The Political Economy of the Investment Treaty Regime

Jonathan Bonnitcha
Lauge N. Skovgaard Poulsen
Michael Waibel

OXFORD
UNIVERSITY PRESS

non-state actors—such as investors, arbitration lawyers, and labour unions—in influencing developed countries' treaty programs, most of which comes from the 2010s. These are important subjects for future research.

Yet, the existing evidence indicates that developed countries largely promoted investment treaties for bureaucratic and political reasons, and not as a response to lobbying by their own outward investors. In some cases, the treaties may have been useful to avoid diplomatic entanglements in investment conflicts abroad. However, at least in the early years, Western states primarily initiated investment treaty programs as a response to challenges to customary international law on investment by repeated UN General Assembly resolutions. During the 1980s and 1990s, the political drivers behind the investment treaty regime evolved, with investment treaties becoming increasingly important as political statements. Except for large agreements, such as the MAI and NAFTA, investment treaties were often the product of mid-level bureaucrats working more or less in isolation, and the investment treaty regime was not a subject of extensive political debate. This is no longer the case. As governments and societal actors have become more aware of the potency and scope of investment treaty arbitration, the regime has become increasingly controversial—particularly when treaties are negotiated between developed countries.

8 Politics of Investment Treaties in Developing Countries

Introduction

As we have seen in Chapter 7, the politics of investment treaties in developed countries has some surprising features. It is an even greater puzzle, however, why developing countries so enthusiastically embraced investment treaties, particularly in the 1990s—the subject of this chapter. For while investment treaties are formally reciprocal, foreign investment between developed and developing countries has traditionally flowed primarily from the former to the latter. As such, the obligations in investment treaties to protect inward foreign investment fell primarily on developing countries in their capacity as host states. This raises the question of why developing countries agreed to treaties that exposed them to potentially expensive arbitrations and restricted their ability to exercise state powers inside their own borders.

This question is the subject of a larger literature than the politics of the investment treaty regime in developed countries. On the basis of this literature, this chapter evaluates three potential explanations for why developing countries adopted the treaties—(i) investment promotion; (ii) promoting or tying in domestic reforms; and (iii) diplomatic and symbolic reasons (unlike the previous chapter, this chapter subsumes 'de-politicization' under this third category). We then examine an important cross-cutting issue—the role of expertise. Regardless, of the objectives that developing countries sought to achieve by adopting investment treaties, this is an important issue as many failed to appreciate the risks and implications of the treaties (Poulsen 2015). The chapter concludes by briefly examining recent developments in the politics of the investment treaty regime in developing countries—including the newfound role of some developing countries as seeking rights for 'their' investors abroad.

Investment promotion

The first and most important reason why developing countries entered into investment treaties was the belief that it would help them attract foreign investment. North–South BITs were originally premised on a 'grand bargain':

'a *promise* of protection of capital in return for the *prospect* of more capital in the future' (Salacuse and Sullivan 2005, 77). Take the example of Zimbabwe. After opening up to foreign investment in 1989, Zimbabwe signed its first BIT in 1990 and joined ICSID in 1991. Robert Mugabe—the president of Zimbabwe and a former Marxist—noted in his opening address to the Zimbabwean Parliament in 1990 that:

The Government has now stepped up its efforts to increase investment, especially in the productive sectors. In addition to the protection of investment embedded in our Constitution, the Government will enter into multilateral and bilateral investment agreements with those countries whose nationals are willing to invest in Zimbabwe. These agreements should go a long way towards attracting investment into Zimbabwe.[1]

This set off a busy negotiation schedule for the Zimbabwean negotiator: 'we were negotiating treaties to promote investment', he recalled, because 'we wanted to be the most competitive investment destination' (quoted in Poulsen 2015, 107).

This is but one example of how investment promotion was the primary justification for adopting investment treaties in developing countries (Poulsen 2015). Insofar as developing countries considered the *reasons* why investment treaties would promote foreign investment, most appear to have believed that investment treaties provided a 'credible commitment' necessary to solve hold-up problems,[2] and/or that entering into such treaties provided a positive 'signal' to foreign investors.[3] As an example of the former, a previous Czech negotiator notes that BITs were seen as necessary to attract foreign investment, as 'investors want guarantees for long-term investments that they will not be expropriated' (quoted in Poulsen 2015, 103). As an example of the latter, a former South African negotiator saw the treaties as instruments that could 'prove to foreign investors . . . that South Africa was an investor friendly country' (quoted in Poulsen 2014, 8). Some developing countries also expected that investment treaties would have an indirect impact on investment flows by facilitating and lowering the price on investment insurance. For instance, when Chile ratified the ICSID Convention in 1991, the president of Chile noted lower insurance premiums as a primary reason not just to become a member of ICSID but also to negotiate BITs, on the basis that they would:

. . . permit foreign investors to obtain lower insurance premiums than those actually obtained in the normal situation [without a BIT]. Therefore, the accession of Chile to

[1] Quoted in Foreign Broadcasting Information Service, Sub-Saharan Africa, Daily Report, FBIS-AFR-90-125, 28 June 1990.

[2] For investment treaties as a solution to hold-up problems, see Chapter 5.

[3] For investment treaties as signals of a safe investment climate, see Chapter 6.

this type of treaties would permit the country to keep an advantaged position in order to attract foreign investment (quoted in Montt 2009, 115).

We raised questions in Chapter 6 about whether these expectations have proven correct. Nevertheless, at the time of signing, it was not always unreasonable for developing countries to believe that investment treaties would help them attract more foreign investment.

