

The London School of Economics and Political Science

Sacrificing Sovereignty by Chance:

Investment Treaties, Developing Countries, and Bounded
Rationality

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Declaration

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Abstract

One of the striking features of modern globalization is the rising prominence of international law as governing institution for state-market relations. Nowhere has this been as pronounced as in the international investment regime. Although hardly known to anyone but specialized international lawyers merely 15 years ago, bilateral investment treaties (BITs) have today become some of the most potent legal tools underwriting economic globalization. This thesis seeks to explain why developing countries adopted investment treaties as part of their governing apparatus.

The study combines econometric analysis with archival work as well as insights from more than one hundred interviews with decision-makers in the international investment regime. On this basis, it finds ‘traditional’ explanatory models of international policy diffusion insufficient to account for the BIT-movement. Instead, both qualitative and econometric evidence strongly indicates that a bounded rationality framework is best suited to explain the popularity of BITs in the developing world. Although careful cost-benefit considerations drove some developing countries to adopt investment treaties, this was rare. By overestimating the benefits of BITs and ignoring the risks, developing country governments often saw the treaties as merely ‘tokens of goodwill’. Many thereby sacrificed their sovereignty more by chance than by design, and it was typically not until they were hit by their first claim, officials realised that the treaties were enforceable in both principle and fact.

The thesis is relevant to a wide range of literature. Apart from being the first comprehensive international relations study on investment treaties, its multi-method approach provides a robust and nuanced view of the drivers of international policy diffusion. Moreover, the study is the first major work in international political economy literature applying insights on systematic – and thus predictable – cognitive heuristics found in the behavioural economics discipline.

To Misha.

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All opinions and errors remain my own.

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SELECTED ABBREVIATIONS

ABA	American Bar Association
BIT	bilateral investment treaty
BLEU	Belgo-Luxembourg Economic Union
CAFTA-DR	Dominican Republic-Central America-United States Free Trade Agreement
CEELI	Central and Eastern European Law Initiative
ECJ	European Court of Justice
ECT	Energy Charter Treaty
EPA	Economic Partnership Agreement
FCN	Treaty of Friendship, Commerce and Navigation
FDI	foreign direct investment
FIAS	Foreign Investment Advisory Services
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
HDSA	Historically-Disadvantaged South Africans
IFC	International Finance Corporation
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICSID	International Centre for the Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes between States and Nationals of Other States 1965
IMF	International Monetary Fund
ITO	International Trade Organization
MAI	Multilateral Agreement on Investment
MIGA	Multilateral Investment Guarantee Agency'
MFN	most favored nation
MNC	multinational corporation
MPRDA	Mineral and Petroleum Resources Development Act

NAFTA	North American Free Trade Agreement
New York Convention	Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958
NIEO	New International Economic Order
OECD	Organisation for Economic Co-Operation and Development
OPIC	Overseas Private Investment Corporation
PRI	political risk insurance
PTA	preferential trade agreement
PTIA	preferential trade and investment agreement
SCC	Stockholm Chamber of Commerce
TRIMS	Trade-Related Investment Measures
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
USAID	United States Agency for International Development
USTR	United States Trade Representative
WTO	World Trade Organization

Preface: The curious case of Pakistan

In October 2001, Pakistan's Secretary of Law received a letter relating to a dispute between the Pakistani government and a Swiss company, Société Générale de Surveillance (SGS). The dispute had begun in 1996 after the Sharif government terminated a contract with SGS due to suspicions that it had been obtained through bribes. SGS objected to the cancellation of the contract and began a series of legal proceedings in both Switzerland and Pakistan. All failed.

The letter received five years after the dispute had begun was not from Switzerland or Pakistani courts. This time it was from Washington DC. It came from a World Bank institution called the International Center for the Settlement of Investment Disputes (ICSID), which said SGS was claiming more than US\$110 million in compensation based on a so-called bilateral investment treaty (BIT). This puzzled the Secretary, as neither ICSID nor the BIT was mentioned by SGS while the contractual dispute had lasted.¹ He therefore called up his Attorney General, Mr. Makhdoom Ali Khan, to ask what he knew about ICSID, and how SGS could possibly use a BIT to make such a claim. Although a leading expert on international public law, Mr. Khan couldn't give him an answer. *'To be perfectly honest,'* he later said to me, *'I did not have a clue.'*² After hanging up, Mr. Khan therefore logged on to Google. Here he typed in two words: 'ICSID' and 'BIT'. That is how he learned of these instruments for the first time.

It didn't take long before the Attorney General realized that the letter from ICSID was serious indeed. Unlike the contract with SGS, which involved specific commercial rights, the BIT apparently provided SGS a right to compensation for a wide range of regulatory conduct based on very vague treaty language. In essence, it provided SGS an 'economic constitution' while operating in Pakistan that was independent from Pakistan's own national laws and enforceable in both principle

1 SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan, ICSID Case No. ARB/01/13, Decision on Jurisdiction, 6 August, 2003, par. 63.

² Interview, Karachi, January 2009. See annex II for interview details. See also, L. Poulsen and D. Vis-Dunbar, 'Reflections on Pakistan's investment-treaty program after 50 years; an interview with the former Attorney General of Pakistan, Makhdoom Ali Khan,' *Investment Treaty News*, 16 March 2009.

and fact. It thus gave Swiss investors the right to settle disputes with the Pakistani government outside Pakistan's own legal system, for instance by using ICSID as the arbitration forum. Here, the tribunal had the authority to admit SGS' claim, rule on its own jurisdiction, as well as award damages binding upon Pakistan and with limited options for appeal. And if Pakistan refused to participate in the proceedings, or chose not to comply with a potential arbitral award, the ICSID Convention allowed SGS to confiscate Pakistan's commercial property in most corners of the world, with only limited options for courts in enforcing states to refuse execution.

Surely, this was not a claim that should be taken lightly. Yet, when inquiring with the relevant ministries, Mr. Khan was unable to trace any records of BIT-negotiations having ever taken place with Switzerland. There were no files or documentation in any of the responsible ministries, and no indication that the treaty had ever been discussed in Parliament. For a treaty with such a considerable scope, this was somewhat of a mystery. Yet, Mr. Khan later learned that this was no exception, as hardly any records existed of Pakistan's past BIT-negotiations. This was not because they were considered too sensitive to document in written form. On the contrary. When foreign delegations had come to the country, or the Pakistani leadership went abroad, BITs had merely been considered '*one of the doables*.'³ According to the Attorney General everyone simply considered the treaties a piece of paper, something for the press - a token of goodwill.

The claim by SGS made it obvious to Mr. Khan that this view was clearly mistaken. For while Pakistan was no stranger to allowing *individual* investors a right to international arbitration based on specific contracts, its BITs had provided a 'standing offer' to international arbitration to foreign investors *as a group*. Combined with their vague and broad treaty language, this not only gave investors a second chance at adjudicating contract disputes, as in the SGS case, but also

³ Ibid.

implied a potentially infinite number of claims involving Pakistan's regulatory conduct.⁴

At the time, SGS was but one of many multinationals increasingly resorting to treaty-based investor-state arbitration when disputes arose. Claims covered both tangible and intangible investments - including intellectual property, bonds and shares, and concessions - and related to a wide range of state measures in virtually every economic sector. As such, investment-treaty disputes often involved key areas of public regulation, including measures taken for public safety, the provision of key utilities, as well as environmental regulation. The size of SGS' claim was not unusual either. After interest, one dispute led to more than US\$350 million in damages against the Czech Government,⁵ for instance, which was equal to the entire health budget of the Czech government and effectively doubled the public sector deficit for that year.⁶ When adjusted for population size and gross national income, it was equivalent to an award of US\$131 billion against the United States.⁷ Similarly, in 2006 the 30 pending cases against Argentina for measures taken during its 2001 financial crisis amounted to an estimated US\$17 billion in claims, which almost equalled the entire annual budget of the Argentinean government, and in 2007 alone Argentina was asked to pay a total of US\$615 million in damages excluding interest.⁸ Quite clearly, BITs were more than mere diplomatic 'tokens of goodwill.' In fact, in the absence of a multilateral investment protection treaty, they were by far the most important treaties governing investor-state relations. Yet, despite being one of South Asia's most notable experts on international public and commercial law, this was all news to Mr. Khan until he followed up on the phone-call from his Secretary of Law.

⁴ G. Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2007), at 63, 99-100; A. Parra 'ICSID and Bilateral Investment Treaties' 17 *ICSID News* 1 (2000), at 12.

⁵ *CME Czech Rep. B.V. v. Czech Republic*, UNCITRAL, Final Award (March 14, 2003).

⁶ T. Kellner 'The Informer: Call it the Ronald Lauder tax', *Forbes Magazine*, April 28, 2003; L. Peterson, *Bilateral Investment Treaties and Development Policy-Making* (Winnipeg: International Institute for Sustainable Development, 2004), at 25-6.

⁷ Van Harten, *op. cit.*, at 7.

⁸ Note that some of these have later been successfully annulled in appeal.

In recent years, Mr. Khan has told his story in speeches around in the world, warning other developing countries against the mistakes made by his country. Yet for many, it probably sounds a little too convenient. Now that Pakistan had to adhere to her international legal obligations, it appears slightly opportunistic to claim ignorance on behalf of his former colleagues. So to corroborate Mr. Khan's story, I contacted a considerable number of officials involved in Pakistan's BIT-program in the past. Surprisingly, all confirmed more or less the same narrative,⁹ and today even government files admit to this view: '*BITs were initially instruments that were signed during visits of high level delegations to provide for photo opportunities...*'¹⁰ It was thereby not until Pakistan was hit by a multi-million dollar arbitration claim that officials actually realized the implications of treaties signed by shifting governments since 1959. So while embassies, politicians, and investment promotion officials are still pushing for Pakistan to sign BITs today, some corners of the bureaucracy are now aware that the treaties involve serious and far-reaching obligations.

This thesis will ask whether Pakistan's experiences have been unique. Did governments in developing countries often fail to carefully consider the costs of one of the most important legal instruments underwriting economic globalization? Did they sacrifice their sovereignty more by chance than by design? And if so, does that tell us anything about the level of rationality we as observers should assume about the decision-making process, when developing countries pursue certain economic policies over others?

⁹ See Annex II.

¹⁰ Communication between Pakistan's Board of Investment and Ministry of Law concerning re-negotiation of German-Pakistan BIT, November 23, 2009. On file with author.

1. International policy diffusion and bilateral investment treaties

The adoption of BITs, not just by Pakistan but practically all countries in the world, illustrates one of the striking features of modern globalization, where governments have pursued largely similar market oriented reforms despite diverse institutional contexts. Removing restrictions on capital and current accounts; selling off state-enterprises; ensuring central bank autonomy; implementing neoliberal tax-reforms – all examples of policies which have also diffused across borders over the last decades. This presents a puzzle for studies on international relations, comparative politics, and international political economy (IPE). For while similar countries occasionally respond to similar conditions independently of each other,¹ economic policies and institutions have often become remarkably alike, even among countries with vastly different social, economic, and political institutions.

This is the subject of a growing literature on international policy diffusion, which is when ‘*government policy decisions in a given country are systematically conditioned by prior policy choices made in other countries.*’² Policy diffusion across borders is of course is not a new phenomenon. The use of quasi-sovereign trading companies from the 17th century onwards, for instance, the wide-spread adoption of the gold-standard in the 19th century, sudden waves of democratization in the 19th and 20th centuries – all are difficult to see as anything but interdependent political developments, however diverse.³ Yet in recent

¹ Z. Elkins and B. Simmons, ‘On Waves, Clusters, and Diffusion: A Conceptual Framework,’ 598 *The ANNALS of the American Academy of Political and Social Science* 33 (2005), at 34; C. Volden, M. Ting, and D. Carpenter, ‘A Formal Model of Learning and Policy Diffusion,’ 3 *American Political Science Review* 102 (2008).

² B. Simmons, F. Dobbin, and G. Garrett (eds.) *The Global Diffusion of Markets and Democracy* (Cambridge: Cambridge University Press, 2007). For a discussion of the (occasional) link between diffusion as a *process* and policy convergence as an *outcome*, see; F. Gilardi, ‘Transnational Diffusion: Norms, Ideas, and Policies,’ in: W. Carlsnaes, T. Risse, and B. Simmons (eds.), *Handbook of International Relations* (London: SAGE Publications, forth. 2012).

³ See generally; M. Ross and E. Homer, ‘Galton’s problem in cross-national research,’ 29 *World Politics* 1 (1976).

decades, decreased communication and transportation costs have augmented the level of interdependence, and facilitated ample opportunities for inspiration across borders through greater links between decision-makers.⁴ In turn, this has made it increasingly difficult to focus solely on domestic politics, when understanding why governments choose some policies and institutions over others.

A potential explanation for policy clustering could simply rely on coordination. If so, this would not be considered international policy diffusion.⁵ To the extent similar trade policies are the result of policy coordination in the World Trade Organization (WTO), for instance, this would not be characterized as diffusion. Similarly, when economic policies pursued in Europe stem from European Union (EU) harmonization, this too would fall outside the scope of international policy diffusion as understood here. Also, while international policy diffusion may surely be the result of softer forms of coercion, policy clustering due to outright imposition is a distinctly different process, as diffusion requires governments to have a real choice, when determining which policies to pursue.⁶ So if poor and aid-dependent governments have absolutely no choice but to enact certain policy templates promoted by powerful states or the international financial institutions, this would not be considered policy diffusion. Similarly, when in different historical periods governments have allowed foreigners to reside in their territories and have full jurisdiction over their own affairs, this was often the result of capitulation treaties imposed on host states and thereby not adopted by choice.

When coordination and imposition are not the driving forces for policies spreading across borders, it has typically been associated with four related yet analytically distinct processes. These are coercion, norm-emulation, competition, and rational learning. With respect to coercion, certain policies may not have been imposed by dominant states or other actors, yet nevertheless diffused due to coercive or quasi-coercive means. International financial institutions like the

⁴ See generally; J. Rosenau, *Distant Proximities: Dynamics beyond Globalization* (Princeton: Princeton University Press, 2003).

⁵ Elkins and Simmons, *op. cit.*

⁶ *Ibid.*

World Bank or the International Monetary Fund (IMF), for instance, have been able to promote a number of market oriented reforms through conditionalities attached to their structural adjustment programs. To the extent developing countries didn't actually welcome such reforms, this could be considered coercion. In other cases, socialization processes may have made governments pursue similar policies based on a 'logic of appropriateness.' Here, countries might have followed international trends because of their normative connotations rather than functional necessity, and often to signal membership of a certain group of nations. Alternatively, policies may diffuse because of governments' need to compete for scarce economic resources, be they tax bases, exports, tourism, foreign investments, and so forth. In most accounts, this is explained as a rational process (at least for the individual government), where strategic cost-benefit considerations lead to similar economic policies in a race to attract footloose capital or other resources. Finally, an explanation for policy diffusion could rely on the fact that governments do not have full information about the costs and benefits of their policies, and therefore tend to learn from each other. In many accounts, this too is considered a rational process: based on notions of Bayesian updating, governments seek information about successful policies abroad, and on that basis adjust their own strategies.

1.1. Bounded rationality and policy diffusion

Although a gross simplification of a diverse literature, it is possible to group the vast majority of explanations for international policy diffusion in one of the four analytical classifications mentioned above. In a series of recent notable contributions, however, Kurt Weyland has developed a novel explanation for policy diffusion.⁷ Weyland argues that even if assuming that international policy diffusion results from a goal-oriented process, and is thereby rational in the broadest sense of the word, we cannot be sure that governments behave according

⁷ K. Weyland, *Bounded Rationality and Policy Diffusion: Social Sector Reform in Latin America* (Princeton: Princeton University Press, 2006); K. Weyland, 'The Diffusion of Revolution: '1848' in Europe and Latin America,' 62 *International Organization* 3 (2009); K. Weyland, 'The Diffusion of Regime Contention in European Democratization, 1830-1940,' 43 *Comparative Political Studies* 8/9 (2010).

to the dictums of ‘comprehensive rationality.’⁸ Based on studies on public sector reform in Latin America as well as the diffusion of European revolutions and democratic reforms, Weyland argues that policy diffusion can be explained by insights from experimental literature on bounded rationality.

In particular, Weyland conjectures that rather than comprehensive cost-benefit calculations, policy diffusion is often driven by systematic – and thus predictable – cognitive shortcuts, consistently found in experimental studies on human cognition and judgments. These guide individuals’ inferences and judgments, for better or worse. For better, because certain cognitive ‘rules of thumb’ facilitate decision-making in spite of limits on information processing, and for worse, because the lack of attention and concern with relevant information can cause significant and lasting biases in human inferences. This, Weyland argues, is important, to understand why, and how, policies diffuse. For instance, decision-makers are often disproportionately influenced by policies, which are immediately available to adopt, rather than carefully considering alternatives that may be superior. Similarly, when learning about policies abroad, they often ignore important information, not because it is costly to obtain but rather because it is not particularly ‘vivid’.

Weyland is of course not the first to apply insights from experimental psychology to the study of politics. In recent years, political scientists in the United States, in particular, have followed the behavioral economics discipline in studying how (political) behavior often fails to meet the standards of comprehensive rationality.⁹ In international relations as well, a number of foreign policy studies have applied

⁸ ‘Comprehensive rationality’ is understood as decision-makers’ having a set of fixed, transitive preferences for alternatives, and the ability to calculate the trade-offs of their choices, both future and present; B. Jones, *Politics and the Architecture of Choice: Bounded Rationality and governance* (Chicago: University of Chicago Press, 2001), at 35.

⁹ Seminal is the work of Bryan Jones; Jones (2001), *op. cit.*; B. Jones and F. Baumgartner, *The Politics of Attention* (Chicago: University of Chicago Press, 2005).

these insights, particularly in the security realm.¹⁰ As such, it may be natural to also extend the bounded rationality approach to the study of policy diffusion.

However, the literature on policy diffusion does not suffer from a lack of theorising but rather a lack of detailed empirical insights.¹¹ And unpacking the concept of rationality inherently opens a Pandora's Box of complex hypotheses on how policies diffuse, potentially at the expense of theoretical parsimony. Also, a major challenge with all political science studies on bounded rationality is that variables isolated in experiments may be difficult to even identify in the complex setting of politics.¹² So while the application of a bounded rationality approach is undoubtedly innovative in the diffusion literature, the 'null-hypothesis' should perhaps still be that it is unnecessary. If 'traditional' explanations are sufficient in elucidating the key characteristics of the international diffusion of a particular policy, there is no inherent need to engage with the complexities of a new cognitive approach.

1.2. Bilateral investment treaties

Using the BIT-movement as its point of departure, this thesis will investigate in more detail whether a bounded rational framework is able to explain important and systematic variation in policy diffusion processes. Developing countries' pursuit of the almost 3,000 BITs in existence today (see Figure 1.1) is a hard case for proponents of a bounded rationality framework. For unlike revolutions, major democratic or social welfare reforms, or other path-breaking policy innovations studied by Weyland, the decision to enter into BITs has not been a one-off event for the individual country, but rather a sequential, or evolutionary, process taking

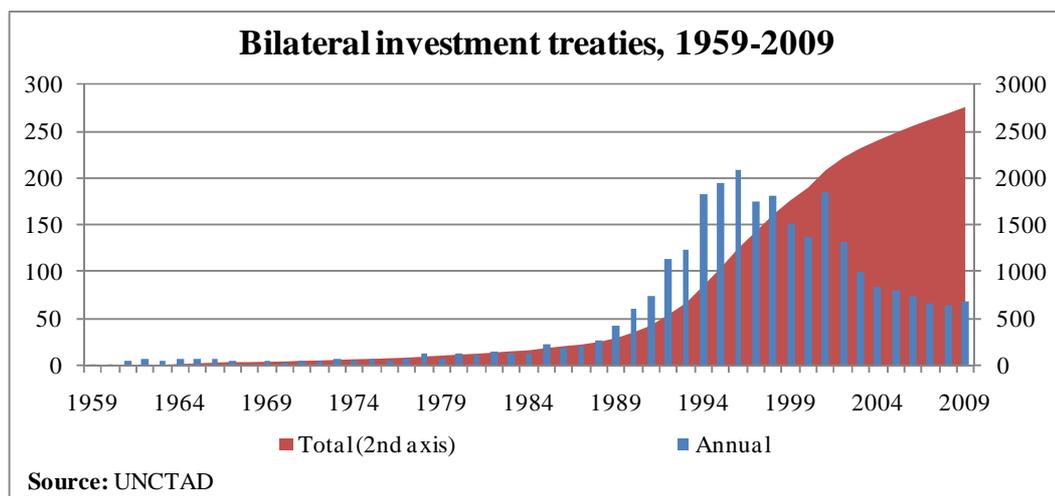
¹⁰ R. Jervis, *Perception and Misperception in International Politics* (Princeton: Princeton University Press, 1976); D. Reiter, *Crucible of Beliefs: Learning, Alliances, and World Wars* (Ithaca: Cornell University Press, 1996); Y. Vertzberger, *Risk-Taking and Decision Making: Foreign Military Intervention Decisions* (Stanford: Stanford University Press, 1998).

¹¹ Gilardi, *op. cit.*

¹² J. Levy 'Prospect Theory, Rational Choice, and International Relations' 41 *International Studies Quarterly* 87 (1997), at 94, 99-100; R. McDermott, *Political Psychology in International Relations* (Ann Arbor: University of Michigan Press, 2004), at 26-8.

place over decades.¹³ Here, developing country governments have had to decide time and again, whether to sign an investment treaty or not. The time pressure has been minimal, and if not satisfied with their initial decision, they didn't have to continue since there is no convincing evidence they were coerced into joining the BIT-movement.¹⁴ The conditions to make an informed choice were thereby considerably greater than the 'single-events' governments were faced with under great uncertainty studied by Weyland, or foreign policy analyses applying insights on bounded rationality to the study of military conflicts.¹⁵ The diffusion of BITs is as such a useful case for the bounded rationality model to be exposed to. For if it has predictive qualities in an area with such ample opportunities for rational learning, it will almost certainly also have it with respect to other policies.

Figure 1.1. The spread of BITs



Secondly, given the far-reaching scope of BITs, developing countries have had strong incentives to carefully consider their implications along the lines suggested by rational choice accounts. For even though claims against a few developed countries, show that countries with prudent and stable investment climates are not insulated from investment-treaty adjudication,¹⁶ the overwhelming majority of

¹³ S. Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Portland: Hart Publishing, 2009), at 86.

¹⁴ This will be clear from chapter four.

¹⁵ E.g. Vertzberger, *op. cit.*

¹⁶ See e.g., *Methanex Corp. v. United States*, UNCITRAL, Award on Merits, August 3, 2005; *Pope & Talbot Inc. v. Government of Canada*, UNCITRAL, Award on Merits and dissenting opinion, December 30, 2002; *Emilio Agustín Maffezini v. Kingdom of Spain*, ICSID Case No.

BIT-claims involve Western investors suing governments from the developing world. So surely, one would assume that developing countries *must* have had strong reasons for signing the treaties. If they didn't, like in the case of Pakistan, that would be surprising. Also, the vast majority of BITs are exceptionally similar in their treaty-language, so we would also in this respect intuitively assume that developing countries *must* have had strong reasons for continuing to adopt BITs for decades with little, and often no, variation.

Based on the assumption that BITs were a rational solution to strategic problems faced by developing countries, a number of powerful hypotheses do indeed exist to explain these puzzles. Some treaties may have been used to 'tie in' liberalizing reforms or intended to make general improvements in the rule of law. Some may have been signed as an alternative to diplomatic protection (espousal) of investors' rights by powerful Western governments. Some may have been signed to retain existing investments; and so forth. Yet, the most widely-accepted explanation for the popularity of the treaties is much simpler: without BITs, developing countries would lose much-needed foreign investment. In this view, BITs are seen as 'credible commitments' to convince risk-averse multinationals that their investments will be safe post-establishment.¹⁷

In theory, these are all powerful reasons why governments would want to pursue the treaties. In traditional accounts of the diffusion of BITs, governments are thus *always* assumed to have made an informed choice based on a careful consideration of the treaties' costs and benefits. Even if they didn't, BITs may still have been signed by developing countries merely to signal their adherence to neo-liberalism for instance. Just as developing countries have often signed up to legal obligations in the human rights regime mostly to adhere to international norms of political liberalism, they may also have used BITs as acts of political

ARB/97/7, Award on Merits, November 13, 2000; D. Vis-Dunbar, 'Indian lawyer pursues claim against the United Kingdom under the India-UK BIT,' *Investment Treaty News*, November 28, 2008.

¹⁷ While followed in many accounts, this view was originally put forth by Andrew Guzman; A. Guzman, 'Why LDC's sign treaties that hurt them: Explaining the popularity of bilateral investment treaties,' 38 *Virginia Journal of International Law* 640 (1998).

symbolism.¹⁸ Similarly, while existing accounts of BIT-diffusion typically assume that developing countries have been aware of the costs of the treaties when signing them, a rational learning framework could potentially explain if they initially underestimated their risks due to imperfect information. If so, that could potentially explain the growing hesitation against the treaties in many corners of the developing world today.

There are, in other words, reasons to expect that a bounded rationality framework is *not* necessary to explain the diffusion of BITs among developing countries. As such, it presents a useful test-case to investigate, whether the international policy diffusion literature has much to lose by sticking with its traditional explanatory models. The overall research question of the thesis will therefore be:

Why, and how, have developing countries entered into bilateral investment treaties?

This is of course an exceptionally broad question, given the diverse motives and ideas that are bound to have been involved, when developing countries have entered into BITs.¹⁹ With almost 3,000 treaties in existence signed over 50 years, any monocausal view is bound to ignore considerable variation and diversity, and surely it would fall outside the scope of *any* research project to explain why every single developing country has signed and ratified BITs. However, as with traditional accounts of the BIT-movement, the aim is here to explain those '*big and important things*', as Kenneth Waltz would say,²⁰ when developing countries decided to sign up to BITs. For although considerable legal and economic studies have been done on BITs, hardly any empirical work exists on how developing

¹⁸ See; S. Jandhyala, W. Henisz, and E. Mansfield, 'Three Waves of BITs: The Global Diffusion of Foreign Investment Policy,' *Journal of Conflict Resolution* (forth., 2011.).

¹⁹ My classification of developing countries (which includes transition economies) can be found in Annex I.

²⁰ K. Waltz, 'Reflections on Theory of International Politics: A Response to my Critics,' in R. Keohane (ed.) *Neorealism and its Critics* (New York: Columbia University Press, 1986), at 329.

countries have pursued investment treaties, and the political foundations for the international investment regime is thereby understudied.²¹

More generally, a detailed study of international policy diffusion, which does not only engage with one particular theoretical framework will provide much needed empirical ‘flesh’ to a nascent literature, much of which fails to consider alternative explanations fully. Dobbin, Simmons, and Garrett are worth quoting at length,

‘... often, these theorists suggest different mechanisms to explain diffusion processes but fail to prove, in the quantitative studies that are emblematic of diffusion research, that their favored mechanism is at work. Too often, they test only their own theory or simply show evidence of diffusion and impute that their favored mechanism is at work. Perhaps the most frustrating empirical tendency across these studies is that champions of each theory often take simple evidence of diffusion to be adequate to prove their particular theory.’²²

This study will take a different route, and seriously engage with a number of potential explanations for the diffusion of BITs. By using more, stronger and more varied evidence than existing accounts of BIT diffusion, it will conclude that a bounded rationality approach is in fact useful to explain why developing countries have signed investment treaties.

This should have implications for other areas of foreign-policy studies as well, and particularly so in IPE, which unlike other corners of international relations have hardly ever engaged with a bounded rationality framework.²³ Also, while sporadic references to bounded rationality can be found in studies on legalization of world politics, when discussing incomplete contracting for example,²⁴ the

²¹ I understand the ‘investment regime’ throughout following Salacuse, who argue that as a group investment treaties constitute a regime since they, ‘*represent a convergence of expectations by states as to how host governments will behave toward investments from other regime members. The norms and rules embodied in investment treaties are intended to constrain and regularize such behavior in order to fulfill those expectations.*’ J. Salacuse, ‘The Emerging Global Regime for Investment,’ 51 *Harvard Journal of International Law* 2 (2010), at 431.

²² F. Dobbin, B. Simmons, and G. Garret, ‘The Global Diffusion of Public Policies: Social Construction, Coercion, Competition, or Learning?’ 33 *Annual Review of Sociology* 449 (2007), at 463.

²³ For calls that the IPE discipline should apply insights on bounded rationality, see; J. Odell, ‘Bounded Rationality and the World Political Economy: The Nature of Decision Making,’ in: D. Andrews, C. Henning, and L. Pauly (eds.) *Governing the World’s Money* (Ithaca: Cornell University Press, 2002); D. Elms, ‘New Directions for IPE: Drawing From Behavioural Economics,’ 10 *International Studies Review* 2 (2008).

²⁴ E.g. K. Abbott and D. Snidal, ‘Hard and Soft Law in International Governance,’ 54 *International Organization* 3 (2000), at 433; A. Hirsch, ‘Cognitive Jurisprudence,’ 76 *Southern California Law Review* 1331 (2003).

approach is generally considered unorthodox.²⁵ So also for that literature, the results could potentially point to new avenues of research.

1.3. Methodological strategy

But how does one ascertain why developing countries have entered into BITs? One approach typically taken by legal scholars is to rely primarily on comparing treaty-texts.²⁶ Yet, this approach has obvious limitations, as it does little to identify policy processes or actor motivations. Also, the negotiating history of BITs is hardly ever documented: with the exception of the ICSID Convention itself and BITs signed with the United States, even tribunals wanting to resort to investment treaties' *travaux* often go away empty handed.²⁷ Whether this is because negotiations have been considered too sensitive to document in written form, or they have simply not been considered important enough to merit careful documentation (as with Pakistan) is unknown. In any case, while access to official negotiating histories would certainly not have been sufficient to understand why, and how, governments pursued BITs, the absence of written documentation does present a considerable challenge.

As an alternative, political scientists have tended to rely on statistical techniques.²⁸ This follows the dominant trend in studies on international policy

²⁵ In *domestic* legal studies approaches based on bounded rationality has become much more prominent, particularly in the United States; see e.g. contributions in, C. Sunstein (ed.) *Behavioural Law and Economics* (Cambridge: Cambridge University Press, 2000). For one call to apply insights on bounded rationality to international economic law also, see; A. Aaken, 'Towards Behavioural International Law and Economics: A Comment on *Enriching Rational Choice Institutionalism for the Study of International Law*,' *University of Illinois Law Review* 47 (2008), at 57-58.

²⁶ E.g. S. Schill, 'Tearing Down the Great Wall: The New Generation of Investment Treaties of the People's Republic of China,' 15 *Cardozo Journal of International And Comparative Law* 73 (2007).

²⁷ C. Schreuer, 'Diversity and Harmonization of Treaty Interpretation in Investment Arbitration,' 3 *Transnational Dispute Settlement* 2 (2006).

²⁸ E.g. Z. Elkins, A. Guzman, and B. Simmons, 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000,' 60 *International Organization* 811 (2006). J. Tobin and M. Busch, 'A BIT is Better Than a Lot: Bilateral Investment Treaties and Preferential Trade Agreements,' 62 *World Politics* 1 (2010); D. Swenson, 'Why Do Developing Countries Sign BITs?,' in, K. Sauvant and L. Sachs (eds.), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford: Oxford University Press, 2009).

diffusion, which almost solely uses econometric models as their methodological foundation.²⁹ Yet, while such an empirical strategy can undoubtedly be helpful if the right data is available, it is risky indeed when it is not. And a general problem in the diffusion literature is the often considerable gap between underlying concepts, such as emulation or learning, and the quantitative indicators actually available.³⁰ The literature on BITs is no exception. Here, the increasing complexity of the statistical models used stands in stark contrast to the dearth of quantitative data needed to investigate why, and how, developing countries have entered into the treaties. Also, even if they had the necessary data, econometric studies are mostly useful to suggest causal *effects* based on patterns of co-variation, whereas they have difficulties in identifying plausible underlying causal *mechanisms*. For that reason alone, the glaring absence of studies with inputs from officials themselves is clearly problematic. At a minimum, it is necessary to triangulate inferences based on econometrics with other types of evidence to conduct a ‘reality check’ of the validity of the model specifications. This study will therefore use a multi-method approach to get a deeper understanding of the drivers of policy-diffusion, combining econometrics with archival work as well as insights from more than one hundred interviews with decision-makers ‘on the ground.’³¹

1.4. Outline

The thesis will progress as follows. The following chapter will briefly outline the historical roots of the BIT-movement. On this basis, chapter three will outline the explanatory models for international policy diffusion in more detail. Apart from presenting the empirical expectations that follow from ‘traditional’ frameworks, it will present a novel theory for the BIT-movement based on insights from the bounded rationality literature. As already mentioned, it will conclude that we need to carefully engage with existing hypotheses from the policy diffusion literature in order to evaluate the necessity of a new approach.

²⁹ E.g. C. Meseguer, *Learning, Policy Making, and Market Reforms* (Cambridge: Cambridge University Press, 2009).

³⁰ Gilardi, *op. cit.*, at 25.

³¹ See annex II for details.

The empirical chapters will therefore begin by seeing the investment regime through the lens of coercion, emulation, competition, and rational learning frameworks. Chapter four will ask if developing countries have been coerced into signing BITs. The focus here will be on the role of the IMF, the World Bank, and dominant Western states. Chapter five will ask whether BITs were justified in normative rather than instrumental terms. In other words, was the popularity of BITs analogous to human rights treaties often signed primarily for normative considerations? Chapter six will evaluate the main functional argument in favor of developing countries entering into BITs based on inter-state competition, namely that the treaties were crucial in order to attract foreign investments. Chapter seven will trace what information was actually available about the costs of BITs during the decades where the global network of treaties expanded rapidly, and ask if a rational learning framework could explain developing countries' evolving behavior in the international investment regime.

The last two empirical chapters will ask if a bounded rationality framework provides considerable value-added to what has already been explained at this point. Chapter eight will offer insights from decision-makers themselves as well as an econometric test of a key expectation from the bounded rationality framework. Finally, chapter nine will ask how much a bounded rationality framework has to offer in explaining a detailed country-case study. Combined with evidence presented in earlier chapters it will illustrate that rather than the laws of statistics, developing country officials have often relied upon biasing heuristics when learning about the implications of BITs. In turn, this led many to entirely ignore the risks of the treaties until hit by a claim themselves.

The final chapter will conclude. Apart from highlighting the theoretical implications of the study for the broader policy diffusion literature and international relations discipline, it will assess whether developing countries and other stakeholders in the investment regime can draw any policy implications from its findings.

2. A brief history of bilateral investment treaties

Before embarking on the analysis of why developing countries have signed BITs, it is necessary to understand the historical context in which the treaties emerged. Later chapters will offer further historical analyses. But for readers which are not necessarily familiar with investment treaties, this chapter will offer a brief history of the BIT-movement.

2.1. *The imperial origins of the BIT-movement*

In the 17th century, the major European trading powers agreed to protect foreign persons and their property according to certain minimum standards. As in modern BITs, the treatment of foreign investors should not only be based on the laws guiding nationals of the host state, but also a further set of standards independent from domestic legal regimes. Interference or outright seizure of assets was prohibited during peacetime, and compensation was generally required if aliens' assets were confiscated during war.¹ These basic principles were accepted and guaranteed by every major European state, as well as the United States after its independence. They were incorporated in the precursors to BITs, Friendship, Commerce and Navigation treaties (FCN treaties), which mostly dealt with commercial and navigation matters but also obliged treaty-partners to uphold certain minimum standards with respect to the treatment of foreign investors.² As stated by John Adams in 1796, after having negotiated the FCN treaty between the United States and France:

'There is no principle of the law of nations more firmly established than that which entitles the property of strangers within the jurisdiction of another country in

¹ E. Borchard, 'The Minimum Standard of Treatment of Aliens,' 38 *Michigan Law Review* 445 (1940); A. Roth, *The Minimum Standard in International Law as Applied to Aliens* (Leiden: A. W. Sijthoff, 1949).

² J. Salacuse, 'BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries' 24 *International Lawyer* 3 (1990).

friendship with their own to the protection of its sovereign by all efforts in his power.³

But whereas this emerging doctrine of investment protection was agreed upon by relatively equal parties aiming to ensure reciprocal arrangements, extending its principles to territories outside of Europe or the United States, changed its political foundation.⁴ Through a combination of treaties, concessions, political pressure, military intervention, or outright colonial occupation, foreign investment law, as stated by Kate Miles, ‘*moved from a base of reciprocity to one of imposition.*’⁵

For the United States the favoured legal instrument was FCN-treaties. Gradually, these expanded their provisions on investment, such as providing for ‘full and perfect protection’, ‘equitable’ and non-discriminatory treatment, as well as compensation for expropriation of property. They also typically included national treatment and most-favored-nation (MFN) treatment of foreign investors generally, or particularly for the transfer of currency out of the host state.⁶ However, in order to ensure the property rights of its citizens and companies abroad, the United States was not shy to resort to military instruments if legal protections were not available or effective.⁷

European investors in the developing world were typically ruled by the courts and administrations of European imperial legal systems. Yet, even in the absence of direct colonial rule, similar arrangements were made with control and enforcement secured by giving local European consuls the right to supervise or even determine disputes and, if necessary, use armed intervention to impose their decisions. Often, the pursuit of European interests would be delegated to selected trading companies, which were granted sovereign powers to be applied on behalf of their home states. These companies therefore became key players in imperial

³ Quoted in R. Dolzer and C. Schreuer, *Principles of International Investment Law* (Oxford: Oxford University Press, 2008), at 11.

⁴ C. Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (Berkeley, University of California Press, 1985), at 12.

⁵ K. Miles, ‘International Investment Law: Origins, Imperialism and Conceptualizing the Environment,’ 21 *Colorado Journal International Environmental Law and Policy* 1 (2010), at 2.

⁶ K. Vandeveld ‘The Bilateral Investment Program of the United States’, 21 *Cornell International Law Journal* 201 (1988).

⁷ A. Newcombe and L. Paradell, *Law and Practice of Investment Treaties* (New York: Kluwer Law International, 2009), at 8-10.

politics – including the politics of international law - and the alignment between power politics and economic interests were as such instrumental in the initial development of international investment law.⁸

Eventually, foreign investment protection became part of the 19th century legal doctrine on the diplomatic protection of aliens.⁹ Just as citizens, companies abroad had to be treated and protected according to international minimum standards – such as the right to compensation for expropriation - a breach of which could justify home state intervention. Again, this system did not necessarily depend on direct colonial rule. In their relationship with Latin American states in the 19th century, for instance, both the United States and European powers repeatedly imposed these legal principles through treaties and international arbitration¹⁰ and applied the political and military tools necessary to enforce them.¹¹

Dissatisfied with the constant threat of foreign interventions triggered by trade or investment disputes, however, Latin American countries began in the mid-19th century to embrace a different set of ideas of a just international economic order. Named after the Argentinean legal scholar Carlos Calvo, the Calvo doctrine argued that the notion of state sovereignty made it illegal for foreign powers to intervene in the affairs of other sovereign states by diplomatic or more forceful means.¹² Also, instead of being favoured with independent standards, aliens solely had a right to be treated as well – or poor - as citizens or companies of the host state. Apart from the substantive standards governing the affairs of foreign investors, this principle of national treatment entailed having investment disputes settled in the courts of host states rather than through international arbitration.¹³

⁸ Miles, op. cit.

⁹ Newcombe and Paradell, op. cit., at 4-6.

¹⁰ Between 1829 and 1990, the United States alone entered into around 40 investment arbitration proceedings with Latin American countries; K. Vandeveld 'A Brief History of International Investment Agreements', In: K. Sauvart and L. Sachs (eds.) *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (New York: Oxford University Press, 2009), at 6, n. 24.

¹¹ S. Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Portland: Hart Publishing, 2009), ch. 1; Lipson, op. cit., at 17-18, 44-50, 53-57;

¹² See; A. Hershey 'The Calvo and Drago Doctrines' 1 *The American Journal of International Law* 26 (1907); Montt, op. cit., ch 1.

¹³ Montt, op. cit.

These ideas were incorporated into laws, contracts, and even certain constitutions in Latin America,¹⁴ yet they were fiercely opposed by the United States and European countries.¹⁵ And by 1914, as the ‘long 19th century’ came to an end, Western powers continued to insist that the international law for foreign investors rested on the key principles of international minimum standards and diplomatic protection.

The breakdown of the colonial order

The reordering of global power relations after the First World War meant that Western states faced greater difficulties in the developing world, when trying to enforce their views on the proper treatment of foreign investors.¹⁶ In the absence of direct colonial rule, Western governments could no longer ignore the views of their developing country counterparts and they therefore had to compromise on key investment protection standards in several major investment disputes involving the expropriation of Western assets.

An important example was of course the expropriations of foreign assets that accompanied the 1917 Soviet revolution. A further challenge came in 1938 with the Mexican nationalizations of American investments in several industries.¹⁷ Her, US Secretary of State Cordell Hull replied to his Mexican counterpart that the international minimum standards on expropriation required ‘*prompt, adequate and effective compensation*’.¹⁸ This later become known as the Hull-standard of compensation and is included in by far the majority of BITs today. Yet at the time, Mexico argued that as a matter of international law compensation was not required. While this response has often been presented as a natural extension of the 19th century Calvo doctrine - both by expropriation countries themselves as

¹⁴ D. Shea, *The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy* (Oxford: Oxford University Press, 1995)

¹⁵ *Ibid.*

¹⁶ Lipson, *op. cit.*, at 66-70.

¹⁷ *Ibid.*, at 76-81.

¹⁸ K. Vandeveldel ‘Sustainable liberalism and the International Investment Regime’ 19 *Michigan Journal of International Law* 373 (1998), at 380.

well as academics¹⁹ - this was clearly a distortion: although the Calvo doctrine used the notion of national treatment to eradicate gun-boat diplomacy in favor of sovereign control, it never advocated the eradication of basic property rights.²⁰ Following Santiago Montt, the Calvo doctrine had in the early 20th century thereby begun to be '*transmuted into a new and opportunistic one: expropriation without compensation.*'²¹

While both the Soviet and Mexican disputes were eventually settled (along with more modest disputes in Eastern Europe, Bolivia and Turkey in the same period²²), they did force Western states to confront the lack of consensus concerning the international minimum standard.²³ It was also clear at the multilateral level that capital-exporting and capital-importing states disagreed over the basic principles that should govern the treatment and protection of foreign investors. An important factor explaining the failure of the League of Nations to codify customary international law at the 1930 Hague Conference, for instance, was differences over the law on the 'Responsibility of States for Damage Caused in their Territories to the Person and Property of Foreigners.'²⁴ Whereas capital-importing states here argued in favor of the Calvo-doctrine, capital-exporting states pushed for an international minimum standard. It also proved impossible to come up with a compromise within the League of Nations and the International Chamber of Commerce (ICC), where parallel efforts failed as well. The wide-ranging 1929 Draft Convention on the Treatment of Foreigners was thus ultimately rejected as too ambitious by several capital-importing states,²⁵ which was to become the first of many failed efforts by Western capital-exporting states to install a multilateral investment agreement.²⁶

¹⁹ See e.g.; Dolzer and Schreuer, *op. cit.*, at 12-13.

²⁰ Montt, *op. cit.*, at 38-62.

²¹ *Ibid.*, at 57.

²² Lipson, *op. cit.*, 70-73.

²³ Newcombe and Paradell, *op. cit.*, at 14.

²⁴ *Ibid.*, at 15-16.

²⁵ G. Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2007), at 18-9.

²⁶ R. Dattu, 'A Journey From Havana to Paris: The Fifty-Year Quest for the Elusive Multilateral Agreement on Investment' 24 *Fordham International Law Journal* 275 (2000).

With the fall of the imperial order after the Second World War, the institutional setup which until then had sustained the international regime for the protection of foreign investment collapsed completely. It was now up to the United States to defend the Western conception of international investment law. This was a difficult task indeed. Force and gunboat diplomacy was not only unfeasible in many parts of the world; it was also in direct contrast to the prevailing liberal ideas at the time. More benign means of enforcement therefore had to be found.

Committed to construct an open international economy through multilateral means, the United States proposed an International Trade Organization (ITO), which would enshrine the international minimum standard for foreign investors, including the Hull standard of compensation.²⁷ While this view appealed to capital-exporting states that was certainly not the case with many developing countries, primarily Latin American countries and India, who in turn associated forced compensation and international arbitration of investment disputes with continued foreign domination and control over their resources.²⁸

The resulting compromise on this and other issues was ultimately rejected by both protectionist interests in the United States as well as the proponents of an open international economic order.²⁹ So with United States Congress refusing to ratify the ITO, the less ambitious General Agreement on Tariffs and Trade (GATT) was put in charge of managing international trade in the post-war era. Completely absent from the GATT, however, was issues pertaining to foreign investment, and the conflict between developed and developing countries over which legal principles should determine the treatment and protection of foreign investors therefore remained unresolved.

²⁷ Note, that the initial US proposal did not include investment provisions, as the US favored bilateral commercial treaties with higher standards than a multilateral agreement based on the 'lowest common denominator' (see below); Newcombe and Paradell, *op. cit.*, at 19-20.

²⁸ Van Harten, *op. cit.*, at 16-7.

²⁹ C. Wilcox, *A Charter for World Trade* (New York: Macmillan, 1949), at 145-8.

Table 2.1. Foreign capital stock in developing countries, 1870-1950

	1870	1914	1950	1973
Foreign capital stock, gross value (US\$ billion)	40.1	235.4	63.2	495.2
Share of developing country GDP (%)	8.6	32.4	4.4	10.9

Notes: The figures are in 1990 prices and refer to the total for Africa, Asia (except Japan) and Latin America.

Source: A. Madisson, *The World Economy: A Millennial Perspective* (Paris: OECD, 2001), table 3.3.

Western investors nevertheless managed to expand their activities substantially (Table 2.1). In particular foreign direct investment (FDI) became a predominant form of international investment flows in the post-war period as multinationals increasingly set up wholly or majority owned subsidiaries in developing countries.³⁰ But in large parts of the developing world the political environment towards foreign investors was more hostile than ever, and rigid industrial policies with discriminatory treatment of foreign investors became fashionable in large parts of the developing world. In the Soviet bloc, of course, foreign investors were seen as *'the last poisonous flowers on the dung-heap of capitalism.'*³¹ Yet, even outside the Soviet Union, economic and political theories of *dependecia* took their hold among many post-colonial states,³² which resulted in development strategies based on import-substitution. While not aiming to keep foreign investors out altogether, import-substitution strategies sought to carefully manage and control them in order to promote domestic industrialization. Dissatisfied with the ability, and willingness, of multinational companies in contributing to national development, foreign investments thereby often became subject to screening mechanisms, performance requirements, capital transfer restrictions, fierce royalty rates, and so forth.³³

³⁰ D. Hanink, *The International Economy: A Geographic Perspective* (Wiley: New York, 1993), at 223-4.

³¹ Klaus Sahlgren quoted in; T. Sagafi-Nejad, *The UN and Transnational Corporations: From Code of Conduct to Global Compact* (Bloomington: Indiana University Press, 2008), at 92.

³² See e.g.; H. Singer 'The Distribution of Gains between Investing and Borrowing Countries' 40 *American Economic Review, Papers and Proceedings* 473 (1950); R. Prebisch 'Commercial Policy in the Underdeveloped Countries' 49 *American Economic Review, Papers and Proceedings* 251 (1959).

³³ See e.g.; F. Bergsten, 'Coming Investment Wars,' *Foreign Affairs*, October, 1974; C. Murphy, *Emergence of the NIEO ideology* (Boulder, CO: Westview, 1984). Note that a parallel development took place even in selected developed countries at the time.

In response, capital-exporting states within the OECD initiated a new round of negotiations for an international investment treaty in 1962 after a series of failed non-governmental attempts during the 1940s and 1950s.³⁴ Named after its lead drafters during the 1950s, the Abs-Shawcross convention proposed a text founded on the international minimum standard, including the Hull standard of compensation, and was particularly notable for allowing investors to submit disputes directly to arbitration against their host states.³⁵ While efforts continued up through the 1960s, the convention eventually failed when it became clear that developing countries would never agree to its terms. For rather than Western perceptions of international minimum standards, developing countries increasingly relied upon the distorted version of the Calvo doctrine to legitimize their nationalist economic policies, which during the 1960s and 1970s culminated in a number of large scale expropriations of foreign capital with either little or no compensation (Figure 2.1).³⁶ In the words of the United States Supreme Court in 1964, *‘[t]here are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state's power to expropriate the property of aliens.’*³⁷

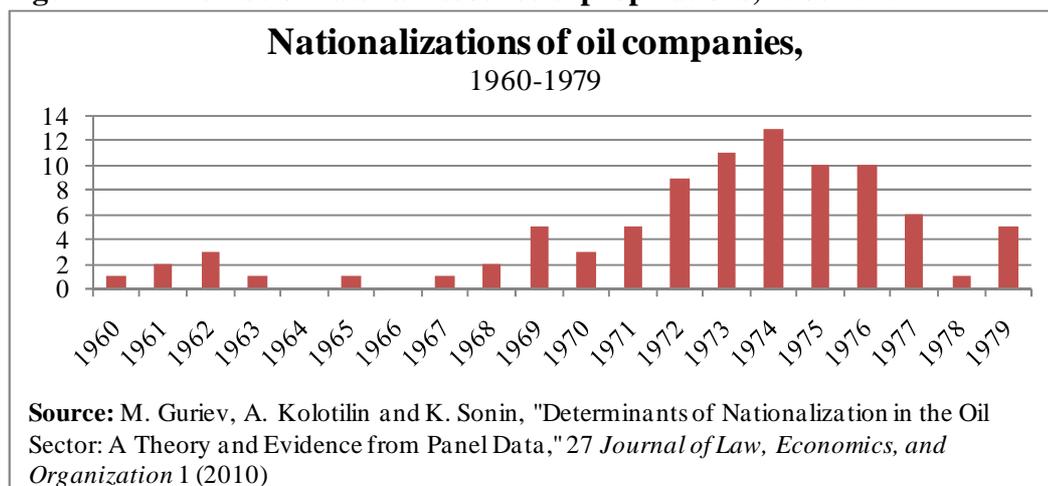
³⁴ Newcombe and Paradell, *op. cit.*, at 20-21.

³⁵ A. Fatouros, ‘International Codes to Protect Private Investment: Proposals and Perspectives,’ 14 *The University of Toronto Law Journal* 1 (1961), at 86; Society to Advance the Protection of Foreign Investment, *International Convention for the Mutual Protection of Private Property Rights in Foreign Countries* (Cologne: Germany, 1957). See also chapter four.

³⁶ Montt, *op. cit.*, ch. 1. As will be discussed further in chapter 4, however, it is important to note that particularly where investments were covered by concession agreements or other types of contracts, international arbitration proceedings did in fact often result in meaningful compensation; see; J. Yackee, ‘Pacta Sunt Servanda and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth and Reality’, 32 *Fordham International Law Journal* (2009).

³⁷ Harlan J in *United States v. Sabbatino*, 374 US 398 (1964).

Figure 2.1. The rise of natural resource expropriations, 1960-1979



As a group, developing countries pursued their strategies of ‘expropriation without compensation’ by taking advantage of their majority vote in the General Assembly of the United Nations (UN). Encouraged by oil-producing countries’ successful establishment of control over their reserves in the 1970s, developing countries here proposed a New International Economic Order (NIEO),³⁸ allowing them ‘Permanent Sovereignty over Natural Resources’.³⁹ A cornerstone result of the NEIO was the 1974 ‘Charter of Economic Rights and Duties of States’ (henceforth the UN Charter),⁴⁰ which not only challenged the Hull standard of compensation but more fundamentally questioned the very concept of an international minimum standard by basing foreign investment disputes on domestic law to be settled in the courts of host states.⁴¹ With repeated resolutions by the General Assembly completely contradictory to Western perceptions of the international norm, the customary international law on foreign investment was thereby, if not in disarray, then clearly in dispute.⁴²

³⁸ UN, General Assembly, 6th spec sess, *Declaration on the Establishment of a New International Economic Order*, Res 3201 (S-VI) (1st May 1974), Off Doc GA UN A/9559, suppl. No. 1 (1974).

³⁹ UN, General Assembly, 17th sess, *Permanent Sovereignty Over Natural Resources*, Res 1803 (XVII) (14 December 1962), Off Doc GA UN A/5217, suppl no. 17 (1963).

⁴⁰ Dolzer and Schreuer, *op. cit.*, at 15.

⁴¹ UN, General Assembly, 29th sess, *Charter of Economic Rights and Duties of States*, Res 3281 (XXIX) (12 December 1974), Off Doc GA UN A/9631, suppl. No. 31 (1975). See also ‘List of Areas of Concern Regarding the Operations and Activities of Transnational Corporations, Note Submitted by the Group of 77,’ in: UNCTC, *Report on the Second Session* (New York: United Nations, 1976), annex I.

⁴² Dolzer and Schreuer, *op. cit.*, at 15.

2.2. The emergence of bilateral investment treaties

What capital-exporting states lost at the multilateral level, they tried instead to obtain through bilateral negotiations. Parallel to its multilateral efforts in the period after the Second World War, the United States thus expanded and upgraded its existing network of FCN treaties.⁴³ But whereas the treaties did not obtain as central a role in the international regime for foreign investment as intended by United States policy makers,⁴⁴ they did provide important inspiration for European States similarly eager to obtain favourable and legally binding standards for their investors abroad.

Having lost almost all its investments after its defeat in the Second World War, West Germany thus entered into a BIT with Pakistan in 1959, which intended ‘... *to create favourable conditions for investments by nationals and companies of either state in the territory of the other State.*’⁴⁵ In contrast to FCN-treaties, the treaty dealt solely with investment and was specifically customized to be negotiated between a developed and a developing country. This was to be the first of a great number of BITs signed during the 1960s, particularly by Germany and Switzerland.

BITs obviously differed from the investment regime during the colonial era as they were based on consent rather than force and referred disputes to international arbitration rather than imperial courts or foreign consuls. Their substantive provisions, however, were directly inspired by the failed OECD convention and thus very much in the line with the Western investment standards developed from the 17th century onwards. While they did not include obligations for foreign investors, with respect to human rights or corruption for instance, BITs granted them far-reaching protections. They thus set an independent standard on the treatment and protection of foreign investors by obliging the contracting parties to provide compensation for expropriation, whether expropriatory measures were direct takings of assets or indirect takings ‘tantamount to expropriation’. They

⁴³ Salacuse, *op. cit.*

⁴⁴ Vandeveld (1988), *op. cit.*, at 207-8.

⁴⁵ Preamble in 1959 Germany-Pakistan BIT. See further in chapter four.

moreover insured investors the repatriation of their profits and other capital and typically included further standards independent from domestic law, such as so-called ‘umbrella clauses’ obliging the contracting parties to observe their contractual obligations vis-à-vis foreign investors, as well as clauses providing for ‘fair and equitable treatment’, ‘full protection and security’, and damages owing to war or conflicts. Finally, many included non-discrimination standards, such as national- and most-favoured-nation treatment.

Initially, the settlement of BIT disputes had to be submitted by the contracting states to the International Court of Justice (ICJ) or *ad hoc* arbitration. In the absence of contracts providing for international arbitration,⁴⁶ foreign investors in the early post-colonial era therefore still depended on their home state being willing to risk diplomatic good-will and foreign policy objectives to fight for their interests abroad.⁴⁷ Security, diplomatic or other reasons unrelated to the investor’s dispute could therefore withhold a state from making a claim. From 1969, this slowly began to change, however, when Italy entered into its BIT with Chad allowing all investors covered by the treaty to submit disputes to international arbitration directly against its host state.⁴⁸ In theory, at least, this allowed the capital-exporting state (Italy) to de-politicize future investment disputes, as it would not be directly involved in the adjudication.

The innovation in the Italy-Chad BIT followed a recommendation made by ICSID,⁴⁹ which had been created under World Bank auspices three years earlier. Rather than incorporating substantive rules on the treatment and protection of foreign investors - which developing countries would anyways resist - the ‘father’ of the ICSID Convention, Aron Broches, found that one pragmatic way to move forward in the field of foreign investment law was to establish a set of impartial

⁴⁶ See discussion in chapter six.

⁴⁷ *Barcelona Traction, Light and Power Company Limited (Belgium v. Spain)* [1970] ICJ Rep. 3, 9 ILM 227, par. 79.

⁴⁸ J. Yackee, ‘Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties,’ 22 *Brooklyn Journal of International Law* 405 (2008), at 430.

⁴⁹ ICSID, ‘Model Clauses Relating to the Convention on the Settlement of Investment Disputes Designed for Use in Bilateral Investment Agreements,’ 8 *International Legal Materials* 1341 (1969).

rules for the settlement of disputes.⁵⁰ Apart from allowing the application of international law to foreign investment disputes, and having awards directly enforceable within all contracting parties, the ICSID Convention was notable for allowing investors direct recourse to international arbitration against host states without, in principle, exhausting local remedies.⁵¹ This was in contrast to the usual procedure of international arbitrations, where foreign investors traditionally needed to go through domestic courts before international proceedings could be initiated.⁵² An equally notable feature of the Convention was its jurisdiction to ‘any legal dispute arising directly out of an investment’,⁵³ thereby extending investment arbitration beyond mere commercial claims to a very wide range of public regulatory disputes.

Figure 2.2. Developing countries signing the ICSID Convention, 1965-1979



Among developing countries, however, the ICSID Convention was primarily adopted by African countries in its early years (Figure 2.2). The same was the case with BITs. Given the opposition to BIT-like rules in the developing world, only few developing countries signed up to BITs at this time, and in the year of the UN-charter the international BIT-network therefore largely remained a phenomenon between Europe and Africa (Figure 2.3).

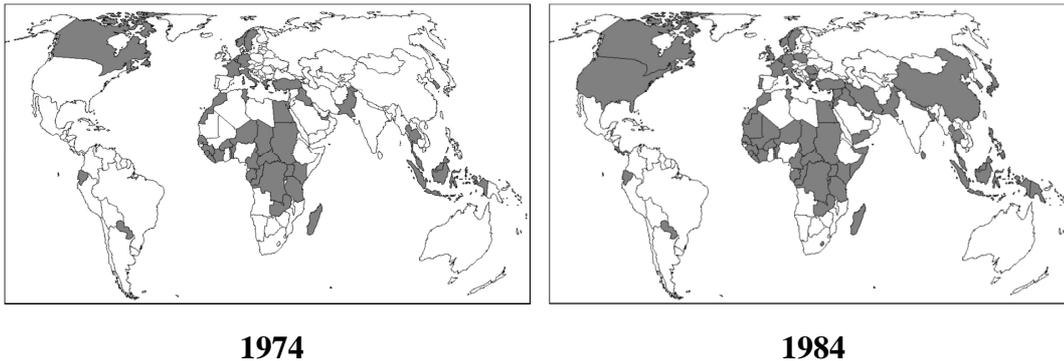
⁵⁰ Schreuer and Dolzer, *op. cit.*, at 20.

⁵¹ *Ibid.*

⁵² Newcombe and Paradell, *op. cit.*, at 6.

⁵³ ICSID Convention, art. 25(1).

Figure 2.3. Countries with at least one signed BIT, 1974 and 1984



Ten years after, however, a number of new developing countries had begun signing investment treaties, including Iran, Sri Lanka, and – importantly – China (Figure 2.3). The spread of BITs at this time was partly due to increasing activism of developed countries. For whereas the early years of the BIT-movement was dominated almost entirely by Germany and Switzerland, this changed with the NIEO. Urged by domestic business communities, and the International Chamber of Commerce (ICC),⁵⁴ developing countries’ collective action in the UN made a number of developed countries begin, or accelerate, their BIT programs in this period.⁵⁵ The United Kingdom, for instance, began its investment treaty program specifically to address the increasing investment protectionism in the developing world,⁵⁶ and the same was the case in the United States, which revived its investment protection program – now in the shape of BITs rather than FCNs.⁵⁷

Apart from the rising number of BIT-programs among developed countries, the increase in developing countries signing up to the BIT-movement also reflected a changing policy-environment surrounding investor-state relations.⁵⁸ The debt crisis in Latin America and successful growth strategies of a number of outward

⁵⁴ ICC, *Bilateral Treaties for International Investment* (Paris: ICC, 1977).

⁵⁵ See also the collective response by OECD countries; *OECD Declaration on International Investment and Multinational Enterprises*, 21 June 1976.

⁵⁶ E. Denza and S. Brooks, ‘Investment Protection Treaties: The British Experience,’ 36 *The International and Comparative Law Quarterly* 4 (1987); Hansard, UK Parliamentary Debates, ‘Overseas Aid, *House of Commons*, 9 June 1971. Series 5 (818) cc1135-1198 (1971).

⁵⁷ U.S. Policy Toward International Investment, Hearings Before the Subcommittee on International Economic Policy of the Committee on Foreign Relations, United States Senate, July 30, Sept. 20, and Oct. 28, 1981; Vandavelde (1988), *op. cit.*

⁵⁸ See chapter five.

oriented emerging markets led to a change in attitude towards multinationals. Occasionally prodded on by international financial institutions, many capital-importing countries thereby began to encourage the influx of foreign capital by loosening rigid controls on the establishment and treatment of international investments.⁵⁹

The Washington Consensus

The end of the Cold War completed the swing of the pendulum from scepticism towards foreign investors to full-fledged embrace.⁶⁰ Foreign capital was no longer perceived as a threat to developing countries' sovereignty, but now regarded as an opportunity for economic growth and development.⁶¹ An organization like the UN, earlier so sceptical about international investments, now saw multinationals as engines of growth which could provide critical '*help [to] make the 1990s a decade of renewed economic development*'.⁶² In John Williamson's 10-point list summarising the 'Washington Consensus' towards development policies, a restrictive attitude towards FDI was now considered outright 'foolish.'⁶³ By and large, developing countries agreed and governments in practically all corners of the world began to liberalise their investment regimes (Table 2.2) and attracted increasing amounts of FDI flows (Figure 2.4).

⁵⁹ D. Encarnation and L. Wells, 'Sovereignty at Garde: Negotiating with Foreign Investors,' 39 *International Organization* 47 (1985); Vandervelde (1998), *op. cit.*, at 386-90.

⁶⁰ Sagafi-Nejad, *op. cit.*

⁶¹ See generally; C. Gore, 'The Rise and Fall of the Washington Consensus as a Paradigm for Developing Countries,' 28 *World Development* 5 (2000).

⁶² UNCTAD, *World Investment Report 1992* (Geneva: United Nations, 1992), at iii. See also chapter five.

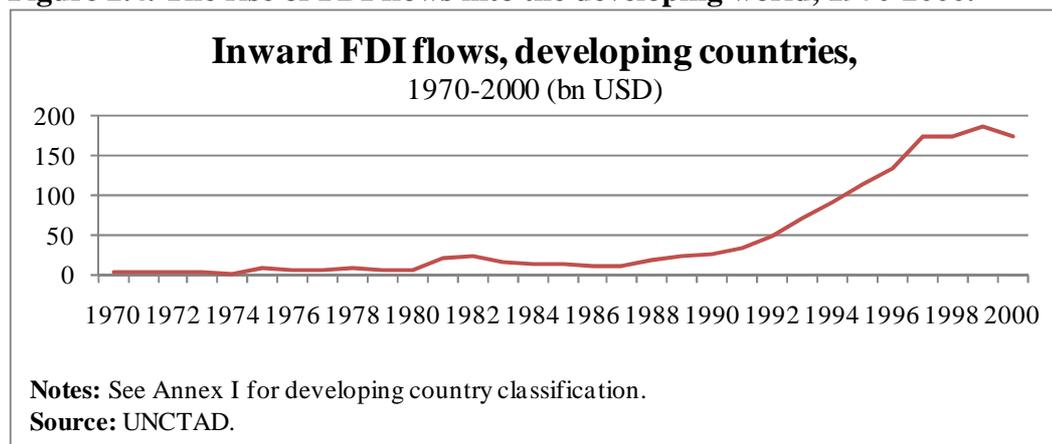
⁶³ J. Williamson, 'What Washington Means with Policy Reform,' in: J. Williamson (ed.) *Latin American Adjustment: How Much has Happened?* (Washington DC: Institute for International Economics, 1990), ch. 2.

Table 2.2. National regulatory changes in domestic investment regimes, 1992-2000

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Number of countries that introduced changes	43	54	49	63	66	76	60	65	70
Number of regulatory changes	77	100	110	112	114	150	145	139	150
Liberalization/promotion	77	99	108	106	98	134	136	130	147
Regulation/restrictions	0	1	2	6	16	16	9	9	3

Source: UNCTAD

Figure 2.4. The rise of FDI flows into the developing world, 1970-2000.



It was in this environment that the current regime for foreign investment was established.⁶⁴ Although many had started slowly in the 1980s, former Communist countries now signed BITs in considerable numbers, and most of Latin America and Asia joined the bandwagon as well, making the BIT-regime a truly global phenomenon. Combined, this helped assure broad participation among developing countries, who by concluding BITs ‘*affirmed a thousand times over that they [sought] a liberal investment regime.*’⁶⁵ As importantly, this was also the period when BITs began to allow for direct investor-state arbitration as a general rule (Figure 2.5), and thereby put in place an adjudicate regime for investment disputes with a scope and potential for protecting foreign investors not witnessed since the height of the Imperial era.⁶⁶ By contrast with assertions by some political

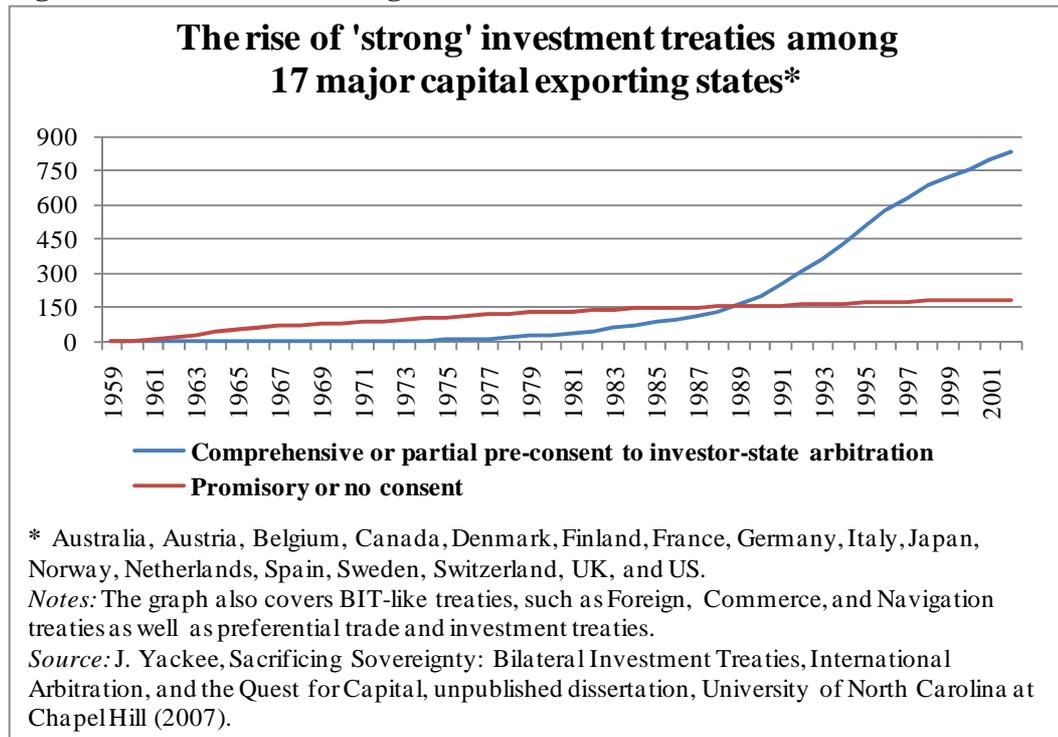
⁶⁴ J. Alvarez, ‘The Once and Future Foreign Investment Regime,’ in: M. Arsanjani, J. Cogan, R. Sloane, and S. Wiesner, *Looking to the Future: Essays of International Law in Honor of W. Michael Reisman* (The Hague: Martinus Nijhoff, 2010), at 617.

⁶⁵ Vandeveld (1998), *op. cit.*, at 641.

⁶⁶ T. Wälde, ‘The ‘umbrella’ clause in investment arbitration: a comment on original intentions and recent cases,’ 6 *Journal of World Investment & Trade* 183 (2005), at 194; Van Harten, *op. cit.*,

scientists,⁶⁷ it was not until then that BITs – at least in theory – could provide investors with something akin to credible commitments. This will be dealt with in more detail later in the thesis.

Figure 2.5. The recent emergence of modern investment treaties.



Notably, BITs reached their ‘global era’⁶⁸ in the 1990s despite the fact that developing countries continued to resist ‘multilateralizing’ BIT-like rules, whether under the auspices of the UN, the OECD, or the WTO. I will return to this in later chapters. For now, it suffices to say that the result has been that multilateral rules governing investment remain severely limited with comprehensive standards in the WTO only covering investors in the service sector and no options for direct investor-state dispute resolution. With the rise of cross-border production-networks this is hardly optimal for international investors, as they are increasingly affected by a whole range of trade-rules not dealt with in

at 13; M. Sornarajah, *Settlement of Foreign Investment Disputes* (New York: Kluwer Law International, 2000), at 159-61.

⁶⁷ E.g.; Jandhyala, S., W. Henisz, and E. Mansfield, ‘Three Waves of BITs: The Global Diffusion of Foreign Investment Policy,’ *Journal of Conflict Resolution* (forth., 2011.).

⁶⁸ Vandevelde (2009), *op. cit.*, at 19.

‘traditional’ investment promotion and protection treaties such as BITs. As a way to pursue more integrated approaches in investment rule-making, developed and developing countries are therefore increasingly signing preferential trade and investment agreements (PTIAs).⁶⁹ PTIAs are broader in scope than BITs by not only imposing preferential treatment on investments but also, *inter alia*, on trade in goods and (often) services, and some - such as the Energy Charter Treaty (ECT) and the North American Free Trade Agreement (NAFTA) - follow modern BITs by authorizing direct claims by investors against their host states. NAFTA, in particular, has been notable as the BIT in its investment chapter, is the first to be signed among two Western capital-exporting states.⁷⁰

That said, with almost 3,000 signed BITs, they remain by far the most widespread and important treaties to protect foreign investors. They have been adopted by practically all countries in the world, and many have signed dozens. In terms of content, most closely follow the original European models with few adjustments, and the vast majority thereby use remarkably similar terms with often identical provisions.⁷¹ Even disregarding the equalizing effect of the MFN standard, developing countries have thereby signed up to standards which often exactly mirror the models developed by capitalist-exporting states, despite actually having alternative models available with less wide-ranging protections.⁷² Explaining why, and how, they did this, is the subject of this thesis.

⁶⁹ These agreements are also sometimes referred to as free trade agreements, regional economic integration agreements, framework agreements on economic cooperation, or closer economic partnership agreements.

⁷⁰ The very few earlier BITs among Western countries, such as the one between Germany and Greece, were signed when one party was much less developed than the other.

⁷¹ C. McLachlan, L. Shore, and M. Weiniger, *International Investment Arbitration: Substantive Principles* (New York: Oxford University Press, 2007), at 5-6; R. Geiger, ‘The Multifaceted Nature of International Investment Law,’ in: K. Sauvant (ed.) *Appeals Mechanisms in International Investment Law* (New York: Oxford University Press, 2008).

⁷² In the 1980s, the Asian-African Legal Consultative Committee (AALC) for instance produced a set of model BITs, some of which offered host states greater regulatory autonomy, for instance with respect to compensation requirements for expropriation and capital transfer provisions; see, 23 *International Legal Materials* 237 (1984).

Conclusion

Offering considerable and enforceable protections to foreign investors independent of national legal regimes, investment treaties reflect legal standards promoted by Western states since the colonial era. They emerged as a response to increasing hostility towards foreign investors in the developing world, and were therefore, not surprisingly, initially adopted by relatively few developing countries. This changed by the 1980s, and particularly 1990s, when foreign private investment was embraced by practically all countries in the world. This thesis seeks to investigate why. There are many ways to attract foreign investors, so why did these particular instruments become so remarkably wide-spread? Why, as posed by Salacuse and Sullivan, would developing countries ‘*constrain their sovereignty by entering into treaties that specifically limit their ability to take necessary legislative and administrative actions to advance and protection their national interests?*’⁷³ And when doing this, why did they so closely follow the models of Western states based on extremely broad and vague treaty language, thereby giving private arbitrators considerable flexibility to determine their regulatory autonomy?

⁷³ J. Salacuse and N. Sullivan, ‘Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain,’ 46 *Harvard International Law Journal* 67 (2005), at 77.

3. International policy diffusion

This chapter will outline explanations for why, and how, international policy diffusion occurs. Traditional explanations will be grouped along four broad categories: coercion, norm emulation, competition, and rational learning. Suffices to say that in empirical work, several or all mechanisms are often found in different combinations, yet as analytical constructs they are distinct. On this basis, the second part of the chapter will outline a new explanation for policy diffusion based on notions of bounded rationality. As this model has rarely been applied in the literature, some level of detail in presentation is warranted compared with the traditional explanations.

Before proceeding one point of clarification should be made, namely the understanding of ‘policies’ in this context. Here, a distinction can be made between diffusion of broad policy ‘principles,’ such as Keynesianism or mercantilism, and the spread of particular policy ‘models.’ Following Weyland:

‘A principle is a general guideline for designing programs or institutions. Such a maxim provides a broad orientation for policy-makers that encompasses several specific design options. It charts an overall direction but not a specific course of action. By contrast, a model is one specific option from the menu offered by a policy principle; a model ... prescribes a coherent, integrated way of organizing a policy program or designing an institution.’¹

In recent literature on democratization, for instance, both the spread of democracy as a policy principle has been studied from a diffusion perspective along with particular democratic policy models, such as constitutions with similar content and structure.² In the context of this thesis, the distinction is also important, where the diffusion of neoliberalism as a policy principle has surely been important for the global spread of BITs as a particular policy model.³ But while references to diffusion studies on both policy principles and policy models will be made below, it is important to keep in mind that this thesis does not seek to explain the rise

¹ K. Weyland, *Bounded Rationality and Policy Diffusion: Social Sector Reform in Latin America* (Princeton: Princeton University Press, 2006), at 18.

² K. Weyland, ‘The Diffusion of Regime Contention in European Democratization, 1830-1940,’ 43 *Comparative Political Studies* 8/9 (2010); Z. Elkins, ‘Diffusion and the Constitutionalization of Europe,’ 43 *Comparative Political Studies* 8-9 (2010).

³ See chapter five.

investor friendly reforms as a policy principle, but rather the almost universal adoption of investment treaties as a specific and largely standardized policy model to promote and protect foreign capital.

3.1. The ‘traditional’ explanations

Coercion

While at first sight policy diffusion appears to be a horizontal process between states, its source may occasionally be the *de-facto* hierarchical nature of the international system.⁴ Here weak and poor governments often have little choice but to enact policy templates promoted by powerful states. In the context of legalization of world politics, for instance, many of the defining features of international law were originally imposed on the developing world during the colonial encounter.⁵ We saw in the last chapter that international investment law was no different in this respect, and although diffusion cannot occur through outright imposition or force,⁶ more subtle coercive mechanisms may be used. So the question is, whether modern investment treaties can be seen as a coercive instrument unwillingly entered into by developing country governments?

In studies of international policy diffusion, the clarification of what coercion is, and what it is not, often remains remarkably vague, if at all addressed.⁷ Surely, distinguishing between coercion and other concepts, such as power, authority and imposition, is bound to be difficult in real-world settings. Yet, some conceptual clarity is necessary before claiming, or refuting, that coercion has taken place.

⁴ See generally; D. Lake, *Hierarchy in International Relations* (Ithaca: Cornell University Press, 2011).

⁵ The key contribution is; A. Anghie, *Imperialism, Sovereignty and the Making of International Law* (Cambridge: Cambridge University Press, 2005). See also; J. Gathii, ‘Imperialism, Colonialism, and International Law,’ 54 *Buffalo Law Review* 1013 (2007); B. Chimni, ‘An Outline of a Marxist Course on Public International Law,’ 17 *Leiden Journal of International Law* 1 (2004).

⁶ See chapter one.

⁷ For an exception, see W. Henisz, B. Zelner, and M. Guillen, ‘International Coercion, Emulation, and Policy Diffusion: Market-Oriented Infrastructure Reforms, 1977-1999,’ 70 *American Sociological Review* 6 (2005).

Lasswell and Kaplan note that coercion is ‘*a high degree of constraint and/or inducement*’,⁸ and coercion can thereby be understood conceptually as a form of power, which following Dahl’s classic exposition is the ability of A to get B to do something B would not otherwise do.⁹ In this sense, coercion is a particularly severe and material form of power, where A has to apply sanctions in order to seek compliance from B. Equally; coercion can also involve positive sanctions, such as dispersion of aid funds or other inducements.

For coercion to have taken place, threats or actual coercive acts must be the main, or only, reason for developing countries to adopt BITs. As noted by Dobbin, Simmons, and Garrett, ‘*[a]ll too often, evidence of the spread of policies that the United States or the World Bank supports is taken as proof of coercion, when other mechanisms may be at work.*’¹⁰ So with respect to conditionalities attached to World Bank or IMF programs, for instance, it is important to note that they are actually rarely credibly enforced,¹¹ which means that their impact has often varied considerably.¹² While adhering *rhetorically* to conditions attached to loan programs, even weak and underdeveloped countries have managed to manoeuvre around them in practice.¹³ And in case of bilateral pressure, if the United States asks Bangladesh to sign an investment treaty and Bangladesh complies, this could only potentially be explained as a coercive event in so far as Bangladesh didn’t want to sign the treaty in the first place. Also, while it would be a strong indication of coercion, if the United States threatened to withhold aid funds to get

⁸ H. Lasswell and A. Kaplan, *Power and Society: A Framework for Political Enquiry* (New Haven, CT: Yale University Press, 1950), at 97-98.

⁹ R. Dahl, ‘The Concept of Power’, 2 *Behavioral Science* 205 (1957).

¹⁰ F. Dobbin, B. Simmons, and G. Garrett, ‘The Global Diffusion of Public Policies: Social Construction, Coercion, Competition, or Learning?’ 33 *Annual Review of Sociology* 449 (2007), at 457.

¹¹ J. Svensson, ‘When is foreign aid policy credible? Aid dependence and conditionality.’ 61 *Journal of Development Economics* 61 (2000); B. Eichengreen and C. Ruehl, ‘The bail-in problem: systemic goals, ad hoc means,’ *NBER Working Paper*, w7653, 2000.

¹² For overviews, see; S. Koeberle, H. Bedoya, P. Silarszky, and G. Verheyen (eds.), *Conditionality Revisited* (Washington: World Bank, 2005); A. Dreher, ‘IMF Conditionality: Theory and Evidence,’ 141 *Public Choice* 1-2 (2009). On the subject of this thesis in particular, regulation of foreign direct investment, see; S. Kobrin, ‘The determinants of FDI policy in developing countries: a cross-sectional analysis, 1992-2001,’ 14 *Transnational Corporations* 1 (2005).

¹³ E.g. K. Akonor, *Africa and IMF Conditionality: the Unevenness of Compliance, 1983-2000* (London: Routledge, 2006); IMF IEO, *Structural Conditionality in IMF-Supported Programs* (Washington DC: IMF, 2007).

Bangladesh to sign the treaty, this is not in and of itself proof of coercion: in some cases such threats may in fact be welcomed by developing country governments to adopt policies they couldn't otherwise pursue due to opposition from certain domestic stakeholders.¹⁴

I thereby follow a behavioral understanding of coercion. This is also typically used when the diffusion literature discusses coercion, however implicit. It is, of course, a limited approach. For instance, even if dominant states or international financial institutions have not coerced developing countries into adopting BITs, they could still have prevented developing countries from withdrawing from BITs once signed.¹⁵ Although touched upon in the concluding chapter, this will be left for future studies to investigate. Also, broader understandings of power based on structural or discursive approaches would focus on how quasi-coercive forces can be involved in the constitution of developing countries' state identities and thereby interests.¹⁶ For instance, while the hegemonic position of the United States may have been instrumental for the popularity of neoliberal ideas, which in turn provided the normative framework facilitating the spread of BITs,¹⁷ this will not be considered coercion in this study, although surely it would in others.

On this basis, the following chapter will ask whether developing countries were coerced by powerful Western states and the international financial institutions to enter into treaties they would not otherwise have signed. From an econometric analysis, for instance, Alle and Peinhardt conclude that BITs' legally binding consent to investor-state arbitration is often the result of coercion: *'for many of the world's weakest and most dependent countries, the inclusion of ICSID clauses within BITs is not so much a choice as it is a requirement.'*¹⁸ Is this in fact the

¹⁴ See particularly; J. Vreeland, *The IMF and Economic Development* (New York: Cambridge University Press, 2003). See also; A. Drazen, 'Conditionality and Ownership in IMF Lending: A Political Economy Approach,' *IMF Staff Papers*, 49 (2002).

¹⁵ See generally; P. Bachrach and M. Baratz, 'Two Faces of Power,' *56 American Political Science Review* 4 (1962); R. Nozick, 'Coercion,' in: S. Morgenbesser, P. Suppes, and M. White (eds.), *Philosophy, Science and Method* (New York: St. Martins Press, 1969).

¹⁶ In the context of international relations, see generally; M. Barnett and R. Duvall, 'Power in International Politics,' *59 International Organization* 1 (2005).

¹⁷ See below.

¹⁸ T. Alle and C. Peinhardt, *'54 International Studies Quarterly* 1 (2010), at 23.

case? More generally, might coercion also have been a general driver for developing countries to sign up to BITs? Did they join the BIT-regime to prevent getting cut off from much-needed aid flows or risking pariah status among international organizations for instance?

Norm emulation

An alternative, though occasionally related, explanation for diffusion, can broadly be described as norm emulation, with norms understood as ‘*collective expectations about proper behavior for a given identity.*’¹⁹ This framework is based on the assumption that norms of what constitute ‘appropriate’ means and ends for state identities can be essential for political strategies, which in turn can make certain policies and institutional innovations diffuse primarily due to their normative appeal.²⁰ Similar policies across dissimilar contexts can for instance result from a need among decision-makers to show that they ‘belong’ in a certain social group.²¹ Just as ‘civilized’ nations had to adhere to certain standards during the imperial era,²² for instance, countries with widely different backgrounds also use a number of policy programs today to signal their commitment to the norms of political liberalism.

Often, such programs are adopted for symbolic reasons without governments necessarily having the capacity, or even inclination, to implement them in practice. Developing countries sign up to human rights treaties, even if not intending or capable of following them.²³ They invite international election

¹⁹ R. Jepperson, A. Wendt, and P. Katzenstein, ‘Norms, Identity, and Culture in National Security,’ in: P. Katzenstein (ed.) *The Culture of National Security: Norms and Identity in World Politics* (New York: Columbia University Press, 1996).

²⁰ The key work is; M. Finnemore and K. Sikkink, ‘International Norm Dynamics and Political Change,’ *52 International Organization* 4 (1998).

²¹ See generally; J. Fearon, ‘What Is Identity (As We Now Use the Word)?’ unpublished manuscript, University of Stanford, 1999.

²² H. Bull and A. Watson (eds.) *The Expansion of International Society* (Oxford: Clarendon Press, 1984).

²³ E. Lutz and K. Sikkink, ‘International Human Rights Law and Practice in Latin America,’ *54 International Organization* 3 (2000); C. Wotipka and F. Ramirez, ‘World Society and Human Rights: An Event History Analysis of the Convention on the Elimination of All Forms of Discrimination Against Women,’ in: B. Simmons, F. Dobbin, and G. Garrett, *The Global Diffusion of Markets and Democracy* (Cambridge: Cambridge University Press, 2007).

monitors, even when elections are rigged.²⁴ They sign up to international obligations guaranteeing welfare rights, yet fail to increase welfare expenditures.²⁵ In such cases, it is primarily a ‘logic of appropriateness’²⁶ that drives the diffusion of policies, rather than any material or other strategic goals. With respect to the spread of democratic norms the end-result is that today:

‘... a proper nation-state has a proper human rights profile and that includes participating in the proper human rights organizations and conferences, signing the proper human rights treaties and conventions, developing proper human rights law and policy, and behaving as if adhering to the regime mattered.’²⁷

Along the same lines, the diffusion of market-oriented and rule-of-law reforms in recent decades could also constitute an international mimetic ‘isomorphism’ of sorts, where countries have adopted a number of programs mainly for symbolic reasons.

Norm-based explanations typically see diffusion as a sequential process.²⁸ In the first step, norms of what constitute appropriate state behavior are promoted by norm entrepreneurs. These could be international financial institutions, whose importance often stems much more from promoting norms of appropriate economic governance rather than arm-twisting and coercion. The spread of central bank independence, for instance, has been heavily promoted by the IMF as a tool to adhere with the norms of neoliberalism.²⁹ Another set of norm entrepreneurs could be professions. Along these lines, Dezalay and Garth have shown how international lawyers played a key role in advancing international commercial

²⁴ S. Hyde, ‘Catch Us if You Can: Election Monitoring and International Norm Creation,’ *American Journal of Political Science* (forth. 2011). See also; J. Kelley, ‘Assessing the Complex Evolution of Norms,’ 62 *International Organization* 2 (2008).

²⁵ D. Strang and P. Chang, ‘The International Labor Organization and the Welfare State: Institutional Effects on National Welfare Spending, 1960-80,’ 47 *International Organization* 2 (1993).

²⁶ See generally; J. March and J. Olsen, *Ambiguity and Choice in Organizations* (Bergen: Universitetsforlaget, 1976); J. Kingdon, *Agendas, Alternatives, and Public Policy* (Boston: Little, Brown; 1984); J. March and J. Olsen, ‘The Institutional Dynamics of International Political Orders,’ 52 *International Organization* 4 (1998).

²⁷ F. Ramirez, J. Meyer, C. Wotipka, and G. Drori, ‘Expansion and Impact of the World Human Rights Regime: Longitudinal and Cross-National Analyses Over the Twentieth Century’ *National Science Foundation grant proposal* (2002).

²⁸ Finnemore and Sikkink, *op. cit.*

²⁹ S. Polillo and M. Guillén, ‘Globalization Pressures and the State: The Global Spread of Central Bank Independence,’ 110 *American Journal of Sociology* 1764 (2005).

arbitration as a transnational adjudication mechanism,³⁰ and together with economists³¹ promoted neoliberal policy norms in Latin American states.³² As will be clear from chapter five, Western private lawyers have also played a key role in promoting investment treaties in the developing world.

Whether initially promoted by international financial institutions, professions, or other actors, a certain point comes after which a ‘critical mass’ of states have adopted a particular policy or institutional innovation. After this ‘tipping point’, a socialization process begins punishing states that fail to conform to international trends and rewarding those that do.³³ In turn, this leads to a norm ‘cascade,’ where policies and institutions suddenly begin to spread like wild-fire. Studies of mass schooling, for instance, have found that once a tipping point was reached after 1950, policies initially tailored to a particular context – in this case Western Europe after the Second World War – rapidly spread to entirely different corners of the world.³⁴ The increased legalization of world politics after the Cold War could also be seen from this perspective. Here, states often adopted international law due to its normative pull as a governing institution,³⁵ and policy-makers today have an inherent need to justify their actions according to international legal obligations - even when violating them.³⁶ Certain environmental policies have similarly been observed to diffuse for normative, rather than strategic, reasons.³⁷ Finally, an example of economic policies is the diffusion of independent

³⁰ Y. Dezalay and B. Garth, *Dealing in Virtue: International commercial arbitration and the construction of a transnational legal order* (Chicago: University of Chicago Press, 1996).

³¹ On the ‘Chicago boys’ in Latin America, see e.g.; J. Chwieroth, ‘Shrinking the State: Neoliberal Economics and Social Spending in Latin America,’ in: R. Abdelal, M. Blyth and C. Parsons (eds.) *Constructing the International Economy* (Ithaca: Cornell University Press, 2010).

³² Y. Dezalay and B. Garth, *The Internationalization of Palace Wars: Lawyers, Economists, and the Contest to Transform Latin American States* (Chicago: University of Chicago Press, 2002).

³³ Finnemore and Sikkink, *op. cit.*

³⁴ J. Meyer, F. Ramirez, and Y. Soysal, ‘World expansion of mass education, 1870-1980,’ 83 *Sociology of Education* 128 (1992).

