backlash Against Investment Arbitration: Perception and Reality* (Kluwer Law International, 2010)

⁵ M. Driemeier, 'Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite' in K. Shauvant and L. Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford University Press, 2009), p. 368.

⁶ L. Poulsen, 'British Foreign Investment Policy Post-Brexit: Treaty Obligations vs. Bottom-Up Reforms', Working Paper July 2017 (UCL European Institute), p. 8.

⁷ D. Gaukrodger & K. Gordon, 'Investor-State Dispute Settlement: A Scoping Paper for the investment policy community' (2012), OECD Working Papers on International Investment No. 2012/13, pp. 17-23.

⁸ M. Sornarajah, *Resistance and Change in the International Law of Foreign Investment* (Cambridge University Press, 2015), p. 392.

⁹ J. Salacuse & N. Sullivan, 'Do BITs really work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain' (2005) 46 Harvard International Law Journal, p. 77.

¹⁰ L. Johnson et al., 'Costs and Benefits of Investment Treaties: Practical Consideration for States' (Columbia Center on Sustainable Development, 2018), p.11.

FDIs.¹¹ Against this backdrop, the aim of the following section is to examine whether the criticism against BITs is pertinent in the case of the Republic of Cyprus (RoC). Apart from raising suspicions that BITs may not be that crucial in attracting FDIs, the present policy paper proceeds with a few policy recommendations.

2. The Case of Cyprus

A. General Remarks

The RoC has signed twenty-seven BITs to date.¹² Seventeen of these treaties have been ratified and are in force. These agreements are broadly similar in their substantive and procedural provisions, while most of them focus exclusively on investment protection and their investment protection provisions are vaguely construed and open-ended. For example, the RoC – China BIT and the RoC – Israel BIT stipulate that foreign investments of either contracting party shall be accorded fair and equitable treatment.¹³ However, none of these agreements include any provisions clarifying what this standard of treatment entails. Furthermore, the RoC's BITs include a binding consent to arbitration in case a dispute arises, while many shall be valid for ten years after they are terminated.¹⁴

The United Nations Conference on Trade and Development (UNCTAD) database indicates that during the past few years, the RoC has been the subject of several claims by foreign investors based on BITs.¹⁵ In light of the above, it goes without saying that disputes of this kind threaten the island's economy with instability and pose several reputational risks for the RoC. Despite this experience, there has been no discussion in Cyprus regarding the potential negative impact of BITs. As a matter of fact, exactly the opposite has happened. India's recent decision to terminate its BITs, including its BIT with the RoC, led the latter to request from India to reconsider its decision.¹⁶

¹¹ See J. Kurtz, 'The Australian Trade Policy Statement on Investor - State Dispute Settlement' (2011), 15 *American Society of International Law (insights)* 22; J. Muniz et al., 'The New Brazilian BIT on Cooperation and Facilitation of Investments: A New Approach in Times of Change' (2017), 32 *ICSID Review* 2.

¹² See UNCTAD Investment Policy Hub <investmentpolicy.unctad.org/international-investment-agreements/countries/54/cyprus> accessed 15//09/2021

¹³ RoC- China BIT, Art. 3(1); RoC – Israel BIT, Art. 2 (2).

¹⁴ For example, see RoC – Qatar BIT Art. 14; RoC – Lebanon BIT Art. 13; RoC – Armenia BIT Art. 13.

¹⁵ See UNCTAD Investment Policy Hub <investmentpolicy.unctad.org/international-investment-agreements/countries/54/cyprus> accessed 15//09/2021.

¹⁶ For example, see *Ayoub-Farid Saab and Fadi Saab v. Cyprus*, 15 January 2019; *Marfin Investment Group v. The Republic of Cyprus*, ICSID Case No. ARB/13/27.

Regardless of this reaction, the recent experience of the RoC with investment disputes coupled with the criticism against BITs raise pressing questions regarding the impact of BITs on the island. Considering the above, in the parts that follow two examples are provided to illustrate that certain BITs may not be that necessary to create an investment-friendly environment.