When initiating negotiations with developing countries, developed countries often asserted that investment treaties were necessary to attract foreign investment. Germany, for example, used the link between investment treaties and federal investment guarantees as a selling point to initiate negotiations (see Chapter 7). Other developed countries used the same argument as a bargaining tactic. Recall from Chapter 7, for instance, that Whitehall acknowledged internally that investment treaties were unimportant for British investors seeking to commit capital abroad. Yet, when the British Foreign and Commonwealth Office initiated negotiations in the early years of its BIT program, it introduced the treaty by noting that:

British industry and British investors have represented to the British Government that, in their view, bilateral investment protection agreements could assist significantly in the creation of a climate of confidence, which would encourage further substantial investment in the Third World. . . . we wish to reinforce success and to encourage our investors to play an even larger part in the strengthening of your economy. It is our hope that the conclusion of agreements of this kind will play a part in promoting a greater flow of resources from developed countries to the developing Third World within a framework of law . . .[4]

In negotiations, US officials also regularly stated that an investment treaty would help the other party attract more investment (Poulsen 2015, ch. 4, ftn. 77).[5] International organizations, too, promoted the idea that investment treaties were important for developing countries if they wanted to attract foreign investment. The World Bank played a particularly important role in generating support for investment treaty arbitration, as did UNCTAD during the late 1990s and early 2000s.[6] Finally, Western legal advisors occasionally played an important role in spreading the idea that the treaties were critical to promote foreign investment (Poulsen 2015, ch. 4).

[4] FCO 59/701.

[5] Formal US policy documents do not repeat this assertion, as it risked inflaming opposition from organized labour unions in the United States concerned about the loss of US jobs (Vandevelde 1992a, 32).

[6] The IMF does not appear to have played a significant role, partly because transfer provisions in many investment treaties conflicted with member state obligations under Article VI Sec 1 of the IMF Articles of Agreement by failing to include exceptions allowing for restrictions on transfers of funds to be imposed in the event of serious balance of payments difficulties (Siegel 2013).

The views expressed by developed countries, international organisations and 'experts' in international investment law provide a partial explanation for how and why developing countries came to believe that entering into investment treaties would help them attract foreign investment. The question of how these beliefs became so widespread notwithstanding the limited empirical evidence to support them (see Chapter 6) remains an important question for further research. But the basic contention that most developing countries adopted the investment treaties due to some vague sense that they would promote foreign capital is uncontroversial. Consistent with this rationale, Betz and Kerner (2015) find that developing countries were most likely to enter into the treaties when they needed foreign capital.[7]

BITS AND THE PRISONER'S DILEMMA

Some scholars have taken the idea that investment treaties were signed to attract foreign investment further and attempted to model negotiation dynamics for developing countries competing for capital. An influential account comes from Guzman (1998). His starting point is a puzzle: why did developing countries oppose Western notions of investment protection in the UN General Assembly, while at the same time signing up to those very same obligations in bilateral treaties with Western countries? Guzman's answer is that developing countries, as a group, would have preferred to offer less generous protections to foreign investors, but had an individual incentive to break the 'cartel' and sign up to bilateral agreements with Western states (Guzman 1998, 643). They were in a prisoner's dilemma.

Figure 8.1 illustrates this dynamic. Two homogeneous developing countries compete for a fixed pool of capital.[8] Foreign investors divide their capital between countries A and B in the absence of BIT protections. Both A and B would be able to extract more value from these investments in the absence of investment treaties, and they would therefore be jointly better off if they did not sign any BITs. Yet, if A signs a BIT and B does not, foreign investment shifts from B to A. While the presence of a BIT would reduce the value that A is able to extract per unit of foreign capital invested,[9] A would still be better off if the treaty leads to significant relocation of foreign investment from B to A. Anticipating this dynamic, B will sign a BIT as well, so as to remove A's competitive advantage. The end result is an outcome in which each developing country is worse off compared to the no-BIT scenario.

[7] This finding is also important because it is difficult to reconcile with other theories of why developing countries adopted investment treaties. For example, it has been suggested to the authors by investment arbitration practitioners that developing countries may have adopted the treaties out of enthusiasm for international law and tribunals. However, although attitudes towards international law during the 1990s undoubtedly provide important context for the investment treaty movement (see Chapter 1), there is little direct evidence that the treaties were used by developing countries primarily to embrace legal internationalism.

[8] For extensions, see Engel (2008). In Chapter 6, we argued that the assumption of a fixed pool of capital available for FDI in developing countries is unhelpful.

[9] See Figure 5.2.

A \ B	*No BIT*	*BIT*
No BIT	100, 100	40, 140
BIT	140, 40	80, 80

PAYOFFS: (State A, State B)

Figure 8.1 Investment treaty adoption as a prisoner's dilemma

Although elegant in its simplicity, a major difficulty with Guzman's model is that it suggests that developing countries would have avoided signing investment treaties if they had only been able to act as a group. Alvarez (2009) correctly points out that this is inconsistent with observed patterns in developing countries' BIT negotiations. During the 1960s and 1970s, when developing countries perceived foreign investment as a continuation of colonial control and as contrary to their import-substitution strategies for industrialization, European states struggled to persuade key investment partners to sign up to investment treaties, and were mostly left with countries of minor commercial importance. In a meeting with the German negotiating team in 1976, for instance, one British official lamented that BITs 'could be made only where they were not necessary, because where they were necessary they could not be negotiated' (quoted in Poulsen 2015, 54). As described in Chapter 1, the network of BITs at the time was limited primarily to Africa. Accordingly, it is inaccurate to suggest that many developing countries were, individually, undermining their collective support for a New International Economic Order at the UN General Assembly, when in fact very few BITs were signed during this period.