³⁵ On the increasing ‘legalization’ of world politics after the Cold War, see e.g.; J. Goldstein, M. Kahler, R. Keohane, A.-M. Slaughter, ‘Introduction: Legalization and World Politics,’ 54 *International Organization* 3 (2000).

³⁶ T. Franck, ‘The Power of Legitimacy and the Legitimacy of Power: International Law in an Age of Power Disequilibrium,’ 100 *American Journal of International Law* 1 (2006).

³⁷ P.-O. Busch, H. Jørgens, and K. Tews, ‘The Global Diffusion of Regulatory Instruments: The Making of a New International Environmental Regime,’ 598 *Annals of the American Academy of Political and Social Science* 146 (2005).

regulatory agencies during the 1990s, which partly took place because it was seen as an ‘appropriate’ regulatory instrument for capitalist countries.³⁸

According to this framework, BITs may also have been signed by developing countries not because they were forced to do so, or it necessarily entailed any material benefits, but rather because it was one of those things (self-identified) liberal states were *supposed* to do. Yackee rightly points out that it is no coincidence that the diffusion of BITs occurred at the same time neoliberal policy principles were at their peak,³⁹ which raises the question of whether BITs – as a particular policy model – have diffused due to norm emulation. Just as developing countries have often signed up to human rights instruments in order to signal membership of the ‘club’ of democratic nations, might BITs have become popular in the age of the ‘Washington Consensus’ merely to symbolize a commitment to the tenets of economic liberalism? Similarly, norm-based explanations for the adoption of international legal institutions are wide spread in legal scholarship,⁴⁰ so perhaps BITs could also have been justified as essential rule of law instruments.

The question is, in other words, whether developing country governments signed BITs without any strategic goal in mind, but rather as acts of political symbolism? According to Jandhyala, Henisz and Mansfield, this was indeed the case during the 1990s.⁴¹ Following the standard approach in literature on BIT-adoption, however, their claim is based almost solely on econometrics and they rightly conclude that qualitative insights are needed to conduct a ‘validity check’ of their model specifications.⁴² One way to do this is to trace whether a ‘discourse trail’

³⁸ E.g. J. Jordana and D. Levi-Faur, ‘The Diffusion of Regulatory Capitalism in Latin America: Sectoral and National Channels in the Making of a New Order,’ *598 Annals of the American Academy of Political and Social Science* 102 (2005).

³⁹ J. Yackee, ‘Are BITs such a bright idea? Exploring the ideational basis of investment treaty enthusiasm,’ *12 U.C. Davis Journal of International Law and Policy* 195 (2005).

⁴⁰ The classic contribution is T. Franck, *Legitimacy Among Nations* (New York: Oxford University Press, 1990). See also, Franck (2006), *op. cit.*; M. Kumm, ‘The Legitimacy of International Law: A Constitutionalist Framework of Analysis,’ *15 European Journal of International Law* 5 (2004).

⁴¹ S. Jandhyala, W. Henisz, and E. Mansfield, ‘Three Waves of BITs: The Global Diffusion of Foreign Investment Policy,’ *Journal of Conflict Resolution* (forth., 2011.).

⁴² Incidentally, some of the only qualitative support found for their claim was a reference to the interview with Makhdoom Ali Khan made by this author (Poulsen, L., and D. Vis-Dunbar,

suggests that BITs have been justified in normative rather than purely instrumental terms.⁴³ This will be investigated in chapter five.

Competition

Yet another explanation for policy diffusion is based on inter-state competition, which has been particularly popular with respect to economic policies. Wanting to increase exports and attract foreign direct investment or other scarce economic resources, countries have had strong incentives to pursue ever more liberal economic reforms over the last decades. Although individually, each sovereign may have preferred considerable market regulation and high levels of public expenditures, international competition can lead to ever greater market-friendly regimes.⁴⁴ With global portfolio markets sensitive to inflationary pressures for instance,⁴⁵ and multinationals often concerned with a battery of regulatory transaction costs,⁴⁶ similar policies may stem from rivalries among countries wanting to reap the greatest material benefits from economic globalization. From this perspective, the appropriation of economic policies is a rational process explained - implicitly or explicitly - by the functions they perform in an era of high economic interdependence. Though results have varied, this has been a wide-used explanation within IPE literature on tax policies,⁴⁷ capital account liberalization,⁴⁸ government spending,⁴⁹ monetary policy,⁵⁰ and environmental regulation.⁵¹

'Reflections on Pakistan's Investment-Treaty Program after 50 years; An Interview with the Former Attorney General of Pakistan, Makhdoom Ali Khan,' *Investment Treaty News*, 16 March, 2009.). Yet, even in Pakistan most of the officials involved with the country's BIT-program during the 1990s genuinely saw the treaties as crucial for the promotion of FDI and thus not *just* as fashion trends – as claimed by Jandhyala, Henisz and Mansfield. See chapter 5.

⁴³ A. Gurowitz, 'The Diffusion of International Norms: Why Identity Matters,' 43 *International Politics* 3 (2006), at 43.

⁴⁴ Simmons, Dobbins, and Garret (2006), *op. cit.*, at 792.

⁴⁵ L. Mosley, *Global Capital and National Governments* (New York: Cambridge University Press, 2003).

⁴⁶ C. Oman, *Policy competition for foreign direct investment: A study of competition among governments* (Paris: OECD, 2000).

⁴⁷ E.g. D. Swank, 'Tax Policy in an Era of Internationalization: Explaining the Spread of Neoliberalism,' 60 *International Organization* 4 (2006).

⁴⁸ E.g. B. Simmons and Z. Elkins, 'The globalization of liberalization: policy diffusion in the international political economy,' 98 *American Political Science Review* 171 (2004).

The competition thesis has also been used in literature on legalization of economic diplomacy. Here, a widely held view on why so many countries bind themselves to ‘the mast’ of international economic law is that it provides them a ‘credible commitment’. Following Schelling, ‘commitment’ refers to surrendering some control over one’s future behavior, and ‘*doing so deliberately, with a purpose.*’⁵² This purpose could be to prevent a roll-back of reforms from future governments, for instance, or changing incentives due to time-inconsistency.⁵³ From this perspective, international economic law is thereby seen as a rational solution designed by sovereigns to solve their problems.⁵⁴

This has also been *the* predominant explanation for the diffusion of investment treaties. In the most widely quoted account, Guzman uses simple game-theoretic reasoning to argue that developing countries have signed the treaties to become relatively more attractive investment-destinations.⁵⁵ He argues that BITs overcome problems of ‘obsolescent bargaining’ by providing investors a credible commitment that their assets will not be expropriated, discriminated against, or otherwise maltreated post-establishment. They do this by (i) clarifying the legal obligations vis-à-vis foreign investors compared to customary international law; (ii) involving the home country as a treaty partner thereby exerting indirect diplomatic pressure on host countries to uphold their commitments; and (iii)

⁴⁹ E.g. G. Garrett, and D. Mitchell, ‘Globalization, government spending and taxation in the OECD,’ 39 *European Journal of Political Research* 145 (2001).

⁵⁰ E.g. L. Mosley, ‘Room to Move: International Financial Markets and National Welfare States,’ 54 *International Organization* 4 (2000).

⁵¹ E.g. M. Kuncze and F. Shogren, ‘On environmental federalism and direct emission control,’ 51 *Journal of Urban Economics* 238 (2002).

⁵² T. Schelling, *Strategies of Commitment and Other Essays* (2006), at 1.

⁵³ K. Abbott and D. Snidal, ‘Hard and Soft Law in International Governance,’ 54 *International Organization* 3 (2000); A. Guzman, *How International Law Works: A Rational Choice Theory* (Oxford: Oxford University Press, 2008).

⁵⁴ An alternative, but similar, view could be based on evolutionary logic of refinement and self-selection: since only efficient policies and institutions ‘survive’ over the long run, such as certain legalized institutions, functionalist reasoning is essentially independent of policy-makers’ initial intent or foresight. For a key application, see; R. Axelrod, *The Evolution of Cooperation* (New York: Basic Books, 1984). Mattli’s account of the rise of international commercial arbitration is associated with this approach; W. Mattli, ‘Private Justice in a Global Economy: From Litigation to Arbitration,’ 55 *International Organization* 4 (2001).

⁵⁵ Guzman, *op. cit.* An updated version is included in; K. Sauvants and L. Sachs (eds.) *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (New York: Oxford University Press, 2009).

providing a powerful enforcement mechanism through investor-state arbitration.⁵⁶ As such, developing countries have signed BITs in a competitive race to attract capital: once one country started, others were inclined to follow in order to avoid losing much needed FDI. And this prisoner's dilemma is why developing countries have not been able to push for a multilateral investment treaty as a group, which could be more aligned with their interests.

In a sophisticated treatment of the subject, Montt presents a related argument focusing on the 'network effects' of BITs.⁵⁷ In particular, Montt asks why developing countries have signed investment treaties with such remarkably similar substantive and procedural provisions. He argues that the diffusion of BITs - slow at first, then spreading like wild-fire - does not have to rely on norm cascades but can be explained with increasing returns. First of all, it became 'cheaper' to draft and negotiate treaties, when standard templates were readily available - negotiators simply had to jump onto the BIT 'bandwagon.' Secondly, with a critical mass of similarly worded treaties already signed, developing countries could by the 1990s reasonably expect an efficient (quasi) jurisprudence to evolve. While the standards may have been broad and open-ended - and thus of little inherent value of themselves - the expectation was that tribunals would make them operative by interpretation, and thereby reduce the uncertainty of their scope and implications.⁵⁸ Rather than having to spend considerable time and costs on agreeing to specific, as opposed to open-ended, investment rules, negotiators made a strategic bet that arbitrators would do the job for them in a way that suited their interests.⁵⁹ Finally, the costs of standing outside the global BIT-network, or insist on different worded treaties, increased considerably once a reasonable number of countries had already joined, as investors and other market actors considered a country with no - or idiosyncratic - BITs to be more risky jurisdictions.⁶⁰ The BIT-movement has thereby seen a lock-in effect due to increasing returns, which according to Montt is what explains explain why they,

⁵⁶ See next chapter.

⁵⁷ Montt, *op. cit.*

⁵⁸ *Ibid.*, at 113.

⁵⁹ *Ibid.*, at 157.

⁶⁰ *Ibid.*, at 114-115, 122.

*'fail to make any efforts to reach a new treaty that may be inherently superior.'*⁶¹ Although based on a sophisticated and important critique of the work of Guzman, Montt thereby shares the same fundamental premise: BITs are a rational instrument for developing countries to attract foreign investment, and the remarkable similarity among BITs is not surprising, as 'one size' *does* actually fit all.

The functionalist nature of both accounts makes them more than difficult to falsify empirically.⁶² Yet, they do present one testable hypothesis. By 'trading sovereignty for credibility' BITs should have a non-negligible impact on investment flows. In particular, if BITs are crucial in the international competition for capital, then they should be important for market-actors assessing and pricing the risk of foreign investments, namely the political risk insurance (PRI) industry.⁶³ I will address this question in chapter six. However, even if BITs have a considerable impact on investment flows, this would of course not be enough to sustain that they have diffused primarily due to competition. When seeing the global network of investment treaties as the result of rational design by far-sighted and highly informed policy-makers, explanations based on competition, risk conflating the intentionality of micro-level motives with (alleged) macro-level results.⁶⁴ And instead of carefully investigating whether rational design has in fact been driving BIT-diffusion, it has typically been an assumption rather than empirical question.

An important exception is a follow-up contribution by Guzman to his original work. Joined by Elkins and Simmons, the authors find econometric evidence that developing countries have signed BITs primarily in response to other countries signing them, and particularly those with which they compete for foreign

⁶¹ Montt, *op. cit.*, at 103.

⁶² Montt is honest about this; *op. cit.*, at 122.

⁶³ *Ibid.*, at 115.

⁶⁴ This is a standard critique of functionalist reasoning in international relations; A. Wendt, 'Driving with the Rearview Mirror: On The Rational Science of Institutional Design,' 55 *International Organization* 4 (2001), at 1037.

capital.⁶⁵ Chapter eight will show that the results in this much-quoted disappear after slight, but justified, changes in model-specification. Yet, even without this empirical problem, it appears that one could easily make the opposite argument: the incentive to sign BITs should be highest for developing countries when *none* of their competitors have done so, as an increase in BITs among economic competitors will decrease the effect a BIT will have on winning investment projects. This is the basic finding of Yackee in his equally sophisticated analysis, which thereby questions the logic of competitive pressures presented by Guzman and co-authors and implies that the theory should be, if not rejected, then at least subject to greater testing.⁶⁶ Also, if developing countries are engaging in a competitive race to attract investments, why haven't more developing countries gone further by including liberalization provisions in their BITs? While more difficult to negotiate politically, legally binding liberalization provisions would arguably be the next logical step to become relatively more attractive to investors after other developing countries have signed up to BITs solely covering the post-establishment phase. One can think of other innovations that would make BITs even more 'investor-friendly' – such as stringent standards on performance requirements⁶⁷ – yet their content has remained largely constant. This questions whether the treaties can truly be considered a 'race to the top' from the perspective of investors.⁶⁸ Finally, as the authors mention themselves the theory is entirely unable to explain the large number of South-South BITs, where the contracting parties do not exchange substantial, if any, investment flows.⁶⁹ This is

⁶⁵ Z. Elkins, A. Guzman, and B. Simmons, 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000,' 60 *International Organization* 811 (2006). The article has since been republished in the *University of Illinois Law Review* (volume 2008, no. 1), as well as; Simmons, Dobbin, and Garrett (2007), *op. cit.*; M. Waibel, A. Kaushal, K.-H. Chung, and C. Balciin (eds.), *The Backlash Against Investment Arbitration* (Alphen aan den Rijn: Kluwer Law International, 2010); and finally in the leading IPE textbook; J. Frieden, D. Lake, and J. Broz, *International Political Economy, 5th Ed.* (New York: Norton, 2010). Moreover, Engel has modelled this argument based on simple game theory; C. Engel, 'Governments in Dilemma: A Game Theoretic Model for the Conclusion of Bilateral Investment Treaties. A Comment on Competing for Capital,' *University of Illinois Law Review* 1 (2008).

⁶⁶ J. Yackee, 'Sacrificing Sovereignty: Bilateral investment treaties, international arbitration, and the quest for capital,' *USC Center in Law, Economics, and Organization Research Paper* (2006).

⁶⁷ See also; K. Vandervelde, 'The Political Economy of a Bilateral Investment Treaty,' 92 *Harvard International Law Journal* 2 (1998), at 643.

⁶⁸ For a related argument, see Montt, *op. cit.*, at 110.

⁶⁹ Elkins et al., *op. cit.* On South-South BITs, see also the following chapter.

unfortunate, and implies that the explanation should be subject to closer empirical scrutiny.

At a minimum, functionalist explanations based on inter-state competition have to show that decision-makers actually anticipated the effects of the policies they promoted (as well as those of their ‘competitors’).⁷⁰ For although unanticipated consequences are of course not inexplicable by rationalistic approaches, they do question the assumption of full information included in traditional competition-based accounts of policy-diffusion.⁷¹ This leads us to a fourth explanation based on policy learning.

Rational Learning

Policy learning can be understood broadly as the process with which policy makers change beliefs as a result of observing and interpreting experiences, which in turn can – but does not have to – lead to policy changes.⁷² Within IPE literature, the most prominent learning-based explanation for policy-diffusion is derived from notions of Bayesian updating, where prior beliefs are weighted against the quantity and quality of observed experience (with ‘quality’ referring to the variability, or consistency, of available outcome information).⁷³ As in competition based frameworks, diffusion is here a rational, goal-oriented and instrumental process, but unlike ‘pure’ rational-choice theories decision-makers are assumed to be imperfectly informed.⁷⁴

⁷⁰ For reflections on this in an early functionalistic account of international policy-making, see; R. Keohane, *After Hegemony* (Princeton: Princeton University Press, 1984), at 80-83. See also; B. Simmons, F. Dobbins, and G. Garrett, ‘Introduction: The International Diffusion of Liberalism,’ 60 *International Organization* 4 (2006), at 792-793. See further in the concluding chapter.

⁷¹ Simmons, Dobbins, and Garrett, *op. cit.*, at 793. On the distinction between unanticipated and unintended consequences, see; L. Martin and B. Simmons, ‘Theories and Empirical Studies of International Institutions,’ 52 *International Organization* 4 (1998), at 750-751.

⁷² See generally; J. Levy, ‘Learning and foreign policy: Sweeping a conceptual minefield,’ 48 *International Organization* 2 (1994).

⁷³ The key contribution is; C. Meseguer, *Learning, Policy Making, and Market Reforms* (Cambridge: Cambridge University Press, 2009).

⁷⁴ Note that intuitively, rational learning frameworks should have difficulties in explaining the adoption of similar policies across dissimilar contexts (see Weyland (2006), *op. cit.*, at 43). For whereas some policy diffusions respond to functional needs that can reasonably be considered

Learning can be a horizontal process, where governments rationally seek and process new information about the impact of policies pursued in other states. Meseguer, for instance, argues that with respect to privatization policies, learning from other countries has played an important role for both developed and developing country governments.⁷⁵ In particular, she showed in a panel setting that the adoption of market based reforms has been strongly associated with information about the outcomes associated with similar reforms abroad, measured both in terms of average outcomes and their variance. Similarly, Gilardi, Füglistler and Luyet have showed that the likelihood of health-care reforms in OECD countries increased, if experience from health-care reforms in other countries was associated with expenditure decreases.⁷⁶ Finally, with respect to BITs, Guzman and his collaborators have found a positive statistical association between countries' decisions to enter into BITs and whether other countries experienced FDI inflows after having signed up to BITs.⁷⁷

Policy learning can also be a vertical process channeled through intermediaries, such as international organizations. Indeed, in the same volume as her work with Elkins and Guzman, Simmons points out that '*international institutions are [a] natural conduit for learning and, especially, for organized pedagogy.*'⁷⁸ The research departments at the IMF and the World Bank, for instance, have been important for disseminating lessons on liberal economic policies.⁷⁹ And with

similar across heterogeneous countries – such as macroeconomic stabilization – others surely cannot. Yet if Montt is right and the incredible similarity of BITs is a rational solution to developing countries seeking to attract FDI, an explanation based on rational learning does not run into this problem.

⁷⁵ C. Meseguer, 'What Role for Learning? The Diffusion of Privatization in OECD and Latin American Countries,' 24 *Journal of Public Policy* 3 (2004).

⁷⁶ F. Gilardi, K. Füglistler, and S. Luyet, 'Learning From Others: The Diffusion of Hospital Financing Reforms in OECD Countries,' 42 *Comparative Political Studies* 4 (2009).

⁷⁷ Elkins, Guzman, and Simmons, *op. cit.*

⁷⁸ Simmons, Dobbin, and Garrett (2006), at 798.

⁷⁹ B. De Vries, 'The World Bank as an International Player in Economic Analysis,' in: A. Coats (ed.) *The Post-1945 Internationalization of Economics* (Durham: Duke University Press, 1997); J. Polak, 'The Contribution of the International Monetary Fund,' in: A. Coats (ed.) *The Post-1945 Internationalization of Economics* (Durham: Duke University Press, 1997); P. Quirk, 'Adopting Currency Convertibility: Experiences and Monetary Policy Considerations for Advanced Developing Countries,' *IMF Working Paper 94/96* (1994); N. Stern and F. Ferreira, 'The World Bank as an 'intellectual actor,' In D. Kapur, J. Lewis and R. Webb (eds.) *The World Bank: Its*

respect to foreign investment policies in particular, the UN has been very important in generating knowledge of FDI regulation, but also World Bank institutions like ICSID and MIGA have played a role. This is likely to be important. When BITs proliferated, they were a novelty for most countries, and even international lawyers themselves were often ignorant about their existence. As the Dutch branch of the Committee on Legal Aspects of a New International Economic Order noted in 1984: *'it is indeed surprising that so little attention has been paid in recent years to this body of bilateral investment treaties. Their significance, even their existence and certainly their abundance, seems to be largely unknown to international lawyers ...'*⁸⁰ So since investment treaty negotiations were 'unchartered territory' for developing countries in particular,⁸¹ most of their officials can safely be assumed to have shared the ignorance of even specialized international lawyers.

Also, learning is not only important when ascertaining the benefits of BITs. Indeed, it is peculiar that while Guzman and his co-authors do not *'assume that policymakers have Herculean powers of observation or analysis'*⁸² when assessing the FDI impact of BITs, they actually do when it comes to the risks.⁸³ Nowhere in their framework do they allow for learning with respect to the potential costs of BITs:

First Half Century, Volume 2 Perspectives (Washington DC: Brookings Institution, 1997); J. Toye and R. Toye, *The World Bank as a Knowledge Agency* (Geneva: UN Research Institute for Social Development, 2005).

⁸⁰ P. Peters, N. Schrijver and P. de Waart, 'Permanent Sovereignty, Foreign Investment and State Practice', in: K. Hossain and S. Chowdhury (eds.), *Permanent Sovereignty over Natural Resources in International Law: Principle and Practice* (London: Frances Pinter, 1984), at 113.

⁸¹ T. Fredriksson and Z. Zimny, 'Foreign direct investment and transnational corporations,' in: UNCTAD, *Beyond Conventional Wisdom in Development Policy: An Intellectual History of UNCTAD 1964–2004* (Geneva: United Nations, 2004), at 128.

⁸² Elkins, Guzman, and Simmons, *op. cit.*, at 831.

⁸³ Note that I understand the 'risks' of BITs in a 'Knightian' sense throughout, i.e. that it is possible in principle to assign a measurable probability – or range of probabilities – to the potential adverse outcomes of the treaties. See; F. Knight, *Risk, Uncertainty, and Profit* (Boston: Houghton Mifflin Co., 1933). This seems appropriate. For while the risk of an investment dispute does involve a range of elements hard for sovereigns to control (e.g. sub-national regulatory entities), it is difficult to argue that it is a case of extreme uncertainty where both the potential outcome and probabilities are entirely unknown, in which case one would have to discuss maximin strategies for instance, see; K. Arrow and L. Hurwicz 'An Optimality Criterion for Decision-Making Under Ignorance', in: C. Carter and J. Ford (eds.) *Uncertainty and Expectations in Economics: Essays in Honour of G. L. S. Shackle* (Oxford: Blackwell, 1972).

‘...striking are the sovereignty costs associated with the delegation of adjudicative authority: virtually any legal change or rule that affects foreign investors is potentially subject to review by a foreign tribunal. *The decision to sign a BIT always involves an assessment by the host of whether the expected benefit of attracting an additional increment of foreign capital outweighs these costs.*’⁸⁴

For the sake of argument I disregard here that most BITs before the late 1980s did in fact not include legally binding investor-state dispute settlement clauses, which in and by itself makes the statement somewhat misleading, as the authors seek to explain the popularity of BITs from 1960 to today.⁸⁵ What is important here instead is that the assumption of full information about the potential costs of BITs has been crucial in all significant contributions to date. While Montt, for instance, notes in passing that there was considerable uncertainty towards the benefits and costs of BITs throughout the 1990s,⁸⁶ his theoretical model only allows for imperfect information concerning the strategies of other states.⁸⁷ Information about the costs of BITs are assumed to have been known and accepted by developing countries when signing BITs,

‘In joining the BIT system, capital-importing countries traded sovereignty and democracy for credibility. ... *That was the cost of seeking additional FDI inflows, and these governments knew and accepted it when they decided to join the BIT-network.*’⁸⁸

In legal scholarship this assumption has also prevailed,⁸⁹ and in political science contributions, the costs of investment treaties are explicitly regarded *not* as ‘*an accidental by-product but intended by both sides*’.⁹⁰ Here, the costs of international arbitration are exactly what ‘*explains [BITs’] popularity in the*

⁸⁴ Elkins, Guzman, and Simmons, *op. cit.*, at 825. Italics added.

⁸⁵ As will be clear from chapter ten, this could have serious consequences for the predictions of their model.

⁸⁶ Montt, *op. cit.*, at 119

⁸⁷ *Ibid.*, at 97.

⁸⁸ *Ibid.*, at 128. Italics added.

⁸⁹ E.g. J. Paulsson, ‘The power of states to make meaningful promises to foreigners,’ 1 *Journal of International Dispute Settlement* 2 (2010), at 344; F. Vicuña, ‘Regulatory Expropriations in International Law: Carlos Calvo, Honorary NAFTA Citizen,’ 11 *New York University Environmental Law Journal* 19 (2002), at 31.

⁹⁰ T. Büthe and H. Milner, ‘Bilateral Investment Treaties and Foreign Direct Investment: A Political Analysis, in: Sauvart and Sachs, *op. cit.*, at 214.

developing world'⁹¹ as the treaties thereby send an important signal by '*pointing to the commercial costs of noncompliance.*'⁹²

Yet, this assumption has never been tested, which means that practically all contributions on BITs equate the results of the treaties with the initial intent of policy-makers without actually having any evidence to sustain it.⁹³ And if information about the potential costs of BITs were not available at the time they diffused, it is likely that decision-makers have not been as informed about the implications of the treaties as standard accounts assume. So instead of assuming *a priori* that the potential liability of BITs were obviously intended and foreseen by policy-makers, chapter seven will investigate what information was actually available about the risks of BITs at the time they proliferated.

This potentially opens up for yet another important but thus far overlooked insight in the study of BITs. Namely that if we relax the unitary actor assumption, then an environment of imperfect information would provide ample opportunities for agency-slip. Some officials in law ministries or regulatory agencies, for instance, may be worried of too haphazard a BIT-policy - they are, after all, binding documents under international law - but lacking information about their risks would make it hard to stop certain actors from pursuing the treaties for their own benefits. Following the public choice literature, advancing BITs could be in the interests of some officials or institutions if it allowed them larger budgets,⁹⁴ augmenting discretionary power,⁹⁵ and/or opportunities for leisure⁹⁶ by facilitating frequent travels abroad for negotiations, participation in inter-governmental

⁹¹ S. Rose-Ackerman, 'The Global BITs Regime and the Domestic Environment for Investment,' in: Sauvart and Sachs, *op. cit.*, 313.

⁹² Tobin and Busch, *op. cit.*, at 31.

⁹³ A notable exception is; Jandhyala, Henisz, and Mansfield, *op. cit.*

⁹⁴ See generally; W. Niskanen, *Bureacracy and representative government* (Alberton: Aldine, 1971)

⁹⁵ See generally; J. Migué and G. Bélanger, 'Toward a general theory of managerial discretion,' 17 *Public Choice* 27 (1974).

⁹⁶ See generally; A. Peacock *Public Choice Analysis in Historical Perspective* (Cambridge: Cambridge University Press, 1992), at 76.

meetings, training-sessions, etc.⁹⁷ According to this logic, embassies or investment promotion officials, for instance, should be strong supporters of BITs as the treaties allow them to ‘show’ the results of their efforts to establish friendly diplomatic relations and ‘do everything in their power’ to increase investment flows, respectively.⁹⁸ Also, if stakeholders with an incentive to take a cautious approach to negotiating BITs had no clear-cut examples of the treaties’ risks, they would have a hard time preventing them from being (mis)used for short-term purposes.

3.2. A new understanding of policy diffusion: the role of bounded rationality

I turn now to a fifth, and new, explanation for BIT-diffusion. It is based on the assumption that even if seeing policy-making as a goal-oriented process, and thereby rational in the broadest sense of the word, we cannot be sure that decision-makers seek and process information in ways rational-choice models predict. Studies in experimental psychology have consistently shown that people fail to meet the standards of comprehensive rationality, and have instead identified systematic - and thus predictable - patterns of reasoning and behaviour, which differs from the postulates of rational-choice models.⁹⁹ As mentioned in chapter one, Weyland has argued this literature may be important to explain international policy diffusion processes.

⁹⁷ For similar considerations with respect to financial market regulation in governments with short time horizons, see; C. Way, ‘Political Insecurity and the Diffusion of Financial Market Regulation,’ 598 *Annals of the American Academy of Political and Social Science* 125 (2005).

⁹⁸ With respect to embassies, this could explain why Alle and Peinhardt find that the existence of embassies considerably raises the likelihood of a BIT between two countries and Elkins, Guzman, and Simmons also find that host countries with a large diplomatic presence are more inclined to sign BITs; T. Alle and C. Peinhardt, ‘Delegating Differences: Bilateral Investment Treaties and Bargaining Over Dispute Resolution Provisions,’ 54 *International Studies Quarterly* 1 (2010), at fn. 37; Elkins, Guzman, and Simmons, *op. cit.*

⁹⁹ For an overview of this literature see the collection of papers in; D. Kahneman and A. Tversky (eds.) *Choices, Values and Frames* (New York: Cambridge University Press, 2000); D. Kahneman, P. Slovic, and A. Tversky (eds.) *Judgment Under Uncertainty* (New York, Cambridge University Press, 1982); T. Gilovich, D. Griffin, and D. Kahneman (eds.) *Heuristics and Biases: The Psychology of Intuitive Judgment* (New York: Cambridge University Press, 2002).

Outside experimental settings, however, insights on cognitive constraints present a considerable challenge in terms of identifying causal mechanisms. This is particularly the case since frameworks acknowledging non-zero costs of information (e.g. Bayesian learning) may often have converging expectations as a framework based on information processing biases. Meseguer, for instance, has shown that when Weyland uses bounded rationality to argue that policies will cluster geographically this can also be explained with a Bayesian model with positive costs on information gathering.¹⁰⁰ So what may appear to be biasing heuristics may in practice be a function of imperfect information, and vice versa.¹⁰¹

There are ways, however, to gauge the approximate value of a bounded rationality approach, also outside the confines of experimental settings.¹⁰² First of all, in some contexts a Bayesian framework and one based on cognitive heuristics will have diverging predictions, which will be further clarified below. Secondly, even when the two approaches may have converging expectations in terms of outcomes, there is no reason that an optimization framework is *inherently* superior, if it is starkly clear that the causal mechanism relied on biasing heuristics rather than Bayesian updating.¹⁰³ So let us proceed by outlining an alternative explanation for policy diffusion based on experimental insights on bounded rationality, which could potentially be important to explain the popularity of BITs in the developing world.

¹⁰⁰ C. Meseguer, 'Rational learning and bounded rational learning in the diffusion of policy innovations,' 18 *Rationality and Society* 1 (2006).

¹⁰¹ In his own discussion of transaction costs, for instance, Williamson embeds it in bounded rationality; yet formal treatments of his insights often chose to model them purely as information costs; J. Conlisk, 'Why Bounded Rationality?,' 34 *Journal of Economic Literature* 2 (1996); O. Williamson *Economic organization: Firms, markets, and policy control* (Brighton: Wheatsheaf, 1986).

¹⁰² J. Levy 'Prospect Theory, Rational Choice, and International Relations' 41 *International Studies Quarterly* 87 (1997), at 94, 99-100; McDermott, *op. cit.*, at 26-8.

¹⁰³ As noted colourfully by Conlisk, '*Deliberation cost and bounded rationality, like elephants in a living room, are sometimes just too much to ignore.*' *op. cit.*, at 691.

The choice of policies

Before choosing a policy, a decision-maker needs to allocate attention to information about the problem at hand and its possible solutions. But rather than a careful, rigorous and balanced search of information - as predicted by models based on comprehensive rationality - decision-makers tend to rely mostly on whatever information is salient at a given time. This follows from the availability heuristic, which refers to people's tendency to rely excessively on information that is vivid and easily available.¹⁰⁴ While obviously useful in many instances, it can also have a biasing impact on people's judgments and behaviour, as it may lead to ignoring information that is relevant and attaching great value to some that is not.¹⁰⁵

This could be important when understanding why some policies diffuse. When seeking solutions, decision-makers may choose certain policies over others, not because of their inherent functional value or legitimacy but rather because, they are immediately available to adopt. This mechanism is likely to be particularly influential, if policies are based on a concrete and clear policy 'model', as this allows policy-makers to follow an already defined template rather than going through the 'hassle' of tailoring their own – however rational that may be.¹⁰⁶

This could be relevant, when understanding the political foundation of the international investment regime. BITs are short and standardized documents – typically less than ten pages – which provide a simple blue-print for developing countries worried that political risks are keeping foreign investors away. So might they have become popular amongst investment-hungry governments in the developing world, not because of careful cost-benefit analyses, but rather due to Western states, international organizations and other actors selectively promoting them as easy and clear-cut instruments to adopt? Might developing countries willingly have adopted BITs without investigating plausible alternatives? By

¹⁰⁴ A. Tversky and D. Kahneman 'Availability: A Heuristic for Judging Frequency and Probability' 5 *Cognitive Psychology* 207 (1973).

¹⁰⁵ E. J. Johnson, J. Hershey, J. Meszaros, and H. Kunreuther 'Framing, Probability Distortions, and Insurance Decisions', in: D. Kahneman and A. Tversky (eds.), *op. cit.*

¹⁰⁶ Weyland (2006), *op. cit.*, at 52-54.

contrast with a rational learning perspective, for instance, this would imply that even stakeholders with an interest in a cautious BIT-strategy, would be much less inclined to seek alternative, and perhaps better, alternatives, before agreeing to sign of on Western states' model BITs. If this is the case, then certain rules may have diffused throughout the global BIT-regime, not because developing countries have found them particularly representative of their national interests after carefully considering alternatives, but rather because they have been immediately available to adopt.¹⁰⁷

Cost-benefit considerations

After a policy has been made 'available,' goal-oriented decision-makers will be interested in their likely consequences and outcomes. While rational-choice models assume that decision-makers will base their inferences on the laws of statistics, this simplifying assumption is often inherently unrealistic and, as such, not always analytically useful.¹⁰⁸ Instead, individuals tend to follow the heuristic of representativeness by quickly extrapolating trends based on extremely small amounts of information, or even detecting patterns from completely random series of events.¹⁰⁹ In his study of Latin America, for instance, Weyland found that officials focused excessively on short-term indicators, when making inferences about the quality of an underlying policy.¹¹⁰ If a policy showed early signs of

¹⁰⁷ See generally; Elkins and Simmons (2005), *op. cit.*, at 43-5; Weyland (2006), *op. cit.*; Weyland (2008), *op. cit.*

¹⁰⁸ See e.g. Conlisk's discussion including the argument of some economists (and political scientists) that while acknowledging imperfect rationality, analysts can often ignore it and proceed 'as if' actors are unboundedly rational; Conlisk, *op. cit.*

¹⁰⁹ A. Tversky and D. Kahneman 'Belief in the law of small numbers' 76 *Psychological Bulletin* 105 (1971); D. Kahneman and A. Tversky 'Subjective probability: A judgment of representativeness' 3 *Cognitive Psychology* 430 (1972); T. Gilovich, R. Vallone and A. Tversky, 'The hot hand in the basketball: On the misperception of random sequences' 17 *Cognitive Psychology* 295 (1985). Two other common fallacies due to the representativeness heuristic, which will not be dealt with in this study, are the neglect of base rates and prior probabilities.

¹¹⁰ Weyland (2006), *op. cit.*, at 48. See also; Elkins and Simmons (2005), *op. cit.*, at 45.

success – even for entirely random reasons – it speeded up the diffusion process.¹¹¹

Along the same lines, the representativeness heuristic could convince decision-makers that BITs are in fact powerful instruments to attract foreign investors based on exceptionally limited information. Similarly, the availability heuristic could systematically skew decision-makers' attention towards confirming, yet anecdotal, information that BITs are important for investors' decision-making process, but ignore the equally important – but less vivid - information that stems from all those investors that do *not* call for BITs to be signed. For although information about 'non-events' has diagnostic value it is typically used less in judgments, as it is less salient than information about events.¹¹² This could have led developing countries to further overestimate the benefits of BITs.

One can of course also think of the opposite pattern: if a policy shows early, or more vivid, signs of failure, this could slow down the diffusion process. Yet, apart from the considerations above, heuristics could have played an important role in making BITs seem successful policies in the early stages of their diffusion. For while investment treaty claims can have massive implications for the host state, they actually rarely occur. For such low-probability risks, people tend to show bimodal responses: some greatly exaggerate them, and others assume they can ignore them completely. The availability heuristic implies that the choice between the two reactions depends on the extent to which people can bring specific instances to mind.¹¹³ If they can, it can lead to inflated concerns. But if they

¹¹¹ Weyland (2006), *op. cit.*, at 49-50. Weyland makes a similar argument with respect to the spread of revolutions; Weyland (2009), *op. cit.*

¹¹² Vertzberger, *op. cit.*, at 82. See references in; T. Gilovich *How We Know What Isn't So: The Fallibility of Human Reason in Everyday Life* (New York, Free Press, 1991), at 32. This corresponds to what Jervis has called the 'drunkard's search'; R. Jervis 'The Drunkard's Search', in: S. Iyengar and W. McGuire (eds.) *Explorations in Political Psychology* (Durham: Duke University Press, 1993). See further in concluding chapter.

¹¹³ G. McClelland, W. Schultze, and D. Coursey 'Insurance for Low-Probability Hazards: A Bimodal Response to Unlikely Events' 7 *Journal of Risk and Uncertainty* 95 (1993). See also; M. G. Morgan 'Probing the Question of Technology Induced Risk', in: T. S. Glickman and M. Glough (eds.) *Readings in Risk* (Washington DC: Resources for the Future, 1990), at 14; P. Slovic, H. Kunreuther, and G. White, 'Decision Processes, Rationality and Adjustment to Natural Hazards,' in: G. White (ed.) *Natural Hazards: Local, National and Global* (New York: Oxford University Press, 1974), at 14. On the closely related affect heuristic, see e.g.; C. Keller, M.

cannot, it can lead to the opposite. And since risks with a low probability are per definition not very likely to be part of the decision-makers immediate past experiences, they often fail to be considered fully until the ‘lightning strikes.’¹¹⁴

So while a Bayesian framework would be able to explain if a lack of disputes perhaps led to an underestimation of the risks of BITs, the availability heuristic would expect that it let many officials to *ignore* them entirely until they themselves got hit by a claim. Just as people tend to insure themselves against low-probability events such as earthquakes *after* they have already taken place,¹¹⁵ countries may also have relied excessively on their own experiences with BITs. This will be further discussed in chapter eight.

Anchoring

One thing is that policies spread across borders due to their immediate availability and decision-makers may misjudge their practical implications, but why do we often see so little adaption of policies to local circumstances? One answer could again come from the cognitive literature, if decision-makers apply the heuristic of anchoring and adjustment.¹¹⁶ This refers to the tendency to rely excessively on their point of departure for future judgments and actions, even when it does not suit their interests to do so. It corresponds to the general finding that individuals tend to value the status quo much higher than rational choice models would

Siegrist, and H. Gutscher ‘The Role of Affect and Availability Heuristics in Risk Communication’ 26 *Risk Analysis* 631 (2006).

¹¹⁴ H. Kunreuther, R. Meyer, R. Zeckhauser, P. Slovic, B. Schwartz, C. Schade, M. Luce, S. Lippman, D. Kranz, B. Kahn, R. Hogarth ‘High Stakes Decision Making: Normative, Descriptive and Prescriptive Considerations’ 13 *Marketing Letters* 259 (2002), at 262, 264; P. Pierson, ‘The Limits of Design: Explaining Institutional Origins and Change,’ 13 *Governance* 475 (2000), at 485. Note that a similar outcome could follow from Kahneman and Tversky’s prospect theory: if governments were concerned about losing FDI from their competitors, loss aversion could lead them to take considerable risks (for instance by signing onto BITs which would not otherwise suit their national interest). Yet, the causal mechanism would be different as this explanation requires actors to realise the risks involved by signing onto BITs. See generally; D. Kahneman and A. Tversky ‘Prospect theory: An analysis of decision under risk’ 47 *Econometrica* 263 (1979).

¹¹⁵ K. Steinbrugge, F. McClure and A. Snow, *Studies in seismicity and earthquake damage statistics* (Washington DC: U.S. Department of Commerce, 1969).

¹¹⁶ See e.g.; A. Tversky and D. Kahneman ‘Judgment under uncertainty: Heuristics and biases’ 185 *Science* 1124 (1974); G. Chapman and E. Johnson, ‘Incorporating the Irrelevant: Anchors in Judgments of Belief and Value,’ in: Kahneman, Slovic, and Tversky (eds.), *op. cit.*

predict, even if the status quo was initially determined randomly.¹¹⁷ The heuristic of anchoring and adjustment therefore shares predictions with much of the institutionalist literature within political science - namely that modifications to existing policies are likely to be few and limited.¹¹⁸

‘While anchoring by no means precludes ... modifications, it keeps their range limited and preserves the basic nature of the imported model. Comprehensive rationality would often call for more profound adjustments, including alterations of a model’s fundamental design.’¹¹⁹

This implies that the content of a developing country’s past BITs may function as a *de facto* model for future negotiations, even if it was initially agreed to for random reasons and information is available that alternative provisions would be more prudent. Rather than network effects (see Montt above), the anchoring heuristic could therefore potentially be the reason for the incredible similarity among BITs over time.

Institutional conditions: expertise and experience

As most of the experimental literature on bounded rationality, the sections above takes individuals as the unit of analysis, yet international relations is typically the study of organizations, firms, and other aggregate actors. Unfortunately, we still don’t know much about whether, and how, observed patterns of individual decision-making can be aggregated to the collective level.¹²⁰ Yet, the institutional conditions under which countries consider, decide, and implement policies are

¹¹⁷ See e.g.; D. Kahneman, J. Knetsch and R. Thaler ‘Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias’, in: Kahneman and Tversky, *op. cit.*; M. Neale and M. Bazerman, *Cognition and Rationality in Negotiations* (New York: Free Press, 1991), at 49-50, 90-2; H. Kristensen and T. Garling ‘The effects of anchor points and reference points on negotiation process and outcome’ 72 *Organizational Behavior Human Decision Processes* 256 (1997); I. Ritov, ‘Anchoring in simulated competitive market negotiation’ 67 *Organizational Behavior Human Decision Processes* 16 (1996); G. Whyte and J. Sebenius, ‘The effect of multiple anchors on anchoring in individual and group judgment’ 69 *Organizational Behavior Human Decision Processes* 75 (1997).

¹¹⁸ See e.g.; J. March and J. Olsen ‘The New Institutionalism: Organizational Factor in Political Life’ 78 *American Political Science Review* 734 (1984); P. Pierson, *Politics in Time* (Princeton: Princeton University Press, 2004).

¹¹⁹ Weyland (2006), *op. cit.*, at 50. See also; J. Jupille and D. Snidal, ‘The Choice of International Institutions: Cooperation, Alternatives and Strategies,’ draft paper, 2005.

¹²⁰ Levy, *op. cit.*, at 102; McDermott, *op. cit.*, at 3; R. Zeckhauser and W. K. Viscusi, ‘Risk Within Reason’ 248 *Science* 559 (1990).

likely to co-determine the extent to which distortions and biases will be present. For while organizations' 'divisions of labor' generally allow them to process a larger stock of information than individuals,¹²¹ the bureaucratic and political structures in many developing countries could possibly augment the role of cognitive heuristics in officials' judgment and inferences about their task domain.¹²²

First of all, developing countries often lack legal *expertise* on international economic law.¹²³ And while acknowledging that experts are also prone to biased judgments and inferences,¹²⁴ their prior knowledge may make them less influenced by the biasing effects of heuristics.¹²⁵ For instance, whereas experts may not necessarily agree on the magnitude of risks associated with BITs – indeed there is much disagreement on this within legal scholarship – they are better able than generalists to understand the plausible implications associated with BIT-provisions.¹²⁶ Generalists tend to have a much broader and more multidimensional perspective on risks than experts.¹²⁷ For many purposes this can be healthy to avoid too narrow conceptions of risk within a given area,¹²⁸ but it is commonsensical that an incomplete understanding of key causal mechanisms at

¹²¹ J. Bendor and T. Hammond, 'Rethinking Allison's Models' 86 *American Political Science Review* 301 (1992), at 312-3; H. Simon, *Administrative Behavior* (New York: Macmillan, 1947), at 79-80.

¹²² Weyland (2006), *op. cit.*, at 225.

¹²³ On the investment regime; see e.g.; UNCTAD *International Investment Rule-Making: Stocktaking, Challenges and the Way Forward* (Geneva: UNCTAD, 2008), at 50, 58; P. Robinson, 'Treaty Negotiation, Drafting, Ratification and Accession of CARICOM states,' 18 *West Indian Law Journal* 1 (1993). On the trade regime, see e.g.; S. Prowse 'The Role of International and National Agencies in Trade-Related Capacity Building' 25 *World Economy* 1235 (2002); V. Delich 'Developing Countries and the WTO Dispute Settlement System', in: B. Hoekman, A. Mattoo, and P. English (eds.) *Development, Trade, and the WTO: A Handbook* (Washington DC: World Bank, 2002).

¹²⁴ See e.g.; Tversky and Kahneman (1971), *op. cit.*; G. Rowe and G. Wright 'Differences in Expert and Lay Judgments of Risk: Myth or Reality?' 21 *Risk Analysis* 341 (2001); G. Wright, F. Bolger, and G. Rowe 'An Empirical Test of the Relative Validity of Expert and Lay Judgments of Risk' 22 *Risk Analysis* 1107 (2002).

¹²⁵ As stated by Neale and Bazerman on the role of experts in negotiations, it is '*not the expert's ability to process more information that gives him or her the edge. Rather it is the ability to know which information is important and to which cues to attend in selecting a successful course of action.*' Neale and Bazerman, *op. cit.*, at 96.

¹²⁶ See generally; H. Einhorn 'Expert judgment: Some necessary conditions and an example' 4 *Journal of Applied Psychology* 1 (1974); Mieg, *op. cit.*, at 143-6.

¹²⁷ P. Slovic 'Perception of Risk' 236 *Science* 280 (1987).

¹²⁸ D. Kahan, P. Slovic, D. Braman, and J. Gastil 'Fear of Democracy: A Cultural Evaluation of Sunstein on Risk' 119 *Harvard Law Review* 1071 (2006).

play is problematic for any policy-maker. For instance, non-expert officials may have vague notions of risk associated with *not* signing BITs, such as what it would do to the country's international image, and while not refuting such risk-perceptions as irrational or irrelevant, they hardly provide a complete picture. This would need to consider more technical questions, such as how certain regulatory conducts can expose a country to BIT-claims or, more fundamentally, what investor-state arbitration actually is in the first place. In the absence of experts such knowledge is not necessarily immediately available for the decision-maker(s) in charge of a developing country's BIT-program, which could have an impact on their quality of decision-making.¹²⁹ As noted by a Korean official, for instance,

'Until recently most Korean experts of international litigation ... were found only in the private sector and not in the government. ... negotiators were often unable to adequately address the complex procedural issues surrounding investor-State dispute resolution. As a result, they often resorted to using the same simple provisions as in previous investment agreements.'¹³⁰

In the absence of expertise, officials can nevertheless develop a level of *experience* through learning and feed-back.¹³¹ Yet, bureaucratic realities in many developing countries make this difficult. To again quote from Weyland's study of policy-reforms in Latin America:

'Since many bureaucracies in the region diverge starkly from Weberian principles, political appointees and even technical experts often face uncertain tenure. In many social agencies, turnover in the upper, decision-making echelons is exceedingly high ... They therefore design reform projects under tremendous time pressure and cannot afford a comprehensive, proactive search for relevant information.'¹³²

Such conditions are not unusual in developing countries.¹³³ They obstruct learning and specialization as those officials actually gaining some level of experience are transferred to other departments before being able to take advantage of it. More

¹²⁹ See e.g.; K. Vandervelde, 'Treaty Interpretation From a Negotiators Perspective,' 21 *Vanderbilt Journal of Transnational Law* 281 (1988), at 301; Robinson, *op. cit.*; UNCTAD (2008), *op. cit.*.

¹³⁰ J. Kim, 'Korea's Development of a Better Investor-State Dispute Resolution System,' in: UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration II* [unedited draft] (Geneva: United Nations, forth.), at 68.

¹³¹ Neale and Bazerman, *op. cit.*, at 86-7, 90. There will of course be inherent dangers in relying on learning from experience compared to relying on expertise, see; *ibid.*, at 93.

¹³² Weyland (2006), *op. cit.*, at 46-7.

¹³³ In the context of trade negotiations, see e.g.; M. Busch, E. Reinhardt, G. Shaffer, 'Does legal capacity matter? A survey of WTO members?,' 8 *World Trade Review* 4 (2009).

fundamentally, officials shifting in and out of departments may be more inclined to rely on inferential short-cuts to learn about their task domain: risk perceptions tend to be associated with personal experiences of risk,¹³⁴ which implies that a high turnover of officials could make the chances of ‘risk-neglect’ considerable. So while acknowledging that experience – just as expertise - is not a guarantee against biased judgments and inferences, we would nevertheless expect that bureaucratic conditions that prevent officials from gaining domain-specific experience are likely to limit the rationality in decision-making.

Finally, as actors are considered goal-oriented and strategic within a bounded rational framework, we need to consider the range of motives among officials or government departments that could impact their propensity to push for certain policies. But while public choice literature focusing on ‘agency slip’ could also explain such preferences within governments (see above), experiments remind us that pre-determined incentives are likely to impact people’s basic processing of information in ways they may not themselves realize. As stated by Kunda:

‘ ... people do not realize that the [inferential, ed.] process is biased by their goals, that they are only accessing a subset of their relevant knowledge, that they would probably access different beliefs and [inferential, ed.] rules in the presence of different goals, and that they might even be capable of justifying opposite conclusions on different occasions’.¹³⁵

For instance, the general finding that people tend to subject evidence they *want* to believe to much less scrutiny than evidence that goes against their preferences,¹³⁶ implies that decision-makers who have an individual interest in promoting a certain policy will be less inclined to question the ‘representativeness’ of perhaps dubious claims that the policy has positive welfare effects, yet they will be much more sceptical of claims that they don’t. Similarly, the finding that not only the *amount* but also the *nature* of information people consider varies systematically

¹³⁴ N. Weinstein, ‘Effects of personal experience on self protective behaviour,’ 105 *Psychological Bulletin* 31 (1989); Keller, Siegrist, and Gutscher, *op. cit.*, at 632.

¹³⁵ *Ibid.*, at 485.

¹³⁶ E. Dawson, T. Gilovich, and D. T. Regan ‘Motivated Reasoning and Performance on the Wason Selection Task’ 28 *Personality and Social Psychology Bulletin* 1379 (2002); T. Gilovich *Motivated skepticism and motivated credulity: Differential standards of evidence in the evaluation of desired and undesired propositions*. Address presented at the 12th Annual Convention of the American Psychological Society, Miami Beach, Florida, June, 2000.

with their preferences,¹³⁷ implies that officials and institutions who gain from pursuing certain policies will tend to focus solely on their benefits.

Outside experimental confines it is of course difficult to disentangle, whether it is rational learning, biasing heuristics or individual agendas that make officials promote BITs. One way to approach this methodologically, however, is to exploit the fact that there are government stakeholders, who should have an incentive to take a much more cautious approach in negotiating BITs than those with an individual interest in promoting them. A public choice perspective would expect that law ministries, for instance, show some interest in shaping BIT-policies, as they will be blamed once the claims begin. Similarly, regulatory agencies whose discretion will be curtailed from BITs should also have an interest in somewhat cautious BIT-strategies. If inferential biases have been at play, however, such actors may nevertheless have been uninterested in spending too much effort on the treaties, if they ignored their risks. Key interests of government actors would therefore not necessarily be realized, and as a result BITs could have become completely ‘de-politicized’ in national policy-making processes before a country was hit by its first BIT-claim. This would not be the prediction of a public choice framework, whether based on perfect information or not.

A note of caution

Through a range of mechanisms, cognitive heuristics may thereby have influenced the diffusion of investment treaties. If so that would offer strong support to Weyland’s suggestion that bounded rationality plays an important role for policy diffusion. That said; Weyland seems to overstate his case, when presenting bounded rationality as *the* superior approach to explain policy diffusion. He dismisses norm-based explanations *a priori*, for instance, based on the understanding that if norm-emulation is the driver of diffusion, then policies should spread like wild-fire almost immediately after they have emerged. Yet this is a peculiar misrepresentation of the literature, as Finnemore and Sikkink explicitly argue that it takes time for norms to emerge, and only after a tipping

¹³⁷ Z. Kunda, ‘The Case for Motivated Reasoning,’ 108 *Psychological Bulletin* 480 (1990).

point can norm cascades begin (they mention adoption of one third of all states). Similarly, Weyland dismisses rational learning models because he argues they can't explain geographical clustering of policies, yet as mentioned above, this is not necessarily the case.¹³⁸ Finally, explanations based on coercion and norm-emulation also appear intuitively helpful to explain many of the defining characteristics of the BIT-diffusion process. So before exploring the bounded rational model, this thesis will engage with traditional explanations for policy diffusion to get a better understanding of whether, and to what extent, a bounded rational framework adds value.

Conclusion

This chapter has presented five main hypotheses to explain the diffusion of BITs. First, it asked whether developing countries have been coerced into adopting BITs. Secondly, it asked whether BITs can be compared with various human rights instruments adopted by many developing country governments for symbolic reasons. Third, it presented the standard accounts of BIT-diffusion based on competition, where the treaties were presented as rational instruments for developing country governments to attract foreign investments. Fourth, it pointed to the potential importance of imperfect information, and asked whether BITs may have become so popular partly because little information was available about their costs at the time they proliferated. Finally, it presented a new theory of policy diffusion based on notions of bounded rationality. Here, it was argued that the combination of cognitive heuristics and institutional conditions in developing countries could have led them to systematically overestimate the benefits of BITs, and ignore their costs. A key hypothesis was that not until a developing country got hit by an investment treaty claim itself did officials carefully seek and process information about the risks involved.

¹³⁸ Meseguer (2006), *op. cit.*

4. A product of coercion?

This first empirical chapter will address the coercion hypothesis. While the content of BITs clearly has roots in the imperial era, and developed countries have been successful in promoting their favoured templates, does this mean that BITs themselves are the product of coercion? Have developing countries been coerced into signing investment treaties with the threat of economic or other sanctions? To address this, I begin with the international financial institutions, the International Monetary Fund (IMF) and the World Bank. The second section will focus on dominant capital-exporting states. Finally, the last section will address the fact that BITs to a considerable extent have been signed without developed countries involved, i.e. between developing countries themselves.

4.1. The International Monetary Fund

In statistical analyses, developing countries' propensity to sign BITs has occasionally been related to whether they have received IMF programs.¹ Elkins, Guzman, and Simmons note that, '*[t]his may mean that states seeking assistance from the IMF are encouraged to enter into BITs. Alternatively, it may be that the conditionality of IMF loans overlaps with the obligations of the BIT, reducing the costs of the latter.*'² Following the discussion in the last chapter, the first of these two explanations implies at least a potential for coercion, yet the role of the IMF in the BIT-movement has never actually been investigated.

Considerable overlaps exist between IMF's work and BITs. One is with respect to capital account liberalization, where BITs' transfer provisions typically give investors the right to freely transfer capital out of the host state.³ In that sense,

¹ Z. Elkins, A. Guzman, and B. Simmons, 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000,' 60 *International Organization* 4 (2006).

² *Ibid.*, at 840.

³ See; A. Kolo and T. Wälde, 'Capital Transfer Restrictions under Modern Investment Treaties,' in: A. Reinisch (ed.) *Standards of Investment Protection* (Oxford: Oxford University Press, 2008).

BITs are relevant for the Fund's work with capital controls, for while IMF's legal obligations relate only to transactions on the current account,⁴ the Fund has been a staunch promoter of capital account liberalization as well.⁵ So perhaps the Fund has pushed for BITs as tools to 'tie in' capital account liberalizations in the developing world.

Secondly, while promoting foreign *direct* investment has never been part of IMF's core functions, Kalderimis notes that the organization's '*expansive view of its mission has led it to focus on investment as an important engine of economic growth.*'⁶ Up through the 1990s, the IMF thus strongly encouraged developing countries to promote FDI,⁷ and in the second half of the 1990s FDI liberalization was explicitly promoted as the first stage of a sequential approach to full scale liberalization of capital flows.⁸ And while only few BITs include liberalization commitments, they are potential tools to promote FDI,⁹ so for this reason as well it would perhaps not be surprising if signing BITs have been among IMF's policy-recommendations.

Note that while important, transfer provisions have rarely been addressed in BIT-claims except for a few related to the Argentinean financial crises in 2001. See e.g.; *Metalpar S.A. y Buen Aire S.A. v. Argentina*, ICSID Case No. ARB/03/5, Award, June 6, 2008.

⁴ Art. 8.2(a) of the IMF Articles provides, '... no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.' By contrast, art. 6.3 provides that, 'Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions ...'. See also Art. 30(d) for IMF's definition of payments for current transactions.

⁵ See; IMF's Independent Evaluation Office (IEO), *The IMF's Approach to Capital Account Liberalization* (Washington DC: IMF, 2005).

⁶ D. Kalderimis, 'IMF Conditionality as Investment Regulation: A Theoretical Analysis,' 13 *Social and Legal Studies* 103 (2004), at 105.

⁷ IMF IEO, *op. cit.*, at 32, 34, and 73. Eichengreen and Mussa also note, for instance, that in Central and Eastern Europe '*almost all IMF-supported programs entailed measures to facilitate inflows of foreign capital, foreign direct investment in particular.*' B. Eichengreen and M. Mussa, 'Capital Account Liberalization: Theoretical and Practical Aspects,' *IMF Occasional Paper 172*, 1998.

⁸ See, e.g. IMF, *World Economic Outlook, October 1995* (Washington DC: IMF, 1995). Through a multi-method approach, Jensen finds that IMF programs have had little impact on FDI flows; N. Jensen, *Nation-States and the Multinational Corporation* (Princeton: Princeton University Press, 2006), ch. 7.

⁹ See the next chapter.

Finally, the IMF has vigorously promoted liberalization of state-enterprises, often with the argument that this would increase inflows of foreign investment.¹⁰ This has been important for the BIT regime, as many treaty-based investment disputes have arisen due to large-scale liberalization programs. One notable case in point is Bolivia, where a condition for both IMF and World Bank loans in 1999 was to privatize its water utilities.¹¹ The following year, the public utility, SEMAPA, was sold to a local subsidiary of the American firm Bechtel, Aguas del Tunari (AdT). But after massive public protests in response to considerably price increases, AdT had to withdraw from the concession and subsequently filed a BIT claim against Bolivia for more than US\$25 million.¹² This illustrates yet another way in which BITs have underwritten IMF's policy-advocacy work, which again would make it unsurprising if the IMF encouraged developing countries to enter into BITs.

However, there are few signs that FDI *protection* has played an important part of IMF conditionalities or even policy recommendations. Kalderimis, for instance, argues that IMF's role in the regime for FDI protection is considerable in theory, but presents no empirical evidence that investment protection has played any tangible role in IMF programs.¹³ As importantly for our purposes, there is no indication that BITs or investor-state arbitration have played *any* direct role for IMF's loan programs or policy advice. One indicator comes from looking at IMF's 'Letters of Intent' and 'Structural Adjustment Facility Framework' papers which comprise the specifics of its structural adjustment programs. While neither constitute actual conditionalities linking compliance with fund dispersal, they are useful indicators of the Fund's priorities. Table 4.1 provides a sample of countries subject to IMF programs from the late 1990s, when BITs were proliferating rapidly.

¹⁰ See e.g. 'Letter of Intent and Memorandum of Economic and Financial Policies of the government of Moldova,' IMF, July 29, 1999 (' .. accelerated large-scale privatization, should also encourage foreign investment ...').

¹¹ See, 'Bolivia: Enhanced Structural Adjustment Facility Policy Framework Paper, 1998-2001,' IMF, August 25, 1998.

¹² *Aguas del Tunari S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3. Note, that after considerable controversy AdT's parent company, Bechtel, later withdrew its claim.

¹³ Kalderimis, *op. cit.* See also; M. Goldstein, 'IMF Structural Conditionality: How Much is Too Much?,' *Institute for International Economics Working Paper*, 2000.

Table 4.1. IMF conditionalities related to foreign investment policies during the 1990s, selected countries

Country	Specifically mentioned among IMF commitments:*					Investment risks	
	Trade treaties	Investment treaties	Inv.-state arbitration	FDI protection	Measures potentially strengthening FDI protection or non-protection measures targeted directly at FDI*	Index**	North-South BITs ratified
Albania (1999)	No.	No.	No.	No.	Implement legal basis for out of court mediation and arbitration.	5.6	13
Armenia (1998)	No.	No.	No.	No.	Establish one-stop-shop for formation of new businesses, particularly with FDI.	4.6	5
Azerbaijan (1997/1999)	Yes.	No.	No.	No.	(i) Introduce Petroleum Law to provide foreign investment in oil sector; (ii) allow foreign banks participation in various money markets.	7.0	1/2
Benin (1998)	Yes.	No.	No.	No.	Revise the mining code to bring it into line with international standards.	n.a.	3
Brazil (1999)	No.	No.	No.	No.	None.	5.9	0
Burkina Faso (1999)	Yes.	No.	No.	No.	Implement Mining Code.	7.8	1
Cambodia (1999)	No.	No.	No.	No.	Revise investment law to rationalize tax and duty exemptions for foreign direct investment.	n.a.	1
Central African Rep. (1998)	No.	No.	No.	No.	Submit new Mining Code for parliamentary approval.	n.a.	2
Ethiopia (1998)	No.	No.	No.	No.	Remove various capital investment limit for foreign investment.	8.4	3
Cambodia (1998)	No.	No.	No.	No.	(I) Establish export and investment promotion agency; (II) introduce legal, regulatory, and incentive frameworks for investors in export processing zone.	6.9	1
Georgia (1998)	No.	No.	No.	No.	Foster foreign banks' participation in the domestic financial market.	n.a.	4
Ghana (1998)	No.	No.	No.	No.	None.	7.4	5
Guinea (1999)	No.	No.	No.	No.	Reform all exemptions granted under the mining and investment code.	7.0	3

Table 4.1. IMF conditionalities related to foreign investment policies during the 1990s, selected countries (contd.)

Country	Specifically mentioned among IMF commitments:**						Investment risks	
	Trade treaties	Investment treaties	Inv.-state arbitration	FDI protection	Measures potentially strengthening FDI protection or non-protection measures targeted directly at FDI*	Index**	North-South BITs ratified	
Ivory Coast (1998)	No.	No.	No.	No.	None.	7.5	4	
Kyrgyzstan (1998)	No.	No.	No.	No.	None.	n.a.	3	
Macedonia (1998)	No.	No.	No.	No.	(I) Allow majority foreign participation in brokerage firms; (II) review and streamline admin. procedures for licenses and approval of foreign investments.	n.a.	4	
Madagascar (1999)	Yes.	No.	No.	No.	(i) Adopt measures to implement the Cross-Border Initiative; (ii) put in place an arbitration system.	6.2	2	
Mali (1998)	Yes.	No.	No.	No.	(I) Adopt new mining code; (II) harmonizing the investment code and commerce code within WAEMU framework.	6.8	2	
Mozambique (1998)	No.	No.	No.	No.	Simplify the licensing of foreign business representative offices.	4.9	1	
Nicaragua (1999)	No.	No.	No.	No.	Install revised law on foreign investment.	6.1	2	
Senegal (1998)	Yes.	No.	No.	No.	(I) Adopt regional investment code; (ii) adopt new arbitration measures; (iii) study options for liberalization of capital flows; (iii) adopt revised Mining Code.	6.9	7	
Tajikistan (1998)	No.	No.	No.	No.	Review FDI legislation in mining sector and amend as necessary.	n.a.	2	
Zambia (1999)	Yes.	No.	No.	No.	None.	8.4	2	

* Measures related to post-establishment treatment and protection of foreign investors and adjudication of investment disputes (e.g. through international arbitration). Liberalization measures with potential foreign participation, such as privatization of state-enterprises, are not included. Focus is on measures targeted to foreign investors, so taxation, trade, or other regulatory measures of general application are not included. Sources are 'Letters of Intent' or 'Enhanced Structural Adjustment Facility Framework' papers available at www.imf.org.

** Political Risk Services (PRS) index averaged over the three years. In the PRS index, each country is given a score from 0 (very high risk) to 12 (very low risk), based on risks associated with (i) expropriation/contract viability; (ii) profits repatriation; and (iii) payment delays.

Notes: Sample of countries have been drawn particularly among developing countries with few BITs ratified with developed countries and/or a 'poor' investment climate.

At the time, the countries in Table 4.1 had some of the most risky ‘investment climates’ and/or fewest BITs ratified with developed countries. Yet, one conclusion stands out: only to the extent national investment codes included protections to foreign investors, or arbitration reforms allowed for international arbitration, did IMF programs target FDI protection. As a general rule, IMF does not appear to have included specific recommendations to protect foreign investors against expropriation for instance. Also, not once do the extremely detailed and comprehensive policy-programs mention investment treaties, or investor-state arbitration for that matter. This illustrates that while FDI liberalization was important for the IMF agenda during the time BITs proliferated in the 1990s, FDI *protection* was probably not.

Also, it is worth noting that investment treaties have hardly ever been mentioned by official IMF reports (unlike in World Bank reports, see below),¹⁴ and only in very few instances have they been mentioned by the IMF as part of countries’ investment framework.¹⁵ Furthermore, when BITs on a rare occasion in 2006 were in fact discussed by IMF Directors, they noted that by contrast with capital account issues, where the Fund had a key role in policy advice, BIT were seen as agreements ‘*negotiated voluntarily by country authorities when considered to be in the national interest.*’¹⁶ So while potentially important for the IMF, the implication was that they should not be part of its arsenal of policy-recommendations.

Surely, this does not rule out that IMF staff on occasion have encouraged developing countries to sign BITs. But although the IMF has promoted investment regimes overlapping with BIT-obligations, and therefore perhaps made the treaties appear ‘cheaper’ instruments as suggested by Elkins, Guzman, and Simmons, nothing implies that the IMF has conditioned its loan programs on recipient

¹⁴ For an exception, see; IMF, *World Economic Outlook, October 1999* (Washington DC: IMF, 1999), at 135 (‘*Clearly, bilateral investment treaties leave scope for discrimination and country-specific provisions.*’)

¹⁵ One rare case has been the Uruguay BIT with the United States. See; IMF, *Uruguay: Letter of Intent and Technical Memorandum of Understanding*, November 12, 2004; IMF, *Uruguay*, IMF Country Report No. 04/172, June 2004.

¹⁶ IMF, *Annual Report for the Executive Board, 2006* (Washington DC: IMF, 2006), at 55.

countries' adoption of BITs, or that the treaties have played any considerable role in the Fund's policy work.

4.2. The World Bank

The picture is murkier with respect to the World Bank. In its Articles of Agreement, one of the Bank's main purposes is to promote foreign private investment.¹⁷ And apart from playing a key role along with the IMF in advancing privatization and liberal economic policies in the developing world since the 1980s, the World Bank has also been the most important international financial institution promoting investment *protection* reforms.

In its work, the Bank has always subscribed to 'traditional' (i.e. Western) views of the proper treatment and protection of foreign investors. Its Guidelines on the Treatment of Foreign Investment (henceforth the Guidelines) are based on international minimum standards, such as fair and equitable treatment, and make reference to the Hull standard of compensation for expropriation.¹⁸ In the drafting of the Guidelines, BITs played a very influential role as inspiration,¹⁹ and were specifically mentioned in the preamble,

'... these guidelines are not the ultimate standards but an important step in the evolution of generally acceptable international standards which complement, but do not substitute for, bilateral investment treaties...'²⁰

When the Guidelines were adopted in 1992, the World Bank Development Committee similarly noted that they were an instrument to,

'... promote fair and equitable international standards for the general treatment of all foreign direct investment *in the absence of applicable treaties, and should be of particular value for developing countries*. Ministers expect the Guidelines to serve

¹⁷ Articles of Agreement of the International Bank for Reconstruction and Development (IBRD), Art. 1.ii.

¹⁸ World Bank Guidelines on the Treatment of Foreign Direct Investment (World Bank Guidelines), Art. 3(2) and 4(2).

¹⁹ See; I. Shihata, *Legal treatment of foreign investment: The World Bank Guidelines* (Washington DC: World Bank, 1992).

²⁰ World Bank Guidelines, Preamble. This sentence was inserted at the request of the United States, Shihata, *op. cit.*, at 140. See also *infra* note 89.

as an important step of the progressive development of international practice in this area and *hope that they will facilitate further developments through bilateral treaties and similar instruments.*²¹

Developing countries welcomed the non-binding and adaptable instrument, but repeatedly stressed that the Guidelines ‘*should not lead to an additional Bank lending conditionality.*’²² This, however, has not been followed, as also predicted at the time by the architect of the Guidelines, Ibrahim Shihata,

‘Although the Guidelines were not intended to be used for the purposes of the Bank’s lending conditionality, it is a fact that such conditionality often included measures, which exceeded the Guidelines’ requirements in terms of their advocacy of the liberalization of investment and trade markets in borrowing countries.’²³

While specific information about the Bank’s conditionalities is difficult to come by, and no one has systematically studied the role of investment protection reforms in its structural adjustment programs, we do know that the World Bank has occasionally provided loans during the 1990s on the condition that borrowing countries adopt legal reforms to protect foreign investors.²⁴ So while no-one has found tangible evidence that BITs have played a considerable role in the Bank’s adjustment programs,²⁵ perhaps its agencies have applied more subtle coercive measures to get developing countries to sign BITs. And since ‘investment climate’

²¹ Development Committee, ‘Communiqué of the Development Committee,’ in: *Presentations to the 44th Meeting of the Development Committee* (Washington DC: World Bank, 1992).

²² *Statement of the Chairman of the Group of Twenty-Four, Mr. Alhaji Ahmadu Abubakar, Minister of Finance and Economic Development, Nigeria*, in: *Ibid.* See also; Group of Twenty-Four, *Communiqué of the 46th Meeting of the Ministers of the Intergovernmental Group of Twenty-Four* (Washington DC: World Bank, 1992)

²³ Shihata (1992), *op. cit.*, at 148.

²⁴ While it is difficult to obtain precise information on the circumstances of these programs, but as an illustration, see e.g.; World Bank, *Development Credit Agreement between Republic of Zambia and International Development Association*, Jul 13, 1992; World Bank, *Development Credit Agreement between Republic of Zambia and International Development Association*, Sep 30, 1993 (requiring Zambia to implement its investment act). See the associated, *Zambia Investment Act*, 1993, VII(1) and (2) (‘*No property of any description shall be compulsorily acquired, and no interest in or right over property of any description of an investor shall be compulsorily acquired, except for public purposes under an Act of Parliament ... which provides for payment of compensation in respect thereof. Any compensation payable under this section shall be made promptly at the market value and shall be fully transferable...*’). On Gabon, see; World Bank, *Technical Annex to the Memorandum and Recommendation on a Proposed Loan to FF 56.7 million to the Gabonese Republic for Privatization and Regulatory Capacity Building Technical Assistance Project* (Washington DC: World Bank, 1997), at 1-4 (requiring Gabon to adopt a Charter on Investment). See the associated, *Charte des investissements du Gabon*, 1998, art. 2.

²⁵ In no publication on World Bank aid programs and conditionalities that this author is aware of are BITs mentioned as a factor. See e.g.; S. Koeberle, H. Bedoya, P. Silarszky, and G. Verheyen (eds.) *Conditionality Revisited* (Washington DC: World Bank, 2005).

projects became ever more important in the Bank's strategic focus when BITs proliferated up through the 1990s,²⁶ the World Bank agencies involved with investment protection did have the opportunity to strongly induce the developing world to adopt the treaties. Let me start with ICSID.

The International Centre for the Settlement of Investment Disputes

Apart from substantive principles for investment protection, as in the Guidelines, the World Bank has also been important with respect to the adjudication of investment disputes. Already in its 1969 'Blue Book', it was stated that the organization had a:

'... direct interest in the creation and maintenance of satisfactory relations between member countries and their external creditors. Accordingly, the normal practice is to inform governments who are involved in such disputes that the Bank or IDA will not assist them unless and until they make appropriate efforts to reach a fair and equitable settlement.'²⁷

Particularly in the early history of the Bank, this policy not only involved it in settling investment disputes, but also to withhold aid from developing countries not providing foreign investors adequate compensation for expropriation for instance.²⁸ Of particular relevance in this respect has been ICSID, which entered into force in 1966 and was created specifically to address concerns about investment protectionism.²⁹

Since hardly any claims were raised under ICSID in the first decades of its existence, the organization instead became deeply involved in drafting model arbitration clauses³⁰ as well as commenting on investment laws and treaties.³¹ This included, of course, the World Bank Guidelines, where states are encouraged

²⁶ World Bank Operations Evaluation Unit (OEU), *An Evaluation of World Bank Investment Climate Activities* (Washington DC: World Bank, 2004).

²⁷ IBRD, *The World Bank, IDA and IFC, Policies and Operations* (Washington DC: The World Bank, 1969), at 31

²⁸ E. Mason and R. Asher, *The World Bank Since Bretton Woods* (Washington DC: The Brookings Institution, 1973), ch. 11.

²⁹ See chapter two.

³⁰ See e.g.; ICSID, *Annual Report 1973/1974* (Washington DC: World Bank, 1974), at 4.

³¹ See e.g.; ICSID, *Annual Report 1995* (Washington DC: World Bank, 1995), at 9.

to submit disputes to ICSID,³² as well as the MIGA Convention, which I will return to below.

While most of the organization's policy work has been urging developing countries to sign up to the ICSID convention itself,³³ it has also promoted BITs. The founding father of the ICSID Convention, Aron Broches, was always clear in his support for the treaties.³⁴ Also, in the closest the organization ever came to an actual 'handbook' for BIT-negotiators - the much-delayed 1995 book 'Bilateral Investment Treaties'³⁵ – the treaties' investment promotion potential for developing countries was stressed repeatedly,

'...the negotiation and conclusion of a BIT by a capital-importing country may be said to send an important signal to the international business community, to the effect that that country not only welcomes foreign investment but will also facilitate and protect certain foreign ventures.'³⁶

Similarly, the book told developing countries that,

'the availability of insurance under such programs [bilateral investment insurance programs, ed.] *is in most instances conditioned* on the existence of a BIT between the insuring State and the host country of the insured investment. ... the BIT should help reduce the 'risk profile' of a covered investment to a level where it can be prudently insured by the investor's home State or investment guarantee agency.'³⁷

I will show in chapter six that this message was not entirely accurate. For the purposes of this chapter, however, it is important to note that partly due to a lack of staff; ICSID has not been as involved with policy reforms as other branches of the World Bank group. ICSID itself has been in no position to coerce developing countries to enter into BITs, or indeed the ICSID Convention, as it has had no real

³² World Bank Guidelines, art. 5(3).

³³ See e.g.; I. Shihata, 'Promotion of Foreign Direct Investment - A General Account, with Particular Reference to the Role of the World Bank Group,' 6 *ICSID Review - Foreign Investment Law Journal* 486 (1991), at 505-507; I. Shihata, 'Judicial Reform in Developing Countries and the Role of the World Bank,' Paper presented at the Seminar on Justice in Latin America and the Caribbean in the 1990s, Inter-American Development Bank, San José, Costa Rica, February 1993, at 33.

³⁴ See e.g.; A. Broches, 'Multi-national Corporations in World Development,' address to the Council on Religion and International Affairs, Aspen, Col., 26 April 1974, reprinted in: A. Broches (ed.) *Selected Essays: World Bank, ICSID, and Other Subjects of Public and Private International Law* (London: Martinus Nijhoff, 1995), at 522; R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (The Hague: Martinus Nijhoff, 1995), at 12 and 156.

³⁵ The book was initially planned to be released already in the mid-1980s, see; ICSID, *Annual Report 1985* (Washington DC: World Bank, 1985), at 5 and 11.

³⁶ Dolzer and Stevens, *op. cit.*, at 12.

³⁷ *Ibid.*, at 156. Italics added.

leverage apart from being part of the World Bank family. It is notable, for instance, that although ICSID was successful in its early years in advocating to the value of international arbitration to developing countries,³⁸ it largely failed to convince key audiences in Latin America and the Arab world until they themselves began subscribing to such views.³⁹ So while ICSID has indeed become a focal point of the investment regime after the surge of investment treaty claims, and may as an organization have an important indirect impact on the adjudication of claims based on its authority to appoint presiding arbitrators,⁴⁰ its impact on the formulation of investment policies has been less prominent than other World Bank agencies, such as the Foreign Investment Advisory Service (FIAS).

The Foreign Investment Advisory Service

During the 1990s and early 2000s, between ten and twenty percent of the World Bank's project lending was to so-called 'core investment climate' projects relating to investor-friendly judicial and legal reforms.⁴¹ Managed by the International Finance Corporation (IFC), FIAS here played a key role. When engaging with developing countries it strongly encouraged them to give foreign investors access to international arbitration to settle their disputes.⁴² And with respect to substantive investment standards, FIAS followed the World Bank Guidelines

³⁸ E. Denza and S. Brooks, 'Investment Protection Treaties: The British Experience,' 36 *The International and Comparative Law Quarterly* 4 (1987), at 911.

³⁹ H. Ruttley, 'Lawyers and Development in the Arab World: The Role of Idli,' 1 *Arab Law Quarterly* 4 (1986); Broches (1974), *op. cit.*, at 524. See also chapter two.

⁴⁰ G. Van Harten, 'Perceived Bias in Investment Treaty Arbitration,' in: M. Waibel, A. Kaushal, K.-H. Chung and C. Balchin (eds.) *The Backlash Against Investment Arbitration* (Alphen Aan den Reijn: Kluwer Law, 2010).

⁴¹ World Bank OEU, *op. cit.*, fig. 4.3.

⁴² By default, FIAS reports are confidential except if released by the host state, but see e.g.: FIAS, *Rwanda: Mini-diagnostic analysis of the investment climate* (Washington DC: World Bank, 2005); FIAS, *Liberia: Mini-diagnostic analysis of the investment climate* (Washington DC: World Bank, 2006). Note that independently of FIAS, the IFC has also promoted international arbitration in its loan agreements, and in one investment treaty claim before ICSID, the IFC – itself a World Bank Agency – had shares in the investment enterprise pursuing the claim; *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/19, Petition for transparency and participation as *amicus curiae*, available at: www.ciel.org/Publications/SuezAmicus_27Jan05_Spanish.pdf (accessed 5 Jan, 2011). The petition mentions a range of other multinationals funded in part by the IFC, which have also pursued claims under ICSID; *Ibid.*, at 14, fn. 39.

encouraging non-discrimination, protections against expropriation, free transfer of capital, etc.

However, FIAS does not appear to have had the leverage to coerce developing countries into following its recommendations in case they resisted. With Brazil, for instance, FIAS noted that in order to attract further investment, it ‘*may require*’ that Brazil signed up to the ICSID and New York conventions as well as BITs.⁴³ Yet today, ten years after, Brazil still remains outside the ICSID system and has yet to ratify any of its BITs. Similarly, in its 2004 report to Sierra Leone, FIAS was highly critical of the fact that the government had not followed several of its recommendations on its draft investment code.⁴⁴ Yet, in the final investment code, Sierra Leone kept several of the provisions, despite FIAS’ objections.⁴⁵

Even if, on occasion, FIAS (and the IFC) has successfully managed to pressure developing country governments to pursue policies they would not otherwise have pursued, it would be surprising if it tried to coerce BITs onto developing countries. Because apart from the promotion of ICSID, there is no indication that FIAS has engaged in any sustained and systematic effort to promote investment treaties. In fact, although FIAS occasionally has encouraged countries to enter into BITs, like in the case of Brazil,⁴⁶ FIAS has mostly focused on BIT-like obligations only in so far as they could be enshrined in domestic laws.⁴⁷ In fact, BITs have often not even been mentioned by FIAS. A country like Grenada, for instance, only had 2 BITs when FIAS reviewed its investment climate, but while considerable comments were made about Grenada’s international trade

⁴³ FIAS, *Brazil: Legal, policy and administrative barriers to investment in Brazil*, vol. 1 (Washington DC: World Bank, 2001), at 37.

⁴⁴ FIAS, *Sierra Leone: Diagnostic Study of the Investment Climate and the Investment Code* (Washington DC: World Bank, 2004), 19-20.

⁴⁵ Government of Sierra Leone, *The Investment Promotion Act*, 26 August, 2004.

⁴⁶ See also; see e.g. FIAS, *Slovak Republic: Legal, Regulatory, and Tax Improvements for Attracting Foreign Direct Investment* (Washington DC: World Bank, 1999), at 27-29; FIAS, *Albania: Diagnostic Study* (Washington DC: World Bank, 2001), at 14; FIAS, *Reducing administrative barriers to investment: lessons learned* (Washington DC: World Bank, 2006), at 7.

⁴⁷ This was confirmed in interviews with FIAS officials. See in this respect also e.g. FIAS, *Former Yugoslav Republic of Macedonia: Improving the Environment for Foreign Direct Investment* (Washington DC: World Bank, 1998) (BITs not mentioned); FIAS, *Honduras: The Climate for Foreign Direct Investment and How It Can Be Improved* (Washington DC: World Bank, 2001) (BITs not mentioned).

commitments, not a word was mentioned about investment treaties.⁴⁸ Similarly, in the case of Bosnia and Herzegovina, FIAS noted that while the country had indeed adopted attractive investment laws, including laws on expropriation, it did not have an effective judiciary system to enforce them in practice.⁴⁹ Yet, FIAS did *not* encourage the government to expand its small investment treaty network.⁵⁰

So while many of FIAS' investment policy reviews still remain confidential, those that are public suggest that the agency has had a rather haphazard and non-systematic approach towards investment treaties.⁵¹ Although FIAS has advised developing countries to adopt BIT-like standards in their domestic investment regimes, the treaties appear to have played a negligible role in and of themselves.

The Multilateral Investment Guarantee Agency

This takes me to the third main World Bank Agency dealing with investment protection regulation, the Multilateral Investment Guarantee Agency (MIGA). Unlike FIAS and the IFC, BITs have always been of critical importance to MIGA, not just since its inception in the 1980s, but also in the decades of discussions leading up to the MIGA Convention.

The idea of a multilateral organization providing investment insurance against political risks in developing countries, such as expropriation, had been on the World Bank agenda since the 1950s.⁵² Yet during the 1960s and 1970s, Latin American countries objected to the project fearing that it was nothing but an investment protection treaty in disguise.⁵³ Interestingly, several developed countries also had objections, fearing that if such an agreement were to include

⁴⁸ FIAS, *Grenada: A diagnostic review of the investment climate* (Washington DC: World Bank, 2004).

⁴⁹ FIAS, *Bosnia and Herzegovina: Institutional Framework for Foreign Investment Promotion* (Washington DC: World Bank, 1999), at 5.

⁵⁰ *Ibid.*; FIAS, *Bosnia and Herzegovina: Commercial Legal Framework and Administrative Barriers to Foreign Investment* (Washington DC: World Bank, 2001).

⁵¹ Note also, that in recent years, when FIAS' successor, the Investment Climate Advisory Services (ICAS), began to assess 'investment climates', it has acknowledged the importance of BITs, yet they have not been used as an indicator in ICAS' assessments. ICAS, *Investing Across Borders, 2010* (Washington DC: World Bank, 2010), box. 7.2.

⁵² See generally; I. Shihata, *MIGA and foreign investment* (The Hague: Martinus Nijhoff, 1988).

⁵³ *Ibid.*, at 40, 54-55.

substantive investor protections, they would become too weak and thereby undercut BITs as well as attempts at pursuing multilateral investment treaties.⁵⁴ During the 1980s, however, when the debt crisis had hit and official aid flows stagnated, the World Bank tried once again to overcome these divisions. The resulting compromise was to establish an agency, which was not a lending institution, nor a treaty-based framework for substantive standards on investment protection. Rather, it was to have two purposes. First, and foremost, the organization should of course issue guarantees to foreign investors against non-commercial risks, and secondly it should carry out complementary activities also assisting in promoting investments into the developing world.⁵⁵ As noted by the architect of the Convention, Ibrahim Shihata, to the Latin American World Bank directors in 1985,

‘The draft Convention does not deal with the substantive standards of treatment of foreign investors or with the method of settlement of disputes between them and their host countries. ... The arbitration referred to in the draft Convention applies only to disputes between the guaranteed investor and the Agency and between the Agency and the host government.’⁵⁶

Ultimately, this appeased the former opponents of the project. And with respect to the fears of developed countries, a compromise was reached that while the Convention did not oblige its parties to provide BIT-like standards to investors, the Agency had a duty to ‘*promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investments.*’⁵⁷ In the words of Shihata, this meant that instead of undermining BITs or other investment treaties, the Agency was ‘*to play a catalytic role in enhancing such attempts.*’⁵⁸

MIGA could do this through its investment advisory functions provided to developing countries,⁵⁹ but a much more important instrument could of course be to withhold investment insurance in case developing countries didn’t sign up to BITs. Political risk insurance (PRI) is essentially a subsidy to foreign investors, and if that subsidy depends on the adoption of BITs, then the World Bank would

⁵⁴ *Ibid.*, at 47,54,81, 200, 228. See also chapter two.

⁵⁵ MIGA Convention, art. 2(a)(b).

⁵⁶ Quoted in Shihata (1988), *op. cit.*, at 82.

⁵⁷ MIGA Convention, art. 23(b)(i).

⁵⁸ Shihata (1988), *op. cit.*, at 228.

⁵⁹ See e.g.; MIGA PAS, *Industrialized Countries' Policies Affecting Foreign Direct Investment in Developing Countries, Volume I* (Washington DC: World Bank, 1991a).

de-facto include investment treaties as part of its conditionalities. Indeed, developing countries expressed concerns in the 1980s that MIGA would potentially pressure them into signing BITs.⁶⁰ Whether MIGA has done this has never been studied, but it has been suggested by Kaushal, for instance, who notes that IMF and World Bank conditionalities,

‘...embrace broad aspects of a country’s economic development: creditworthiness and compliance measures are linked to a country’s level of openness to investment and the availability of foreign investment insurance is linked to the existence of a BIT with the host state.’⁶¹

If this is true, it would perhaps not be surprising, since BITs are of relevance to the underwriting process within MIGA, both directly and indirectly.⁶² The direct relevance of BITs arises because the Operational Regulations stipulate that if the investment is covered by a BIT then it has adequate legal protection for MIGA to insure it.⁶³ If the investment is not covered by a BIT, however, it can nevertheless still be covered by MIGA, if the agency can ‘*satisfy itself as to the investment conditions in the Host Country, including the availability of fair and equitable treatment and legal protection for the investment.*’⁶⁴ Indirectly, BITs could be relevant for this condition too. If the country has signed BITs with countries other than the investor’s home country that could potentially still provide a signal that investment conditions in the host country are adequate, particularly since ‘*fair and equitable treatment*’ is a key standard in most BITs.

This raises the question, whether MIGA has actually favoured investment projects covered by BITs, or reversely withheld guarantees from developing countries if they didn’t enter into the treaties. Figure 4.1 below summarises investment projects with MIGA guarantees from 1990 to 2009, distinguished by whether they

⁶⁰ Shihata (1988), *op. cit.*, at 220.

⁶¹ A. Kaushal, ‘Revisiting History: How the Past Matters for the Present Backlash Against the Foreign Investment Regime,’ 50 *Harvard Journal of International Law* 2 (2009).

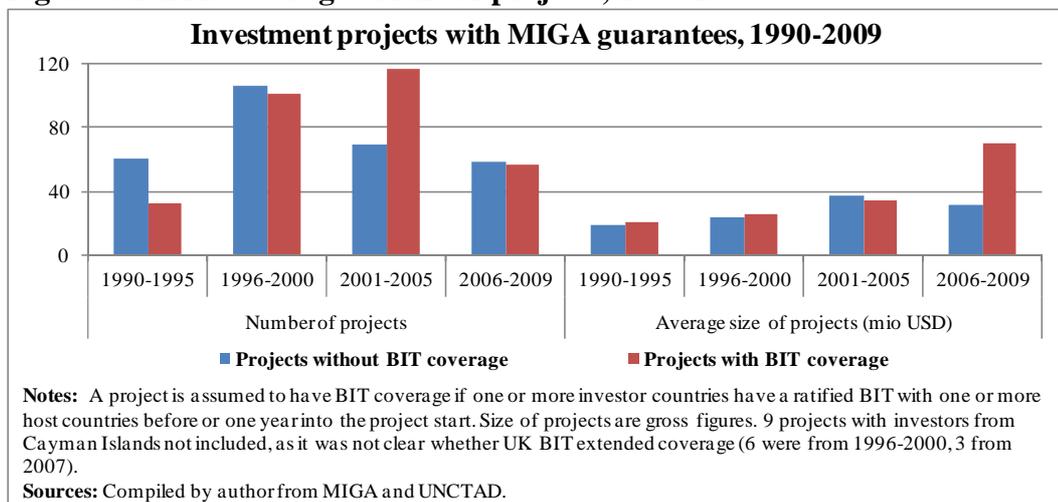
⁶² MIGA, *Operational Regulations, as amended by the Board of Directors through October 1, 2007* (MIGA Operational Regulations). Note also that article 23(b)(iii) of the MIGA Convention states that the Agency shall: ‘promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investments.’