B. Cyprus – Russian Federation BIT

The main benefit of BITs to the RoC would be if foreign investors have invested in Cyprus because of the legal protection provided by such agreements.¹⁷ Another benefit would be if Cypriot companies have invested abroad because of BITs.¹⁸ As it was highlighted in the previous section, the extent of these potential benefits should be evaluated rather than assumed. In this context, the Cyprus-Russian Federation BIT constitutes a useful case study to illustrate that BITs may not be that relevant with respect to increasing FDI flows.

Even though the Cyprus-Russian Federation BIT was signed in 2007, it never came in force. It is understood that Russia has refused to ratify the BIT with the RoC because of the risks of claims under these treaties.¹⁹ Despite the absence of a BIT between these two States, Russian FDIs in the RoC have skyrocketed in the last decade. According to the Russian Central Bank, during the past years, the RoC was one of the largest investor states in the Russian Federation.²⁰ Correspondingly, during the same period, companies based in RoC were substantially active in the Russian Federation.²¹ As a matter of fact, until recently and before the war in Ukraine, several Russian businesses use the RoC as their basis for incorporation.²²

Despite the absence of a BIT between these two states, Russian FDIs in the RoC have skyrocketed in the last decade.

¹⁷ L. Poulsen et al., 'Analytical Framework for Assessing Costs and Benefits of Investment Protection Treaties', p.1 (UK Government, 2013)

<assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/260503/bis-13-1285-analytical-framework-for-assessment-costs-and-benefits-of-investment-protection.pdf>.

¹⁸ *Ibid*, p. 7.

¹⁹ N. Rubins & E. Rubinina, 'GAR Investment Treaty Arbitration: Russia' (GAR Insight, 2018), p.11.

²⁰ The Central Bank of the Russian Federation, External Sector Statistics <www.cbr.ru/eng/statistics/macro_itm/svs/>.

²¹ *Ibid*.

²² H. Smith, 'Welcome to Limassolgrad: The City getting rich on Russian Money' (The Guardian, 17th February 2018) www.theguardian.com/world/2018/feb/17/welcome-to-limassolgrad-the-city-getting-rich-on-russian-money accessed 25/11/2019.

The increase of Russian FDI in the RoC has been attributed to several key factors. According to Ernst & Young, the favourable tax regime, the diversification of risks, and the EU membership constitute important factors for Russian companies investing in the RoC.²³ Bureaucracy is seen as the greatest disadvantage of the RoC as a business destination and a key factor that hinders business expansion.²⁴ Despite the widespread view about the importance of BITs, the absence of a binding BIT between these two states has not been mentioned as a negative factor for investing in the RoC or the Russian Federation.

Being aware of these indications, a study by UNCTAD may provide an explanation behind the following paradox. That is the rapid increase of FDI flows between the Russian Federation and the RoC in the absence of an applicable BIT. According to UNCTAD, the existence of a BIT 'is by far not only the determinant that decides on whether FDI takes place or not.'²⁵ Other factors, such as the economic attractiveness of a state, its market size, its labor force, its endowment with natural resources, the quality of its legal system, and the respect of the rule of law may be much more important.²⁶

In conclusion, the Russian Federation – Cyprus BIT constitutes a concrete example illustrating that BITs may not be that crucial in attracting FDIs. Other factors may be much more important when it comes to creating an investment-friendly environment. Nonetheless, this realization does not necessarily mean BITs are obsolete. It is also worth attempting to examine whether existing BITs between the RoC and other States have fulfilled their stated purpose.

C. BITs with other states


A concrete example illustrating that BITs may not fulfil their key objective is a series of BITs the RoC is a contracting party. As explained earlier, one of the primary benefits of BITs would be if Cyprus-based companies use the existing stock of treaties for protecting their assets abroad or if foreign companies have been making investments in the RoC because of BITs. If BITs do not fulfill their stated purpose, then the RoC should consider terminating or amending its existing BITs stock.

²³ Ernst & Young, 'Russia Doing Business in Cyprus: Measuring Quality and Efficiency Survey Report', p. 10 <[www.ey.com/Publication/vwLUAssets/Cyprus-Russian_Study_Report_en/\\$FILE/ey-russian-report.pdf](http://www.ey.com/Publication/vwLUAssets/Cyprus-Russian_Study_Report_en/$FILE/ey-russian-report.pdf)>.