Instead, the spread of modern investment treaties went hand in hand with liberalization of domestic investment regimes during the 1980s and, particularly, the 1990s, due to the changing investment policy principles (see Chapter 1). At the time, developing countries implemented similar standards of protection to those found in investment treaties in their domestic legal regimes (Alvarez 2009), and a few even consented to investor–state arbitration in domestic investment laws (see Chapter 3).[10] The fact that developing countries adopted investment treaties in parallel to changes in domestic laws and policies illustrates the importance of shifts in prevailing ideas about the benefits of foreign investment in explaining the spread of BITs. Typically, developing countries began looking to sign investment treaties abroad only once they had opened the door to FDI at home. By the time the investment treaty movement took off, many developing countries had thus already

[10] By 1981, 13 domestic laws gave advance consent to ICSID–often prompted by the ICSID secretariat (St John 2017, ch. 6).

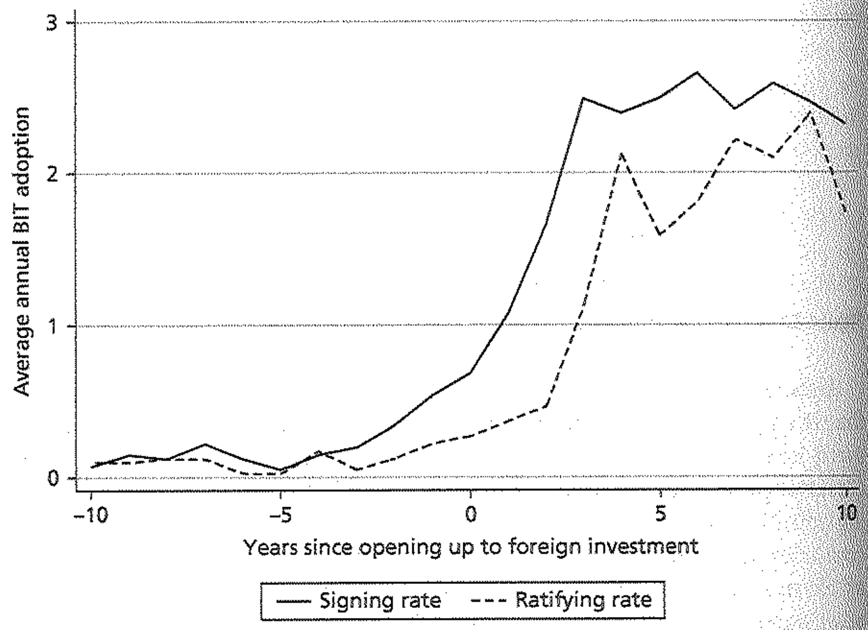

Figure 8.2 Domestic liberalization preceded the global era of investment treaties

Notes: Figure shows the average rate of signing and ratifying BITs among 47 developing countries against the year in which the same countries initiated considerable reforms to attract foreign investment.

Source: Poulsen (2015).

accepted the basic standards enshrined in the agreements (Figure 8.2).[11] In short, developing countries *did* sign investment treaties to attract capital, but not due to the dynamics suggested by the prisoner's dilemma.

Take the example of India.[12] While pursuing import substitution policies during the 1960s and 1970s, India discouraged FDI except in a few sectors. At the time, New Delhi was a strong proponent of the NIEO and accordingly refused Western invitations to sign BITs. After opening up its economy during the 1990s, however, India began adopting BITs with the primary aim of attracting foreign investment. In fact, during investment talks in the WTO in the 2000s—a multilateral forum where developing countries could negotiate as a group—India resisted with the argument that BITs better served India's interests. India's WTO representative noted in 2001 that BITs 'were favoured by countries like India because they did not require countries to make fundamental changes to their FDI policies, required countries to grant national treatment only in the post-establishment phase and made it possible

[11] For an extension of this claim, see Poulsen (2015, chs. 7–8).

[12] Unless otherwise stated, this paragraph is based on Poulsen (2015, 130–1).

to vary the definition of investment in light of the particular needs of the parties to such treaties'.[13]

NETWORK EFFECTS

Bubb and Rose-Ackerman (2007) and Montt (2009) pose two different challenges to Guzman's account. In their models, developing countries also compete for capital, and BITs are credible commitment devices that affect investors' willingness to invest in host states. In Bubb and Rose-Ackerman's account, as in that of Guzman's, BITs promote FDI, and the marginal benefit of individual treaties decreases as the global network of treaties expands. However, according to their view, the decision of developing countries to accept the Hull rule in bilateral negotiations did not leave them worse off as a group.[14] On the contrary, once developing countries had reaped the windfall from expropriating investments made during the colonial period, they were prepared to commit to protect *future* investments in order to attract new FDI. In their account, this strategic timing explains both the very limited adoption of BITs in the early years following decolonization, and their rapid spread from the late 1980s onwards.

Montt (2009) also contests Guzman's model of prisoner's dilemma. His starting point is opposite to that of Bubb and Rose-Ackerman. In his view, rather than decreasing in value as the number of BITs go up, investment treaties have *increasing* returns to scale (network effects). Once boilerplate treaties became readily available, it became 'cheaper' to draft and negotiate treaties—negotiators simply had to jump onto the BIT 'bandwagon'. Moreover, with a critical mass of similarly worded treaties already in place by the 1990s, developing countries could reasonably expect a predictable and efficient (quasi) jurisprudence to evolve. While the standards may have been broad and open-ended—and thus offer little predictability—developing-country negotiators expected that tribunals would operationalize them through interpretation, and thereby reduce the uncertainty of their scope and implications (Montt 2009, 113). Rather than spending considerable time and costs on agreeing to specific investment rules, negotiators anticipated that arbitrators would interpret common open-ended clauses in investment treaties in a way that gave greater precision to their legal content while bearing in mind developing countries' interests (Montt 2009, 157). This process of arbitrators increasing the precision in the legal effect of investment treaties[15] is also in

[13] World Trade Organization, Report on the Meeting of 7 and 8 March 2001, note by the secretariat, WT/WGTI/M/14.