⁶³ MIGA Operational Regulations, Par. 3.16.

⁶⁴ Par. 3.15. Finally, if none of these conditions are fulfilled, par. 3.17 stipulates that MIGA can still provide coverage if it has a special agreement with the host country, assuring that with respect to guaranteed investments, MIGA ‘*has treatment at least as favorable as that agreed by the member concerned for the most favored investment guarantee agency or State in an agreement relating to investment ..*’ (MIGA Convention Article 23(b)(ii)).

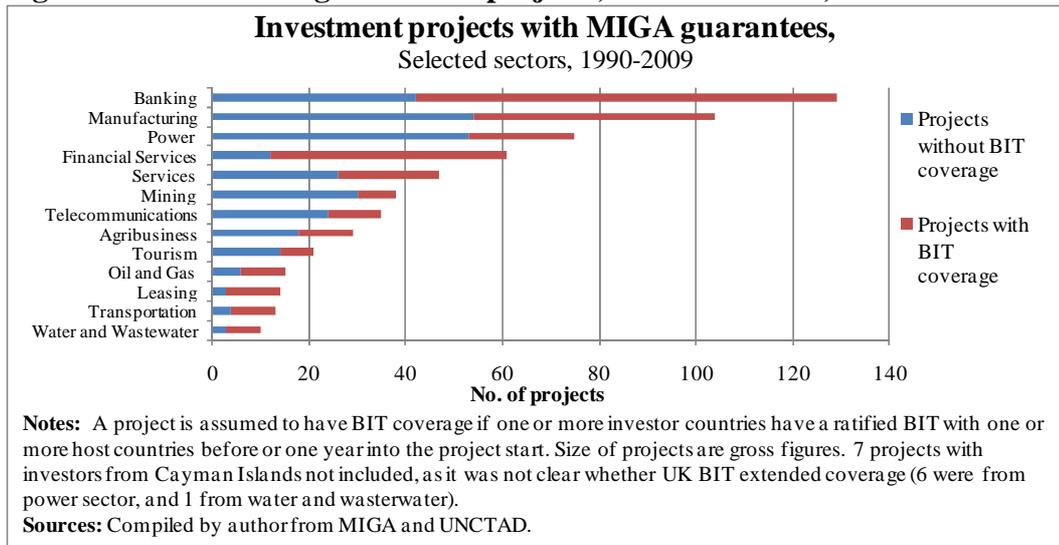
had BIT-coverage or not. This is not a clear-cut exercise. First of all, the figure is likely to underestimate the projects with investment treaty coverage, as it doesn't include other investment treaties, such as the ECT or PTIAs. At the same time, however, it is likely to overestimate whether the investors in the projects have access to treaty-based investor-state arbitration, as I do not distinguish between BITs with and without a binding consent to investor-state arbitration. Nor have I engaged in a detailed analysis of the substantive provisions and the specific conditions for investor coverage, as MIGA officials would have to do on a project by project basis.

Figure 4.1. BIT-coverage of MIGA projects, 1990-2009



Overall, however, the picture is nevertheless clear: MIGA does not appear to have systematically favoured investment projects covered by BITs. In fact, it has tended to provided guarantees for more projects without BIT-coverage. The exception is the early 2000s, yet at that time the vast majority of BITs had already been signed, so if MIGA wanted to indirectly promote BITs it was not necessary at that point. Also, while there is a tendency for BIT-covered projects to have been larger, the differences do not suggest any systematic bias. Finally, if we break down the projects by sector, we don't see any clear tendencies either (Figure 4.2). In fact, in some areas where investments are typically made for the very long term, such as mining or the power sector, the share of projects covered by BITs is less than one third. Yet, these are the same sectors where investors to a considerable extent have availed themselves of BIT-protections in recent years.

Figure 4.2. BIT coverage of MIGA projects, selected sectors, 1990-2009



As MIGA’s contracts are not publicly available, it is not possible to more carefully investigate exactly what role BITs play in MIGA’s underwriting decisions. The extent to which they do, however, is largely up to MIGA underwriting staff themselves. For although they are obliged to take BITs into account in the underwriting process, they are not forced to make the treaties crucial determinants for either coverage or pricing. With respect to coverage, a BIT is a sufficient but far from necessary condition, and with respect to pricing, MIGA is advised to consider almost sixty rating factors when determining the underwriting premium rates for expropriation, for instance, and only one of these relates to the existence of an ‘investment protection agreement’ (Table 4.2).⁶⁵ This itself is a rather broad term, which apart from BITs for instance covers preferential trade agreements with investment chapters, the European Convention of Human Rights, and the ECT.

⁶⁵ Annex A(d)(3).

Table 4.2. Rating factors when MIGA considers expropriation risks

**RATING FACTORS FOR MIGA WHEN CONSIDERING RISK OF EXPROPRIATION
AND SIMILAR MEASURES**

A. Investment

1. Form of investment, especially equity/non-equity.
2. Size of investment, including its size relative to the (i) Investment Project, and (ii) Host Country's gross national product.
3. Investment agreement with Host Government, especially dispute resolution mechanism (international arbitration), fairness to Host Country, clarity, flexibility (renegotiation clauses).

B. Investment Project

1. Sector, especially hydrocarbons, mining, public utilities, natural resources, manufacturing, services.
2. Importance of sector for host economy.
3. Size, including size relative to:
 - (i) Host Country's gross national product; and
 - (ii) pertinent sector in host economy.
4. Position in host economy, e.g., monopoly or part of an oligopoly.
5. Relationship to locally or state-owned enterprises.
6. Contribution to host economy, especially generation of export revenues, import substitution.
7. Economic viability.
8. Dependence on incentives or trade restrictions.
9. Dependence on Host Government, e.g., as monopoly supplier or monopoly purchaser.
10. Exposure to Host Governmental regulation, such as price controls, export and import quotas, performance requirements, tax regime, environmental protection, labor legislation, capital market regulation.
11. Vulnerability to adverse economic developments.
12. Importance to labor market in Host Country.
13. Potential for disinvestments, especially mobility of assets.
14. Profitability, including lead times and volatility of profits.
15. Ownership and control, especially joint venture, wholly-owned subsidiary or sole proprietorship of Guarantee Holder, majority/minority participation, management contract.
16. Joint venture partners, e.g., Host Government, domestic investors, investors of different nationalities, third country institutions, international institutions.
17. Providers of long-term financing, including the duration of their exposure in relation to the period of
18. Visibility as foreign-owned enterprise.

C. Guarantee Holder

1. On-going contributions to Investment Project, especially ongoing control over key technologies, technical processes employed in Investment Project, or changes for marketing of goods and services produced, or provided, by Investment Project.
2. Interest in Investment Project, e.g., profit maximization, export promotion, raw material procurement.
3. Overall interest in Host Country, especially other investments, export interests.
4. Overseas experience, reputation, record.
5. Reasons for seeking coverage.

**RATING FACTORS FOR MIGA WHEN CONSIDERING RISK OF EXPROPRIATION
AND SIMILAR MEASURES (CONTD.)**

D. Host Country

1. Legal protection of guaranteed investment under domestic law, especially specific legal assurances covering particular vulnerability of Investment Project, likely stability of protective law (constitution, statutes, decrees, etc.), enforceability of protective laws (judicial and administrative procedures).
2. Judicial system, especially independence, predictability, efficiency.
3. Investment protection agreement with home country of Guarantee Holder including its extension to coverage of investment under consideration against the risks to be covered.
4. Agreement with the Agency on the treatment of the guaranteed investment under Article 23(b)(ii) of the Convention.
5. Record of interventions in foreign investments, including settlement record.
6. Pending investment disputes, especially those involving the Agency itself or national or regional investment guarantee agency.
7. General attitude of Host Government toward foreign investment.
8. Relationship with Guarantee Holder's home country, including Host Country's interest in cooperation with home country.
9. Dissident elements inclined toward expropriatory action, including their strength at present and over the period of guarantee, as well as degree of hostility to foreign investment.

E. Terms and Conditions of Guarantee

1. Amount of compensation, especially its computation on basis of net book value or fair market value and applicable accounting principles.
2. Covered loss, especially limitation to total loss or extension to business interruption cost.
3. Period(s) between first expropriatory action and payment of claim.
4. Delimitation of "indirect" and "creeping" expropriation, especially any exclusions of potential events from coverage.
5. Point in time for determining loss in case of "creeping" expropriation.
6. Required nexus between expropriatory measure and loss, especially delimitation of measure from deterioration of business environment.
7. Undertakings of Guarantee Holder to avert or minimize loss.
8. Remedies required to be pursued by Guarantee Holder, especially requirement to pursue arbitral proceedings.
9. Responsibility for documenting claims and burden-of-proof rules.
10. Level of coinsurance by Guarantee Holder.
11. Period of guarantee.
12. Reductions of amount of guarantee over time.
13. Rights of Agency to premium increase or adjustment of other terms in case of change of circumstances.
14. Reference rate of exchange for compensation and date for its determination.

F. Potential for Recoupment

1. Agreement between Agency and Host Country under Article 23(b)(ii) of the Convention.
2. Concurrence between the Agency's rights as subrogee of Guarantee Holder and its obligations toward Guarantee Holder under contracts of guarantee.
3. Liquidity position of Host Country and its likely development over period of guarantee.
4. Capacity of Host Country to compensate from earnings of Investment Project.
5. Record of Host Country in honoring arbitral awards.
6. Interest of Host Country in relations with Agency.
7. Co-exposure of third country agency or international institution in Investment Project, especially as joint or parallel underwriter with Agency.
8. Level of Guarantee Holder's coinsurance and home country's investment protection policies.

Source: MIGA Convention Annex A.

MIGA staff has thereby had considerable discretion to determine just how important BITs should be in their underwriting decisions. And as a general rule, they haven't been as important as often assumed. Current and past MIGA officials thus noted in interviews that while they naturally follow the operational regulations by reviewing relevant BITs before issuing guarantees, the absence of a BIT has never in itself been a sufficient reason for MIGA to withhold a guarantee. As one former high-ranking official stated, '*BITs were of marginal importance within MIGA, and of no practical importance when covering political risks.*'⁶⁶ In his experience, BITs were far from crucial when determining whether an investment was eligible for MIGA insurance or the pricing of such insurance. Similarly, a current senior official there mentioned that, '*BITs are naturally important to our underwriting process, as we would like to know which rights we have in case of subrogation, but they are not at essential to underwrite an investment.*'⁶⁷ Others concurred: '*while we have to look to BITs, they are not important determinants to our perception of the risk of an investment project*' and '*it is very rare that BITs become crucially important for us in practice.*'⁶⁸

Suffice it to say that if countries engage in conduct that signals a scale-back of investor protections – such as violating existing BIT-obligations or withdrawing their consent to submit investment disputes to international arbitration - that would naturally be factored into MIGA's underwriting decisions.⁶⁹ The relevance of this practice for countries such as Bolivia, which recently withdrew from ICSID, is obvious. However, for developing countries that are not planning to expropriate or otherwise maltreat its foreign investors, the message is clear, '*provided we can expect a country to remain committed to foreign investments and the rule of law, cancelling all its BITs would not have a substantial impact on*

⁶⁶ MIGA official I.

⁶⁷ MIGA official II. Note that just as government agencies, MIGA does not have standing under ICSID. In case benefits are paid out to investors, MIGA will typically recover its losses by requiring the investor to pursue the claim and be reimbursed by any subsequent proceeds, see, MIGA Convention Article 18(a), and Operational Regulations 4.15(i). For an example, see, K. W. Hansen, 'A BIT of insurance,' in Theodore Moran, ed., *International political risk management: needs of the present, challenges for the future* (Washington DC: World Bank, 2007), at 11.

⁶⁸ MIGA official III.

⁶⁹ *Ibid.* Note also Annex A(f)(5), where the pricing of expropriation insurance is dependent on the '*record of host state in honoring arbitral awards.*'

whether, and to what extent, MIGA would be willing to underwrite investments to that country.’⁷⁰

It is indeed notable, that in 2009 more than 10% of MIGA’s total outstanding portfolio was with countries with less than five ratified BITs (Table 4.3). Djibouti, for instance, was not a member of ICSID and had only ratified one BIT, yet it retained the fourth largest exposure of MIGA’s portfolio. Brazil was not an ICSID member either and had *no* BITs ratified, yet it had the seventh largest portfolio exposure.⁷¹ Combined with the observations above, this indicates that even if MIGA has encouraged developing countries to pursue BITs, it has not used its most obvious leverage to pursue this aim, namely withholding insurance.

Table 4.3. Outstanding MIGA portfolio among countries with less than five ratified BITs, 2009

	Gross exposure, (\$M)	% of Gross	ICSID member	BITs signed	BITs ratified
Djibouti	407.4	5.6	No	7	1
Brazil	244.2	3.4	No	14	0
Afghanistan	77.3	1.1	Yes	3	3
Central African Republic	33.9	0.5	Yes	4	2
Nepal	30.0	0.4	Yes	4	3
Guinea Bisseau	24.1	0.3	Yes	1	1
Sierra Leone	10.7	0.1	Yes	3	1
Total	827.6	11.4	-	-	-

Sources: MIGA and UNCTAD

None of this is to say that the Bank has not been instrumental in the spread of the treaties. It undoubtedly has. Charles Brower has noted about Shihata, for instance, that,

‘...since he arrived on duty in Washington, no less than 1,235 bilateral investment treaties have been concluded around the world ... the masterful missionary, Ibrahim Shihata, may disclaim responsibility, but the world knows better.’⁷²

Yet, while this may be true, the World Bank has not forced developing to sign the treaties through conditionalities or otherwise. Like in the case of the IMF, the Bank has been instrumental in promoting enabling conditions for the treaties, but

⁷⁰ MIGA official IV.

⁷¹ MIGA, *Annual Report, 2009* (Washington DC: World Bank, 2009).

⁷² C. Brower, ‘Ibrahim Shihata and the Resolution of International Investment Disputes: The Masterful Misionary,’ 31 *Studies in Transnational Legal Policy* 79 (1999) at 82-83.

when it has advanced BITs it has done so primarily through persuasion rather than coercion. In fact, as we shall see in the next chapter, the United Nations has been equally, or even more, important in promoting investment treaties, despite not having the same sanctions at hand.

4.3. The role of dominant Western states

Even if the international financial institutions have not coerced developing countries into signing BITs, dominant western states may have done so on a bilateral basis. Let me here start with the ‘usual suspect’, the United States, which many argue played a hegemonic role in international economic relations in the decades where BITs proliferated.

The United States

Using coercive means to obtain investment protection is no stranger to American foreign policy. In fact, a developing country expropriating American assets without providing adequate and effective compensation or submitting the dispute to international arbitration will not only get bilateral aid flows suspended, but the American President is also obliged to instruct his Executive Directors of the international financial institutions to vote against multilateral loans.⁷³ The American business lobby has explicitly asked for the administration to make use of such instruments,⁷⁴ and we know of at least one instance, where a multilateral loan was delayed until an (unrelated) investment dispute involving an American investor in Costa Rica was referred to arbitration.⁷⁵ In turn, this led Costa Rica to

⁷³ United States Foreign Aid Act of 1961. On American use of foreign aid sanctions in relation to investment disputes, see; C. Lipson, *Standing Guard: Protecting Foreign Capital in Nineteenth and Twentieth Centuries* (Berkeley: University of California Press, 1985), ch. 4.

⁷⁴ U.S. Policy Toward International Investment, *Hearings Before the Subcommittee on International Economic Policy of the Committee on Foreign Relations, United States Senate, July 30, Sept. 20, and Oct. 28 1981*, at 173.

⁷⁵ *Compañía del Desarrollo de Santa Elena, S.A. v. Republic of Costa Rica*, ICSID Case No. ARB/96/1.

join ICSID in order to stop the American pressure.⁷⁶ Also in 2011, the United States began to decline most aid spending to Argentina – bilateral or multilateral; in part because of the country’s refusal to comply with investment arbitral awards related to its financial crisis.⁷⁷

Surely, this mechanism will make aid-dependent countries in the developing world think twice before expropriating American assets. So perhaps similar coercive means may also have played a key role in the American BIT program? Alvarez noted in the early 1990s, for instance, that,

‘BIT partners turn to the U.S. BIT with the equivalent of an IMF gun pointed at their heads. ... A BIT negotiation is not a discussion between sovereign equals. It is more like an intensive training seminar conducted by the United States, on U.S. terms, on what it would take to comply with the U.S. draft.’⁷⁸

While this refers to the power of the United States in bilateral negotiations, its hegemonic role may also have been important in developing countries’ propensity to adopt the treaties in the first place. An example is Grenada, where talks about a BIT with the United States began two years after the American invasion in 1983 and concluded after one hour of ‘negotiations’ with the Grenadian prime minister, while he was getting medical treatment in a Washington DC hospital.⁷⁹ But while anecdotes like this may raise suspicions that the United States has imposed BITs on the developing world, this has generally not been the case.

First of all, it is important to keep in mind that the United States was not responsible for the emergence of BITs. It started its BIT-program much later than many European countries after business interests feared they were losing out to their European counterparts. Both the International Chamber of Commerce (ICC) and the State Department’s Advisory Committee on Transnational Enterprises thus explicitly referred to the European success, when encouraging the BIT program during the 1970s.⁸⁰ Also, even after the United States had begun its BIT

⁷⁶ Interview with Costa Rican official II.

⁷⁷ See; J. Finkman and J. Morgenstern, ‘US voting ‘NO’ on new multilateral lending to Argentina,’ *HSBC Global Research Note*, 22 September 2011.

⁷⁸ J. Alvarez, ‘Remarks,’ 86 *ASIL Proceedings* 551 (1992), at 552-553.

⁷⁹ K. Vandavelde, ‘The BIT Program: A Fifteen-Year Appraisal,’ 86 *American Society of International Law Proceedings* 532 (1992), at 539.

⁸⁰ K. Vandavelde, ‘The Bilateral Investment Treaty Program of the United States,’ 21 *Cornell International Law Journal* 201 (1988), at 208-209, fn. 67.

program in the 1980s and BITs generally began to spread worldwide, the American preference for multilateralism meant that instead of advocating bilateral treaties it focused considerable attention on including comprehensive investment rules into the GATT (which largely failed).⁸¹

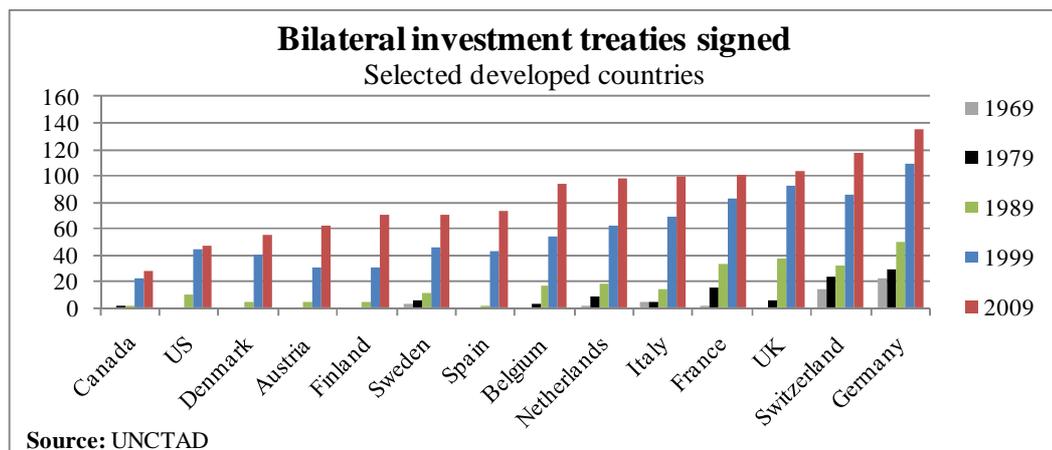
Secondly, coercion does not appear to have been an important mechanism in the United States' own BIT-program. In fact, the United States has been relatively unsuccessful in signing BITs - despite its hegemonic status (Figure 4.3). Already in the early 1980s, Gary Hufbauer noted in front of a Congress subcommittee that, '*we haven't been able to negotiate treaties with either Singapore or Egypt to this day, and one would have thought if we could negotiate treaties anyplace it would have been with those two countries.*'⁸² In later years, the United States has also had difficulties in expanding its BIT-network. The combination of a rather uncompromising negotiating approach and a far-reaching BIT-model - which unlike European models includes liberalization provisions - has made some developing countries wary of entering into BITs with the American government.⁸³ Also, and perhaps most importantly, due to American economic and political influence in most corners of the world the politics surrounding *any* international agreement with the United States is bound to raise considerably attention – and criticism – by host state stakeholders compared to agreements with most other countries. Combined, this means that many developing countries have been much more careful, when negotiating BITs with the United States, as will become clearer from later chapters. In any event; such relatively poor BIT-‘performance’ of the United States surely does not correspond well with a view that American hegemony has been a deciding factor for the spread of investment treaties.

⁸¹ See, P. Christy III, 'Negotiating Investment in the GATT: A Call for Functionalism,' 12 *Michigan Journal of International Law* 743 (1990-1991). It should be noted that during the 1950s, the United States advocated *against* an OECD based multilateral investment treaty and instead favored FCN treaties, see: S. Metzger, 'Multilateral Conventions for the Protection of Private Foreign Investment,' *Journal of Public Law* 10 (1960). See also, S. Katzenstein, 'Innovating to Preserve the Status Quo: The Turn to Immunity Waivers in BITs,' *mimeo*, 2011, on file with author.

⁸² Gary Hufbauer, in: U.S. Policy Toward International Investment, *op. cit.*, at 155.

⁸³ K. Vandevelde, 'U.S. Bilateral Investment Treaties: The Second Wave,' 14 *Michigan Journal of International Law* 621 (1993), at 628. Note that later in the thesis we shall see that whereas developing countries were often careful to negotiate liberalization obligations, not just in North American BITs but also in multilateral fora, they often failed to consider the implications of BITs' arbitration provision. In turn, this made European BITs look far more benign.

Figure 4.3. The small BIT-network of the United States.



Third, to the extent the United States has signed BITs, it has often been *developing* countries themselves that have initiated negotiations. A veteran American BIT negotiator notes that the changing investment climate in the early 1990s meant that for ‘*many developing countries, the BIT represents a tangible way of signalling their receptivity to foreign investment, and thus may seem to assist in attracting capital from the United States and other developed countries.*’⁸⁴ In some cases the United States has even declined such invitations,⁸⁵ which again does not fare well with an explanation for the BIT-movement based on American hegemonic imposition.

Finally, it is worth noting that the American PRI agency, OPIC, does *not* condition provision of investment insurance to American multinationals on the adoption of BITs. Instead, OPIC has its own set of inter-governmental agreements, which provide for international arbitration and allows OPIC to subrogate covered investors’ claims. Accordingly, a former high ranking OPIC official noted in my interview with him that ‘*the existence of BITs was entirely*

⁸⁴ *Ibid.*, at 638.

⁸⁵ As an example, talks over a BIT between Pakistan and the United States began already in the 1980s. But when in the 1990s, Pakistan asked the United States to take these talks further, the Clinton administration refused. The American government told Pakistan that in order to sign an investment treaty, the two countries first needed to sign a treaty on protection on intellectual property (IP) rights. See; ‘United States no to talks to investment treaty before IPR record,’ *Business Recorder*, March 19, 1995. See also; *Private Sector Investment Climate Assessment of Balochistan*, United States AID report, July 1990, available at: http://pdf.usaid.gov/pdf_docs/PNABU894.pdf (accessed 12 April 2011), at 17.

*inconsequential when underwriting risks ...*⁸⁶ A current official there concurs, noting that *'in OPIC we don't pay much attention to BITs.'*⁸⁷ In other words, even if one would want to portray a linking of a (Western) government's PRI and BIT programs as a quasi-coercive tool to get developing countries to sign BITs (see also below), this is not how United States' policy has proceeded.

This is not to say that the United States has not played an important role in advancing neoliberal investment reforms bilaterally or via its influence in international organizations.⁸⁸ Also, once developing countries negotiate a BIT with the United States, in many cases the unequal bargaining power puts them in a disadvantage if they want to depart from the American model BIT. Similarly, and as mentioned in the preceding chapter, once the United States has signed a BIT, coercive forces may still be involved in making sure the other contracting party doesn't cancel it later on.⁸⁹ But when the American government has signed BITs, it has often been on the initiative of developing countries themselves, and there are no indications that the decision has been driven by fear of political or economic repercussions if they didn't.

Germany

With most major European countries having signed around 100 BITs, or more, Europe has played a considerably greater role in the diffusion of BITs than the United States. In a sense, the BIT-movement mirrors the global financial system, where Abdelal has found that rather than the United States, it was in fact European countries – and particularly France – which promoted capital account liberalization.⁹⁰ The question is, however, whether European countries have

⁸⁶ OPIC official I.

⁸⁷ OPIC official II.

⁸⁸ See also next chapter.

⁸⁹ See e.g.; 'Czechs face uphill battle to cancel United States investment treaty,' *Czech Position*, 7 Apr, 2011, at: <http://bilaterals.org/spip.php?article19344&lang=en> (accessed 8 April 2011).

⁹⁰ R. Abdelal, *Capital Rules: The Construction of Global Finance* (Boston: Harvard University Press, 2007). It is interesting in this respect to note that France was also the country that initiated the World Bank Guidelines on foreign investment, whereas the United States was initially highly critical of the project, see; Shihata (1992), *op. cit.*

promoted BITs through coercive means. The most notable country in this respect has been Germany.

Going back to the 1950s, the then chairman of the Deutsche Bank, Herman Abs, initiated the German Society to Advance the Protection of Foreign Investments, whose prime aim was to gather support for an investment protection treaty based on international minimum standards and investor-state arbitration.⁹¹ He moreover urged the six European Common Market members to initiate a common policy on investment protection, which should serve '*first and foremost [as] an instrument of pressure for inducing third countries*' to accept Western notions of international investment law.⁹² This proposal was particularly remarkable as it suggested that the parties to such a convention should take collective measures against *any* country violating its principles, '*whether that country has adhered to the Charter or not*' (i.e. also non-members).⁹³ In particular, it suggested that countries should have official loans or investment guarantees withheld if they didn't execute arbitral awards, or if they refused to submit investment disputes to international arbitration in the first place.⁹⁴ Ultimately, Abs' suggestions were watered down before he presented a draft multilateral investment treaty to the OECD along with a group of British lawyers, led by Hartley Shawcross. As mentioned in chapter two, this initiative failed, however, as developing countries refused to accept its wide-ranging scope, and Abs' suggestion for a common European investment protection policy never materialized either.⁹⁵

It was therefore up to Germany itself to develop a network of investment treaties, which for the German administration was a major priority due to its lack of formal or colonial ties with the developing world, which it felt left its investors with

⁹¹ A. Fatouros, 'International Codes to Protect Private Investment: Proposals and Perspectives,' 14 *The University of Toronto Law Journal* 1 (1961), at 86; Society to Advance the Protection of Foreign Investment, *International Convention for the Mutual Protection of Private Property Rights in Foreign Countries* (Cologne: Germany, 1957). I am grateful to Suzanne Katzenstein for making me aware of several of the sources in this paragraph. See also; Katzenstein, *op. cit.*

⁹² European League for Economic Co-operation (ELEC), *Common Protection for Private International Investments* (Brussels: ELEC, 1958), at 17.

⁹³ *Ibid.*, at 16.

⁹⁴ *Ibid.*, at 25. The draft is less clear on this later point.

⁹⁵ On this, see below.

weaker safeguards.⁹⁶ Germany was thus the first country to ever enter into BITs and has since developed the largest BIT-network in the world. Its model BIT closely followed the Abs-Shawcross draft, which subsequently has become the standard reference for the vast majority of BITs in existence. In this sense, Germany has been a much greater force in the BIT-movement than the United States.

Independently of its own negotiations, Germany has also strongly encouraged developing countries to sign BITs. In its development aid program, for instance, the German state has repeatedly told developing countries that in order to attract investment they need to sign BITs.⁹⁷ In these efforts, the German government has occasionally used coercive means. In an ongoing dispute over an airport terminal between a German investor and the Philippines, for instance, Germany decided in early 2011 to withhold US\$61 million in development aid to fight HIV/AIDs and tuberculosis until the dispute was solved.⁹⁸ Moreover, in the recent negotiations over the 'update' of the fifty-year old BIT between Germany and Pakistan, Germany asserted considerable pressure on the (very few) elements of the Pakistani bureaucracy that objected to its terms.⁹⁹ In fact, when a legal officer

⁹⁶ H.-M. Burkhardt, 'Investment protection treaties: recent trends and prospects,' 41 *Aussenwirtschaft: Schweizerische Zeitschrift für international Wirtschaftsbeziehungen* 1 (1986), at 99–104.

⁹⁷ See e.g.; The Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), for instance, covers BITs in its publications and training workshops. See e.g.; GTZ, *Foreign Direct Investment (FDI) in Land in Developing Countries* (Eschborn: GTZ, 2009) ("This lack of a [BIT, ed.] may be a risk and a chance: (...) This leads to a loss in attractiveness in investing in the target country. On the other hand it may raise the bargaining power for the target country by offering such provisions by requiring own conditions at the same time.", at 27); Silke Trumm (GTZ), presentation at ILEAP Workshop, 23 - 24 October 2008, Libreville, Gabon. Available at: www.ileap-jeicp.org/downloads/libreville_08/Presentations/08_10_23_gtz_epa_services_chapter_development_dimension.pdf (accessed 4 March 2010) (arguing that in order to attract investments, ACP countries needs to enter into BITs, slide 3).

⁹⁸ M. Callar, A. Cruz and B. Pulta, 'Germany: No resolution of NAIA-3 row, no aid to RP,' *Daily Tribune*, 5 Jan, 2011; The claim was; *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25. After an annulment of the first decision, a new claim has been registered; J. Hepburn, 'Fraport files new claim at ICSID over expropriation of airport terminal project; Annulment committee ruling paved way for new hearing by finding breach of investor's right to be heard,' *Investment Arbitration Reporter*, 31 Mar, 2011.

⁹⁹ At this time, Siemens had been faced with considerable difficulties in Pakistani courts in a dispute starting in the late 1990s and an Italian consortium with a German shareholder, Zublin, had sued Pakistan under ICSID. So when Mr. Khan and the BOI insisted on a different set of provisions than those in the German model, the German ambassador protested fiercely to all levels of the Pakistani government from the Prime Minister and down; interview with Makhdoom Ali Khan, Karachi, January 2009. See also; Haque, I., 'Germany wants equal treatment for investors,'

within the Law Ministry objected to the treaty, Germany is reported to have threatened with withholding aid if the BIT was not finalized.¹⁰⁰ The extent to which Germany would have withheld financial assistance had Pakistan's Law Ministry successfully blocked the treaty in its current form is unknown. Also, while this is the closest anyone has come to a 'smoking gun' indicating outright coercion for a developing country to adopt an investment treaty, it doesn't actually sustain this conclusion: the Pakistani embassy in Berlin strongly promoted the BIT, and so did the Pakistani Board of Investment (BOI),¹⁰¹ both of which must have welcomed the threat in so far as it could assist in silencing protests from the Law Ministry. In fact, the BOI pushed to have the BIT vetted by another officer in the Law Ministry less critical towards the treaties.¹⁰² So while Germany had applied pressure for almost ten years, it was primarily a shift in staff within the Pakistani bureaucracy that led to the BIT being finalized.

It should also be stressed that this is likely to have been a unique event, given the symbolic importance of having the treaty finalised at a major celebration in Frankfurt of the fifty-year anniversary of the BIT-movement.¹⁰³ For while Germany has indeed used what some would characterise as a coercive instrument to get developing countries to sign BITs, it has not been aid conditionalities. Instead, the German BIT program has been tied to its investment guarantees – as initially suggested by Abs in the 1950s. So if developing countries cannot be expected to offer German investors BIT-like protections, they must sign a BIT in

5 *The World Trade Review* 4 (2005); *Impregilo S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3.

¹⁰⁰ Interview with Pakistan official VI; Communication between Pakistan's Board of Investment and Ministry of Law concerning re-negotiation of German-Pakistan BIT, November 23, 2009 (on file with author). It should be stressed, that no official documentation exists for this claim, but it is noteworthy that at the event where the BIT was signed, Germany announced it would enhance its development assistance to Pakistan from 64 million Euros to 125 million; 'Germany to enhance aid to 125 million euros: nation to hear good issues on Kashmir issue: Gilani,' *Business News*, 1 December, 2009, at: <http://finance.kalpoint.com/highlights/business-news/germany-to-enhance-aid-to-125-million-euros-nation-to-hear-good-news-on-kashmir-issue-gilani.html> (accessed: 12 April 2011). Note also that in official Pakistan reports the BIT is mentioned in connection with the aid increase; Pakistani Ministry of Information and Broadcasting, *Promise Policy Performance: Two Years of Peoples Government 2008-2010*, at 135 ('The new BIT has opened a new chapter in the bilateral economic relationship. The German Government has started to extend investment guarantees for companies investing in Pakistan. Germany increased development assistance for Pakistan from €64 million to €125 million.').

¹⁰¹ Interviews with Pakistan officials IV, V and VI.

¹⁰² Interviews with Pakistan officials II and VI.

¹⁰³ See; www.50yearsofbits.com. (accessed 11 January 2011).

order for the German state to issue investment guarantees.¹⁰⁴ As noted by a current German official,

‘Since the guarantees have a BIT as a precondition, we look at the conditions of the BIT which in turn will impact the condition of the guarantee. So limited substantive provisions will limit the risk the guarantee is covering.’¹⁰⁵

One reason for linking the BIT and the PRI program is that BITs allow Germany’s PRI agency to subrogate insured investors’ claims against host countries, thereby providing a legal basis for the government’s insurance agency to recover benefits paid out to investors.¹⁰⁶ Another reason, however, is of course the one suggested by German bankers initially, namely that it can act as a strong incentive for developing countries enter into a BIT with Germany, not because they necessarily found it to be in their general interest, but rather because it is set as a condition by the German government to insure its investors there.¹⁰⁷

However, the linking of the BIT and PRI programs does not in and of itself indicate that developing countries would not have pursued BITs with Germany otherwise. When in 1959 Germany signed its first ever BIT, it was presented to Pakistan as a condition for German investors being able to obtain Federal guarantees of their investments.¹⁰⁸ Yet, there were no indications that Pakistan signed it under duress. ‘*We shall be taking big steps in the economic field,*’ Pakistan’s Finance Minister said at the time, and ‘*from the first day of independence we have been very keen to develop economic relations with Germany.*’¹⁰⁹

¹⁰⁴ German Federal Ministry of Economics and Technology and PriceWaterhouseCoopers, *Granting of federal guarantees abroad*, (July 2006), at 3. Note that Germany suggested a similar arrangement for MIGA; Shihata (1988), *op. cit.*, at 250 ftn. 23.

¹⁰⁵ German official I.

¹⁰⁶ See e.g. Lebanon-Germany BIT (1997), art. 8. Note that the subrogation process would have to take place under UNCITRAL or other ad hoc rules as ICSID does not accept government administered insurance programs as a party to a claim; C. Schreuer, *The ICSID convention: a commentary* (Cambridge: Cambridge University Press, 2001), at 185-91; N. Ziade, ‘ICSID clauses in the subrogation context,’ *7 News From ICSID* 4 (1990). The extent to which this takes place in practice has not been studied, but no reports suggest that it happens on a regular basis.

¹⁰⁷ Note that the German government suggested a similar arrangement in MIGA, see; Shihata (1988), *op. cit.*, ftn. 23 at 50.

¹⁰⁸ ‘Pakistan W. German investment accord: way cleared for basic industries’ growth,’ *DAWN News*, 27 November, 1959.

¹⁰⁹ *Ibid.*

Also, even if PRI coverage has been offered to developing countries as a ‘bribe’ to sign BITs with Germany,¹¹⁰ it is not likely to have been particularly effective. German investors have many other options of getting PRI coverage than their state-sponsored program: MIGA is available, and in recent decades a considerable private market for PRI has also developed.¹¹¹ This should make any implicit German threat of withholding PRI rather toothless.

Other European countries

With respect to other European governments, there is no indication that they have coerced developing countries into signing BITs either, through aid conditionalities or other means. As mentioned above, European countries have entered into trade agreements as a group, yet most matters of investment protection have until recently been exclusive member state competence. For Eastern European countries, for instance, this means that they were *not* forced to grant BIT-like protections to investors from the ‘old’ member states as a condition for EU membership.¹¹² It also implies that while EU has been successful on promoting strong intellectual property rights regimes in its FTAs with developing countries, for instance, questions of expropriation or investor-state arbitration has never been part of EU’s external negotiations until the recent Lisbon treaty.¹¹³

It has therefore been up to member states themselves to use bilateral aid and loans to promote investment treaties. Yet, it is difficult to see how the small European countries should have been capable of doing so with major developing countries like Venezuela, India, Russia, Iran, and China, (Table 4.4). Surely, such countries

¹¹⁰ The term is Yackee’s, J. Yackee, *Sacrificing Sovereignty: Bilateral Investment Treaties, International Arbitration, and the Quest for Capital*, unpublished dissertation, University of North Carolina at Chapel Hill (2007), at 81-82.

¹¹¹ See chapter six.

¹¹² Instead, a considerable number of intra-EU BITs still exist, many of which have been used for investment treaty claims over the last decades. E.g. *CME Czech Republic v. Czech Republic*, UNCITRAL; *Parkerings Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8.

¹¹³ See e.g.; A. Mestral, ‘The Lisbon Treaty and the Expansion of EU Competence Over Foreign Direct Investment and the Implications for Investor-State Arbitration,’ in: K. Sauvant (ed.) *Yearbook on Investment Law and Policy 2009/2010* (New York: Oxford University Press, 2010). Only the European Convention of Human Rights allows investors access to investor-state arbitration, though protections are somewhat weaker than in traditional BITs.

would not have signed investment treaties with countries like Denmark and Portugal, if they didn't support the BIT-movement themselves.

Table 4.4. Year for BIT-signature between small European countries and major developing countries

	Argentina	China	Egypt	India	Indonesia	Iran	Mexico	Russia	Venezuela
Denmark	1992	1985	1996	1995	2007	-	2000	1993	1994
Finland	1993	2004	2004	2002	2006	2002	1999	1989	-
Sweden	1991	2004	1978	2000	1992	2005	2000	1995	1996
Portugal	1994	2005	1999	2000	-	-	1999	1994	1994

Source: UNCTAD

Indeed, like in the case of the United States, it has often been developing countries themselves that have initiated BIT-negotiations with European countries. A former Danish negotiator notes, *'often it was actually developing countries, and not us, that asked if we wanted to sign these agreements.'*¹¹⁴ This is also the response from negotiators from the major European countries. One experienced negotiator from Switzerland notes that *'most often it is the other country that takes the initiative. Developing countries quite often contact us.'*¹¹⁵ Similarly in the Netherlands, the treaties were initially seen as a favour to developing countries, so during the 1990s, developing country governments had to initiate negotiations themselves – which they often did.¹¹⁶

Such eagerness amongst many developing countries to develop wide-ranging BIT-networks corresponds with the statistical finding of Elkins, Guzman, and Simmons, that developing countries' BIT-signing activity has been considerably more clustered than that of developed countries.¹¹⁷ They take this to imply that *'while the major capital exporters stand ready with model treaties in hand, the decision whether and when to sign is left to a large extent to the host.'*¹¹⁸ Given the feedback presented here, their observation appears to be correct.

¹¹⁴ Danish official I.

¹¹⁵ Swiss official I.

¹¹⁶ Dutch official I.

¹¹⁷ Elkins, Guzman, and Simmons, *op. cit.*, at 822.

¹¹⁸ *Ibid.*

Also, even if the German government should have been successful on occasion in using its PRI program as a quasi-coercive tool to get developing countries to sign BITs, this would be an exception, in that most other European programs do not incorporate BITs as a precondition for coverage.¹¹⁹ And as in the case of MIGA and OPIC, officials there generally take less notice of BITs than has often been assumed in the literature (including the ICSID publication mentioned above):¹²⁰

‘The existence of a BIT may provide us with comfort, but they are not specifically taken into account when we are considering investment projects.’ (UK)

‘BITs can perhaps simplify our analysis in some cases if taken as an indicator that the legal regime is favorable towards the protection of investment. But in practice they are hardly ever decisive.’ (Netherlands)

‘BITs do not play a great role in our work. ... In some cases, if we are dealing with a particularly risky country, we do look to BITs and their provisions. But it is very rare.’ (Denmark)

‘I could perhaps speculate that for a certain very risky economy we may want the treaty in place, but that has never actually been the case.’ (Finland)

‘In some rare cases we may look at BITs. But they are no precondition for getting the insurance and don’t actually impact the pricing. So while we might look at them, they don’t really play a role in the underwriting process.’ (Austria)

‘While it is in our formal guidelines that we should look towards BITs as a risk-mitigating factor, their existence is unlikely to have had any impact on our pricing.’ (Sweden)

‘The availability and pricing of our insurance is pretty much unrelated to whether there is a BIT or not. ... We regard them simply as signals of good relations between the two countries, but they don’t actually provide a safety net for us in practice.’ (Italy)

Again, since details of the agencies’ projects are typically not publicly available, it is not possible to corroborate these statements further. However, unless PRI officials are being systematically dishonest, it appears there is a general disconnect between European countries’ political risk guarantee agencies and their BITs.¹²¹ This is important when assessing the investment impact of the treaties, as

¹¹⁹ Historically, the French and Swiss programs have also had BIT-coverage as a condition for the availability of insurance although the extent to which officials could depart from these rules is unclear.

¹²⁰ Among contributions assuming that BITs are crucial in PRI’s underwriting strategies, see e.g.; Dolzer and Stevens, *op. cit.*. See also next chapter.

¹²¹ This is also the case in developed countries outside of Europe. A representative from Japan notes; ‘*It is of course only the very big companies that are even aware of the treaties. ... But since we don’t have as many BITs as the Europeans, what usually happens is that investors first make the decision to invest, and then they lobby the Japanese government to sign a BIT.*’ Japanese official I.

discussed in a later chapter, but it is also important in this context: an obvious instrument available to European governments to get developing countries to sign BITs has not been used to any considerable extent. So while the PRI agencies are somewhat akin to ‘tied aid’ programs, where indirect subsidies are granted to investors for pursuing projects in developing countries, it appears that they do not tend to operate with the adoption of BITs as an implicit condition for issuing guarantees.

All in all, it is difficult to see BITs as the product of Western imposition. In fact, developing countries themselves have often seen investment treaties as an *alternative* to having their economic policies dictated. In 1992, a judge from Sri Lanka’s Court of Appeal thus noted that,

‘Although substantial aid is given by the developed countries and their agencies to the Third World countries, the latter are unhappy about the conditions attached to such aid programs. Thus, they prefer foreign direct investments, in which they are equal partners with the investors ... The concept upon which [BITs, ed.] are based, namely reciprocity, accords well with that thinking; the principle of reciprocity is in conformity with the concept of sovereignty.’¹²²

4.4. South-South BITs

Also, if developing countries have been coerced into signing BITs, why have they entered into so many BITs among themselves? While the process started in 1964 with the Kuwait-Iraq BIT,¹²³ the share of South-South BITs out of the global BIT landscape remained rather small until the mid 1990s, after which an increase in South-South investment flows and revived efforts to improve South-South cooperation began a pro-active effort of many developing countries to expand their BIT-networks with other developing countries.¹²⁴ Today, almost 40% of all BITs are between developing countries; an astonishing share given that BITs were

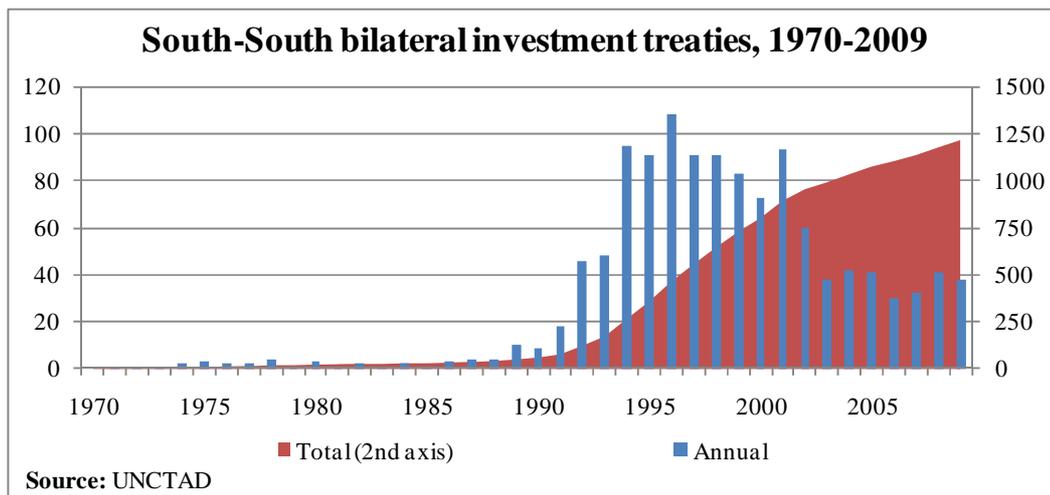
¹²² A. Gunawardana, ‘The Inception and Growth of Bilateral Investment Promotion and Protection Treaties,’ 86 *ASIL Proceedings* 544 (1992), at 546.

¹²³ This BIT reflected the general trend of early South-South BITs, namely that they tended to be concluded between geographically close countries to promote investment between neighbouring countries. See; UNCTAD, *South-South Cooperation in International Investment Agreements* (New York: UNCTAD, 2005), at 14-15.

¹²⁴ UNCTAD, *World Investment Report 2005* (New York: UNCTAD, 2005), at 24

initially tailored to protect Western investors in the developing world (Figure 4.4).¹²⁵ With only few exceptions,¹²⁶ these treaties are very much similar to ‘normal’ North-South BITs in their provisions on treatment and protection of established foreign investors.

Figure 4.4. The rise of South-South BITs



That said, BIT-negotiations between developing countries do of course not preclude coercion from having taken place. When a country like China negotiates an investment treaty with small investment-hungry African states, surely this must be expected to be largely on China’s terms. However, even among South-South BITs, a remarkably high share involves parties with hardly any commercial links at all and therefore with less possibility for bilateral coercion. Table 4.5 illustrates this trend by listing South-South BITs signed in 1996, where none of the parties are large capital exporters, such as Mexico, China, Malaysia, Saudi Arabia, Russia, or India. Large developing country capital exporters are here defined as countries, whose outward FDI stock were either in the top 10 in a given year among developing countries, or top 10 using average and median shares from 1980 to 2009. The table shows that countries like Bulgaria and Morocco, Uruguay and the Czech Republic, and Lebanon and Ukraine have signed investment treaties with each other. In such cases, it is difficult to see how coercive

¹²⁵ Note that UNCTAD lists a much smaller share, as it distinguishes between developing countries and transition economies.

¹²⁶ L. Poulsen, ‘The Significance of South-South BITs for the International Investment Regime’ 30 *Northwestern Journal of International Law and Business* 1 (2010).

mechanisms should have been in play, which illustrates yet again that in recent decades in particular, developing countries have themselves strongly supported the BIT-movement.

Table 4.5. BITs among developing countries which are not major capital exporters, 1996

Country I	Country II	Ratified ID	ID II	Ratified ID	ID II	Ratified
Algeria	Jordan	1997	Cuba	Venezuela	2004	Kyrgyzstan Uzbekistan .
Algeria	Mali	1999	Czech Rep.	Kazakhstan	1998	Lao Vietnam 1996
Algeria	Vietnam	.	Czech Rep.	Uruguay	2000	Latvia Lithuania 1996
Armenia	Georgia	1997	Egypt	Jordan	1998	Latvia Uzbekistan 1997
Armenia	Turkmenistan	.	Egypt	Lebanon	1997	Lebanon Ukraine 2000
Azerbaijan	Georgia	1996	Egypt	Sri Lanka	1998	Macedonia Poland 1997
Azerbaijan	Iran	2002	Egypt	Turkey	2002	Nigeria Turkey .
Azerbaijan	Kazakhstan	.	Egypt	Yemen	1998	Pakistan Syria 1997
Azerbaijan	Uzbekistan	1996	El Salvador	Peru	1996	Pakistan Tunisia .
Barbados	Cuba	1998	Estonia	Latvia	1996	Paraguay Venezuela 1997
Belarus	Bulgaria	1997	Georgia	Kazakhstan	1998	Peru Venezuela 1997
Belarus	Czech Rep.	1998	Georgia	Turkmenistan	1996	Romania Uzbekistan 1997
Bosnia	Iran	2000	Iran	Kazakhstan	1999	Sri Lanka Thailand 1996
Bulgaria	Croatia	1998	Iran	Kyrgyzstan	2005	Syria Yemen 2005
Bulgaria	Moldova	1997	Iran	Turkey	2005	Tajikistan Turkey 1998
Bulgaria	Morocco	2000	Iran	Turkmenistan	2004	Turkey Ukraine 1998
Bulgaria	Vietnam	1998	Iran	Ukraine	2004	Turkmenistan Uzbekistan 1996
Croatia	Macedonia	2002	Iran	Yemen	2000	Uzbekistan Vietnam 1998
Cuba	Romania	1997	Kazakhstan	Romania	1997	

Notes: The table lists South-South BITs signed in 1996. It excludes BITs signed by large developing country capital exporters: Argentina, Brazil, China, Chile, Hungary, India, Indonesia, Malaysia, Mexico, Panama, Russia, Saudi Arabia, and South Africa.

Source: UNCTAD

Conclusion

Although the origin of BIT-standards might have been imposed on the developing world during the colonial encounter, this does not appear to be the case in recent decades. Here, developing countries have typically been more than willing to sign up to broad investor protections in BITs, whether with Western countries or among themselves. Clearly one cannot reject the possibility that unequal bargaining power have led certain developing countries to sign a BIT in order to avoid diplomatic or economic repercussions from capital-exporting states or the international financial institutions. In fact, after considerable efforts I was able to find an example of somewhat coercive means being used to finalize a BIT-

negotiation. As a general explanation for the BIT-movement, however, coercion is entirely unconvincing. As will become clear in later chapters also, the spread of investment treaties is a process which to a considerable extent has been driven by developing countries themselves, particularly in recent years. Here, practically all developing country governments have rushed to follow international trends, even those which are neither weak nor structurally dependent on aid flows.

5. A quest for legitimacy?

Policies typically diffuse when they ‘resonate’ with already accepted normative frameworks.¹ One explanation for the spread of BITs could therefore rely on norm emulation, with norms understood as ‘*collective expectation about proper behavior for a given identity*.’² Of course, one could argue that unlike human rights treaties, for instance, BITs were actually rather poor public relations instruments, as they were typically signed entirely under the radars of public discourse and received little attention by parliaments, the press, or the public at large. As noted by Montt, BITs have been one of those ‘*supranational governance activities*’ that ‘*go virtually unnoticed*’.³ As will also be clear from later chapters, only few paid much attention to BITs before the early 2000s with the possible exception of treaties entered into with the United States. That said, BITs did not go unnoticed by the World Bank, for instance, and practically all developed countries had BIT-programs during the 1990s, so they could have been one of a range of instruments used by developing countries to adhere to prevailing global norms.

This is the argument of Jandhyala, Henisz, and Mansfield, who conclude that BIT-adoption during the 1990s reflected a ‘norm cascade’.⁴ But while based on a sophisticated analysis, the authors rightly conclude that their:

‘... empirical tests have relied on inference rather than direct examination. Instead of directly examining the motivations of adopters, we have tended to infer these motivations from other characteristics A more granular approach ... would greatly enhance our understanding of micro-processes and mechanisms.’⁵

¹ E.g.; M. Keck and K. Sikkink, *Activists Beyond Borders: Advocacy networks in international politics* (Ithaca: Cornell University Press, 1998), at 204.

² R. Jepperson, A. Wendt, and P. Katzenstein, ‘Norms, Identity, and Culture in National Security,’ in: P. Katzenstein (ed.) *The Culture of National Security: Norms and Identity in World Politics* (New York: Columbia University Press, 1996).

³ D. Esty, ‘Good Governance at the Supra-National Scale: Globalizing Administrative Law,’ 115 *Yale Law Journal* 1490 (2006), at 1509. Quoted in: S. Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Portland: Hart Publishing, 2009), at 143.

⁴ S. Jandhyala, W. Henisz, and E. Mansfield, ‘Three Waves of BITs: The Global Diffusion of Foreign Investment Policy,’ *Journal of Conflict Resolution* (forth., 2011.).

⁵ *Ibid.*, at 22.

One way to do this is to investigate the actual justifications given for investment treaties during this period. For if, as the authors argue, BITs were signed less for instrumental than normative reasons, then this is also how they should have been justified.

This will be investigated in this chapter, which will be in three parts. The first will briefly address two norms potentially important for the spread of BITs in the 1990s, neoliberalism and legal internationalism. The second section will ask, whether we can identify a considerable effort on the part of some actors promoting BITs in normative terms. While I have already addressed a number of BIT-advocates in the last chapter – the World Bank, the United States, Germany, etc. – they all primarily promoted the treaties in instrumental terms.⁶ However, when the diffusion of BITs reached a ‘tipping point’ after which they began to spread like wild-fire, i.e. the early 1990s, it follows from the norm emulation model that external actors could have assisted in a socialisation process, justifying BITs in highly normative terms. This could take place both through ‘strategic framing’ of BITs, where some actors may attempt to achieve their ends by using norms manipulatively, or through *bona fide* persuasion, where actors have promoted BITs without any inherent gains involved.

I will focus on two potential norm-entrepreneurs. The first is the United Nations (UN) and the second is the Western community of private investment lawyers and arbitrators. Unlike many of the actors investigated in the last chapter - which of course were crucial for the spread of neoliberalism as the broader policy framework for the BIT-movement (see below) - neither had the opportunity to coerce developing countries into signing BITs. Yet, both were important in

⁶ With respect to the United States, only its Eastern European BITs and the BIT with Argentina were explicitly promoted in normative terms as symbolising that they had embraced a market-oriented economic policy and abandoned the Calvo doctrine, respectively, see; K. Vandeveld, ‘U.S. Bilateral Investment Treaties: The Second Wave,’ 14 *Michigan Journal of International Law* 621 (1992-1993). The same has the World Bank: see e.g.; MIGA PAS, *Industrialized Countries' Policies Affecting Foreign Direct Investment in Developing Countries, Volume I* (Washington DC: World Bank, 1991), at 31; and ICSID, R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (Hague: Martinus Neijhof, 1995), at 12 and 156. Finally, as a group, developed countries have also primarily advanced the view that BITs could promote investment flows, see e.g.; OECD, *Intergovernmental agreements relating to investment in developing countries* (Paris: OECD, 1985), par. 89; OECD, *User Guidance for the PFI investment policy questions* (Paris: OECD, 2010), at 27.

spreading support for the treaties and they are thereby useful to isolate the potential role of normative persuasion. Finally, if state identity has been an important explanatory factor for BIT-diffusion, we should also be able to trace a ‘discourse trail’ among developing countries themselves justifying BITs in normative terms. This will be investigated in the third and final part of the chapter.

Before proceeding, it is worth noting that the aim is to investigate, whether signing investment treaties as a particular and specific policy model was promoted, and justified, as a normative rather than instrumental choice. A broader question will not be dealt with here, namely the role of state identities when liberal investment regimes and legal internationalism became popular norms in the 1980s and, particularly, 1990s. This opens up for the possibility that norm-entrepreneurs could have been instrumental in persuading developing countries to embrace neoliberalism as a policy norm, for instance, yet *not* justified BITs in normative terms. Similarly, while a commitment to international law could potentially be explained with a normative framework, governments’ decision to sign BITs may nevertheless have followed a logic of consequences based on their (socially constructed) interests, such as attracting international investors.⁷ In other words, even if BITs have been promoted and justified in instrumental terms, this does not rule out that a constructivist framework has value in explaining the broader contours of international investment policies, where BITs are only one constituent part, albeit an important one.

A second caveat is that while the chapter points to the need for further reflection on the role of ‘epistemic communities’ and ‘advocacy networks’ in the international investment regime, the primary focus here is on discourse, rather than the actors themselves. Some basic reflections on the background and ideas of organisations advising developing country governments is necessary, but the intent is not to investigate their motives in any detail.

⁷ Suffice it to say, this raises the more than thorny question about the relationship between interests and ideas, rationalism and social constructivism. For a useful (and pragmatic) discussion, see; J. Fearon and A. Wendt, ‘Rationalism v. Constructivism: A Skeptical View,’ in: W. Carlsnaes T. Risse, and B. Simmons (eds.) *Handbook of International Relations* (London: SAGE, 2002).

5.1. Which norms?

Neoliberalism

Kathryn Sikkink noted in her innovative study of development policies in Brazil and Argentina that ‘international investment [can] be perceived as an opportunity or as a danger, depending on the ideas held by policymakers.’⁸ In this respect, a key norm – or ‘causal belief’⁹ – underlying the modern BIT-regime is undoubtedly that international investments are in fact desirable for development.¹⁰ Surely, it is no coincidence that the BIT-movement was at its peak when the neoliberal ideals underlying the Washington Consensus were the predominant development discourse.¹¹

In fact, attracting FDI was perhaps *the* most widely accepted part of the Washington Consensus agenda. Compared to short-term capital flows, for instance, direct foreign investments were considered the ‘safe’ source of finance for developing countries irrespective of political outlook.¹² Fair and equitable treatment of foreign investors, compensation for expropriation at fair market value, and non-discrimination – all are principles that were not just enshrined in BITs, but also in the vast majority of national investment codes and practices during this period.¹³ And while domestic investment reforms could of course in some circumstances have been directed by Western pressure, this has not been the main driver. When the World Bank Guidelines were adopted, there was wide-

⁸ K. Sikkink, *Ideas and Institutions: Developmentalism in Brazil and Argentina* (Ithaca: Cornell University Press, 1990), at 19.

⁹ J. Goldstein and R. Keohane, ‘Ideas and Foreign Policy: An Analytical Framework,’ in: J. Goldstein and R. Keohane (eds.) *Ideas and Foreign Policy: Beliefs, Institutions, and Political Change* (Ithaca, Cornell University Press, 1993).

¹⁰ Vandervelde (1998), *op cit.*

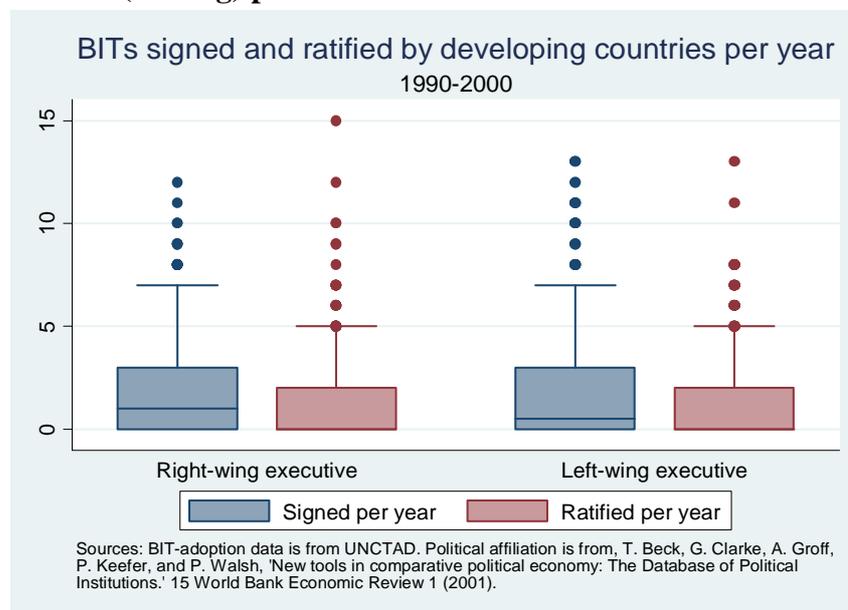
¹¹ J. Yackee, ‘Are BITs such a bright idea? Exploring the ideational basis of investment treaty enthusiasm,’ 12 *U.C. Davis Journal of International Law and Policy* 195 (2005).

¹² Note that liberalization of short-term capital flows was actually not on Williamson’s initial list comprising the Washington Consensus, yet it was promoted by the Washington Institutions.

¹³ J. Alvarez, ‘A BIT on Custom,’ 42 *New York University Journal on International Law and Politics* 17 (2009), at 52-56. In fact, whereas the first modern investor-state arbitration was based on rights similar to those enshrined in BITs, its jurisdiction was based on the Egyptian investment law; *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/84/3.

spread consensus on their value, and the Chairman of the Third World Forum wrote to Shihata at the time, that ‘*for once, I will be defending the views of the Bretton Woods Institutions.*’¹⁴ So even though later chapters will show that many countries have been distressed when realizing the potentially broad scope of some BIT provisions - or even the very fact that they could be taken to international arbitration - most BITs reflected broader simultaneous changes in national investment policies from the late 1980s onwards.¹⁵ In turn, this means that it is actually not too surprising that there has been no marked ‘partisan bias’ in BIT-adoption during the time they proliferated (Figure 5.1).¹⁶

Figure 5.1. The (lacking) partisan bias of BITs



Yet, for countries wanting to truly display their commitment to economic liberalism not just in domestic laws but also when meeting with foreign leaders, BITs could have been useful as they presented themselves, ‘*as quintessentially liberal documents.*’¹⁷ In their preambles, BITs almost always cite the creation of

¹⁴ I. Shihata, *Legal Treatment of Foreign Investment: The World Bank Guidelines* (Washington DC: World Bank, 1992), at 147.

¹⁵ A. Gunawardana, ‘The Inception and Growth of Bilateral Investment Promotion and Protection Treaties,’ 86 *ASIL Proceedings* 544 (1992), at 550.

¹⁶ See also; J. Yackee and L. Keele, ‘The Partisan Bias of Bilateral Investment Treaties,’ paper presented at the 2008 Annual Meeting of the Midwest Political Science Association, Chicago. See also chapter nine.

¹⁷ K. Vandeveld, ‘The Political Economy of a Bilateral Investment Treaty,’ 92 *American Journal of International Law* 4 (1998), at 627-628. Note that with respect to the substance of BITs,

favourable investment conditions as their main goal. In fact, based on the belief that foreign investments are crucial to promote economic prosperity, this is often the *only* purpose cited, and typically no qualifications are made that such investments such be ‘sustainable’ for instance. As an example, the Sri Lankan model BIT used during the 1990s simply stated that,

‘Desiring to create conditions favourable for greater investment by investors of one Contracting Party in the territory of the other Contracting Party;

Recognizing that the encouragement and reciprocal protection under international agreement of such investments will be conducive to the stimulation of individual business initiative and will increase prosperity in both States;’¹⁸

As noted by Peterson, investment treaties have thereby typically ‘*been drafted in narrow, uni-dimensional terms, with treaty preambles hailing the need to enhance economic cooperation and create a favourable investment climate, and often little else in the way of broader policy objectives.*’¹⁹

But while BITs may have been an important ‘*institutional partner*’ of neoliberalism,²⁰ this doesn’t necessarily mean this is how they have been justified in practice. The question here is not whether neoliberal norms have been important for the spread of BITs. They undoubtedly have, but this is not a surprising or particularly informative point in and by itself. Rather the question is whether, as Vandeveldel suggests, the treaties have in fact been signed ‘*because they symbolize a commitment to economic liberalism.*’²¹

Vandeveldel argues that several aspects depart from the liberal economic model, such as the lack of liberalization provisions. ‘*BITs were intended to affirm liberalism, even if they were not primarily liberal documents.*’ (fn. 77).

¹⁸ Sri Lanka Model BIT, included in; UNCTAD, *International Investment Instruments: A Compendium*, vol. 5 (Geneva: United Nations, 2000). See also e.g. Egyptian Model BIT in same publication.

¹⁹ L. Peterson, *Bilateral Investment Treaties and Development Policy-Making* (Winnipeg: International Institute for Sustainable Development, 2004), at 23. See also; A. van Aaken, ‘Opportunities for and Limits to an Economic Analysis of International Law,’ *University of St. Gallen Law and Economics Working Paper*, No. 2010-09, 2010. Compare also the preamble of BITs with the first two sections of the WTO preamble, for instance, which refers both to ‘*full employment*’, an ‘*objective of sustainable development*’, as well a need ‘*to protect and preserve the environment*’ and ‘*positive efforts designed to ensure that developing countries ... secure a share in the growth of international trade.*’

²⁰ D. Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy’s Promise* (Cambridge: Cambridge University Press, 2008), at 41-42, at 2.

²¹ Vandeveldel (1998), *op. cit.*, at 628.

Investigating this question admittedly takes us into a methodological grey area. On the one hand, justifying BITs by their potential to increase foreign investment simultaneously signal that developing countries belong to a group of states believing foreign investments are in fact worth pursuing. Yet, as noted by Gurowitz,

‘Spotting identity as a constraint means looking for statements like: ‘*we cannot do X because we are a liberal democracy,*’ and ‘*we must do Y because we are a global power.*’²²

Translated into our context: if participation in the BIT-movement became one of those things (self-identified) market-oriented governments were *supposed* to do, we should be able to identify a communication trail, where advocates of the treaties and developing countries themselves justified BITs not just by their potential for attracting investments, but in more normative terms. If state identity has played crucial roles, we should be able to find statements along the lines of ‘*as a state committed to economic globalization we sign BITs*’ or in the case of BIT advocates, ‘*as a state committed to economic globalization you should sign BITs.*’

Legal internationalism

Investment treaties did not just match neoliberal ideals after the end of the Cold War, following the terminology of Razeen Sally they also represented a ‘liberalism from above’, i.e. the belief that inter-governmental treaties are effective and crucial instruments in achieving a liberal international economic order.²³ Rather than alleviating domestic root-causes of investment protectionism, BITs give international investors rights that often go over and beyond domestic laws. The most important right, of course, is that rather than relying on domestic courts, investors can sidestep them and instead rely on an adjudicative mechanism on the international plane. This fitted well with the growing prominence of

²² A. Gurowitz, ‘The Diffusion of International Norms: Why Identity Matters,’ 43 *International Politics* 3 (2006).

²³ R. Sally, *Classical Liberalism and International Economic Order* (London: Routledge, 2002).

international law as a governing institution during the 1990s.²⁴ Here, augmented levels of interdependence and the growth of transnational regimes and institutions made it increasingly difficult to uphold the domestic/international distinction, facilitating what Koh observed as '*the era of global law in which we now live*'.²⁵

Nowhere was the move towards international law as predominant as in the economic sphere. Here, the WTO not only established a legalized dispute settlement mechanism but also moved far 'behind the borders' subjecting domestic regulation to international disciplines in areas such as intellectual property rights, service provision, and technical standards. Indeed, a former chairman of the Appellate Body of the WTO saw one of his functions as moving the world a little closer to Grotius' ideal international legal order.²⁶ So in this sense, Montt reminds us that the '*BIT generation is not a completely unique case in the history of modern international law and institutions.*'²⁷

In fact, the arbitration mechanism in modern investment treaties went considerably further than the WTO, or indeed any other international adjudicative mechanism. If investment treaty arbitration was to become a guiding principle for international law, surely a number of pertinent questions would arise. Van Harten is worth quoting at length,

'For what reasons and in what circumstances should individuals [then, ed.] be allowed to make such claims? Should foreign migrant workers be able to claim damages against states that deny them access to the same benefits and protections as domestic workers? Should refugees be able to initiate claims against states that unlawfully refuse to accept them? Should indigenous peoples be treated as subjects of international law with the right to make claims against states that expropriated their lands? ... With the notable exception of the European Union, states have resisted allowing individuals to make international claims against them and, since states are the only actors with the authority to change customary rules of international law, such reforms have not been forthcoming. This is why the

²⁴ E.g.; H. Koh, 'Review Essay: Why do nationals obey international law?' 106 *Yale Law Journal* 2599 (1997). See also; M. Kumm, 'The Legitimacy of International Law: A Constitutionalist Framework of Analysis,' 15 *European Journal of International Law* 5 (2004); J. Goldstein, M. Kahler, R. Keohane, A.-M. Slaughter, 'Introduction: Legalization and World Politics,' 54 *International Organization* 3 (2000).

²⁵ Koh, *op. cit.*, at 2630.

²⁶ J. Bacchus, 'Groping Towards Grotius: The WTO and the International Rule of Law,' 44 *Harvard International Law Journal* 2 (2003)

²⁷ Montt, *op. cit.*, at 129.

authorisation by states of international claims by investors is so groundbreaking.²⁸

Yet this unique feature of BITs in a public law context is also what makes them symbolically useful. BITs had the potential to send a very strong signal that adopting countries belonged to the group ‘law abiding’ nations, and they could do this without having to grant all the legal rights Van Harten mentions above, which in many cases would – right or wrong - be much more politically sensitive.

This raises the question, similar to the one above, whether developing countries have signed BITs not so much to attract foreign investment or achieve other strategic goals, but rather to signal their adherence to an international rule of law.²⁹ Surely, from a functional perspective rule of law institutions can be critical to promote foreign investments, or indeed any market-based transactions.³⁰ But taking a limited perspective focusing solely on discourse, the question is whether the (instrumental) aim of attracting foreign investment has been at the forefront, or the treaties have been presented as part of broader normative endeavor to establish a ‘just’ and ‘fair’ international legal order.

5.2. Were BITs framed in normative terms by BIT-advocates?

As a first step to investigate these questions, I will focus on the UN as a BIT-advocate that could have assisted in a socialisation process by framing BITs in ways that fitted with underlying policy norms.

²⁸ G. Van Harten, ‘Private authority and transnational governance: the contours of the international system of investor protection,’ 12 *Review of International Political Economy* 4 (2005), at 603. See also; G. Van Harten and M. Laughlin, ‘Investment Treaty Arbitration as a Species of Global Administrative Law,’ 17 *European Journal of International Law* 121 (2006), at 149.

²⁹ For a discussion of the rule of law concept in the context of international law, see e.g.; D. Dyzenhaus, ‘The Rule of (Administrative) Law in International Law,’ 68 *Law & Contemporary Problems* 127 (2005).

³⁰ Within the economics discipline, Douglass North is a classical proponent of this view but it has long roots, see e.g.; A. Smith (1776), *An Inquiry into the Nature and Causes of the Wealth of Nations*, edited by E. Channan (Chicago: University of Chicago Press, 1976), in particular, Book IV, ch. IX and Book V, ch. III.

5.2.1 The United Nations

UNCTC and the shifting norms towards multinationals

The UN has played a central role in the modern international investment regime, starting with its Centre on Transnational Corporations (UNCTC).³¹ Established in 1974, UNCTC evolved directly out of the NIEO movement and was as such primarily concerned with protecting the interests and sovereignty of the developing countries in their engagement with foreign investors.³² High priority was given to achieve a multilateral investment agreement in the shape of a Code on Transnational Corporations,³³ which apart from standards on the rights of multinationals vis-à-vis their host states (as in BITs) was intended to incorporate standards on investors' own obligations (as many investor-state contracts, but unlike BITs).³⁴ BITs, however, were not on the agenda within the first years of UNCTC's existence, and delegations noted in 1983 that the treaties appeared to have been overlooked in the organization's work on international investment rules.³⁵

This prompted UNCTC to initiate an annual update to its member states on issues pertaining to international investment agreements, including BITs. But while the first report was somewhat sceptical towards BITs,³⁶ and criticised by some UN delegates to be unduly biased against the treaties (undoubtedly from OECD countries),³⁷ its message began to change in subsequent years. Both in 1986 and

³¹ Note that the UN's Industrial Development Organisation (UNIDO) was also involved in promotion of industrial projects by foreign investors in developing countries, for instance by establishing a network of Investment Promotion Services, see; I. Shihata, 'Promotion of Foreign Direct Investment - A General Account, with Particular Reference to the Role of the World Bank Group,' 6 *ICSID Review - Foreign Investment Law Journal* 486 (1991), at 493-494.

³² T. Sagafi-Nejad, *The UN and Transnational Corporations: From Code of Conduct to Global Compact* (Bloomington: Indiana University Press, 2008), ch. 5.

³³ *Ibid.*

³⁴ See; United Nations Draft International Code of Conduct on Transnational Corporation, 23 *ILM* 626 (1984).

³⁵ UNCTC, 'Report on Ninth Session,' Official Records of the Economic and Social Council, 1983, Supplement No. 7a, E/C.10/1983/15, at 15.

³⁶ UNCTC, 'Bilateral, regional and international arrangements on matters relating to transnational corporations,' Official Records of the Economic and Social Council, 1984, E.C.10/1984/8, at 8.

³⁷ UNCTC, 'Report on the Tenth Session,' Official Records of the Economic and Social Council, 1984, Supplement No. 8, E/C.10/1984/20, at 20. See also; UNCTC, 'Report on the Eleventh

two years later in the first UNCTC report dedicated solely to BITs, the treaties were still considered only one of several factors influencing investors' decision-making process as in its report two years earlier, but for some countries they were now presented as a '*decisive element in attracting foreign capital to a country where it would not otherwise go.*'³⁸ Yet, this conclusion was based solely on an OECD report, which didn't actually present any evidence to sustain it.³⁹ Similarly, while the first report stated bluntly that BITs were not '*balanced*', since they didn't include obligations for foreign investors,⁴⁰ later reports were much softer in tone, raising considerable counterarguments to this allegation despite no additional information about the implications of the treaties compared to the early 1980s.⁴¹

The background for UNCTC's emerging change in attitude towards BITs was the larger shift within the UN system trying to reestablish itself at the centre of the international investment policy-making after having been associated with the NIEO since the 1970s.⁴² As the attitude towards FDI became increasingly positive in development-circles during the 1980s, any staunch opposition to investment treaties would have placed the organization outside the mainstream on this issue compared to its stakeholders.⁴³ This was reflected internally in the organization as well. As one who contributed significantly to its work put it:

'Within the UNCTC there were very different views as to how favorable these treaties were for developing countries. But the earlier skepticism of the organization gradually subsided up through the 1980s, partly because of changes in staff.'⁴⁴

Session,' Official Records of the Economic and Social Council, 1985, Supplement No. 8, E/C.10/1985/19, at 22-23.

³⁸ UNCTC, *Bilateral Investment Treaties* (New York: United Nations, 1988), at 11.

³⁹ OECD, *Intergovernmental agreements relating to investment in developing countries* (Paris: OECD, 1985), at 24.

⁴⁰ UNCTC (1984), *op. cit.*, at 7.

⁴¹ UNCTC (1988), *op. cit.*, at 75-76.

⁴² Sagafi-Nejad, *op. cit.*; R. Rothstein, *Global Bargaining: UNCTAD and the Quest for a New International Economic Order* (Princeton: Princeton University Press, 1979).

⁴³ See generally; Sagafi-Nejad, *op. cit.*, at 209-211.

⁴⁴ Not for attribution telephone interview, March 2010. See also, I. Taylor and K. Smith, *United Nations Conference on Trade and Development* (UNCTAD) (New York: Routledge, 2007), ch. 5.

Similarly, in the early years of UNCTC the organization always had its Code of Conduct to compare the treaties with to stress that the lack of investor obligations in BITs made them much less attractive to developing countries. As discussions over the Code stalled, however, a long-standing staff member notes that '*BITs were all that was left, so this is where we focused our attention.*'⁴⁵ The head of the organization at the time concurs: '*it became increasingly difficult for us to advise against the bilateral treaties, as we suddenly didn't have much of an alternative to offer.*'⁴⁶ So while BITs – or BIT-like standards – had earlier been contested in the UN on occasion, and UNCTC staff had the necessary expertise and information to document the potential downsides of the treaties, the shift in attitude meant that opposition to BITs lost its organizational platform towards the late 1980s.

A few years later, the UNCTC report 'The Determinants of Foreign Direct Investment' thus stated that:

'it seems unnecessary, perhaps undesirable, for developing countries to attempt to present distinctive unilateral policies on political risk, beyond perhaps *a normal embracing of bilateral investment protection treaties* and comparable multilateral programs. This should serve as a *routine backdrop to a more positive focus on the economic environment for foreign direct investment.*'⁴⁷

While the report rigorously analyzed the survey and econometric evidence on FDI determinants, no analysis or new studies were used to conclude that BITs provided a positive economic environment for FDI.⁴⁸ So even though no new information had become available on the investment impact of BITs, the message to developing countries from the key international organization involved in information dissemination on BITs was nevertheless clear: while not quoting any surveys, investor interviews, or quantitative studies, BITs had by the early 1980s gone from being legal instruments without any real economic benefits for

⁴⁵ UNCTC official I.

⁴⁶ UNCTC official II.

⁴⁷ UNCTC, *The Determinants of Foreign Direct Investment: A Survey of the Evidence* (New York: United Nations, 1992), at 61 (italics added). See also; UNCTC, 'International, framework for transnational corporations,' Official Records of the Economic and Social Council, 1993, E/C.10/1993/8, at 21.

⁴⁸ It simply made reference to an overview article of BITs, which itself had no evidence that BITs helped developing countries attract FDI: H.-M. Burkhardt, 'Investment Protection Treaties: Recent Trends and Prospects,' 41 *Aussenwirtschaft* 99 (1986).

developing countries to ‘a routine backdrop’ stimulating a favorable economic environment to attract foreign capital.

But although the shifting normative framework towards international investments made UNCTC change its position on investment treaties, it never evolved into an actual norm-entrepreneur. UNCTC was never responsible for the *emergence* of BIT-movement, as this happened well before the agency got involved. So while UNCTC may have been important in spreading support for BITs, it only speeded up a process that was already underway. Also, rather than advocating BITs, as norm-entrepreneurs would be expected to do, UNCTC hesitantly supported them in order to conform to international trends.⁴⁹ It didn’t have an actual ideological commitment to the treaties and therefore also never tried to persuade developing countries into signing them. In fact, when offering to produce a model BIT, some members strongly opposed it so as to limit UNCTC’s influence.⁵⁰ While it is not clear from public records, it was almost surely the United States, which had a long-standing resistance towards the UNCTC.⁵¹ Finally, it is important to note, that when the organization occasionally gave its cautious support for the treaties, it was always in instrumental and somewhat mundane terms, in that they could assist in promoting investment flows and make PRI more readily available. In 1986, for instance, UNCTC noted that access to (cheaper) PRI was a key economic benefit of BITs, ‘*the existence of a bilateral agreement with the respective host country is very often a pre-condition for political risk insurance by the investor’s home country.*’⁵² We saw in the last chapter that this message was not exactly accurate.

⁴⁹ See generally; Finnemore and Sikkink, *op. cit.*, at 897-898.

⁵⁰ UNCTC, ‘Other international, regional and bilateral arrangements and agreements related to transnational corporations,’ Official Records of the Economic and Social Council, 1991, E/C.10/1991/9, at 7-8; UNCTC, ‘Report on the thirteenth session,’ Official Records of the Economic and Social Council, 1987, Supplement No. 9, E/C.10/1987/16, at 25.

⁵¹ Taylor and Smith, *op. cit.*, at 69; Sagafi-Nejad, *op. cit.*, at 119-120.

⁵² UNCTC (1986), *op. cit.* at 23. See also, UNCTC (1988), *op. cit.* at iv (‘*The existence of a bilateral investment treaty is often the condition for national insurance against such political investment risks as dispossession, impossibility of currency transfer and war damage.*’).

UNCTAD as a BIT-advocate

In the early 1990s, the United States managed to facilitate an organizational shift within the UN system, with the UN Conference on Trade and Development (UNCTAD) taking over from the UNCTC to handle all research and capacity building activities pertaining to FDI promotion and protection.⁵³ Like UNCTC, UNCTAD had no resemblance to international financial institutions such as the World Bank or the IMF. It was explicitly created as developing countries' organizational platform in the global economy and therefore also historically associated with the NIEO. For this reason, it had not been an instrument of power of the United States, which during the 1980s was not only critical towards UNCTC but also blamed UNCTAD for being 'ideological'.⁵⁴ Yet, while the United States successfully managed to install a new management within UNCTAD in the end 1980s/early 1990s, which was more attuned to neoliberal ideas,⁵⁵ it would be an exaggeration to see it as an instrument of Western hegemony to the same extent as some may argue the World Bank has been. Finally, UNCTAD wasn't even a formal organization in that it only had status as a permanent forum, a 'conference,' and therefore only had expertise and persuasion as instruments to encourage developing countries to follow its advice.

To an even greater extent than UNCTC, UNCTAD had also moved away from its earlier skeptical stance towards FDI. By the early 1990s, UNCTAD fully endorsed the Washington Consensus view on foreign investments, seeing them as engines of growth for developing countries.⁵⁶ As mentioned, this view was partly due to a change in staff, but also based on the realisation that this was the only way the organization could survive.⁵⁷ The organization quickly became the leading international agency dealing with FDI regulation in developing countries.

⁵³ See generally; Sagafi-Nejad, *op. cit.*, at 121-122.

⁵⁴ Taylor and Smith, *op. cit.*

⁵⁵ *Ibid.*

⁵⁶ UNCTAD, *World Investment Report 1992* (Geneva: United Nations, 1992), at iii.

⁵⁷ Taylor and Smith, *op. cit.*

Skeptics even began referring to UNCTAD as the ‘Global OECD’,⁵⁸ and the ongoing discussions for a Multilateral Agreement on Investment (MAI) in the actual OECD made its services and expertise particularly relevant for the developing world.⁵⁹ For although developing countries were not part of the MAI negotiations several participated as observers and all were eventually intended to sign up to the treaty.

Partly due to NGO pressure, however, developed countries failed to agree to the MAI,⁶⁰ which led UNCTAD to shift its focus to BITs. At this time, UNCTAD was the only organization, which offered extensive capacity building services pertaining directly to BITs. Through numerous courses and publications from the latter half of the 1990s, its investment treaty secretariat thereby became instrumental in alerting developing countries of the importance of various provisions, understanding the nature of investor-state arbitration, and so forth.⁶¹ Yet, this is not its only legacy. In a 2005 external evaluation report, for instance, two thirds of developed country negotiators noted that because of UNCTAD’s work over the years, they had witnessed ‘*a positive change in their developing country negotiation partners’ ability to engage in discussions and/or negotiations of IIAs over time.*’⁶² And they were not only referring to greater quality of decision-making, but also a more positive attitude towards BITs.

⁵⁸ M. Finger and B. Ruchat, *The Transformation of International Public Organizations: The Case of UNCTAD*, Working Paper of IDHEAP 14/2000 (Lausanne: Institut de Hautes Etudes en Administration Publique, 2000), at 9.

⁵⁹ C. Wilkie, ‘FDI, development and investment rules: a critique of the UNCTAD Series on Issues in International Investment Agreements,’ 10 *Transnational Corporations* 135 (2001), at 137-139. In the Midrand meeting in 1996, UNCTAD was for instance charged with ‘Identifying and analysing implications for development of issues relevant to a possible multilateral framework on investment, beginning with an examination and review of existing agreements, taking into account the interests of developing countries ...’; UNCTAD, *Midrand Declaration and Partnership for Growth and Development*, Adopted at the Ninth session, Midrand, 27 April 1996. See also; Fredriksson and Zimny, *op. cit.*; Wilkie, *op. cit.*; Taylor and Smith, *op. cit.*, at 27.

⁶⁰ A. Walter, ‘NGOs, business and international investment rules: MAI, Seattle and beyond,’ 7 *Global Governance* 51 (2001).

⁶¹ For an overview by some of the main UNCTAD officials involved, see; A. Joubin-Bret, M.-E. Rey, and J. Weber, ‘International Investment Law and Development,’ in: M.-C. Segger, M. Gehring, and A. Newcombe (eds.) *Sustainable Development in World Investment Law* (Alphen aan den Rijn: Kluwer, 2010) at 25-30.

⁶² O. Karsegard, P. Bravo, and H. Blom, *UNCTAD work programme on capacity building in developing countries on issues in international investment agreements: Final in-depth evaluation report* (Geneva: United Nations, 2006).

In fact, UNCTAD itself actively facilitated the signing of BITs. While not itself participating in negotiations, UNCTAD promoted the process by bearing the costs of travel, full board and lodging for developing country officials as well as organizing the necessary facilities and substantive support.⁶³ Between June 2000 and July 2005, nine such events led to 160 BITs signed between 60 developed and developing countries - almost one fourth of all BITs signed between 2000 and 2005 - and several countries noted that many of them would not have been signed without UNCTAD's assistance (see Table 5.1).⁶⁴

Table 5.1. UNCTAD's BIT facilitation rounds and signing ceremonies

Date	Activity	Place	Participating countries
19 - 30 June 2000	Facilitation round	Sapporo, Japan	Cambodia, Colombia, Croatia, Egypt, Ghana, India, Indonesia, Iran, Lao, Myanmar, Peru, Philippines
15 - 19 January 2001	Facilitation round for Kyrgyzstan	Geneva, Switzerland	Austra, Denmark, Kyrgyzstan, Latvia, Sweden
24 Januar - 3 February 2001	Facilitation round for Francophone LDCs	Geneva, Switzerland	Beglium, Benin, Burkina Faso, Burundi, Cameroon, Chad, Comoros, Egypt, Ghana, Guinea, Libya, Madagaskar, Mali, Mauritania, Mauritius, South Africa, Switzerland, Zambia
29 - 28 February 2001	Facilitation round for India	New Delhi, India	China, Croatia, India, Ethiopia, Yemen
19 - 28 April 2001	Facilitation round for Croatia	Dubrovnik, Croatia	Belarus, Croatia, Latvia, Malta, Moldova, Pakistan
18 May 2001	Signing ceremony	Brussels, Belgium	Belgium, Benin, Burkina Faso, Burundi, Cambodia, Cameroon, Chad, Comoros, Croatia, Ghana, Guinea, Mali, Mauritania, Mauritius
1 - 6 October 2001	Facilitation round for LDCs	Bonn, Germany	Belgium, Cambodia, Eritrea, France, Malawi, Mozambique, Netherlands, Sudan, Sweden, Uganda, Zambia
4 - 13 November 2002	Facilitation round for LDCs	Geneva, Switzerland	Belgium, Benin, Burkina Faso, Burundi, Cambodia, Cameroon, Canada, Chad, Egypt, France, Gabon, Guinea, Guinea-Bisseau, Korea, Lebanon, Mali, Mauritania, Netherlands, Senegal, Togo
20 June - 4 July 2003	Facilitation round for LDCs	Geneva, Switzerland	Barbados, Belgium, Botswana, China, Egypt, Ethiopia, Finland, France, Ghana, Italy, Lesotho, Malawi, Mauritius, Switzerland, Tanzania, Uganda, Zimbabwe
2 - 6 February 2004	Facilitation round for Francophone LDCs	Brussels, Belgium	N/A
15 June 2004	Signing ceremony	Sao Paulo, Brazil	Benin, Chad, Guinea, Lebanon, Mauritania, Switzerland

Source: Compiled from; O. Karsegard, P. Bravo, and H. Blom, *UNCTAD work programme on capacity building in developing countries on issues in international investment agreements: Final in-depth evaluation report* (New York: United Nations, 2006).

'In our two weeks here we managed to finalize five agreements,' said the head of the Philippine delegation during the 'Sapporo round' for instance, 'which is far

⁶³ *Ibid.*

⁶⁴ *Ibid.*, at 4 and 14.