²⁴ *ibid*, 11.

²⁵ UNCTAD, 'The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries' (United Nations, 2009). p. 6.

²⁶ *ibid*, pp. 6 and 32.



Providing a legal avenue for compensation to potential Cypriot investors or investors operating in the RoC is an important aspect of BITs. Yet, as the paper argues, this is not enough to justify BITs.

In light of the above, the RoC has signed, among others, BITs with Albania, Iran, Jordan and Montenegro.²⁷ However, according to official statistics by the Central Bank of Cyprus and the World Investment Report, there has not been any significant FDI activity between the RoC and these states during the past years.²⁸ Furthermore, it is doubtful whether the RoC ever had or attempted to establish a substantial economic relationship with these states that justifies the conclusion of a BIT. The critical question to assess the importance of these BITs is whether FDIs flows between the contracting parties would have been hindered in their absence.²⁹ Providing a legal avenue for compensation to potential Cypriot investors or investors operating in the RoC is an important aspect of BITs. Yet, as the paper argues, this is not enough to justify the existence of BITs.

Without any substantive positive impact, BITs merely expose contracting parties to costly investment arbitration proceedings. Even if a contracting party wins an investment dispute, the legal fees and tribunal expenses could still be burdensome. Another factor that potentially undermines the usefulness of BITs is the fact that foreign investors operating in the RoC or Cypriot investors operating abroad have multiple legal avenues to seek judicial redress. Furthermore, there is a real risk that certain foreign investors may rely on BITs without these treaties previously contributing to attracting the relevant investment in the RoC. In other words, foreign investors may become aware of the existence of a BIT after they have committed capital in a host state.

²⁷ *Supra* note 11.

²⁸ Central Bank of Cyprus, Reports on Foreign Direct Investment <www.centralbank.cy/en/publications/foreign-direct-investment>; World Investment Report 2019, Cyprus Fact Sheet <unctad.org/sections/dite_dir/docs/wir2019/wir19_fs_cy_en.pdf>.

²⁹ Poulsen argues that many BITs were concluded as diplomatic instruments of good faith with little consideration by states for their consequences. See L. Poulsen, *Bounded Rationality and Economic Diplomacy: The Politics of Investment Treaties in Developing Countries* (Cambridge University Press, 2015), p.168.

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As a matter of fact, in a recent report, it has been argued that the fundamental drivers of FDI flows in EU member states include the internal market, which has reduced the risk and cost of investing across the EU, the population density of a host state, and a high FDI concentration.³⁰ It is also worth mentioning that the accessibility in the internal market is ensured through the strong legal protection offered by EU Law.³¹ In line with what has been previously mentioned, it is further confirmed in the policy paper that several other factors contribute in the selection of a location for FDI. These factors include the market size of a state, the language, and the domestic legal system.³²

Considering the above, it becomes extremely difficult to unconditionally accept that BITs between the RoC and other

States are necessary prerequisites to ensure FDI flows between them. The importance of BITs as instruments of legal protection to a foreign investor is further diminished by the strong legal assurances provided by EU Law and the robust domestic legal systems of EU member states.

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In conclusion, the above analysis indicates that the criticism against BITs is pertinent in the case of the RoC. However, the limited data regarding the impact of BITs, invites for additional research regarding the relationship between FDIs and BITs in the RoC. It would, therefore, be a mistake to unequivocally conclude that BITs entail negligible economic benefits. In case where a Cypriot investor receives significant and tangible benefits from a BIT, then this could provide a solid argument in favor of keeping this treaty in place. By the same token, if the benefits of a BIT are very few, or none, this may

³⁰ E. Sunesen et al., 'The World in Europe, global FDI flows towards Europe: Intra-European FDI' (ESPON, 2018), p.20.

³¹ European Parliament, Fact Sheets on the Internal Market <www.europarl.europa.eu/factsheets/en/section/189/the-internal-market> accessed 26/11/2019.