[14] On the Hull rule, see Chapter 4.

[15] Greater precision by decisions of arbitrators differs fundamentally from the trend in the 2010s, discussed in Chapters 4 and 9, towards greater precision in investment treaty *drafting* by states.

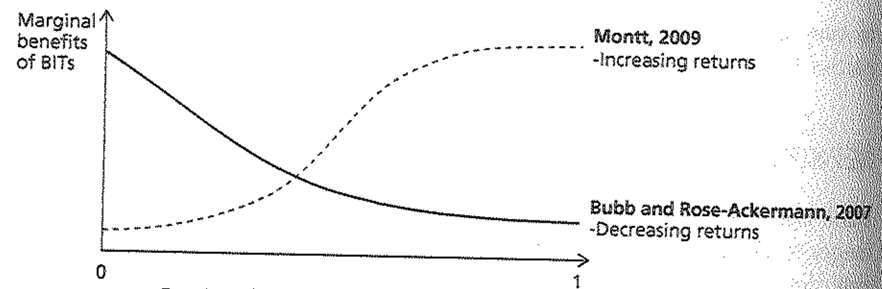

Figure 8.3 Investment treaty adoption with network effects

investors' interests as they could now assess the value of the treaties, and would therefore increasingly factor them into their FDI decisions. Once a critical mass of countries had adopted the treaties by the early 1990s to attract investment, the costs for other developing countries staying out of the regime increased considerably. This was because investors and other market actors now perceived a country with no BITs as a riskier jurisdiction (Montt 2009, 114–15, 122). Montt argues that this dynamic explains the s-shaped diffusion pattern of BITs—slow at first in the 1970s and 1980s, then spreading like wildfire in the 1990s.

Figure 8.3 contrasts the two accounts. In the two models, the size of the global BIT network has opposite effects on the marginal benefits of individual BITs. Montt's model results in an s-shaped curve, whereas the model of Bubb and Rose-Ackerman results in a concave curve. Crucially, however, both models accept Guzman's premises that:

1. Investment treaties provide unique credible commitment instruments for developing countries seeking to attract foreign investment (see particularly Montt 2009, 128; Bubb and Rose-Ackermann 2007, 300); and
2. Developing countries adopted investment treaties as the results of fully rational decisions.

We raised questions about the first premise in Chapters 5 and 6: investment treaties were never *unique* credible commitment devices, but rather complements to a range of other instruments addressing political risks, such as investment contracts and investment insurance (Yackee 2007; Alvarez 2011a, ch. 2). Perhaps for this reason, evidence of investment treaties' effectiveness in increasing FDI is mixed. However, even if investment treaties were not as effective in attracting foreign investment as anticipated, the second premise could still be correct. It would still have been rational for states to enter into investment treaties if developing countries had good reasons to *believe* the treaties were important to attract investment at the time they entered into them (Peinhardt and Allee 2012a, 777; Montt 2009, 122). This

scaled-down assumption underpins Guzman's later work with Elkins and Simmons, to which we now turn.

A CAREFUL AND STRATEGIC COMPETITION FOR CAPITAL?

In the widely quoted account of Elkins, Guzman, and Simmons (2006), investment treaties matter in particular for footloose investors—that is, investors with low relocation costs. Light manufacturing plants, for instance, can more easily move from one country to another than large energy or mining investments with considerable sunk costs. They argue that developing countries *believe* that they are in a competition for such investment, and that investment treaties are highly relevant to the investment location decisions of such investors. One testable proposition that follows from this theory is that countries that depend on, and compete for, light manufacturing investments are most likely to adopt investment treaties, and they find evidence to sustain this view. Whether developing countries saw BITs as credible commitments or signals to imperfectly informed investors, Elkins, Guzman, and Simmons argue that they were engaged in a strategic race to attract capital—as in Guzman's original model.[16]

This argument is difficult to reconcile with theories of *how* investment treaties promote foreign investment. Chapter 5 suggests that footloose investors should be the *least* interested in investment treaty protections because their exit from host states in case of mistreatment is less costly. Only a small minority of registered ICSID cases have involved claimants of the type that Elkins, Guzman, and Simmons consider to be most important in driving the adoption of investment treaties. By contrast, more than 40 per cent have been in industries typically characterized by large sunk costs (energy, mining, and utilities) (ICSID 2017). Moreover, Elkins, Guzman, and Simmons do not provide any direct evidence that developing-country policy-makers in fact believed that investment treaties were particularly important for footloose manufacturing firms. Perhaps it is for these reasons that their econometric results do not appear robust when making small, but justified, changes to their statistical model (Poulsen and Aisbett 2013).

Furthermore, if developing countries signed investment treaties as part of a rational competition for capital in line with this account, we would also expect this competition to manifest itself in the content of the treaties. Yet, very few countries tried to progressively 'upgrade' their BITs to become more 'competitive'—for instance, by including increasingly higher levels of protection for foreign investment (Poulsen 2015). Instead, investment treaties have remained remarkably similar, 'anchoring' to template agreements rather than including

[16] Swenson (2005) presents a related account. She argues that foreign investors who have *already* invested abroad use a tacit threat of exit to lobby host states to sign BITs.

ever more investor-friendly provisions. Finally, extensive qualitative evidence shows that very few developing-country governments investigated whether the treaties actually worked as intended—through simple investor surveys or otherwise—and hardly any host state reacted strategically to the BIT adoption of 'competitor' countries (Poulsen 2015; see also Chalamish 2010, ftn. 89). So, although most developing countries *did* enter into investment treaties to attract investment, they were rarely as strategic and careful in their approach as the model of Elkins, Guzman, and Simmons suggests.