*more than we could otherwise have done in two years.*⁶⁵ Not only UNCTAD,⁶⁶ but also its external evaluators highlighted these sessions as a great success at the time due to the economies of scale involved in having BIT negotiations centralized leading to considerable cost-savings for the countries involved.⁶⁷

But while UNCTAD was thereby instrumental in speeding up the diffusion of BITs, this does not in and by itself make it an actual socialising agent, as understood by Finnemore and Sikkink. Its positive attitude towards the treaties was almost always based on the assumption that they were useful instruments to attract foreign investment and only on rare occasions were they justified in normative terms. In its World Investment Reports, for instance, UNCTAD occasionally presented the treaties as part of an ‘*appropriate FDI framework*’⁶⁸ for developing countries, but this was an exception. Mostly, BITs were described as instruments that did not necessarily have much to say about FDI incentives,⁶⁹ but which could nevertheless contribute to a successful FDI ‘*performance*.’⁷⁰ As in other of its publications, UNCTAD presented BITs as ‘*important signals concerning a country’s investment climate*,’⁷¹ and as such partly responsible for ‘*the strong growth of FDI*.’⁷²

The first major UNCTAD study to test the credibility of such statements came in 1998 with what was the first (publicly available) econometric attempt to estimate the impact of BITs.⁷³ The results were discouraging, though, as they found no real impact. UNCTAD must be credited for publishing an analysis that apparently

⁶⁵ Quoted in, UNCTAD, 22 *Bilateral Investment Treaties Signed at Sapporo (Japan)*, TAD/INF/PR/048 29/06/00 (2000).

⁶⁶ UNCTAD, *Progress report: Work undertaken within UNCTAD's work programme on international investment agreements between the 10th Conference of UNCTAD, Bangkok, February 2000 and July 2002* (Geneva: United Nations, 2002), at 9.

⁶⁷ Karsegard, Bravo, and Blom, *op. cit.*, at 14. UNCTAD (2002), *op. cit.*, at 9.

⁶⁸ UNCTAD, *World Investment Report 1996* (Geneva: United Nations, 1996), at 61.

⁶⁹ UNCTAD, *World Investment Report 1995* (Geneva: United Nations, 1995), at 302.

⁷⁰ UNCTAD, *World Investment Report 1997* (Geneva: United Nations, 1997), at xxi.

⁷¹ UNCTAD (1996), *op. cit.*, at 147; UNCTAD, ‘Current international arrangements governing foreign direct investment,’ 1 August 1996, TD/B(43)/5, at 6.

⁷² UNCTAD, ‘Draft Report of the Commission on Investment, Technology and Related Financial Issues on its third session,’ 17 September 1998, TD/B/COM.2/L.7, at 2.

⁷³ UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (Geneva: United Nations, 1998a), ch. 4.

contradicted some of its statements with respect to the investment promotion potential of BITs, yet the report did go to great lengths to stress that BITs probably could be important drivers of investments nevertheless, for instance by facilitating the purchase of PRI.⁷⁴ Also, in the press release to the first BIT-facilitation event in Geneva, UNCTAD commented on the (undoubtedly uncomfortable) fact that the organisation had just released a study showing no great causal link from BITs to FDI:

‘While an analysis of FDI flows between signatory countries shows that the influence of BITs on FDI is, in fact, weak, BITs are nevertheless increasingly regarded by foreign investors as an expected component of a country’s investment environment. In many cases, they have become a *sine qua non* for the availability of political-risk insurance. An international comparison of FDI determinants leads to the overall conclusion that other determinants of FDI flows such as the size of the host country’s market are more decisive than BITs in influencing FDI flows. But as countries around the world compete for FDI as part of their development efforts, all other conditions being equal, *the presence of a BIT can help tilt the balance in investors’ locational decisions.*’⁷⁵

Similarly, UNCTAD noted in the same context that by ‘*signing BITs between themselves, developing countries are sending a strong signal of their commitment to provide a predictable, stable and reliable legal environment for foreign direct investors, to stimulate investors’ confidence, and boost FDI flows.*’⁷⁶ This understanding of the treaties was shared by participating countries as well. In the same press release, a representative from Jamaica noted about the initiative that the ‘*conclusion of BITs will facilitate FDI between member countries of the G-15, in the mutual interest of promoting our development.*’⁷⁷

In recent years, UNCTAD has also strongly encouraged developing countries to enter into BITs with the same argument. Table 5.2 below lists a sample of UNCTAD’s recommendations to developing countries in its Investment Policy Reviews.

⁷⁴ Ibid., at 142.

⁷⁵ UNCTAD, ‘UNCTAD hosts bilateral investment treaty negotiations by group of fifteen countries,’ press release, 7th January, 1999.

⁷⁶ Ibid.

⁷⁷ Ibid.

Table 5.2. Excerpts from UNCTAD's 'Investment Policy Reviews' relating to BITs

Country	Year	Comment on BITs	Pages
Ecuador	2001	<i>Foreign investors do not perceive [Ecuadorian investor-state contracts, ed.] as a useful instrument and tend to prefer guarantees offered by bilateral investment treaties as well as regional and multilateral arrangements.... The broadening of bilateral investment treaty partners should be another task of immediate priority. In this regard UNCTAD's expertise and special scheme could facilitate the conclusion of such treaties.</i>	57, 92
Ghana	2003	<i>Ghana's network of BITs remain fairly small, and efforts should be made to expand it.</i>	28
Nepal	2003	<i>Nepal should ... consider two actions: (a) if changes to the foreign investment law are being made it could take the opportunity to modernize the treatment and protection provisions to reflect the BIT terms; and (b) it could develop a wider BIT network to entrench these assurances. It should be a priority to conclude a modern BIT with India.</i>	31
Lesotho	2003	<i>There is ... a miniscule network of bilateral investment treaties (BITs), which are used by countries to protect foreign investors and ensure their adequate treatment.</i>	23
Kenya	2005	<i>[Kenya should, ed.] [n]egotiate and ratify additional BITs with key FDI source countries.</i>	58
Rwanda	2006	<i>Overall, Rwanda's network of BITs is extremely limited. Additional BITs could reassure foreign investors unfamiliar with Rwanda and provide extra certainty in what is a "frontier territory" for most people.</i>	34
Nigeria	2006	<i>The official explanation for the low rate of [BIT, ed.] ratification is the lack of action by treaty partners. However, the process of seeking ratification within Nigeria is not proactive and not well organized. In this respect, a more coordinated and energetic approach on the side of the Nigerian BIT negotiators should be considered, both to (a) obtain ratification of negotiated BITs with strategic partners such as South Africa or China; and (b) conclude new BITs with countries that are emerging as potentially large investors in Nigeria in the short to medium run, such as India.</i>	27
Colombia	2006	<i>Given the considerable effort taken in its design [of a model BIT, ed.], the Government should ensure that it is used as a launch pad for a new round of BIT negotiations as a mechanism to improve investment protection and investment promotion.</i>	22
Botswana	2006	<i>Extension of the BIT network is desirable; it should be guided by two principles: (i) It should be proactive in supporting specific initiatives to attract FDI. The most obvious initiative is the International Financial Services Centre (IFSC). An expanded BIT network with neighboring countries would support this initiative if the BITs were to contain extensive funds' repatriation provisions. ...; and (ii) Otherwise it should be reactive by relying on requests from governments whose investors place great importance on having BITs in place... This sparing approach should ensure that once a request is made, there is capacity to respond with impressive speed. To this end, UNCTAD's forum for BIT negotiations could be utilized.</i>	29
Zambia	2007	<i>Zambia should ratify its outstanding BITs and negotiate agreements with countries from which most of its FDI originates, the United Kingdom and South Africa.</i>	62
Sierra Leone	2010	<i>In order to close the gap and create a more conducive environment for investment, the current policy of promoting FDI from different sources should target the negotiation of BITs with countries that have the potential to become important sources of FDI.</i>	25

Source: UNCTAD's Investment Policy Reviews.

Where justification for its encouragement to sign BITs is given, it is again based on the argument that they can contribute to investment inflows.⁷⁸ So although UNCTAD has indeed been an important facilitator of BITs, this has primarily based on the instrumental reasoning that BITs could assist developing countries in attracting FDI. Although more detailed studies of the organization's work with investment treaties may very well reveal a normative commitment to the treaties as a governing institution, UNCTAD's discourse has been consequentialist: '*sign BITs to get FDI*'.

5.2.2. Private lawyers

I turn now to another potential category of norm-entrepreneurs in the international investment regime, namely Western private lawyers. Lawyers have of course always been at the heart of the regime. As noted in the last chapter, the content of the almost 3,000 investment treaties as well as the generally recognised rules and principles of investment arbitration cannot be understood without reference to the work of civil servants like Lord Shawcross, Aron Broches, and Ibrahim Shihata, for instance. Today, however, it is increasingly private lawyers, rather than public officials, that are having a transformative impact on the architecture of the international investment regime. In the increasing number of investment treaty claims over often sensitive areas of public regulation private lawyers often play a dual role. By acting as both legal counsel and arbitrator, controversy has erupted over the potential conflicts of interests involved, when arbitrators themselves may have a vested interest in promoting a legal regime favourable to foreign investors.⁷⁹ While still controversial, this point is beginning to be accepted, and

⁷⁸ See also; UNCTAD, *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries* (Geneva: United Nations, 2009), ('[BITs, ed.] add a number of important components to the policy and institutional determinants for FDI, and thereby contribute to enhancing the attractiveness of countries. In particular, they improve investment protection and add to the security, transparency, stability and predictability of the investment framework... Developing countries have concluded BITs as part of their desire to improve their policy framework in order to attract more FDI and benefit from it.', at xii and 29).

⁷⁹ G. Van Harten, *Investment treaty arbitration and public law* (Oxford: Oxford University Press, 2007); D. Hranitsky and E. Romero, 'The 'Double Hat' Debate in International Arbitration,' *New York Law Journal*, June 14th 2010.

acted upon, amongst the international legal community.⁸⁰ But yet another potential conflict of interest appears to have gone almost completely unnoticed. Because apart from interpreting investment treaties, when representing clients or serving as arbitrators, prominent investment lawyers from private firms often also advise governments on whether, and how, such treaties should be drafted in the first place.

Private lawyers have been not only been used as experts UNCTAD's technical assistance programs, for instance, they have also acted as advisors to developing countries on their investment treaty policies.⁸¹ This delegation of a public service is notable. Because the more countries signing investment treaties allowing investors recourse to international arbitration, the more claims will be brought, and the more contracts will be available for counsellors and arbitrators alike. So although this has never actually been subject to considerably scrutiny, the triple role of investment lawyers – as counsel, arbitrator, and government advisor – is potentially important, since prominent lawyers working with investment treaties may have been co-architects of an international legal order, which in turn provides the market for their own legal services.⁸²

When advancing BITs, the legal industry has occasionally presented the treaties as part of a broader, and legitimate, movement towards international law as a governing mechanism. The late Thomas Wälde is a case in point. Before he became a leading investment lawyer and arbitrator, Wälde advised over 60 developing countries on their investment policies during his career at the UN.⁸³ He was always clear in his support of investment treaties, and this support was

⁸⁰ For instance, having noted this conflict of interest, one ICSID arbitrator has decided not to accept new instructions to act as counsel in ICSID cases; see homepage of Philippe Sands, at: www.matrixlaw.co.uk.

⁸¹ See below as well as chapter nine. It should also be noted that a well-known phenomenon within the field of international arbitration is private lawyers seeking academic teaching positions and publications as a way to cultivate an intellectual image, which in turn can assist them in getting appointed as arbitrators. Also there, lawyers have been in a unique position to shape the causal beliefs and normative positions of the future guardians of the investment regime within governments and international organizations; see here generally; M. Larson, *The Rise of Professionalism* (Berkeley: University of California Press, 1978).

⁸² For a parallel development in the field of international commercial arbitration, see; Y. Dezalay and B. Garth, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order* (Chicago: Chicago University Press, 1996).

⁸³ See, www.dundee.ac.uk/cepmlp/staff/twalde.php (last accessed 5 January 2011).

occasionally justified with the argument that investment protection treaties were part of a broader international law effort, ‘to create equal rules for all, to tame the natural asymmetry of sheer power with rules and procedure’ and ‘to create prosperity and peace to prevent a new Hitler or Stalin from emerging.’⁸⁴

Judge Stephen Schwebel is another example. While serving for the American government, Schwebel was deeply involved in the American opposition towards the NIEO movement playing out in the UN, and after having served at the International Court of Justice, Schwebel has acted as arbitrator and counsel in numerous investment treaty claims.⁸⁵ Schwebel has moreover been used recently by the American government in work on its BIT-model, where he deplored the ‘regressive’ development, when the model was weakened from the perspective of foreign investors.⁸⁶ More generally, Schwebel has referred to BITs as ‘an ideal law for foreign investment.’⁸⁷ And in an article called ‘The Overwhelming Merits of Bilateral Investment Treaties’, he argues that the institutionalization of investor-state arbitration in BITs has been,

‘...one of the most important progressive developments in the procedure of international law in all its history. It is a development that is consistent with the advancement of human rights internationally, including the right to own and enjoy the use of property. It is consonant with broader international trends that have dethroned the State as the sole subject of international law.’⁸⁸

Finally, Judge Charles N. Brower is another case in point. Brower also has a background in the United States government, and he has served as a judge in the Iran-United States Claims Tribunal as well as in numerous investment treaty arbitrations as both counsel and arbitrator. Like Schwebel, Brower has argued that

⁸⁴ T. Wälde, ‘The Present State of Research Carried Out by the English-Speaking Section of the Centre for Studies and Research,’ in P. Kahn and T. Wälde (eds.) *New Aspects of International Investment Law* (Hague: Martinus Neijhoff, 2007).

⁸⁵ Note that considerable controversy erupted when Poland challenged Schwebel’s impartiality as an arbitrator in the *Eureka* case; D. Vis-Dunbar and L. Peterson, ‘Belgian Appeals Court Rejects Poland’s Challenge to Arbitrator in Eureka Case,’ *Investment Treaty News*, Nov. 15, 2007.

⁸⁶ Schwebel’s comments are available at: www.state.gov/e/eeb/rls/othr/2009/131118.htm#9 (last accessed 11 January 2010). See also; S. Schwebel, ‘The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law,’ in: G. Aksen, K.-H. Bockstiegel, M. Mustill, P. Patocchi and A. Whitesell (eds), *Global Reflections on International Law, Commerce and Dispute Resolution: Liber Amicorum in Honour of Robert Briner* (Paris: ICC Publishing, 2005).

⁸⁷ S. Schwebel, ‘The Influence of Bilateral Investment Treaties on Customary International Law,’ 98 *American Society of International Law Proceedings* 27 (2004), at 28.

⁸⁸ S. Schwebel, ‘The Overwhelming Merits of Bilateral Investment Treaties,’ 32 *Suffolk Transnational Law Review* 263 (2008-2009), at 267.

BITs are inherently legitimate instruments. Based on Thomas Franck's work on legitimacy in international law, he has portrayed investment treaties as advancing the role of arbitrators, who '*through their independent and impartial application of the governing law, foster the international rule of law ...*'⁸⁹ In another context Brower has similarly noted that subjecting public regulation to international investment arbitration means that, '*the rule of law will be realized, and thus strengthened for the future.*'⁹⁰ Also here, BITs are presented as much more than mere mundane economic instruments to promote investment flows.⁹¹

That said, even within the legal industry, BIT-advocacy has often been based on at least some element of economic instrumentalism. Jan Paulsson is a good illustration. Paulsson is, or has been, president for several arbitration organizations, including the International Council for Commercial Arbitration and the London Court of International Arbitration. He is a university professor, for instance at the London School of Economics, and has advised several governments on their investment treaty policies.⁹² And whereas Paulsson has also promoted the view that BITs are essential rule-of-law instruments,⁹³ he ultimately states that '*[t]he occasional costs of having offered international protection of investors' rights appear miniscule compared to the macroeconomic effects of the treaty overall.*'⁹⁴ While he is not of the view that BITs will promote investments in and of themselves, they are essentially justified as being part a broader effort of

⁸⁹ C. Brower and S. Schill, 'Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law,' 9 *Chicago Journal of International Law* 471 (2009), at 497.

⁹⁰ C. Brower and L. Steven, 'Who Then Should Judge? Developing the International Rule of Law under NAFTA Chapter 11,' 2 *Chicago Journal of International Law* 193 (2001), at 202.

⁹¹ Note that among the younger generation of arbitrators, the same view is being promoted on occasion. One example is Zachary Douglass, who along the same lines argues that the guiding principles of investment treaty arbitration should not just be the '*the promotion of foreign investment or respect for sovereign authority in the abstract*' but rather '*the principles of justice and fairness and the international rule of law...*'; Z. Douglas, 'Nothing if Not Critical for Investment Treaty Arbitration: Occidental, Eureka and Methanex,' 22 *Arbitration International* 27 (2006), at 27.

⁹² Paulsson advised Mexico on the negotiation of NAFTA's chapter 11, and officials in both Pakistan and South Africa note that he gave advice on their BIT-policies as well after having acted as counsel in investment treaty disputes.

⁹³ J. Paulsson, 'The Power of States to Make Meaningful Promises to Foreigners,' 1 *Journal of International Dispute Settlement* 2 (2010), at 346.

⁹⁴ J. Paulsson, *Denial of Justice in International Law* (Cambridge: Cambridge University Press, 2005), at 240

investment protection, which can ‘*convince investors to invest for the longest time possible and for the lowest possible return.*’⁹⁵

Daniel Price is another example. Before joining private practice as both counsel and arbitrator in investment treaty disputes, Price was USTR’s lead negotiator of NAFTA and Assistant to the President and Deputy National Security Advisor for International Economic Affairs in the George W. Bush administration. Price has always been clear that BITs are crucial instruments to sustain large levels of foreign investment flows.⁹⁶ Any weakening of BIT standards, according to Price, create:

‘... no discernible benefits but imposes real costs. Our standard of living and economic growth are increasingly dependent on cross-border investment. Our companies, entrepreneurs, workers and shareholders have billions of dollars at risk abroad and are thus the principal beneficiaries of current investment rules. Any dilution of these rules may simply result in U.S. multinationals moving economic activity to other jurisdictions - e.g., the United Kingdom, Germany, the Netherlands - whose treaty network retains strong protections.’⁹⁷

Dolzer – another noticeable figure in the arbitration industry with a background in the German government – argues that, ‘*bilateral investment treaties are an agreed set of rules that serve to attract foreign investment*’⁹⁸ So while BITs may reflect broader norms of legal internationalism, they are essentially commercial instruments to promote FDI. Finally, it is worth noting that the same view has come out of professional legal organizations. The ICC - which apart from being a

⁹⁵ Paulsson (2010), *op. cit.*, at 347.

⁹⁶ Note, that after his career within the American administration, Price has promoted this view also on behalf of American business. ‘Testimony of Daniel Price On Behalf of the United States Council of International Business,’ *House of Representatives Committee on Ways and Means Subcommittee on Trade: Hearing on the Outcome of the Summit of the Americas and Prospects for Free Trade in the Hemisphere*, 8 May, 2001. Reprinted in: *27 Canada-United States Law Journal* 313 (2001)

⁹⁷ D. Price, ‘Keep International Protections,’ *The Washington Times*, 14 May, 2009. See also Van Harten’s comments on Price, *op. cit.*, at 26-27.

⁹⁸ R. Dolzer, ‘The Impact of International Investment Treaties on Domestic Administrative Law,’ *26 New York University Journal of International Law and Policy* 953 (2005), at 953-954. See also; T. Weiler, ‘NAFTA Investment Arbitration and the Growth of International Economic Law,’ *36 Canadian Business Law Journal* 405 (2002), at 435; P. Juillard, ‘Bilateral Investment Treaties in the Context of International Investment Law,’ OECD Roundtable, Dubrovnik, Croatia, 28-29 May, 2001, at 6. Note also that despite occasional normative references, Wälde too relied on the functional argument that without investment treaties providing a ‘rule of law’ for foreign investors, developing countries would have difficulties in attracting foreign investment; Wälde (2006), *op. cit.*, at 461.

business organization also provides arbitration services - has primarily advocated in favour of the treaties on the basis that they are strategic instruments to protect and promote investments,⁹⁹ and so has the American Bar Association (ABA).¹⁰⁰

So from their unique position in the international investment regime to promote the popularity of BITs, private investment lawyers have thereby used both normative and instrumental arguments in favor of the treaties. On the one hand, the treaties have been presented as part of a broader, and just, movement towards the protection of individual rights under international law. This is reflected also in their role as arbitrators, where the fair and equitable treatment standard, for instance, has occasionally been presented as allowing for '*justice to be done*'¹⁰¹ or '*servicing the purpose of justice*'.¹⁰² On the other hand, many tribunals have also ascertained the basic purpose of BITs in highly instrumental terms. Rather than lofty ideals of international justice, the tribunal in *Siemens A.G. v. Argentina* noted for instance that the BIT:

'... is a treaty 'to protect' and 'to promote' investments. The preamble provides that the parties have agreed to the provisions of the Treaty for the purpose of creating favorable conditions for the investments of nationals or companies of one of the two States in the territory of the other State. Both parties recognize that *the promotion and protection of these investments by a treaty may stimulate private economic initiative and increase the well-being of the peoples of both countries. The intention of the parties is clear. It is to create favorable conditions for investments and to stimulate private initiative.*'¹⁰³

This approach has been followed by other tribunals as well,¹⁰⁴ and follows the instrumental discourse of many prominent arbitrators, presenting BITs in similar

⁹⁹ See ICC, *op cit.*

¹⁰⁰ A. Rovine, 'Report on Bilateral Investment Treaties,' 21 *The International Lawyer* 274 (1987), at 274, 277

¹⁰¹ *PSEG Global Inc et al v. Turkey*, ICSID Case No ARB/02/05, Award, 19 January 2007, par. 239.

¹⁰² *Sempra Energy International v. Argentina*, ICSID Case No ARB/02/16, Award, 28 September 2007, par. 300.

¹⁰³ *Siemens A.G. v. Argentina*, Decision on Jurisdiction, 3 Aug. 2004, at par. 81. Italics added.

¹⁰⁴ E.g.; *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction, 29 Jan. 2004, par. 116 (the BIT '*is a treaty for the promotion and reciprocal protection of investments. ... It is legitimate to resolve uncertainties in its interpretation so as to favor the protection of covered investments.*'); *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award, Dec. 08, 2003, par. 307 ('*the BIT itself is a document that requires certain treatment of investment which the parties have considered necessary to 'stimulate the flow of private capital'*').

terms as UNCTAD, namely as useful to assist developing countries in attracting foreign capital.

The case of CEELI

A notable and illustrative example took place in Eastern Europe in the 1990s, where the United States became deeply involved in promoting BITs in the former Communist bloc.¹⁰⁵ The process was backed up by the United States Agency for International Development (USAID), which played a key role in promoting investment protection reforms through the Eastern European Democracies program¹⁰⁶ and its funding of the Commercial Law Development Program run by the Commerce Department.¹⁰⁷ More important in this context, however, was USAID's support to the Central and Eastern European Law Initiative (CEELI), organized by private lawyers of the ABA. While a massive effort to promote investor-friendly reforms in the former Communist bloc, it has unfortunately been completely overlooked in existing accounts of the international investment regime.¹⁰⁸

Eastern and Central European countries were desperate for CEELI assistance on how to introduce the rule of law after communism,¹⁰⁹ and CEELI analyses were all extremely detailed and competent, which was helpful for legislators and government officials lacking expertise in drafting laws and regulations to promote

¹⁰⁵ Vandeveld (1993), *op cit.*

¹⁰⁶ 'Support for East European Democracy (SEED) Act,' USAID, available at: www.usaid.gov/locations/europe_eurasia/countries/cz/seed_act.html (accessed 4 March 2010). On USAID activities generally, see for instance; USAID, *USAID FY 1997 Congressional Presentation* (last modified 24 March 1999). Available at: <http://www.usaid.gov/pubs/cp98/index.html> (accessed 4 March 2010). See also; J. deLisle, 'Lex Americana? United States Legal Assistance, American Legal Models, and Legal Change in the Post-Communist World and Beyond,' 20 *University of Pennsylvania Journal of International Economic Law* 179 (1999), at 185-188.

¹⁰⁷ Its Commercial Law Development Program (CLDP) has arranged seminars and training sessions since the early 1990s, many of which has dealt with investment protection and arbitration (see: www.cldp.doc.gov).

¹⁰⁸ I would like to thank Philippe Sands, QC, for drawing my attention to this point.

¹⁰⁹ See generally; DeLisle, *op. cit.*; 'The History of CEELI, the ABA's Rule of Law Initiative, and the Rule of Law Movement Going Forward (panel debate)' 18 *Minnesota Journal of International Law* 304 (2009).

FDI. And while some recommendations were clearly inspired by for instance NAFTA's Chapter 11, others were careful not to simply 'import' investment laws and regulations into economies with different legal traditions and capacities.¹¹⁰

FDI promotion was an explicit goal of CEELI, and the organization repeatedly argued that in order to stimulate inward investment, governments would be well-advised to enter into BITs and, more generally, give investors access to international arbitration clauses, for instance with reference to ICSID.¹¹¹ But although one lawyer promoted BITs explicitly to spread 'libertarian ideas and practices',¹¹² and on at least one occasion included references to libertarian writers such as Hans-Herman Hoppe and Murray Rothbard,¹¹³ this was an exception. Another lawyer used by CEELI notes that, '*in order to attract investments from abroad, developing countries need to enter into BITs and be signatories to the ICSID convention. So this naturally played a role in the advice I gave.*'¹¹⁴ For instance, in the input given to the Lithuanian Chambers of Commerce and Industry, CEELI therefore noted that in order to '*be successful in attracting foreign capital*', Lithuania should '*enter into BITs with the U.S. and other Western States.*'¹¹⁵ Also the Albanian government was urged to negotiate BITs by CEELI lawyers,¹¹⁶ who forwarded the text of several US BITs for inspiration.¹¹⁷

¹¹⁰ See for instance the highly critical comments by CEELI lawyers on an overwhelmingly complex investment law drafted for the Lithuanian government by the United Nations Development Programme (UNDP), which was almost exactly similar to Canada's investment act despite the fact that Lithuania did not have a common law tradition. UNDP had drafted it in such a hurry that they even forgot to remove Commonwealth references to 'Her Majesty'; CEELI, *Analysis of Two Draft Proposals on Foreign Investment for Lithuania* (Washington DC: American Bar Association, 1993).

¹¹¹ See e.g.; N. Kinsella, 'Draft Law on Stimulation of Foreign Investment for the Republic of Romania,' Memorandum to Mr. John C. Knechtle, Director, Legal Assessments, ABA/CEELI, March 25 1997.

¹¹² CEELI lawyer I.

¹¹³ CEELI, *Analysis of the Draft Law on Foreign Investment Activities in Nizhny Novgorod Oblast* (Washington DC: American Bar Association, 1996), fn. 19.

¹¹⁴ CEELI lawyer II.

¹¹⁵ N. Kinsella, 'Comments on Draft Project of Law on Foreign Capital Investment in the Republic of Lithuania,' Memorandum to Mr. M. Černiauskas, President, Association of Lithuanian Chambers of Commerce and Industry, 18 November 1993, at 2-3.

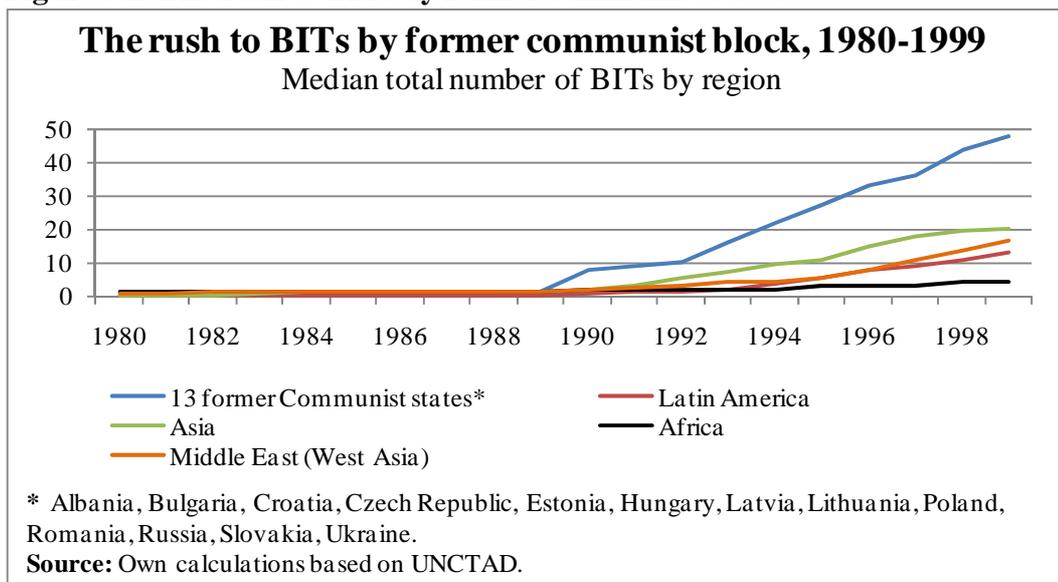
¹¹⁶ International Investment and Development Committee of the American Bar Association's Section of International Law and Practice, 'Preliminary comments of international investment and development committee on draft Albanian foreign investment law,' at 1; in: CEELI, *Analysis of Albania's Foreign Investment Act* (Washington DC: American Bar Association, 1992).

While not mentioning CEELI directly, Philippe Sands notes about the foreign legal advisors at the time that:

*'To encourage foreign investment, Albania was told it would be necessary to promulgate various national laws and investment protection treaties. ... Until the 1990s Albania had no treaties to protect the investments of foreigners. It signed its first one, with neighboring Greece, in August 1991. Twenty-one more were signed within four years.'*¹¹⁸

Generally, it appears that the intense efforts of CEELI bore fruit. In the early 1990s, Eastern European governments rushed to enter into BITs with both the US and other Western states (Figure 5.2).¹¹⁹ So whereas the Communist bloc earlier had been particularly sceptical towards the foreign (Western) investments, its former members now suddenly represented *'the most fertile source of new BIT-partners.'*¹²⁰

Figure 5.2. The rush to BITs by former communist states.



This is notable. For while the lawyers involved in CEELI worked on a *pro bono* basis, it is not difficult to see the potential conflicts of interest: by promoting extensive rights for foreign investors in the region and advising in favor of having

¹¹⁷ *Ibid.*, annex. In other analyses, CEELI forwarded the text of NAFTA's chapter 11 for inspiration; see e.g. CEELI, *Analysis of Amendments to Kyrgyzstan's Foreign Investment Law* (Washington DC: American Bar Association, 1993).

¹¹⁸ P. Sands, *Lawless World* (Penguin Books, 2006), at 118. Italics added.

¹¹⁹ With the exception of Hungary, the United States managed to complete BITs with all countries included in Figure 5.2.

¹²⁰ Vandeveld (1993), at 703.

disputes settled through international arbitration rather than in domestic courts, lawyers working for private firms simultaneously carved out a market for their own legal services to governments or private clients in the future.¹²¹ So while the presence of CEELI and similar organizations was clearly justified by their expertise in capitalist legal systems and most lawyers involved had, and still have, impeccable reputations, the foreign investment reforms - including the encouragement to sign BITs - cannot be said to have been promoted without a degree of vested interest. Whether this conflation of interests was real, as opposed to merely potential, is outside the scope of this study to determine, but as the literature on American legal assistance pointed out long ago:

‘International and national interests, professional and self-interests, developmental and humanitarian interests – the various motives for American legal assistance worked together ... Potential conflicts between interests were overlooked, pushed aside by the implicit celebration of American legal ways.’¹²²

However, what is again important to note is that while some CEELI lawyers may have been involved for ideological reasons, the primary argument presented to Eastern European countries was instrumental in nature: without BITs, it will be difficult to attract foreign investment. As we shall see below, this view of BITs has also been shared by developing countries themselves when justifying their participation in the BIT-movement.

5.3. Developing country justifications for signing BITs

Although there are few records available from the time, the recollection of officials involved in countries that began signing BITs during the 1980s does not

¹²¹ Moreover, through their involvement in the CEELI program, the lawyers also produced a by-product: expertise about foreign investment laws in the countries involved, which gave them a specific advantage for multinationals seeking advice when investing there. For a similar story in the context of the American trade bar and NAFTA, see: D. M. Trubek, Y. Dezalay, R. Buchanan, and J. Davis, ‘Global restructuring and the law: Studies of the internationalization of legal fields and the creation of transnational arenas,’ 44 *Case Western Reserve Law Review* 407 (1994), at 469. For a general discussion of United States legal assistance programs; see e.g. M. Fowler and J. Bunck, ‘Legal imperialism or disinterested assistance? American legal aid in the Caribbean basin,’ 66 *Alabama Law Review* 815 (1992); deLisle, *op cit.*

¹²² J. Gardner, *Legal Imperialism: American Lawyers and Foreign Aid in Latin America* (Madison: University of Wisconsin Press, 1980), at 285.

suggest that state-identity was particularly important. One interesting case was Sri Lanka, which after liberalising its economy in the late 1970s began negotiating BITs.¹²³ Sri Lanka is notable, as it was not only the first country to ever be subject to a BIT-claim,¹²⁴ it was also somewhat unique among developing countries in having a very targeted and informed BIT-strategy, which for instance gave its BITs the force of law directly through its Constitution (once approved by a two-thirds Parliamentary majority).¹²⁵ The reason for signing the treaties, however, was primarily based on economic reasoning. A senior advisor involved at the time notes that '*we began signing BITs as we sought a stable legal environment, and wanted to attract foreign capital.*'¹²⁶ Similarly, a former judge of the Sri Lankan court of appeals noted in the early 1990s that developing countries like Sri Lanka:

'... beset with economic difficulties, have come to realize that one of the best ways in which their economies can be developed is by encouraging foreign investments, and that the bilateral investment treaty is a fine instrument to achieve that objective.'¹²⁷

Other, in fact most, countries had less coordinated BIT-strategies.¹²⁸ There, the decision to enter into BITs often relied on individual agencies or bureaucrats. In Ghana, for instance, a representative who was involved in starting the country's BIT-program, recalls that in the 1980s:

'... we realized the need to enter into BITs, because we had much interference in ownership of companies, expropriations, and so forth, which became an image problem, we wanted to address with BITs. *The treaties were intended to push forward reform, keep politicians on their toes to tell politicians to refrain from doing things, and to assure foreign investors.*'¹²⁹

Ghana's spurt to sign investment treaties in the late 1980s was thereby also justified in instrumental terms. Another example from Africa is the report from Asian-African Legal Consultative Committee on BITs, which also presented the treaties as 'effective' instruments to promote investments:

¹²³ R. Pererra, 'Technical Assistance and Capacity Building, lessons learned from experiences and the way forward,' *Making the Most of International Investment Agreements*, OECD, 12 Dec, 2005.

¹²⁴ See chapter seven.

¹²⁵ Sri Lankan Constitution, art. 157.

¹²⁶ Sri Lanka official I.

¹²⁷ Gunawardana, *op. cit.*, at 546.

¹²⁸ See chapter eight.

¹²⁹ Ghanaian official I. Italics added.

‘Even though several countries offer such safeguards under their constitution or laws, there is a better psychological impact when the investment is made under government to government umbrella agreements. This method has proved to be very effective in recent years and many developed countries accordingly consider such bilateral investment protection agreements to be of considerable importance.’¹³⁰

Also a country like Turkey, which too began to sign investment treaties during the 1980s, is on record stating that:

‘Turkey began to negotiate BITs with a view to *creating and maintaining favourable conditions for foreign investment* to foster its economic growth in the second half of the 1980s, when a liberal and flexible foreign investment policy was adopted as part of the programme of economic transformation which was launched at the beginning of that decade.’¹³¹

Many socialist states also began BIT-programs at this time. While this reflected domestic developments in countries like China and the Soviet Union gradually opening up their economies to foreign investors and accepting international law as a governing institution,¹³² there is no indication that the treaties were justified in normative terms. At least in the case of China, BITs were regarded as useful to convince foreign investors that the opening up of the Chinese economy was ‘real’, because by ‘*committing to international obligations through bilateral agreements, the trust and foreign investors [could] be won.*’¹³³ Secondly, compared with other

¹³⁰ Asian-African Legal Consultative Committee, *Report of the 23rd session, 1983* (New Delhi: Asian-African Legal Consultative Committee, 1983), at 154. Italics added.

¹³¹ Communication from Turkey, WTO Working Group on the Relationship between Trade and Investment, 18 September 1998, WT/WGTI/W/51. Italics added.

¹³² The year before the Soviet Union began signing BITs, Gorbachev gave a remarkable speech in the UN, urging, ‘*the political, juridical and moral importance of the ancient Roman maxim: Pacta sunt servanda! - agreements must be honored,*’ and noted that ‘*[a]s the awareness of our common fate grows, every state would be genuinely interested in confining itself within the limits of international law.*’ Quoted in Koh, *op. cit.*, at fn. 156. There is no indication that the Soviet Union decided to sign BITs as a result of Western norm-entrepreneurs, as it began signing BITs after it liberalised its foreign investment regime but *before* it invited foreign advisors to the country in 1988. Also, when UNCTC and American lawyers produced a 138 report for the Soviet Union with analyses and recommendations, it hardly even mentioned BITs – even when noting the wide range of policy instruments available to attract foreign investments. A. Crevon, ‘Bilateral Investment Treaty Overview – Russian Federation.’ Available at: www.investmentclaims.com; UNCTC, *Joint Ventures As a Form of International Economic Co-operation*, Background Documents of the High-Level Seminar Organized by the United Nations Centre on Transnational Corporations in Co-operation with the State Foreign Economic Commission, and the State Committee on Science and Technology of the Union of Soviet Socialist Republic, Moscow, 10 March 1988 (New York: United Nations, 1988b). On the Soviet BIT negotiations with the United States, which were far ahead in 1991 when the Soviet Union collapsed, see; Vandeveld, *op. cit.*, at 9

¹³³ L. Shishi, ‘Bilateral Investment Promotion and Protection Agreements: Practice of the People’s Republic of China,’ in: P. De Waart, P. Peters, and E. Denters (eds.), *International Law and Development* (Dordrecht: Martinus Neijhoff, 1988), at 165.

international instruments, BITs were seen as allowing ‘*particular conditions with respect to each party*’ and ‘*quite efficient in securing full implementation by the parties of the various provisions set out.*’¹³⁴ Third, the treaties provided protections for Chinese investors investing abroad. Finally, they allowed China to strike the right balance between granting investor rights but at the same time preserving state sovereignty, as the Chinese insisted on having investment disputes adjudicated primarily through domestic remedies.¹³⁵

Although obviously not exhaustive, this indicates that instrumental rather than normative considerations were probably the primary driver, when countries signed BITs during this period. While the broader movement towards neoliberal investment policies may have been justified in normative terms, the discourse surrounding BITs was highly instrumental – ‘*we sign BITs to get X.*’ This does not rule out, of course, that state identities played an important role in the diffusion of BITs in later years. Although not entirely corresponding with the model of Finnemore and Sikkink, Checkel reminds us that policies initially pursued for instrumental reasons can, over time, be pursued without any conscious cost-benefit calculus but primarily due to socialisation and normative internalization.¹³⁶ Yet also during the 1990s - when Jandhyala and collaborators suggest norm-emulation was behind much of the BIT-movement - the ‘communication trail’ suggests that material rather than normative arguments were the main reasons developing countries pursued BITs.

Let us begin with Asia, where in Thailand, for instance, an official involved with the country’s BIT-program notes that ‘*the idea in the 1990s was that we would have more investment if we negotiated those bilateral instruments.*’¹³⁷ And both in Cambodia and Lebanon, BITs were used not so much to signal adherence to global norms but rather as strategic instruments to comfort investors in post-war

¹³⁴ Ibid., at 166.

¹³⁵ Ibid.

¹³⁶ J. Checkel, ‘International Institutions and Socialization in Europe: Introduction and Framework,’ 59 *International Organization* 4 (2005).

¹³⁷ Thai official I.

environments.¹³⁸ Also, even while spear-heading opposition towards multilateral investment rules in the context of the WTO,¹³⁹ India negotiated numerous BITs with one primary aim in mind: to ‘*boost investor confidence*’ and thereby facilitate investment inflows.¹⁴⁰ Finally, even in the case of Pakistan, BITs were not *just* seen as fashion trends – as claimed by Jandhyala, Henisz and Mansfield – but there was also a sincere belief among key policy-makers that the treaties would be important in attracting foreign capital. As one senior official there noted about negotiations during the 1990s, ‘*during the period we signed the treaties a good amount of investment also came, so the BITs worked.*’¹⁴¹ Among some key officials, this perception is still present: ‘*BITs do provide an incentive for foreign investments. They are a commitment to the investor from the state that they can go to arbitration, and it is thereby an investment incentive that we can provide quickly.*’¹⁴²

In Latin America the discourse was largely similar. The Venezuelan UNCTAD representative noted in 1997, for instance, that while BITs should include further FDI-promotion provisions, they ‘*could contribute to attracting FDI*’ even in their traditional form.¹⁴³ In Ecuador as well, officials involved notes that the country began signing BITs during its transition to a market-based regime because ‘*we thought these treaties were very important to attract investments.*’¹⁴⁴ Similarly, a senior Costa Rican representative who negotiated BITs during the 1990s recalls that ‘*we started signing BITs in the mid-1990s because we thought they would be very important tools to attract investments.*’¹⁴⁵ And just as UNCTAD and other

¹³⁸ Cambodian official I; Lebanese official I.

¹³⁹ See particularly; WTO WGTI, *Communication from India*, WT/WGTI/W/86 (2000). (BITs were preferred over a multilateral investment treaty as they give ‘flexibility to a lot of countries enabling them to channel FDI into areas of priority determined by them’). See also; WTO WGTI, Report on the Meeting of 11 October 2000, WT/WGTI/M/12 (2000); WTO WGTI, Report on the Meeting of 7 and 8 March 2001, WT/WGTI/M/14 (2001).

¹⁴⁰ P. Ranjan, ‘Indian Investment Treaty Program in Light of Global Experiences,’ 45 *Economic and Political Weekly* 7 (2010). See also; P. Chidambaram, ‘Foreward,’ in: *India’s Bilateral Investment Promotion and Protection Agreements*, Vol. I (New Delhi: Ministry of Finance, 1997).

¹⁴¹ Pakistani official VII.

¹⁴² Pakistani official V.

¹⁴³ Quote in; UNCTAD, Draft Report of the Commission on Investment, Technology and Related Financial Issues on its Second Session, TD/B/COM.2/L.4/Add.1, 3. October 1997.

¹⁴⁴ Ecuadorian official III.

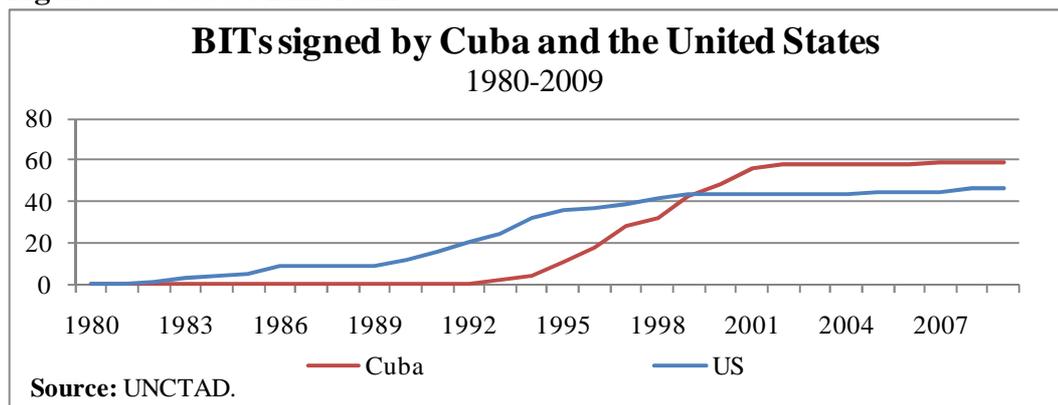
¹⁴⁵ Costa Rican official I. See also; WTO WGTI, Report on the Meeting of 7 and 8 March 2001, WT/WGTI/M/14, 30 April 2001.

organizations stressed that BITs were important for the provision of PRI, this was also one of the main instrumental arguments for Chile to initiate its BIT program for instance. In the *travaux préparatoires* for the Statute approving the ICSID Convention, the President of Chile noted lower insurance premiums as a primary reason not just to sign up to ICSID but also to BITs,

[Concluding BITs and the ICSID Convention, ed.] will permit foreign investors to obtain lower insurance premiums than those actually obtained in the normal situation [without a BIT, ed.]. Therefore, the accession of Chile to this type of treaties would permit the country to keep an advantaged position in order to attract foreign investment.¹⁴⁶

This view was shared by Chilean negotiators as well.¹⁴⁷ Another example is Jamaica, which apart from its 1989 BIT with the UK, began signing numerous BITs in the 1990s. A BIT-negotiator from the time notes that what prompted developing countries like his to agree to BITs was, *‘the pragmatic consideration that they will receive foreign investment from their treaty partners which are usually developed capital exporting States.’*¹⁴⁸ Moreover, even Cuba began signing numerous BITs after Castro embraced foreign investments in the early 1990s.¹⁴⁹ So despite hardly being an easy target for neoliberal propaganda or famous for wanting to ‘look good’ vis-à-vis Western governments, Cuba has today signed even more BITs than its archrival, the United States (Figure 5.3).

Figure 5.3. Cuba’s BIT-rush



¹⁴⁶ Quoted and translated in; Montt, *op. cit.*, at 115.

¹⁴⁷ Interview conducted by Montt referred to in *ibid.*, at 115. See, however, next chapter.

¹⁴⁸ P. Robinson, ‘Treaty Negotiation, Drafting, Ratification and Accession of CARICOM states,’ 18 *West Indian Law Journal* 1 (1993), at 7. Underline added.

¹⁴⁹ J. Pérez-López and M. Travieso-Díaz, ‘The Contribution of BITs to Cuba’s Foreign Investment Program,’ 32 *Georgetown Law and Policy in International Business Journal* 529 (2001).

Finally, in the case of Eastern Europe discussed above, there was also a perception that BITs were important in attracting foreign investments. Although officials in a country like Croatia are reported to have seen BITs purely as instruments to promote diplomatic relations¹⁵⁰, in Estonia, for instance, BITs were signed in the beginning of the 1990s to ‘*promote Estonia as an investment destination*’.¹⁵¹ Similarly, in Czechoslovakia – and later the Czech Republic – officials were even of the view that BITs were a ‘prerequisite’ for Western investors committing capital there.¹⁵²

All in all, this suggests that not only (most) external advocates, but also developing countries themselves mainly justified BITs in instrumental terms, with the primarily – though not only – argument being that the treaties could assist them in attracting foreign investors. This is not to suggest that all developing countries had exactly the same reasons for adopting investment treaties over the last many decades, and surely normative considerations have been relevant on occasion. But it does appear that the most important driver of the BIT-movement was the perception that the treaties were critical to attract FDI. A veteran American BIT-negotiator thus also notes that although the United States did *not* try to promote the view that BITs were crucial for developing countries to attract foreign investments,¹⁵³ developing countries initiated BIT-negotiations with the United States during the 1990s primarily because they thought it would help them attract foreign capital.¹⁵⁴

¹⁵⁰ Croatian official I.

¹⁵¹ Estonian official I.

¹⁵² Czech official I.

¹⁵³ The reason was primarily political, since organised labor groups would have opposed the program, if it was framed as an instrument to increase capital flow abroad; K. Gudgeon, ‘United States Bilateral Investment Treaties: Comments on Their Origin, Purposes, and General Treatment Standards,’ 4 *International Tax and Business Lawyer* (1986), at 112.

¹⁵⁴ Vandervelde (1988), at 212.

Recent BIT-adjustments as a reflection of protectionism?

Finally, it is worth noting that while some lawyers have presented recent adjustments of BITs in favour of host states as a general move towards investment protectionism,¹⁵⁵ this is a questionable analysis. Although outright opposition towards investment treaties has overlapped with anti-capitalist sentiments in parts of Latin America, the gradual rebalancing of the regime has *not* followed partisan or ideological lines. This will be further discussed in later chapters, but a few remarks are worth making here. A country like South Africa, for instance, has become exceptionally sceptical towards BITs in recent years despite no real change in overall policy outlook vis-à-vis international investments.¹⁵⁶ Others, such as Mexico and the Czech Republic, have continued to sign BITs but been much more careful in clarifying and restricting their scope, again despite no real change in their commitment to international investments. Similarly, not all countries sceptical towards neoliberal investment policies have followed the path of countries like Ecuador and Bolivia. A country like Russia, for instance, has become much more wary of international investments,¹⁵⁷ but although some restrictive changes in its BIT-strategy can be traced, Russia has not denounced existing BITs or asked to have them renegotiated.¹⁵⁸ A parallel development has taken place in developed countries. Here, the United States and Canada have scaled back key protections in their BITs, despite a continued commitment to international investments.¹⁵⁹ By contrast, a notable rise in anti-FDI sentiments in a

¹⁵⁵ See e.g. Schwebel, *op. cit.*; Price, *op. cit.*

¹⁵⁶ See chapter 9.

¹⁵⁷ President Putin's own economic ideas on 'resource nationalism' has played a key role, see e.g.; M. Olcott, 'The Energy Dimension in Russian Global Strategy: Vladimir Putin and the Geopolitics of Oil,' Paper prepared for the James A. Baker III Institute for Public Policy, October (2004).

¹⁵⁸ *Russian Bilateral Investment Treaties*, presentation by L. Poulsen, European Center for International Political Economy, November 20, 2008.

¹⁵⁹ Alvarez, *op. cit.*, at 31-9; K. Vandervelde 'A Comparison of the 2004 and 1994 U.S. Model BITs: Rebalancing Investor and Host Country Interests', in: K. Sauvant (ed.) *Yearbook of international Investment Law and Policy 2008/2009* (New York: Oxford University Press, 2009), at 283. In recent years, concerns about foreign acquisitions have risen in United States and Canada, particularly when target firms were considered strategic industries or when investment was facilitated through sovereign or quasi-sovereign entities. Overall, however, this cannot be construed as an outright backlash against multinationals. See; K. Sauvant, 'Driving and Countervailing Forces: A Rebalancing of National FDI Policies,' in: K. Sauvant (ed.), *Yearbook on International Investment Law and Policy 2008/2009* (New York: Oxford University Press, 2009).

country like France has not been associated with any tangible restrictions in its BIT-policy, which continues to rely on protection provisions, which in some ways are more far-reaching than those of the United States.¹⁶⁰ Such variation is difficult to explain with changing norms towards neoliberalism, and later chapters will show that rather than ideology, the availability and processing of information about the risks of BITs have played a key role.

Conclusion

While norms may have played an important part of the overall shift in investment policy principles during the 1980s and 1990s, investment treaties as a particular policy model were most often justified in instrumental terms. By and large, developing countries have joined the BIT-movement in pursuit of self-perceived (and perhaps socially constructed) material interests and in particular in order to attract foreign investments. Similarly, while some corners of the international legal community have presented the treaties as part of a broader movement towards an international rule of law – a ‘liberalism from above’ – such justifications are difficult to find among developing countries themselves.

So while surely a logic of appropriateness must have played an important role in some cases, with BITs signed merely as part of a broader attempt to conform with a neoliberal development agenda or a move towards legal internationalism, this cannot be said to have been the main driver of the BIT-movement. Instead, a competition based approach appears intuitively better to adequately capture the broader dynamics of the diffusion of BITs. So let us proceed by asking whether existing accounts of the BIT-movement are correct, when assuming that by entering into BITs, developing country governments were able to attract or retain greater levels of foreign investment, directly or indirectly. This is an important

¹⁶⁰ Here, calls for ‘economic patriotism’ has led to sustained efforts to prevent foreign firms taking over its national champions (Sauvant, *op. cit.*, at 243), yet French treaties signed over the last couple of years still closely follow the structure and content of BITs as they have been signed over the last several decades. See e.g. BITs with Kenya (2007) and Syria (2009).

question. For as noted by Alvarez in 1992, '*Countries are now turning to BITs in hope of economic benefits; if the benefits fail to materialize, there is the danger of a potent backlash.*'¹⁶¹

¹⁶¹ J. Alvarez, 'Remarks,' 86 *ASIL Proceedings* 551 (1992), at 553.

6. A rational competition for capital (or trade agreements)?

The overarching theme in literature on BIT-diffusion has been that without the treaties developing countries would attract considerably less FDI. Recall, Guzman, for instance, arguing that without BITs, developing countries are not able to make ‘credible commitments’ to foreign investors, and will therefore be less attractive investment destinations.¹ A slight variation of this argument is that even if imperfectly informed investors cannot rely on a BIT for protection, they may nevertheless take them into account as a ‘signal’ that the government is generally committed to treat *all* investors fairly.² As Montt argues, signing BITs with all the risks they entail was the ‘*cost of seeking additional FDI inflows ...*’³

So whether it is by ‘trading sovereignty for credibility’ or providing a general signal to foreign investors, BITs could in theory make developing countries more attractive investment destinations. If so, then it could be perfectly rational for them to sign the treaties to prevent losing out in the race to attract foreign capital. To investigate this claim, the chapter is structured as follows. The first section will review the econometric literature, and the second will review the surveys on the role of BITs for investors’ investment decisions and provide further insights by discussing my interviews with BIT-negotiators from capital exporting countries. The third section will review the claim that BITs provide a ‘stepping stone’ to broader economic integration agreements, which in turn may lead to FDI. The fourth section will discuss the role of BITs for private PRI agencies, again with substantial interview feedback from practitioners. On this basis, the fifth section will compare the role of BITs to alternative risk mitigating

¹ A. Guzman, ‘Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties,’ 38 *Virginia Journal of International Law* 639 (1998).

² E. Neumayer and L. Spess, ‘Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?’ 33 *World Development* 1567 (2005).

³ S. Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Portland: Hart Publishing, 2009), at 128.

instruments for multinationals, such as investor-state contracts; and finally, the last section will conclude.

6.1. Econometric evidence

That BITs can be important for some investors establishing investments abroad is indisputable. This is confirmed by reports of treaty shopping, for instance, where investors choose to invest from countries that have a BIT with the host country rather than investing from their home country.⁴ But the fact that BITs at times can impact how investments are structured does not necessarily imply that these investments would not have taken place in the absence of BITs. Similarly, anecdotal reports that some investors have postponed already planned investments until BITs were in place⁵ do not tell us much about the treaties' impact on the decision to invest in the first place. For host countries wanting to attract investments, therefore, the relevant question is not whether BITs have an impact on the legal structure or timing of investments, but whether they have an impact on their destination and volume.

Practically all studies investigate this question apply econometric techniques. Yet, while most authors may share a quantitative approach as their methodological foundation, many differ starkly in conclusions: some studies find that BITs have a strong effect on international investment flows, some find only a weak effect, and other still find no effect at all. In 2009, however, UNCTAD published a review of econometric studies on the impact of BITs and FDI and concluded that,

⁴ K. Sauvants and L. Sachs, 'BITs, DTTs, and FDI flows: an overview,' in: K. Sauvants and L. Sachs (eds.) *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows* (New York: Oxford University Press, 2009), at lv. Some notable investment treaty claims have dealt with this issue, see e.g., *Aguas del Tunari S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Jurisdiction, 21 October 2005; *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, 29 April 2004; *Phoenix Action, Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, award, 15 April 2009. In practice, though, double taxation treaties will probably be much more important than BITs for most investors' 'choice' of home country. A well-known case in point is the considerable investments into India made through Mauritius, due to the favorable double taxation treaty between the two countries. See e.g. Eduardo Baistrocchi, 'The structure of the asymmetric tax treaty network: theory and implications,' *Bepress Legal Series, Working Paper 1991* (2007).

⁵ UNCTAD quotes a report from Germany suggesting this to be the case; UNCTAD, 'The Impact on Foreign Direct Investment of BITs,' in: Sauvants and Sachs, *op. cit.*, at 347.

‘recent studies published between 2005 and 2008 – based on much larger data samples, improved econometric models and more tests – have shifted the balance towards concurring that BITs do have some influence on FDI inflows from developed countries into developing countries.’⁶

Whether this actually sustains the conclusion that BITs are in fact important for FDI flows is questionable. The most widely quoted recent study that finds a strong effect is the 2005 study of Neumayer and Spess who, based on their panel data analysis, conclude that BITs not only have a substantial impact on investment but can also provide a substitute for poor institutional quality in host countries.⁷

According to them:

‘The message to developing countries therefore is that succumbing to the obligations of BITs does have the desired payoff of higher FDI inflows ... BITs fulfill their purpose, and those developing countries that have signed more BITs with major capital exporting developed countries are likely to have received more FDI in return.’⁸

This naturally provides a strong argument in favor of signing the treaties and appears to back up the claim that BITs are useful legal instruments to attract investment. In his doctoral dissertation, however, Yackee replicates the analysis and shows that the results disappear after conducting slight, but justified, changes in estimation strategy.⁹ Similarly, using more comprehensive tests than that of Neumayer and Spess, Hallward-Driemeier¹⁰ finds little evidence that BITs have stimulated investment flows to developing countries. In contrast to Neumayer and Spess, as well as studies by Grosse and Trevino¹¹ and Gallagher and Birch¹², the results of Hallward-Driemeier are based on bilateral flows and bilateral treaties

⁶ UNCTAD, *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries* (Geneva: United Nations, 2009), at xiii.

⁷ See; Neumayer and Spess, *op. cit.*

⁸ *Ibid.*, at 1582-3.

⁹ J. Yackee, *Sacrificing sovereignty: bilateral investment treaties, international arbitration, and the quest for capital*, PhD-dissertation, University of North Carolina at Chapel Hill, 2007, ch. 4; see also J. Yackee (2009a) ‘Do BITs really work? Revisiting the empirical link between investment treaties and foreign direct investment,’ in: Sauvants and Sachs, *op. cit.*

¹⁰ M. Hallward-Driemeier, ‘Do bilateral investment treaties attract FDI? Only a bit ... and they could bite,’ in: Sauvants and Sachs, *op. cit.*, at 349. Note that Hallward-Driemeier also rejects the suggestion by Neumayer and Spess, - that BITs ‘substitute’ for poor institutional quality in host countries. See; Neumayer and Spess, *op. cit.*

¹¹ R. Grosse and L. Trevino, ‘New institutional economics and FDI location in Central and Eastern Europe,’ in: Sauvants and Sachs, *op. cit.*, at 273.

¹² K. Gallagher and M. Birch, ‘Do investment agreements attract investment? Evidence from Latin America,’ in: Sauvants and Sachs, *op. cit.*, at 295. Note that in a separate set of regressions, Gallagher and Birch *do* look at the impact of U.S. BITs on bilateral flows between Latin American countries and the U.S. (see *infra* note 31).

rather than aggregate flows and the total number of BITs. This is a superior econometric strategy for several reasons, the most important being that it allows for a more accurate separation of the effects of BITs from the strong upward trend in FDI over time. Finally, in a sophisticated study, Aisbett shows that Neumayer and Spess, as well as the 2005 study by Salacuse and Sullivan,¹³ fail to properly take into account the endogenous relationship between BITs and investment flows.¹⁴ When more carefully considering the possibility of reverse causality – that BITs may be signed among countries already exchanging large investment flows – developing countries do not appear to become more attractive investment destinations as a result of signing BITs. Indeed, a former U.S. BIT-negotiator, Kenneth Vandavelde, suggests that the priority by capital-exporting states to sign BITs with states that were already hosts to large stocks of investments mean that ‘... BITs may be caused by investment flows and not the other way around.’¹⁵ Also, in a Granger-type analysis, Aisbett changes the dependent variable from FDI flows to an index measure of expropriation risk and finds that while decreases in expropriation risk ratings are negatively correlated with the number of BITs a country enters into, the reverse is not true; BITs do not appear to decrease subsequent expropriation risk ratings.¹⁶

BITs, however, can differ markedly in their substantive and procedural provisions. So perhaps ‘strong’ BITs may have a stronger impact on investment flows? For instance, one would expect that BITs with market access provisions would have a greater impact on investment flows than BITs covering only the

¹³ J. Salacuse and N. Sullivan, ‘Do BITs really work? An evaluation of bilateral investment treaties and their grand bargain,’ 46 *Harvard International Law Journal* 67 (2005).

¹⁴ E. Aisbett, ‘Bilateral investment treaties and foreign direct investment: correlation versus causation,’ in: Sauvants and Sachs, *op. cit.*

¹⁵ K. Vandavelde, ‘Investment liberalization and economic development: the role of bilateral investment treaties,’ 36 *Columbia Journal of Transnational Law* 501 (1998), at 524–25; See also D. Swenson, ‘Why do developing countries sign BITs?’ in: Sauvants and Sachs, *op. cit.*

¹⁶ It should be mentioned that in their equally refined contribution Egger and Pfaffermayr find BITs to have positive and significant effect on outward FDI stock from OECD countries; P. Egger and M. Pfaffermayr, ‘The impact of bilateral investment treaties on foreign direct investment,’ in Sauvants and Sachs, *op. cit.* However, the 30% effect of ratified BITs in their preferred model-specifications appears exceptionally high, particularly in light of the above-mentioned studies of FDI flows and the qualitative evidence presented below. The same applies to Kerner’s result that a BIT between two countries should somehow increase their dyadic flows by more than US\$620 million each year (!); A. Kerner, ‘Why should I believe you? The costs and consequences of bilateral investment treaties,’ 53 *International Studies Quarterly* 73 (2009), Table 2.

post-establishment phase. Similarly, BITs which incorporate a legally binding consent to arbitrate a wide range of investment disputes with private investors are likely to be valued higher by investors than BITs where such consent is limited or absent. Both of these propositions have been tested, however, and none have been convincingly confirmed to date. While Haftel finds that U.S. BITs – which include liberalization provisions – do impact investments,¹⁷ Tobin and Rose-Ackerman¹⁸ as well as Peinhardt and Allee¹⁹ come to the opposite result, and Gallagher and Birch²⁰ find no effects of U.S. BITs on FDI inflows to Latin American and Caribbean countries.²¹ Similarly, in a particularly important result, Yackee shows that even BITs with ‘strong’ arbitration provisions do not appear to impact international investments,²² which is remarkable since arbitration clauses are the most attractive feature of a BIT from the perspective of foreign investors.²³ On the other hand, however, Berger, Busse, Nunnenkamp, and Roy, do actually find a considerable effect of both ‘strong’ and ‘weak’ BITs in an equally sophisticated study.²⁴

¹⁷ Y. Haftel, ‘Ratification counts: U.S. investment treaties and FDI flows into developing countries,’ 17 *Review of International Political Economy* 2 (2010).

¹⁸ J. Tobin and S. Rose-Ackerman, ‘Foreign direct investment and the business environment in developing countries: the impact of bilateral investment treaties,’ *Yale Law and Economics Research Paper*, No. 293 (May 2 2005).

¹⁹ C. Peinhardt and T. Allee, ‘The costs of treaty participation and their effects on U.S. foreign direct investment,’ paper presented at American Society for International Law’s International Economic Law Interest Group Meeting, Washington, DC, USA, November 2008.

²⁰ Gallagher and Birch, *op. cit.*

²¹ This is surprising as it would make intuitive sense if BITs are more likely to be considered by U.S. firms. Apart from U.S. BITs’ legally binding liberalization provisions, the inclusive and open debates in Washington on these issues are likely to lead to a greater awareness of the treaties among U.S. multinationals. This contrasts with Europe, where my interviews with BIT-negotiators referred to below all confirmed that BITs have hardly ever been politicized (see in this respect the concluding chapter). Finally, the U.S. has been on the respondent end of a number very controversial and, eventually, very public investment claims under NAFTA, which are also likely to have raised the awareness of investment treaties. That said; the share of U.S. BITs in the global population of BITs is of course quite small, and it is unclear the extent to which the expertise of some U.S. multinationals with respect to BITs has translated into actual corporate decision making. See; K. Vandevelde, *United States Investment Treaties* (Deventer: Kluwer, 1992), at 32; K. Vandevelde, ‘Investment liberalization and economic development: the role of bilateral investment treaties,’ 36 *Columbia Journal of Transnational Law* 501 (1998).

²² Yackee (2009a), *op. cit.*

²³ T. Wälde, ‘The ‘umbrella’ clause in investment arbitration: a comment on original intentions and recent cases,’ 6 *Journal of World Investment and Trade* 183 (2005), at 194.

²⁴ A. Berger, M. Busse, P. Nunnenkamp, and M. Roy, ‘More Stringent BITs, Less Ambiguous Effects on FDI? Not a Bit!,’ *Economics Letters* (forth.).

The econometric evidence is therefore largely inconclusive. This is primarily because of the limited data available, which precludes the quantitative literature to answer the most pertinent questions. BITs are, for instance, likely to be more important in certain sectors than others. Historical experience, as well as recent developments in parts of Latin America, shows that resource extraction sectors are particularly prone to discriminatory or even predatory government interference. Accordingly, natural resource investors may take more notice of BITs than investors in less politicized sectors. Similarly, the importance of BITs for investors' decision-making process is likely to depend on the size of the investment, as the enforcement mechanism can involve significant arbitration costs for the investor should it come to a dispute with the host country. In turn, this may make the treaties more or less redundant for small investors.²⁵ On the other hand, very large multinationals can often rely on diplomatic protection by their home country and are moreover able to bargain for investor-state contracts with similar or greater legal guarantees than those provided in BITs (see below). It follows that if BITs are important in the pre-establishment phase of foreign investment decisions, it would most likely be for medium-scale investors. Unfortunately, these hypotheses are inherently difficult to test using international investment data, which are too incomplete and often incomparable at disaggregated levels, whether measured as flows or stocks.

These are not the only challenges for the econometric literature. For instance, the effects of BITs are likely to depend on a range of political and social conditions which can be difficult to measure. Irrespective of recent advances in quantitative indexes measuring ambiguous concepts such as governance or institutions, it remains a challenge to carefully control for such intangible variables. Another challenge is that developing countries have often entered into BITs as part of broader economic reform packages, which means the treaties often come into

²⁵ R. Daniño, Secretary-General of ICSID, Opening remarks at 'Making the most of international investment agreements: a common agenda' (December 12, 2005, Paris), available at: <http://www.oecd.org/dataoecd/5/8/36053800.pdf> (last visited January 30, 2010); J. Coe Jr., 'Taking stock of NAFTA Chapter 11 in its tenth year: an interim sketch of selected, themes, issues and methods,' 36 *Vanderbilt Journal of Transnational Law* 1381 (2003), at 1400-1401. For a different view, see Wälde, *op. cit.*, at 204-206.

effect alongside a number of other domestic and international economic instruments. To the extent that simultaneous initiatives, such as preferential trade agreements (PTAs) or reforms in domestic investment and taxation codes have an impact on investment flows, they would have to be taken into account. For instance, Berger and colleagues find that the effects of BITs is only considerable in so far as Eastern European countries are included in the sample, but while their model controls for host country liberalization trends, it is not able to account for demand-side factors among home countries.²⁶ Indeed, we saw in the last chapter the intensive effort of public and private American organizations in shaping the regulatory framework for investment in post-communist Europe, and to the extent such efforts led to increase interest from Western investors – independently of BITs – this would make their results spurious. Similarly, with respect to PTAs, some literature suggests that they have a substantial effect on FDI flows between the contracting parties,²⁷ which implies that studies on BITs could systematically overestimate their effects on FDI if PTAs are not taken into account.

A related point is that developing countries often enter into BITs when heads of state meet at home or abroad. Such high level meetings typically involve many other bilateral economic cooperation initiatives however, and to the extent such initiatives lead to investment projects between the two countries, they could also result in systematic biases if not controlled for. In the case of Pakistan, for instance, most of its BITs were signed in the past as part of a ‘road-show’, where numerous other investment promotion activities also took place.²⁸ Interviews with

²⁶ Berger, Busse, Nunnemkamp, and Roy, *op. cit.* I am grateful to Emma Aisbett for making this clear.

²⁷ See e.g., E. Yeyati, E. Stein and C. Daude, ‘Regional integration and the location of FDI,’ *Inter-American development bank research department working paper 492* (2003); D. Medvedev, ‘The impact of preferential trade agreements on FDI inflows,’ *World Bank Policy Research Working Paper 4065* (2006). A review of the literature can be found in UNCTAD (2009), *op. cit.*

²⁸ To mention a few examples, see e.g.; ‘Pak-Romanian collaboration,’ *Business Recorder*, 25 January, 1978 (apart from the Romania-Pakistan BIT signed a few days earlier - later to be updated in the 1990s - several investment initiatives were agreed between the governments such the construction of a major cement plant); ‘9 UK firms sign project agreements,’ *Business Recorder*, 1 December, 1994 (apart from the UK-Pakistan BIT, memoranda of understandings for several projects in the oil and gas exploration, hydropower and chemicals sectors were signed with British investors); ‘Private investment from Singapore,’ *Business Recorder*, 12 March, 1995 (apart from the Singapore-Pakistan BIT, memoranda of understandings with Singaporean infrastructure firms were signed with a total expected inflow of investment into Pakistan of about US\$500

current and past Pakistani BIT-negotiators confirmed in interviews that the BITs played no real role for these simultaneous initiatives. So if a considerable portion of the projects actually materialized, they would arguably have to be controlled for if one wants to estimate the impact of Pakistani BITs. Assuming this pattern holds for other countries as well, it is unfortunate that no studies have directly confronted it as a possible source of endogeneity between capital flows and the signing of BITs.

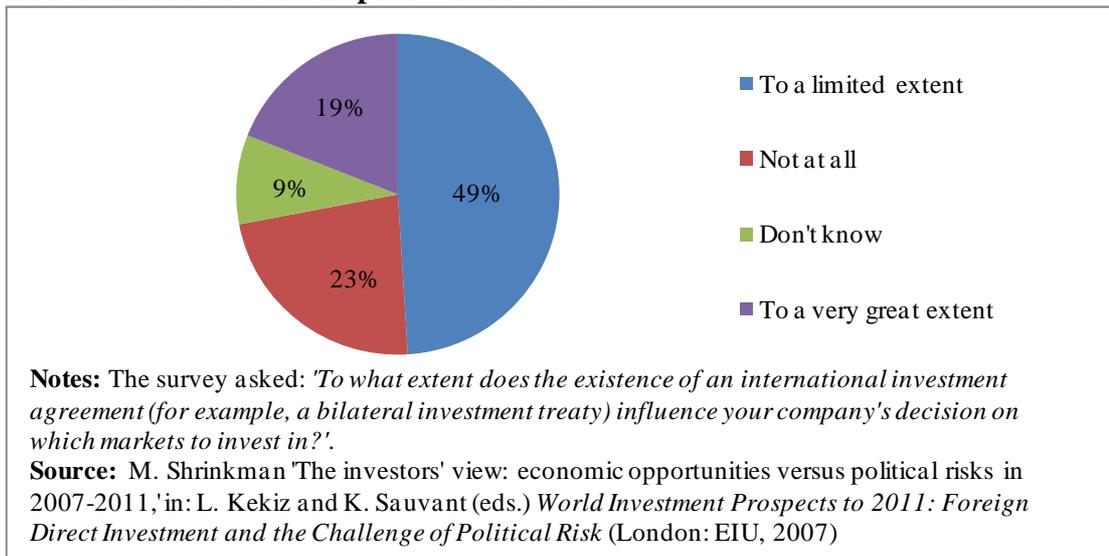
Substantial data limitations as well as a range of possible omitted variables therefore continue to hamper the econometric literature. But given these constraints, it is noteworthy that very little work has tried to ask foreign investors themselves whether they take these treaties into account when deciding where, and how much, to invest.

6.2. Survey evidence

The few surveys that do ask about BITs appear to support the conclusion that they are not a particularly important factor in the establishment phase for the vast majority of foreign investors. One survey asked 602 corporate executives to what extent an international investment agreement, such as a BIT, influences which markets their company invests in (Figure 6.1).

million); 'Turkey, Pakistan discuss setting up export zones,' *Business Recorder*, 17 March, 1995, and 'Protocol signed for creation of Turco-Pak Business Council,' *Business Recorder*, 18 March, 1995 (apart from the Turkey-Pakistan BIT, the two governments initiated talks on setting up export zones, and business representatives from the two countries agreed to set up a bilateral business council); 'Benazir returns from Malaysia with investment pledges,' *Business Recorder*, 10 July, 1995 (apart from the Malaysia-Pakistan BIT, Prime Minister Bhutto received US\$530 million worth of investment pledges from Malaysian companies).

Figure 6.1. The influence of international investment agreements on the locational decisions of corporate executives



Around one fourth of the survey respondents replied that investment agreements did not at all affect their decisions to invest, slightly less than half said to a limited extent, and a little less than a fifth said investment agreements were very important. While UNCTAD takes this to imply that BITs are important when investors make investment decisions,²⁹ Sachs questions whether some executives may have strategically overestimated the importance of investment treaties here 'in order to encourage the granting of such further protections international investment agreements may offer them.'³⁰ For the purposes of this chapter it is moreover unfortunate that the survey did not distinguish between BITs and other international investment agreements, such as the ECT, investment chapters in PTAs, or double taxation agreements, and it is therefore likely to overestimate the importance of BITs.

One survey that *did* ask directly about BITs, however, is the 2007 UNCTAD survey, which led the organization to conclude that BITs are ranked 'among the most significant investment decision factors' for transition economies in

²⁹ UNCTAD (2009), *op. cit.*, at 51.

³⁰ L. Sachs, 'Bilateral investment treaties and FDI flows,' *World Association of Investment Promotion Agencies (WAIPA) Newsletter* 5 (2009), fn. 5.

particular.³¹ Yet this remarkably strong conclusion was based on feedback from only 14 foreign affiliates.³² And when MIGA asked almost 200 investors about BITs, only 16 percent of service firms responded they played a role in their investment decisions, and the corresponding figure for manufacturing firms was as low as 10 percent.³³ It is not clear from the report how many of these found the treaties to be very important as opposed to merely relevant, but it does list – not surprisingly - that BITs were not among the top 20 ‘critical’ location factors.

Similarly during the investment-negotiations in the WTO, the European Commission asked about the role of BITs for European investors and here half of the 300 respondents had never heard of the treaties and only 10% had used them in their professional activity (Figure 6.2).³⁴ Note, however, that these 10% cover both investors that take the treaties into account in their establishment phase *as well as* investors that have considered them in case of a dispute. That the later should be a far greater number than the former is supported by the World Bank, which suggests that *‘many investors are not aware that a BIT is in place at the time of considering an investment, and indeed investors may remain oblivious until some issue arises when its provisions may be relevant.’*³⁵

³¹ UNCTAD (2009), *op. cit.*, at 52. Note that this survey is also used by Berger and colleagues to sustain their conclusion that BITs were crucial to attract investments into Eastern Europe; Berger, Busse, Nunnemkamp, and Roy, *op. cit.*

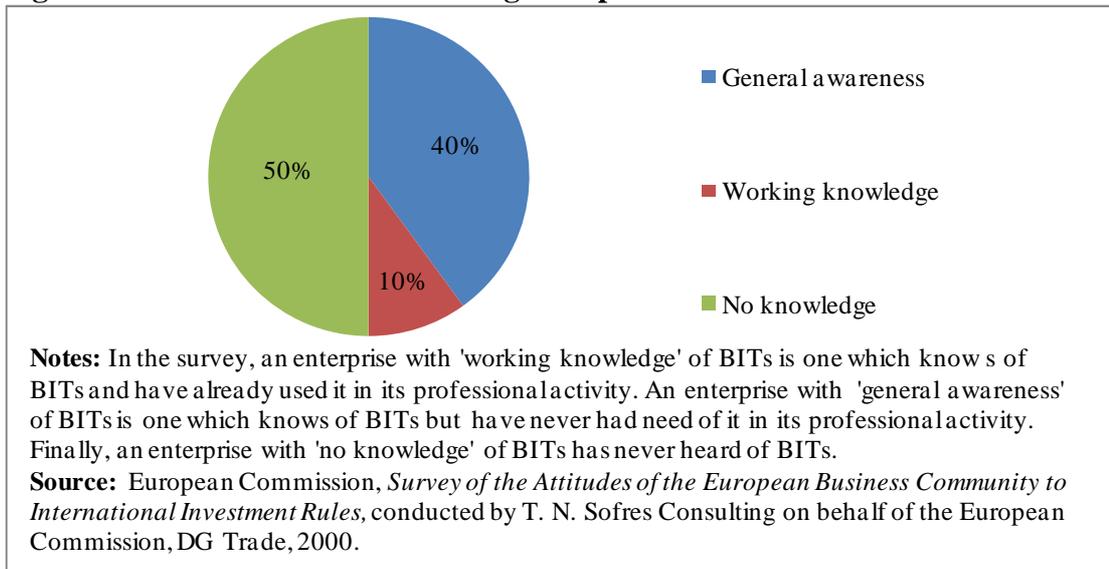
³² UNCTAD, *Worldwide survey of foreign affiliates*, Occasional Note (Geneva: United Nations, 2007), annex Table 2. Note also, that the question was asked in a way that Sachs’ above-mentioned critique of the survey by Shrinkman holds for this survey as well.

³³ MIGA, *Foreign Direct Investment Survey* (Washington DC: World Bank, 2002).

³⁴ European Commission, *Survey of the Attitudes of the European Business Community to International Investment Rules*, conducted by T. N. Sofres Consulting on behalf of the European Commission, DG Trade, 2000. Note that like the MIGA survey, this survey is not mentioned in the 2010 UNCTAD report mentioned above either.

³⁵ World Bank, *World Development Report 2005: A better investment climate for everyone* (Washington DC: World Bank, 2005), at 177.

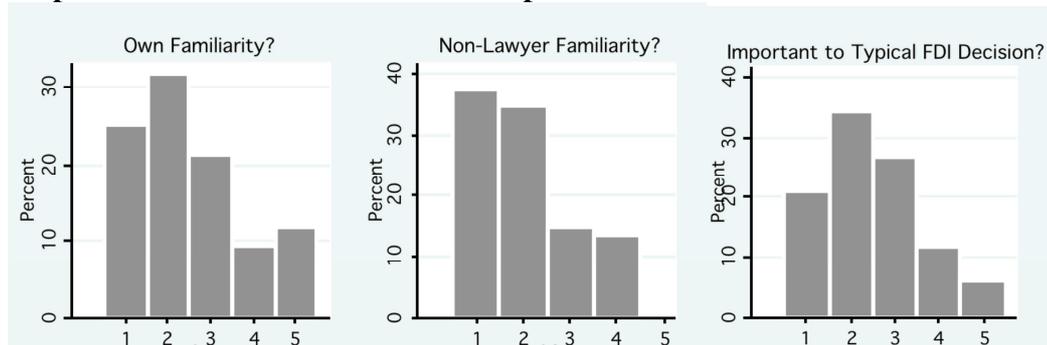
Figure 6.2. Awareness of BITs among European investors



Finally, in the most sophisticated survey to date, Yackee interviewed in-house legal counsel in American multinationals. His 2010 results were severely damaging to those convinced that BITs are crucial to FDI flows, as the survey reported that company officials are actually not particularly familiar with the treaties (Figure 6.3). Note for instance, that none of the lawyers thought that senior executives without a law-background were 'very familiar' with BITs, and only around 5 percent found them 'very important' in typical FDI decisions. So whereas American BITs are the most far-reaching in terms of liberalization obligations, American multinationals do not appear to be very affected by the treaties when determining where and how much to invest. This corresponds with an early 1998 survey on NAFTA and the ECT, which indicated that foreign investors were not particularly interested or influenced by these treaties, despite their considerably greater scope than stand-alone BITs.³⁶

³⁶ M. Omalu, *NAFTA and the Energy Charter Treaty* (London: Kluwer, 1998), ch. 6.

Figure 6.3. Response from general counsel within American multinational corporations about awareness and importance of BITs



Notes: Histogram reports responses from 75 respondents to: (i) How familiar are lawyers in your office with the basic provisions of BITs; (ii) how familiar are non-lawyer senior executives in your corporation with the basic provisions of BITs?; and (iii) how important is the presence or absence of a BIT to your company's typical decision to invest in a foreign country? For the first two questions, 1 indicates 'Not at all familiar' and 5 indicates 'Very familiar.' For the last, 1 indicates 'Not at all important' and 5 indicates 'Very Important.'

Source: J. Yackee, 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Sources of Evidence,' 51 *Virginia Journal of International Law* 2 (2010).

Given this evidence, it may appear surprising that Bütte and Milner report that European BIT-negotiators have told them in interviews that investors and investment advisors contact them inquiring about the details about particular BITs.³⁷ The authors construe this as indirect evidence that investors do in fact take BITs into account when determining where to invest; why would they otherwise inquire about them? But while qualitative inputs of this kind are welcome in a debate otherwise dominated by statistical discussions over often precarious data, it is questionable whether the interviews actually reflect what the authors claim. The relevant question for whether BITs attract investment is not whether they are relevant for investors - which they of course often will be in case of disputes or when contemplating how to legally structure a major investment - but instead whether, and how often, investors refrain from investing in a particular country if their investments cannot be covered by a BIT. Also, the relevant question for the signaling hypothesis is whether and to what extent the fact that host countries have *not* entered into a substantial number of BITs keep multinationals from investing there. And the fact that multinationals are often involved in the

³⁷ T. Bütte and H. Milner, 'Bilateral investment treaties and foreign direct investment,' in: Sauvart and Sachs, *op. cit.*, at 209-213.

development of capital-exporting states' BIT programs³⁸ and may at times lobby for the signing of BITs³⁹ does not in itself imply that the absence of BITs would make them invest less or elsewhere. When I interviewed BIT-negotiators in capital-exporting countries, all thus confirmed that while they receive direct requests from investors about BITs on occasion, such requests are relatively rare and investors typically inquire about BITs only *after* the investment-decision has been made. The interviewees reported:

'Sometimes those dealing with incorporation of companies contact me to hear if we have a BIT with that country, but it is hardly the most important factor. What is probably really important, though, are double taxation treaties.' (Netherlands)

'In some cases, where there is a major investment the company might approach us. But that is typically where a contract or other instrument has been signed, and therefore probably after the decision for the investment has been made.' (Finland)

'We do get questions about BITs from investors themselves, but as far as I'm aware, they never contact us to get a treaty signed as a precondition for an investment.' (Sweden)

'I don't think many Danish companies have heard of these treaties, and it is highly unlikely that they will be taken into account when they make their investment decisions. ... In the few cases I have been contacted over the last years, it is when a dispute has arisen.' (Denmark)

'We've been told in general terms by business organizations that they value the assurance provided by BITs, but have no direct evidence as to whether or not the presence or absence of a BIT is an important consideration for British companies making investment decisions. We tend to be contacted only by investors who are already established abroad and who have run into difficulties with the host state.' (UK)

³⁸ See e.g., Emergency Committee for American Trade (ECAT), *Letter to US Government concerning its model BIT*, (December 18, 2003), available at: www.ecatrade.com/statements/content.asp?ID=408 (last visited January 30, 2010); ECAT, *Written statement of the Emergency Committee for American Trade concerning the Administration's review of the model bilateral investment treaty (BIT)*, (July 31, 2009), available at: www.ecatrade.com/uploads/content/D8E14AD1AD7B4EF196C0E53E710E7925.pdf (last visited January 30, 2010); United States Department of State, *Advisory committee on international economic policy submits report on U.S. model bilateral investment treaty*, (September 30, 2009), available at: www.state.gov/r/pa/prs/ps/2009/sept/130097.htm (last visited January 30, 2010); Confederation of Norwegian Enterprise, *Modell for investeringsavtaler – høring*, (January 7, 2008), available at: <http://www.regjeringen.no/upload/NHD/Vedlegg/hoeringer/2008/Modellavtale/StatoilHydro.pdf> (last visited February 8, 2010)); not-for attribution interviews with BIT-negotiators, April-October 2009.

³⁹ See e.g., ECAT, *Business community welcomes launch of U.S.-China BIT negotiations and urges achievement of a high-standard agreement*, (July 22, 2008), available at: www.ecatrade.com/statements/content.asp?ID=743 (last visited January 30, 2010); R. Hirdina and T. Jost, 'German Outward FDI and its policy context,' *Columbia FDI Profile*, Apr 9, 2010, at 5.

‘I think it is unlikely that even big German companies take BITs into account in their investment decisions. ... The requests we get from German investors do not appear to be when they decide where to invest. ... We do, however, get a lot of requests about double-taxation treaties, which are probably much more relevant for the investment decision.’ (Germany)

‘It is the exception that investors contact us directly before making an investment, probably because our BITs don’t include market access. Once the investment is made, investors do contact us when they run into problems with the host state. In these cases, however, the existence of a BIT does not appear to have been the most important element of the investment decision.’ (Switzerland)

‘It is usually once they have an investment in place or they run into regulatory problems with the host state that companies ask us to get BITs signed.’ (Canada)

‘It is of course only the very big companies that are even aware of the treaties. ... But since we don’t have as many BITs as the Europeans, what usually happens is that investors first make the decision to invest, and then they lobby the Japanese government to sign a BIT. But even if the BIT doesn’t get signed, the investors will make the investment anyways because their decision has already been made.’ (Japan)

So while investors, lawyers, and consultants, do occasionally inquire about BITs, this is generally *not* to decide whether a particular investment should be made or not. That is a decision which available quantitative and qualitative evidence suggest is unlikely to be driven by the presence or absence of whether a BIT is in place.⁴⁰

6.3. Indirect effects

However, even if BITs tend to be ‘an overlooked tool’ by investors themselves,⁴¹ there could be indirect channels through which they may nevertheless affect investment flows. One could be if BITs have an impact on credit rating agencies’ sovereign risk evaluations, as these might affect risk premiums and hence investment decisions. While I doubt credit rating agencies would pay much

⁴⁰ Note also that in the recent review of the Australian BIT-policy, the Australian Productivity Commission had asked for but received no feedback from the business community, despite suggesting to exclude investor-state arbitration from its future agreements; Australian Productivity Commission, ‘Bilateral and Regional Trade Agreements,’ *Productivity Commission Research Report*, November 2010, at 270.

⁴¹ D. Freyer, B. Garfinkel, and H. Ghavari, ‘Arbitration under bilateral investment treaties: an often overlooked tool,’ 13 *Mealey’s International Arbitration Report* 44 (1998).

attention to BITs, there are no publicly available studies on this question.⁴² Yet, a more likely indirect channel could be if BITs function as a ‘stepping stone’ for developing countries to enter into a PTA at a later stage, which has been suggested in a recent contribution.

BITs as stepping stones to PTAs

Using statistical techniques, Tobin and Busch analyze annual data on pairs of developing and developed countries between 1960 and 2004 and conclude that BITs ‘raise the prospects of getting a North-South PTA with all the deeper and reciprocal obligations that these entail.’⁴³ If true, that would be an exceptionally important finding that may add weight to the argument that BITs have a positive effect on investment flows, since PTAs may have a stronger impact on where, and how much, multinationals invest abroad.⁴⁴ BITs may in other words not impact investment flows extensively in and by themselves, but they might do so indirectly by increasing the likelihood of broader economic integration agreements.

Tobin and Busch’s argument is in two parts. First, the authors posit that Western multinationals lobby their governments to sign both BITs and PTAs as a way to protect their investments and reduce trade costs, respectively. But for developed country governments, BITs are ‘easier’ agreements to conclude than PTAs, as the latter are often met with opposition from their own protectionist constituents. So whereas wealthy states willingly pursue BITs with developing countries, they only pursue a PTA when it provides exceptionally large benefits. And this, they argue, is when the PTA can provide home state multinationals advantages vis-à-vis their foreign competitors. The twist to the argument, however, is that such

⁴² The methodology of Moody’s, for instance, does not imply that international economic treaties can mitigate sovereign risks; Moody’s, *Sovereign Bond Ratings, Rating Methodology*, September 2008.

⁴³ J. Tobin and M. Busch, ‘A BIT is Better Than a Lot: Bilateral Investment Treaties and Preferential Trade Agreements,’ *62 World Politics* 1 (2010), at 31.

⁴⁴ See above.

advantages will be partly eroded if competing firms are also covered by BITs in the host state. This implies that support for a PTA will be greatest if the developing country has not already concluded too many BITs with other developed country governments.⁴⁵ So to increase the likelihood of a PTA, Tobin and Busch therefore argue that ‘a BIT is better than a lot’.