³² S. Guerin, 'Do the European Union's bilateral investment treaties matter? The way forward after Lisbon' CEPS Working Document No. 333/July 2010, p. 2.

provide an argument for its termination. A full assessment of the potential economic benefits and risks should be undertaken.



What should be the appropriate response by the RoC about its BIT program? Answering this question requires a deeper assessment whether the benefits of BITs outweigh the risks, and whether any other foreign investment policies are more suitable.

3. Policy Recommendations

Considering several BITs between the RoC and other States as examples, it is doubtful, to say the least, whether several of these treaties fulfil their stated purpose. As pointed out in the first section, BITs may also lead to costly legal proceedings as well as to situations where contracting parties would have to compensate foreign investors.

The above raise a critical question: What should be the appropriate response by the RoC about its BIT program? Answering this question requires a deeper assessment whether the benefits of BITs outweigh the risks, and whether any other policies are more suitable. It is suggested therefore that three separate, albeit interconnected, studies should take place before taking any decision with respect to the future of the RoC's BIT program:

1. A thorough study comparing the legal protection provided to foreign investors under BITs with those offered in Cypriot and EU Law. This study will provide a clear picture regarding whether BITs provide stronger legal protection compared to Cypriot and EU law.
2. A sample study examining the impact of BITs on the business operations of Cypriot investors abroad. This study will provide the necessary data to assess whether BITs are necessary for Cypriot companies investing overseas.
3. A sample study examining the impact of BITs on the business activities of foreign investors operating in the RoC. This study will assist the Cypriot authorities to assess whether BITs entail negligible economic benefits and, subsequently, to what extent BITs enhance the attractiveness of the RoC as a business destination.

All these inquiries are of cardinal importance to fully understand whether certain BITs are necessary for the purpose of attracting FDIs, and to what extent BITs live up to their proclaimed goal. In a scenario where it is concluded that a BIT has become obsolete or requires amendment, the RoC has several options:

1. First and foremost, the RoC can agree to the mutual termination of a BIT.³³ In the absence of pending disputes being pursued under the BIT, and if both contracting parties agree to 'neutralize' the survival clause, such agreement will be terminated immediately.³⁴

2. In a scenario where a BIT is necessary for the purpose of attracting FDIs, while certain provisions are considered problematic, the RoC should consider renegotiating its content.³⁵ This option may require terminating or clarifying certain provisions of BITs through joint interpretative declarations or unilateral statements. Such legal instruments must be considered by tribunals in the context of investment disputes and, therefore, can be used to protect vital interests of the RoC.

3. The constantly changing landscape of investment policy protection means that the RoC is obliged to consider other options for attracting and protecting FDIs. Instead of keeping BITs, the RoC may opt to negotiate investor-state contracts, which can provide strong legal protection to strategic investors. The RoC should further continue focusing on investment facilitation through transparent, efficient, and, most importantly, targeted investment schemes. Such schemes appear to be more suitable for developed states.³⁶ Establishing modern investment schemes may also alleviate any reputational risks that may arise following a termination of a BIT.

4. In light of the growing awareness with BITs, the UNCTAD and the European Union³⁷ support efforts to reform this area of law. Since the RoC is a member of both organizations, it is suggested that monitoring these developments would be a good practice to address issues of substance and/or procedure in relation to BITs. Most

³³ See L. Johnson et al., 'Clearing the Path: Withdrawal of Consent and Termination as Next Steps for Reforming International Investment Law' (Columbia Center on Sustainable Development, 2018).


³⁴ See UNCTAD, 'Phase 2 of IIA Reform: Modernizing the Existing Stock of Old-Generation Treaties' (United Nations, 2019), p.9

³⁵ *ibid.*

³⁶ *Supra* note 2, pp. XIV-XV.

³⁷ See European Commission, 'The identification and consideration of concerns as regards investors to state dispute settlement' (Brussels, 2017).

importantly, the RoC should engage more actively with the EU's efforts to establish a multilateral instrument that would hopefully reform multiple BITs simultaneously.³⁸



³⁸ European Commission, 'EU member states agree on a plurilateral treaty to terminate bilateral investment treaties' (Brussels, 2019) <ec.europa.eu/info/publications/191024-bilateral-investment-treaties_en>.