Investment treaties and domestic reforms

Apart from investment promotion, some developing countries also adopted investment treaties to 'lock in' domestic policies by preventing successors from scaling back reforms of their domestic investment regimes. This type of strategic behaviour is the subject of a long tradition in political science scholarship, including work on how governments use international agreements to play 'two-level games'[17] (Putnam 1988)—for instance, in the fields of human rights (Moravcsik 2000), European integration (Moravcsik 1998), and trade (e.g. Mansfield and Milner 2012).

The role of investment treaties for domestic policy-making has not been subject to considerable research to date. The interaction between investment treaty obligations and domestic reforms is bound to vary significantly depending on whether the treaties only include post-establishment protections or are among the small minority that also include binding liberalization obligations, such as US BITs and the investment chapters of preferential trade agreements (PTAs) (e.g. NAFTA). The latter are the most likely to have an immediate impact on the domestic regulatory environment in host states (cf. the comments by India's WTO representative earlier), so we address these first.

LIBERALIZATION

By including obligations to provide pre-establishment national treatment in investment treaties, the contracting parties agree not to impose any conditions

[17] The nature of a two-level game is that a government is assumed to be involved in two different 'games' at any given point in time. It is trying to achieve certain objectives at the international level through its interactions with other states; at the same time, it is also trying to achieve certain domestic policy objectives within its own territory. Two-level games emphasize the ways in which actions taken by players of the game at one 'level' can affect the options, pay-offs, and incentives of players in the game at the other level.

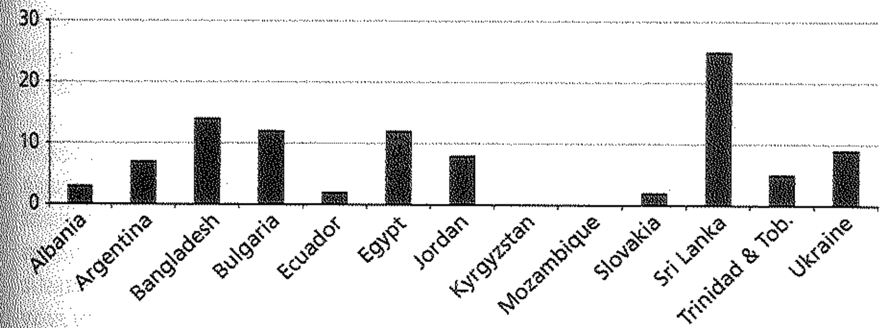

Figure 8.4 Exceptions to pre-establishment national treatment in selected US investment treaties

Note: Figure counts the number of sectors or matters, where the countries reserve the right to make or maintain exceptions to pre-establishment national treatment in their BITs with the United States. The figure does not necessarily represent the scope of the exceptions, which will depend on the exact formulation as well as the importance of the relevant sector or matter.

Source: Compiled by the authors.

or restrictions on new foreign investment beyond those that apply to new domestic investment. Typically, these obligations are subject to reservations enumerated through a 'negative list' (see Chapter 4), where the parties specify the sectors and areas of activity excluded from the scope of the pre-establishment national treatment obligation. If none are listed, the country allows foreign investors of the other party to invest in all sectors of the economy on the same terms and conditions that apply to domestic investors. And indeed, some US BIT partners have included no, or very few, exceptions to their liberalization schedules (Figure 8.4).

To the extent that these obligations reflected pre-existing domestic regulation, they have the effect of increasing the cost to a future government of imposing new restrictions or conditions on inward US investment. Mexico's accession to the NAFTA is the classic example. After its spiralling debt crisis in the 1980s, Mexico agreed to an IMF-designed austerity program, part of which entailed opening up the Mexican economy to foreign trade and investment. Mexico subsequently joined GATT (in 1986) and opened up most of the economy to majority foreign ownership. In 1990, President Salinas initiated talks with Canada and the United States to join their PTA, the Canada–US FTA (CUSFTA), partly to attract capital but primarily to lock in his liberalizing reforms (Manger 2009). To 'stabilize the policy environment' against future 'backtracking' by the opposition at the time (Pastor and Wise 1994, 484), Salinas pushed not just for deep trade obligations but also strong disciplines on foreign investment (Cameron and Tomlin 2000, 101). The result was NAFTA's Chapter 11 and the subsequent initiation of Mexico's

BIT program.[18] Mexico is not the only example of such motivations. When discussing the US–Egypt trade and investment agreement, for instance, the former Egyptian finance minister noted that 'if anybody in the future wants to go backwards, they cannot' (quoted in Alden 2005).

To the extent that the liberalization provisions of investment treaties entail commitments to allowing foreign investment in sectors in which foreign investment was previously restricted, these obligations require a significant *change* in the domestic regulatory framework. In such cases, policy-makers may have used investment treaties to overcome pressure from domestic constituencies who oppose investment liberalization. For example, they may have agreed to liberalization commitments within a treaty that other domestic constituencies support for other reasons (for similar arguments in the trade regime, see e.g. Mansfield and Milner 2012).[19] This contrasts with the situation mentioned earlier where liberalization commitments in treaties are used to 'lock-in' *pre-existing* reforms. However, at the time of this writing, the authors are aware of no publicly available evidence of states using investment treaties as tools to facilitate *new* domestic reforms, although the growing number of investment treaties with liberalization provisions makes this an important subject for further research. Moreover, there may be important interaction effects between investment, trade, and other obligations in broader PTAs, as these more recent agreements allow governments to push forward a broader set of domestic reforms. This, too, has yet to be studied in empirical work.