One of the key underlying assumptions is thereby that a BIT can give multinationals considerable *preferential* advantages when a developing country has not signed BITs with home states of competing firms. Yet, as intuitive as this may sound, it misrepresents investment treaties' practical implications. For the most part, BITs include broad and open-ended definitions of investments, and many expressly cover indirectly controlled investments. So if firms are seriously concerned that they do not have the same BIT-coverage as their competitors, they have the option of structuring their investment vehicles accordingly, for instance through holding companies in third countries. While the extent of ‘treaty-shopping’ is not well understood, Barton Legum, the former head of NAFTA’s arbitration division, is probably correct in stating that:

‘The reality that foreign capital is highly fungible and the breadth of the definitions of investor and investment thus combine to effectively transform the facially bilateral obligations of the BIT into an obligation that the host State must consider potentially applicable to all investors.’⁴⁶

The multi-layered corporate legal structure of modern multinationals thereby implies that while protections granted in BITs are perhaps preferential in theory, this is rarely the case in practice. Even a single BIT with the ‘traditional’ broad coverage of investors and investments should for all practical purposes be understood as involving obligations owed to every other state and investor.⁴⁷ Along the same lines, Schill notes in his study on the ‘multilateralization’ of international investment law that:

⁴⁵ Tobin and Busch also argue that too many PTAs with other wealthy states make them less attractive as PTA partners. While the underlying logic for this part of their argument is indeed convincing, I will here only focus on their conclusions concerning BITs.

⁴⁶ B. Legum, ‘Defining Investment and Investor: Who is Entitled to Claim?’, 22 *Arbitration International* 521 (2006), at 525.

⁴⁷ *Ibid.*, at 524.

[i]nvestors are not only in a position to free themselves from bilateral inter-State relations, but corporate structuring also requires host States to treat BIT obligations as if they were part of a multilateral regime. ... The protection of shareholders, therefore, *de facto* multilateralizes international investment protection even absent the operation of a treaty provision granting MFN treatment.⁴⁸

In other words, the claim by Tobin and Busch that a multinational can retain future PTA preferences if developing countries do not sign BITs with other home states appears somewhat out of sync with the potential coverage of the global BIT-network.

But while this questions the curve-linear relationship between BITs and PTAs suggested by Tobin and Busch—i.e. that a BIT is better than a lot—it doesn't necessarily contradict their first proposition, namely that developed countries tend to couple their programs on BITs and PTAs. Indeed, there are pragmatic reasons for doing so. Modern PTAs often include investment protection chapters, so having already signed a BIT would make any subsequent PTA negotiations simpler. Also, a BIT negotiation could indicate whether the developing country partner is 'mature' enough to enter into the much more complex and time-consuming PTA negotiations. Yet, while a country like Japan is in fact using BITs as 'stepping stones' to PTAs for these very reasons,⁴⁹ does this really reflect a broader phenomenon? Should developing countries expect that by signing a BIT with a developed country, a subsequent PTA becomes more likely?

Let us start with the United States. While the United States Trade Representative (USTR) has occasionally mentioned that a BIT with the United States may lead to a PTA, it is doubtful that such a linkage has existed as a matter of policy.⁵⁰ The

⁴⁸ S. Schill, *The Multilateralization of International Investment Law* (Cambridge: Cambridge University Press, 2009), at 199, 218-219

⁴⁹ Japanese official I. See e.g.; 'Japan, Columbia sign investment agreement to null free trade pact,' *China Post*, September 3rd, 2011; C. Sung, 'Taiwan, Japan sign investment accord in 'stepping stone' to FTA,' *Bloomberg*, September 22, 2011.

⁵⁰ For instance, Tobin and Busch support their econometric findings with a USTR quote that its BIT-negotiations with Pakistan would lead to a subsequent PTA. But while this was also the expectation of several key Pakistani negotiators, it is doubtful whether it was actually the US position. A USTR official notes that '*since Musharraf had vested so much political capital into the possibility of a PTA, we couldn't openly state that we found it practically impossible to get through in Washington, so we played along.*' (Comment at seminar on Pakistan's BIT program, Johns Hopkins School of Advanced International Studies' South Asia Program, May 11, 2009). Another recent example is with Korea; L. Peterson, 'New US Ambassador to Korea reiterates

veteran American BIT-negotiator mentioned above, Kenneth Vandavelde, fails to discuss any link between BIT and PTA negotiations in any of his extensive works on the US BIT program for instance.⁵¹ Also, no studies of US PTAs that this author is aware of can help sustain that BITs paved the way for American trade agreements in any substantial way.⁵² So when looking at the actual sequencing of US BITs and PTAs, it is no surprise that the pattern hardly provides strong evidence in favour of Tobin and Busch's claim: out of the thirteen US PTAs with developing or transition economies (including NAFTA), only three were preceded by a BIT. These are the PTAs with Morocco, Panama, and CAFTA-DR (where BITs had been signed with El Salvador, Honduras, and Nicaragua), yet Tobin and Busch provide no evidence that the BITs in question were in any way connected with the subsequent trade negotiations.

However, even if American decision-makers have on occasion thought of BITs as potential stepping stones to a PTA, one should recall that the US has signed less than fifty BITs. While important, these constitute a miniscule share of the global BIT-network. EU15 countries alone have signed more than a 1000. So when suggesting a general pattern in BIT policy making among developed countries, Europe is clearly the litmus test. Also, since the pattern doesn't hold in the case of the United States, it must be European investment treaties that are driving Busch and Tobin's results. Yet, here the suggested linkage between BITs and PTAs is even harder to follow. Recall that at least until the entry into force of the Lisbon treaty (on 1 December 2009) EU member states negotiated BITs individually while entering into PTAs as a group. But although 61 percent of the developed countries in Tobin and Busch's analysis are EU member states, they do not discuss what this implies for their theoretical model. Nor is it accounted for in their statistical analysis,⁵³ which leads to a rather bold implicit claim: a

obstacles to BIT,' *INVEST-SD: Investment Law and Policy Weekly News Bulletin*, October 13, 2004.

⁵¹ E.g. K. Vandavelde, *U.S. International Investment Agreements* (Oxford: Oxford University Press, 2009), in particular 66-82,

⁵² See e.g.; J. Schott (ed.) *Free Trade Agreements: US Strategies and Priorities* (Washington DC: Institute for International Economics, 2004); D. Gantz, 'The Evolution of FTA Investment Provisions: From NAFTA to the United States – Chile Free Trade Agreement,' 19 *American University International Law Review* 269 (2003-2004).

⁵³ Tobin and Busch code an EU PTA as a series of bilateral PTAs with EU member states.

(hypothetical) developing country with no other investment treaties in place can increase its predicted probability to enter into an EU PTA from 0.01 to 0.05 simply by signing a BIT with an EU member state. That the absence or presence of BITs has played such a crucial role for the choice of EU PTA partners would probably surprise most European policy-makers, and the authors quote no official reports, interviews, or any study of EU trade politics that can support it. Also, if we go back to their second proposition - a few BITs increase the likelihood of a PTA, whereas too many do the opposite - the implication in the European context is that a developing country with only one BIT, say with Finland, is *more* likely to obtain an EU PTA than one that has signed BITs with most EU member states. To the extent that BITs have played *any* substantive role in European trade politics thus far - which is more than questionable - this is a rather counterintuitive suggestion to say the least, and there again appears to be no additional evidence to support it apart from their statistical model.

Overall, the econometric work of Tobin and Busch is thereby difficult to reconcile with realities on the ground. Their claim is based on a flawed understanding of BITs' practical implications, and the statistical analysis is almost entirely contradicted by the politics of investment treaty rule-making in most developed countries.

BITs and political risk insurance

I therefore turn to another – and more likely – indirect channel through which BITs may impact investment flows, namely if PRI agencies take them into account when determining the availability and pricing of investment insurance. Recall from the last chapter, that this has been presented to developing countries as a key economic benefit of the treaties by organizations such as ICSID and, in particular, UNCTAD. It is also the primary (testable) hypothesis in Montt's framework for BIT-diffusion.

Some (but not all) of the risks covered by BITs are also covered by PRI.⁵⁴ Uncompensated expropriation, breaches of contract, restrictions on repatriation of profits and damages due to political violence are thus covered by most PRI providers. Accordingly, it would only be natural if they took BITs into account when assessing the risk of investment projects. If so, then BITs would indirectly decrease the transaction costs of FDI by lowering the price and increasing the availability of PRI. Unfortunately, there are practically no publicly available empirical studies investigating this question. The only exception is UNCTAD's Investment Policy Review of Brazil, where UNCTAD asked PRI providers on their view of BITs, and briefly concluded that some find them important and some do not.⁵⁵ However, the questions seem to have been limited to the case of Brazil and were only asked of six PRI providers.

Recall, however, the findings from chapter four: neither MIGA, OPIC, or the vast majority of other public PRI agencies found BITs particularly important for their underwriting decisions. So while there should perhaps be a considerable link between public PRI and BIT programs that doesn't appear to be the case in practice. And as a considerable part of the global market for investment insurance is offered by providers like MIGA and OPIC, this is yet another indication that BITs are not particularly important for investment flows. As an alternative to public PRI, however, private companies (mainly Anglo-Saxon) have offered investment insurance for the last three decades that complements or competes with those offered by government-sponsored programs.⁵⁶

⁵⁴ P. Comeaux and N. Kinsella, *Protecting foreign investment under international law: legal aspects of political risk* (New York: Oceana Publications, 1997), ch. 6; T. Matsukawa and O. Habeck, *Review of risk mitigating instruments for infrastructure financing and recent trends and developments* (Washington DC : World Bank, 2007); For an overview of the PRI industry, see, World Bank, *World investment and political risk* (Washington DC: World Bank, 2009), ch. 2 and 3; K. Gordon, 'Investment guarantees and political risk insurance: institutions, incentives, and development,' *OECD investment policy perspectives* (2008).

⁵⁵ UNCTAD, *Investment policy review of Brazil*, UNCTAD/ITE/IPC/MISC/2005/1 (2005), at 45. See also UNCTAD (2009), *op. cit.*, at 18-19.

⁵⁶ P. Comeaux and N. Kinsella, 'Reducing political risk in developing countries: bilateral investment treaties, stabilization clauses, and MIGA and OPIC investment insurance,' 15 *New York Law School Journal of International and Comparative Law* 1 (1994), at 45.

So perhaps firms have based their commercial decisions on whether developing countries have entered into BITs or not. Wälde noted in 2000, for instance, that while BITs were still largely ignored by foreign investors themselves, a country,

‘... will attract a higher risk rating and therefore higher borrowing costs together with an expectation of higher investor returns for an infrastructure project if it has not concluded a BIT with the relevant investor home state... Therefore, it is advisable to encourage host states to negotiate BITs with relevant home states ...’⁵⁷

Yet, the feedback from the private market largely corresponded to that from the public PRI agencies.⁵⁸ That said, some firms did indeed factor BITs into their decision making. Apart from relying on BITs’ arbitration mechanism in case of disputes,⁵⁹ a few innovative companies have also attempted to incorporate BITs into their products. For one major firm ‘*the treaties play a role as a guiding tool to whether we want to take a risk or not,*’ and another finds that over the long term, BITs are likely to have an impact on the industry, as investors who manage to obtain favorable arbitration awards through the BIT-mechanism will be more effective in making subsequent claims against their insurers (something that traditionally has been difficult for events that fall short of outright expropriation⁶⁰). So even if the host country does not honor its award, an arbitration ruling could in itself increase the chances of a favorable result in a subsequent claim against an insurer.⁶¹ Finally, a few firms have begun to insure treaty-based arbitration award defaults, an idea that became the talk of the town among industry leaders after a 2006 MIGA-Georgetown seminar, where it was

⁵⁷ T. Wälde, ‘Treaties and Regulatory Risk in Infrastructure Investment,’ *34 Journal of World Trade* 2 (2000), at 16.

⁵⁸ The following section is based on interviews with underwriters and senior managers from sixteen PRI providers and re-insurers accounting for almost 50% of the global private market capacity for ‘Confiscation, Expropriation, and Nationalization’ insurance. See further in annex II.

⁵⁹ As private insurance companies typically can’t subrogate BIT-claims directly, some have instead paid for investors’ legal expenses.

⁶⁰ One example of an unsuccessful expropriation claim against an insurer arising out of the Argentinian financial crisis is; *Sempra Energy v. National Union Fire Ins., Co. of Pittsburgh, Pa., not reported, F.Supat2d, 2006 WL 3147155, S.D.N.Y., 2006*, (October 31, 2006).

⁶¹ However, the prospects of having to go through lengthy BIT-arbitrations before being able to lead a successful claim against an insurer is of course not a particularly attractive option for foreign investors.

suggested by a private lawyer.⁶² While some firms continue to do so, the experiment was disappointing for others:

‘While we initially thought this was a good idea, the problem we found was that in the case of Argentina the BIT-process just didn’t work. Arbitrations took much too long, and we were surprised there was not more World Bank pressure to honor arbitration awards. Naturally, this meant that investors are not particularly inclined to rely on the arbitration process, so now there is even less interest from those making FDI to buy such coverage. So in practice, BITs are not particularly important for us today with respect to either pricing or coverage.’

Although such feedback is undoubtedly informative, what is perhaps particularly striking is that it is still the exception rather than the rule that insurance firms take BITs into account. Two experienced industry-representatives state:

‘Just as extremely few investors seem to be aware of these treaties, most private insurers don’t make them part of their underwriting process.’

‘To take BITs seriously in insurance policies, as we do, is probably rather unusual within the industry.’

This impression is confirmed by interviews with representatives from large and medium-sized firms, Lloyd’s Syndicates, and re-insurers, few of which find BITs of much relevance when determining the risk of investment projects:

‘If it is a country we are not that familiar with we will look if they’ve signed up with MIGA and OPIC regimes, but not so much BITs.’

‘While they should perhaps have a role to play, I would say they are likely to be considered completely irrelevant by underwriters today and thus irrelevant for the pricing of risk insurance. ... Rather than having a role in the investment decision, they are just an extra arrow in the lawyer’s quiver on the occasions where disputes arise.’

‘We do not take the treaties into account, because we are not convinced that they will have an impact on countries’ willingness to pay out claims.’

‘We do look at BITs occasionally. However, they are one out of so many factors we take into account and we actually don’t have any real experience with them. ... So the fact of the matter is that BITs most often don’t matter much.’

‘They are practically never incorporated into decisions concerning the coverage and pricing of risk insurance. ... So while they probably should be taken into account, I’m not aware that they have in fact made any difference at all.’

⁶² The presentation has been published: Hansen, A BIT of insurance, *op. cit.* See also; R. Wray and F. Johnston, ‘Treaty-based recourse for investor-host government disputes,’ 1 *Political Risk Insurance Newsletter* 1 (April 2005); F. Johnston and R. Wray, ‘Insuring arbitration outcomes,’ *Political Risk Insurance Newsletter* 2 (October 2005); F. Jenney, ‘Political risk insurance for collection of arbitral awards,’ in D. Bishop (ed.), *Enforcement of arbitral awards against sovereigns* (New York: Juris, 2009), at 223.

‘Do we look at BITs? Yes, but I have never experienced a risk not taken because the investment was not covered by a BIT, and they probably don’t impact pricing either.’

‘For major infrastructure investments in difficult jurisdictions, they could potentially signal that host states are willing to uphold their contractual obligations with the investor. But BITs are never a prerequisite for insurance and I have never experienced that they have factored into an underwriting decision in any material way.’

‘In theory, BITs should improve the risks, but in practice the jury is out on the actual value of these treaties, and they are certainly not a primary motivator for us.’

‘We have never taken a great deal of notice of them. Governments wanting to expropriate will do it irrespective of their BITs, so they are not a primary consideration at all.’

‘While some of the major American firms may take them into account, I think this is the exception. For underwriters, BITs would typically be very far down their checklist, and they are therefore unlikely to play a determining factor in the underwriting process.’

‘I would be very surprised if out of a sample of 10 underwriters any of them would mention BITs as being directly relevant for their risk-evaluations. ... While the treaties are part of the backdrop to the investment regime, and will be relevant if claims arise, they don’t play any direct role for the ranking or pricing of investment risks.’

It appears that practitioners themselves find it unlikely that BITs have had a major impact on the private PRI market thus far. However, as with MIGA it is of course important to note that most industry representatives did mention that if cancelling or failing to honor existing BITs can be taken as signals that the host country plans to weaken its investor protections, then this would naturally be noted and taken into account in the underwriting process. But for developing countries that are otherwise in compliance with their international investment law obligations and treat foreign investors fairly and in a non-discriminatory way, BITs very rarely provide a ‘positive return’ in the private industry’s underwriting process.

The conclusion arising from this review is therefore remarkable: BITs are basically aimed at reducing the risk of investing abroad, but the vast majority of not only of public but also private agencies that price the risk of foreign investments rarely take them into account to any serious extent. This contradicts

the hypothesis that BITs are fundamental instruments to decrease the risk of investing abroad.⁶³

6.4 BITs reconsidered

All in all, it is therefore unlikely that BITs are crucial to the decisions of most foreign investors about where, and how much, to invest abroad. However, if the issue is simply a lack of awareness on the part of investors', then the rising awareness of BITs that is likely to follow from the current increase in BIT-claims may make the treaties much more important in the future. The same follows for the insurance industry, where some of the 'innovators' in the industry expect that other firms may start taking the treaties into account after realizing their potential.⁶⁴ BITs' risk-reducing potential should, as suggested by Wälde, materialize only '*over time and [only] once the application [of the treaties] is sufficiently well tested.*'⁶⁵ So perhaps econometric studies and surveys may soon conclude that while BITs were not important drivers of investment in past decades, they are today. On the other hand, there are reasons other than ignorance that may explain why BITs are not particularly useful for most developing countries to attract investments.

First of all, it is doubtful that 'obsolescent bargaining' is as important a strategic problem for investors as is often assumed. Rather than regarding the bargaining relationship between foreign investors and their host countries as a two-step prisoner's dilemma, a substantial body of evidence suggests that host countries are

⁶³ In subsequent work, Yackee also interviewed PRI officials and came to the exact same conclusions as here. Yackee (2010), *op. cit.* Parts of this chapter was published earlier that year in; K. Sauvart (ed.) *Yearbook on International Investment Law and Policy* (New York: Oxford University Press, 2010).

⁶⁴ Interview, October 2009.

⁶⁵ Quoted in J. Yackee, 'Do we really need BITs? Toward a return to contract in international investment law,' 3 *Asian Journal of WTO and Health Law* 121 (2008b), at 128. Note, that this is arguably what happened in the sphere of international commercial arbitration, when a series of petroleum disputes in the 1970s made multinationals aware of the utility of carefully drafted investment agreements, which in turn led to an increase in the use of such agreements, see, Y. Dezalay and B. Garth, *Dealing in virtue: international commercial arbitration and the construction of a transnational legal order* (Chicago: University of Chicago Press, 1996), at 92.

typically aware of the long term reputational costs of mistreating foreign investors.⁶⁶ While uncompensated expropriation (direct or indirect) as well as other regulatory abuses of foreign investors obviously still occur in the developing world, it is in many cases not as substantial a concern as is implied by obsolescent bargaining models. The premiums caused by regulatory risks are often surprisingly limited - even in 'high risk' sectors where investments tend to be sunk post-establishment.⁶⁷ This suggests that the risks which BITs are intended to reduce may often be much lower than is often assumed.⁶⁸

Second, to the extent that BITs do cover risks that are of practical concern to investors, a range of market-based strategies are available to confront them. Entering into joint ventures with local companies, obtaining financing from local creditors, structuring investments over long time periods, or bringing in powerful partners such as major foreign banks, are options for investors to insure that a host country has a long-term interest in treating them fairly.⁶⁹ Also, multinationals can finance their investments by borrowing from national or international agencies such as the IFC, OPIC, the European Bank for Reconstruction and Development, or the Asian Development Bank. Since many developing countries are dependent on these agencies for future funding, they will be deterred from interfering with the investor's assets.⁷⁰ Rather than using legal protections in treaties, the management of political risk is thus often handled through business strategies on the ground.

⁶⁶ Yackee (2008b), op. cit., at 125-6.

⁶⁷ See references in; ibid., at 126-7.

⁶⁸ Instead, it is often government regulations not covered by (most) BITs, which are of concern to investors in their establishment phase, such as lack of transparency, performance requirements, or other direct or indirect barriers to market access. On the importance of market access regulations; see European Commission, op. cit.; see also, United States Congress Committee on Foreign Relations U.S. policy toward international investment, 'Hearing before the subcommittee on international economic policy of the committee on foreign relations,' 97th Cong., 1st Sess. (1981).

⁶⁹ Comeaux and Kinsella (1997), op. cit., at 130-1; C. Lipson, *Standing guard: protecting foreign capital in the nineteenth and twentieth centuries* (Berkeley: University of California Press, 1985), at 127-30; E. Woodhouse, 'The obsolescing bargain redux? Foreign investment in the electric power sector in developing countries,' 31 *New York University Journal of International Law and Politics* 121 (2006); R. Ramamurti, 'Can governments make credible commitments? Insights from infrastructure projects in developing regions,' 9 *Journal of International Management* 253 (2003).

⁷⁰ Comeaux and Kinsella (1997), op. cit., at 131. See generally G. West, 'Political risk investment insurance: a renaissance,' 5 *Journal of Project Finance* 29 (1999); Matsukawa and Habeck, op. cit. Note that these considerations are also taken into account when MIGA underwrites investments, see e.g. Annex A(b)(15) and A(b)(16) quoted in Table 2.

Third, obtaining investment insurance as an alternative to reliance on BITs is often a more direct and straightforward option to protect investment against political risks, given that investors can obtain compensation even if the host country refuses to pay damages.⁷¹ The determination and payment of PRI recovery is also likely to be quicker than the BIT arbitration process. Moreover, just as financing by national or international agencies can provide host countries with a greater incentive to treat investors fairly, this is also the case with investments covered by agencies such as MIGA.⁷² If developing countries fail to resolve disputes with MIGA, they may risk a suspension of both future aid and loans from the World Bank.⁷³ Similar actions may be taken by national governments as well as private insurance companies if their insurance claims are not solved in a satisfactory manner. As a result *‘once the full cost of prospective action against an insured investor is realized, these disputes often become ‘misunderstandings’ which are quietly and successfully resolved.’*⁷⁴ While MIGA, for instance, has issued guarantees for more than US\$17 billion since its inception in 1988, it has only had to pay out five claims to investors, only two of which were based on expropriation.⁷⁵ Similarly, while the German government grants guarantees for Euros 6 billion a year, it is exceptionally rare that it has had to pay out damages as the vast majority of disputes are settled diplomatically.⁷⁶

Finally, the idea promoted by Guzman and others that BIT’s are the *only* investment protection instruments that can ‘tie governments to the mast’ of international law is somewhat peculiar. For if various transaction strategies, insurance products or other instruments cannot provide sufficient protection

⁷¹ Note that as it was suggested above in the case of BITs, it also appears to be medium sized investors that have particular use of PRI, see, MIGA, ‘Survey of political risk insurance providers,’ report, January 2008, Table 8. On the difficulties of enforcement and execution of BIT-obligations, see, A. Alexandroff and I. Laird, ‘Compliance and enforcement,’ in P. Muchlinski, F. Ortino, and C. Schreuer, (eds.), *The Oxford handbook of international investment law* (New York: Oxford University Press, 2008).

⁷² Comeaux and Kinsella (1997), *op. cit.*, at 184; West, *op. cit.*

⁷³ Note that in the eyes of some private insurers, this is in contrast with the BIT-regime as indicated by the quote pertaining to this issue above. Another representative from the industry notes, *‘we were surprised to learn that it doesn’t seem to have an impact on World Bank lending policy, when a country defaults on its ICSID obligations. It appears the whole BIT-system is lacking teeth.’*

⁷⁴ West, *op. cit.*

⁷⁵ The other three were based on coverage of war and civil disturbance.

⁷⁶ German official I.

against political risks, investors still have the option of relying on investment contracts governed by international law.⁷⁷ These can secure investments with the same standards as investment treaties, including recourse to international arbitration backed by the New York or ICSID Conventions.⁷⁸ And while the question of whether, and to what extent, there exists an ‘international law of contracts’ has been subject to some debate,⁷⁹ it is nevertheless indisputable that international tribunals have recognized their jurisdiction over the arbitration of investor contracts disputes throughout the post-war era and have relied, when necessary, on principles of law outside the host country to provide meaningful compensation for both expropriation and other contractual breaches.⁸⁰ Even the adoption of the Charter of Economic Rights and Duties of States did not dispense with international tribunals’ willingness to treat investor-state contracts as enforceable, both in principle and in practice, as well as provide investors with compensation for their losses.⁸¹ One of the key assumptions of Guzman’s influential contributions, namely that ‘[t]he mechanisms for the enforcement of a contract between a state and a private firm is at best extremely weak and at worst altogether non-existent,’⁸² therefore appears doubtful. Even in the absence of

⁷⁷ See generally; Yackee (2008b), *op. cit.*; J. Yackee ‘Pacta sunt servanda and state promises to foreign investors before bilateral investment treaties: myth and reality,’ 32 *Fordham International Law Journal* 1550-1613 (2009b).

⁷⁸ I. Delupis, *Finance and protection of investments in developing countries* (Epping: Wiley, 1973), at 41. Note that many developing countries often also enshrine the right to international arbitration in their domestic investment laws, see, I. Shihata and A. Parra, ‘The experience of the international centre for settlement of investment disputes,’ 14 *ICSID Review- Foreign Investment Law* 299 (1999).

⁷⁹ For some notable critics, see, I. Brownlie, *Principles of public international law* (New York: Oxford University Press, 1990), at 549; D. Bowett, ‘State contracts with aliens: contemporary developments on compensation for termination or breach,’ 59 *British Yearbook of International Law* 49(1988), at 54. For a recent discussion, see, A. Maniruzzaman, ‘State contracts in contemporary international law: monist versus dualist controversies,’ 12 *European Journal of International Law* 309 (2001). See also; The International Law Commission, ‘Commentaries to the draft articles on responsibility of states for internationally wrongful acts,’ *Official Records of the GA, 56th Sess, Supat No. 10 (A/56/10), ch. IV.E.2* (2001), at 87.

⁸⁰ Yackee (2009b), *op. cit.*, at 61-2. Of course, this does not imply that every breach of contracts amounts to breaches of international law, see American law institute, *Restatement of the law, foreign relations law of the United States* (1986), at 712, Comment h, vol. 2, at 201 (‘... not every repudiation or breach by a state of a contract with a foreign national constitutes a violation of international law.’).

⁸¹ Yackee (2009b), *op. cit.*

⁸² Guzman, *op. cit.*, at 659-60. He continues: ‘[I]t is reasonable to model investor behavior under the assumption that these rights are of little or no value to the investor. More importantly, because these protections are unreliable, international law does not allow the host to make credible contractual commitments.’

BITs, investors are quite capable of obtaining credible guarantees from their host countries through carefully drafted contracts.⁸³

In fact, from the perspective of many investors, contracts should be superior legal instruments to protect their assets compared to BITs. Apart from allowing the parties to use much more precise terms than the often vague provisions found in BITs, they also go further in specifying additional rights and obligations. With respect to substantial provisions, they thus typically deal with royalty and tax rates, customs regulations, stabilization of law, and other key issues not dealt with in BITs, and with respect to procedural rights, international law precludes host countries from revoking their consent to arbitrate contractual disputes if the investor does not agree.⁸⁴ This is in contrast to BITs, where states' can unilaterally revoke their consent to international arbitration, if investors have not yet formally provided their own reciprocal consent (which in the absence of a contract typically doesn't happen before an actual dispute arises).⁸⁵

When considering whether contracts are good substitutes for BITs, it is naturally true that smaller investors may have less bargaining power when negotiating contracts with host governments compared to large multinationals. However, BITs are arguably of limited value to them anyway due to the expensive and time-consuming mechanisms of international arbitration.⁸⁶ Similarly, while it is important to note that the home government of an investor is of course not party to a contract; investors nevertheless often use their governments to assert pressure on the host country to uphold its contractual obligations. Lastly, while the difficulty of enforcing damages against sovereigns of course imply that contractual instruments cannot *guarantee* that host countries will uphold their commitments to investors, neither can BITs.

⁸³ The best guarantee to 'internationalize' contracts is of course to have it apply stabilization clauses, general principles of law and/or international law, as well as international arbitration.

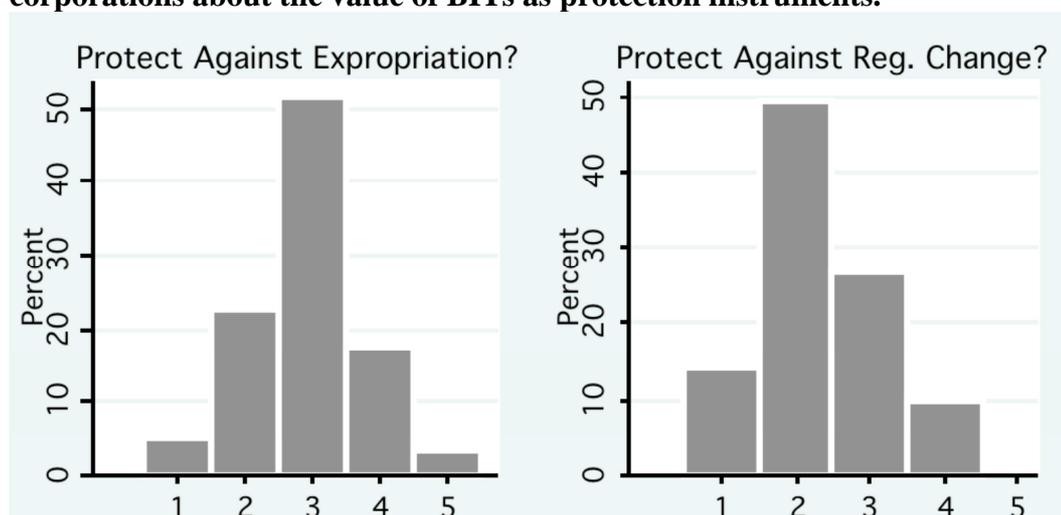
⁸⁴ Yackee (2008b), *op. cit.*, at 136. On the rules of ICSID in this regard, see, Schreuer, *op. cit.*, at 206-7.

⁸⁵ Yackee (2008b), *op. cit.*, at 122-3. See also, J. Alvarez, 'The once and future foreign investment regime,' in M. Arsanjani, J. Cogan and S. Weissner, eds., *Looking to the future: essays on international law in honor of W. Michael Reisman* (The Hague: Martinus Nijhoff, 2010).

⁸⁶ See Daniño, *op. cit.*

Apart from obtaining indirect protection through a range of market-based instruments, such as distributing shareholdings or obtaining lending from major lending institutions, PRI and investor-state contracts thus also provide investors with plausible and effective remedies when worried about political risk. The claim that BITs are the only instruments capable of convincing foreign investors that their assets will be safe post-establishment therefore appears somewhat detached from realities on the ground. Indeed, this is also the feedback from company lawyers themselves, who in Yackee’s survey quoted above generally find BITs of only limited value to protect international investors against political risks (Figure 6.4).

Figure 6.4. Response from general counsel within American multinational corporations about the value of BITs as protection instruments.



Notes: Histogram reports responses from 75 respondents to: (i) ‘In your view, how effective are international treaties like BITs at protecting foreign investments from expropriation by a foreign government?’; (ii) ‘In your view, how effective are international treaties like BITs at protecting foreign investments from adverse regulatory change in the foreign country?.’ 1 indicates ‘not at all effective’ and 5 indicates ‘very effective.’

Source: J. Yackee, ‘Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Sources of Evidence,’ 51 *Virginia Journal of International Law* 2 (2010).

Implications

While many actors in the investment regime still have somewhat inflated views towards the investment promotion potential of BITs, some developing countries are today reconsidering their belief that the treaties were important to attract

foreign capital.⁸⁷ Instead, they are increasingly looking to include investment obligations in PTIAs. The broader context for the rise of preferential trade agreements is of course primarily the delay in multilateral trade talks in the Doha round, but the inclusion of considerable investment coverage is a relatively recent phenomenon. And the realization that BITs have failed to promote investments has played some part in this development. In Thailand, for instance, one official notes that in the past, *'We may have perceived that to enter into a BIT would be a useful way to promote investments... [But, ed.] we found a survey which seems to show that BITs are not very important in comparison to other factors.'*⁸⁸ So whereas Thailand is increasingly entering into BITs to protect its own investors abroad, it is moving towards a greater focus on investment obligations in PTAs.⁸⁹ Similarly, in Costa Rica, a negotiator notes that that *'we started signing BITs because we had an aggressive policy in attracting FDI. But experience shows they are not important tool in this regard. Now we feel that comprehensive FTAs with investment chapters, including market access, work better as they touch on more rules.'*⁹⁰ Also key officials in Ecuador share these views. One notes, *'after the Central Bank did an economic analysis showing many of the treaties did not have an effect on investment flows, it was decided they should be cancelled.'*⁹¹ Finally, a representative from Chile concurs, stating that *'in the 1990s, the idea was that we would have more investment if we negotiated those instruments. But time proved that wrong.'*⁹² Recall that a key reason Chile entered into BITs was to get access to cheaper investment insurance.⁹³ Yet this expectation hasn't materialized, so *'today we prefer to adopt a more comprehensive approach, by focusing on investment chapters in free trade agreements.'*⁹⁴ So while not all governments in the developing world share these views,⁹⁵ many are likely to have overestimated the benefits of BITs during the decades, when they proliferated rapidly. And

⁸⁷ See the preceding chapter.

⁸⁸ Thai official I.

⁸⁹ Ibid.

⁹⁰ Costa Rican official II.

⁹¹ Ecuadorean official II.

⁹² Chilean official I.

⁹³ See chapter five.

⁹⁴ Chilean official I.

⁹⁵ See chapter eight.

today, they are increasingly looking for alternative treaty-based instruments to attract foreign investment.

Conclusion

During the 1980s and 1990s, there were strong reasons to expect BITs to impact investment flows and risk insurance premiums – after all, that was their main purpose. But while the preceding chapter showed that most developing countries entered into investment treaties expecting to attract foreign capital, data about the FDI impact of BITs was exceptionally scarce at the time. For instance, even though the link between BITs and PRI has historically been assumed to be considerable it was not until this chapter was published that anyone had systematically investigated the role of BITs for the PRI industry.⁹⁶ However, the fact that hopes about the economic impact of BITs have been largely unfulfilled does not imply it was necessarily irrational to sign the treaties during the 1980s and 1990s. Recall, that if information about certain policies is scant, it is not irrational from a Bayesian perspective to give it little weight. The combination of strong prior beliefs and a lack of information could thereby be construed as the reason developing countries assumed that legally binding treaties promising to promote investment flows did actually work as intended. In fact, this is exactly what a Bayesian framework would predict since if, *‘experience is scant ... and/or prior beliefs are strong, then observed experiences carry less weight in the formation of posterior beliefs. In such circumstances, prior beliefs may still dominate the revising process, precluding convergence on posterior beliefs.’*⁹⁷ The next chapter will take this perspective further. For while it should now be

⁹⁶ Poulsen, *op. cit.* Partly reprinted in; L. Poulsen, ‘Political Risk Insurance and Bilateral Investment Treaties: A View From Below.’ In: K. Sauvart, L. Sachs, K. Davies, and R. Zandvliet (eds.) *FDI Perspectives: Issues in International Investment* (New York: Columbia University, 2011); L. Poulsen, ‘How Important Are Bilateral Investment Treaties Really for PRI?’, Political Risk Insurance Newsletter, forth. 2011.

⁹⁷ C. Meseguer, ‘Policy Learning, Policy Diffusion, and the Making of a New Order,’ 598 *The ANNALS of the American Academy of Political and Social Science* 67 (2005), at 75.

quite clear that many developing countries overestimated the benefits of BITs, they could also have severely underestimated their costs.

7. Learning about investment treaties

The question addressed by this chapter is whether developing countries not only had overly optimistic views towards the benefits of BITs during the decades when they proliferated, but also underestimated their risks. If so, then even small expected benefits of BITs would have made them reasonable instruments from an economic perspective. And following a rational learning framework, we would expect that once clear information about the potential costs of BITs became available more hesitant BIT-policies would ensue.¹

To investigate this, I take a broad understanding of policy learning, assuming that developing countries learned about the implications of BITs not only from experiences of other states but also through intermediaries, such as international organizations. As mentioned in earlier chapters, particularly the UN has been important in this respect. On this basis, the chapter will be divided into three sections. The first will review what was written about the risks of BITs by international organizations and others around the time the treaties began to proliferate. The second section will review the first investment treaty claims to investigate, when the potency of BITs actually revealed itself through adjudicative awards. Finally, the third section discusses the current adjustments in the regime.

7.1. What was written about the risks of BITs?

In a rather controversial argument, Sornarajah conjectures whether investors' right to bring international claims directly against host states under BITs – the manifestation of BITs' risks for host states – was in fact 'artificially' created by

¹ Recall that I understand the 'risks' of BITs in a 'Knightian' sense, i.e. that it is possible in principle to assign a measurable probability – or range of probabilities – to potential adverse outcomes of the treaties. See chapter three fn. 81.

arbitrators themselves.² According to Sornarajah, this implication of BITs was not realized by early commentators on - or drafters of - BITs. He notes the peculiarity:

‘that the draftsmen and commentators on the investment treaties did not claim that the dispute settlement clauses in the treaties had the unique effect of creating unilateral rights in foreign investors, often unknowable to the parties.’³

If true, that would be remarkable as it implies that arbitrators themselves generated the ‘bite’ of BITs. So although it may be true from a legal perspective that ‘*much water has flown over the bridge and that it is futile to rake up this matter now*,’⁴ it is very far from futile when investigating what developing countries knew, and were told, at the time they signed up to the BIT regime in large numbers. But while this chapter will otherwise be in general agreement with Sornarajah’s basic point that developing countries may not have entirely understood the implications of BITs when they began signing them, he nevertheless appears to overstate his case: already before the claims began, considerable literature and comments on investment treaties did in fact quite clearly state that ‘arbitration without privity’⁵ was the natural extension of properly drafted arbitration clauses.

Sornarajah bases his claim on the comments by early British drafters of BITs. Yet, while he is correct that they are not exactly crystal clear about the implications of arbitration clauses, it appears farfetched to claim that they did not include ‘any reference’⁶ to the possibility of dispute settlement provisions granting foreign investors unilateral rights. In fact, they stated that the UK model BIT included a provision, ‘*for compulsory arbitration of disputes between an investor and a host State under the Washington Convention machinery.*’⁷ Similarly, Sornarajah notes that the first secretary general of ICSID, Aron Broches, was ‘cautious’ about the

² M. Sornarajah, ‘The Neo-Liberal Agenda in Investment Arbitration: Its Rise, Retreat and Impact on State Sovereignty,’ in: W. Shan, P. Simons, and D. Singh (eds.), *Redefining Sovereignty in International Economic Law* (Portland: Hart, 2008).

³ *Ibid.*, at 210.

⁴ *Ibid.*, at 211.

⁵ J. Paulsson, ‘Arbitration Without Privity,’ 10 *ICSID Review - Foreign Investment Law Journal* 232 (1995).

⁶ Sornarajah (2008), *op. cit.*, ft. 25.

⁷ E. Denza and S. Brooks, ‘Investment Protection Treaties: The British Experience,’ 36 *International and Comparative Law Quarterly* (1987), at 911. Underline added.

effect of BITs' arbitration clauses.⁸ If so, that would be crucially important as ICSID played a considerable role in information dissemination particularly in its early years. But is Sornarajah's reading of Broches correct? This is what Broches wrote in 1982:

'a large and increasing number of investment protection treaties contain provisions which clearly establish host State consent to conciliation and/or arbitration before the Centre... Provisions of this kind, subject to the conditions stated therein and subject further to their compatibility with the Convention, will enable the investor to institute proceedings against the host State before the Centre, and may entitle the host State to avail itself of the same remedy.'⁹

Such consent by the host state notes Broches, is 'irrevocable' once an investor has signified her own consent and does not require the exhaustion of local remedies except if clearly stated in the treaty.¹⁰ As such, BITs may '*lay the foundation for the jurisdiction of the Centre in such a manner as to enable an investor to invoke it without requiring further consent of the host State.*'¹¹ These conclusions appear anything but cautious and clearly foresaw the possibility of investor-state arbitrations based on BITs. They were also followed in academic publications at the time¹² and UNCTC. In its 1984 report, for instance, UNCTC told developing countries that the gradual inclusion of wide-ranging investor-state arbitration clauses in BITs meant that if investment disputes:

'... are not resolved by the two parties themselves or through local remedies within a certain period, then either party may submit the dispute for conciliation or arbitration ... the standard provision is that such disputes shall be submitted to an *ad hoc* arbitration tribunal, if they cannot be resolved by diplomatic means. ... The award of the tribunal is binding upon both parties.'¹³

⁸ M. Sornarajah, *The International Law on Foreign Investment* (Cambridge: Cambridge University Press, 1994), at 268-269.

⁹ A. Broches, 'Bilateral Investment Protection Treaties and Arbitration of Investment Disputes,' reprinted in: Aron Broches (ed.) *Selected Essays: World Bank, ICSID, and Other Subjects of Public and Private International Law*, (London: Martinus Nijhoff, 1995), at 450-451. Commenting on the exact same clause as Broches, Sornarajah states that they 'may' create jurisdiction to ICSID, by contrast to Broches who states that 'they clearly' create jurisdiction.

¹⁰ *Ibid.*, at 453-454.

¹¹ *Ibid.*, at 457.

¹² See e.g.; P. Robin 'The BIT Won't Bite: The American Bilateral Investment Treaty Program,' 33 *American University Law Review* 931 (1983-1984), at 953-956; G. Gallins 'Bilateral Investment Protection Treaties,' 2 *Journal of Energy and Natural Resources Law* 77 (1984), at 91-94; P. Peters, N. Schrijver and P. de Waart, 'Permanent Sovereignty, Foreign Investment and State Practice', in: K. Hossain and S. Chowdhury (eds.), *Permanent Sovereignty over Natural Resources in International Law: Principle and Practice* (London: Frances Pinter, 1984), at 118-119.

¹³ UNCTC, 'Bilateral, regional and international arrangements on matters relating to transnational corporations,' Official Records of the Economic and Social Council, 1984, E.C.10/1984/8, at 7.

This was subsequently repeated by UNCTC in many of its various reports and comments on BITs.¹⁴

Similarly, while the actual implications of BITs' substantive provisions could not be completely known without having been interpreted by adjudicators, the wide range of protections granted to investors was noted by UNCTC and others. As an example, in 1988 - when only 10 percent of the current number of BITs had been signed - UNCTC made a comprehensive and detailed comparative analysis of the content of numerous BITs and BIT-models.¹⁵ It for instance noted the 'very broad' definitions of investment and - at times - investors, the curious fact that FET-standards were wide-spread in BITs even when the developing country party otherwise promoted the Calvo-doctrine, and the potential broad scope of 'umbrella clauses.' It mentioned the inclusion of clauses covering indirect expropriation, and so on and so forth. Also, all of UNCTC's reports noted that BITs did *not* include obligations for investors' conduct pertaining to issues such as corruption, environmental protection, and restrictive business practices. In other words, while the legal analysis provided to developing countries in the 1980s was naturally not as extensive as UNCTAD's later work for instance, it did cover most of the key legal building blocks of BITs. So although the potential for treaty-shopping and expansive and/or inconsistent arbitration decisions was probably not foreseen, both early academic literature and the more accessible reports issued by organizations such as the UNCTC clearly reflected the view that BITs should not be considered merely as 'toothless' tokens of goodwill, but rather as serious legal obligations.

But while the legal obligations enshrined in BITs were clearly communicated as binding and important in theory, another matter is whether they were actually thought to be effective in practice. Some thought they were. One view promoted by the ICC in the 1970s and 1980s, for instance, was that the treaties had deterred investment disputes, which explained the lack of arbitration claims.¹⁶ Also, based

¹⁴ E.g.; UNCTC, *Bilateral Investment Treaties* (New York: United Nations, 1988), at 66-70.

¹⁵ UNCTC, 'Bilateral arrangements and agreements related to transnational corporations,' Official Records of the Economic and Social Council, 1986, E/C.10/1986/7.

¹⁶ ICC, *Bilateral Treaties for International Investment* (1977). A similar argument was repeatedly made by Aron Broches with respect to the effectiveness of the ICSID Convention. See e.g.; A.

on three anecdotes where BIT-obligations had been alerted to host states while settling expropriation disputes in the 1970s, OECD concluded that the treaties were indeed very effective in protecting foreign investments.¹⁷ At the time, however, such views were probably the exception rather than the rule. The comments made by the director of UNCTC in 1988 on this matter are worth quoting in length:

‘... there is little empirical evidence that these treaties have actually been implemented or relied upon in live situations involving nationalisation and compensation. ... There is hardly any evidence that the standards enunciated in these treaties have been applied to the computation of the quantum of compensation or the treatment of foreign companies generally. In this regard it is irrelevant to assert that the mere existence of these treaties has deterred nationalisation. Even if this were true, the issue is not deterrence but whether the standards for nationalisation have been applied, an issue which does not arise where there has been no nationalisation.’¹⁸

Similarly, two years earlier a former legal advisor to the US State department questioned the view of the ICC, and noted that there was only ‘limited’ evidence that BITs had been invoked to successfully resolve investment disputes.¹⁹ In particular, he referred to doubts at the time whether the brief and simple European BIT-texts did in fact provide sufficient guidance to be useful in the enforcement context.²⁰ Similarly, in 1980 it was noted that ‘*bilateral investment treaties in practice seem to be of comparatively reduced significance either as an incentive or as a protective measure*’²¹ and ten years after, in 1990, an academic commentator similarly noted that documented ‘*use of BIT provisions to protect an investment appears to be slight*.’²² It was perhaps for that reason UNCTC stated

Broches, ‘Foreign Investment and the Settlement of Disputes with Particular Reference to ICSID,’ 1980, reprinted in: A. Broches (ed.) *Selected Essays: World Bank, ICSID, and Other Subjects of Public and Private International Law*, (London: Martinus Nijhoff, 1995), at 263. See also; P. Peters, ‘Dispute Settlement Arrangements in Investment Treaties’, in: *Netherlands Yearbook of International Law, 1991* (Cambridge: Cambridge University Press, 1991), at 95.

¹⁷ OECD, *Intergovernmental agreements relating to investment in developing countries* (Paris: OECD, 1985), par. 79.

¹⁸ S. Asante, ‘International Law and Foreign Investment: A Reappraisal,’ 37 *The International and Comparative Law Quarterly* 588 (1988), at 607.

¹⁹ S. Gudgeon, ‘United States Bilateral Investment Treaties: Comments on Their Origin, Purposes, and General Treatment Standards,’ 4 *International Tax & Business Lawyer* 105 (1986) at 130.

²⁰ *Ibid.*, at 110.

²¹ K. Grewlich, *Transnational Enterprises in a New International System* (Alphen aan den Rijn: Sijthoff & Noordhoff, 1980), at 56.

²² J. Salacuse, ‘BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries,’ 24 *The International Lawyer* 3 (1990), at 674.

that even though BITs' '*increasingly rigid*' clauses contrasted with investment policies in a great number of developing countries,²³ this probably had limited implications in actual investment disputes since:

'... injured parties – both investors and their home State – do not necessarily insist in such cases on total compliance with the provisions of the agreement: treaty provisions would seem to lose their binding character to a certain extent and become arguments in a diplomatic debate or provide a basis from which negotiations can proceed.'²⁴

This is notable. Not only legal advisors and academics were unsure about the actual practical implications of BITs in protecting foreign investments, the key international organization advising developing countries on these matters was also hesitant in its view of whether BITs had much 'bite' in practice.

So while developing nations may have been told repeatedly that the treaties entailed binding obligations under international law - which in principle could be adjudicated by international arbitral tribunals - the absence of disputes suggested that the actual potential of BITs to protect investments was fraught with uncertainty. It was therefore not until investment treaty claims began to arise that the importance of BITs could be comprehended. And as will be argued in the following section, it took as long as until the early 2000s for the real potency of BITs to truly reveal itself.

7.2. The potency of BITs revealed

The first claims.

The first time an investor initiated a BIT-claim against its host state was in 1987.²⁵ The claimant was a Hong Kong firm - Asian Agricultural Products Ltd (AAPL) - which had entered into a joint venture with a Sri Lankan company set up to cultivate and export shrimp. After an operation by Sri-Lankan security forces against Tamil rebels resulted in the destruction of the farm, AAPL argued that the

²³ UNCTC (1986), *op. cit.*, at 24. See also; UNCTC (1988), *op. cit.*, at 73.

²⁴ UNCTC (1986), *op. cit.*, at 25. See also; UNCTC (1988), *op. cit.*, at 74.

²⁵ *Asian Agricultural Products Limited (AAPL) v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Award, 27 June 1990.

security forces had not taken sufficient precautionary measures to minimize the destruction of the farm. Following attempts to settle the dispute amicably, AAPL brought the dispute before ICSID claiming a violation of the Sri-Lanka-UK BIT. The stakes of this dispute were high - and not only for the parties involved. First of all, while I have argued above that commentators and drafters clearly saw BITs as giving investors a unilateral right to ‘arbitration without privity,’ this had never before been tested. In other words, had Sri Lanka given its consent to international arbitration with foreign investors *as a group* purely by entering into the treaty? Unfortunately, there was no negotiation history to clarify whether such a crucial departure from customary international law was really the intent of the parties. Secondly, what should be the applicable law of such a dispute: national law, customary international law, the BIT itself, or some combination of the three?²⁶ 1987 was still a time where contemporary commentators found international law often to be ‘... *irrelevant to the resolution of substantive issues involved in the disputes between foreign investors and the host state.*’²⁷ So did it, for instance, matter that the Sri Lankan constitution stated that international investment treaties were binding *except* if administrative or executive actions were taken in the interest of national security?²⁸ Third, could a tribunal constituted to deal with investment matters have competence to decide on a crucial public law issue, namely the legality of force during times of war?²⁹ These were not minor questions of interest only to a limited circle of international lawyers. On the contrary, they addressed fundamental issues of state sovereignty, and they were to be decided by an arbitral tribunal consisting of three individuals - none of which had a background in public international law³⁰ - and with practically no possibility for appeal.

²⁶ See generally, O. Spiermann, ‘Applicable law,’ in: P. Muchlinski, F. Ortino, and C. Schreuer (eds.), *The Oxford Handbook of International Investment Law* (Oxford: Oxford University Press, 2008).

²⁷ T. Ocran, ‘Bilateral Investment Protection Treaties: A Comparative Study,’ 8 *New York Law School Journal of International and Comparative Law* 401 (1987), at 420

²⁸ Incidentally, this very provision was discussed in the context of BITs three years before the dispute; see Peters, Schrijver and de Waart, *op. cit.*, at 134.

²⁹ See e.g. comments in M. Sornarajah, *The International Law on Foreign Investment* (Cambridge: Cambridge University Press, 2004), at 248.

³⁰ C. Amerasinghe, ‘The Prawn Farm (AAPL) Arbitration,’ 4 *Sri Journal of International Law* 155 (1992), at 155.

The tribunal decided largely in favor of the investor. Without hesitation, it agreed with the claimant that by entering into the BIT, Sri Lanka had allowed AAPL to initiate international arbitration without a specific arbitration agreement (such as a contract) or first having exhausted local remedies. Secondly, the majority of the tribunal held that as both the parties had relied heavily on the BIT during the course of the proceedings, an implicit ‘mutual agreement’ could be inferred that the parties agreed the BIT should have prominence over national law (such as the Sri Lankan constitution).³¹ On this basis, the tribunal proceeded to the merits of the case, where it also found in favour of AAPL and awarded compensation of US\$460,000 plus interest. Given that the provision on which jurisdiction had been established was included in many BITs; one commentator noted at the time that the decision ‘*appears to mark the beginning of a trend that will have to be carefully watched.*’³² The extent to which developing countries followed that advice is doubtful. Even UNCTC failed to discuss the case in its reports on BITs the following years³³ and no delegates as much as hinted to the dispute when BITs were discussed in UNCTC sessions.³⁴

However, from a purely economic perspective it is worth recalling that the award was rather limited; in fact it was less than a tenth of what AAPL had sought in compensation.³⁵ So even if bureaucrats in developing countries read the

³¹ This was despite the fact that the parties had recorded diverging views on this point, and that when claimants raised points of substance based on the BIT, it was only natural for Sri Lanka’s counsel to address these irrespective of whether it agreed the BIT was the proper choice of law, see; *Asian Agricultural Products Limited (AAPL) v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/87/3, dissenting opinion, 27 June 1990.

³² D. Asiedu-Akrofi, ‘ICSID Arbitral Decision,’ 86 *American Journal of International Law* 2 (1992), at 376.

³³ UNCTC, ‘Other international, regional and bilateral arrangements and agreements related to transnational corporations,’ Official Records of the Economic and Social Council, 1991, E/C.10/1991/9; UNCTC and ICC, *Bilateral Investment Treaties, 1959-1991* (New York: United Nations, 1992).

³⁴ UNCTC, ‘Report on Seventeenth Session,’ Official Records of the Economic and Social Council, 1991, Supplement No. 10, E/C.10/1991/17; UNCTC, ‘Report on Eighteenth Session,’ Official Records of the Economic and Social Council, 1992, Supplement No. 6, E/1992/26; UNCTC, ‘Report on Nineteenth Session,’ Official Records of the Economic and Social Council, 1993, Supplement No. 10, E/1993/30.

³⁵ *Asian Agricultural Products Limited (AAPL) v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Award, 27 June 1990, at 568.;

discussion of the award in the ICSID Review³⁶ - or some of the few other comments on the case at the time³⁷ - its limited (pecuniary) implications could hardly have provoked the same strong reaction as much more considerable awards did many years later (see below). Also, AAPL's expansionary reading of the BIT to establish a strict liability standard higher than pre-existing rules of international law was not accepted by the tribunal, which combined with the small damages made Sri Lanka see the award as a great success according to Sri Lankan officials involved in the case.³⁸ It therefore didn't really hint at the potential for considerable costs of a BIT-based arbitration system. Developing countries would as such have been justified if they kept a view, along with for instance UNCTC, that entering into BITs entailed only limited practical implications for the resolution of investment disputes. Indeed, Vagts noted in the year the dispute was determined that '*so far as the literature discloses, BITs have not yet been put to the test so that we do not know how much they enhance the security of foreign investment.*'³⁹ Similarly, while an organization like MIGA was continuing to push for the treaties, it noted in 1991 that only '*[p]rofessional advisors, such as accountants or merchant bankers, would be people to concern themselves with such minutiae....*'⁴⁰

The second award based on investment-treaty arbitration that we know of didn't come until 1995. Here a tribunal found that Poland had applied its environmental protection laws in a way that was tantamount to expropriation of an investment made by a German paper company, Saar Papier.⁴¹ While the Polish government was aware that the Polish subsidiary of Saar Papier made use of used paper in its

³⁶ N. Zaidé, 'Some recent decisions in ICSID cases,' 6 *ICSID Review-Foreign Investment Law Journal*(1991), at 514.

³⁷ See e.g.; C. Amerasinghe, 'The Prawn Farm (AAPL) Arbitration,' 4 *Sri Journal of International Law* 155 (1992); D. Asiedu-Akrofi, 'ICSID Arbitral Decision,' 86 *American Journal of International Law* 2 (1992); S. Vasciannie, 'Bilateral Investment Treaties and Civil Strife: The AAPL/Sri Lanka Arbitration,' 29 *Netherlands International Law Review* 332 (1992).

³⁸ Sri Lankan officials I and II.

³⁹ D. Vagts, *The question of a reference to international obligations in UNCTC code of conduct: a different view* (Geneva: United Nations, 1990), at 12.

⁴⁰ MIGA PAS, *Industrialized Countries' Policies Affecting Foreign Direct Investment in Developing Countries, Volume I* (Washington DC: World Bank, 1991), at 92. Underline added.

⁴¹ *Saar Papier Vertriebs GmbH v. Poland*, (German/Poland BIT), Award, 1995 (not public). See; L. Peterson, 'Early investment arbitrations against 'improper' use of environmental laws uncovered,' *Investment Law and Policy Weekly News Bulletin*, January 5, 2004.

production, Polish environmental authorities nevertheless halted imports of used paper classifying it as 'waste'. As a result, Saar Papier could no longer produce its products and argued that the 1989 BIT between Poland and Germany obliged Poland to pay compensation for its losses. The tribunal agreed and awarded the German investor 2.3 million Deutchmark.⁴² Whatever the merits of the case, one would perhaps expect that this decision would have received considerable attention. After all, an *ad hoc* tribunal had just ruled on the legality of Polish environmental regulation and decided that the government had to pay considerable damages to a foreign investor – all outside the Polish legal system. Yet, it in fact received no attention at all because the dispute was kept completely confidential and basic information on the nature of the case is still not available today.⁴³ For that reason, developing countries – or developed countries for that matter - had no way of knowing that BIT provisions on expropriation had been interpreted to circumvent regulation enacted to protect the environment.

Today we know that around this time, an increasing number of BIT claims appeared before arbitral tribunals but as with the Saar claim, most were pursued under non-ICSID rules and thus kept secret.⁴⁴ Poland was on the respondent end of several other claims, but also Russia,⁴⁵ Kazakhstan,⁴⁶ and a yet unknown Latin American country⁴⁷ were involved in disputes. Some involved considerable claims - such as one by the American firm Ameritech against Poland of approximately US\$500 million⁴⁸ - and while several were eventually settled, there is no publicly available information on the terms of the settlement agreements. So except for bureaucrats in the countries in question, as well as legal practitioners with privileged access to information about the cases, the general perception by the mid-1990s was that there had in fact only been one BIT claim – AAPL v. Sri

⁴² Note that the claiming argued one year later that this was just a partial award, and claimed a further 31 million Deutchmarks in damages in a subsequent claim.

⁴³ Peterson (2004), *op. cit.*

⁴⁴ Empirical data on confidentiality of investment arbitration awards, see; F. Ortino, 'External Transparency of Investment Awards,' working paper, July, 2008.

⁴⁵ *Sedelmayer v. Russia*, SCC rules, 1996. Investor was awarded more than US\$2 mio. plus interest (see http://ita.law.uvic.ca/documents/investment_sedelmayer_v_ru.pdf).

⁴⁶ *Biederman v. Kazakhstan*, SCC rules, 1996. Investor was awarded more than US\$8 mio.

⁴⁷ The ICC claim involved a European hotel investment. It was eventually withdrawn.

⁴⁸ Using UNCITRAL rules, Ameritech claimed approx. US\$500 mio. under the United States-Poland BIT. The case was settled on undisclosed terms.

Lanka. That some investors slowly started to realize the potency of BITs was therefore largely kept under the radars of most governments. Indeed, the two main textbooks on international investment law at the time only referred to the AAPL case⁴⁹ and in 1997 experts at an UNCTAD meeting commented that ‘*there is very little practical experience with the use of bilateral investment treaties and the information available on their application is mostly anecdotal.*’⁵⁰ Similarly, in an important article on investment treaties, Sacerdoti noted the same year that ‘*major conflicts between host States and foreign investors tend to be rare,*’ and he made no reference to the rising number of investment treaty claims pursued in private.⁵¹

Also in 1997 - 10 years after AAPL brought its claim against Sri Lanka – the second award based on a BIT claim was made public. The dispute was brought by a US company, American Manufacturing and Trading (AMT), against Zaire (now Dem. Rep. of Congo).⁵² AMT’s property had been looted and damaged during riots in Kinshasa, and the company submitted that it was entitled to compensation under the US-Zaire BIT. The ICSID tribunal again found in favor of the investor and awarded AMT US\$9 million plus interest.⁵³ This was a considerable sum for one of the poorest countries in the world, but the award was provisionally stayed as per Zaire’s request, so it was not until the revision proceedings ended in 2000 that the case was finally concluded. Perhaps, it is for this reason that UNCTAD, for instance, failed to mention it in its annual World Investment Reports at the time⁵⁴ as well as its otherwise extensive 1998 report on BITs.⁵⁵ Nor did the case

⁴⁹ Sornarajah, *op. cit.*; Dolzer and Stevens, *op. cit.*

⁵⁰ Comments by experts at UNCTAD meeting; UNCTAD, ‘Expert Meeting on Existing Agreements on Investment and their Development Dimensions: Chairman’s summary,’ 2 June 1997, TD/B/COM.2/EM.1/5, at 4.

⁵¹ G. Sacerdoti, ‘Bilateral Treaties and Multilateral Instruments on Investment Protection,’ 269 *Recueil des Cours* (1997), at 339.

⁵² *American Manufacturing & Trading, Inc. v. Democratic Republic of the Congo*, ICSID Case No. ARB/93/1.

⁵³ Note, that by comparison with the ‘megalawyerling’ surrounding most of today’s investment arbitration cases, Zaire was solely represented by one government lawyer and Zaire’s ambassador to France.

⁵⁴ See e.g.; UNCTAD, *World Investment Report 1997* (Geneva: United Nations, 1997); UNCTAD, *World Investment Report 1998* (Geneva: United Nations, 1998b); UNCTAD, *World Investment Report 1999* (Geneva: United Nations, 1999). Note that in the 1996 World Investment Report, UNCTAD made a list of pending and concluded ICSID cases, but did not comment that a number of these were based on BITs; UNCTAD, *World Investment Report 1996* (Geneva: United Nations, 1996), Table v.6.

appear to have featured much - if at all - in the ongoing discussions on the proposed Multilateral Agreement on Investment (MAI).⁵⁶

In 1998, two ICSID awards were based on BIT disputes.⁵⁷ The *Fedax* arbitration was notable, as it was the first ICSID case where the objection to jurisdiction concerned the notion of ‘investment’,⁵⁸ and the tribunal applied a rather expansive reading of the term. It allowed the Dutch firm to bring a claim against Venezuela based on a dispute concerning promissory notes issued by the Venezuelan government, but which had been transferred to the Dutch firm by a Venezuelan company. No capital had actually flowed from the Netherlands to Venezuela, yet the tribunal argued that since the BIT in question – as most BITs – referred to investment as ‘every kind of asset’ and the ICSID Convention didn’t itself provide a definition, the loan instruments were protected under the BIT as well as the Convention. The decision showed that BITs allow investors to ‘...become foreign by a paper transfer of assets among companies without any commitment of new money to the host economy.’⁵⁹ Even so, as with the other dispute finalized that year - *Goetz v. Burundi* - the actual damages were limited. In the *Goetz* arbitration, the parties agreed in a settlement agreement for damages of less than US\$5 million as well as create a new free trade zone regime for the investors, and in the *Fedax* arbitration the award was less than US\$1 million. So while particularly the *Fedax* dispute did hint at the considerable scope of protection provided in BITs, neither of the two disputes were particularly damaging in economic terms. UNCTAD thus noted the same year that it was ‘remarkable that, after nearly 40 years of BIT practice, information on the experience with the application of BITs still remains rather sketchy and anecdotal.’⁶⁰ Similarly,

⁵⁵ UNCTAD (1998a), *op. cit.*

⁵⁶ See; www1.oecd.org/daf/mai/index.htm; P. Malanczuk, ‘State-State and Investor-State Dispute Settlement in the OECD Draft Multilateral Investment Agreement,’ 3 *Journal of International Economic Law* 417 (2000). See also below.

⁵⁷ *Goetz v Republic of Burundi*, ICSID Case No. ARB/95/3, Award, 10 February, 1999 (the award embodied a settlement agreement made in 1998); *Fedax NV v Venezuela*, ICSID Case No. ARB/96/3, Award, 9 March 1998. A third arbitration was settled the same year on undisclosed terms; *Lanco International Inc v. Argentine Republic*, ICSID Case No. ARB/97/6.

⁵⁸ See: <http://ita.law.uvic.ca/documents/Fedax-1998-Last.pdf>.

⁵⁹ G. Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2007), at 116.

⁶⁰ UNCTAD (1998a), *op. cit.*, at 141.

Wälde noted also in 1998 that as a method, the unconditional consent to investor state arbitration included in BITs was ‘*very little tested and thought through ...*’⁶¹

A more notable dispute revealing the potency of the treaty-based investment arbitration system came the same year. It involved a claim under Chapter 11 of NAFTA brought by an American firm, Ethyl Corporation, which claimed more than US\$250 million in compensation for an environmental regulation issued by the government of Canada.⁶² The Canadian health ministry had introduced an act prohibiting interprovincial trade of a specific fuel additive, one reason being the fear of health-risks when its by-products were released into the atmosphere. Since the substance wasn’t produced in Canada, the trade ban effectively removed it from Canadian gasoline. After the tribunal decided in July 1998 that it had jurisdiction to hear the claim, Canada settled the dispute by reversing the ban, paying US\$13 million in legal fees and damages to Ethyl, as well as issuing a statement that available scientific information did not show harmful effects of the substance. One reason for the settlement was probably the considerable expenses Canada would have to incur had the arbitration continued, as well as the scope of the damages it would have to pay had Ethyl won the case. This decision attracted considerable media attention and became highly politicized in Canada.⁶³ Western NGOs moreover began using it in their campaign not only against NAFTA but also the ongoing MAI negotiations.⁶⁴

Recall, that both *AAPL*, *Fedax*, and *Goetz* were relatively minor disputes, *AMT* had not yet been finalized, and the remaining claims had been kept secret. As

⁶¹ T. Wälde, ‘Investment Arbitration Under The Energy Charter Treaty: From Dispute Settlement to Treaty Implementation,’ 1998, at 54. Available at: www.dundee.ac.uk/cepmlp/journal/html/Vol1/article1-10.pdf (accessed 11 October 2010).

⁶² *Ethyl Corporation v. Canada*, UNCITRAL Rules, Decision on Jurisdiction, 24 Jun, 1998.

⁶³ See e.g. ‘NAFTA Cone of Silence,’ *The Globe and Mail*, 26 August 1998 (‘*lawsuits against the Canadian government under NAFTA’s Chapter 11 end up being composed almost entirely of rumor and leaks rather than official documents.*’). See generally; G. Alvarez and W. Park, ‘The New Face of Investment Arbitration: NAFTA Chapter 11,’ 28 *Yale Journal of International Law* 365 (2003).

⁶⁴ See generally; E. Graham, *Fighting the wrong enemy: antiglobal activists and multinational enterprises* (Washington DC: Institute for International Economics, 2000), ch. 2; A. Walter, ‘NGOs, Business, and International Investment: The Multilateral Agreement on Investment, Seattle, and Beyond,’ 7 *Global Governance* 51 (2001), at 62-63;

result, few - if any - noted at the time that *Ethyl* was in fact not the first investment treaty claim to rule on environmental regulations (*Saar Papier*) and larger claims had been brought against developing/transition economies (*Ameritech*). In discussions and publications by the end of the 20th century, *Ethyl* was often presented as the first major and controversial settlement of an investment treaty dispute. That said, even though both the dispute settlement provisions and expropriation clauses of NAFTA could be found in many of the more than 1,500 BITs signed by 1998, the case did not call too much attention to BITs. Although minor references were made in UNCTAD publications the same year to the fact that indirect takings were also covered in BITs, *Ethyl* was primarily presented as relevant to the NAFTA parties only,⁶⁵ and there was no foreshadowing of the surge in claims that was about to begin.⁶⁶

The year after, yet another investor was awarded almost US\$10 million in compensation under a BIT claim against Kazakhstan, yet this was not mentioned by UNCTAD at the time, probably because it was under SCC rules and thus pursued under public radars.⁶⁷ The same year, UNCTAD noted that there,

‘... is very little known on the use that countries and investors have made of BITs. They have been invoked in a few international arbitrations, and presumably in diplomatic correspondence and investor demands. The most significant function appears to be that of providing signals of an attitude favoring FDI.’⁶⁸

The 2000s

Not long after, however, the ‘floodgates’ of investment treaty claims were opened.⁶⁹ In the context of NAFTA, *Metalclad v. Mexico*, *Pope and Talbot v. Canada*, *S.D. Meyers v. Canada*, *Methanex v. the United States*, and *Loewen v.*

⁶⁵ E.g., UNCTAD (1999), *op. cit.*, at 134.

⁶⁶ *Ibid.*, at 118; UNCTAD, *World Investment Report 2000* (Geneva: United Nations, 2000), at 6.

⁶⁷ *Biederman v. Kazakhstan*, SCC, Award, August 1999.

⁶⁸ UNCTAD, *Trends in International Investment Agreements: An Overview* (Geneva: United Nations, 1999), at 47.

⁶⁹ Note that in 2000, another award came out against Spain. Particularly the ruling on the scope of the MFN standard – to also cover dispute settlement provisions - has in later years attracted considerable attention for the considerable implications. Yet given the relatively small number of disputes at the time, it did not attract too much attention in 2000; *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7 Decision on Jurisdiction, 25 January 2000.

the United States were pending or partly completed by 2000. All led to concern among the NAFTA parties and NGOs that NAFTA might – right or wrong – be undermining the countries’ capacity to regulate in the public interest. *Metalclad*, for instance, raised questions of how to balance concerns of the environment and public health with the rights of foreign investors, when a permit to operate a hazardous waste site was denied by a local authority in Mexico. And many observers became concerned when arbitrators relied solely on the *federal* assurances given the American investor, ignoring that the Mexican municipal authorities were in fact allowed under Mexican law to deny the permit.⁷⁰ Also, the tribunal based part of its award against Mexico on a somewhat idealized standard of ‘perfect governance’,⁷¹ by reading a far-reaching transparency obligation into the fair and equitable treatment standard:

[transparency is, ed.] the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any Party . . . become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.’⁷²

This was a remarkable interpretation divorced from the realities of state practice, and was also later set aside by the British Columbia Supreme Court, which argued that the tribunal had exceeded its jurisdiction.⁷³ Subsequent discussions of the fair and equitable treatment standard in the aftermath of the award, however, demonstrated that even countries like Canada and the United States had not, ‘...entirely grasped the real nature of the standard. Some had rarely given a second thought to its potential breadth ... As was the case with the majority of *BIT* provisions, second thoughts only began to arise when arbitral tribunals began to

⁷⁰ See e.g. discussions in S. Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Portland: Hart Publishing, 2009), ch. 6; D. Schneiderman, *Constitutionalizing Economic Globalization* (Cambridge: Cambridge University Press, 2008), ch. 3.

⁷¹ Montt, *op. cit.*, at 321.

⁷² *Metalclad v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Merits award, 30 Aug, 2000, par. 76.

⁷³ *United Mexican States v. Metalclad Corp.*, [2001] B.C.T.C. 664, para. 68 (Can.).

shed light on these provisions.’⁷⁴ This was also clear in the *Pope and Talbot* claim, where the tribunal held that Canada was wrong in arguing that the fair and equitable treatment clause did not entail obligations that went over and beyond the customary international law standard.⁷⁵ According to the tribunal, it did.

All this became too much for the NAFTA parties. With a number of other NAFTA-claims in the pipeline, American officials began to fear that such an understanding of the provision could mean that their government could be in breach of Chapter 11.⁷⁶ So a few months after the interim award in the *Pope* dispute, NAFTA’s Free Trade Commission issued an interpretative note that the three governments did *not* intend the provision to go over and beyond what was expected from customary international law.⁷⁷ Also, both the Canadian government and the American Association of State Attorneys General expressed further concern over the far-reaching nature of indirect expropriation provisions as interpreted by the NAFTA tribunals.⁷⁸ Ultimately, the claims led to a change in the BIT-models of both the United States and Canada, which clarified and restricted the scope of the fair and equitable treatment standard, the expropriation provision, and MFN treatment.⁷⁹ In one session, the US Intergovernmental Policy Advisory Committee (IGPAC) for instance noted that, ‘*The Methanex and Loewen cases in particular have reinforced concerns that the provision [on*

⁷⁴ K. Yannaca-Small, ‘Fair and Equitable Treatment Standard: Recent Developments,’ in: A. Reinisch (ed.) *Standards of Investment Protection* (Oxford: Oxford University Press, 2008), fn. 9.

⁷⁵ *Pope & Talbot v. Canada*, UNCITRAL, Interim Merits Award, 26 Jun, 2000.

⁷⁶ T. Weiler, ‘NAFTA Article 1105 and the Free Trade Commission: Just Sour Grapes, or Something More Serious?’ 29 *International Business Lawyer* 491 (2001), at 493; M. Clodfelter, *U.S. State Department Participation in International Economic Dispute Resolution*, 42 *The South Texa Law Review* 1273 (2001), 1438.

⁷⁷ Note of Interpretation of the NAFTA Free Trade Commission, 31 July 2001. See also the NAFTA parties’ subsequent critique of the *Pope* tribunal, including the fact that the tribunal presented the note as an illegitimate attempt to interfere with the case, *Mondev International Ltd. v. United States*, Award, 11 Oct, 2002, ICSID Case No. ARB(AF)/99/2, par. 106, 108-110.

⁷⁸ D. Gantz, ‘The Evolution of FTA Investment Provisions: From NAFTA to the United States-Chile Free Trade Agreement,’ 19 *American University International Law Review* 679 (2004), at 740-742.

⁷⁹ See e.g.; K. Vandevelde, ‘A Comparison of the 2004 and 1994 U.S. Model BITs: Rebalancing Investor and Host State Interests,’ in: K. Sauvant (ed.) *Yearbook on International Investment Law and Policy 2008/2009* (New York: Oxford University Press, 2009); J. MacIlroy, ‘Canada’s New Investment Promotion and Protection Agreement: Two Steps Forward, One Step Back?’ 5 *Journal of World Investment* 621 (2004); G. Gagné and J.-F. Morin, ‘The Evolving American Policy on Investment Protection: Evidence From Recent FTAs and the 2004 Model BIT,’ 9 *Journal of International Economic Law* 2 (2006).

*dispute settlement, ed.] will be abused by investors who simply hope to circumvent established legislative and judicial procedures.'*⁸⁰ Similarly, in Canada the NAFTA claims has meant that, '*the level of legal focus is incomparable compared to 15 years ago,*' as one officials notes.⁸¹

One thing is the lessons learned by the NAFTA parties, however, another is what role the claims played for developing countries. Luke Peterson observed in 2001, for instance, that while the NAFTA claims, the MAI, and the investment negotiations in both the WTO and the Free Trade Agreement for the Americas were extensively commented upon, this was still not the case with BITs.⁸² As mentioned above, due to the secrecy surrounding the earlier disputes there was an understanding at the time that BITs had not been used for similar purposes as the NAFTA claims.⁸³ In WTO's investment discussions that year, for instance, no mention of the disputes was made by any of the developing countries arguing in favor of BITs instead of multilateral investment disciplines.⁸⁴ Also, in UNCTAD's 2001 World Investment Report, none of the NAFTA claims were mentioned as being important for the BIT-movement.⁸⁵ Given that this was by far the most important publication informing developing country officials about trends in the international investment regime,⁸⁶ this is notable. Similarly, in the organization's report on the relationship between investment treaties and environmental regulation the same year, which commented on the NAFTA

⁸⁰ United States Intergovernmental Policy Advisory Committee (IGPAC), 'Advisory Committee Report to the President, the Congree and the United States Trade Representative on the US-Australia Free Trade Agreement,' 12 Mar, 2004, 14-15.

⁸¹ Canadian official I.

⁸² L. Peterson, 'Changing Investment Litigation, BIT by BIT,' available at: www.iisd.org/pdf/2001/trade_inv_litigation.pdf (accessed 22 Jan 2010).

⁸³ E.g. H. Mann and M. Araya, 'An Investment Regime for the Americas: Challenges and Opportunities for Sustainability,' *Yale Center for Environmental Law and Policy*, Mar 2001 ('*there is no track record of BIT's being used to lobby against the making of environmental or human health protection laws, or to seek compensation for the adoption of such laws.*' On this basis, the authors note that the '*NAFTA investor-state litigation will be tested in the bilateral context, and [the Methanex, ed.] case may provide a harbinger of such a shift.*' at fn. 24).

⁸⁴ See e.g., WTO WGTI, Report on the Meeting of 7 and 8 March 2001, WT/WGTI/M/14.

⁸⁵ UNCTAD, *World Investment Report 2001* (Geneva: United Nations, 2001).

⁸⁶ See e.g. Dunning quoted in; T. Frederiksson, 'Forty Years of UNCTAD Research on FDI,' *12 Transnational Corporations* 3 (2003).

disputes, BITs were mentioned only twice and that too in passing.⁸⁷ So while the early NAFTA claims were indeed noteworthy, they were not yet construed as particularly relevant for BITs. Indeed, 2001 was the year were the largest number of countries were involved in BIT-negotiations – 97 – and UNCTAD had a particularly productive year managing to facilitate the signing of more than 70 BITs at its negotiation rounds.⁸⁸

It was not until 2002 that the debate began about the risks of investment treaty arbitration for developing countries. This is when a large number of BIT arbitrations had begun. Most notable were the cases against Argentina in the wake of its financial crises. Here, foreign utility firms like Enron and Vivendi sued the country after the government withdrew from a promise that their tariffs would be pegged to inflation-adjusted US dollars.⁸⁹ This guarantee had been enshrined in investor-state contracts during the heydays of Argentina’s liberalization in the early 1990s, yet the financial crisis meant that the government had to restructure its finances rapidly and considerably in order to prevent a complete economic meltdown. As a result, foreign investors were no longer insulated from the losses associated with the crisis, which led to a surge of claims beginning in 2001, which by 2002 amounted to more than US\$4 billion.⁹⁰

Also in 2002, news had come out on a peculiar set of events in the second half of 2001, involving a dispute between Ronald Lauder, the American cosmetics billionaire, and the Czech Republic. Lauder pursued his claim involving a TV broadcasting station through two BITs simultaneously. Apart from the US-Czech BIT, where he was covered by being a US national, he also filed a claim under the

⁸⁷ UNCTAD, *Environment, UNCTAD Series on Issues in International Investment Agreements* (Geneva: United Nations, 2001).

⁸⁸ See chapter five.

⁸⁹ See generally, W. Burke-White, ‘The Argentine Financial Crisis: State Liability under BITs and the Legitimacy of the ICSID System,’ in: ‘Perceived Bias in Investment Treaty Arbitration,’ in: M. Waibel, A. Kaushal, K.-H. Chung and C. Balchin (eds.) *The Backlash Against Investment Arbitration* (Alphen Aan den Reijn: Kluwer Law, 2010). Note, that Argentina has recently succeeded in annulling a number of awards; *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Decision on Annulment, 29 Jun, 2010; *Enron Corporation and Ponderosa Assets LP v. Argentina*, ICSID Case No. ARB/01/3, Decision on Annulment, 30 Jul, 2010.

⁹⁰ See chapter 2.

Dutch-Czech BIT, where he had incorporated a holding company, Central European Media Enterprises (CME). But despite the fact that the dispute was based on the same set of facts and two similarly worded BITs, the two tribunals came to completely opposite conclusions, and that too within 10 days.⁹¹ This confirmed a concern already pointed out in 1997, by then Secretary General of ICSID, Antonio Parra, that the broad definition of investors and the *ad hoc* nature of BITs' adjudication mechanism increased the likelihood of multiple awards concerning identical events, where the '*scope for inconsistent decisions in regard to essentially the same issues is obvious.*'⁹² Furthermore, the decision did not lead to concerns about the predictability of the arbitration system, it also resulted in a massive compensation award the year after of US\$350 million, which led the dissenting arbitrator, Ian Brownlie, to note that,

'[t]he Czech Republic should have the benefit of civilized modern standards in the treatment of States. Even States which have been held responsible for wars of aggression and crimes against humanity are not subjected to economic ruin. ... It would be strange indeed, if the outcome of acceptance of a bilateral investment treaty took the form of liabilities 'likely to entail catastrophic repercussions for the livelihood and economic well-being of the population' of the Czech Republic.'⁹³

On this background, a debate gradually began in 2002 over the potential risks of investment treaty arbitration for developing countries. In the context of the WTO, Argentina now provided detailed comments on the potential risks of investment treaty arbitration.⁹⁴ In the same session, UNCTAD noted that the WTO delegates should be aware that treaty-based investor state arbitration could give rise to '*different – even conflicting - rulings on the same issue. This was due, for example, to overlapping membership of different agreements and had indeed become a real issue, as had been witnessed in recent arbitration cases.*'⁹⁵ Similarly, in the UNCTAD's expert meeting on investment treaties in 2002,

⁹¹ *Lauder (Ronald S.) v. The Czech Republic*, UNCITRAL Rules, Award on Merits, 3 September 2001; *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*, UNCITRAL Rules, award on merits, 13 September 2001.

⁹² A. Parra, 'Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment,' 12 *ICSID Review* 2 (1997), at 352.

⁹³ *CME v. Czech Republic*, UNCITRAL, Separate Opinion, Mar 14, 2003, par. 77-78.

⁹⁴ WTO WGTI, Report on the Meeting held on 16 - 18 September 2002, WT/WGTI/M/19, 3 Dec, 2002, par. 198.

⁹⁵ *Ibid.*, par. 169.

several experts commented that if future disputes followed some of the past rulings on expropriation and fair and equitable treatment it could place considerable burden on developing countries.⁹⁶ Finally, 2002 was also the year the most important NGO in the area, the International Institute for Sustainable Development (IISD) began to seriously discuss BITs,⁹⁷ rather than almost solely focusing on NAFTA.

2002 thus marked the beginning of the current debate about the risks for developing countries to consent to treaty-based investor-state arbitration. From that point onwards, investment treaty disputes were mentioned in every annual report of UNCTAD,⁹⁸ and IISD began an intensive effort to report on the rise of BIT claims.⁹⁹ So if developing countries sought information about the scope and potency of BITs, they had easy access to both by 2002, even if they had not been sued themselves. Despite being exceptional,¹⁰⁰ the many cases against Argentina were a cause for worry and *CME* was for the BIT-movement what *Ethyl* and *Metalclad* had been for NAFTA.

7.3. Adjustments

The lack of disputes - or publicly available information about disputes - meant that it wasn't until around 2002 that developing countries had clear information

⁹⁶ UNCTAD, 'Report of the Expert Meeting on Experiences with Bilateral and Regional Approaches to Multilateral Cooperation in the Area of Long-Term Cross-Border Investment, particularly Foreign Direct Investment,' 12 to 14 Jun, 2002.

⁹⁷ L. Peterson, *Investor Rights and Wrongs: Suffering from 'calligroeconomia'* (Winnipeg: IISD, 2002).

⁹⁸ See e.g.; UNCTAD, *World Investment Report 2003* (Geneva: United Nations, 2003), at 116-118, and fn. 53; UNCTAD, *World Investment Report 2004* (Geneva: United Nations, 2004), at 194; UNCTAD, *World Investment Report 2005* (Geneva: United Nations, 2005), 30-31, 71; UNCTAD, *World Investment Report 2006* (Geneva: United Nations, 2006), 27, 76, 229.

⁹⁹ See; L. Peterson, *Research note: Emerging bilateral investment treaty arbitration and sustainable development* (Winnipeg: IISD, 2003); L. Peterson and K. Grey, *International Human Rights in Bilateral Investment Treaties and in Investment Treaty Arbitration* (Winnipeg: IISD, 2003); A. Cosbey, H. Mann, K. Moltke, and L. Peterson, *Investment, Doha, and the WTO* (Winnipeg: IISD, 2003), at 16-20; L. Peterson (2003), 'Latest arbitration against Argentine emergency financial measures,' *Investment Law and Sustainable Development Weekly News Bulletin*, 7 Mar, 2003.

¹⁰⁰ See below.

available that BITs' ability to expose host states to liabilities was very real and concrete, rather than merely vague and abstract.¹⁰¹ In fact, from 2003 onwards, the annual number of investment treaty claims much exceeded that of WTO disputes. Yet at that point, by far the majority of the existing network of BITs had already been signed and ratified. So while practically all contributions on BIT-diffusion to date assume that developing countries 'knew what they got themselves into' during the 1990s, this is surely questionable: the 'costs' of gathering information about BIT-claims during this period were high, and even international organizations concluded that the treaties were probably not very relevant for the settlement of investment disputes. Following a rational learning model, we should therefore expect that after the claims made the implications of the treaties more clear, developing countries would calibrate their BIT policies. And on the surface, this actually appears to be what happened.

Rebalancing investment treaties

In many, if not most, cases exceptionally broad and vague treaty standards were agreed upon not as a result of fully informed analyses, but simply because developing countries – and others - were not fully aware about the possible implications. As a result, some countries are today following the example of the United States and Canada in being much more careful in clarifying and restricting key provisions. It is beyond the scope of this chapter to document this development in much detail, but let me mention a few examples for the sake of illustration.¹⁰²

As its Northern American counterparts, Mexico, for instance, has begun to specify that the fair and equitable treatment provision does not go over and beyond the

¹⁰¹ While not developing the point into an argument as to why developing countries have signed BITs, Salacuse notes this as well, '*While confidentiality may facilitate dispute settlement between the immediate parties, it weakens regime rulemaking, which requires wide and public dissemination of rules set down by regime decisionmaking bodies.*', J. Salacuse, 'The Emerging Global Regime for Investment,' 51 *Harvard International Law Journal* 427 (2010), at 462.

¹⁰² See generally; UNCTAD, *Investor-State Dispute Settlement and Impact on Investment Rulemaking* (Geneva: United Nations, 2007).

customary international minimum standard.¹⁰³ Similarly, the lacking understanding of BITs' implications has today led Malaysia to be more careful:

'We learned our lesson with the arbitration cases, the treaties have to be balanced. ... So we are also tightening up our provisions, just like the Americans. ... And we are limiting the role of arbitrators making sure they don't run wild favoring investors.'¹⁰⁴

As an example, Malaysia's 2009 BIT with Syria – the only BIT Malaysia has signed since 2002 – guards against investors trying to construe MFN clauses to cover dispute settlement provisions. Article 3 therefore specifies that: '*For greater certainty, this Article shall not apply to procedures regarding Settlement of Investment Disputes between a Party and an Investor of the Other Party which are available in other agreements to which either Party is a party.*'¹⁰⁵ This follows discontent among some countries with the expansive interpretation of MFN provisions by a few arbitral tribunals. In a footnote to the MFN provision in the 2003 draft Free Trade Agreement of the Americas, for instance, it was stated that:

'The Parties note the recent decision of the arbitral tribunal in *Maffezini* ... which found an unusually broad most favored nation clause in an Argentina-Spain agreement to encompass international dispute resolution procedures. ... By contrast, the Most-Favored-Nation Article of this Agreement is expressly limited in its scope to matters 'with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.' The Parties share the understanding and intent that this clause does not encompass international dispute resolution mechanisms ... and therefore could not reasonably lead to a conclusion similar to that of the *Maffezini* case.'¹⁰⁶

Statements like these reflect a broader trend. As noted by Schreuer, '*[l]ooking at some of the reactions, especially of host States, one cannot help the feeling that treaty drafters did not fully appreciate the far-reaching repercussions of MFN clauses and somehow wish they could get the genie back in the bottle.*'¹⁰⁷

Other parts of BITs are being revisited as well, for instance after the Lauder arbitrations illustrated the risks of 'treaty-shopping' due to broad definitions of

¹⁰³ E.g. 2006 Mexico-UK BIT, art 3.2.

¹⁰⁴ Malaysian official II.

¹⁰⁵ Art. 3.3.

¹⁰⁶ Ftn. 13 to art. 5.

¹⁰⁷ C. Schreuer, 'A Decade of Increasing Awareness of Investment Arbitration and Increasing Activity: an Assessment,' (2005) at 3. Available at: www.oecd.org/dataoecd/5/54/36055388.pdf.

investors. In this respect, the Czech Republic and Croatia are examples of countries that typically included very wide definitions of investors in their BITs during the 1990s, but now tend to require a more substantial link to a state in order for it to be considered an investor of that party.¹⁰⁸ One case in point is the 2008 treaty between themselves, where a ‘legal person’ has to have a ‘*permanent residence in the territory of one of the contracting parties.*’¹⁰⁹ Similarly, one reason the Czech Republic is reported to have initiated the renegotiation of its BIT with the United States (thus far in vain) is the perception that it fuels ‘*speculative foreign investments and indirect investments made with the sole goal of later launching legal proceedings ...*’¹¹⁰

Dispute settlement clauses have also been adjusted by some countries in recent years, by for instance allowing for a consolidation of claims,¹¹¹ or including ‘fork-in-the-road’ provisions to preclude investors from pursuing claims both in domestic courts and under international arbitration.¹¹² Finally, the broad scope of investment treaty arbitration has made some countries insist on provisions addressing environmental and health issues. Again, the United States and Canada have led the way, but some developing countries have also insisted on such provisions. One example is the 2009 BIT between Denmark and Bangladesh, where the Danish negotiator had to accede to a request by Bangladesh to specify that ‘*investment objectives should be achieved without relaxing health, safety, and environmental measures of general application.*’¹¹³ Moreover, the treaty stipulates that if either of the two countries suffers environmental or public health damages due to acts of investors of the other party, the governments are entitled to

¹⁰⁸ Compare e.g. the Czech BITs with Jordan (2009) and Bulgaria (1999), and the Croatian BITs with Azerbaijan (2007) and Hungary (1996).

¹⁰⁹ Art. 1b.

¹¹⁰ ‘Czechs face uphill battle to cancel US investment treaty,’ *Czech Position*, 7 Apr, 2011.

¹¹¹ Mexico is again an example, e.g. UK Mexico BIT (2008), art. 14. Note that in one recent class of disputes, Mexico failed to convince the tribunal to consolidate claims based on similar facts; *Cargill, Incorporated v. United Mexican States*, ICSID Case No. ARB(AF)/05/2; *Archer Daniels Midland and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/5; *Corn Products International, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/1.

¹¹² Annex to Art. 11.

¹¹³ Art. 2.2. Note that this formulation mirrors provisions found in preambles in certain recent Dutch BITs, such as with Mozambique (2001), Namibia (2002), and Suriname (2005).

compensation from the investor as per their laws or international law.¹¹⁴ This, of course, is unusual to include in BITs as it relates to the obligations rather than rights of investors, but such innovations were ‘*insisted upon by the Bangladeshi team*’, according to the then Danish negotiator.¹¹⁵ These are but a few examples of how the rise of investment treaty arbitration has, in the words of UNCTAD,

‘... led numerous countries to realize that the specific wording of IIA provisions does matter, and that it can make a significant difference to the outcome of an investment dispute. ... the increase in investment disputes has tested the wisdom of negotiating IIAs with extremely broad and imprecise provisions.’¹¹⁶

Improved implementation

In other instances, the content of BITs has remained largely constant, yet their implementation has been improved. As noted by Wälde, ‘*the negotiation of a treaty is usually accompanied by considerable excitement. Yet once it is finalized, its appeal often declines dramatically.*’¹¹⁷ This is problematic for a host of reasons, one obvious being that while investors may not take much notice of BITs when they invest abroad, treaty-violations sends a signal – right or wrong – that host countries are unwilling to protect foreign capital.¹¹⁸ And the realisation that BIT-disputes very often relate to decisions taken by municipal or provincial government offices or sector-specific regulatory authorities, has made some – though still very few - governments engage in greater information sharing and coordination across government stakeholders to prevent or settle disputes before they are taken to arbitration.¹¹⁹ Peru, for instance, has put in place an ambitious dispute prevention system, where national, regional and local government entities are informed about BIT-obligations and provided facilities to solve disputes with

¹¹⁴ *Ibid.*

¹¹⁵ Danish official I.

¹¹⁶ UNCTAD (2007), *op. cit.*, at 91-92.

¹¹⁷ T. Wälde, ‘Treaties and Regulatory Risk in Infrastructure Investment,’ 34 *Journal of World Trade* 2 (2000), at 47.

¹¹⁸ See generally; T. Allee and C. Peinhardt, ‘Contingent Credibility: The Impact of Investment Treaty Violations on Foreign Direct Investment,’ 65 *International Organization* 401 (2011).

¹¹⁹ See generally; UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration* (Geneva: United Nations, 2010); J. Salacuse, ‘Is There a Better Way? Alternative Methods of Treaty-Based, Investor-State Dispute Resolution,’ 31 *Fordham International Law Journal* 128 (2007-2008), at 139-140.

foreign investors amicably rather than through arbitration.¹²⁰ Also Colombia, Guatemala, and the Dominican Republic are considering similar dispute prevention systems.¹²¹

Politicization

For some developing (and developed) country governments, the disputes have thereby not led to a general backlash against investment treaties, or to a questioning of the fundamental principles enshrined therein, but rather made them better aware of the risks entailed by ‘incomplete contracting’ with overly broad treaty provisions or insufficient implementation. This is uncontroversial, generally accepted, and entirely possible to explain using a rational learning framework: after arbitrators ‘filled in the blanks’ of exceptionally vague treaty obligations, subsequent calibrations of treaty-practice and implementation ensued.

In other cases, however, developing countries have continued to pursue BITs exactly as before, yet with a greater politicization in the decision-making process. To go back to the case of Pakistan from the preface, for instance, Mr. Khan managed to install a more careful BIT-policy in the early 2000s. But after he resigned and new staff also came to the Pakistani Board of Investment, Pakistan has signed BITs as before the claims begun. Recall, for instance, the recent ‘upgrade’ of the German BIT mentioned in chapter four which almost completely follows traditional models used during the 1990s.¹²² Unlike in the past, however, at least government stakeholders like the Law Ministry went to great lengths to make negotiators aware of the risks involved in signing up to such standards.¹²³ Similar experiences will be discussed in later chapters. So even if we relax the unitary actor assumption and acknowledge the possibility that embassies,

¹²⁰ See; UNCTAD (2010), *op. cit.*, ch. 4.

¹²¹ *Ibid.*; Dominican Republic official III. Although not a developing country, see also the practices of Korea; J. Kim, ‘Korea’s Development of a Better Investor-State Dispute Resolution System,’ in: UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration II* [unedited draft] (Geneva: United Nations, forth.); H.-T. Shin, ‘An Obudsman as one Avenue Facilitating ADR and Socio-Cultural Factors Affecting ADR in Investment Treaty Dispute Resulting,’ in: *ibid.*

¹²² Germany-Pakistan BIT (2009).

¹²³ See chapter four.

investment-promotion officials still occasionally push for the treaties to promote their own short-term agendas, they have less of a carte-blanche than before, as the claims have led to a greater awareness among stakeholders with an interest in more cautious BIT-policies.¹²⁴

Slowdown in BIT-participation

The learning process about the implications of BITs could also potentially explain the slowdown in BIT-signing activity seen in recent years.¹²⁵ Figure 7.1 shows that the rush to sign investment protection treaties clearly slowed down after the ‘floodgates’ of investment treaty arbitrations opened.¹²⁶ Unlike the otherwise similar graph in chapter one, I have here identified BITs with European countries, as some EU member states put their BIT-negotiations almost entirely on hold in the early 2000s, when it became clear that the competence to enter into investment protection agreements might be delegated to the European Union (EU).¹²⁷ So even if developing countries wanted to, they have not always been able to conclude BITs with EU member states in recent years. Yet we see that the trend holds for BITs with European and non-European countries alike.¹²⁸ The slowdown is clear also if one considers that some countries today prefer PTIAs over BITs.¹²⁹ For while important, one should not exaggerate this development: in 2008, for instance, only 7 investment protection treaties other than BITs were signed, bringing the total number of treaties with BIT-like protections up to 81 that year – which is still less than half of what was signed just ten years before.¹³⁰

¹²⁴ See next chapter.

¹²⁵ A. Aaken, ‘The International Investment Protection Regime through the Lens of Economic Theory,’ in: Waibel, Kaushal, Chung and Balchin, *op. cit.*; S. Jandhyala, W. Henisz, and E. Mansfield, ‘Three Waves of BITs: The Global Diffusion of Foreign Investment Policy,’ *Journal of Conflict Resolution* (forth., 2011.).

¹²⁶ ICSID official quoted in; Van Harten, *op. cit.*, at 30.

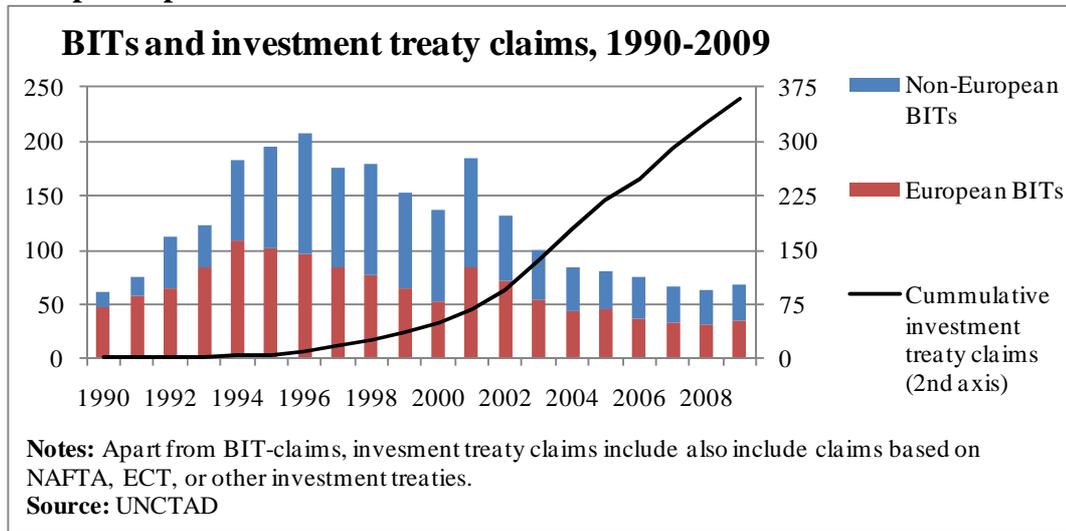
¹²⁷ See generally; M. Bungenberg, ‘Going global? The Common Commercial Policy after Lisbon.’ In; C. Herrmann and J. Terhechte (eds.) *European Yearbook of International Economic Law* (Berlin: Springer-Verlag, 2010), at 123-151.

¹²⁸ The spike in 2001 is likely due to the ‘UNCTAD-effect’. See above as well as Table 5.1.

¹²⁹ See chapters 2 and 5.

¹³⁰ See; UNCTAD, ‘Recent Developments in International Investment Agreements (2008 – June 2009),’ *IIA Monitor No. 3* (2009), annex 2. Apart from the PTIA between Singapore and the Gulf Cooperation Council, all were bilateral trade and investment deals.

Figure 7.1. The rise of investment treaty arbitration and the slowdown in BIT-participation



Part of the slowdown could of course have been due to saturation.¹³¹ By the late 1990s, developing countries with 20 BITs or more had already covered most important destinations, or sources, of investment flows, so they had few significant BIT-partners left to sign with. In this respect, it is important to note that the drop in BIT-signing activity began already in the latter half of the 1990s, when claims had yet to take off. But saturation only explains part of the slowdown. By 2009, 25 percent of developing countries had still signed less than ten BITs, and between the 174 countries participating in the BIT-movement only around 20 percent of the total possible number of BITs had been signed.¹³² So when controlling for lagged BIT-participation the slowdown is still considerable. Table 7.1 thus shows the results of a simple negative binomial regression of developing countries' BIT participation from 1990 to 2009 with country-fixed effects.¹³³ I control for past BITs signed, including its square and cubic functions, as well as lagged ratification measures. The model will be extended and discussed further in chapter nine, but for now it suffices to say that it shows that after 2001

¹³¹ This is suggested in; D. Saban, F. Bonomo, and N. Stier-Moses, 'Analysis and Models of Bilateral Investment Treaties using a Social Networks Approach,' *Physica A: Statistical Mechanics and its Applications* 389, no. 17.

¹³² Maximum number of BITs is: $[174!]/[2!(174-2)!]=15,051$. Suffice it to say that many would be insignificant in economic terms, yet this didn't seem to stop many negotiators in the past.

¹³³ A negative binomial is chosen as the dependent variable is a count variable. The base model has been developed in collaboration with Emma Aisbett. See chapter eight.

developing countries have indeed been much less inclined to sign BITs - also when controlling for the size of their BIT-networks. The BIT-claims appear to have reduced developing countries' signing of BITs by between thirty and forty percent.¹³⁴

Table 7.1. Slowdown in developing countries' BIT signing activity holds when controlling for past BIT participation

	(I)	(II)
<i>Period dummy:</i>		
2002-2009	-0.415*** (0.053)	-0.366*** (0.075)
<i>Participation measures:</i>		
L.Total Signed		0.071*** (0.007)
L.Total Signed ²		-0.001*** (0.000)
L.Total Signed ³		0.000*** (0.000)
L4.Total Ratified		-0.045*** (0.006)
L10.Total Ratified		0.008 (0.007)
Constant	0.394*** (0.053)	0.182 (0.107)
Observations	2640	2640

Standard errors in parentheses.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Dependent variable is the annual number of BITs signed. Table reports coefficients from negative binomial fixed effects regressions. L refers to a one-year lag, L4 a four-year lag, and L10 a ten-year lag.

Variability in experiences with BITs

This indicates that developing countries have become less keen to sign what has been revealed as very potent legal instruments. Needless to say, this is a broad generalization but it does very much follow in line with a Bayesian learning framework. Yet, while the slow-down in BIT-signing activity is marked, and more and more countries are beginning to revisit the content of their treaties, very few

¹³⁴ $1 - \exp(-0.415) = 0.40$ and $1 - \exp(-0.366) = 0.31$. Note that in Estonia, the country slowed down its BIT-negotiations in the 1990s due to the ongoing multilateral negotiations and not the claims (Estonian official I). As a general explanation, however, this would have implied that BIT-participation slowed down during investment negotiations in the MAI and WTO and then picked up when they failed, which is not what we see. See also next chapter.

have actually abandoned BITs entirely. Only a few countries in Latin America have begun to renounce their BITs, and at least in the case of Bolivia this has been associated with a marked ideological shift towards multinationals.

Yet, the fact that few developing countries have entirely stopped signing BITs, or renounced existing treaties, does not necessarily conflict with a rational learning framework. Recall that from a Bayesian perspective, actors are assumed to learn not just from outcomes, but also from their variance. And while governments may have learned from particularly egregious cases¹³⁵ – e.g. the Argentina claims and *CME* – there has been considerable variability in experiences with BITs. The treaties may have had plausible material benefits in some cases, as developing countries themselves can use them to protect their own increasing stocks of outward investments, and in individual cases, they may lure investors to the country.¹³⁶ While chapter four showed that the latter is likely to have been rare, just a single foreign investor can make a considerable difference, particularly in small developing countries.¹³⁷

Also, with respect to the risks of BITs, it is worth recalling that just about 6 percent of the total BIT-network has been used as the jurisdictional basis for claims (Table 7.2). The corresponding figure for the North-South BITs network also remains less than 10 percent. So while a country like Argentina has been on the respondent end of more than 50 BIT claims, many developing countries have yet to experience their first. Among developing countries with ratified BITs, only around half have been hit by a BIT claim.

¹³⁵ On learning from remarkable cases in a Bayesian framework, see; C. Meseguer, ‘Rational learning and bounded rational learning in the diffusion of policy innovations,’ 18 *Rationality and Society* 1 (2006).

¹³⁶ Note also from chapter five, that officials in some developing countries (such as Malaysia) still appear convinced that BITs have a considerable impact on investment flows and the pricing and availability of PRI.

¹³⁷ See e.g. MIGA, *The Impact of Intel on Costa Rica* (Washington DC: World Bank, 2006).

Table 7.2. Summary of BIT claims, 1999 and 2009

	1999	2009
Number of developing countries having experienced a BIT claim	19	66
Percent of developing countries with at least one ratified BIT having experienced a BIT claim	15.0	48.9
Total claims against developing countries, where jurisdiction was based on a BIT	26	270
Average BIT claims per developing country with at least one ratified BIT	0.2	2.0
Maximum BIT claims against one developing country	5	51
Share of BITs used as jurisdictional basis for investor claims	1.4	5.7
Percent of North-South BITs used for one or more BIT claims	2.1	8.7
Percent of South-South BITs used for one or more BIT claims	0.2	2.5
Source: own calculations.		

Also, even when BITs have been used for disputes, tribunals have far from always come to politically sensitive conclusions. While some claims continue to lead to massive awards in favour of investors,¹³⁸ particularly when seen in per capita terms,¹³⁹ many have led to awards in favour of host states.¹⁴⁰ And although some inconsistent and contradictory decisions continue to cause concerns,¹⁴¹ this is of course not unique for investor-state arbitration, and most awards on questions such as indirect investments, for instance, reflect the emergence of a somewhat consistent jurisprudence.¹⁴² Similarly, while egregious cases of ‘treaty-shopping’

¹³⁸ E.g. *France Telecom v. Lebanon*, UNCITRAL, Award, 22 Feb, 2005 (\$266 million).

¹³⁹ K. Gallagher and E. Shrestha, ‘Investment Treaty Arbitration and Developing Countries: A Re-Appraisal,’ Global Development and Environment Institute Working Paper No. 11-01, May 2011.

¹⁴⁰ See generally, S. Franck, ‘Empirically evaluating claims about investment treaty arbitration,’ 86 *North Carolina Law Review* 1 (2007).

¹⁴¹ On Argentina’s defense of necessity in connection with its obligations towards foreign investors during the crisis, compare e.g.; *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, 12 May, 2005; and *LG&E Capital Corp., and LG&E International, Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Award, 25 Jul, 2007. On umbrella clauses, compare e.g.; *SGS Société Générale de Surveillance v Pakistan*, ICSID Case No. ARB/01/13, Decision on Jurisdiction, 6 August, 2003; and *SGS Société Générale de Surveillance v Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction, 29 Jan, 2004. On whether MFN provisions cover dispute settlement, compare e.g.; *Siemens v. Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, 3 Aug, 2004; and *Salini Costruttori S.p.A. and Italstrade S.p.A. v. the Hashemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction, 29 Nov, 2004.

¹⁴² J. Paulsson, ‘Avoiding Unintended Consequences,’ in: K. Sauvant (ed.) *Appeals Mechanism in International Investment Disputes* (New York: Oxford University Press, 2008); J. Alvaréz and K. Khamsi, ‘The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime,’ in: Sauvant (2009), *op. cit.*, at 467; C. Schreuer and M. Weiniger, ‘A doctrine of precedent?’ in: Muchlinski, Ortino, and Schreuer (eds.) *op. cit.*, at 1198.

continue to cause outrage in some corners,¹⁴³ other tribunals have thrown out claims based on obvious abuses of process.¹⁴⁴

Indeed, it is tempting to conclude that part of the reason that tribunals may have been more moderate in their approach compared to the early years of investment treaty arbitration is the realization that the entire BIT-movement could unravel if they go ‘too far’ in their decisions.¹⁴⁵ When commenting on the novelty of investment treaty arbitration, Paulson warned his colleague arbitrators already in 1995 that states were likely to ‘*take fright and reverse tracks*’ if the system was pushed too far.¹⁴⁶ So although none of this rules out that critics of the regime are necessarily wrong, when pointing to its potential for institutional biases¹⁴⁷ or regulatory chill,¹⁴⁸ the variability in the experiences with BITs does imply that while there may be information available now that BITs have considerable bite in practice, there is not overwhelming evidence to suggest that it would necessarily be *inherently* rational for all developing countries to withdraw entirely from the regime. Although the material benefits of the BIT-movement may have been oversold, the costs of the regime may similarly not be as great as sometimes claimed among its most ardent critics. And indeed, while we do see an adjustment of the content of BITs and a slowdown in the participation rate, very few developing countries have abandoned investment treaty arbitration as a governing institution.¹⁴⁹

¹⁴³ *Tokios Tokelés v. Ukraine*, ICSID Case No ARB/02/18, Decision on jurisdiction, 29 April 2004; *Aguas del Tunari SA v. Republic of Bolivia*, ICISD Case No. ARB/02/3, Decision on jurisdiction, 21 October 2005.

¹⁴⁴ *Phoenix Action Ltd v. Czech Republic*, Decision on Jurisdiction, 15 Apr, 2009, ICSID Case No. ARB/06/5.

¹⁴⁵ This seems to have been a particular concern, when claims have been made against developed countries. For a remarkable account from one of the arbitrators in the *Loewen* case, see; Judge A. Mikva, *Audiotape: Symposium on Environmental Law and Judiciary*, Pace Law School, 6-8 Dec, 2004; discussed in: D. Schneiderman, ‘Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes,’ 30 *Northwestern Journal of International Law and Business* 383 (2010). See also; *S.D. Meyers, Inc. v. Canada*, UNCITRAL, Separate Concurring Opinion, 13 Nov, 2000, par. 218 (‘*a finding of expropriation might contribute to public misunderstanding and anxiety about both this decision and the wider implications of the investment chapter of NAFTA.*’)

¹⁴⁶ Paulsson, *op. cit.*, at 257.

¹⁴⁷ Van Harten, *op. cit.*

¹⁴⁸ K. Tienhaara, *The Expropriation of Environmental Governance* (Cambridge: Cambridge University Press, 2010).

¹⁴⁹ On exiting investment treaties see further in the concluding chapter.

Conclusion

This chapter has shown that even if we assume that developing country governments have been perfectly capable of seeking and correctly processing available information on BITs, it was in exceptionally short supply when the treaties proliferated. This point has not been taken seriously in any existing studies of BIT-diffusion, but it is important. For today, developing countries have learned from the surge in claims and are less keen to sign what has been revealed as very potent legal instruments, while at the same time being less important in promoting investment flows than many thought during the 1990s. While there has been no general opposition to principles enshrined in BITs – many of which are included in domestic investment codes already – the investment treaty claims have made many relevant agencies reconsider their unwavering support of BITs during the 1990s. Relaxing the assumption of full information is thereby crucially important to understand the historical development of the global BIT-regime.

The question is, however, whether this takes us far enough. Have developing countries been surprised about more than just how arbitrators have interpreted key provisions? Did they in fact seek and process the information about BITs in ways predicted by rational choice models? Even with the information available, Van Harten, for instance, doubts whether developing countries in fact carefully weighed their costs and benefits ‘*based on a sound understanding of the treaties.*’¹⁵⁰ This will be the subject of the next chapter, which will relax the assumption that decision-makers have followed the dictums of comprehensive rationality.

¹⁵⁰ G. Van Harten, ‘Five Justifications for Investment Treaties: A Critical Discussion,’ 2 *Trade, Law and Development* 1 (2010), at 42.

8. When the claim hits: Bilateral investment treaties and bounded rationality

The previous chapter observed that while ‘modern’ BITs have been signed since the late 1980s, information about their practical implications was in short supply until the early 2000s. When considering whether to sign investment protection treaties with often vague and broad provisions, developing country officials could therefore easily have underestimated the risks involved. And given the incomplete information available, such misperception of the treaties’ implications cannot be said to have been irrational, or indeed unexpected. This chapter will ask, however, whether developing countries did in fact learn rationally from the information available. Did developing country officials seek and process information about BITs in ways predicted by Bayesian models? Or have risk-assessments followed a ‘threshold model’, like in Pakistan, where when the probabilities of risks were low they were not only underestimated but ignored completely?¹ Similarly, did developing countries carefully learn from experiences abroad, or did rely excessively on their own experiences? Is it, for instance, a coincidence that the countries mentioned in the last chapter, which had recently adjusted their treaty practice had all been hit by BIT-claims *themselves*? Similarly, is it a coincidence that only developing countries that have been subject to disputes themselves, have established a body of specialized civil servants to address investment treaties?²

To address these questions, the chapter is divided into two sections. The first will use econometrics to assess how important a country’s own experiences with BIT claims have been for their propensity to sign and ratify BITs. Furthermore, the results in the often-quoted article on BIT-diffusion by Elkins, Guzman, and Simmons will be questioned based on a reproduction of their analysis. The second section will present qualitative insights from a group of developing countries

¹ E.g.; G. McClelland, W. Schulze, and D. Coursey, ‘Insurance for low-probability hazards: A bimodal response to unlikely events,’ 7 *Journal of Risk and Uncertainty* 95 (1993).

² D. Khayat, ‘Bridging the investment claim gap between sophisticated investors and unprepared host states,’ in: UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration II* [unedited draft] (Geneva: United Nations, forth.).

spread over each major geographical region to triangulate the findings from the quantitative analysis.

8.1. A large- N test of bounded rational policy learning

With Emma Aisbett³

We saw in the last chapter that there has been a marked slowdown in BIT-participation after the claims began. The question addressed here is how developing countries have responded to these claims, and in particular just how important countries' *own* experiences with investment treaty claims have been for their continued adoption of BITs. Recall from chapter three that given the low-probability nature of BIT-claims, a Bayesian learner would be particularly careful to factor in the experiences of other countries, when learning about the implications of BITs, since the costs of ignoring information are considerably larger if it is *the only* information available.⁴ When learning about BITs, we would thereby expect that rational governments carefully considered the information revealed, when *other* countries became subject to investment disputes.

An alternative explanation for the slow-down in BIT participation comes out of the policy learning literature based on bounded rationality. If the availability heuristic has biased risk-assessments of BITs, a key expectation here is that it is not until a country *itself* became subject to a claim that officials truly understood the implications of the treaties. Just as people tend to insure themselves against low-probability events *after* they have already taken place,⁵ countries may also

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⁴ J. March, *The Ambiguities of Experience* (Ithaca: Cornell University Press, 2010); P. Slovic, H. Kunreuther, and G. White 'Decision Processes, Rationality and Adjustment to Natural Hazards', in: P. Slovic (ed.), *The Perception of Risk* (London: Earthscan, 2000).

⁵ K. Steinbrugge, F. McClure and A. Snow, *Studies in seismicity and earthquake damage statistics* (Washington DC: U.S. Department of Commerce, 1969). See also;

have been ‘prisoners of their experience’ when it comes to BITs.⁶ This is an important difference in the predictions of the two hypotheses: whereas rational policy-makers are expected to learn from *all* relevant experiences, policy-makers that apply inferential shortcuts when seeking and interpreting information are expected to learn much more from their own experiences, as that information is more readily available.⁷

Dependent variable(s)

To test these two models of policy-learning in the international investment regime, our main dependent variable counts the number of BITs signed by a developing country in a given year. This is a standard measure for quantitative studies on the diffusion of BITs.⁸ It assumes that although each the result of a separate negotiation, BITs can nevertheless be conceived as comparable legal instruments. This is not unreasonable. As mentioned in earlier chapters, the content of BITs is largely similar, and even when differences exist, they are often leveled out by the most-favored-nation (MFN) provision.⁹ Moreover, the often broad definition of investors and investments combined with the complexities of corporate structuring makes differences between BITs even less relevant in practice.¹⁰ So while simply looking at BIT-participation rates is obviously not able to capture how countries have responded to claims with respect to the content of their treaties, it is a useful starting point, given that the few studies that have coded BITs’ content remain too restrictive or cover too few treaties to be useful for our purposes.¹¹

⁶ The term is from Kates’ classic study of risk-adjustments to low-probability hazards; R. Kates, *Hazard and Choice Perception in Flood Plain Management* (research paper no. 78), Uni. Of Chicago, Dep. of Geography, at 142.

⁷ We address the difficulty of providing a rational baseline in the latter part of the paper.

⁸ See e.g. Z. Elkins, A. Guzman, and B. Simmons ‘Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000,’ 60 *International Organization* 811 (2006).

⁹ See e.g.; L. Poulsen, ‘The Significance of South-South BITs for the International Investment Regime’ 30 *Northwestern Journal of International Law and Business* 1 (2010).

¹⁰ See again; B. Legum, ‘Defining Investment and Investor: Who is Entitled to Claim?,’ 22 *Arbitration International* 521 (2006), at 525.

¹¹ See e.g.; Poulsen, *op. cit.*; J. Yackee ‘Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties’ 22 *Brooklyn Journal of International Law* 405 (2008); D. Blake, ‘Thinking Ahead: Time Horizons and the Legalization of International Investment Agreements,’ *working*

One aspect where BITs *do* systematically and meaningfully vary, however, is in their dispute settlement provisions, since it wasn't until the late 1980s that BITs began, as a general rule, to give investors access to investor-state arbitration.¹² Since it is unclear from arbitral decisions whether the MFN-clause also covers procedural provisions,¹³ this difference is crucial as investment treaties would be largely irrelevant for foreign investors without their effective and comprehensive consent to investor-state arbitration.¹⁴ We therefore restrict our sample to the period when the vast majority of BITs included a binding consent to investor-state arbitration, namely from 1990 onwards. Another reason for doing this is that our identification strategy (discussed in detail below) involves comparing behavior across countries in a given year. And since only one BIT claim had been filed prior to 1990, there were no claims to learn from and thus no identifying variation in our main explanatory variable in this period.

To check the robustness of our results we include two further measures of BIT participation. The first alternative measure of BIT participation is the number of BITs that came into force in a given year (hereafter referred to as 'ratified BITs'). Although signing a treaty has some legal implications - as the contracting parties are not allowed to take actions that defeat its object and purpose¹⁵ - it does not actually establish legally binding obligations upon the parties. While some BITs stipulate that they come into force upon signature, this is rare. The vast majority only come into force after the contracting parties have notified each other that their domestic requirements are met. Such requirements vary across countries, but in practice this often means that both national parliaments have to ratify the BIT

paper, available at: <http://politics.as.nyu.edu/docs/IO/17562/blake.pdf> (last accessed 16 November 2010); T. Alle and C. Peinhardt, 'Delegating Differences: Bilateral Investment Treaties and Bargaining over Dispute Resolution Provisions,' 54 *International Studies Quarterly* 1 (2010).

¹² See chapter two.

¹³ See, e.g., *Emilio Augustin Maffezini v. Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction, January 25, 2005; and *Vladimir & Moise Berschader v. Russian Federation*, SCC Case No V(080/2004). See generally L. Hsu, 'MFN and Dispute Settlement: When the Twain Meet,' 7 *Journal of World Investment & Trade* (2006) 25.

¹⁴ T. Wälde, 'The 'umbrella' clause in investment arbitration: a comment on original intentions and recent cases,' 6 *Journal of World Investment & Trade* 183 (2005), at 194.

¹⁵ Vienna Convention on the Law of Treaties, Art. 18.

before it enters into force.¹⁶ This doesn't always happen: with 24% of the almost 2800 BITs yet to come into force, a great number of investment treaties still remain mostly 'pieces of paper.' Brazil, for instance, has not ratified any of its BITs for constitutional reasons.¹⁷ So to capture the propensity to enter into BITs that are actually legally binding, we also check whether our base model holds when replacing signed BITs with the number of BITs that come into force for a developing country in a given year. The disadvantage of this measure is of course that idiosyncratic ratification processes may introduce measurement error.

Our final measure of BIT participation is the number of BITs signed by a developing country in a given year that came into force (i.e. were ratified) within three years of being signed. Though novel, this measure combines the key strengths of each of the measures of participation commonly used in the literature. Like 'ratified' BITs, our novel measure of participation has the advantage of not counting BITs which countries sign without the intention of making them legally binding. Similarly to 'signed BITs', this measure avoids the measurement error introduced in the 'ratified BITs' measure by idiosyncrasies in the (often lengthy) ratification process in each country. We chose three years as our cutoff as, among the BITs that have entered into force, more than four-fifths did so within three years of signature.¹⁸

Main explanatory variable

As we are interested in what happened once developing countries were subject to their first BIT claim, this again raises a question of comparability: can BIT-claims reasonably be assumed to be comparable in their practical implications? Clearly, this will not always be the case. For instance, the availability heuristic would also imply that controversial claims discussed extensively in the media would have a much larger impact than other claims. But while we acknowledge this challenge,

¹⁶ See; UNCTAD, 'The Entry into Force of Bilateral Investment Treaties (BITs),' *IIA Monitor No. 3* (2006), at 2.

¹⁷ See e.g., D. Wei, 'Bilateral investment treaties: An empirical analysis of the practices of Brazil and China,' *European Journal of Law and Economics*, May (2010).

¹⁸ UNCTAD (2006), *op. cit.*

it should make it *more* difficult to find an effect of the first claim. Similarly, although we do control for the size of investment treaty arbitrations in robustness tests (see below), we nevertheless refrain from distinguishing between claims that have been ‘won’ or ‘lost’ by respondent states. For while some quantitative attempts to scrutinize the outcomes of BIT arbitrations readily regard arbitrations where investors have been awarded compensation as a ‘win’ for the investor, this will in many cases be misleading.¹⁹ Did Sri Lanka really ‘lose’ the AAPL claim, for instance, when AAPL was only awarded a tenth of what it claimed, and the tribunal found entirely in favor of Sri Lanka on the key question on merits?²⁰ Legal officials in Sri Lanka didn’t think so, and the lesson learned was limited to one clause only.²¹ And what about settled claims? Did Pakistan really ‘lose’ 110 million USD to Imbregilo in their settlement, given that the ruling on jurisdiction was so favorable for Pakistan that Imbregilo agreed to settle for less than a fourth of its claim rather than proceeding to the merits?²² That, at least, is not the perception among key legal officials in Pakistan.²³ We therefore leave such thorny conceptual questions for others to resolve, and instead merely include a dummy variable that takes the value of one from the year a country was subject to its first BIT-claim – defined as the year the claim was registered by the arbitral tribunal – and zero otherwise (see Annex III for details).

Our dataset of claims was created by merging BIT-participation data based on UNCTAD’s country-lists of BITs with information on arbitrations compiled from a range of different sources.²⁴ Although comprehensive, this is no guarantee against some degree of measurement error. The secrecy of some disputes adjudicated under non-ICSID rules, means we actually do not know for sure when

¹⁹ See e.g., S. Franck, ‘Development and Outcomes of Investment Treaty Arbitration,’ 50 *Harvard Journal of International Law* 2 (2009).

²⁰ *Asian Agricultural Products Limited (AAPL) v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Award, 27 June 1990; A. Perera, ‘The Role and Implications of Bilateral Investment Treaties,’ 26 *Commonwealth Law Bulletin* 1 (2000). The key question was whether the obligation to provide ‘full protection and security’ entailed a ‘strict liability standard’ (it didn’t).

²¹ Sri Lankan official I (‘*We were mostly concerned on standard of liability and the 4.2 provision, and on those issues it ended on satisfactory terms for us.*’).

²² *Impregilo S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction, 22 April 2005.

²³ Pakistan official VI.

²⁴ See Annex III.

a country found itself on the respondent end of a BIT claim for the first time. As mentioned in the last chapter, it was not until recently that Luke Peterson ‘uncovered’ a number of BIT-claims against Poland in the early 1990s for instance. Yet, while this is a legitimate cause of concern for our identification strategy, it should not be exaggerated, as it is reasonable to assume that the vast majority of investment treaty awards have in fact found their way to the public domain.²⁵ Furthermore, to the extent that we are missing the first claims for certain countries, it would again tend to make our results more conservative, i.e. biased *against* finding an effect of the first treaty claim in our data.

Our approach is conservative for another reason as well, since the year a country was subject to its first BIT-claim is not necessarily the year it was first *threatened* with a claim.²⁶ This too is information that is typically not in the public domain. We know today, for instance, that Panama was notified as early as 1992 about a potential breach of its BIT with the United States, and changed its practice to avoid a dispute.²⁷ Similarly, although Cambodia is listed as having its first investment treaty claim in 2009, reports indicate that a French investor threatened it with a dispute five years earlier.²⁸ So while threats of arbitrations also have potential to ‘reveal’ the potency of BITs to the respondent government, we only include actual BIT claims in our analysis, which means our model is potentially underspecified.²⁹ Again, however, this implies that only a particularly systematic and strong response to countries’ first claims would show up in the data.

²⁵ G. Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2007), at viii.

²⁶ See generally; K. Tienhaara, *The Expropriation of Environmental Governance: Protecting Foreign Investors at the Expense of Public Policy* (Cambridge: Cambridge University Press, 2009), ch. 8; D. Schneiderman, *Constitutionalizing Economic Globalization* (Cambridge: Cambridge University Press, 2008), at 120-129.

²⁷ K. Vandevelde, ‘U.S. Bilateral Investment Treaties: The Second Wave,’ 14 *Michigan Journal of International Law* 621 (1993), at 11.

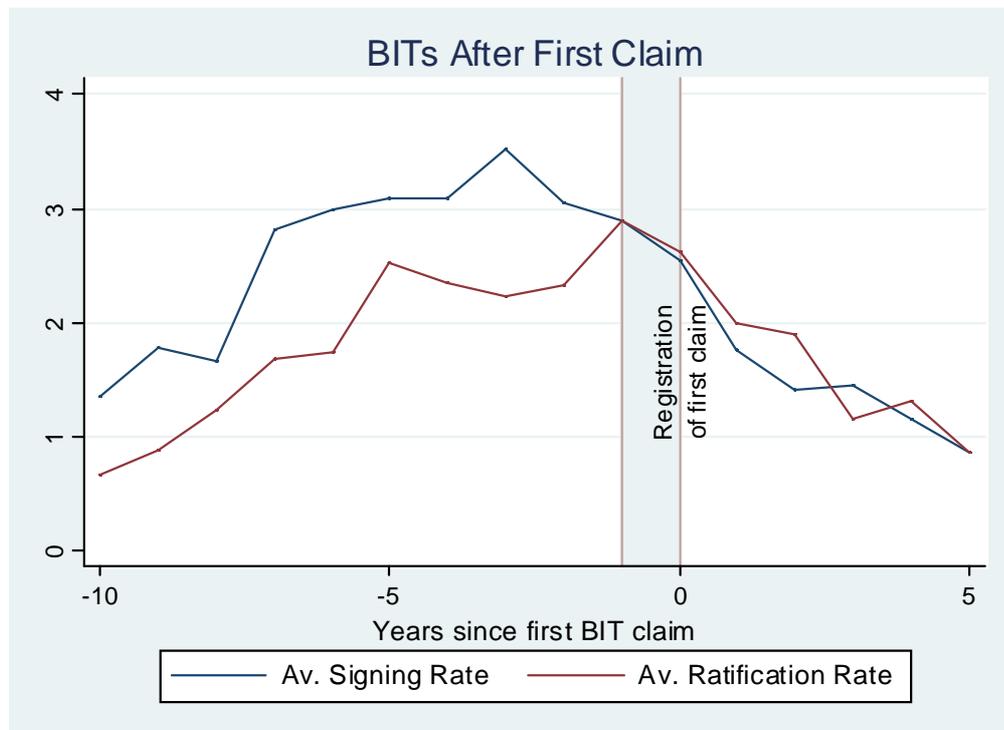
²⁸ L. Peterson, ‘French insurance firm alleges Cambodia violated investment treaty,’ *INVEST-SD: Investment Law and Policy News Bulletin*, May 5, 2005; D. Vis-Dunbar, ‘French investor criticizes governments’ handling of Cambodian dispute,’ *Investment Treaty News*, August 23, 2006. Note that that at least among Cambodian negotiators; these threats have had no impact on their view on BITs (*‘I don’t see any side-effects of BITs.... The cases have not changed our thinking at all. We are still very keen.’*); Cambodian official I.

²⁹ Note also that we limit ourselves to ‘pure’ BIT-claims, while acknowledging that investor-state arbitrations can touch upon BIT-obligations, even if their jurisdiction is based on other legal instruments - such as investor-state contracts, the laws of the host state, or other investment

Event study

As a first-cut to address how important a country's own experiences have been for its BIT-policies, Figure 8.1 uses an 'event study' approach to provide a preliminary visual assessment of the proposition that participation responded principally to claims against *themselves*. The y-axis shows the average annual number of BITs signed or ratified by developing countries which have had at least one BIT-based claim brought to arbitration. The x-axis shows time relative to the year of registration of the first BIT claim against the country. The pattern provides strong support for what we heard from Pakistan in the preface, namely that the rush to sign BITs slowed down considerably once countries became subject to their first dispute. We see that while signing rates were already decreasing on average prior to the time of first claim, this downward trend amplified considerably after the claim was registered. Even more notable is that the upward trend in number of BITs ratified per year reverses in the year of the first claim.

Figure 8.1. Average BITs entered into by developing countries before and after their first BIT-claim.



treaties. We included these other claims in robustness tests, and it had no impact on our results since by far the majority of claims involving BIT-obligations are in fact 'pure' BIT claims.

This is surprising if countries were careful to factor in experiences from abroad. Yet as supportive of the bounded rationality approach as Figure 8.1 is, we may still be concerned that the correlation between experience of a claim and decreased BIT participation is a spurious one, driven by omitted variables such as global shocks, national political or economic environment, and participation dynamics (such as the exhaustion of treaty-partner possibilities). To address these concerns we turn to the tools of econometrics.

Base regression

We examine the statistical validity of this hypothesis by estimating the Negative Binomial fixed-effects model of Hausman, Hall, and Griliches (see below), with dependent and independent variables as in equation 1. Our parameter of interest in equation 1 is φ .

$$f(BITs_{it+1} | BITClaim_{it}, X_{it}) = g(\exp(\varphi BITClaim_{it} + \alpha X_{it} + \eta_t + \varepsilon_{it})) \quad (1)$$

Where $BITs_{it+1}$ is the number of new BITs participated in year $t+1$,

$BITClaim_{it}$ is a dummy variable which is zero in years before the first BIT claim was lodged against country i , and 1 otherwise,

X_{it} comprises FDI inflows, net FDI outflows, GDP, the investment risk index, and controls for previous BIT participation,

η_t are year effects, and

ε_{it} are idiosyncratic errors, which we assume to be clustered by country-year.

Control variables

A key component of our identification strategy is the inclusion of a full set of year dummies to control for global shocks shared by all countries, such as business cycles, the global number of BITs, changing global norms towards foreign capital (e.g. the rise and fall of the Washington Consensus), the global number of BITs, or the global number of BIT claims. Controlling for global BIT claims in this way

means that the effects we observe are *additional* to any effect of claims against other countries. Thus if countries treated claims against other countries as being as informative as claims against themselves, we would expect to find zero effect from our (own BIT claims) variable of interest. As mentioned above, this would of course not be rational as idiosyncratic country differences do make claims against one's own country somewhat more informative than claims against other countries. Yet from a rational learning framework we should not expect the effect of own claims to be particularly large.³⁰

Our base model also controls for a country's FDI inflows and outflows as well as its market size/level of economic development proxied by GDP. We further control for investment risks, as a government with protectionist urges towards FDI may both be at higher risk of BIT-claims and at the same time less inclined to sign BITs. Think of Venezuela. A number of indexes are available to measure investment risks, but among those usually relied upon the assessment of the Political Risk Services (PRS) Group comes closest to the risks covered in BITs. In the PRS index, each country is given a score from 0 (very high risk) to 12 (very low risk), based on risks associated with (i) expropriation/contract viability; (ii) profits repatriation; and (iii) payment delays. All of these explanatory variables are lagged one year to reduce simultaneity.

Finally, we include a range of indicators to control for saturation, i.e. the fact that a slowdown in a country's BIT participation can be a function of the size of its existing BIT-network.³¹ Since a more extensive BIT network will also raise the probability of a claim (*ceteris paribus*) omitting previous participation would likely lead us to over-estimate the downward effects of claims. We therefore control for the cumulative number of BITs participated in (measured by signing or ratification according to the dependent variable in the regression) as well as its square and cubic functions. Additionally, since claims can only arise from ratified

³⁰ See below for the discussion on the inherent difficulties in providing a rational baseline outside the confines of experiments.

³¹ See chapter seven.

BITs, in all estimations we control for the cumulative number of BITs ratified with four and ten year lags.

Summary statistics and sources all raw and constructed variables used in our analysis are provided in Tables AIII.1 and AIII.2 in the Appendix. Missing data for some series means that our base regression uses around 1600 of the potential 2740 observations.

Choice of estimator

Since our dependent variable is a count variable, an estimator based on a gamma distribution is likely most appropriate. While acknowledging that there may be some resulting lack of efficiency compared to a simple poisson model, we have opted for a high degree of flexibility and estimate the fixed-effect negative binomial model of Hausman, Hall and Griliches.³² Furthermore, lack of efficiency is not a major concern for us as our coefficients of interest are generally significantly different from zero at the 1% level.

The fixed-effect estimators are the workhorse of cross-country panel applications because they significantly reduce the influence of omitted time-invariant country characteristics. In our case, relevant characteristics include region, legal tradition, geographical size, and colonial history. Using a full fixed-effect model for our purposes, however, may cause bias as including lagged cumulative participation is akin to including a lagged dependent variable.³³ Thus our base specification is something of a compromise, allowing for country-specific dispersion in a negative binomial specification, (thus allowing country-specific intercepts) but not being a pure fixed-effect model.³⁴ In robustness checks we compare our results to those obtained in both a fixed-effect poisson model and a negative binomial model

³² J. Hausman, B. Hall and Z. Griliches, 'Econometric Models for Count Data with an Application to the Patents-R&D Relationship,' 52 *Econometrica* 909-938 (1984).

³³ For an excellent discussion of these sorts of issues in dynamic panel data models, see, M. Arellano and B. Honoré, 'Panel data models: some recent developments.' In: J. Heckman and E. Leamer (eds.) *Handbook of Econometrics*, vol. 5 (Amsterdam: Elsevier, 2001).

³⁴ P. Allison and R. Waterman, 'Fixed-Effects Negative Binomial Regression Models', 32 *Sociological Methodology* 1 (2002).

without country-specific dispersion. The results (in Annex III) indicate that our choice of estimator does not qualitatively affect our findings.

Additional robustness tests

The immediately preceding subsections have described our checks for robustness to choice of estimator and specification of both the dependent and main explanatory variable. We also checked of the robustness of our findings to adding or removing other control variables as well as removing – one at a time - any of the controls in our base regression, which might potentially be endogenous or cause other forms of bias. Finally, we checked the robustness of our results to the inclusion of two additional controls. Firstly, using the World Bank’s database on political institutions,³⁵ we captured possible partisan biases by including a dummy variable indicating whether a country’s executive and/or majority party was left-wing.³⁶ Secondly, we checked for whether a country’s BITs have been used to adjudicate claims against other countries: for while only few developing country investors have filed BIT-claims, the rising stocks of investment from developing countries mean they increasingly have an interest in not just attracting investment from the West but also protecting their own investors abroad. The obvious case in this respect is China. In the interest of space we do not present these results here, however, as neither control had any appreciable explanatory power or impact on other coefficients.

Augmented models and ancillary questions

As many countries experienced their first investment treaty claim around the same time, we include specifications that control for cross-border learning effects by including dummy variables for whether a country within the same region has been hit as well as the total number of regional claims. This is a much simpler approach than Elkins, Guzman, and Simmons, for instance, who include complex (and data

³⁵ T. Beck, G. Clarke, A. Groff, P. Keefer, and P. Walsh, ‘New tools in comparative political economy: The Database of Political Institutions,’ 15 *World Bank Economic Review* 1 (2001).

³⁶ See chapter five.

dependent) learning measures based on ambitious assumptions of highly advanced BIT-strategies.³⁷ Not only will we show that their learning measure does not hold – even in their own dataset - we are also less optimistic about the sophistication of developing country strategies in the international investment regime and therefore limit learning effects to countries close by. Note again, however, that any observed impact of this variable is *over and above* the impact of the global number of claims (i.e. including claims far away).

Finally, we studied specifications which distinguish between BIT partners. For although BITs are largely comparable in their legal content, hundreds of BITs have been signed between countries which exchange next to zero investment flows. While legally binding, and at times relevant through the MFN provision, these BIT are rarely important in practice. And since by far the majority of claims (still) involve Western investors suing developing country governments, we distinguish between North-South and South-South BITs. We also use an alternative classification, where only South-South treaties which do not have a major developing country capital exporter³⁸ as one of the contracting parties are considered ‘frivolous’ BITs.

Results

Table 8.1 reports coefficients from our base specification. The dependent variables from left to right are respectively the annual number of BITs signed, ratified, and signed with ratification within 3 years. In all three columns the effect of having at least one BIT claim is negative and we are able to reject the null of positive or no effect at the 5% significance level or better.³⁹ The experience of a

³⁷ Elkins, Guzman, and Simmons, *op. cit.*

³⁸ This measure is also summarised in chapter four: we took the country’s outward FDI stock as a share of the total developing country sample outward FDI stock and calculated the maximum, average, and median shares. Top 10 from each were then considered large developing country capital exporters. These were: Brazil, Russia, South Africa, China, Argentina, Panama, Mexico, Malaysia, Saudi Arabia, Indonesia, Hungary, Chile, Panama, and India. An alternative would have been to use bilateral investment flows, yet these are in short supply and particularly so for south-south flows.

³⁹ The one-sided nature of the t-test for our null allows us to reject the null at a 5% level of significance even in the regression with ratification as the dependent variable.

BIT claim reduces signing by around 35% and ratification by somewhat less with around 17%.⁴⁰ This provides strong support for our hypothesis that when a country is subject to at least one BIT claim it reduces its participation in BITs considerably; and that this effect is over and above any effect from observing claims against other countries. Note that, as expected, the results are weaker when ‘ratification’ is the dependent variable due to the idiosyncratic differences.

Table 8.1. Strong negative effect of first BIT claim on participation in BITs by developing countries.

	Signing	Ratifying	Sign & Ratify
L.BIT Claim	-0.423*** (0.107)	-0.187* (0.112)	-0.463*** (0.144)
L.Inward FDI	-0.016 (0.011)	0.009 (0.011)	-0.030** (0.014)
L.Outward FDI	-0.011 (0.014)	-0.006 (0.013)	0.016 (0.020)
L.GDP	0.001** (0.001)	0.001 (0.001)	0.002*** (0.001)
L.Invest.Protect.	0.071*** (0.022)	0.092*** (0.025)	0.067** (0.028)
Constant	2.260*** (0.494)	2.467*** (0.555)	-2.021** (0.885)
Observations	1604	1524	1448

Standard errors in parentheses.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Participation is measured by signing in column 1, ratification in column 2, and column 3 measures BITs signed in that year which were ratified within 3 years. Sample size varies across columns as countries for which dep. var. is always zero are dropped. Table reports coefficients from negative binomial, fixed effect estimation. Year dummies and cubic function of lagged total BIT participation as well as four and ten year lags of ratification also included but coefficients not reported. All other controls are lagged one year.

In the interests of space we present results for all other regressions only for signing as the dependent variable. Signing was chosen over ‘Signed and Ratified’ since the two measures have very similar results but the former is more consistent with the existing literature on BIT participation. Annex III presents the results of checks of the robustness of our base signing regression to changes in the set of control variables as well as to the choice of count-data estimator. Our finding of a large significant negative effect of having a BIT-claim is robust to all these changes.

⁴⁰ E.g. $1 - \exp(-0.423) = 0.34$

Despite the robustness of our results, we may be concerned that they are driven by a tendency for first-claims to occur after BIT-participation has already started to decline. The graphical ‘event-study’ in Figure 8.2 provides suggestive evidence that – to the extent participation was already in decline – the first claim exaggerated this trend. Table 8.2 provides regression-based evidence to further support this and thus allay the concern that our results are driven by spurious correlation with some underlying trend toward decreased participation. Columns 1-5 in Table 8.2 control respectively for 2 years prior to the registration of the first BIT claim through to 2 years after the BIT claim is lodged. If our BIT claim dummy were picking up some spurious trend, we would expect all the coefficients on the different leads and lags of BIT claims to be similar. Instead we find that the coefficients in the year of the BIT claim and the two subsequent years are roughly twice as large as those in the two years prior. Furthermore, the coefficients on BIT-claim one and two years prior (columns 1 and 2) are not significant at the 10% level, while the coefficients in columns 3-5 are negative and significant at the 1% level. These results correspond well with Figure 8.2 and provide strong evidence that the structural break in participation behavior coincides with the registration of the first BIT claim.

Table 8.2. Timing of significant reduction in participation coincides with first BIT claim

	(1)	(2)	(3)	(4)	(5)
F2.BIT Claim	-0.134 (0.098)				
F.BIT Claim		-0.158 (0.010)			
BIT Claim			-0.325*** (0.103)		
L.BIT Claim				-0.423*** (0.107)	
L2.BIT Claim					-0.302*** (0.110)
L.Inward FDI	-0.028*** (0.011)	-0.018* (0.011)	-0.017 (0.011)	-0.016 (0.011)	-0.017 (0.011)
L.Outward FDI	0.000 (0.016)	-0.012 (0.015)	-0.012 (0.014)	-0.011 (0.014)	-0.011 (0.014)
L.GDP	0.002*** (0.001)	0.001*** (0.001)	0.001** (0.001)	0.001** (0.001)	0.001** (0.001)
L.Invest.Protect.	0.064*** (0.022)	0.072*** (0.022)	0.069*** (0.022)	0.071*** (0.022)	0.073*** (0.022)
Constant	2.500*** (0.520)	2.078*** (0.493)	2.173*** (0.492)	2.260*** (0.494)	2.205*** (0.497)
Observations	1518	1604	1604	1604	1604

Standard errors in parentheses.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Dependent variable is the annual number of BITs signed. Table reports coefficients from negative binomial, fixed effect estimation. Year dummies and cubic function of lagged total BIT participation as well as lags of ratification also included but coefficients not reported. All other controls are lagged one year.

Being confident of the robustness of our primary result, we now consider ancillary questions. Table 8.3 examines the impact of increasing numbers of claims against a host and of claims against countries in the same region. In all specifications in Table 8.3 we see that the total number of BIT claims (Cum. BIT claims) is only very weakly negatively correlated with participation, suggesting that learning about the potential of BITs occurs primarily in response to the first BIT claim. This corresponds well with the predictions of bounded rationality, namely that a single ‘vivid’ event often has a considerably greater impact than expected by Bayesian frameworks. The latter would predict that each additional claim reveals further information about the risks BITs entail, yet this is not what we find.

Table 8.3. BIT participation reacts less to claims against other countries within same geographic region than to claims against itself.

	(1)	(2)	(3)	(4)
L.Cum. BIT Claims	-0.018 (0.0191)	-0.003 (0.016)	-0.003 (0.016)	0.010 (0.016)
L.BIT Claim		-0.419*** (0.110)	-0.416*** (0.111)	-0.393*** (0.110)
L.Region BIT Claim			-0.015 (0.098)	0.010 (0.097)
L.Region cum.BIT Claims				-0.011*** (0.004)
L.Inward FDI	-0.018* (0.011)	-0.016 (0.011)	-0.016 (0.011)	-0.017 (0.011)
L.Outward FDI	-0.012 (0.015)	-0.011 (0.014)	-0.011 (0.014)	-0.011 (0.014)
L.GDP	0.001*** (0.001)	0.001** (0.001)	0.001** (0.001)	0.001** (0.001)
L.Invest.Protect.	0.071*** (0.022)	0.071*** (0.022)	0.071*** (0.022)	0.073*** (0.022)
Constant	2.036*** (0.497)	2.253*** (0.495)	2.272*** (0.509)	2.808*** (0.541)
Observations	1604	1604	1604	1604

Standard errors in parentheses.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Dependent variable is the annual number of BITs signed. Table reports coefficients from negative binomial, fixed effect estimation. Year dummies and cubic function of lagged total BIT participation as well as lags of ratification also included but coefficients not reported. All other controls are lagged one year.

Columns 3 and 4 of Table 8.3 examine the response to claims against other countries in the same region. Interestingly the pattern is reversed here: countries show little response to the first claim in the region, but do seem to respond to the cumulative average number of claims per country in the region. This could mean that policy-makers have learned rationally from countries close by, yet this is unlikely given the observations above and the qualitative evidence presented below. Instead, it probably indicates that claims against other countries in the region elicit significantly less of an emotional response for policy-makers than claims against their own country. Thus our result suggests that, consistent with theories of bounded rationality, policy learning is more ‘rational’ when the emotional content of the information is lower.

Finally, Table 8.4 addresses the question of whether participation in ‘serious’ BITs responds in the same way as participation in more frivolous or ‘photo-opportunity’ BITs. The perceived benefits of participation in BITs for countries can range from apparently minor ones such as ‘having something to do’ when a

dignitary from another country visits through to the potential attraction of much-needed high-technology investment. Similarly, the potential costs of BITs may appear negligible – for example if there is almost no inflow of FDI ever likely from the partner country – or they may be substantial – for example if there are substantial amounts of investment from the partner in high political-risk sectors. So if our results are purely driven by a slowdown in BITs with little, if any, material importance (except through the MFN clause) our analysis may have little relevance for the investment regime overall. Yet Table 8.4 shows that this is not the case. While participation in all types of BITs responds negatively to a claim, the impact is strongest for BITs with the largest potential economic implications.

Table 8.4. Participation in BITs with potentially significant economic implications is more affected by claims than participation in 'photo-opportunity' BITs.

	(1)	(2)	(3)	(4)
	North-South BITs	South-South BITs	Serious BITs	Photo ops.
L.BIT Claim	-0.373** (0.170)	-0.257** (0.125)	-0.421*** (0.150)	-0.198 (0.136)
L.Inward FDI	-0.044*** (0.017)	-0.024* (0.013)	-0.030** (0.014)	-0.025* (0.014)
L.Outward FDI	-0.067** (0.026)	-0.018 (0.015)	-0.0505** (0.022)	-0.021 (0.016)
L.GDP	0.003*** (0.001)	0.003*** (0.001)	0.002*** (0.001)	0.003*** (0.001)
L.Invest.Protect.	0.093*** (0.033)	0.063** (0.025)	0.059** (0.028)	0.086*** (0.029)
Constant	3.114*** (0.778)	3.186*** (0.509)	2.890*** (0.664)	2.974*** (0.551)
Observations	1558	1595	1558	1538

Standard errors in parentheses.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Dependent variable is the annual number signed of the type of BITs described in the column heading. Table reports coefficients from negative binomial, fixed effect estimation. Year dummies and cubic function of lagged total BIT participation as well as lags of ratification also included but coefficients not reported. All other controls are lagged one year.

A final robustness test

Evidence presented thus far provides good grounds to believe that the pattern of responses to BIT claims has been strongly 'narcissistic' - and thereby bounded rational. We find it unlikely that a rational learner would react so strongly to the first claim at home while completely ignoring the first claim in the region. Also, a rational learner should learn progressively from its claims rather than reacting so

strongly only to the first. However, as is often the case in studies without the luxuries of the controlled experiment, we are unable to provide a clearly defined rational ‘baseline’ to compare our results with.⁴¹ Indeed, the difference between rational and bounded rational learning remains one of degree in our case, since a rational stakeholder should know that the probability of a claim depends on a large number of factors including the investment and governance profile of the country. She therefore knows that a claim against her own country, or a similar country (e.g. within same region), provides more information about the probability they will face future claims than a claim against a more ‘distant’ country. Thus a rational but imperfectly-informed policy-maker would also react more strongly to claims close by and stronger still to claims at home than they would to more distant claims. Skeptics might therefore argue that the reactions we observe to countries’ own claims are not ‘strong enough’ to indicate bounded rational learning. More generally, Meseguer argues that *‘bounded learning and rational learning yield the same results as soon as one drops the rational learning assumption that there are zero costs to gathering new information.’*⁴²

While we do not disagree with Meseguer’s conclusion of observational equivalence in the context of her specific study, we are able to confront this argument – even without relying on the interview evidence below. For unlike the unilateral policies studied by Meseguer and Weyland, BITs are bilateral instruments. This means that there are potentially two dimensions of distance, or relevance, of a piece of information: one in relation to the ‘host’ country, and one in relation to the partner country. On their sensitivity to this second dimension of distance, Bayesian and bounded rational learners will differ. Analogously to the case of closeness for the host country, a fully-rational policy-learner will place more weight on cases brought *by* investors from the potential BIT-partner than it will on other cases. This would be rational since the probability that claims are brought by a certain country is likely to vary with the amount and type of outward investment of the country, the type of BITs they tend to sign, and the experience

⁴¹ See generally; J. Conlisk, ‘Why Bounded Rationality?’ 34 *Journal of Economic Literature* 2 (1996).

⁴² Meseguer, C., ‘Rational Learning and Bounded Rational Learning in the Diffusion of Policy Innovations,’ 18 *Rationality and Society* 1 (2006), at 35.

of the lawyers from that country in bringing BIT claims. In contrast, a bounded rational learner may ignore information about BIT claims brought by investors from the potential partner country. Furthermore, the availability heuristic will not apply in the same way as with claims against the host, since claims brought by the partner will not be as ‘vivid’, or readily available. Thus, on the question of how BIT participation responds to claims brought by potential partner countries, the expectations of bounded and full rationality models are not just different by degree, they are not observationally equivalent. To test these competing hypotheses require data with dyad’s as the unit of analysis. So in a final robustness test we merge our claims data with an updated dataset of Elkins, Guzman and Simmons (EGS),⁴³ and run their main regression with the addition of the dummies for ‘first claim against host’ and ‘first claim by partner’.

Recall, that the study by EGS is by far the most quoted work on BIT-diffusion. After its publication in *International Organization*⁴⁴ it was subsequently reprinted in law publications,⁴⁵ an important volume on international policy diffusion,⁴⁶ as well as a main textbook in IPE.⁴⁷ It is therefore interesting to note that when restricting EGS’ sample to the period in which BITs actually had some ‘bite’, i.e. 1990 and onwards, their main result related to rational competition dynamics is no longer statistically significant (Table 8.5., column 2). This is the case even without our new measures.

⁴³ Z. Elkins, A. Guzman, and B. Simmons, ‘Replication data for: Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1959-2000 (August 2008 version)’. Due to a few missing variables, we were only able to reproduce their Models 2 and 3.

⁴⁴ Elkins, Guzman, and Simmons (2006), *op. cit.*

⁴⁵ *University of Illinois Law Review* (volume 2008, no. 1); M. Waibel, A. Kaushal, K.-H Chung, and C. Balcin (eds.), *The Backlash Against Investment Arbitration* (Alphen aan den Rijn: Kluwer Law International, 2010).

⁴⁶ B. Simmons, F. Dobbin, and G. Garrett, *The Global Diffusion of Markets and Democracy* (Cambridge: Cambridge University Press, 2007)

⁴⁷ J. Frieden, D. Lake, and J. Broz, *International Political Economy, 5th Ed.* (New York: Norton, 2010).

Table 8.5. In a bilateral setting, claims against host significantly reduce likelihood of BIT-formation while claims by investors from partner have no effect.

	(1)	(2)	(3)	(4)
BITs among export product competitors	1.111*** (0.038)	1.027 (0.039)	0.999 (0.039)	0.976 (0.040)
BIT claim			0.799* (0.101)	0.744** (0.095)
Host lagged BITs			1.022*** (0.003)	1.043*** (0.003)
BIT claim brought				0.964 (0.132)
Home lagged BITs				1.051*** (0.002)
Years included	1960-2000	1990-2000	1990-2000	1990-2000
Observations	208610	63461	61222	60083

Standard errors in parentheses.

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Exponentiated coefficients (hazard ratios) from Cox proportional hazards model. Column 1 of this table reproduces the results of ‘Model 2’ of Table 2 in Elkins, Guzman, and Simmons (EGS) (2006) with updated dataset provided by EGS. ‘BITs among export product competitors’ is defined in EGS’ article. Full set of controls included from EGS, but not reported. Column 2 of this table restricts EGS’ regression to 1990-2000. Columns 3 and 4 add controls from our data for BIT participation and claims for host and home/partner.

For our purposes, however, the most important point is that columns 3 and 4, are clearly in favor of our hypothesis made above. While our ‘first claim against’ dummy is negative and significant just as in our main results, the ‘first claim by partner’ dummy is completely insignificant. Developing countries have in other words reacted strongly to their first claim, yet not seemed to be influenced at all by whether investors from their BIT-partners have filed claims, which further sustains the conclusion that developing countries have been bounded rational when learning about the implications of BITs. This will become even clearer in the section below.

8.2. Country experiences

Using econometrics to investigate the relationship between BIT-claims and BIT participation naturally involves a series of restrictive assumptions. First of all, the analytical unit has thus far been the state, rather than sub-national units (ministries, investment promotion agencies, etc.). As in so many econometric studies, this was for pragmatic reasons, as sub-national datasets on which

ministry, official, etc. promoted BITs are not available. Secondly, and crucially, questions of *how* decision-makers learn are essentially *procedural* in nature, as they focus less on the nature and substance of the outcome – as in the analysis thus far - but more on the process with which decision-makers arrive at their inferences and decisions. So while the quantitative analysis does support a key prediction of the bounded rational learning literature, it is clearly not sufficient without additional evidence tracing the actual processes whereby investment treaties have been contemplated and negotiated within, and between, government bureaucracies. This section will therefore proceed by investigating the underlying causal mechanisms for *why* these patterns are found. As mentioned in chapter one, this has unfortunately not been usual practice within quantitative studies on international policy diffusion.⁴⁸

Unique case approximating the rational ideal: Costa Rica

I begin with an outlier difficult to explain with the results above, namely Costa Rica. By the early 1990s, the Costa Rican Central Bank and Treasury Department found that since the country had already liberalised its capital account and generally provided strong protections to foreign investors, it would be logical to also have a BIT program to complement those reforms.⁴⁹ The task was given to the Ministry of Trade, where a small but highly skilled team were in charge of negotiations. Most of the staff had graduate degrees in international economic law from Western universities, and all coordination pertaining to both trade and investment agreements happened within that unit. This meant that Costa Rica pursued a coherent strategy pushing for investment treaty obligations not just bilaterally but also in the context of the WTO⁵⁰ as well as the MAI, where Costa

⁴⁸ Among quantitative BIT studies not mentioned already, see also statistical attempts to apply ‘rational design’ theory explain the content of BITs; T. Alle and C. Peinhardt, ‘Revisiting ‘Rational Design’: Preferences, Power, and the Design of Bilateral Investment Treaties,’ working paper, April, 2010; D. Blake, ‘Thinking Ahead: Time Horizons and the Internationalization of International Investment Agreements,’ working paper, April, 2010.

⁴⁹ Costa Rican official I. Note, that although Costa Rica signed a few BITs during the 1980s, this was done on an *ad hoc* basis with no real strategy – unlike Sri Lanka for instance (see chapter five).

⁵⁰ See e.g.; WTO WGTI, Report on the Meeting of 7 and 8 March 2001, WT/WGTI/M/14.

Rica was an invited observer. The staff occasionally rotated to stations abroad, such as the WTO, yet always returned to the same unit, such that the legal expertise and experience remained.⁵¹

The team was clear from the beginning that unlike many other countries (see below), ‘*we didn’t just want a BIT, whenever a President was visiting.*’⁵² So although not all obligations were well-understood due to the lack of disputes,⁵³ Costa Rica’s negotiations were based on a sound understanding of the legal questions involved. Although in some cases, negotiators were unable to resist the pressure of politicians to use BITs as diplomatic photo-ops, these were exceptions as both key stakeholders (e.g. the Treasury) and negotiators themselves pursued a coherent and approximately rational BIT-strategy by engaging carefully in each negotiation based on the necessary expertise.⁵⁴ So even though the CAFTA negotiations with the United States led to considerable debate in Costa Rica over the implications of investor-state arbitration, it did not lead to major changes in strategy apart from putting in place an appropriate defense team.⁵⁵ Neither did the arbitration cases against Costa Rica starting a few years after,⁵⁶ which one would also expect if a BIT-strategy was pursued realizing that the treaties potentially involved enforceable protections. Instead, it was the many cases against Argentina that led Costa Rica to make certain restrictive changes in the content of its treaties – which also follows the expectations of a Bayesian decision-making model.⁵⁷

As we shall see below, however, this appears to have been a rather unique case. Although some developing countries undoubtedly have pursued similar BIT

⁵¹ Costa Rican official I. See again Annex II for details about the interview and sampling procedure.

⁵² *Ibid.*

⁵³ *Ibid.*

⁵⁴ *Ibid.* Throughout, I understand ‘negotiators’ broadly as officials involved directly in investment treaty negotiations, whether in BITs or other types of investment treaties with investor-state arbitration. ‘Stakeholders’ are similarly understood in a broad sense, as both regulatory agencies with a stake in investment treaties as well as politicians.

⁵⁵ Costa Rican official II.

⁵⁶ E.g. *Alasdair Ross Anderson and others v. Republic of Costa Rica*, ICSID Case No. ARB(AF)/07/3.

⁵⁷ Costa Rican official II; see also last chapter.

policies approximating the Bayesian ideal – such as China perhaps⁵⁸ - this is the exception rather than the rule, which is important to explain the correlations found above.

Considerable impact of first claim, even in the presence of expertise

A number of other countries have also been well endowed with expertise in early BIT-negotiations. Unlike in the case of Costa Rica, however, there was nevertheless a considerable impact on the politics of investment treaties, when the countries were hit by their first claim, since stakeholders of the treaties entirely failed to appreciate their importance until the first claim. Lebanon is an example. There, it was not before the country got hit by investment arbitrations in the early 2000s that anyone but one or two officials took the treaties seriously. According to a key legal official, the first case⁵⁹ did not attract much attention among stakeholders, as it wasn't discussed in the media (and was thus less 'vivid'), but the second case did.⁶⁰ It was not until then, that politicians and concerned regulatory agencies realized that these treaties were not merely 'ink on paper.'⁶¹ So while Lebanon continues to sign BITs based on the understanding that they promote investments, the cases and subsequent inputs from UNCTAD seminars and publications has led to a much more careful engagement from more than just the negotiator in charge.⁶²

The experiences in Ghana have been very similar. Here, the legal architect of the BIT-program took the treaties very seriously, which was unusual on the African

⁵⁸ On the Chinese BIT-program, see e.g.; L. Shishi, 'Bilateral Investment Promotion and Protection Agreements: Practice of the People's Republic of China,' in: P. De Waart, P. Peters, and E. Denters (eds.), *International Law and Development* (Dordrecht: Martinus Neijhoff, 1988); A. Berger, 'The Politics of China's Investment Treaty-Making Program,' in: T. Broude, M. Busch, and A. Porges (eds.) *The Politics of International Economic Law* (Cambridge: Cambridge University Press, 2011).

⁵⁹ Claim was pursued in 2000 based on the Egypt-Lebanon BIT under the Cairo Regional Centre for International Commercial Arbitration rules. Claimant is unknown.

⁶⁰ *France Telecom v. Lebanon*, 2002, UNCITRAL rules. Claimant was awarded \$266 million in 2005.

⁶¹ Lebanese official I.

⁶² Ibid.

continent.⁶³ But despite the fact that Ghana actually had the expertise necessary, no one was able to convince politicians or other stakeholders that BITs were not just ‘tooth-less’ instruments along the lines of cultural collaboration agreements.⁶⁴ Moreover, like in Lebanon it was not until Ghana itself was hit by a claim⁶⁵ that people ‘woke up’, as the Lebanese official put it:

‘The cases allowed us to point out to policy makers that we have to be careful and proper in our approach. And when we had to settle some disputes it became clear to them that there are implications of these treaties.’⁶⁶

Finally, India is a similar case, and also particularly interesting given its long history of guarding its sovereignty in the post-colonial era. With respect to BITs, India has occasionally had very well-trained legal officials involved, who had a detailed understanding of the treaties.⁶⁷ Yet, because of an almost complete lack of coordination between the Ministry of Finance, which negotiates BITs, and the Ministry of Commerce, which is in charge of negotiating PTIAs and other trade treaties with investment provisions, India has pursued contradictory policies in the investment regime.⁶⁸ Based on extensive interviews and archival research Ranjan notes that, ‘*India’s domestic regulations on foreign investment are completely oblivious of the international regulatory regime on foreign investment contained in BITs signed by India.*’⁶⁹ Secondly, India has pursued contradictory investment obligations when negotiating investment obligations in different types of treaties, simply because of lacking coordination. In fact, one may speculate that the failure of the Commerce Ministry to truly understand the scope of BITs⁷⁰ was also part of

⁶³ See below. Note that Ghana was also lucky to have a national as the Chief Legal Advisor and later Director of the UNCTC.

⁶⁴ Ghanaian official I.

⁶⁵ *Telekom Malaysia v. Ghana*, 2003, UNCITRAL rules; Gustav F W Hamester GmbH & Co KG v. Republic of Ghana, ICSID Case No. ARB/07/24.

⁶⁶ Ghanaian official I.

⁶⁷ See e.g.; S. Rao, ‘Bilateral investment protection agreements: A legal framework for the protection of foreign investments,’ 26 *Commonwealth Law Bulletin* 1 (2000).

⁶⁸ P. Ranjan, ‘Finmin vs. Commerce ministry,’ *The Financial Express*, 14 Jun, 2010.

⁶⁹ *Ibid.*

⁷⁰ P. Ranjan, ‘Object and Purpose’ of Indian International Investment Agreements: Failing to Balance Investment Protection and Regulatory Power,’ in: V. Bath and L. Nottage (eds.) *Foreign Investment and Dispute Resolution Law and Practise in Asia* (London: Routledge, 2011) (‘*this researcher’s meetings and interactions with Indian government officials has revealed that ... [BITs, ed] relationship with regulatory power has not yet been fully realized. ... There is also a*

the reason for India's refusal to include investment obligations into the WTO. There, it continuously argued against multilateral investment rules because it thought BITs were much more flexible than MAI-like rules.⁷¹ According to an official deeply involved in those negotiations, the perception appeared to be that since BITs did not include liberalization provisions they *had* to be flexible – thereby overlooking the most important innovation in BITs, the investor-state arbitration clause.⁷² In any event, what is important is that even if India's BIT-negotiators have had some level of expertise, it was not until recently that more than a few officials realized that the treaties offered wide and rigid protections.⁷³ The change in attitude towards BITs came not from the NAFTA arbitrations or claims against other developing countries in the past, but when India itself came on the respondent end of arbitration claims related to the Dabhol power project.⁷⁴ Based on this experience, the government decided to revise its model investment treaty.⁷⁵ At the time of writing, the outcome of this is still unknown, yet it is clear that once again it was not until India *itself* was hit by a claim that the government decided to pursue a less haphazard investment treaty policy.

lack of adequate understanding about the actual impact and working of IIAs across different government departments...).

⁷¹ E.g. WTO WGTI, Communication from India - Stocktaking of India Bilateral Agreements for the Promotion and Protection of Investments, WT/WGTI/W/71, par. 6. See also; WT/WGTI/M/14, op. cit.

⁷² Not-for-attribution interview, April 2011. Wälde makes a similar suggestion concerning the investor-state arbitration provision in the Energy Charter Treaty: 'Relatively little time by relatively few people seems to have been spent on the arbitration question it is quite possible that the Art. 26 solution came about by rather rapid import of precedent solutions (mainly US/UK BIT and NAFTA practice) ... but not very much in-depth reflection on the implications.' T. Wälde, *Investment Arbitration Under The Energy Charter Treaty: From Dispute Settlement to Treaty Implementation*, 1998, at 32-33. Available at: www.dundee.ac.uk/cepmlp/journal/html/Vol11/article1-10.pdf (accessed 11 October 2010).

⁷³ P. Ranjan, 'International Investment Agreements and Regulatory Discretion: Case Study of India,' 9 *Journal of World Investment and Trade* 2 (2008), at 214. E.g.; *Capital India Power Mauritius I and Energy Enterprises (Mauritius) Company v. Government of India*, UNCITRAL rules.

⁷⁴ E.g.; *Capital India Power Mauritius I and Energy Enterprises (Mauritius) Company v. Government of India*, UNCITRAL rules.

⁷⁵ I am grateful to Prabhash Ranjan for making me aware of this. See also; comments by an Indian Commerce Ministry official in; IISD, *Report on the Fourth Annual Forum of Developing Country Investment Negotiators*, available at: www.iisd.org/pdf/2011/dci_2010_report.pdf (accessed 29 April 2011). Note also that and when trying to dilute provisions in its trade and investment agreement with Singapore in ways that would diverge considerably with past Indian BIT practice, one official explained that the Indian government had to be careful not to repeat the Dabhol experience; 'India seeks to amend trade treaties,' *The Economic Times*, 30 March, 2004. See also; L. Peterson, 'India-Singapore FTA inked, investment provisions include important innovations,' *INVEST-SD: Investment Law and Policy News Bulletin*, August 3, 2005.

The typical case: BITs as tokens of good-will

I turn now to a third and much more wide-spread group of countries, where lacking awareness of the basic implications of BITs did not just plague stakeholders but also negotiators themselves. Let us begin by revisiting the case of Pakistan from the preface. Here, negotiators involved during the 1990s, almost entirely failed to appreciate the significance of what they were negotiating. This meant that unlike the cases above, no one was in a position to make diplomats and politicians aware that the treaties were in fact more than diplomatic gestures. As one officer who was involved during the 1990s puts it, *'earlier we didn't take much notice of BITs. They were often signed in a hurry... Parliament never discussed these issues.'*⁷⁶ This was also his impression from signing BITs with other developing countries, since they did not have much expertise either.⁷⁷ And the legal officer in Pakistan, who was supposed to vet the treaties, didn't find this practice to be any cause for alarm.⁷⁸ Inputs were limited to proof-reading, and at times, albeit rarely, some minor suggestions on the text.⁷⁹ This all changed with the SGS claim, however, as already mentioned in the preface. As one official involved recalls, it was the SGS case that *'made the Pakistani government alert.'*⁸⁰ After that, the Attorney General, who until then had never heard of BITs, initiated a learning process for all relevant stakeholders by inviting foreign experts and informing key offices about important aspects of investment treaties. This led to a considerable improvement in the negotiating capacity at the time. However, because of bureaucratic career rotations, staff changes meant that the expertise failed to institutionalize and instead diffused to other departments, and today negotiating expertise is almost back at the level before the SGS claim. As one official who moved to another department puts it, *'a problem is the fast nature of the different jobs within the bureaucracy, they change all the time all the*

⁷⁶ Pakistan official I.

⁷⁷ Ibid.

⁷⁸ Pakistan official II.

⁷⁹ Pakistan official III. Note also that what appears to be a biasing impact of the representativeness heuristic meant that officials were of the view that, *'during the period we signed the treaties, a good amount of investment also came so the BITs worked!'* (Pakistan official VII.)

⁸⁰ Pakistan official VIII.

*developed expertise gets repatriated.*⁸¹ This became clear from interviewing negotiators in charge of Pakistan's BIT program in recent years. One key negotiator is today of the impression, for instance, that BITs allow investors to sue *each other* (which they don't).⁸² Another official notes that, '*..if the leadership of our countries meet at some point, we can show the public that: "Ok fine, we mean business with each other, since we are connecting with each other and doing so many agreements with each other"*.'⁸³ Unlike the time before the SGS claim, however, today at least parts of the Law Ministry are making negotiators aware that the treaties do in fact involve serious and far-reaching obligations. This is a first in the country's history, but whether it is listened to, is another question. The long and detailed analyses from the ministry on the recent upgrade of the Pakistan-Germany BIT, for instance, were considered by negotiators as mere '*commas, full stops, and so forth.*'⁸⁴

In the case of Thailand, an official from the Ministry of Foreign affairs notes that while Thailand had signed BITs since 1961, officials failed to appreciate the most important feature of modern BITs; the investor-state arbitration mechanism.⁸⁵ This led to a gross misperception of the treaties practical implications, which persisted to as late as 2004 when plenty of other cases had already been filed against developing countries other than Thailand. Another official thus notes that before Thailand became subject to its first investment treaty claim in 2005⁸⁶, '*few took BITs very seriously. We had very complex obligations on paper, but no one used them so that was fine.*'⁸⁷ Based on the understanding that the treaties were immaterial, the level of expertise going into the negotiations was minimal: '*Most of the time we put the best people on the agreements with high priority such as FTAs rather than BITs. That has implications for the legal expertise going into*

⁸¹ Pakistan official VI.

⁸² Pakistan official IV.

⁸³ Pakistan official V.

⁸⁴ Pakistan official IV. See also chapter four.

⁸⁵ V. Mangklatanakul, 'Thailand's First Treaty Arbitration: Gain From Pain,' in: UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration II* [unedited draft] (Geneva: United Nations, forth.), at 82.

⁸⁶ The claim was: *Walter Bau v. Thailand*, 2005, UNCITRAL rules.

⁸⁷ Thai official I.

*BIT negotiations.*⁸⁸ It was not until Thailand itself got hit by the claim that officials realized this was not a rational way to engage with a serious set of obligations. *‘That shift in attitude came with the German claim.’*⁸⁹ So while the Thai Board of Investment is still very much in favor of BITs (*‘their mandate is to promote investments, so they want BITs’*⁹⁰) other agencies are now much more careful than before. A Thai official notes that this learning experience is important for other countries to consider: *‘they must be careful, lest they inadvertently find themselves to be victims of their own creation.’*⁹¹

More or less similar examples are found in Eastern Europe. In the Czech Republic, officials lacked *‘any relevant knowledge of investment treaty protections’* when signing numerous BITs during the 1990s.⁹² As one key civil servant notes,

*‘Negotiators really didn’t know that the treaties had any bite in practice. They were neither aware of the costs or the fact that it could lead to arbitration. Their potential implications were not known until around 10 years ago.’*⁹³

Recall, that it was 10 years ago that the Czech Republic was hit by the *Lauder* arbitrations. In Croatia, the process was largely similar. When Eastern Europe rushed towards BITs - occasionally prodded on by CEELI and others - the importance of the treaties were not realised by Croatian officials, who merely saw them as a means to obtain *‘political cooperation’*.⁹⁴ And as in the case of the Czech Republic and other countries, stakeholders as well as negotiators themselves did not just underestimate the potential costs of the treaties, they were not even aware that BITs could potentially result in arbitration claims. *‘It took a few cases before we realized the importance. In the past, we didn’t have many disputes, when we did they were not brought to arbitration. And when there were no cases against Croatia, we didn’t think they were that important.’*⁹⁵ After

⁸⁸ *Ibid.*

⁸⁹ *Ibid.*

⁹⁰ *Ibid.*

⁹¹ Mangklatanakul, *op. cit.*, at 84.

⁹² G. Veselá, ‘Bilateral Investment Treaty Overview – Czech Republic,’ available at: www.investmentclaims.com (last accessed: 10 January 2010).

⁹³ Czech official I.

⁹⁴ Croatian official I.

⁹⁵ *Ibid.*

Croatia was hit by a claim in 2004,⁹⁶ however, this changed and now the propensity to sign BITs has slowed down. Although there is still considerable pressure from diplomats and politicians to sign them as '*just another cultural photo-opportunity*', officials are today able to better withstand that pressure since now they '*understand the relevance and power of BITs.*'⁹⁷

We find this pattern also in Africa. The Ghanaian official from above notes,

'We came across many countries that handled this in a very superficial level. .. We did not find capacity to negotiate in most places in Africa. It has to with an understanding and appreciation of what is involved. It is not just another cooperation agreement without teeth, yet most negotiators on the other side of the table didn't actually negotiate.'⁹⁸

Even a country like South Africa, which was much better endowed with bureaucratic capacity, officials entirely failed to realize that the obligations they were negotiating went over and beyond the South African constitution in a number of crucial areas. As will become clear from the coming chapter, it was not South Africa itself became on the respondent end of treaty-based investment arbitrations that officials became aware that the treaties were serious indeed.

Moving on to Latin America, Chile is a country which, like South Africa, has both considerable inward and outward investments to protect. Yet, one official notes that, '*like most countries in the 1990s, we signed a lot of treaties not knowing sometimes what we were committing ourselves to. We didn't know the scope of the treaties, and the arbitrations got started and the awards and interpretations came, we began to rethink our view.*'⁹⁹ Chilean officials did, in other words, learn from other countries' experiences. Yet, the defining moment for the Chilean BIT-program was when Chile itself was subject to a claim. '*It is when we started to be sued, we understood the implications.*'¹⁰⁰ As a result, Chile is today reviewing approach carefully trying to learn from other countries' experiences.

⁹⁶ See, L. Peterson, 'Croatia prevails in confidential arbitration with Canadian investor,' 1 *Investment Arbitration Reporter* 16, December 11, 2008.

⁹⁷ Croatian official I.

⁹⁸ Ghanaian official I.

⁹⁹ Chilean official I.

¹⁰⁰ Ibid.

Also in the Dominican Republic negotiators failed to appreciate the significance of BITs. One official notes, '*we never thought about disputes that may arise from the treaty. It was a marketing sign for the country, and also a diplomatic photo-opportunity along with many other commercial treaties.*'¹⁰¹ Again, however, this changed after the Dominican Republic in 2007 was sued. '*The disputes changed the mind completely on the negotiations.*'¹⁰² And while the learning that came from the CAFTA negotiations had led to a review process (cf. also Costa Rica above), it was the first claim against the Dominican Republic itself that made officials truly realise the implications of the treaties. Another official notes:

The notice of arbitration from SGS created awareness among negotiators that we should look back and question whether we could actually adhere to these agreements. This led to a complete halt in negotiations as we became aware that we are legally liable.¹⁰³

So although no-one within the administration has considered cancelling BITs based on this experience, the Dominican Republic is today reevaluating its approach towards a more cautious BIT-policy.

Even in Mexico, the experience of negotiating NAFTA with the United States and Canada didn't lead to a particularly strategic approach towards BITs. Like in several countries already mentioned, two different government offices were negotiating investment obligations depending on whether they were included in BITs or broader economic integration agreements. Until the early 2000s, one branch of the government were therefore negotiating investment obligations based on NAFTA, whereas another were negotiating BITs based on the traditional European models.¹⁰⁴ One official notes, '*nobody really questioned whether the strategy had results.*'¹⁰⁵ and another official remarks, '*during the 1990s, BITs were a very different animal than FTAs, the WTO, and other globalization instruments. ... By contrast with FTA agreements, there was no legal review, control, or scrutiny to the content. ... Often BIT negotiations have been done by a*

¹⁰¹ Dominican Republic official I.

¹⁰² Ibid.

¹⁰³ Dominican Republic official II.

¹⁰⁴ Mexican official II.

¹⁰⁵ Mexican official I.

*couple of guys; they sent it to parliament with no real discussion... Apart from a copy of the BIT in the negotiator's office no one was even aware how many BITs the country had in the 1990s.*¹⁰⁶ The reason for such risk-neglect again appears to be due to the biasing impact of the availability heuristic,

‘Many here in Latin America thought it was harmless to sign these treaties, no-one had an idea what they meant. Many who negotiated were not lawyers, so they just signed them of within a few days, hours, or even over email because travels are too expensive. ... Governments want to display corporation, and one way to do that is to sign promotion treaties that sounds nice. ... No discussion, analysis, goes into it.... And even if it gets a legal review, the lawyers don't have the experience what to check for. ... No-one cares until the dispute comes.’¹⁰⁷

The learning process that resulted from the disputes against Mexico remained within a small circle of technical staff. A key official notes, *‘I would have expected reactions against BITs after the ICSID cases, but there has never been such discussion here, unlike with FTAs. No doubts or inquires by the Senate, which is a paradox. ... Also, no regulatory agencies are aware of the treaties at all.’*¹⁰⁸ Yet, due to the experiences of the claims against Mexico, negotiators at least have become more careful in their approach. As a recent negotiator remarks,

‘At times, the treaties don't make sense, such as the one with Belarus. ... But unlike many countries just recklessly writing BITs to get a picture in the newspaper – which we see with many countries who are not knowledgeable about the treaties or arbitrations – our approach is different.’¹⁰⁹

Finally, there is a case like Ecuador, which has recently withdrawn from ICSID and several of its BITs. One official involved in past negotiations noted that when Ecuador began signing BITs, a model agreement was more or less copied from those of developed countries. And while the international arbitration clauses were discussed among some officials, due to Ecuador's long-standing opposition to such clauses, the treaties were *‘not politicized at all ... there was no idea that the risks of BITs were so substantial.’*¹¹⁰ Other officials concur, stating that the way Ecuador consented to BITs was again not just based on an underestimation of the

¹⁰⁶ Mexican official II.

¹⁰⁷ Ibid.

¹⁰⁸ Mexican official I.

¹⁰⁹ Ibid.

¹¹⁰ Ibid.

risks of BITs, but a complete misunderstanding of their basic implications. One official notes, that when Ecuador was visited *‘by a president from another country, BITs were used to signify the event. So they started without understanding the responsibilities and obligations.’*¹¹¹ This approach persisted, and *‘we didn’t start to worry about it before we ourselves were sued. ... After the claims, the ministry of finance affairs got involved and the legal offices also.’*¹¹² Before then it was solely foreign ministry officials that were involved, but because of career rotations there was *‘no continuity. I don’t think we had one negotiator who participated in more than three negotiations, for instance.’*¹¹³ Another official notes, *‘often Ambassadors would sign BITs at the end of their stay at a country to ‘finish with a bang’ – not knowing the implications.’*¹¹⁴ However, after the claims against Ecuador - one of which led to an award translated into US\$5.5 per capita¹¹⁵ - officials began taking UNCTAD reviews and other countries’ experiences seriously, and revisited its approach as a result. *‘When we went to UNCTAD courses we realized other countries were in the same situation. Mexico had been sued but we didn’t realize that before the UNCTAD courses. Before that date I didn’t have any knowledge of it.’*¹¹⁶ This experience also led to a study undertaken by the Central Bank investigating whether Ecuador’s BITs had actually had an impact on investment flows, which it concluded they didn’t. After an intensive hearing process, an inter-ministerial committee therefore decided to withdraw from a number of treaties and renegotiate others.

These country experiences present a somewhat different picture of the way developing countries have contemplated and negotiated BITs than standard accounts of the BIT-movement. In fact, the misinterpretation of BITs even by negotiators themselves is reported also by their developed country counterparts.

¹¹¹ Ecuadorian official I.

¹¹² Ibid.

¹¹³ Ibid.