POST-ESTABLISHMENT TREATMENT AND PROTECTION

A related issue is whether, and if so how, states have used post-establishment standards such as national treatment and FET to tie in domestic reforms (see e.g. Echandi 2011). Although it is possible for a country to enact similar protections to those contained in investment treaties through domestic laws, treaty obligations can be important complements as countries cannot unilaterally alter them. As Chapter 3 describes, survival clauses in investment treaties in some cases tie in treaty obligations for up to twenty years. So even if a future government did want to shield domestic investors from competition from established foreign firms already operating in the host country, enforceable treaty commitments preventing discrimination and mistreatment of foreign investors would, in principle, tie the hands of future governments. In

[18] See further Poulsen (2015, ch. 6).

[19] Note that this argument assumes that those negotiating investment treaties on behalf of developing countries fully understood the present and future implications of the investment liberalization obligations included in the treaties. See the following text.

turn, this should act as a deterrent from policy reversals, which would improve long-term predictability for foreign investors.

Some developing countries used this argument as a justification for adopting investment treaties. For instance, when Argentinean president Carlos Menem initiated wholesale privatizations in the early 1990s, the Argentine Congress passed an Economic Emergency Law that authorized the executive branch to adopt investment treaties. The treaties were useful instruments to attract investment in newly privatized industries, partly by making sure that future governments would not renationalize those assets or dismantle the regulatory framework established to govern the industries in question. The Argentinean foreign minister noted in 1990 that the reason the country had begun adopting BITs was '. . . so that people from abroad know that Argentina offers the utmost in legal security. Not only under a domestic law, which might be amended by another one, but under bilateral agreements, which obviously can be altered only by mutual accord'.[20]

Poland is another example. St John (2017) describes how, in 1989, the communist leader Jaruzelski told the United States that the inexperience of the Solidarity movement meant that its imminent takeover of the Polish government would quickly bankrupt the country. The transition to a market economy had already begun, and the BIT was a useful tool to tie in future governments. In this context, President Jaruzelski explicitly told President HW Bush that 'pressure is needed from the outside to adopt the reforms' (quoted in St John 2017, 161). Poland quickly signed and ratified the agreement, such that commitments to protect foreign-owned private property would be locked in, even when Solidarity assumed power.[21] More broadly, US negotiators have noted that some investment treaty negotiations with Central and Eastern European countries proceeded in parallel to the revision of their national investment laws after the Cold War, and the treaties thereby served 'to anchor their economic reform efforts in these areas' (quoted in Poulsen 2015, 86).

Apart from *tying in* existing or ongoing reforms, 'traditional' BITs may also theoretically *push forward* reforms, provided treaty obligations go beyond domestic laws. As an example, many developing (and indeed developed) countries would have to initiate significant regulatory reforms if they were to live up to *Tecmed's* expansive understanding of 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

[20] Quoted and translated in Daily Report: Latin America, FBIS-LAT-91-012, 17 January 1991. See also Post (2014).

[21] Note that the US–Poland BIT includes national treatment for the pre-establishment phase, but the provision is subject to domestic laws and regulations, which significantly reduces the teeth of the obligation.

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... (*Tecmed v. Mexico*, para. 154)

Although less far-reaching, a minority of treaties also explicitly includes treaty language on transparency, requiring host states to make relevant regulations, laws, and administrative rulings promptly available, and a few require relevant foreign stakeholders to be consulted before implementing relevant measures to the extent possible (UNCTAD 2012). The reforms that these interpretations and innovations in treaty language require could theoretically *promote* domestic reforms.[22]

In Chapter 6, however, we noted that, insofar as evidence is available, it suggests that investment treaties have not triggered fundamental reform at the domestic level.[23] Moreover, the evidence available again suggests that, when post-establishment provisions of investment treaties were part of a 'two-level game', they were primarily used by developing countries to tie in—rather than push forward—domestic reforms (Poulsen 2015). The expected impact of the treaties on domestic policies and policy-making therefore remains a critical subject for future research.[24]

Investment treaties and diplomacy

The accounts in the preceding text are unable to explain a significant number of investment treaties signed among countries that were not significant trading or investment partners. In 1996, for instance, Vietnam signed BITs with Algeria, Bulgaria, and Uzbekistan. And, in 1998, North Korea signed BITs with countries such as the Czech Republic, Serbia, and Slovakia. In the absence of foreign investment in either direction, these treaties have no practical implications (except for their effect on other investment treaties through MFN clauses, or in the event of significant future investment between the countries). Yet, hundreds of such 'strange' investment treaties have been signed, which points to a third category of explanations on how developing countries used investment treaties to promote diplomatic agendas. Four arguments are particularly relevant: (i) de-politicization; (ii) foreign policy objectives; (iii) diplomatic symbolism; and (iv) investment treaties used as diplomatic 'perks'. These arguments are not necessarily inconsistent with the objectives of investment promotion and tying in domestic reforms. Indeed, the second, third, and fourth arguments all complement the two accounts considered in the preceding text.

As outlined in the previous chapter, a first explanation for the popularity of BITs among developing countries was the promise that investment treaty arbitration would 'de-politicize' investment disputes, and thereby avert the threat of home state intervention in one form or another (Shihata 1986). The founders of ICSID emphasized this argument at a time when major investment disputes threatened to undermine sensitive foreign policy and security goals. As such, investment treaty arbitration should make inter-state conflicts less likely, which should be a particular benefit for weak states.

Yet, de-politicization does not seem to have been a primary objective of investment treaty programs in developing countries (Poulsen 2015).[25] A partial exception is Costa Rica, where the primary impetus to ratify the ICSID Convention in 1993 was to stop pressure from the United States in an investment dispute.[26] Even Costa Rica, however, had initiated its BIT program in the 1980s, with the primary objective of promoting foreign investment rather than de-politicizing investment disputes (Poulsen 2015). Moreover, as Chapter 7 describes, it is unclear whether de-politicization even played a particularly crucial role in the BIT programs of developed countries. So while some of the early architects (particularly the founders of ICSID) of the investment treaty regime saw de-politicization as an important promise of investment treaty arbitration, other diplomatic factors were more important.

Second, a large literature in political science suggests that broader diplomatic strategies often drive international economic integration (e.g. Gowa and Mansfield 1993). As Chapter 7 mentioned, this was an important factor in some investment treaty negotiations of developed countries. And, in some developing countries, governments also used investment treaties to signal and reinforce friendly diplomatic relations. Diplomatic links between countries are a significant predictor of investment treaty adoption, and governments often justified BITs in the broader context of promoting and reinforcing diplomatic

[22] Such reforms could, in turn, benefit domestic investors and other domestic constituencies as well.

[23] A partial explanation may be that investors cannot typically directly invoke investment treaties before domestic agencies and courts—unless they are given effect in domestic law. How treaties are given effect in domestic law varies significantly across countries, and the literature has yet to take this variation into account in evaluating the effect of investment treaties on domestic reforms.

[24] Some studies point to the theoretical possibility that authoritarian regimes may have used investment treaties to increase leadership survival. On this basis, one study argues that the treaties promote foreign investment into authoritarian regimes and thereby help political leaders to stay in office (Arias, Hollyer, and Rosendorff 2015), whereas another argues that the treaties undermine property right protections for small- and medium-sized domestic firms to the benefit of rent-seeking business elites propping up authoritarian leaders (Mazumder 2015). It remains to be seen whether qualitative evidence exists to back up these claims.

[25] Collectively, the authors of this book have also advised several developing countries on their investment treaty programs and specific investment treaty negotiations. In their (admittedly anecdotal) experience, the authors have also not found de-politicization of investment disputes to be among the primary objectives of developing countries in negotiating investment treaties.

[26] *Compañia del Desarrollo de Santa Elena S.A. v. Costa Rica* (2000).

links (Poulsen and Aisbett 2016). In the case of Chile, for instance, a previous negotiator notes that BITs were signed during the early 1990s as part of a 'policy to put the name of Chile among the international community coming back from Dictatorship. We wanted to renew relationships with a lot of countries, where we did not have political relationships before. So BITs were part of that bigger picture' (quoted in Poulsen and Aisbett 2016, 86). During the 1990s, Chile signed BITs not just with important investment partners but also countries such as Croatia, Romania, and Tunisia. Equally, Vandevelde describes a telling case in point:

> Just prior to a State visit to Washington in early 1990, the Congolese government notified the United States that it would be interested in concluding a BIT. Negotiations were complete during the State visit and an agreement signed at the conclusion of the visit. The final agreement was identical to the 1987 model negotiating text. . . . the almost unavoidable inference is that the value of the BITs as political symbols was an important factor in their negotiation (Vandevelde 1992b, 635–6).

Third, Jandhyala, Henisz, and Mansfield (2011) offer a complementary explanation for such behaviour. They argue that the adoption of BITs during the 1990s was often about 'keeping with accepted norms or standards' (2011, 1056). Political symbolism and transnational mimicry were the main drivers of many investment treaties rather than instrumental considerations relating to the legal content and the practical implications of the treaties. There is a degree of similarity here to human rights agreements, which states also increasingly ratified in the 1990s, not because they thought they entailed material benefits or they were coerced to ratify them, but merely because it was considered the *appropriate* thing to do (Lutz and Sikkink 2000; Wotipka and Ramirez 2007; Simmons, 2009; see generally, Axelrod 1986; March and Olsen 1998; Goodman and Jinks 2013).

Fourth, and finally, apart from diplomatic agendas and symbolism, individual bureaucrats and politicians sometimes used investment treaties for their own 'selfish' reasons.[27] This is in line with the public choice literature, which highlights how personal interests of officials can shape broader public policies (e.g. Buchanan and Tullock 1962).[28] As one South African official notes:

> South African politicians went all over Africa, 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 (quoted in Poulsen 2015, 181).

Embassy and investment promotion officials have also typically supported investment treaties. For ambassadors, the treaties were occasionally used 'as an

[27] Unless otherwise stated, this paragraph is based on Poulsen and Aisbett (2016).

[28] For public choice perspectives on other international legal regimes, see Colombatto and Macey (1996) and Abbott (2008). See also Gray (2015) on the patronage functions of international organizations.

indicator of their performance', 'a possible achievement during their tenure', and the ability to finish their posting 'with a bang' (various developing-country officials quoted in Poulsen 2015, ch. 6). For officials at home, the process of negotiating BITs facilitated funded business trips to attractive locations—an important perk for officials in some of the poorest developing countries (see also Rose-Ackerman and Truex 2013). A previous Pakistani investment official recalls that whenever there was 'a proposal for an international agreement to be negotiated, everyone says "yes", because you get a free trip out of it' (quoted in Poulsen and Aisbett 2016, 89). Even if collectively irrational for the country as a whole, this can be rational for the individual bureaucrat. For, even if the treaty gives rise to arbitrations against the state in the future, those involved in negotiations would likely have moved on to other positions at the time. So, particularly during the early days of the investment treaty movement with few arbitrations, bureaucrats and politicians sometimes pursued the treaties primarily to advance their own careers.