¹¹⁴ Ecuadorian official II.

¹¹⁵ K. Gallagher and E. Shrestha, ‘Investment Treaty Arbitration and Developing Countries: A Re-Appraisal,’ Global Development and Environment Institute Working Paper No. 11-01, May 2011. The claim was; *Occidental Exploration and Production Company v. Ecuador*, LCIA Case No. UN3467.

¹¹⁶ Ecuadorian official I.

An experienced Dutch negotiator notes that, *‘during the 1990s, developing countries often asked what even basic provisions meant. ... But now that investors have invoked the treaties it has led to a greater understanding and, at times, more difficult negotiations.’*¹¹⁷ A Swiss official concurs, noting that *‘the big question is of course whether developing countries actually knew what they signed. ... We have certainly seen a rising awareness of these issues in developing countries, and today they are much better prepared.’*¹¹⁸ Similarly a Canadian official recalls that, *‘... in the past we actually had to drop some negotiations simply because the level of understanding was lacking.’*¹¹⁹ Finally, even some senior investment lawyers concede that BITs have often been entirely misunderstood by adopting governments until the disputes began. In his expert testimony to one case against Argentina, for instance, Schreuer was asked whether, *‘he really believed that two sovereign States will negotiate, sign and ratify a Bilateral Investment Treaty without caring to consider what was put in it.’* He replied:

*‘... many times, in fact in the majority of times, BITs are among clauses of treaties that are not properly negotiated. BITs are very often pulled out of a drawer, often on the basis of some sort of a model, and are put forward on the occasion of state visits when the heads of states need something to sign, and the typical two candidates in a situation like that are Bilateral Investment Treaties, and treaties for cultural co-operation. In other words, they are very often not negotiated at all, they are just being put on the table, and I have heard several representatives who have actually been active in this Treaty-making process, if you can call it that, say that, ‘We had no idea that this would have real consequences in the real world’.’*¹²⁰

Example of a country without a claim: Libya

I end this brief review with a country that is *not* reported to have been on the respondent end of an investment treaty claim yet, and that is Libya. Based on the insights above, we would expect that Libya still has a much more haphazard BIT policy than developing countries, which have themselves been hit by claims. And there are indeed some indications of this. When Qadhafi recently visited Spain,

¹¹⁷ Dutch official I.

¹¹⁸ Swiss official I.

¹¹⁹ Canadian official I.

¹²⁰ *Wintershall Aktiengesellschaft v. Argentina*, ICSID Case No ARB/04/14, Award, 8 Dec., 2008, par 85.

this is a Wikileaks report on the BIT signed between the two countries during the visit:

‘... the Government of Libya (GOL) indicated ... that it wished to quickly finalize language for an education and culture agreement, a defense cooperation agreement, a bilateral legal cooperation and extradition treaty, an investment security agreement and a double taxation-exemption agreement. ... Spain had tried for some time to finalize several of the agreements, but to no avail. ... [A Spanish official, ed.] lamented that the rush to finalize agreements for signature in time for Qadhafi’s visit had precluded meaningful bilateral discussions of what the two sides’ understanding of those accords would mean and how they would be implemented.’¹²¹

If this report is reliable, the pattern is as expected: since Libya had not been subject to a BIT claim it still rushed through the treaties alongside all sorts of other diplomatic agreements, such as on education and cultural exchanges, without any ‘meaningful bilateral discussions’. As the Spanish official remarked, ‘*The form is more important to the GOL than the substance.*’¹²² This was as late as 2007.

Learning from own claims

These country experiences explain the quantitative findings from section one. By contrast with the expectations from a Bayesian framework, they show that key stakeholders in developing countries did not just slightly underestimate the risks of disputes or learn from claims abroad only if they were relevant for their own BIT-program. Instead, they ignored the risks entirely and did not even consider other countries’ experiences before they themselves were hit by a claim. In fact, even negotiators often failed to appreciate the most important aspect of BITs – the binding consent to investor-state arbitration. This is notable, as the countries above were generally richer and had greater inward and outward FDI stocks when the treaties proliferated than most other developing countries.¹²³ They therefore did not just have a greater capacity to engage with BITs than many other developing countries, they also had a greater incentive to do so, given their stake

¹²¹ ‘Qadhafi’s travel to Spain,’ Report by American Embassy in Tripoli, 12 December 2007; Wikileaks - 07TRIPOLI1033.

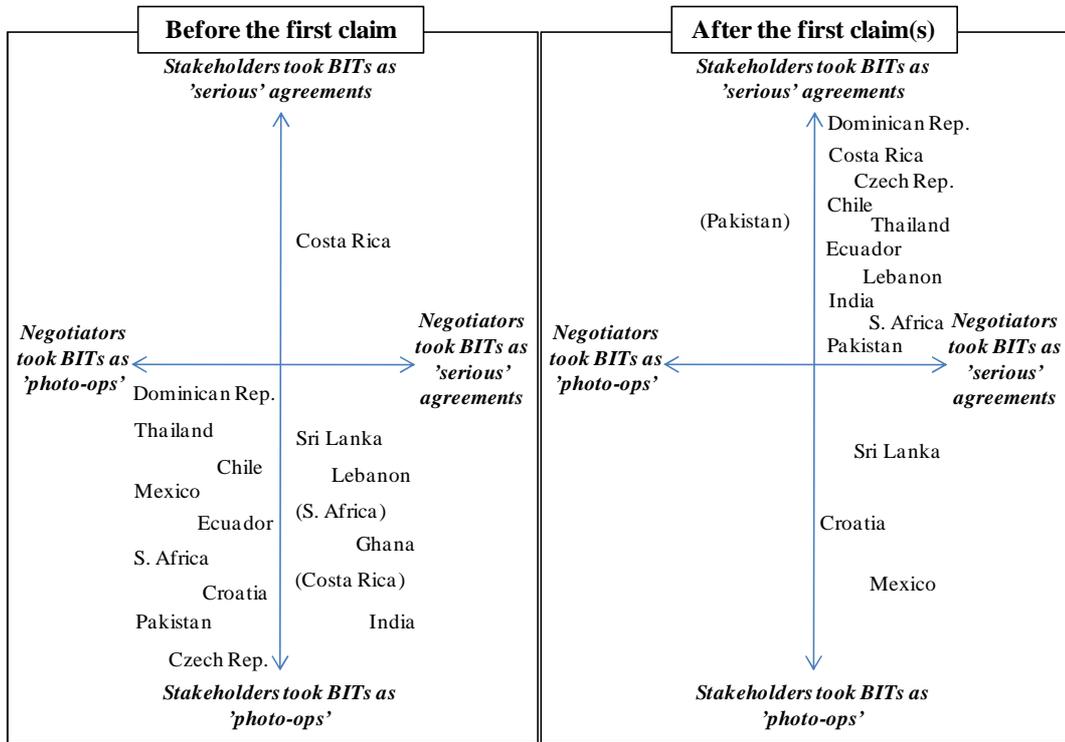
¹²² Ibid.

¹²³ See Annex II for details.

in the system. Yet, the availability heuristic appears to have made stakeholders and (often) negotiators entirely ignore the risks of BITs until their own country was hit by a claim. As an illustration, Figure 8.2 below shows a simplified version of this learning process.

Apart from backing up the main econometric findings, these experiences add to our understanding of them. Recall, for instance, that the impact of the first claim was less with respect to ratification than signing patterns. While this may be due to idiosyncratic differences in ratification procedures, the country insights indicate that it is also likely to be because stakeholders – like parliaments – have often continued to neglect the importance of the treaties, even after the first claim. Recall also that the impact of the first claim was larger for ‘serious’ BITs rather than ‘photo-op’ BITs, which again is explainable by the fact that even when negotiators have started pursuing more cautious BIT-policies, they were not always capable of withstanding political pressure to continue signing ‘photo-op’ BITs.

Figure 8.2. Examples of countries learning from first BIT claims



Notes: ‘Stakeholders’ is understood broadly as officials or politicians affected by, but not in charge of, BIT-negotiations. South Africa is included also in brackets in the first graph as one legal official with a deep understanding of the treaties did become involved for a short time before South Africa’s first claim. Pakistan is included also in brackets in the second graph as changes in staff a few years after the first claim meant that the expertise and experience gained from the first claim diffused to departments not directly involved in negotiations. Costa Rica is in brackets in the first graph as it was not the first claim that led stakeholders to engage more care with BITs, but rather FTA negotiations with the United States. Given that graphs are based almost solely on interview feedback, more in-depth studies may reveal individual country positions to be inappropriate in certain cases.

Sources: Primarily interview feedback from one or more officials involved in the countries’ BIT-programs, directly or from a management position. Countries included in the figure had all had at least one BIT-claim by 2009. See further in Annex II.

A potential counter-argument

Suffice it to say, there are a range of methodological concerns in relying on negotiator and stakeholder interviews. For although the characteristics of the countries above indicate that the bounds of rational decision-making may well have been considerably more narrow in many other developing countries, there could of course be validity concerns. Policy-makers usually have an incentive to

portray a ‘careful, multidimensioned process of policy-making’,¹²⁴ yet this may not necessarily be the case here. One arbitrator argues that ‘negotiators in developing countries knew exactly what BITs were and the potential implications of signing them. The only reason they would say otherwise today, is that the disputes have led to political pressure to oppose the treaties.’¹²⁵ Following this logic, a public choice explanation for the pattern observed in the regressions could be that while negotiators knew about the implications of BITs, the political costs of pursuing them for their own individual reasons (e.g. career promotion, travels, etc.) became too high once the claims began. This will be further investigated in the next chapter. As a general explanation, it appears unlikely; however, as it would imply a major conspiracy, given that *all* stakeholders and negotiators interviewed have stated independently of each other that most developing countries seriously misunderstood the implications of investment treaties. Also, as stated in chapter three, a number of stakeholders had an individual interest in pushing for more cautious BIT-strategies, yet they didn’t until the first claim hit. Finally, there are many other ways for ambassadors and politicians to get their ‘photo-ops’, and for most countries BITs only entailed individual benefits for one or two bureaucrats in charge of the negotiations. So had stakeholders carefully sought and processed information about the risks of BITs, it should have been relatively easy to convince governments of more prudent BIT-policies. Yet they didn’t. The burden of proof thereby appears to be on those arguing that developing country officials are being systematically dishonest, disingenuous, or just generally self-serving, when stating that the implications of consenting to investor-state arbitration in investment treaties took many by complete surprise.

¹²⁴ A. George and A. Bennett, *Case Studies and Theory Development in the Social Sciences* (Cambridge: MIT Press, 2005), at 102.

¹²⁵ Not-for-attribution interview, April 2010.

Conclusion

Existing accounts of the BIT-regime have set out to solve a considerable puzzle: why would developing countries consent to investment treaties that potentially entail massive costs and constrain their ability to regulate foreign investors? Based on the assumption that developing countries actually understood the implications of the treaties, explanations have often been based on remarkable expectations about the sophistication of developing country policy-making. Yet this assumption does not hold in most cases. Indeed, it is telling that when political scientists and legal scholars have claimed that developing countries knew all along that BITs entailed potentially costly legal obligations, it has been stated as an assumption without providing any sustaining evidence. It may be tempting to think that developing countries ‘*knew and accepted*’ the costs of investment treaties,¹²⁶ and that they constantly outweighed the expected benefits of BITs with the risk of having ‘*virtually any legal change or rule that affects foreign investors is potentially subject to review by a foreign tribunal.*’¹²⁷ And for rational-choice accounts, it may be intuitive to assume that the considerable costs of investment treaties have been regarded *not* as ‘*an accidental by-product but intended by both sides*’.¹²⁸ Yet, based on the insights of this chapter, these assumptions – and thus the basic foundation of all studies on BIT-diffusion this author is aware of - are largely misleading.¹²⁹

Instead, there is considerable evidence in support of a BIT-diffusion process characterized by bounded rather than comprehensive rationality on the part of developing country decision-makers. This was shown in an econometric setting,

¹²⁶ S. Montt, *State Liability in Investment Treaty Arbitration* (Oxford: Hart Publishing 2009), at 128.

¹²⁷ Elkins, Guzman, and Simmons, *op. cit.*, at 825. Italics added.

¹²⁸ T. Büthe and H. Milner, ‘Bilateral investment treaties and foreign direct investment,’ in: K. Sauvart and L. Sachs (eds.) *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows* (New York: Oxford University Press, 2009), at 214.

¹²⁹ It is therefore no surprise that Allee and Peinhardt struggle to predict the content of BITs using ‘Rational Design’ theory in an econometric working paper. The authors find this surprising, yet offer no alternative hypotheses; T. Allee and C. Peinhardt, ‘Not the Least BIT Rational: An Empirical Test of the ‘Rational Design’ of Investment Treaties,’ working paper, 2008.

which indicated that developing countries learned much more from their own claims than one would have expected if they sought to rationally optimize their BIT-strategies. To complement the statistical results, the second part of the chapter included insights from decision-makers themselves on how they arrived at their inferences and decisions pertaining to BITs. The interviews indicated not just coordination problems, which could potentially be explained by rational-choice models, but also risk-neglect and lack of learning from other countries – even when individual stakeholders had an interest in a more careful BIT-strategy.

Mistaken inferences were particularly wide-spread when expertise and experience was absent. This is not surprising, for as mentioned in chapter three a lack of expertise and/or experience narrows the bounds of rationality by adding even greater constraints on information processing. So while future quantitative studies may consider taking this analysis further by conditioning on survey data on expertise, for instance, the combination of the qualitative insights and the econometric analysis is sufficient to show that Bayesian models do not take us far enough in understanding the political foundation of the international investment regime.

The chapter limited itself to focus solely on the risks of BITs. It did not investigate how countries have learned in practice from information about the economic implications of BITs. Why is it that officials in Cambodia, Malaysia and the Democratic Republic of Congo, for instance, still remain convinced that BITs are crucial for foreign investors and the provision of PRI?¹³⁰ Might the representativeness heuristic have a role to play in such assessments?

Also, while the chapter showed that the availability heuristic meant that governments often moved towards a new institutional equilibrium after themselves having been subject to claims, it did not discuss whether the often limited adjustments have been due to careful cost-benefit calculations or a status-

¹³⁰ Malaysian official I (*'All countries investing here have a BIT, and without the BIT those investments would probably not have come'*), Cambodian official I (*'BITs bring tranquility to the mind of foreign investors... There are plenty of research saying at the end of day BITs are not instrumental for FDI. ... As a practitioner in charge of FDI promotion, these studies have had no impact on my decision'*), DR Congo official I (*'BITs are very important for insurance.... A BIT provides OPIC with the possibility for insurance'*).

quo bias. When officials in a country like Croatia and the Dominican Republic, for instance, have become concerned about the risks of BITs and are convinced the treaties don't have much economic value, why is it they would not even consider withdrawing from the treaties?¹³¹

Third, the analysis focused on the recent slow-down in BIT-adoption, and not the initial upsurge. Naturally, a general explanation of the BIT-movement would have to account for both. Lastly, given the large-N nature of the chapter, it did not carefully engage with a final alternative hypothesis, namely that BIT-negotiators and certain stakeholders have been systematically disingenuous for decades by knowingly sacrificing national welfare to achieve higher personal benefits. As already mentioned this public-choice explanation appears unlikely, but a more detailed country-case study would undoubtedly be better able to disentangle whether decisions that were irrational for countries as a whole were also irrational for individual officials.

The next and final empirical chapter will provide some potential answers to these outstanding questions by giving a much more detailed insight to how officials have contemplated and negotiated investment treaties both within and between government bureaucracies.

¹³¹ Croatian official I; Dominican Republic official II.

9. Bounded rational policy diffusion: A case study

Focusing on South Africa, this last empirical chapter will provide the most detailed investigation into decision-making procedures surrounding BITs in a developing country to date. The chapter is divided into three sections. The first will briefly outline why South Africa was chosen as a useful case to further investigate the predictive qualities of a bounded rationality framework. The second will introduce South Africa's economic reforms post-apartheid, and outline South Africa's experience with its BITs. The third will provide an in-depth historical study of why, and how, South Africa entered into the treaties. In doing so, it will illustrate the mechanisms through which the politics of purpose interacts with imperfect information, lack of expertise and experience, as well as cognitive constraints.

9.1 Why South Africa?

A number of factors make South Africa a useful case-study to provide deeper insights into the bounds of rationality, when developing countries have engaged with BITs. First of all, South Africa is a relatively rich developing country with inward and, particularly, outward foreign investments playing a considerable role in its economy. This gives the country a greater stake in the investment treaty system than many other countries, and thus a greater incentive to carefully engage with the treaties.

Secondly, studying South Africa allows us to distinguish between imperfect information and imperfect processing of information more clearly than in many other countries. For while the country was not hit by a major claim until the early 2000s and information about other countries' claims was difficult to come by before then, it entered into BITs during the 1990s that were in outright contradiction to politically sensitive elements of its newly enacted Constitution. So even if the risks of actual investment disputes were difficult to gauge, the

government nevertheless had considerable incentives to carefully consider the content of BITs.

Third, the country is endowed with a greater degree of expertise within its bureaucracy compared to many other developing countries. Stakeholders with an individual interest in cautious BIT-strategies were therefore in a better position to process information about BITs than stakeholders in some of South Africa's regional neighbours, for instance.

Fourth, with respect to the possible, but doubtful, counter-argument from the public choice literature,¹ South Africa is a useful case, since like many other countries it had a very small negotiating team during the 1990s: often it was only a single relatively junior public official, who obtained significant individual benefits from promoting BITs through foreign travels, larger budgets, or just generally career promotion. So to the extent that just a few stakeholders had sought and processed information about the conflict between the country's BIT-obligations and the Constitution, there were ample opportunities to avoid 'agency-slip'. This was not just in the national interest, but also in the individual interest of legal advisors, for instance, to make sure they couldn't later be blamed for incompetence and negligence.

Combined, these characteristics make South Africa a particularly useful case for our purposes. It is, however, important to note that all the experiences of South Africa cannot necessarily be generalized to the population of developing countries. Indeed, no one country can be construed as being truly representative of the population of developing countries in the international investment regime. That would raise concerns over external validity due to geography for instance: Latin American countries have had distinct experiences with the international investment regime due to their affiliation with the Calvo doctrine, Western legal transfer played a particularly important role in Eastern Europe after the demise of socialism (see chapter five), and so on. If these geographically contingent experiences vary systematically with variables of interest – such as expertise, availability of information, level of politicization, etc. – the causal mechanisms

¹ See the last chapter.

could look considerably different if another case study had been chosen. Similarly, very large economies – such as China, India, and Russia – or indeed very small and poor economies may have had discrete practices, which would have to be studied separately. So rather than suggesting that South Africa is a ‘typical’ case, it is primarily intended to complement the survey findings in the last chapter by providing a more detailed investigation into how developing country officials have learned about investment treaties.²

A second caveat should be mentioned as well. I managed to trace all BIT-negotiators involved with the South African program since its inception, mostly through snow-ball sampling, and the analysis will almost exclusively rely on their interview feedback.³ While detailed documentation to corroborate interview data would naturally have been preferable, very little was available. Indeed, a recent report by the South African government - which I shall return to - notes about the many treaties signed during the 1990 that ‘*no policy documentation informing the rationale for the conclusion of such BITs could be found.*’⁴ This lack of written material forces the case study to primarily rely on ‘oral history’ with the risks that entails, such as interviewees having forgotten the events of interest or slanting their accounts to promote some hidden agenda. Yet as we shall see, the lack of extensive records actually sustains the overall conclusion of the chapter that BITs were not taken as seriously as a rational learning framework would predict: until recently the investment treaty program was not considered important enough to merit detailed official documentation.

² See generally; B. Flyvbjerg, ‘Five misunderstandings about case-study research,’ in: C. Seale et al. (eds.) *Qualitative Research Practice* (London: Sage, 2004), at 228; H. Eckstein, *Regarding Politics: Essays on Political Theory, Stability and Change* (Berkeley: University of California Press, 1992), at 143-144; J. Levy, ‘Case studies: Types, designs, and logics of inference,’ 25 *Conflict Management and Peace Science* 1 (2008), at 6-7.

³ See Annex II.

⁴ Department of Trade & Industry (DTI), Republic of South Africa, *Government Position Paper on Bilateral Investment Treaty Policy Framework Review* (June 2009), at 14.

9.2. The embrace of foreign investors and BITs

The stage for South Africa's BIT program was set in 1994, when the African National Congress (ANC) won the elections. This marked a new beginning for the South African polity. Not only could it begin rectifying deeply entrenched racial inequalities, South Africa could also reverse the disastrous economic management under Apartheid. To do this, the ANC's economic platform aimed at providing basic welfare provision to South Africa's poor. But rather than populist redistributive policies – such as wide-scale nationalizations - and booming rates of inflation and public debt, ANC governments pursued borderline conservative macroeconomic reforms, including liberalisation of commodity trade and the capital account.

South Africa's investment policy after Apartheid

From the outset, attracting foreign investment was also an important component of the ANCs' economic strategy. Due to the combination of international sanctions and tight capital controls, South Africa received next to no FDI inflows during Apartheid – a mere US\$300 million from 1980 to 1993. This had to be reversed. *'The rates of economic growth cannot be achieved without important inflows of foreign capital,'* Nelson Mandela told an audience of American business leaders in 1991.⁵ *'We are determined to create the necessary climate, which the foreign investor will find attractive.'*⁶ Going against the more socialist fractions of the ANC, the new government therefore welcomed foreign investment in the 1994 whitepaper on the Reconstruction and Development Programme (RDP), and aimed to provide foreign investors national treatment.⁷ Nelson Mandela assured investors that *'not a single reference to things like*

⁵ Quoted in; H. Marais, *South Africa: Limits to Change* (London: Zed Press, 1998), at 123.

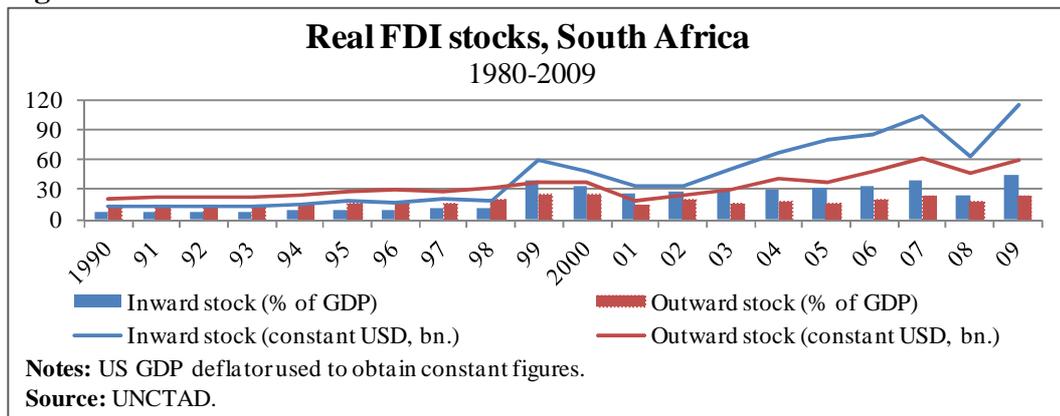
⁶ *Ibid.*

⁷ Parliament of the Republic of South Africa, 'White Paper on Reconstruction and Development,' *Government Gazette*, 23 November (1994), at 23.

nationalisation’ was present in his government’s economic policies and that his platform had been cleansed of ‘*any Marxist ideology*.’⁸

South Africa therefore liberalised its investment regime in practically all sectors, allowing foreign investors 100 % ownership, dismantling earlier discriminatory taxes towards non-residents, losing restrictions on capital repatriation, provided cash incentives to invest in manufacturing, avoiding performance requirements, signing double-taxation treaties, ratifying the MIGA Convention, establishing an investment promotion agency, and so forth.⁹ In short, South Africa followed the international trend of the last couple of decades by replacing ‘*red tape with red carpet treatment of foreign investors*.’¹⁰ Yet, with sluggish economic growth and one of the highest unemployment rates in the world, the ANC’s economic reforms had disappointing outcomes,¹¹ and South Africa also failed to attract much FDI through the 1990s (Figures 9.1 and 9.2).

Figure 9.1. FDI to and from South Africa.



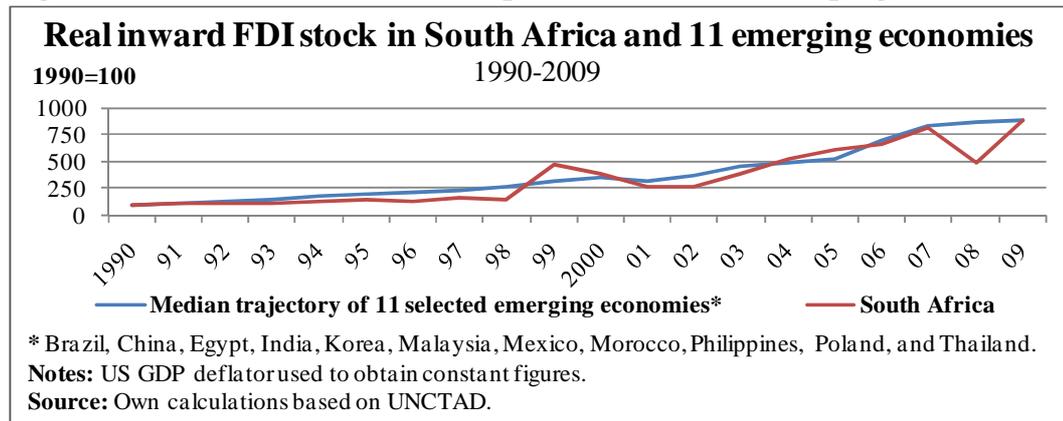
⁸ Quoted in; Marais, *op. cit.*, at 95.

⁹ See; OECD, *Regulatory Environment for Foreign Direct Investment*, draft paper, 2005; O. Akinboade, F. Siebrits and E. Roussot, ‘Foreign Direct Investment in South Africa,’ in: S. Ibi Ajayi (ed.), *Foreign Direct Investment in Sub-Saharan Africa: Origins, Targets, Impact and Potential* (Nairobi: African Economic Research Consortium, 2006); B. Vickers, ‘Foreign Direct Investment (FDI) Regime of South Africa,’ Institute for Global Dialogue, February 2002.

¹⁰ K. Sauvart, ‘Driving and Countervailing Forces: A Rebalancing of National FDI Policies,’ in: K. Sauvart (ed.), *Yearbook on International Investment Law and Policy 2008/2009* (Oxford: Oxford University Press, 2009), at 222.

¹¹ See; D. Rodrik, ‘Understanding South Africa’s Economic Puzzles,’ *NBER Working Paper 12565*, 2006; M. Lundahl and L. Petersson, Post-Apartheid South Africa: An Economic Success Story?, *UN-WIDER Research Paper No. 2009/56*.

Figure 9.2. FDI in South Africa compared with other developing countries.



The limited interest of foreign investors in the early years of the post-Apartheid regime has been attributed to a range of reasons,¹² but one thing is clear: it was not due to a lack of investment protection treaties. As part of South Africa's strategy to attract foreign investment, it entered into almost 50 BITs from 1994 onwards (Table 9.1). Although these are unlikely to have helped South Africa attract more FDI (see chapter six), the decision to develop a wide-ranging BIT-network led to serious and far-reaching implications to which I will now turn. Some level of detail is necessary in order to understand the learning process South African officials went through.

Investment treaty claims

While we are only aware of one South African investor using a BIT to claim damages against its host state,¹³ foreign investors in South Africa have in recent years used BITs to question a wide range of regulatory actions, culminating in a compensation claim of more than quarter of a billion US dollars concerning South Africa's constitutionally enshrined post-Apartheid program to redistribute wealth to the black population.

¹² See e.g.; A. Arvanitis, 'Foreign Direct Investment in South Africa: Why Has It Been So Low?,' in: M. Nowak and L. Ricci (eds.), *Post-Apartheid South Africa. The First Ten Years* (Washington DC: IMF, 2005); Akinboade, Siebrits and Roussot, *op. cit.*

¹³ In 2009 MTN, a subsidiary of a South African telecommunications company, used the UAE-Yemen BIT to file a claim, which was discontinued the year after; *MTN (Dubai) Limited and MTN Yemen for Mobile Telephones v. Republic of Yemen*, ICSID Case No. ARB/09/7.

Table 9.1. South Africa's BITs

Partner	Signed	Ratified	Partner	Signed	Ratified
United Kingdom	20-Sep-94	27-May-98	Greece	19-Nov-98	05-Sep-01
Netherlands	09-May-95	01-May-99	Russia	23-Nov-98	12-Apr-00
Switzerland	27-Jun-95	29-Nov-97	Czech Repu	14-Dec-98	17-Sep-99
Korea, Rep.	07-Jul-95	06-Jun-97	Uganda	08-May-00	.
Germany	11-Sep-95	10-Apr-98	Nigeria	29-Apr-00	.
France	11-Oct-95	22-Jun-97	Turkey	23-Jun-00	.
Canada	27-Nov-95	.	Algeria	24-Sep-00	.
Cuba	08-Dec-95	07-Apr-97	Rwanda	19-Oct-00	.
Denmark	22-Feb-96	23-Apr-97	Brunei	14-Nov-00	.
Austria	28-Nov-96	01-Jan-98	Tunisia	28-Feb-02	.
Mozambique	06-May-97	28-Jul-98	Libya	14-Jun-02	.
Italy	09-Jun-97	16-Mar-99	Yemen	01-Aug-02	.
Iran	03-Nov-97	05-Mar-02	Qatar	20-Oct-03	.
China	30-Dec-97	01-Apr-98	Eq. Guinea	17-Feb-04	.
Mauritius	17-Feb-98	07-Oct-98	DR Congo	31-Aug-04	.
Sweden	25-May-98	01-Jan-99	Israel	21-Oct-04	.
Senegal	05-Jun-98	.	Angola	17-Feb-05	.
Ghana	09-Jul-98	.	Tanzania	22-Sep-05	.
Argentina	23-Jul-98	01-Jan-01	Congo	01-Dec-05	.
BLEU	14-Aug-98	14-Mar-03	Madagascar	13-Dec-06	.
Finland	14-Sep-98	03-Oct-99	Sudan	07-Nov-07	.
Spain	30-Sep-98	23-Dec-99	Ethiopia	18-Mar-08	.
Egypt	28-Oct-98	.	Zimbabwe	27-Nov-09	.
Chile	12-Nov-98	.			

Source: UNCTAD and South Africa's Department of Foreign Affairs.

The first known instance of investors using BITs to promote their interests vis-à-vis the South African government was in 2001. After the 9/11 attacks in New York, South African policy-makers suggested a ban on foreign ownership and forced divestment among the approximately 5,000 private security firms in the country - one of the largest security industries in the world when seen relative to the size of the South African economy.¹⁴ Foreign firms objected fiercely and the British government let South Africa know that any such measure would breach the BIT between the two countries.¹⁵ Eventually, the foreign-owned security companies won the argument: kicking out firms who brought in close to 2 billion

¹⁴ 'An industry hijacked,' *The Economist*, 6 October, 2001.

¹⁵ L. Peterson, *South Africa's Bilateral Investment Treaties: Implications for Development and Human Rights* (Geneva: Friedrich Ebert Stiftung, 2006), at 15-16.

South African rand a year¹⁶ turned out to be too costly an endeavour – even without a BIT claim - and the government withdrew its plans.

The risk of a treaty-based investment dispute materialised the same year, but in a different industry entirely. During the 1990s, South African negotiators had finalised a BIT with Switzerland in 1997. Around the same time, a farm in the northern parts of South Africa was being looted, vandalised, and later entirely destroyed. It was owned by a Swiss national, who in 2001 used the BIT to ask for compensation damages from South Africa.¹⁷ As the claim was pursued under UNCITRAL rules, it was kept entirely under the radar until 2006, when Luke Peterson managed to uncover some of its details.¹⁸ The Swiss investor made two arguments: first of all, the investment was subject to ‘creeping’ expropriation due to its destruction over time or, alternatively, due to the subsequent land-claims process by local black and other Historically-Disadvantaged South Africans (HDSA) seeking restitution for land takings under the Apartheid regime. This process was part of South Africa’s Black Economic Empowerment (BEE) regime, which based on the 1996 Constitution mandates redistributive efforts to rectify the vast economic inequalities as a result of Apartheid. Yet these fundamental social policies of the South African state were now argued to conflict with its investment treaty obligations (see also below). Secondly, the investor argued that a lack of effective policing of the investor’s property – or the lack of prosecution of apprehended looters – was a breach of the BIT’s provision on ‘full protection and security.’

The expropriation claim was dismissed by the tribunal: the land-claims process was still ongoing and the outcome uncertain at the time – including the possibility of compensation under domestic South African law. However, by not having effectively protected the Swiss-owned property, the tribunal found South Africa in breach of its obligation to provide full protection and security. During the

¹⁶ Ibid.

¹⁷ Trade Law Centre for Southern Africa, *Investment Project: South African Case Study* 10 (2004), at 14.

¹⁸ All information on this case referred to below is from: Peterson (2006), op. cit.; and L. Peterson, ‘Swiss investor prevailed in 2003 in confidential BIT arbitration over South Africa land dispute,’ *Investment Arbitration Reporter*, 22 October 2008.

proceedings, South Africa had argued that the obligation should be seen in its proper context: as a third world country, capacity constraints meant that it could not be expected to provide the same level of protection to the investor as he could obtain in developed countries. While the due diligence obligation may be a standard independent of national laws and regulations, it had to be modified to take into account the host state's level of economic development.¹⁹ This reasoning, however, was entirely rejected by the tribunal. It argued that simply doing '*the best it could in the circumstances*' based on the state's capacity to act was not enough according to the obligatory minimum standards under public international law, as that would allow developing countries to '*escape*' their investment treaty obligations.²⁰ In 2004, the tribunal therefore awarded the investor almost 7 million Rand in compensation - approximately US\$1 million – which the South African government paid the year after.

Also in 2004, a letter was sent to the South African government from the Italian embassy. It indicated, in not-so-subtle terms, that a second BIT claim was underway.²¹ This time it concerned recently enacted legislation for the mining industry in South Africa. The legislation had been many years in the making. Up through the 1990s and early 2000s, various sticks and carrots in the BEE program, mentioned above, had led multinationals such as Deutsche Bank, Merrill Lynch, and de Beers to sell off equity stakes to black-owned enterprises or black employees, appoint black managers, enter into joint ventures with black operators, etc.²² So after a long consultative process,²³ the time had come to extend the program to the mining industry – the largest in Africa, and one of the largest in the world. To rectify the unequal access to South Africa's natural resources as a result of the Apartheid regime, mining legislation was enacted in 2002 to replace

¹⁹ See generally; N. Gallus, 'The Influence of the Host State's Level of Development on International Investment Treaty Standards of Protection,' 6 *Journal of World Investment and Trade*, 5 (2005).

²⁰ Quoted in Peterson (2008), *op. cit.*

²¹ Peterson (2006), *op. cit.* at 28; L. Peterson and R. Garland, *Bilateral Investment Treaties and Land Reform in Southern Africa* (Montreal: Rights and Democracy, 2010), at 7.

²² See references in; D. Schneiderman, *Constitutionalizing Economic Globalization* (Cambridge: Cambridge University Press, 2008), at 152-154.

²³ P. Leon, 'Creeping Expropriation of Mining Investments: An African Perspective,' 27 *Journal of Energy & Natural Resources Law* 4 (2009), at 599; *A Minerals and Mining Policy for South Africa* (Pretoria: Department of Minerals and Energy, 1998).

the old Mining Act of 1991.²⁴ The new Mineral and Petroleum Resources Development Act (MPRDA)²⁵ – along with the ‘Mining Charter’²⁶ – vested all mineral rights with the South African state and only allowed holders of ‘old order rights’ to obtain new licenses (‘new order rights’) if they divested a considerable percentage of their shareholdings to HDSA. This gave effect to the South African Constitution, where Section 25(4)(a) encourages ‘reforms to bring about equitable access to all South Africa’s natural resources.’²⁷ The act moreover obliged companies to provide special programs for HDSA employees – such as housing, training, and medical care – as well as reach 40% HDSA participation in management by 2009. Finally, ‘new order rights’ would be for a limited time period, they *had* to be exercised, and holders would be subject to thorough review of their social and environmental obligations.

During discussions with the industry, South African law firms made the government aware that the new regulatory regime was likely to conflict with South Africa’s BIT-obligations,²⁸ and so did foreign firms.²⁹ And while there is no evidence that it was specifically due to the potential conflicts with investment treaty obligations, the fierce opposition from the industry led the South African government reduce the target HDSA ownership in the mining sector from 51% to 26% to be achieved by 2014. Yet, this was still considered too high by the industry, which argued that BEE groups simply did not have the billions of Rand

²⁴ See Kaplan and Dale, *A Guide to the Minerals Act* (Durban: Butterworths, 1991).

²⁵ GG 26264, GN 25 of 23 April 2004. See also; H. Berg, ‘Ownership of minerals under the new legislative framework for mineral resources,’ 1 *Stellenbosch Law Review* 139 (2009); P. Leon ‘A Fork in the Investor-State Road: South Africa’s New Mineral Regulatory Regime Four Years on,’ 42 *Journal of World Trade* 4 (2008).

²⁶ The Chamber of Mines of South Africa, the Department of Minerals and Energy, the South African Mining Development Association and the National Union of Mineworkers, *Broad-Based Socio-Economic Empowerment Charter for the South African Mining Industry*, 18 June 2002, available at: www.capecoast.gov.za/Text/2004/5/theminingcharter.pdf (last accessed 10 November 2010).

²⁷ Constitution of the Republic of South Africa, Act 108 of 1996.

²⁸ Peterson (2006), *op. cit.*, at 17.

²⁹ In a 2002-interview, for instance, the Executive Director of Anglo-American – a former branch of De Beers – noted that: ‘We are fully aware of the 1994 Investment Protection and Promotion Agreement (IPPA) between the UK and SA governments. It is the view of some of the protagonists in the minerals debates here that the Minerals Bill flouts key provisions of the Agreement.’ Quoted in L. Peterson, ‘South Africa’s Plans for Black Economic Empowerment Confronting Foreign Investor Rights,’ *Investment Law and Policy Weekly News Bulletin*, May 9, 2003.

necessary to pay ‘fair market value’ for the rights.³⁰ Italian investors, in particular, continued to object strongly to the commercial losses they were bound to suffer, and tried to use their BIT to push the South African government to further water down the legislation. Given the political sensitivities of the affair it is perhaps remarkable that they were backed up by their government, which in 2005 sent the letter referred to above to the South African Minister for Minerals and Energy.³¹ Arguing that the BEE efforts in the mining sector had gone too far, the Italian embassy’s ‘Aide Memoire’ noted that the MRPDA had ‘*a significant and deleterious effect on Italian investors’ investments in the South African mining industry ...*’ and by granting more favourable treatment to HDSAs, it essentially favoured ‘*South African investors as a group.*’³² As such, the ‘*social upliftment objectives*’ of the act ‘*might produce a breach*’ of the 1997 BIT between Italy and South Africa, which had no carveouts for affirmative action measures in any of its substantive provisions.

If true, this was not to be taken lightly. Even if compensation was required for the mining act according to South African law – as a judge in an ongoing High Court case has alluded to³³ - the 1997 BIT with Italy gave the investors a right to ‘*immediate, full and effective compensation*’, rather than the ‘*less than market value*’ standard proscribed by South African law when compelling social objectives are involved.³⁴ The following year the threat materialised: along with a group of Belgian investors, the Italian miners initiated a BIT claim arguing that the mining legislation was tantamount to discrimination and expropriation and

³⁰ B. Sergeant, ‘South Africa: an inflection point?’, at: www.mineweb.com (last accessed: 4 November 2010).

³¹ Similarly, in 2004 British Foreign Minister, Jack Straw, was asked in the British Parliament about the ‘expropriation of privately-owned common law mineral rights under the 2002 Act,’ upon which he replied that: ‘*under the provisions of the UK/South Africa Investment Promotion and Protection Agreement any dispute between a UK investor and the South African Government may be submitted to international arbitration.*’ Yet British firms – such as AngloAmerican – chose not to file a claim due to the political ramifications that would have for its future relationship with the South African government. See; Peterson (2006), *op. cit.*, at 17.

³² Quoted in: Peterson (2006), *op. cit.*, at 28; Peterson and Garland, *op. cit.*, at 7.

³³ *Agri South Africa and Annis Mohr Van Rooyen v The Minister of Minerals and Energy* (Case No 558896/2007), Judgment of March 6, 2009 in the High Court of South Africa (North and South Gauteng High Court, Pretoria).

³⁴ L. Peterson, ‘South African court rules that mineral rights holders can claim for expropriation following introduction of new minerals rights regime; meanwhile, government about to file its written defense in international arbitration challenging the same legislation,’ *Investment Arbitration Reporter*, March 17 2009. See generally; section 25 of the South African Constitution.

asked for US\$350 million in compensation.³⁵ This was a sizeable claim for the South African government: it translated into more than US\$7 per capita and corresponded to 70% of its entire Strategic Health Programme for preventing and treating HIV/AIDS that year for instance.³⁶ More importantly, it touched upon fundamental issues of concern to the South African polity. If successful, it had potential to open the flood-gates for similar claims questioning the re-distributive efforts of the post-Apartheid regime,³⁷ which could result in ‘*a significant – and potentially unquantifiable - liability for the South African government,*’ as one South African lawyer put it.³⁸

Unlike the Swiss investor a few years earlier, Foresti et al. pursued their claim under ICSID’s Additional Facility Rules, which meant that its existence – if not actual proceedings - had to be made public. The immediate result was predictable: after ICSID had approved the claim in 2007, non-governmental organizations (NGOs) in South Africa and abroad were quick to pick up on the politically charged case, and both the International Commission of Jurists, a Geneva-based NGO, and four additional NGOs led by the Centre for Applied Legal Studies in South Africa sought amicus curia status in the arbitration proceedings.³⁹ Apart from the question of compensation to the claimants in question, the NGOs argued that the case touched upon ‘*a wide range of issues of concern to the citizens of all countries.*’⁴⁰

³⁵ While arguments were not specified in the award (see below), investors further argued that the act was a breach of provisions on ‘fair and equitable treatment’ as well as ‘national treatment’; *Piero Foresti, Laura de Carli and others v. the Republic of South Africa*, Award, ICSID Case No. ARB(AF)/07/1 (henceforth ‘Foresti award’), par 78.

³⁶ See, www.treasury.gov.za/documents/national%20budget/2007/ene/15%20health.pdf (at 10) (last accessed 10 November 2010).

³⁷ Centre for Applied Legal Studies (CELS), *Application to be Admitted as Amicus Curiae in the Matter Between Agri South Africa and the Minister of Minerals and Energy, and in the Matter Between Annis Mohr Van Rooyen and Minister of Minerals and Energy*, High Court of South Africa, Pretoria, 30 June 2009, at pars. 54.2.3-54.2.4.

³⁸ Peter Leon, quoted in; B. Ryan, ‘Offshore investors may sue SA government,’ 15 September 2005, available at: www.miningmx.com (last accessed: 4 November 2010).

³⁹ CELS, the Center for International Environmental Law, the International Centre for the Legal Protection of Human Rights, and the Legal Resources Centre, *Petition for limited participation as non-disputing parties*, in ICSID ARB(AF)/07/01.

⁴⁰ *Ibid.*, par. 41.

In 2010, however, the investors eventually withdrew the case as they managed to negotiate rather favourable terms with South African mining regulators: instead of having to sell of more than a fourth of their investment to re-obtain their licenses, they were now allowed to sell only 5% - and that too as part of a share-ownership scheme to their own employees.⁴¹ Initially, the South African government objected to Foresti's withdrawal as it was certain it would win on the merits.⁴² Ultimately, South Africa agreed to discontinue the proceedings as long as it was on a *res judicata* basis and the Tribunal could determine the distribution costs. Much to its surprise, however, the Tribunal only made the investors reimburse a little more than half a million US dollars out of the almost 8 million spent by the South African government on legal fees and costs.⁴³

9.3. BITs as tokens of good-will

These claims, and particularly the controversial *Foresti* dispute, raise a set of pertinent questions: why did South Africa enter into treaties that allowed foreign investors the right to claim millions of dollars in damages over as sensitive issues as its affirmative action policies? Also, why would South Africa offer protections to foreign investors that went over and beyond the South African Constitution, when the stated policy goal was merely to provide foreign investors national treatment? Even if we relax the unitary actor assumption and see the BIT-program from a public choice perspective, the questions still stand: while it would be understandable if negotiators pushed for the treaties for individual gains, why did politicians and other stakeholders agree? If embassies and politicians wanted 'photo-ops', why not instead use some inconsequential agreements that didn't contradict South Africa's own Constitution and expose the government to liabilities? Going through the major South African newspapers from around the

⁴¹ Foresti Award, at 21.

⁴² South African official X.

⁴³ Note that a few months before the Foresti claim was discontinued, South Africa was threatened by yet another BIT claim of approximately US\$20 million. Whether it will reach arbitration is unclear at the time of writing. See; Submission by Michael Duerr in front the South African Parliamentary Select Committee of Finance, 25 August 2010.

BITs were signed indicates that with the exception of the first BIT with the UK, there was never much attention paid to the treaties.⁴⁴ So while they provided some benefits in terms of diplomatic ‘photo-ops’, many other bilateral instruments could easily have been used for this purpose instead. Similarly, why would legal officers or regulatory agencies agree to treaties, which contradicted sensitive domestic social policies? Not being directly involved in the negotiations, the BITs entailed no individual benefits for these actors (e.g. foreign travels or larger budgets). Yet, if they did not make sure the treaties were carefully drafted, they exposed themselves to considerable criticism for neglect of their professional duties in case any disputes arose.

*The crucial first treaty*⁴⁵

We begin in 1992. As the Apartheid regime was crumbling and South Africa was about to end decades of isolation from the international community, the United Kingdom (UK) approached the South African government to enter into a BIT.⁴⁶ Accounting for a third of South Africa’s inward FDI stock British firms were the largest investors in South Africa,⁴⁷ and the Thatcher administration feared that the new ANC government – which partly relied on communist backing – would begin expropriating British assets.⁴⁸ The proposed text was the English template BIT,

⁴⁴ Selected dates of: *Mail and Guardian*, and *Cape Times*, 1994-2010. A typical example was when the Dutch BIT was signed; ‘SA, Dutch sign investment pact,’ *Cape Times*, May 10, 1995 (the full article reads: ‘*Agreements to protect investments and promote small business in South Africa were signed by Trade Minister Mr. Trevor Manuel and Dutch Foreign Trade Minister Ms Anneke Dok van Weele in Cape Town yesterday. The investment guarantee agreement is designed to strengthen economic ties and stimulate capital and technology flow between SA and the Netherlands.*’).

⁴⁵ According to UNCTAD’s online database, the Apartheid regime entered into a BIT with Paraguay in 1974. However, the treaty signed when President Stroessner visited South Africa cannot be characterised as a BIT, but is rather an economic cooperation agreement with mostly aspirational obligations and no means of dispute settlement. See, ‘Agreement Relating to Economic Co-Operation and Investment Between the Government of the Republic of South Africa and the Government of the Republic of Paraguay,’ Pretoria, April 3, 1974. For press coverage at the time, see; ‘SA, Paraguay sign 2 pacts,’ *Rand Daily Mail*, April 4, 1974.

⁴⁶ South African official I.

⁴⁷ See; South Africa Reserve Bank, *Quarterly Bulletin*, September 1997.

⁴⁸ Ibid.

based on a 6-page ‘standard’ OECD model.⁴⁹ In very brief terms it stipulated that foreign investors and their investments had to be treated fairly and equitably, there should be no discrimination or expropriation, contracts should be upheld, there should be no capital restrictions, and disputes could be adjudicated through international investor-state arbitration.

But while perhaps sounding harmless at the time, it was serious indeed for South Africa. It granted a wide range of protections, which touched upon all government agencies administering the regulatory framework affecting foreign (British) investors at the national and sub-national levels. These protections were backed up by a general consent that allowed private investors recourse to international arbitration – which would be a first for South Africa. The draft also included a number of provisions that potentially conflicted with South Africa’s broader economic policies.⁵⁰ For instance, a new Constitution was in the making, which expressly encouraged affirmative action measures in order to advance the black population’s ownership and participation in the economy, yet the national treatment provision in the BIT included no explicit provision affirming the state a right to give locals preferential treatment. So to the extent British companies and nationals would be structurally handicapped when competing with predominantly black-owned or managed local companies over licenses or acquisitions of state-owned enterprises, this could violate the national treatment provision as enshrined in the UK model. Similarly, the interim Constitution of 1993 made a clear distinction between expropriation and mere deprivation. No compensation was due for the latter if the measures were pursuant to law and not arbitrary. This distinction was nowhere to be found in the British BIT, which covered both direct expropriation and measures having equivalent effect to expropriation (indirect expropriation), and the British draft therefore left up to private arbitrators whether British investors could be granted expropriation protections greater than those in the South African Constitution. Similarly, as was briefly mentioned above, the

⁴⁹ The model is included in; UNCTAD; *International Investment Instruments: A Compendium, vol. III* (Geneva: UNCTAD, 1996).

⁵⁰ If not otherwise stated, the following section is based on Peterson (2006), *op. cit.*, at 22-36; and, D. Schneiderman, ‘Promoting Equality, Black Economic Empowerment, and the Future of Investment Rules,’ 2 *South African Journal on Human Rights* 2009, at 16-29.

new Constitution stipulated that compensation for expropriation had to reflect the balance of interests between those affected and the public - including '*the nation's commitment to land reform, and to reforms to bring about equitable access to all South Africa's natural resources*' – yet the proposed BIT did not allow deviations from 'prompt, adequate, and effective compensation' amounting to the 'genuine value of the investment.' If property was redistributed to the black population, for instance, the BIT could be construed as setting a stricter compensation standard than the South African Constitution.

So while the regulatory agenda in the early post-Apartheid regime was obviously packed, this was clearly not a treaty to be taken lightly. With respect to the potential for costly investment disputes, it is important to recall that by the early 1990s few could foresee the very serious risks such a treaty entailed. Decision-makers did not have any way of knowing, for instance, that similarly worded expropriation provisions were being used in major claims over environmental regulations in Poland under non-ICSID rules. At the time, only one investment treaty claim had been made public – AAPL – which was very limited in scope and outcome, and one can therefore hardly blame South African officials if they did not foresee the risks of multi-million dollar investment disputes over sensitive areas of public regulation. But even the introduction of basic property rights in the new South African Constitution had been debated intensely, so a binding document under international law taking such protections further surely required some attention and deliberation, whether they were to be applied in investment disputes or not.

This never happened, however, as no one seemed to realize the scope of what the British proposed. It was sent to the investment promotion agency, which was later to become the lead agency in South Africa's BIT program. There, a key official did not find the BIT to be in any sort of conflict with South African laws, and he therefore saw it as: '*a win-win situation without any risks or legal problems. ... BITs just established basic principles and we found nothing in there contrary to good common sense.*'⁵¹ The only difference between the BIT and South African

⁵¹ South African official I.

national laws, he continued, ‘*was the international arbitration clause. That’s it. ... It was very simple and straightforward. Europe had used these agreements for some time and had standard texts. When Britain came to us they presented the text and we did not have a problem with it.*’⁵² So while the arbitration clause was discussed at the time,⁵³ the risk of investment disputes was not only considered low, it was thought to be practically zero. As the officials did not have a specific instance of a major investment treaty claim ‘available’ on their radars, they followed the availability heuristic by almost completely disregarding the risks of such claims. ‘*The risk of claims was not present. ... No departments raised such concerns at all.*’⁵⁴

The bureaucrats charged with negotiating the treaties were not government lawyers however. Rather than having detailed legal and technical expertise in international law, their job was investment promotion. Yet, when they forwarded the draft for legal vetting, the responsible officials did not find any critical issues with the proposed British text either. It was sent to the small team of six lawyers in the Ministry of Foreign affairs, who dealt with everything from law of the seas, legal issues pertaining to Antarctica, customs unions, double taxation agreements, and now also BITs.⁵⁵ The official who was eventually charged with vetting it was very junior in the department, and found the British treaty to be ‘*clear and well drafted*’ not breaching the country’s international obligations, and the state law advisor could not see ‘*any*’ problems pertaining to South Africa’s national law either.⁵⁶ Also, while this was the first treaty for South Africa to provide a general consent to investor-state arbitration over a wide range of regulatory issues, the novelty of the arbitration provision in the British model was not realized at the time:

‘Obviously we did not consider it [the arbitration provision, ed.] as an issue. From the legal position we did not have a problem because under our domestic legislation the state can be sued and under our Constitution discrimination based on ethnicity and nationality is also outlawed. So it would merely place a foreign investor in the same position that he in any case had. ... So why should we have a problem with it?’

⁵² Ibid.

⁵³ 1994 DTI file on UK BIT.

⁵⁴ South African official IV.

⁵⁵ South African official III.

⁵⁶ Ibid.

Clearly, this was – and is – a faulty analysis: by consenting to investor-state arbitration, South Africa gave foreign investors access to a dispute settlement forum and enforcement mechanisms not available to South African investors. Also, while legal literature as well as UNCTC and UNCTAD reports were published at the time alerting officials that apart from the arbitration provisions, key protection standards – such as BITs’ expropriation provisions – often went over and beyond national laws, these were not consulted. Rather than rationally seeking and processing information about BITs, officials again followed the availability heuristic: important information was ignored as it was not readily available, and key officials involved with the proposed British BIT systematically neglected the fact that they were dealing with a set of very serious and far-reaching legal obligations. According to a veteran BIT negotiator, one reason the officials so willingly accepted the British draft was evidently *‘due to ignorance or a failure to appreciate the significance of the provisions they ... accepted.’*⁵⁷

This was also the reason hardly any relevant government stakeholders got involved in the process, despite the fact that their regulatory authority would potentially be restricted by the BIT. The impression that the treaty did not have any implications and its provisions corresponded completely to South African law, meant there was no reason for key stakeholders to spend precious time and resources on learning about these new and somewhat ‘exotic’ legal instruments. *‘The only other department with a slight interest was the department of foreign affairs and they firmly endorsed what we were doing. They were the ones who had to get the thing legally ready, so they were firmly onboard’*, one official recalls.⁵⁸ The departments responsible for resource exploitation, for instance, were not pushing to make sure the treaty would not undermine their right to regulatory takings otherwise legal under the Constitution; the Chief Law Advisor’s office did not alert decision-makers of the legal significance of the treaty, and so on. *‘For the British treaty I invited all government departments, mining, labor - everything around the table. And they all gave us the mandate, said they were fine with these*

⁵⁷ P. Robinson, ‘Treaty Negotiation, Drafting, Ratification and Accession of CARICOM states,’ 18 *West Indian Law Journal* 1 (1993), at 9.

⁵⁸ South African official IV.

*treaties and that they did not have to be present.*⁵⁹ Apart from the reserve bank - which made sure South Africa's foreign exchange policy were not undermined by the BIT (see below) - key interests of government stakeholders were evidently not realized.

But what about political stakeholders? While bureaucrats may not have been too concerned about the proposed BIT, surely the political parties would want to thoroughly consider and insist on rigorous negotiations of a wide-ranging treaty with their former colonial power. Following much of the literature on why developing countries have entered into the BIT regime (see earlier chapters), one would expect that the economic rationale for entering into the treaty would be held up against its potentially serious legal implications. Yet, no critical questions were asked from politicians about the scale of the legal guarantees granted to foreign investors – not even from the communist factions – as the negotiator presented the treaty based on what was clearly a faulty analysis: *'the agreement did not place British investors in SA in a better position than local residents because the agreement stated that SA law would apply.'*⁶⁰ Furthermore, based on this biased perception there was no reason for parliamentarians or others to ask for a survey to investigate its importance for investors: why go through the hassle, if the treaty could not hurt anyway? As the implications of entering into the BIT were thought to be miniscule and the legal analysis of the treaty was severely flawed, it did not really matter if it did not entail considerable benefits.

Information about the risks of the treaty was thereby not just short in supply (due to few investment treaty claims) and somewhat costly to obtain (due to an already crowded political agenda) but also processed in a way few rational choice scholars would be able to explain. While organizations such as UNCTC and UNCTAD for years had told countries like South Africa that while entering into investment treaties would be in their national interest they had to carefully consider the legal implications, this was ignored completely and hardly any stakeholders took much

⁵⁹ Ibid.

⁶⁰ 'Parliamentary Committee approves investment agreement with UK,' *BBC Monitoring Service: Africa*, March 3, 1998.

notice of the treaty, making it completely de-politicized in the national policy-making process. As Weyland also found in his study of bounded rationality in bureaucratic decision-making,⁶¹ inferential shortcuts biased officials' risk assessments and shaped who thought of themselves as a stakeholder in the process, and who did not. In this case, the risks and scope of the BIT were not understood, which meant hardly any departments realized the relevance of the treaty.

The two-day negotiations over the British BIT were therefore amicable to say the least. In fact, 'negotiations' is hardly a representative term. When comparing the British model BIT from the early 1990s⁶² with what became the South Africa-UK BIT, it confirms that the treaty passed through both the bureaucracy and political system without any critical engagement from either. As an experienced negotiator has observed;

'A drafting formulation in the midst of negotiations, especially when it is in written form, takes on a life of its own, and more importantly, a kind of permanence; it becomes fixed in the minds of the other negotiating States and can give the author a clear psychological advantage as the negotiations then begin to centre around his proposal.'⁶³

The British model text was not just the centre around the negotiations, however, it was agreed to with hardly any changes: the only provision which seems to have been discussed was the transfer clause,⁶⁴ where a protocol devised by the Reserve Bank on South Africa's foreign exchange restrictions was included. Otherwise, the two texts matched up almost word for word, and the treaty was subsequently signed by Nelson Mandela and John Major, when the latter made his first visit to South Africa in 1994.

⁶¹ K. Weyland, *Bounded Rationality and Policy Diffusion: Social Sector Reform in Latin America* (Princeton: Princeton University Press, 2006), at 62.

⁶² For the model, see; R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (The Hague: Martinus Nijhoff, 1995).

⁶³ Robinson, *op. cit.*, at 9.

⁶⁴ 'Reciprocal Bilateral Agreements on the Promotion and Protection of Investments with the British Government,' 1994, South African file on UK BIT, on file with author; 'Agreement for the Promotion and Reciprocal Protection of Investment (IPPA) – United Kingdom,' 1996, South African file on UK BIT, on file with author; Letter from British High Commission Cape Town to Mr. Alec Ervin, Minister for Trade and Industry, Republic of South Africa, 11 June 1996; on file with author.

At the same visit, Major spoke of the need for liberalizing the South African economy and brought along pledges for 530 million Rand in development aid.⁶⁵ Yet, there is no indication that the aid package was specifically tied to the treaty: although officials at the time did find there was considerable political pressure to finalize the treaty,⁶⁶ there are no signs of coercion from the British government, international organizations, or others. South African officials and politicians welcomed the British offer and no-one within the government or political institutions raised any critical voices at any point.

The BIT program begins

Based on this experience, an administrative decision was made by the new South African government to begin an actual BIT program. The government was adamant on opening the country up to trade and foreign investments to help rebuild an economy suffering from past populist economic mismanagement,⁶⁷ and the type of treaty the British had brought to their attention seemed a useful legal tool to assist in that process.

A few other treaties by major capital exporters were consulted,⁶⁸ but the standard OECD-model enshrined in the British BIT was used as a *de facto* model for future negotiations. This was not as a result of a careful consideration of its provisions, however, but rather because it was the first that had come to the officials' attention. *'When Britain came to us they presented the text and we did not have a problem with it, so it was accepted by and large as the standard text to use.'*⁶⁹ Another official remarks, *'obviously the US and Canada have their own models, which we were confronted with at a later stage, and there were some South-South agreements, but the first treaty was with a European country so we gravitated to*

⁶⁵ 'Major tells of a new age for South Africa,' *Cape Times*, 21 September, 1994.

⁶⁶ 'Reciprocal Bilateral Agreements on the Promotion and Protection of Investments with the British Government,' 1994, South African file on UK BIT, on file with author.

⁶⁷ See e.g. N. Mandela, 'South Africa's Future Foreign Policy,' 72 *Foreign Affairs* 86 (1993); Marais, *op. cit.*

⁶⁸ South African official III; South African official V.

⁶⁹ South African official I. See also; Communication from DTI to South African Embassy in Rome, 3 November, 1994 (*'DTI feels this wording should be basis for similar agreements.'*)

*those types of treaties.*⁷⁰ Even though no one actually knew whether the treaties were considered important by investors themselves, as no surveys or hearing processes were initiated,⁷¹ this seemed immaterial: even if the treaties only marginally assisted in stabilizing the investment climate,⁷² there was no apparent reason not to go ahead signing them, as negotiators were of the (wrong) perception that they would only really matter in cases of outright expropriation:

‘What you are trying to do is to think forward in eventualities when negotiating expropriation clauses, etc. But because of how our system works this was never going to happen. South Africa was never going to go and have a mass expropriation so given that it doesn’t really matter whether you include reservations on whether it happens for public policy reasons, or whatever – so there was really not much point in being so pedantic and difficult because it was never going to be an issue; so my take was that we might as well just get it done.’⁷³

Notably, the official now in charge actually had a graduate degree in international law. Yet, with the understanding that BITs were ‘*no-sweat agreements*’,⁷⁴ South Africa rushed to spread out a web of investment treaties (see table 9.1), and the following year no less than seven BITs were signed.

Apart from Korea, the first five were with other European countries. Initiatives typically came from the other side,⁷⁵ and South African negotiators had no problem in relying on their model BITs during negotiations, as they did not depart significantly from the British text. The BIT with the Netherlands, for instance, almost exactly followed the Dutch model BIT of 1993 word for word.⁷⁶ Just as in the British BIT, no carveouts were made for South Africa’s affirmative action policies, and future tribunals were given no hints in the preambles about the country’s aspirations to promote social and economic equality. The process, according to the negotiators involved, was ‘*very much learning by doing*,’⁷⁷ and often negotiations only took a day or two.⁷⁸ At no point did anyone object to the

⁷⁰ South African official III.

⁷¹ South African official I.

⁷² Ibid.

⁷³ South African official II.

⁷⁴ South African official V.

⁷⁵ Draft Department of Trade and Industry (DTI) Cabinet Memorandum, 1994, quoted in: DTI, op. cit., at 14; South African official IV.

⁷⁶ Model is available in: Dolzer and Stevens, op. cit.

⁷⁷ South African official IV.

⁷⁸ Ibid.; South African official II.

process, and a review of South African newspapers around the time of signing and ratifying the treaties revealed that the press did not show much interest either.⁷⁹

Relying on the brief and simple but incredibly far-reaching British model made it easy to sign BITs with partners relying on similar OECD-based models. ‘*We were trying to have as many agreements finalized as possible and because we used the European model we were quite effective with the European model, so there was a certain momentum*’, one legal official noted.⁸⁰ ‘*This allowed us to finalize a lot of agreements in a short span of time. From the lawyers’ department, think of the amount of texts we finalized in so few months, just two people with many other responsibilities at the same time.*’⁸¹ The understanding that BITs were agreements with no risks in other words meant that a criteria of success became to sign as many, as quickly as possible.

Anchoring to the OECD-model

Then along came Canada. As Schneiderman has observed, the Canadian model BIT was no different than earlier BITs in being ‘*discordant with the stated goals of the South African property rights regime*’ and it had the potential to ‘*undermine constitutional objectives foundational to the democratic transition in South Africa*’.⁸² In fact, it was in some ways more far-reaching than the European models. Based on NAFTA’s Chapter 11, it included extensive protections on intellectual property rights, for instance, legally binding establishment provisions and obligations on performance requirements. Unlike the United States model, however, its liberalization provisions were not subject to investor-state arbitration, and while some of the carveouts included in Canada’s current model were not included until Canada later got sued under NAFTA, it was still a somewhat more flexible text than those South Africa had already signed up to. Unlike the European models, it included carveouts for measures taken to protect the

⁷⁹ See above.

⁸⁰ South African official III.

⁸¹ Ibid.

⁸² Schneiderman (2008), op. cit., at 146.

environment or cultural industries, for instance. Yet, Canadian negotiators have had a very difficult time concluding BITs:

‘Even if we find interested developing countries, it is always a challenge to explain why our model actually provides more flexibility than European models. It takes a long time to explain to them why our model is better than what they’ve done in the past. The liberalization provisions are not that difficult, but it is a big challenge to convince developing countries that they are not being tricked by the detail of the post-establishment and dispute settlement provisions, but that our model is actually more balanced in terms of preserving regulatory flexibility.’⁸³

Accordingly, when Canada initiated talks with South Africa over a BIT it was not so much the scope of the agreement that intimidated the South African negotiating team, as it was its lengthy and ‘legalistic’ appearance compared to the brief and vague European models. Also, whereas negotiations with European countries had proceeded as if the treaties were mere tokens of goodwill, the Canadian approach was intimidating.

‘The Canadians were a nightmare. I think it was mostly an ego thing, but they took a very difficult stance. These were people who took BITs as real and serious legal instruments with teeth, rather than what they really are, namely pure signals. ... The treaties are a symbolic gesture, so why be so pedantic and difficult in worrying so much about the legal details? It was very difficult.’⁸⁴

But despite of the ‘difficult and pedantic’ approach on the Canadian side, the South African negotiation team agreed to the text nevertheless. ‘*South Africa was a junior partner in all these negotiations, so we were in no position to dominate, and would always give into their demands.*’⁸⁵ The result was curious. For instance, the agreed text expressly specified that the treatment and protection provisions did not apply to preferential rights and measures provided to *Canadian* aboriginal peoples, but the South African negotiation team did not make sure this carveout also covered their constitutionally enshrined affirmative action policies. South Africa therefore ended up agreeing to *more* stringent standards than the Canadians, not because they thought this would make the BIT a more ‘credible

⁸³ South African official VII.

⁸⁴ South African official II.

⁸⁵ South African official IV.

commitment’, but rather because South African officials considered such differences in BITs to be ‘*mostly about cosmetics*.’⁸⁶

Apart from the fact that the Canadian treaty departed significantly from the ‘standard’ OECD model, it also stood out as the only of the early treaties that was not eventually ratified. Yet, while the failing ratification process was a result of domestic ‘veto players’ blocking the treaty, it was hardly the way rationalistic accounts would have expected.⁸⁷ For instance, although the treaty would arguably have allowed major Canadian mining companies to bring claims based on South Africa’s redistributive policies in the natural resource sector, there was no opposition from the responsible regulatory agencies, as they remained oblivious to the implications of the treaty.⁸⁸ Instead, it came down to a single legal officer, whom I will return to below.

The somewhat paradoxical situation of the negotiation team having difficulty accepting treaties, which in some ways were more flexible treaties compared to the European models was not a unique event. South Africa and Malaysia, for instance, had agreed to enter into a BIT,⁸⁹ and during the negotiations South Africa was asked to exclude a national treatment clause from the agreement due to Malaysia’s infant industry protection policies and preferential treatment of its indigenous peoples (the bumiputra).⁹⁰ Yet, while this would have made sense given South Africa’s own affirmative action measures – at least compared to national treatment clauses where such measures were not excluded - the South African negotiators did not want to depart from their initial OECD-based model. While a more careful consideration of the legal implications would almost undoubtedly have appreciated the Malaysian approach – particularly since there were no South African investors to protect in Malaysia – the treaty never materialised as South African officials were committed to stick with their OECD-

⁸⁶ *Ibid.*

⁸⁷ For a rationalistic account of why some BITs are ratified and some are not, see; Y. Haftel and A. Thomson, ‘Ratification Matters: The Domestic Fate of Bilateral Investment Treaties,’ *working paper*, 2008. Available at: papers.ssrn.com.

⁸⁸ South African official II; South African official IV.

⁸⁹ ‘Memorandum of Understanding Between The Government of the Republic of South Africa and the Government of Malaysia on Concluding Agreements that Enhance Trade and Investments Between the Two Countries,’ 8 August, 1994.

⁹⁰ South African official II.

based approach.⁹¹ While this may appear irrational – even for negotiators themselves who might have benefited individually from finalizing the treaty - the anchoring heuristic reminds us it was not unpredictable.

Coordination concerns: multilateral v. bilateral investment obligations

South Africa's investment obligations were of course not just negotiated in BITs, and during the OECD-based talks for the Multilateral Agreement on Investment (MAI), a number of South African BIT negotiators occasionally went as observers, but as with many others, they were dismissive of the project. This was not so much because of the substance of the agreement, but rather the approach. *'The MAI was take-it-or-leave-it with the whole agenda set by the OECD without any sense of negotiating or hearing the views of developing countries. This annoyed us and many others out of principle.'*⁹² The continued reliance on bilateral deals rather than support for a comprehensive multilateral investment treaty was not based on ingenious cost-benefit analyses, as expected by Guzman's game-theoretic model. In the case of the MAI, it was more simple: *'BITs at least give us a feeling that we are listened to. We are craving to be treated as equal partners with respect, and BITs do that; the MAI did not.'*⁹³ However, when in 1996 it was suggested that the WTO – a more inclusive forum – should include investment protection rules, South Africa was also sceptical. While never at the forefront of multilateral investment discussions,⁹⁴ including those in the WTO,⁹⁵

⁹¹ Ibid.

⁹² South African official IV.

⁹³ Ibid.

⁹⁴ In UNCTAD, for instance, South Africa hardly ever made any submissions in the Commission on 'Investment, Technology and related financial issues' concerning international investment rules. See e.g. reports at; www.unctad.org/Templates/WebFlyer.asp?intItemID=2092&lang=1#com2 (last accessed: 7 November 2010).

⁹⁵ Hardly any submissions were made by South Africa in the WTO's 'Working Group on the Relationship between Trade and Investment.' See; http://docsonline.wto.org/gen_home.asp (last accessed: 7 November 2010). In the subsequent investment discussions during the Doha Round, South Africa was not a major player either. For a useful overview of the negotiations and submissions, see; P. Sauve, 'Multilateral Rules on Investment: Is Forward movement Possible?,' 9 *Journal of International Economic Law* 2 (2006). It should, however, be noted that as a group the African Union (AU) pushed to exclude investment from the negotiations, see; African Union, 'Kigali Consensus on the Post-Cancun Doha Work Programme,' AU/TD/MIN/Decl.1(II) Annex.

an advisor to South Africa's trade minister commented in the press about the possibility of investment protection rules in the WTO that:

'it is *'absolutely clear'* that some of the proposed new measures *'would be destructive to weaker economies'* whose domestic firms cannot compete with transnational corporations. 'It would be unfair to impose such new rules before these countries have had a chance to engage in full economic reforms'.⁹⁶

Any new investment rules, he said, would *'remove the last vestiges of national planning and pose a threat to national sovereignty.'*⁹⁷ Although the message might have been tailored to suit the audience (the general public), this was nevertheless a somewhat puzzling statement. While willingly entering into BITs, which included broadly drafted protections that went over and beyond South Africa's new Constitution, a multilateral agreement negotiated in a forum where developing countries could act as a bloc was rejected as being a 'threat to national sovereignty.' But again, although the exact explanation remains somewhat uncertain, even for officials present at the time, the contradictory policies were clearly not a result of careful considerations of the negotiating dynamics at the bilateral and multilateral levels. Rather it happened for more mundane reasons.

One the one hand, ignorance was unfortunately a deciding factor again. For instance, one official who was in a senior position at the time was of the view that:

'BITs did not go over and above WTO commitments. ... Generally we favor multilateral commitments – global rules – and WTO is the most appropriate forum, so you shouldn't make commitments at the bilateral level in BITs that you haven't made at the multilateral level in WTO. So until we had found a multilateral compromise we did not want to push BITs above WTO obligations. We did not want to further add to the WTO agenda, but were content with signing BITs *as they did not have any risks*. That was our position.'⁹⁸

He was, in other words, of the understanding that BITs did not go over and beyond existing investment obligations in the WTO after the conclusion of the Uruguay round (i.e. primarily the TRIMS agreement and some parts of the GATS agreement). According to this (severely mistaken) view, any further WTO

⁹⁶ Quoted in: T. Wall, 'New Investment Rules Cause Concern,' 10 *Africa Recovery* 3, December 1996.

⁹⁷ Ibid.

⁹⁸ South African official V. Italics added.

obligations, such as those discussed after the 1996 Singapore inter-ministerial meeting, would therefore go over and beyond BIT-obligations.

Another reason for the paradoxical position was a complete lack of coordination, as we also heard from other countries in the last chapter. Within the Department of Trade and Industry (DTI), officials working on BITs were aware (to some extent) that they went over and beyond WTO obligations, but they had nothing to do with WTO negotiations, even if they touched upon investment. In fact, the multilateral and bilateral cells of the DTI's international trade division had little, if any, contact. *'People work almost entirely in silos,'* a senior official notes, *'which at times lead to such contradictory policies. We had a WTO unit and a bilateral unit, and we never communicated so there was no coordination what-so-ever.'*⁹⁹ *'In our unit, we decided to oppose investment protection as part of the Singapore issues, as we wanted to push WTO into a direction more in line with developing country interests,'* another official recalls *'but during the time there was very little coordination between, and within, ministries. ... We had nothing to do with the officials negotiating BITs. This situation was quite normal for developing countries I think'*¹⁰⁰ As we shall see below, this was not the last time South Africa's contradictory behaviour in the international investment regime was a result of poor coordination between, and within, organizational units.

Minor, but inconsistent, adaptations

So despite of the critical stance at the multilateral level, the bilateral trade relations unit of DTI's international trade division continued the BIT program almost unabated. During 1997, however, they began thinking through the relationship between the Constitution and investment treaties and decided it might be prudent to make certain exceptions to safeguard South Africa's affirmative action policies. The treaties with Iran, China, Mauritius, Ghana, Russia, and the Czech Republic therefore explicitly stated that provisions on national- and MFN treatment as well as fair and equitable treatment would not apply to measures

⁹⁹ South African official VIII.

¹⁰⁰ South African official XIII.

taken to promote equality or protection or advancing natural or legal persons disadvantaged by unfair discrimination. As the legal officer vetting many of the early agreements noted, *'we were clear that we should not provide more rights than our Constitution, and created some wording to take that into account.'*¹⁰¹ After having signed twelve BITs already, the South African BIT negotiators had clearly become aware of the potential legal implications of an investment treaty program out of sync with their country's constitutional priorities.

Or had they? As is often the case in developing countries' BIT programs,¹⁰² the adaption to the BIT-program remained entirely inconsistent. First of all, although exceptions to promote equality were included in the treatment provisions, the expropriation standards remained the same and had no such carveouts. In the BIT with the Czech Republic, for instance, the article on discriminatory and unfair and inequitable treatment exempted:

'... any law or other measure the purpose of which is to promote the achievement of equality in its territory, or designed to protect or advance persons, or categories of persons, previously disadvantaged by unfair discrimination.'¹⁰³

Yet, this expropriation provision still followed the 'traditional' OECD-model, and thereby remained discordant with the South African Constitution (see above).

Secondly, in the Swedish and Finish BITs, for instance, no exceptions were included even in the treatment provisions, despite being signed during exactly the same period. The same was the case for the Belgium/Luxembourg BIT, which along with the Italian BIT was later to be used in the major investment treaty claim on this very issue. So while there might have been a better understanding that such exceptions could be important than during the first wave of treaties, it remained superficial. The key South African negotiators looked at it this way,

'Some people were like, my goodness; we can't give them these provisions as others are going to invoke them through the MFN clause. As negotiators, we were much more pragmatic in our approach, understanding that it did not really matter

¹⁰¹ South African official III.

¹⁰² See generally; L. Poulsen, 'The Significance of South-South BITs for the International Investment Regime: A Quantitative Analysis,' 30 *Northwestern J. Intl. L. & Buss.* 1 (2010)

¹⁰³ South Africa – Czech Republic BIT, art. 3.3.

whether we included various reservations as it would never become an issue in practise.’¹⁰⁴

With a biased assessment of the implications of what they were negotiating, South African officials therefore continued to enter into BITs which, if they were to be honoured, could prevent measures to pursue South Africa’s developmental agenda, and if they were not, would subject the country to potentially costly and far-reaching investment treaty disputes.

BITs as ‘apple-pie agreements’

Recall, that authors like Guzman, Elkins, and Simmons, for instance, argue that developing countries sign BITs with developed countries as a response to competitive pressures for investment with other developing countries. But if cognitive heuristics are at play, the choice of BIT-partners could very well be much more haphazard. If inferential shortcuts have led decision-makers in developing countries to systematically ignore the risks of BITs, officials would be less inclined to engage in careful consideration of which countries to sign BITs with. Failing to realize the substantial scope and implications of what they are signing, decision-makers may have chosen BIT-partners without any reasoned national or personal strategic calculus, but rather on the basis of which-ever government leaders meet with at a given point in time.

This was surely the case in South Africa. While the first treaty with Britain was clearly intended by the British government to protect already existing investments and the economic rationale for some other BIT-partners also appeared somewhat sensible at the time, it did not reflect any agreed strategy on the part of South Africa. On the contrary. *‘Many foreign governments wanted to show interest in the new South African regime, and when they wanted to sign agreements with us, we pretty much always said yes – as it would be offensive to decline the offer.’*¹⁰⁵ Cuba was an early example. The two countries had embarked on a number of cooperation projects in the area of health, for instance, where Cuban doctors were

¹⁰⁴ South African official II.

¹⁰⁵ Ibid.

assigned to South African hospitals and South African medical students sent to Cuba.¹⁰⁶ Cooperation was also initiated in the education field, where Cuban teachers were invited to teach in South African rural schools.¹⁰⁷ So while the two countries had hardly any economic links in terms of trade or investments, Cuba asked South Africa to also enter into a BIT to further seal their diplomatic relationship. On the way home from the Canadian negotiations, the negotiators therefore stopped over in Havana to quickly finalize an agreement.¹⁰⁸ No other reasoned strategic calculus went into the agreement, apart from the observation that it would have been ‘offensive to decline the offer’. The systematic failure to appreciate the implication of investment treaties, thereby led to a haphazard choice of BIT-partners with no economic rationale. This is one, out of many, examples of a South-South BIT, which the rationalistic literature has had difficulties in explaining.¹⁰⁹

Cuba was no exception. While many of the first negotiations had primarily been initiated by Western capital exporting countries, South Africa produced its own template BIT – primarily based on the British model¹¹⁰ – and asked the foreign office to pass it out to all its embassies to see who would be interested in signing a BIT.¹¹¹ The embassies were highly supportive of this new instrument. ‘*The ambassadors used them as a possible achievement during their tenure, so we had requests from embassies all the time to sign these agreements.*’¹¹² Politicians were equally thrilled, and began using the treaties as photo-opportunities when going abroad or receiving international guests.

‘A lot of South African politicians went all over Africa, in particular, and because politicians want to be seen doing something constructive, they would often suggest a BIT even if no investments were flowing between the countries. They considered the treaties as a mere piece of paper with no real implications, and they did not go through any channels. ... So when an inward or outward visit would

¹⁰⁶ Ibid.

¹⁰⁷ See e.g.; ‘The Cuban option for SA schools,’ *Cape Times*, November 29, 1995.

¹⁰⁸ South African official II; South African official IV.

¹⁰⁹ See e.g. Z. Elkins, A. Guzman, and B. A. Simmons, ‘Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000,’ 60 *International Organization* 811 (2006).

¹¹⁰ Compare the two in: UNCTAD (1996), *op. cit.*

¹¹¹ South African official II

¹¹² South African official VIII.

happen, politicians looked for something to put on their agenda and they suggested the BIT',¹¹³

Recall that we heard of similar experiences in the last chapter. However, the fact that embassies and politicians acted upon their individual incentive to push for BITs should come as no surprise for public choice students of bureaucratic politics. It does not, in and by itself, signify limited rationality on the part of policy-makers. For without proper control and oversight mechanisms, domestic stakeholders can successfully pursue their own interests at the expense of broader national welfare concerns. Yet, the lack of information about the implications the treaties, and the imperfect processing of whatever information was available, meant that government agencies with an incentive to *oppose* the treaties did not. This was not because of lacking oversight or other factors - as principal-agent models point to when 'shirking' occurs - but rather because they remained oblivious of their own interests. The treaties remained:

'... very under-politicized. Apart from a few technical things in the reserve bank pertaining to exchange control, which were usually the hardest issues, there were no problems at all. One or two times we explained it all to the parliamentary committee, but even there it was acknowledged as a technical agreement. ...The parliament never discussed it, the Justice department was fine, and so were other stakeholders. No one thought it was a bad idea to sign these treaties.'¹¹⁴

So since no-one told politicians and embassy officials that BITs were in fact serious agreements, South Africa's web of BITs began to spread even more quickly. The policy of finalizing investment treaties whenever there was a state visit somewhere meant the guiding principles of South Africa's BIT policy was left almost entirely to chance. A somewhat bizarre example of this was Mali. During a formal visit there, the South African foreign minister presented his counterpart with the draft BIT, who agreed to it. The process went so fast, however, that the document sent back to the foreign office in Pretoria was just a copy of the South African model: it did not even have the two countries' names on it, which made it impossible to submit for ratification.¹¹⁵

¹¹³ South African official II.

¹¹⁴ Ibid.

¹¹⁵ Ibid.

With a few exceptions - such as one treaty signed as preconditions for a specific investment project¹¹⁶ - BITs were thereby being (mis-)used based on a mistaken understanding of their basic implications. This ‘*shot-gun approach*’¹¹⁷ of embassies and politicians signing BITs as ‘*merely pieces of paper*’¹¹⁸ led to even further capacity constraints for the officials involved. In fact, at several negotiations only one South African official was present during this period. Initially, he was satisfied with this situation as it gave him the freedom to finalize a great number of agreements, not least because the expertise and experience in many other developing countries was even less than in South Africa.¹¹⁹ But eventually, the time pressure became tremendous. ‘*I actually had to sit down and calculate: It took 15 minutes to walk to the department to get their opinion on it; it took 15 minutes to walk back put it all together – and I worked out how much time it took on average. It became too much in the end.*’¹²⁰ When telling this to his superiors, they realised that even though no one actually objected to the content of the agreements, this approach was perhaps too haphazard and chaotic. A targeted two-track approach was therefore agreed upon: South Africa should continue to accept invitations to sign with capital exporting states who were major trading or investment partners, but also actively pursue South-South BITs in countries where South African companies had, or were planning to conduct, investments – particularly on the African continent. In other words, rather than merely signing BITs, right, left, and centre – as would be predicted by a norm-emulation approach - there was an objective of pursuing a strategic and reasoned BIT-strategy, an ‘intended rational behaviour’ as Herbert Simon would put it.¹²¹ Also, it is notable that the same official who suggested a more careful approach was the same official who had most to benefit from promoting BITs, as it allowed him extensive travel, perhaps larger budgets, or plainly career promotion. Yet, by

¹¹⁶ *Ibid.* It concerned a French investment into Mozambique channeled through South Africa, where a precondition for the investment was a BIT between South Africa and Mozambique. See; ‘SA and Mozambique sign up for the next great trek,’ *Cape Times*, business section, front page, May 7 1997 (‘*trade and industry minister Alec Erwin and Mozambican finance minister Tomaz Salomao signed an agreement on the mutual protection of investments, without which the Mosagrius project could not go ahead.*’).

¹¹⁷ South African official II.

¹¹⁸ *Ibid.*

¹¹⁹ *Ibid.*

¹²⁰ *Ibid.*

¹²¹ H. Simon, *Models of Man* (New York: Wiley, 1957), at 199.

contrast with the predictions of a public choice framework, he was the one who slowed down the process.

While this new strategy was more manageable, the perception remained that the treaties entailed only benefits, and no risks. Although investment treaty claims were beginning to pop up against other countries (see chapter seven), these remained outside the officials' radar-screens. When asked whether they followed the ongoing claims against other developing countries, it became apparent that by 2009 some former officials still did not know such claims existed: *'We did not follow those arbitrations you are referring to. Personally, I do not know of any international arbitrations under BITs. Perhaps rogue regimes like Burma and North Korea have been hit.'*¹²² Another official was more well-informed, yet he never sought information about the disputes as this was *'the last thing people would think about.'*¹²³ So while the negotiators would participate in UNCTAD seminars, where nuances in various models would be discussed,¹²⁴ there was not much reason to update the South African model since they were not *'very serious legal agreements'* anyway.

The targeted approach did not last long though. After South Africa's sole negotiator was posted overseas in 1999, the responsibility to negotiate BITs was delegated to regional desk officers within the foreign office. This augmented the lack of expertise and experience that went into the actual negotiations even further. *'All the negotiation skills, experience, and so forth were lost, which was unfortunate but I think the decision was made simply because the treaties were low on the priority list.'*¹²⁵ Accordingly, regional desk officers were allowed to negotiate treaties they, until then, had hardly heard of. As one senior official recalled:

'No one had any legal qualifications, but the BITs really gave the regional desk officers something to do. Do 10 agreements and you have been successful during that year. It also gave them an opportunity to travel. So BITs became used as

¹²² South African official IV.

¹²³ South African official II.

¹²⁴ Ibid.

¹²⁵ Ibid.

perks because no one informed them what the consequences of these agreements were about.¹²⁶

Interviewing some of those officers, clearly confirmed this view. *'We used to call them apple-pie agreements intended to give comfort to politicians: it was really nice for a politician to say they had signed a BIT, and the officers from foreign affairs also really liked to see the treaties signed under their tenure.'*¹²⁷ So based on the understanding that there was *'absolutely no risk in signing BITs for South Africa as they were entirely consistent with the constitution and national legislation'*¹²⁸ the South African web of BITs proliferated, particularly in 2000. When embassies would request a BIT (*'they like photo-sessions and smiles, so they love to have a minister to come and sign an agreement, no matter how small the country'*¹²⁹) the regional desks did not find any problems in proceeding. Rather than serious and far-reaching legal obligations, they were considered as *'a gateway to understand the other country. The agreements were important to create cultural and political relations.'*¹³⁰

With that level of understanding of the treaties, South Africa gladly accepted the invitation from UNCTAD in 2001 to join one of their BIT-signing sessions. Recall from chapter five, that almost one fourth of all BITs signed between 2000 and 2005 were signed at these UNCTAD sessions. For the 2001 session, a legal officer from the multilateral trade negotiations unit within the DTI went along to Geneva due to a cancellation at the last minute.¹³¹ This officer had specialized degrees in international trade and investment law as well as a background as a practicing lawyer. So although the fact that he was a legal expert - at least compared to his colleagues - did not make him less prone to inferential shortcuts, he was able to have a much more informed understanding of the treaties' legal importance. And what he saw in Geneva took him by surprise. *'The OECD model was actively promoted during this session, and no real negotiations actually took*

¹²⁶ South African official VIII.

¹²⁷ South African official IX.

¹²⁸ Ibid.

¹²⁹ Ibid.

¹³⁰ South African official X.

¹³¹ South African official VIII.

*place. Treaties were just signed off in a rush in two or three hours.*¹³² While puzzled about this process, he could not object at the time and South Africa signed four BITs at this one session alone (with Benin, Burkina Faso, Chad, and Mauritania).¹³³

A new approach

Later that year, however, the same officer was put in charge of South Africa's investment negotiations. So he began investigating just what South Africa had signed up to over the last six years, and he was shocked.¹³⁴

‘There was absolutely no consideration as to whether these agreements were in South Africa's interest or not. In fact, I once talked to one of the negotiators from the time, and he had no clue what ‘fair and equitable’ treatment, national treatment, MFN, and so forth even meant. He actually had no understanding. ... And as a lot of other developing countries, people here appear to have fallen for the propaganda that the moment a BIT was signed with a country, capital would start flowing from there.’

He urged the government to take a much more conservative approach. A policy-decision was taken not to enter into any more BITs with developed countries, and BITs should only be signed with developing countries after a proper policy had been put in place. And under no circumstance should South Africa participate in UNCTAD ‘signing sessions’ again.

This new, and more hesitant, approach had major implications for South Africa's external investment policy. First of all, the officer blocked the ratification of numerous BITs - including the one with Canada - and renegotiated others, such as the treaty with Cuba. Secondly, FTA negotiations between the Southern African Customs Union¹³⁵ and the United States began in 2003,¹³⁶ yet already the year

¹³² *Ibid.*

¹³³ See also; UNCTAD, *Progress report: Work undertaken within UNCTAD's work programme on international investment agreements between the 10th Conference of UNCTAD, Bangkok, February 2000 and July 2002* (New York: United Nations, 2002).

¹³⁴ South African official VIII.

¹³⁵ SACU is the customs union between South Africa, Botswana, Lesotho, Namibia, and Swaziland.

¹³⁶ Note that, according to the former South African negotiators, the United States also approached South Africa for a BIT around 1996. No records exist of these negotiations, however, and when asked top officials in both the United States Trade Representative and State Department at the time

after talks had stalled,¹³⁷ and finally in 2006 the negotiations collapsed. Among the reasons was the American refusal to exclude comprehensive investment disciplines from the agreement, which South Africa thought conflicted with their BEE program.¹³⁸ Particularly the establishment provisions in the US model were problematic. '[T]he South African government is unwilling,' Karan Bhatia, Deputy USTR, complained, 'to provide equitable access [to government procurement, ed.] for foreign firms as this could negatively impact on its black economic empowerment initiatives.'¹³⁹ Eventually, the investment obligations in the FTA turned out to be a 'major obstacle'¹⁴⁰ and combined with other conflicts over intellectual property rights and trade in services, for instance, the negotiations collapsed.

Third, South Africa refused to include investment obligations as part of an Economic Partnership Agreement (EPA) with the EU. Starting in 2006, South Africa had joined the negotiations but was, along with Namibia, the only African country that did not give in to European pressure to include investment and services in the negotiating process.¹⁴¹

did not recall such negotiations having taken place. Also, they are not mentioned in any of the extensive works on the American BIT program by veteran BIT-negotiator Kenneth Vandevlede (see e.g. *U.S. International Investment Agreements* (Oxford: Oxford University Press, 2009)). According to the South African team, however, the (alleged) negotiations collapsed partly due to the conflicts over intellectual property disputes with South Africa (South African official IV), but also because: 'When we met with the USTR, they rolled out 15 or 16 lawyers sitting in 2 rows. On the other side of the table we were 3 people. Each of the lawyers explained us the article in details. ... We did not have the capacity to work with that.' (South African official III). Another recalls, 'Talks were held, but the parties were quite far apart concerning the scope of the envisaged agreement - the USA wanted a very broad agreement including issues such as services, patent rights, and a host of other matters over and above the normal matters covered in the BITs previously concluded by South Africa with other countries. ... My understanding was that South Africa was not yet comfortable with extending the scope of BITs to include the aspects requested by the USA.' (South African official I).

¹³⁷ 'U.S.-SACU Free Trade Negotiations Put on Hold; New Mechanism Being Created,' *International Trade Reporter*, December 16, 2004.

¹³⁸ South African official VIII.

¹³⁹ Quoted in: Schneiderman (2010), *op. cit.*, at 32-33.

¹⁴⁰ 'Administration, Business Pressure SACU for Comprehensive FTA, *Inside US Trade*, 10 December 2004.

¹⁴¹ See; DTI, 'SADC EPA Group – EC Negotiations: Assessing the Emerging Outcome,' 30 January 2008, available at: www.dti.gov.za/parliamentary/EPAoutcomes.pdf (last accessed 8 November 2010); DTI, 'Trade Negotiations Update,' Parliamentary Portfolio Committee Briefing Session, Cape Town, 11 June 2008, available at: www.dti.gov.za/parliamentary/tradeneg.pdf (last accessed 8 November 2010); X. Carim, 'Update on EPA Negotiations,' speaking points to Tralac Seminar, Cape Town, 13 September 2010, available at:

Finally, and crucially, South Africa is one of the only countries in Africa that is not a member of ICSID.¹⁴² When in 1998 the South African Law Commission made its recommendations concerning South Africa's outdated arbitration law,¹⁴³ joining ICSID was one of them. After having obtained inputs from a number of experts, including Antonio Parra from ICSID¹⁴⁴ as well as prominent arbitrators such as Karl-Heinz Böckstiegel and Jan Paulsson¹⁴⁵ (who was later to become counsel to South Africa in the Foresti claim), the Commission recommended that:

‘Ratification of the Convention would ... be another positive signal which South Africa could send out to indicate that the new government is eager to create the necessary legal framework to encourage foreign investment. ... On the other hand, South African companies are eagerly looking for investment opportunities in other African countries, virtually all of which are members of ICSID. Ratification of the Convention by South Africa would facilitate such investment and further the economic development of the region.’¹⁴⁶

It further noted the need to join ICSID now that South African BIT negotiators had included ICSID arbitration clauses in their BITs, which ‘*created the expectation among potential investors in those countries that South Africa intends acceding to the Washington Convention.*’¹⁴⁷ But a few years into the hearing process after the Law Commission submitted its draft Bill to Parliament in 2001 through the Minister of Justice, the DTI officer put in charge of investment negotiations objected. Although not taking issue with the broader arbitration bill, the experience with the Swiss and Italian/Belgium BIT claims led DTI to

http://trade.ec.europa.eu/doclib/docs/2010/september/tradoc_146522.30%20July%202010.2.pdf
(last accessed 8 November 2010).

¹⁴² During its pariah status before 1994, the country was generally on the outside of the international legal order, which explains its non-participation in ICSID at the time. See; D. Butler and E. Finsen, ‘Southern Africa,’ in: E. Cotran and A. Amisshah (eds.) *Arbitration in Africa* (Kluwer Law International 1996), at 198, fn. 37. See also; A. Agyemang, ‘African States and ICSID Arbitration,’ 21 *Comparative International Law Journal of South Africa* 2 (1988).

¹⁴³ South African Law Commission (henceforth SA Law Commission, *Arbitration; an international arbitration act for South Africa; report* (1998). See generally; R. Christie, ‘South Africa as a Venue for International Commercial Arbitration,’ 9 *Arbitration International* 2 (1993); A. Agyemang, ‘African courts, the settlement of investment disputes and the enforcement of awards,’ 33 *Journal of African Law* 1 (1989); D. Butler, ‘South African Arbitration Legislation – the Need for Reform,’ 27 *Comparative International Law Journal of South Africa* (1994).

¹⁴⁴ SA Law Commission, *op. cit.*, fn 48.

¹⁴⁵ *Ibid.*, Annex C1. Note that a major conference was held in 1997 with participation from a considerable amount of prominent figures in the international arbitration community, including from the London Court of International Arbitration (LCIA), the International Chamber of Commerce (ICC), ICSID, and others. Not surprisingly, the discussion paper by the South Africa's Law Commission recommended joining ICSID was well received (*ibid.* at 11).

¹⁴⁶ *Ibid.*, at 144-145.

¹⁴⁷ *Ibid.*, at 145

conclude that it was not in South Africa's interest to join ICSID.¹⁴⁸ DTI was adamant on this point and eventually ICSID membership was removed from the proposed bill, which means that South Africa is likely to remain outside ICSID in the foreseeable future.¹⁴⁹

Coordination problems, again

Yet at the same time as South Africa objected to investment obligations in the EU EPA, the US PTA, and in the context of ICSID, it is clear from Table 9.1 that the South African web of BITs continued to spread. As already mentioned, this appears to go against the predictions from the last chapter. Yet again, South Africa's investment policy was plagued by poor coordination, as some of the regional desks continued their negotiations despite the imposition of the moratorium. One of the regional desk officers saw it like this:

‘Taking a legalistic perspective on these treaties is a bit problematic because then they become very difficult to negotiate. When legal people meet, they have all their jargon, which is a bit boring. So since the other side was typically not very legalistic either, we did not always involve the South African lawyers.’¹⁵⁰

The leadership of the DTI therefore had to block the ratification of a number of agreements with North African countries, for instance, which took place behind their back. Similarly, when reading in the newspaper that a minister had travelled to Israel to sign a BIT in 2004, the leading official involved in the new BIT policy raised a red flag realising that since Israeli diamond cutters considered the South African export duty on rough diamonds to constitute expropriation, the BIT could have been used to initiate a claim.¹⁵¹ In short, the South-African BIT program was in disarray: different agencies with different agendas and levels of expertise

¹⁴⁸ South African official XII. A key argument was that joining ICSID would remove the option of having domestic courts in the state of arbitration review, and set aside, arbitral awards, for instance based on public policy grounds.

¹⁴⁹ Note that in a recent ruling at the Pretoria High Court, to be discussed below, the judge relied heavily on the Law Commission's arbitration report and strongly encouraged the Cabinet to enter ICSID; *Crawford Lindsay Von Abo v. The Government of the Republic of South Africa, et. al.*, High Court of South Africa (Transvaal Provincial Division), Case No. 3106/2007, Judgment of Prinsloo J., July 24, 2008 (pars. 26-399) (hereafter ‘Von Abo v. South Africa’).

¹⁵⁰ South African official X.

¹⁵¹ *Ibid.*

pushed the treaties right, left, and center, to the frustration of officials trying to analyse the complexities and potential liabilities involved.

South Africa's BIT program after Foresti

This all ended with the Foresti claim, which was a major affair. In one of the hearings, for instance, South Africa not only sent its considerable legal team from Freshfields, one of the world's leading law firms specialised in investment arbitration, but also: one ambassador, two senior officials from the State Attorney of Pretoria (incl. the State Attorney of Pretoria herself), the directors general of the DTI and the Department of Minerals and Resources, the Head of Legal Services at the Treasury, as well as senior officials from the President's office.¹⁵² Until the Foresti claim, few of these had ever taken BITs seriously.

As stated by one senior official: *'it was not until we got sued, we truly realized that we should have had red flags up when signing these treaties.'*¹⁵³ Similarly, DTI noted to a Parliamentary committee that: *'... the real impact of BITs was brought to the fore for RSA in an investment-related dispute, which directly challenges RSA's new minerals legislations ...'*¹⁵⁴ Upon DTI's suggestion, the government therefore started a thorough review of its investment treaties - the first in the country's history. In the words of the appointed 'Task Team', the review *'was partly necessitated by various arbitral proceedings initiated against the Republic of South Africa ... and the need to conduct a comprehensive risk assessment.'*¹⁵⁵ The law firm which represented South Africa in the Foresti case – Freshfields – offered to assist in this process, which is noteworthy in light of the

¹⁵² See Foresti award, at 10-11.

¹⁵³ South African official XI. Another official notes: *'It was the Foresti claim that made Cabinet realise that we really had to review what these treaties were all about.'* (South African official XIII).

¹⁵⁴ X. Carim and S. Adam, 'Bilateral Investment Treaty Policy Framework Review,' *briefing to Portfolio Committee on Trade & Industry*, presentation notes, 6. October 2009, at 2.

¹⁵⁵ DTI (2009), *op. cit.*, at 5.

policy-making role of private lawyers in the investment regime as reviewed in chapter five. Yet, the offer was declined by the South African official in charge.¹⁵⁶

As the policy review was finalised in late 2010, DTI made its concluding recommendations to Cabinet: South Africa should not sign any more investment treaties which allows investor-state arbitration clauses.¹⁵⁷ Existing BITs should be renegotiated on these terms, or allowed to expire. Although in favour of providing the necessary legal guarantees to attract FDI at home and protecting South African investors abroad, investment treaties in their most potent form should no longer be used as a tool.¹⁵⁸ Finally, it is worth noting that the draft report from the year earlier included a few comments on the past strategy as well: South African negotiators had been misguided when entering into BITs in the past, since *‘the risks posed by such treaties were not fully appreciated at that time.’*¹⁵⁹ It went on to say that *‘the impact of BITs on future policies were not critically evaluated ...’* and that *‘the inexperience of negotiators at that time and the lack of knowledge about investment law in general resulted in agreements that were not in the long term interest of [South Africa, ed.]’*¹⁶⁰ Similarly, with respect to the inherent lack of coordination between, or even within, departments the report mentioned that, *‘the formal legal basis for FDI policy is scattered across various line function departments that do not always coordinate policy interventions ...’* and *‘there does not appear to be a consistent approach to bilateral policy-making and strategic planning.’*¹⁶¹

¹⁵⁶ South African official X.

¹⁵⁷ South African official VIII.

¹⁵⁸ South Africa nevertheless proceeded to enter into a BIT with Zimbabwe around the same time. This had a very specific background: in a 2008 ruling, a Pretoria High Court judge held that the South African government had failed to live up to its constitutional obligations to assert diplomatic protection of South African citizens’ whose property had been expropriated or looted in Zimbabwe as part of Mugabe’s confiscation of white farmer’s land. One promise the government never fulfilled, was to enter into a BIT with Zimbabwe to facilitate the possibility of investor-state arbitration. See; *Von Abo v. South Africa*, *op. cit.* (Note, that this ruling was later overturned by South Africa’s Supreme court). DTI, ‘The Promotion and Reciprocal Protection of Investments Agreement between the Governments of the Republic of South Africa and the Republic of Zimbabwe,’ *Explanatory Memorandum*, 29 March 2010.

¹⁵⁹ DTI (2009), *op. cit.*, at 5.

¹⁶⁰ *Ibid.*

¹⁶¹ *Ibid.*, at 6 and 15.

These were harsh conclusions to include in an official report towards now retired South African officials. This is particularly the case, since no interviews were actually made with the BIT negotiators from the mid-1990s, as the authors of the report were not able to trace them.¹⁶² But I did, and my review above suggests that, while perhaps harsh, the report's conclusions are clearly a fair characterisation of the time, when South Africa spread out its web of investment treaties.

Conclusion

This chapter provided a detailed study of the decision-making processes surrounding a BIT-program in a developing country, which had a considerable public policy incentive to engage carefully with investment treaties. Yet, officials failed to carefully seek and process information about the implications of BITs until the country itself was hit by a major claim. Combined with bureaucratic conditions, particularly the lack of expertise and coordination, biasing heuristics made officials entirely ignore the risks of BITs, and overestimate their benefits. Even officials with an individual incentive to advocate a cautious BIT-strategy didn't do so based on the perception that the treaties were immaterial. The BIT-movement was thereby joined not after careful consideration of costs and benefits of the treaties compared to alternative investment promotion instruments, but simply because it was readily available to adopt after a capital-exporting country had made the government aware of the treaties' existence. On this basis, the BIT-program anchored almost entirely to the first treaty signed, despite having been determined randomly and future BIT-parties introducing alternative BIT-models more in line with the national interest. Also, experiences with investment treaties abroad were ignored entirely, which meant that the BIT-program remained un-politicized with no government stakeholders asking questions until the first claim hit.

¹⁶² South African official VIII.

This gives further credence to the conclusions from the quantitative and survey evidence in the last chapter, namely that the expectations in much of the literature about the sophistication and rigor with which developing countries have considered and negotiated BITs are often in stark contrast with realities on the ground. It also provides a building-block at the micro-level for future studies aiming to understand the sometimes irrational, yet predictable, patterns of international policy diffusion. This will be further discussed in the coming, and concluding, chapter.

10. Unanticipated consequences and bounded rationality

For most developing countries, the BIT-movement has not been about lofty ideals of international justice or symbolic attempts to adhere to neoliberal ideals. Instead, it has been about something as mundane as increasing national welfare. And while a number of developing countries can today use investment treaties to protect their own investors abroad, most signed BITs to attract foreign capital. Yet, when the treaties proliferated in the 1990s their material benefits were often oversold and their risks largely unknown. These two simple facts, and particularly the latter, have not been taken seriously in any work on why developing countries joined the BIT-movement.

Although a number of controversial treaty-based investment disputes were brought against developing countries up through the 1990s, few realized this as the claims were pursued in private. Also, to the extent developing countries took their cues from international organizations, such as UNCTAD, they were of the understanding that the treaties were not important for investment disputes until the late 1990s, or even early 2000s. This makes it difficult to sustain the claim that most developing country governments realized that by signing investment treaties, they were in fact restricting their sovereignty *in practice*. It also explains in part why officials involved in the process note that although many had high hopes for the treaties' potential to promote investment – some indeed still do - few thought they actually had much 'bite'. By counterfactual reasoning, one might speculate that had *Saar Papier*, for instance, become public knowledge earlier, or had the *Lauder* arbitrations taken place (and been made public) in the mid-1990s, the global network of BITs could very well have looked considerably different today and been much less wide-spread. It might even have convinced developing countries that it was in fact worth pursuing a multilateral investment treaty as an alternative to their bilateral deals.

10.1. Unanticipated consequences

International legal regimes with unanticipated consequences are of course not unique to the investment area. Just as few were able to predict the current authority that investment arbitral tribunals have over governments' regulatory discretion, few foresaw the wide-ranging role of the European Court of Justice (ECJ) for instance.¹ States have also found their sovereignty constrained in ways they didn't anticipate both in the WTO and the International Court of Justice.² Even in the context of human rights treaties, developing countries have occasionally been shocked to realise that what they thought were merely pieces of paper later permitted transnational actors to use them for effective political pressure.³

But by contrast with human rights treaties, BITs have not merely been useful points of reference for transnational actors advocating investor-friendly policies; they are actually enforceable in practice. In the spectrum between diplomacy and legalism, the two types of treaties are at completely separate ends.⁴ Also, the unanticipated consequences of investment treaty arbitration is not (only) a case of tribunals strategically trying to expand their own jurisdiction, a principal-trustee problem.⁵ Tribunals may occasionally have exploited the vague terms of the treaties and few possibilities for appeal by expanding the scope of their authority, but their remarkable flexibility in determining fundamental questions of public law stems from the almost complete lack of attention by developing country negotiators in the 1990s. So although 'incomplete contracting' is of course seen in

¹ A.-M. Burley and W. Mattli, 'Europe before the Court: A Political Theory of Legal Integration,' 47 *International Organization* 1 (1993). See also; W. Mattli and A.-M. Slaughter, 'Law and politics in the European Union: a reply to Garrett,' 49 *International Organization* 1 (1995); K. Alter, 'Who are the "Masters of the Treaty"?: European Governments and the European Court of Justice,' 52 *International Organization* 1 (1998).

² K. Alter, 'Agents or Trustees? International Courts in their Political Context,' 14 *European Journal of International Relations* 1 (2008).

³ K. Sikkink, 'Human Rights, Principled Issue-Networks, and Sovereignty in Latin America,' 47 *International Organization* 3 (1993).

⁴ See generally; J. Smith, 'The politics of dispute settlement design: Explaining legalism in regional trade pacts,' 54 *International Organization* 1 (2000).

⁵ On international courts as trustees (rather than agents), see; Alter (2008), *op. cit.*

many other areas of international law,⁶ the fact that private tribunals were given such considerable flexibility in ‘filling out the blanks’ of vague and broadly drafted treaties was not even considered at the time they proliferated. While most developing countries adhered to the principles enshrined in BITs, hardly any realised the power granted to third parties to determine the meaning of those principles in practice.

This will undoubtedly sound paternalistic to some. Jan Paulsson, for instance, calls it outright insulting to negotiators;⁷ and another famous arbitrator, Francisco Viciña, concurs;

‘The guns are pointing ... to the vast network of bilateral investment treaties. ... The argument is based on the false assumption that developing countries have been ignorant of what they were actually signing and that this was not to their advantage. Thank you for that paternalistic thought, but with respect I must say that lawyers from developing countries are not dummies.’⁸

Apart from the fact that Paulsson himself noted in 1995 that many governments ‘*may not have appreciated the full implications*’ of the unique nature of BITs’ adjudication mechanism,⁹ the claim is not that officials from developing countries were necessarily ‘dummies.’ However, if Viciña or others want to suggest that a great number of developing countries invested considerable expertise and bureaucratic resources to engage with BIT-negotiations during the 1980s and 1990s, this is clearly out of touch with reality.¹⁰ Also, in an environment of very

⁶ See e.g.; J. Trachtman, ‘The Domain of WTO Dispute Resolution,’ 40 *Harvard International Law Journal* 333 (1999); M. Kumm, ‘The Legitimacy of International Law: A Constitutionalist Framework of Analysis,’ 15 *European Journal of International Law* 5 (2004). For a useful discussion, see; A. Van Aaken, ‘International investment law between commitment and flexibility: a contract theory analysis,’ 12 *Journal of International Economic Law* 2 (2009).

⁷ J. Paulsson, ‘The power of states to make meaningful promises to foreigners,’ 1 *Journal of International Dispute Settlement* 2 (2010), at 344.

⁸ F. Viciña, ‘Regulatory Expropriations in International Law: Carlos Calvo, Honorary NAFTA Citizen,’ 11 *New York University Environmental Law Journal* 19 (2002), at 31.

⁹ J. Paulsson, ‘Arbitration Without Privity,’ 10 *ICSID Review - Foreign Investment Law Journal* 232 (1995), at 257.

¹⁰ E.g.; UNCTAD *International Investment Rule-Making: Stocktaking, Challenges and the Way Forward* (Geneva: UNCTAD, 2008), at 50, 58; P. Robinson, ‘Treaty Negotiation, Drafting, Ratification and Accession of CARICOM states,’ 18 *West Indian Law Journal* 1 (1993). Even in the more politicized trade regime, there are still real concerns of legal capacity for developing countries; M. Busch, E. Reinhardt, G. Shaffer, ‘Does legal capacity matter? A survey of WTO members?’, 8 *World Trade Review* 4 (2009); S. Prowse ‘The Role of International and National Agencies in Trade-Related Capacity Building’ 25 *World Economy* 1235 (2002); V. Delich ‘Developing Countries and the WTO Dispute Settlement System’, in: B. Hoekman, A. Mattoo, and

limited information, even officials that did have an understanding of the legal implications were prone to make biased judgments on BITs' costs and benefits. This is the case, even if we assume they rationally sought and processed information, as predicted by Bayesian frameworks. Also, in the few cases where legal officials actually argued for a careful engagement with BITs during the 1980s and 1990s, it was difficult to convince politicians, embassies, and investment promotion officials not to use the treaties for short-term political purposes.

Investment treaties with the United States and Canada were somewhat different. Along with the MAI, they included liberalization provisions the implications of which were quite clear to negotiators and stakeholders.¹¹ Yet, the vast majority of BITs include only post-establishment provisions, so when the potential liabilities of investor-state arbitration were misunderstood, 'traditional' BITs appeared entirely benign. Hardly any cases could be used to illustrate their potential scope, and most expected the treaties to have an impact on investment flows. So while in some countries, officials did manage to prevent some of the most important legal instruments governing economic globalization from being used as diplomatic gestures of goodwill, they were the exception - not the rule.

Yet, it was not only a lack of information that often made developing countries misjudge the character of investment treaties. Even when information was available, officials frequently failed to seek and process it in ways predicted by rational choice models of policy-making. This led them to not just underestimate the risks of BITs – as could potentially be explained by a Bayesian framework – instead they often ignored them completely. Based on the understanding that BITs were *entirely* immaterial, even stakeholders who should have had an interest in preventing too haphazard BIT-strategies failed to speak up. This is difficult to explain using rationalistic frameworks, including that of public-choice. And rather than fully factoring in experiences of investment treaty claims against other

P. English (eds.) *Development, Trade, and the WTO: A Handbook* (Washington DC: World Bank, 2002).

¹¹ On this; see chapters four, eight, and nine.

governments, officials often relied excessively on their own experiences before adjusting their approach. So while some developing country governments are still using BITs as ‘photo-ops’ along the lines of cultural agreements and other diplomatic gestures, a key determinant for why some countries have adjusted their BIT strategies, and others have not, is whether they *themselves* have been hit by a dispute.

10.2. Bounded rationality

These crucial patterns can best be explained by a theoretical framework based on bounded rationality. This approach acknowledges goal-oriented behaviour, which is useful in this context as developing countries did mostly enter into BITs for instrumental reasons. But while not claiming that people are ‘dummies’, it is based on what we actually know about the capabilities of the human mind rather than abstract, hypothetical and unrealistic expectations of judgment. Herbert Simon notes:

‘The classical theory is a theory of a man choosing among fixed and known alternatives, to each of which is attached known consequences. But when perception and cognition intervene between the decision-maker and his objective environment, this model no longer proves adequate. We need a description of the choice process that recognizes alternatives are not given but must be sought; and a description that takes into account the arduous task of determining what consequences will follow on each alternative’¹²

Here the experimental literature on bounded rational decision-making is a valuable starting point. It provides a micro-foundation of hypotheses and theoretical ideas, which can then be tested when analyzing patterns of decision-making outside the confines of experimental settings. While questions of external validity should of course be carefully considered,¹³ experiments on bounded

¹² H. Simon. ‘Theories of decision making in economics and behavioral science,’ 49 *American Economic Review* 253 (1959), at 272.

¹³ J. Levy, ‘Prospect Theory and International Relations: Theoretical Applications and Analytical Problems,’ 13 *Political Psychology* 283 (1992), at 98-100; E. Shafir, ‘Prospect Theory and Political Analysis: A Psychological Perspective,’ 13 *Political Psychology* 311 (1992), at 320-1; R. McDermott, *Political Psychology in International Relations* (Ann Arbor: University of Michigan Press, 2004), at 27.

rationality were started not in a vacuum but due to the existence of biased judgments in the real world.¹⁴ Similar to the assertions of any other theoretical framework, studies may prove them wrong in various contexts, but at least they are derived through empirically grounded observations rather than hypothetical speculation. And in the case of the BIT-movement, they do indeed appear to have considerable predictive qualities. While a bounded rationality approach will naturally not be able to explain why, and how, every single developing country has signed BITs, this study has shown that in many, if not most, cases it offers far greater insights than traditional explanations.

Bounded rationality and policy diffusion

This has broader theoretical implications. For only recently did Weyland seriously engage with notions of bounded rationality in the study of international policy diffusion. By contrast with Weyland, however, I choose to focus on a particularly hard case for a bounded rationality framework. BITs have been signed over decades with many countries negotiating dozens. Also, even if feedback from actual disputes was limited, governments were repeatedly told by international organizations like UNCTAD that while they might be useful to promote investment flows, they should be taken seriously, as they entailed potentially far-reaching obligations. This provided decision-makers more ample opportunities for Bayesian updating than the policy-choices studied by Weyland, such as revolutions or major social policy reforms.¹⁵ As such, the study also differed from international relations work applying bounded rationality insights to military

¹⁴ T. Gilovich and D. Griffin, 'Introduction – Heuristics and Biases: Then and Now,' in: T. Gilovich, D. Griffin, and D. Kahneman (eds.) *Heuristics and Biases: The Psychology of Intuitive Judgment* (New York: Cambridge University Press, 2002), at 11.

¹⁵ As Newell notes, 'given sufficient time, an intelligent system moves toward the knowledge level, where the signs of the struggle to think fade away and only the adaptive response to the task environment remains. At this point the system may be said to have gained the peaks of rationality. But getting there takes some doing.' A. Newell, *Unified Theories of Cognition* (Cambridge: Harvard University Press, 1990), at 363.

conflicts,¹⁶ which are fraught with even greater uncertainties and time-pressure and thereby make the application of biasing heuristics less surprising.

Secondly, when investigating the necessity of a bounded rationality framework, the study distinguished itself from most other work on policy diffusion by refraining from relying exclusively on one theoretical framework, or treating other frameworks only in passing. While every study, including this one, is bound to give weights to certain aspects of diffusion and discuss others in less detail, I pursued a robust approach by carefully considering the explanatory potential of each main theoretical account of international policy diffusion processes. This brought about considerable insights in and of itself, which will hopefully lead to future and more detailed research. For instance, while it has occasionally been suggested that developing countries were somehow coerced into signing BITs, I showed in detail that developing countries themselves have often initiated negotiations. While a country like Germany may occasionally have used coercive methods, the treaties played no direct role for the IMF, for instance, and much less of a role than often assumed for a World Bank organization like MIGA. Indeed, it is notable that for all the critics of the BIT regime, no-one has actually found much ‘smoking-gun’ evidence for coercion. Secondly, while in the context of competition frameworks, BITs have been described as stepping stones to broader economic integration agreements or crucial for insurance premiums – and thus influencing investment flows indirectly – this was shown not to be the case either. Third, a normative perspective highlighted the role of an organization like UNCTAD in spreading support for the BIT-movement, and indicated that work should investigate the role of private lawyers in shaping and upholding the investment regime due to their occasional triple role as private counsel, arbitrator, and government advisor. This could be done from either constructivist or rationalist approaches, or in combination.¹⁷ Also, as will be discussed below, there is no reason to believe that lawyers themselves could not also have been bounded rational in some respects – despite their expertise. Fourth, and as mentioned

¹⁶ E.g.; Y. Vertzberger, *Risk-Taking and Decision Making: Foreign Military Intervention Decisions* (Stanford: Stanford University Press, 1998).

¹⁷ See e.g.; K. Abbott and D. Snidal, ‘Values and Interests: International Legalization in the Fight against Corruption,’ 31 *The Journal of Legal Studies* 1 (2002).

above, investigating what information was actually available to developing countries at the time the treaties proliferated showed that studies based on assumptions of full information about the risks of BITs are inherently unrealistic. Finally, I discussed the potential of public choice frameworks to explain, why some actors within developing country bureaucracies have been particularly supportive of the BIT-movement.

Yet, even after having gone through these and other overlooked aspects of the BIT-movement, the study was still able to conclude that a bounded rational framework did in fact have considerable ‘value-added’ to explain important and systematic variation in developing countries’ behavior. Surely, future studies should consider more ‘analytical eclecticism’, by combining insights from different theoretical approaches rather than making them ‘compete’ up against a bounded rationality framework.¹⁸ More formal models of bounded rational policy diffusion would also help clarify the importance of the component parts of the theory. However, the approach taken in this study will hopefully convince skeptics that, when investigating why some policies diffuse and others do not, bounded rationality should no longer be considered an unorthodox explanatory framework.

Mixed methods and policy diffusion

One reason for the neglect of the bounded rationality in the diffusion literature is that in order to take its insights seriously, one need to discuss not only substantive issues of opportunities and constraints – including constraints on information - but also procedural questions essentially relating to human cognition.¹⁹ Traditional studies of international policy diffusion tend to include information solely on actors’ goals (e.g. attracting investment; or in the case of individual officials,

¹⁸ See generally; P. Katzenstein and R. Sil, *Beyond Paradigms: Analytic Eclecticism in the Study of World Politics* (London: Routledge, 2010).

¹⁹ H. Simon, *An Empirically Based Microeconomics* (Cambridge, Cambridge University Press, 1997), at 18-9.

foreign travels) and the objective characteristics of their situation, namely the costs and benefits of the policy (e.g. to sign a BIT) compared to alternative causes of action.²⁰ Yet, to understand if, and under what circumstances, cognitive constraints intervene between interests and contexts, one would often have to apply qualitative methodologies, which is not the typical approach in diffusion studies.²¹

Based on more than one hundred interviews, this study provides an important step to rectify this gap, and it has closed a major gap in the literature on BIT-diffusion in particular. Here inputs from decision-makers themselves have been remarkably absent, which has let a number of scholars astray as to the sophistication of the BIT-making process. Suffice it to say that much more qualitative work is needed, particularly in terms of process-tracing case-studies, yet as a starting point this study has offered considerable country-specific insights for future studies to build on.

Unlike the path-breaking work of Weyland, however, I did not rely *solely* on qualitative data. Rather, my conclusions stem from triangulating qualitative and quantitative research, including econometric analyses of one of the key expectations of a bounded rationality framework. And while high-quality statistical data is indeed in short supply and has nowhere near the level of disaggregation necessary to isolate many of the key variables involved in diffusion processes, it was reassuring that some broad and important contours of the BIT-movement followed the predictions of a cognitive heuristics framework. So while future studies should take this much further, for instance based on negotiator and stakeholder survey data, the study provided a more serious engagement with mixed-methods than past studies on international policy diffusion.

²⁰ See generally; H. Simon, 'Human Nature and Politics: The Dialogue of Psychology with Political Science' 79 *American Political Science Review* 293 (1985), at 294; H. Simon, *Models of Bounded Rationality* (Cambridge: MIT Press, 1982), ch. 8.

²¹ F. Gilardi, 'Transnational diffusion: Norms, ideas, and policies,' draft paper, March, 2010, at 6.

Bounded rationality, international political economy, and international economic law

What has been said about the neglect of bounded rationality in the diffusion literature applies to an even greater extent to the broader IPE discipline. For unlike economics and political science, IPE analysts ‘... *have shown impressive resistance to the bounded rationality literature and its implications.*’²² Odell writes,

‘Political economy knowledge would be better empirically if we paid more attention to how economic policy decisions are actually made. ... Systematic acknowledgment of the limits on rationality can generate valuable contributions missed by other frameworks.’²³

To my knowledge, the only one to take up Odell’s call thus far has been Elms, who in 2008 reinterpreted important IPE contributions through the lens of bounded rationality, and concluded that it should be ‘*the first of an avalanche of new explanations.*’²⁴ This study went further by not only reinterpreting the work of others but instead producing new insights based on detailed empirical work on the mechanisms of economic diplomacy. I showed that although architects of the institutional framework for economic globalization may have been strategic and goal-oriented, they have not always been as rational as traditional IPE scholars would have us believe.

This naturally begs the question, whether similar patterns can be found in other areas of IPE? Could important aspects of international trade negotiations also be explained through a similar framework, both in the context of the WTO as well as regional trade agreements? What role has the availability heuristic played for regulation of ‘fat-tailed’ risks in the context of international financial markets for instance? Might the heuristic of anchoring and adjustment play an important role in the political economy of international environmental regulation? Does the representativeness heuristic have anything to say about governments’ regulatory

²² J. Odell, ‘Bounded Rationality and the World Political Economy,’ in: D. Andrews, R. Henning, and L. Pauly (eds.) *Governing the World’s Money* (Ithaca: Cornell University Press, 2002), at 178.

²³ *Ibid.*, at 168, 172.

²⁴ D. Elms, ‘New directions for IPE: Drawing from Behavioral Economics,’ 10 *International Studies Review* 239 (2008), at 262.

response to globalization? Whether nested into constructivist frameworks, traditional rational-choice approaches,²⁵ or as stand-alone explanatory frameworks, these are but a few of the questions future IPE studies might consider.

Similarly, the study raises questions whether insights from bounded rationality might not only enlighten the law-making functions of international investment law, as focused on here, but also the adjudicative process of investment treaty arbitration itself. Although it would probably be fiercely denied by arbitrators themselves, there is no reason to expect they are not also subject to predictable cognitive constraints, which could impact their law-applying functions in systematic ways. But while behavioral approaches has become an established tradition in (particularly American) domestic legal studies,²⁶ they have yet to be applied to international economic law. Perhaps it is time to start.

10.3. Expanding the bounds of rationality in the investment regime

Apart from potentially advancing our understanding of political economy or adjudicative processes, the questions above naturally have little practical value for law-makers in the investment regime.²⁷ Particularly the IPE discipline has unfortunately tended to exist in a vacuum with few paying much attention except for the research community itself.²⁸ So theoretical and methodological implications aside, does the study have any repercussions for developing countries themselves? Might insights on the limits of rationality offer practical policy implications for the future of the investment regime?

²⁵ See generally, Katzenstein and Sil, *op. cit.*

²⁶ See e.g.; C. Sunstein (ed.) *Behavioural Law and Economics* (Cambridge: Cambridge University Press, 2000).

²⁷ See generally; C. Lindblom and D. Cohen, *Usable Knowledge: Social Science and Social Problem Solving* (New Haven: Yale University Press, 1979); Katzenstein and Sil, *op. cit.*

²⁸ P. Katzenstein, R. Keohane, and S. Krasner, 'International Organization and the Study of World Politics,' *52 International Organization* 4 (1998), at 684.

There is (probably) no bounded rational version of pacta sunt servanda

From a legal perspective, the answer is most likely no. Many developing countries may have misjudged the character of investment treaties, but as a matter of law, most arbitrators would probably find this more or less irrelevant. The intent of a treaty is almost only important for interpretation in so far as it is expressed in the treaty text.²⁹ When adjudicating disputes in the investment regime or elsewhere, international dispute resolution bodies will have to assume that governments were goal-oriented in their behaviour and knew the implications of their actions when signing up to international obligations. So it may not be considered a legitimate argument during investor-state disputes if the responding (often developing) country claimed ignorance about the implications of signing and ratifying the BIT. In the absence of outright imposition, ratified treaties are binding upon states whether they like it or not. Loewenfeld notes, for instance, that while the reason so many developing countries suddenly rushed to sign BITs is not irrelevant from a legal perspective, it 'is not dispositive' either.³⁰ After all, a fundamental premise of international law is that by granting its consent in a treaty, a state binds itself to certain obligations 'even if it subsequently changes its mind about that behavior.'³¹ So while many treaty drafters did not appreciate BITs' far-reaching repercussions and overestimated their benefits, most arbitrators are likely to find this irrelevant for the adjudication of investment disputes.

But what about political implications? If we are all subject to systematic biases and erroneous beliefs, can developing country governments do anything but to give up, and let their investment policies continue to be determined more by chance than by rational design? Not necessarily. For accepting that flaws in judgment are a fact of life, in politics or elsewhere, does not imply that the bounds of rationality cannot be extended. In fact, one of the reasons IPE studies have

²⁹ The Vienna Convention of the Law of Treaties, art. 31 and 32. See a discussion in the context of BITs in; K. Vandevelde, 'Treaty Interpretation from a Negotiator's Perspective,' 21 *Vanderbilt Journal of Transnational Law* 281 (1988).

³⁰ A. Loewenfeld, 'Investment Agreements and International Law,' 42 *Columbia Journal of Transnational Law* (2003-2004) at 126.

³¹ M. Beyers, 'Taking the Law out of International Law: A Critique of the 'Iterative Perspective',' 38 *Harvard International Law Journal* 201 (1997), at 202.

often failed to be considered by policy-makers themselves is that they tend to be based on entirely unreasonable expectations of decision-making. Odell is again worth quoting at length,

‘Documenting – partly at the individual level – how past monetary and economic policy decisions went awry would bring findings down from the global level to the level at which lessons will be applied if at all. Information about two types of heuristics and biases would be useful to practitioners: biases at home that need offsetting and biases abroad that could constitute either opportunities or obstacles to strategies based on the assumption of unbounded rationality.’³²

So given that this study did actually document such decisions going ‘awry’, what might the lessons be for policy-makers? Can biases at home be offset by developing countries, and biases abroad be avoided or perhaps even exploited?

Expertise, experience, and coordination

First of all, while expertise is no guarantee against biased judgments, it does provide decision-makers better and more varied information-processing techniques useful to understand their task domain. Spending time and effort in ‘learning how to think’ is nothing if not a response to cognitive limitations and thus bounded rationality.³³ Unfortunately, however, many countries still lack sufficient legal capacity to engage carefully with investment treaties and investor-state arbitration. The most skilled legal bureaucrats have often been put in charge of trade negotiations, which in many countries have had much higher priority, and particularly so if they have not themselves been hit by a claim.³⁴ So for developing countries that have the resources, a key long-term strategy to pursue more rational BIT-policies would be to invest in at least a couple of ‘in-house’ experts. And for those that do not have the resources to attract highly skilled legal expertise, one can only hope that developed countries realize that an important instrument in enhancing the legitimacy of the investment regime would be to fund one or more independent advisory centers on investment law, as recently initiated

³² Odell, *op. cit.*, 192-193.

³³ J. Conlisk, ‘Why Bounded Rationality?’, 34 *Journal of Economic Literature* 2 (1996), at 691.

³⁴ See also; D. Khayat, ‘Bridging the investment claim gap between sophisticated investors and unprepared host states,’ in: UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration II* [unedited draft] (Geneva: United Nations, forth.).

in Latin America.³⁵ Unlike the Advisory Centre on WTO Law, these would have to not just assist developing countries in case of disputes, but also with respect to negotiations and implementation.

Expertise can also be facilitated through experience. So although there may be good reasons why many developing countries promote generalist bureaucrats, it hampers specialized learning. This narrows the bounds of rational decision-making for individual officials and thereby also for their organizations as a whole. Observers of the trade-regime have noted that diplomatic career rotations undermine the establishment of experienced trade negotiators,³⁶ and the same was seen in this study in the context of investment negotiations in Pakistan, South Africa, and Ecuador for instance. Instead, developing countries should consider facilitating experience with investment treaties by establishing specialized units in charge of negotiations, dispute settlement, and inter-agency coordination (see below).³⁷ This would also decrease the chances that individual bureaucrats promote BITs purely for private gain knowing they will not be around, when the claims hit.

A third instrument to offset biases at home is to increase inter-agency coordination. A lack of bureaucratic coordination is a cause of concern even in many developed countries, yet the problems are amplified in developing countries due to capacity constraints. We learned from countries as diverse as India, Mexico, and South Africa that lacking coordination made officials fail to take into account policies and strategies pursued in other departments and organizations, which in turn led to contradictory policies pursued at different levels of government. In fact, that may explain one of the key puzzles identified by Guzman, for instance, namely that some developing countries have pursued BITs while at the same time rejecting BIT-like standards in multilateral negotiations.

³⁵ C. Leathley, 'What will the recent entry into force of the UNASUR Treaty mean for investment arbitration in Latin America?' *Kluwer Arbitration Blog*, 13 April, 2011. See also; E. Gottwald, 'Leveling the playing field: Is it time for a legal assistance center for developing nations in investment treaty arbitration?' *22 American University International Law Review* 237 (2007); Memorandum from Karl Sauvant, Executive Dir., Vale Columbia Ctr. on Sustainable Int'l Inv., and other colleagues at Columbia Univ., to the Office of the President, Sec'y of State, Sec'y of the Treasury, Dir. of the Nat'l Econ. Council, and U.S. Trade Representative, Jan 29.

³⁶ Busch, Reinhardt, Shaffer, *op. cit.*

³⁷ See also; *ibid.*

For rather than unitary and rational decision-makers who pursue their economic self-interests by responding to changing incentives depending on whether they act as a group or individually, as hypothesised by Guzman, it is clear that some important developing countries in this process simply failed to realize the contradictory policies in the first place. Coordination problems can of course also be explained with rationalistic frameworks as long as they relax the unitary actor assumption,³⁸ yet the fact that government stakeholders often failed even realising the contradicting policies is best explained by bounded rationality. For future negotiations, however, such situations can be avoided at relatively low cost, if developing countries charge one government unit with *all* negotiations pertaining to international investment obligations.

Suffice it to say that these conclusions may appear mundane in and by themselves. Yet, when reading existing studies on the BIT-movement, the impression has thus far been that practically all developing countries *naturally* had the necessary expertise, experience, and coordination capacity, when engaging in the investment treaty movement. Unfortunately, such assumptions have been somewhat out of touch with realities.

Avoiding myopia

A key finding of this thesis has been excessive myopia on the part of developing country governments: while happily importing policy models from abroad (diffusion), they focused excessively on their own experiences with those models after they had been adopted. Although this has not been a subject of this thesis, there is no reason to expect that similar ‘tunnel-vision’ will not also hamper developing countries’ otherwise well-meaning external advisors. International agencies and other advisors play important and positive roles, particularly if they can alert countries not yet subject to disputes about the risks involved with BITs. Yet, developing countries should still be cautious of what Jervis has called the ‘drunkard’s search’, where the drunk looks for her keys under the lamp, not

³⁸ On coordination challenges even with fully rational actors, see e.g.; T. Schelling, *The Strategy of Conflict* (Cambridge: Harvard University Press, 1960), at 54-58.

because that is where she lost her keys, but simply because that is where the light is.³⁹

For instance, when investment lawyers argue that BITs are crucial to attract investment and reduce risk premiums, governments should welcome such advice, but question just how representative it is. In particular, they should consider the diagnostic value of all the investment advisors, companies, and underwriting agents that hardly ever take the treaties into account (and therefore rarely talk with investment lawyers!). Incidentally, this goes for developing countries themselves as well: when embassies abroad or investment promotion officials are convinced that BITs have major economic benefits, they might very well be unduly influenced by a small and unrepresentative sample of investors. Particularly damaging is, of course, when officials equate correlation with causation and ignore investment flows from all the countries with which they do not have BITs. During my many interviews with developing country officials it was surprising, for instance, that hardly any governments had tried to ask representative samples of investors about the value of these treaties. So given their potential liabilities, perhaps it is time developing countries start investigating just how important BITs are to attract investors into their jurisdiction.

Also, consider recent calls by international organizations and the arbitration community that developing countries should undertake large scale bureaucratic reforms to implement their BIT-obligations.⁴⁰ Proper implementation of BIT-obligations in their current form not only entails informing national and sub-national agencies about the implications of the treaties, but would often also necessitate bureaucratic systems in place reducing the chance and scope of disputes. Only few examples exist of governments actively trying to avoid investment treaty disputes through various consultation and coordination schemes.⁴¹ But while such reforms may occasionally be prudent and have positive spill-over effects, they take up scarce bureaucratic resources, which in some cases

³⁹ R. Jervis, 'The Drunkard's Search,' in: S. Iyengar and W. McGuire (eds.) *Explorations in Political Psychology* (Durham: Duke University Press, 1993).

⁴⁰ Paulsson (2010), *op. cit.*, at 351-352; UNCTAD (forth.), *op. cit.*

⁴¹ See chapter seven.

might be better spent elsewhere. Consider, for instance, the reforms tax-payers would have to pay for in developing (and indeed many developed) countries before being able to offer foreign investors, what one tribunal understood by fair and equitable treatment,

‘The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparent in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives ...’⁴²

While it may be tempting to argue that developing countries should initiate wholesale domestic reforms to be able to offer such assurances to foreign investors, this would rarely be a prudent economic development policy - even if we assume it is feasible in the real world. Hausman, Rodrik, and Velasco remind us of a simple, yet often overlooked fact, when otherwise well-intended laundry-lists of reforms are handed over to developing countries to implement:

‘Governments face administrative and political limitations, and their policymaking capital is better deployed in alleviating binding constraints than going after too many targets all at once. So growth strategies require a sense of priorities.’⁴³

With respect to the investment regime, this implies that the question is not whether such reforms promote foreign investment or prevent future disputes. Rather, the challenge is to be aware that biasing heuristics may occasionally influence the judgments of the international investment treaty community, and governments therefore need to ask whether major bureaucratic reforms pertaining to BITs actually provide them with ‘*biggest bang for the reform buck*’?⁴⁴ Considering the costs and political capital required this will only be the case for countries, where the lack of (sustainable) foreign investment is in fact the most binding constraint on their economy. If it is not, then perhaps they should spend their scarce attention and resources elsewhere.

⁴² *Tecnicas Medioambientales Tecmed v. United Mexican States*, ICSID Case No ARB(AF)/00/2, Award, 29 May, 2003, par. 154.

⁴³ See generally; R. Hausman, D. Rodrik, and A. Velasco, ‘Growth Diagnostics,’ in: D. Rodrik (ed.) *One Economics, Many Recipes: Globalization, Institutions, and Economic Growth* (Princeton: Princeton University Press, 2007), at 57.

⁴⁴ Hausman, Rodrik, and Velasco, op. cit.

Avoiding status quo bias

One may argue, of course, that although developing countries have joined the BIT-movement in a haphazard fashion, the absence of such reforms will continue to expose them to treaty-based investment claims. The transaction costs in renegotiating dozens of treaties can be prohibitive, and refusing to comply with arbitral awards is a risky option given the strong enforcement mechanism enshrined in the system. Also, even when it is feasible to prevent execution by hiding assets, few would want to blatantly violate their international obligations. So it might be tempting to assume that developing countries have no choice but to initiate far-reaching and expensive reforms to minimize the chance of disputes. This, however, leads me to the third point: beware of excessive anchoring.

Experimental studies have consistently shown that individuals tend to value the status quo, even if it was initially determined randomly.⁴⁵ Alternative, and better, choices are often discarded also when the transaction costs of departing from the status quo are not prohibitive. Indeed, most adjustments of investment treaty policies remain remarkably limited given the lack of consideration that often went into joining the BIT-movement in the first place. As mentioned above, this is partly due to some developing countries turning into capital-exporters. But when governments consider the value of future or existing BITs, they should always ask themselves, whether alternatives might in fact better suit their interests. Let me mention two examples for the sake of illustration.

A multilateral investment treaty has proven difficult in the past, but as late as the recent WTO-discussions, many developing countries had yet to understand the true implications of BITs. This meant that opponents, like India, continuously praised the bilateral alternative to a WTO-negotiated agreement for their flexibility.⁴⁶ Other countries opposed a WTO agreement on the (wrong)

⁴⁵ See e.g.; D. Kahneman, J. Knetsch and R. Thaler 'Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias,' in: Kahneman and Tversky, *op. cit.*; P. Samuelson and R. Zeckhauser, 'Status Quo Bias in Decision Making,' 1 *Journal of Risk and Uncertainty* 7 (1988).

⁴⁶ E.g.; WTO WGTI, Communication from India - Stocktaking of India Bilateral Agreements for the Promotion and Protection of Investments, WT/WGTI/W/71 (1999), par. 6.

impression that they hadn't already given their consent to a *de facto* multilateral investment treaty regime with similar protections.⁴⁷ In the meantime, relevant stakeholders in countries like India have learned the hard way, just how inflexible BITs can be, and other developing countries have had to realize that by signing up to BITs, they had *already* allowed investors the right to file claims against governments on the international plane. Yet today, the very option of a multilateral investment treaty - for instance based on the UNCTC Code - is hardly ever mentioned in discussions over the future investment regime.

Anthea Roberts has presented an alternative way of 're-anchoring' the investment regime without a multilateral treaty or large-scale renegotiation. She posits that apart from being actual or potential respondents in investment treaty disputes, states have another role as BIT parties, namely interpreting the treaties through subsequent practice.⁴⁸ As affirmed by the International Court of Justice, '*subsequent practice ... can result in a departure from the original intent on the basis of a tacit agreement between the parties.*'⁴⁹ This can happen in a number of ways, including updated model BITs, common internal practices, public statements, intervention as a non-disputing treaty party, or even coordinated efforts, such as the NAFTA Free Trade Commission's intervention in the early 2000s. Yet, with the exception of the NAFTA parties, few countries have been active or coordinated in asserting their interpretative authority to limit and clarify their treaties after realizing what they signed up to.⁵⁰ Although information processing constraints have almost surely prevented developing countries from even considering this option, perhaps it is time they start.

To be clear, the suggestion here is not that any of these proposals are *necessarily* more 'rational' than simply sticking with, and implementing, existing BIT-

⁴⁷ See e.g. Egypt's intervention in; WTO WGTI, Report on the Meeting held on 16 - 18 September 2002, WT/WGTI/M/19 (2002), par. 207. Note that in other cases, like Malaysia, the opposition to WTO negotiations was simply because, they were found too long compared with BIT negotiations; Malaysian official I.

⁴⁸ A. Roberts, 'Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States,' 104 *American Journal of International Law* 179 (2010).

⁴⁹ *Dispute Regarding Navigational and Related Rights (Costa Rica v. Nicaragua)*, International Court of Justice, July 13, 2009, par 64. Quoted in Roberts, *ibid.*

⁵⁰ Roberts, *op. cit.*

networks. However, developing countries and other actors in the investment regime should carefully consider, whether a status-quo bias might be partly responsible for the neglect of ‘re-anchoring’ reforms in current debates.

Voice from a position of weakness

Although heuristics probably have a role to play in the very limited adjustments taking place in the investment regime, a number of developed countries are likely to resist alternatives as well. Roberts’ suggestion may work with the United States and Canada, for instance, who themselves have been subject to disputes, or Australia which was recently threatened by a controversial claim.⁵¹ Yet, the ongoing negotiations to establish a common European investment protection policy have made clear that many countries are still intent on pursuing ‘traditional’ OECD-based models.⁵² Until Western Europe gets its own equivalent of an *Ethyl* claim, or is seriously threatened with such a dispute, it will be an uphill battle for developing countries to come to agreement that their old treaties need to be restricted through reinterpretation, that it is time to install a multilateral investment treaty, or indeed any other re-anchoring reforms.⁵³

If so, then developing countries should not underestimate their ability for ‘voice’ to assert pressure.⁵⁴ They can join coalitions with each other as well as domestic

⁵¹ Australia recently decided to exclude investor-state arbitration from its economic treaties, partly due to Phillip Morris threatening to file a claim against the country’s tobacco-regulations; L. Peterson, ‘In policy switch, Australia disavows need for investor-state arbitration provisions in trade and investment agreements,’ *Investment Arbitration Reporter*, April 14, 2011.

⁵² As noted by Aaken: ‘Western European states until now have been largely spared from the position of defendant in investor-state disputes... It might well be that those countries become more cautious in negotiating BITs that restrict sovereignty too much once they realize that the reciprocity of those treaties exists not only de iure but also de facto.’ A. Aaken, ‘The International Investment Protection Regime through the Lens of Economic Theory,’ in: M. Waibel, A. Kaushal, K.-H. Chung and C. Balchin (eds.) *The Backlash Against Investment Arbitration* (Alphen Aan den Reijn: Kluwer Law, 2010), at 545. See also; L. Peterson and D. Vis-Dunbar, ‘UK and Mexico sign investment treaty, following on heels of UK treaty review,’ *Investment Treaty News*, May 15, 2006.

⁵³ Note that due to the Lisbon Treaty, EU members would most likely have to sign investment protection treaties as a group in the future with a considerable say of the European Parliament. Whether, and to what extent, this will lead to considerably changes in the content of European investment treaties remains uncertain at the time of writing.

⁵⁴ See generally, A. Hirschmann, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Harvard, Cambridge, Mass: Harvard University Press, 1970).

stakeholders in developed countries, including NGOs. Also, if rationality is limited, the power of the mass media and the use of framing symbols make powerful allies.⁵⁵ Developing countries could consider exploiting the availability heuristic by mounting campaigns in international media: the more headlines in Western newspapers about environmental and health regulations being questioned under BITs, the greater the pressure on developed country negotiators to compromise. Recall that NGOs used the *Ethyl* claim to help bring down the MAI. Whether this was an outcome to be praised is subject to dispute, but it shows that even within the investment regime, we have seen clear examples of how particularly salient events have a remarkable impact on public opinion, whether they are representative for the regime or not.

If some developing countries want to re-anchor the investment regime, another potentially effective, but often overlooked, strategy is to use their legally enshrined option of ‘exit’ (and threats of exit).⁵⁶ Again, this can be considered both in isolation and along with like-minded countries. The practical implications of this approach will be limited over the medium term, given that ‘survival’ clauses included in many BITs bind the parties between ten or twenty years in respect to investments made before the termination. Still, the costs involved for home states would be considerable. Although many of their investors would remain protected, it would seriously question the legitimacy of the system if developing countries threatened, or actually began, to leave it in the absence of reform. As noted by Helfer, states can exit treaties,

‘...to challenge or revise disfavoured legal norms or institutions ... Withdrawing from an agreement (or threatening to withdraw) can give a denouncing state additional voice, either by increasing its leverage to reshape the treaty to more accurately reflect its interests ... or by establishing a rival legal norm or institution together with other like-minded states. Exit thus sits at a critical intersection of law and power in international relations.’⁵⁷

⁵⁵ See also, Odell, *op. cit.*, at 193.

⁵⁶ Most BITs are in effect for ten or fifteen years. At the end of that period each party can decide not to prolong it, usually with one year’s notice. Most modern BITs have thereby gone past their first ‘tenure,’ so in order to threaten to exit investment treaties developing countries would have to terminate the treaties. Yet this would not be an unlawful act. See, generally; L. Helfer, ‘Exiting Treaties,’ 91 *Virginia Law Review* 7 (2005).

⁵⁷ *Ibid.*, at 1588.

Indeed, governments do actually withdraw from treaties to a much greater extent than often asserted.⁵⁸ So for those developing countries that joined the BIT-movement in a disorganized, chaotic, and uninformed manner and today regret that decision, withdrawal from BITs (or threats thereof) is a potential instrument for ‘voice’ that should not be overlooked.

This is not to say that it will necessarily be easy. There could be first-mover disadvantages in departing from the status-quo,⁵⁹ and particularly so for very small developing countries. Yet, one should not exaggerate this hurdle. Chapter six showed that few developing countries would have lost considerable, if any, amounts of foreign capital if they refrained from joining the BIT-movement. So if developing countries make it painstakingly clear that their exit is not opportunistic, as perhaps exemplified by Venezuela, and they still adhere to the underlying principles of investment treaties as well as the rule of law, it is questionable just how harshly international markets would react. In fact, rather than continuing to violate their BIT-obligations leading to costly investment disputes, withdrawing from the treaties while continuing to adhere to their guiding principles would demonstrate respect rather than contempt for international law. Helfer writes,

‘The most basic distinction is that a withdrawing state is actually adhering to the treaty’s rules by publicizing its decision to exit prospectively... The choice to denounce ... together with any explanation the state offers to justify its decision, may signal an intent to ‘play by the rules’ of future treaties as well. As a result, the harm to the withdrawing state’s reputation as a law abiding nation may be minimal.’⁶⁰

So instead of listening to the predictable outrage of the arbitration community, when such suggestions are considered,⁶¹ developing countries should perhaps instead recall the feedback from the senior MIGA official quoted in chapter four,

⁵⁸ *Ibid.*

⁵⁹ S. Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Portland: Hart Publishing, 2009), at 103. This observation holds true even if ‘network effects’ were not the reason developing countries joined the BIT-movement in the first place, as hypothesized by Montt.

⁶⁰ Helfer, *op. cit.*, at 1621.

⁶¹ When Australia recently decided to abstain from including investor-state arbitration clauses in its economic integration agreements, prominent investment lawyers referred to is ‘*not worldly*,’

‘...provided we can expect a country to remain committed to foreign investments and the rule of law, cancelling all its BITs would not have a substantial impact on whether, and to what extent, MIGA would be willing to underwrite investments to that country.’⁶²

Given that MIGA has been much more concerned with investment treaties than many other market-actors, this is worthy to keep in mind. Also, to the extent some investors may react to withdrawals from BITs, developing countries can always offer them contracts with the same substantive rights as investment treaties and backed up by investor-state arbitration.

To repeat, my study provides no insights on whether individual developing countries should actually pursue any of these policies. Particularly the (relatively few) developing countries who joined and stayed in the BIT-movement based on clear and informed decisions may have already considered some of the options above and decided not to pursue them. So the conclusion here is not that developing countries should *necessarily* withdraw from BITs or otherwise re-anchor their investment treaty policies. But for countries which today regret not being more careful when negotiating investment treaties in the past, it is important to bear in mind whether anchoring to the status-quo is in fact less costly than sustainable alternatives. For while many may have developed their BIT-networks more by chance than by design, it is not too late to make their investment protection policies just a little BIT more rational.

‘naïve’, and conveying ‘a hint of pomposity.’ Submission to the OGEMID list-serv, 16 April, 2011. See also; J. Paulsson, *Denial of Justice in International Law* (Cambridge: Cambridge University Press, 2005), at 231-232 (referring to critics of NAFTA’s Chapter 11 as ‘neo-nationalist,’ ‘attracted by sensationalist allegations of conspiracies against the public interest,’ ‘disinclined to make an effort to grasp the more complex themes of international rules,’ and ‘shrill voices.’); T. Wälde, ‘Investment arbitration and sustainable development: good intentions—or effective results?’ 6 *International Environment Agreements* 459 (2006), at 460 (dismissing attacks on investment treaties from NGOs and others as nothing more than ‘autistic moralism’).

⁶² MIGA official IV.

Annex I: Country classification

There is no official legal definition of a developing country, and different organizations use different classifications, which makes the distinction between developing and developed countries a difficult one. Particularly in studies over time, any classification is bound to be imperfect.

I take as my starting point, the World Bank's historical income classifications, which are listed at:

<http://econ.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20487070~menuPK:64133156~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html> (last accessed: 10 February, 2011).

On this basis, I define a developing country as one, which the World Bank has not classified as a 'high-income' country for the majority of the period listed in its World Development Indicators, starting in 1987 and ending in 2009;

Afghanistan, Albania, Algeria, Angola, Antigua and Barbuda, Argentina, Armenia, Azerbaijan, Bangladesh, Barbados, Belarus, Belize, Benin, Bhutan, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Bulgaria, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde, Central African Republic, Chad, Chile, China, Colombia, Comoros, Congo, Rep., Costa Rica, Côte d'Ivoire, Croatia, Cuba, Czech Republic, Djibouti, Dominica, Dominican Republic, DR Congo, DR Korea, Ecuador, Egypt, El Salvador, Equatorial Guinea, Eritrea, Estonia, Ethiopia, Fiji, Gabon, Gambia, Georgia, Ghana, Grenada, Guatemala, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Hungary, India, Indonesia, Iran, Iraq, Jamaica, Jordan, Kazakhstan, Kenya, Kiribati, Kyrgyzstan, Latvia, Lebanon, Lesotho, Liberia, Libya, Lithuania, Macedonia, Madagascar, Malawi, Malaysia, Maldives, Mali, Malta, Marshall Islands, Mauritania, Mauritius, Mexico, Micronesia, Moldova, Mongolia, Montenegro, Morocco, Mozambique, Myanmar, Namibia, Nepal, Nicaragua, Niger, Nigeria, Oman, Pakistan, Palau, Panama, Papua New Guinea, Paraguay, PDR Lao, Peru, Philippines, Poland, Puerto Rico, Romania, Russia, Rwanda, Samoa, São Tomé and Príncipe, Saudi Arabia, Senegal, Serbia, Seychelles, Sierra Leone, Slovakia, Solomon Islands, Somalia, South Africa, Sri Lanka, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Sudan, Suriname, Swaziland, Syria, Tajikistan, Tanzania, Thailand, Timor-Leste, Togo, Tonga, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Turks and Caicos Islands, Tuvalu, Uganda, Ukraine, Uruguay, Uzbekistan, Vanuatu, Venezuela, Vietnam, Yemen, Zambia, and Zimbabwe.

Accordingly 'developed countries' include here not only Western countries but also countries like Korea and the United Arab Emirates. While these countries have signed numerous investment treaties with Western countries, their role in

BIT negotiations is arguably often that of capital exporters, and it is therefore not unreasonable to group them in the 'developed country' category, which includes;

Andorra, Aruba, Australia, Austria, Bahamas, Bahrain, Belgium, Bermuda, Brunei Darussalam, Canada, Cyprus, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Israel, Italy, Japan, Korea, Kuwait, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Qatar, Singapore, Slovenia, Spain, Sweden, Switzerland, Taiwan, United Arab Emirates, United Kingdom, and United States.

Annex II: Interview information

From January 2009 to May 2011, I conducted more than one hundred interviews – most of them over the phone. Many are quoted or otherwise referred to directly in the thesis; others were used solely for background information, partly due to anonymity requirements (see below).

Private PRI industry

All firms and Lloyds syndicates in table AII.1 below were contacted. Several did not respond and a few had policies of not disclosing information on their PRI policies. As a result, I interviewed representatives from syndicates accounting for almost 50% of Lloyds' Confiscation, Expropriation, and Nationalization' (CEN) capacity and representatives accounting for 50% of the listed firms' CEN capacity. I moreover interviewed representatives from a few additional firms not mentioned on the list, but whose risk-capacity I have not been able to trace or quote (information on the private PRI industry is generally in short supply). The interviews covered firms spread over the three leading insurance centres: the United States (primarily New York), Bermuda, and London. In all cases, I interviewed only officials with an involvement in underwriting decisions, either directly or from a managing position. Interviews were semi-structured, but all were asked the question: *'to what extent, if any, do BITs impact the pricing and coverage of political risk insurance of [company]'*.

Table AII.1. Private providers of political risk insurance for foreign investors

PROVIDER	MARKET CAPACITY PER PROJECT
COMPANIES	
ACE European Group Ltd	80 mio USD, 10 years
AIG	120 mio USD, 15 years
Aspen	70 mio USD, 7 years
Atradius	70 mio USD, 6 years
Axis	100 mio, 7 years
Coface	70 mio, 10 years
Chubb	75 mio USD, 10 years
HCC	35 mio USD, 5 years
Sovereign	100 mio USD, 15 years
Zurich	150 mio USD, 15 years
LLOYD'S SYNDICATES (syndicate no.)	
Ace Global Markets (2488)	80 mio USD, 10 years
Amlin (2001)	12,5 mio USD, 3 years
Ark (4020)	32 mio USD, 7 years
Ascot (1414)	15 mio USD, 5 years
Aspen (4711)	70 mio USD, 7 years
Beazley (623)	30 mio USD, 7 years
Catlin (2003)	90 mio USD*, 10 years
Chaucer (1084)	20 mio USD, 5 years
Hardy (382)	20 mio USD, 5 years
Hiscox (33)	25 mio USD, 5 years
Kiln (510)	60 mio USD, 7 years
Liberty Syn Mgmt (4472)	15 mio USD, 5 years
Limit (1036)	10 mio USD, 3 years
Marketform (2468)	15 mio USD, 5 years
MAP (2791)	20 mio USD, 3 years
Novae (2007)	20 mio USD, 5 years
C.V. Starr (1919)	15 mio USD, 7 years
Pembroke (4000)	10 mio USD, 5 years
QBE (1886)	50 mio USD, 7 years
Talbot (1183)	20 mio USD, 5 years
<p>Notes: Figures are with respect to 'Confiscation, Expropriation, and Nationalization' (CEN) insurance.</p> <p>* Industry representatives state that in practise the maximum line of Catlin's London-platform is only 30 mio USD.</p> <p>Sources: Author's compilation based on publicly available information, industry inputs, and FirstCity, <i>Political Risks Insurance: Report and Market Update</i>, July 2009.</p>	

Public (or mixed private/public) PRI providers

I interviewed one or more officials from public or mixed private/public PRI providers in table AII.2. I was not able to interview officials from the French PRI provider. Like with private providers, I interviewed only officials with an involvement in underwriting decisions, either directly or from a managing

position. Similarly, interviews were semi-structured and all were asked the question: ‘to what extent, if any, do BITs impact the pricing and coverage of political risk insurance of [provider]’.

Table AII.2. Public providers of political risk insurance for foreign investors

PROVIDER	MARKET CAPACITY PER PROJECT
Atradius Dutch State Business NV (Netherlands)	100 mio EUR (max. compensation), 15 years
ECGD (UK)	No stated limit, 15 years
EDC (Canada)	No stated limit, 15 years
EKF (Denmark)	No stated limit, 15 years
EKN (Sweden)	No stated limit, not found
Finnvera (Finland)	No stated limit, 20 years
MIGA (Multilateral)	110 mio USD, 15 years
NEXI (Japan)	No stated limit, 15 years
OeKB (Austria)	No stated limit, not found
OPIC (United States)	250 mio USD, 20 years
PwC/Euler Hermes (Germany)	No stated limit, 15 years
SACE (Italy)	No stated limit, 15 years

Sources: Author's compilation based on publicly available information.

Individuals involved in developed country BIT programs

I interviewed one or more individuals involved in investment treaty programs from:

- Canada* (Department of Foreign Affairs and International Trade)
- Denmark* (Ministry of Foreign Affairs)
- Finland* (Ministry of Foreign Affairs)
- Germany* (Federal Ministry of Economics and Technology and Deutsche Gesellschaft für Internationale Zusammenarbeit)
- Japan* (Ministry of Economy, Trade, and Industry)
- Netherlands* (Ministry of Economic Affairs)
- Sweden* (Ministry of Foreign Affairs)
- Switzerland* (State Secretariat for Economic Affairs)
- United Kingdom* (Foreign Office and the Department for Business, Innovation, and Skills)

United States (USTR, Department of State, Department of Commerce, USAID, Chamber of Commerce, Council for International Business, as well as one lobbyist)

Three capital-exporting countries I contacted about their BIT-negotiations did not respond (Austria, France and Italy). All interviews were semi-structured with the overall theme being business input when contemplating and negotiating BITs (used in chapter six). Officials were also asked about their experiences with negotiations, but to the extent they had been involved in BIT-negotiators for an extended period of time, few were willing to give much input. In cases where negotiators explicitly said the comments were not to be quoted even on a not-for-attribution basis, they have not been included. This includes *all* feedback from American officials and business representatives.

Other organizations

Semi-structured interviews were made with one or more officials, from the following organizations:

The American Bar Association's Central European and Eurasian Law Initiative

The Foreign Investment Advisory Services

The International Centre for the Settlement of Investment Disputes

The International Law Institute

The Multilateral Investment Guarantee Agency

The United Nations Centre on Transnational Corporations

The United Nations Conference on Trade and Development

In some cases officials were retired, and in a few cases officials were only indirectly associated with the organization, such as lawyers used in training programs (when their feedback is in the thesis, this is made clear).

Developing countries

Officials in developing countries were traced through a four-stage process. First, I gathered participation lists from UNCTAD seminars and other organizations involved in investment treaty politics. Secondly, I contacted countries' WTO representations in Geneva to inquire about who to contact in home capitals about investment treaties. Third, I gathered other publicly available information (for instance from websites) on the agencies in developing countries responsible for investment treaty negotiations and contacted them directly. Fourth, I was assisted by the UNCTAD secretariat to trace officials involved, who were then subsequently contacted over email.

In many countries efforts were in vain. In some cases, I traced officials involved, yet they did not respond to emails (e.g. Russia, Iran, Haiti, Nicaragua, Bulgaria). In some cases, officials responded that they were not willing to discuss such matters (e.g. Turkey and Brazil), or officials agreed to discuss, but then subsequently decided not to (e.g. India, Egypt, and Honduras). In other cases, language barriers prevented meaningful engagement (e.g. Morocco, Vietnam, Mongolia, and Cote d'Ivoire). Finally, I decided not to include some interviews, if it became clear that officials were not in fact involved in investment treaty policies themselves, either directly or from a managing position, but merely referred to hearsay (e.g. Yemen).

Ultimately, I was left with the following sample of nineteen developing countries, among which I interviewed one or more officials in more than fifty interviews:

Cambodia (Council for the Development of Cambodia)

Chile (Ministry of Foreign Affairs)

China (Ministry of Commerce)

Costa Rica (Ministry of Foreign Trade)

Croatia (Ministry of Economy, Labour, and Entrepreneurship)

Czech Republic (Ministry of Finance)

Dominican Republic (Export and Investment Center)
DR Congo (Agence Nationale Pour la Promotion des Investissements)
Ecuador (Solicitor General Office, Ministry of Industries and Competitiveness, and Ministry of Foreign Affairs)
Ghana (Investment Promotion Center)
Estonia (Ministry of Foreign Affairs)
Jamaica (Jamaica Promotions Corporation)
Lebanon (Ministry of Finance)
Malaysia (Malaysia Industrial Development Authority and Ministry of International Trade and Industry)
Mexico (Secretariat of the Economy)
Pakistan (Attorney General's Office, Board of Investment, Embassy in Washington DC, Ministry of Industries and Production, Ministry of Finance, Ministry of Law, Ministry of Foreign Affairs , Reserve Bank, Securities and Exchange Commission)
South Africa (see below)
Sri Lanka (Attorney General Office and Ministry of Foreign Affairs)
Thailand (Bank of Thailand and Board of Investment)

All interviews were semi-structured with the overall theme being the countries' experiences with negotiating investment treaties. When individual bureaucrats seemed to not have a deep understanding of investment treaties, this was sought confirmed through a number of 'control'-questions pertaining the content of BITs and very basic points from particular controversial aspects of the jurisprudence (e.g. that MFN clauses might cover dispute settlement provisions). Note that experiences of some countries are included, yet not discussed in detail if officials had only been involved for a short period of time, and particularly if they were not involved before the country's first claim (e.g. Estonia and Malaysia).

In some countries I interviewed officials more than once, and in others I was able through snowballing to interview more than one relevant official. Apart from

South Africa (see below), the later was particularly the case of Pakistan, which led to the ‘mini’ plausibility probe in the preface. Here, interviews were made in Lahore and Islamabad, January 2009 to August 2010, as well as over the phone until May 2011. Several interviewees were interviewed on numerous occasions to make sure Mr. Khan’s story was in fact a fair depiction of the Pakistani BIT-program. Note that three officials strongly objected to Mr. Khan’s story, yet none of them were involved directly with the BIT-program in the past and had only a vague idea of the treaties’ implications.

Table AII.3 lists some key sample statistics from the year, where the BIT-movement resulted in the most amounts of treaties, 1996. It is clear that that while spread over each region, the sample is generally considerably richer than the population of developing countries. As importantly, they have much larger FDI stocks than most other developing countries and thereby represent a very large share of the total inward FDI stock (45% with China, 26% without) and outward stock (40% with China, 28% without). The sample covers six of the top fifteen developing countries in terms of both inward and outward FDI stock, and three of the top five in terms of inward FDI stock (China, Mexico, and Malaysia). This is important as the opposite pattern could have slanted the sample in favour of a bounded rationality explanation (e.g. lack of expertise, lack of stake in the system, etc.). Note that apart from these nineteen countries, the thesis uses additional insights from other developing countries based on publications, newspaper clips, statements in the WTO, etc.

Table AII.3. Descriptive statistics of developing countries where one or more officials were interviewed, 1996

	Share of total	Share of total, excl. China	Average	Average, excl. China	Median
Inward FDI					
Sample	45.17%	25.98%	16.74	10.19	2.94
Developing countries	100%	100%	4.60	3.74	0.55
Outward FDI					
Sample	40.14%	28.23%	4.19	3.14	0.45
Developing countries	100%	100%	1.78	1.58	0.11
GDP					
Sample	33.28%	18.64%	102.44	60.57	21.28
Developing countries	100%	100%	41.77	35.91	5.37
<i>Notes:</i> All figures are in current bn. USD. See annex I for developing country classification.					
<i>Sources:</i> UNCTAD and World Development Indicators.					

South Africa

For the case study in chapter nine, I traced and interviewed *all* negotiators involved in South Africa's BIT program since its inception in 1994 as well as a number of stakeholders. A total of fourteen interviews were made from April 2009 to May 2011, with officials from:

Department of Trade and Industry (DTI)

Department of International Relations and Cooperation

Department of Justice and Constitutional Development

Export Credit Insurance Corporation

Industrial Development Investment Center (within the DTI)

Office of the Chief State Law Advisor (Ministry of Foreign Affairs)

Most interviews were very long (in many cases several hours) and several officials were interviewed twice or more. I also interviewed one investor involved in an investment claim with South Africa.

A comment on anonymity

Anonymity was a condition *sine qua non* for practically all interviewees, and for the private PRI providers few wanted their company name mentioned. Apart from

Makhdoom Ali Khan, all interview feedback is therefore on a not-for-attribution basis. Many interviewees asked not to be quoted at all, even if anonymous, in which case they were used solely for background information.

When the parts of the thesis related to PRI were published, it was criticized in strong terms by Susan Franck for relying on anonymous feedback. But while agreeing with Prof. Franck that this reduces the transparency of the research strategy, anonymity is a necessary evil if one wants to include comprehensive qualitative feedback, which as mentioned in chapter one is critical to get a deeper understanding of the investment regime.¹

Note also that while in the case study of South Africa, several interviewees did not ask to remain anonymous; I decided to keep their identities hidden nevertheless. For while the chapter includes critical comments on the role of key bureaucrats, the intention is not to slander individual officials but rather to illustrate a broader story about how studies based on too narrow assumptions of rational decision-making may have failed to account for when bureaucratic and political elites in developing countries have thoroughly misjudged the character and implications of BITs.

¹ *See*, comments made by Susan Franck on OGEMID (Oil-Gas-Energy-Mining-Infrastructure Dispute Management) mail service, 27 January, 2010.

Annex III: Background data and robustness tests for econometric analysis¹

Summary statistics and information on first BIT-claim

Table AIII.1. Summary statistics for econometric analysis.

Variable	Description/measure	Mean	SD	Min	Max	N	Source
BIT claim	1 if country has been subject to a BIT claim, 0 otherwise (see; Table AIII.2).	0.19	0.39	0	1	2740	(I)
Cummulative BIT claims	Cummulative BIT claims.	0.57	2.57	0	51	2740	(I)
Signed	Annual BITs signed.	1.23	2.03	0	17	2740	(II)
Cummulative signed	Cummulative BITs signed.	16.16	18.89	0	124	2740	(II)
Ratified	Annual BITs coming into force.	0.90	1.74	0	15	2740	(II)
Cummulative ratified	Cummulative BITs coming into force.	11.18	15.06	0	97	2740	(II)
Signed and ratified	Annual BITs signed which came into force within three years.	0.73	1.55	0	15	2740	(II)
Cummulative signed and ratified	Cummulative BITs signed which came into force within three years.	8.63	11.32	0	85	2740	(II)
FDI inflows	Net inflows, BOP, bn. current USD.	1.64	6.90	-4.75	148	2471	(III)
FDI outflows	Net outflows, BOP, bn. current USD.	0.44	3.21	-3.51	67.68	2101	(III)
GDP	Bn. current US USD.	56.93	197.21	0.08	4330	2494	(III)
Investor protection	Investment risk profile index from 0 (very high risk) to 12 (very low risk).	6.91	2.34	0	12	1949	(IV)
Regional BIT claim	1 if a country in same region has been subject to a BIT-claim, 0 otherwise.	0.73	0.45	0	1	2740	(I)
Cummulative regional BIT claims	Cummulative BIT-claims in region.	9.27	16.53	0	91	2740	(I) & (V)
North-South BITs signed	Annual BITs signed with developed countries.	0.47	0.96	0	8	2740	(II)
South-South BITs signed	Annual BITs signed with developing countries.	0.76	1.48	0	15	2740	(II)
'Serious' BITs signed	Annual BITs signed with developed countries or developing countries with large outward capital stocks.	0.62	1.16	0	8	2740	(II) & (III)
'Photo-op' BITs signed	Annual BITs signed with developing countries with small outward capital stocks.	0.60	1.29	0	15	2740	(II) & (III)

Sources: (I) unctad.org/iaa-dbcases, worldbank.org/ICSID, ita.law.uvic.ca, and iareporter.com; (II) UNCTAD; (III) IMF IFS; (IV) PRS Group; (V) unstats.un.org/unsd/mdg/Host.aspx?Content=Data/RegionalGroupings.htm.

Notes: Sample covers 137 developing and transition economies from 1990 to 2009.

¹ The econometric analysis in chapter eight was conducted in collaboration with Emma Aisbett.

Table AIII.2. First (known) BIT claim against developing countries.

Host	Claimant in first BIT claim (ICSID Case No./non-ICSID arbitration rules)	Brought
Sri Lanka	Asian Agricultural Products Limited (ARB/87/3)	1987
Congo, DR	American Manufacturing and Trading (ARB/93/1)	1993
Albania	Tradex Hellas SA (ARB/94/2)	1994
Poland	Saar Papier (UNCITRAL)	1994
Burundi	Antoine Goetz and others (ARB/95/3)	1995
Kazakhstan	Biederman (SCC)	1996
Russia	Franz Sedelmayer (ICC)	1996
Venezuela	FEDAX N.V. (ARB/96/3(1))	1996
Argentina	Compañía de Aguas del Aconquija S.A. and Vivendi Universal (ARB/97/3)	1997
Chile	Víctor Pey Casado and President Allende Foundation (ARB/98/2)	1998
Egypt	Wena Hotels Ltd. (ARB/98/4)	1998
Paraguay	Eudoro Armando Olguin (ARB/98/5)	1998
Ukraine	Joseph Charles Lemire (ARB(AF)/98/1)	1998
Czech Rep.	Ronald Lauder (UNCITRAL)	1999
Estonia	Alex Genin, Eastern Credit Limited, Inc (Arb/99/2)	1999
Latvia	Swembalt AB (UNCITRAL)	1999
Malaysia	Philippe Gruslin (ARB/99/3)	1999
Moldova	Link Trading (UNCITRAL)	1999
Lebanon	Eastern Company (CRCIA)	2000
Mexico	Tecnicas Medioambientales Tecmed (ICSID Case No ARB(AF)/00/2)	2000
Morocco	Salini Costruttori and Italstrade (ARB/00/4)	2000
Guyana	Booker PLC (ARB/01/9)	2001
Hungary	AES Summit Generation Ltd. (ARB/01/4)	2001
Pakistan	SGS (ARB/01/13)	2001
Romania	Noble Ventures (ARB/01/11)	2001
South Africa	Swiss investor (UNCITRAL)	2001
Trinidad & Tob.	F-W Oil Interests, Inc. (ARB/01/14)	2001
Bolivia	Aguas del Tunari S.A. (ARB/02/3)	2002
Ecuador	Occidental Exploration and Production Company (LCIA Case No. UN3467)	2002
Jordan	Salini Costruttori S.p.A. and Italstrade S.p.A. (ARB/02/13)	2002
Philippines	SGS (ARB/02/6)	2002
Turkey	PSEG Global Inc. et al. (ARB/02/5)	2002
Algeria	Consortium Groupement L.E.S.I. - DIPENTA (ARB/03/8)	2003
Bulgaria	Plama Consortium Limited (ARB/03/24)	2003
El Salvador	Inceysa Vallisoletana S.L. (ARB/03/26)	2003
Ghana	Telekom Malaysia (UNCITRAL)	2003
India	Capital India Power Mauritius I and Energy Enterprises (Mauritius)	2003
Peru	Lucchetti S.A. and Lucchetti Peru, S.A. (ARB/03/4)	2003
Saudi Arabia	Ed. Züblin AG (ARB/03/01)	2003
Mongolia	Alstom Power Italia SpA and Alstom SpA (ARB/04/10)	2004
Tunisia	ABCI Investments (ARB/04/12)	2004
Viet Nam	Trinh Vinh Binh and Binh Chau Joint stock Company (UNCITRAL)	2004
Bangladesh	Saipem S.p.A. (ARB/05/7)	2005
Georgia	Ares International S.r.l. and MetalGeo S.r.l. (ARB/05/23)	2005
Lithuania	Parkerings Compagniet AS (ARB/05/8)	2005
Serbia-Mont.	Mytilineos (PCA)	2005

Table AIII.2. First (known) BIT claim against developing countries (contd.)

Host	Claimant in first BIT claim (ICSID Case No./non-ICSID arbitration rules)	Brought
Tanzania	Biwater Gauff (Tanzania) Ltd. (ARB/05/22)	2005
Thailand	Walter Bau (UNCITRAL)	2005
Yemen	Desert Line Projects LLC (ARB/05/17)	2005
Zimbabwe	Bernardus Henricus Funnekotter and others (ARB/05/6)	2005
Kyrgyzstan	Sistem Muhendislik Insaat Sanayi ve Ticaret A.S. (ARB(AF)/06/1)	2006
Nicaragua	Shell Brands International AG and Shell Nicaragua S.A. (ARB/06/14)	2006
Panama	Nations Energy, Inc. and others (ARB/06/19)	2006
Slovakia	Branimir Mensik (ARB/06/9)	2006
Uzbekistan	Romak (UNCITRAL)	2006
Armenia	Global Gold Mining LLC (ARB/07/7)	2007
Azerbaijan	Fondel Metal (ARB/07/1)	2007
Bosnia and Herz.	ALAS International Baustoffproduktions AG (ARB/07/11)	2007
Costa Rica	Alasdair Ross Anderson and others (ARB(AF)/07/3)	2007
Dominican Rep.	Société Générale (UNCITRAL)	2007
Nigeria	Shell Nigeria Ultra Deep Limited (ARB/07/18)	2007
Iran	Turkcell (UNCITRAL)	2008
Senegal	Millicom International Operations BV et al (ARB/08/20)	2008
Belize	Dunkeld International Investment Limited (UNCTIRAL)	2009
Guatemala	Iberdrola Energía, S.A. (ARB/09/5)	2009
Macedonia	Swisslion DOO Skopje (ARB/09/16)	2009
Turkmenistan	Adem Dogan (ARB/09/9)	2009

Sources: unctad.org/ia-dbcases, worldbank.org/ICSID, ita.law.uvic.ca, and iareporter.com.

Robustness tests

Table AIII.3 shows the robustness of the finding to the choice of estimator from within the set of count-data models which could potentially be used in the application. The strong negative impact of a BIT claim is detected by all the estimators. From left to right the estimators are a standard Poisson, fixed-effect Poisson, Negative Binomial (constant dispersion), Hausman, Hall and Griliches' 'fixed effects' estimator (our base estimator),² and a negative binomial model including country-dummies (as suggested by Allison and Waterman).³

² J. Hausman, B. Hall and Z. Griliches, 'Econometric Models for Count Data with an Application to the Patents-R&D Relationship,' 52 *Econometrica* 909-938 (1984).

³ P. Allison and R. Waterman, 'Fixed-Effects Negative Binomial Regression Models', 32 *Sociological Methodology* 1 (2002).

Table AIII.3. Strong negative effect of first claim on participation is robust to choice of count-data estimator and treatment of country-effects.

	(1) Poisson	(2) FE- Poisson	(3) NegBin.	(4) Base	(5) NegBin- FE
L.BIT Claim	-0.417*** (0.101)	-0.343*** (0.089)	-0.468*** (0.117)	-0.423*** (0.107)	-0.379*** (0.139)
L.Inward FDI	-0.031*** (0.007)	-0.031*** (0.008)	-0.034*** (0.009)	-0.016 (0.011)	-0.028** (0.012)
L.Outward FDI	-0.021 (0.025)	-0.015 (0.011)	-0.004 (0.017)	-0.011 (0.014)	-0.010 (0.014)
L.GDP	0.002*** (0.000)	0.002*** (0.000)	0.002*** (0.000)	0.001** (0.001)	0.002*** (0.001)
L.Invest.Protect.	0.051* (0.027)	0.067*** (0.018)	0.077*** (0.026)	0.071*** (0.022)	0.088*** (0.029)
Constant	-1.972*** (0.293)		-2.166*** (0.304)	2.260*** (0.494)	-0.774 (0.480)
Inalpha			-0.482*** (0.123)		-1.407*** (0.198)
Observations	1632	1604	1632	1604	1632

Standard errors in parentheses

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Dependent variable is the annual number of BITs signed which will be ratified within 3 years. See text for description of estimators. Coefficients and standard errors reported. Year dummies and cubic function of lagged total BIT participation as well as lags of ratification also included but coefficients not reported. All other controls are lagged one year.

Table AIII.4 shows the robustness of the strong negative impact of BIT claims on participation to plausible changes in the base specification. In column 1 the controls for FDI flows are omitted from the base specification. While chapter six showed that BITs are unlikely to have a considerable impact on investment flows, some scholars still disagree with this suggestion. And if BITs do affect FDI flows, it is possible that including FDI on the right hand side could bias all the coefficients in the regression. Furthermore, including FDI on the right hand side may cause bias due to non-random missing values in the FDI data. However, the economically and statistically insignificant difference between the coefficients on BIT claim in columns 1 and the base regression suggest neither endogeneity nor selection bias problems in the base regression. Column 2 omits all lagged BIT-participation controls. The robustness of the result here confirms that the negative BIT claim effect is not a spurious time-series artifact due to the lagged participation controls. Column 3 omits the year dummies from the base specification and instead includes global BIT participation and claims. As we

would expect the total number of BITs signed globally is positively related to participation, while the impact of increasing total global claims is negative.

Table AIII.4. Strong negative effect of claims on participation is robust to different specifications, including controlling for large BIT claims and non-BIT investor claims.

	(1)	(2)	(3)	(4)	(5)
L.BIT Claim	-0.436*** (0.102)	-0.441*** (0.107)	-0.465*** (0.110)	-0.421*** (0.107)	-0.365*** (0.120)
L.GDP	0.000 (0.000)	0.001*** (0.000)	0.001** (0.001)	0.001** (0.001)	0.001** (0.001)
L.Invest.Protect.	0.073*** (0.021)	0.064*** (0.022)	0.046** (0.021)	0.071*** (0.022)	0.071*** (0.022)
L.Inward FDI		-0.018* (0.011)	-0.010 (0.010)	-0.016 (0.011)	-0.015 (0.011)
L.Outward FDI		-0.011 (0.014)	-0.011 (0.014)	-0.012 (0.014)	-0.011 (0.014)
Global BITs			0.001*** (0.000)		
Global Claims			-0.004*** (0.001)		
L.non-BIT Claim				0.182 (0.188)	
L.Big BIT Claim					-0.169 (0.166)
Constant	1.603*** (0.434)	1.339*** (0.318)	0.437** (0.215)	2.234*** (0.494)	2.203*** (0.495)
Observations	1832	1604	1604	1604	1604

Standard errors in parentheses

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Dependent variable is the annual number of BITs signed. Table reports coefficients from negative binomial, fixed effect estimation. Year dummies (except in column 3) and cubic function of lagged total BIT participation as well as lags of ratification (except in column 2) also included but coefficients not reported. All other controls are lagged one year.

Columns 4 and 5 add to the base specification respectively controls for non-BIT investor-state arbitrations - i.e. with jurisdiction based on national investment laws or other investment treaties - and BIT claims where investors sought more than US\$100 mio. in compensation. Controlling for non-BIT claims has negligible effect on the base regression. Controlling for large BIT claims (in column 5) substantially reduces the coefficient on all BIT claims. This makes sense as the coefficient on all BIT claims should now be interpreted as the response to small, medium or publicly unknown magnitude claims.

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