The role of expertise

In Chapter 7, we suggested that developed countries have frequently been surprised by the way in which arbitral tribunals interpreted and applied certain provisions of investment treaties. This is not unexpected, as no one could have accurately predicted how tribunals would fill in the blanks of vaguely drafted provisions such as FET. In many developing countries, however, the failure to appreciate the implications of investment treaties was more fundamental. Many policy-makers and negotiators did not realize the basic point that the treaties were enforceable, and potentially costly, not just in principle but also in fact. As such, this was not just a problem of imperfect information resulting from the fact that investors had filed very few arbitrations before the 2000s. Many developing countries also suffered from imperfect processing of information that was publicly available due to a lack of expertise.[29]

At least until the end of the 1990s, developing countries normally entered into investment treaties without careful negotiations and with little consideration of the implications. Legal experts rarely negotiated investment treaties, as governments typically delegated the task to generalist bureaucrats, many of who mistook the emerging investment treaty regime for aspirational 'soft-law'.

[29] Unless otherwise stated, the following section is based on Poulsen (2015). Note that, in some cases, a fundamental lack of understanding hampered developed countries as well. The Israeli government, for instance, offered BITs to two Korean firms in 2005, which according to Chalamish reflects 'the confusion between a bilateral investment treaty between states and an Israeli governmental contract' (Chalamish 2010, ftn. 47). The authors are also aware of a couple of developed countries whose negotiators have been generalist bureaucrats rather than legal experts.

Numerous investment treaty negotiators, stakeholders, as well as archival records confirm this crucial point. In the case of South Africa, for instance, officials incorrectly assumed that the treaties contained only broad statements of policy principles and failed to realize that their provisions potentially gave foreign investors' protections over and beyond those enshrined in the South African constitution (Poulsen 2014; on compensation for expropriation in the South African constitution see Chapter 4). Similarly, in the Czech Republic, a former negotiator recalls that the staff involved: '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' (quoted in Poulsen 2015, 141–2; cf. also Veselá 2009 and Fecák 2011). Mexico is representative of the 'strategies' that many developing countries adopted,

> During the 1990s, BITs were a very different animal than FTAs, the WTO, and other globalization instruments… Many here in Latin America thought it was harmless to sign these treaties, no one had an idea what they meant… They just signed them off within a few days or hours… There was no legal review, control, or scrutiny of the content… No one cared until the dispute came (quoted in Poulsen 2015, 146).

Although future studies may reveal similar lack of expertise among some developed countries, previous negotiators from several major developed countries have suggested that their developing-country counterparts often failed to appreciate the meaning of even basic provisions. Arbitrators themselves have also noted this peculiar aspect of the investment treaty regime. Schreuer is one,

> … many times, in fact in the majority of times, BITs are among clauses of treaties that are not properly negotiated…. and I have heard several representatives who have actually been active in this Treaty-making process… say that, 'We had no idea that this would have real consequences in the real world' (Schreuer quoted in *Wintershall v. Argentina* 2008, para. 85).

Similarly, Sands describes how one of his former students contacted him in the mid-1990s asking if he could assist with an arbitration against Albania, where the first hearing was scheduled only two weeks later:

> … He was based in the legal adviser's office, and until shortly before our phone conversation had been denied access to a locked wooden cupboard. Inside he eventually discovered a bundle of discarded and mostly unopened Federal Express packages sent from the Secretary General of [ICSID]….. ICSID's initial letters had received no response from Albania, perhaps because they were being treated as bills…. Plainly, no one had taken the trouble to explain to Albania exactly what it was signing up to… (Sands 2006, 117–18).[30]

[30] The arbitration was *Tradex v. Albania* (1999).

Partly because of the absence of any significant expertise going into the negotiations, investment treaty talks during the 1990s and early 2000s often proceeded as 'mock-negotiations', with template agreements of developed countries accepted as 'default rules' almost without question (on similar 'copy–pasting' in trade agreements, see Allee and Elsig 2016).[31] As a former South Korean official noted,

> … 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 (Kim 2011, 68).

Berge and Stiansen (2016) confirm this link between expertise and acceptance of the other party's model BIT template. In addition, the failure of some developing countries to appreciate the potency of BITs also helps explain why they preferred bilateralism in the regime. When the potential inclusion of investment protection provisions was placed on the WTO agenda in the early 2000s, for instance, core South African officials objected in the belief that their existing BIT obligations did not exceed those relating to foreign investment in the WTO (Poulsen 2014). This, of course, was a mistake.[32]

There were exceptions to this lack of expertise going into negotiations. For idiosyncratic reasons, Costa Rica always appreciated the potency of investment treaties, and put experts on international law in charge of BIT negotiations. China has also pursued a careful and strategic investment treaty policy since the 1980s (Berger 2011; see the following text), and, during the late 1980s and early 1990s, legal bureaucrats in Thailand were hesitant to include investor–state arbitration clauses into investment treaties (Nottage and Thanitcul 2016). Similar examples are bound to emerge as more detailed case studies are conducted. But, overall, it is difficult to account for the popularity of BITs in many developing countries without appreciating the limited understanding of the implications of the treaties among negotiators and stakeholders at the time they were negotiated. This also explains why some developing countries adopted investment treaties in such a haphazard fashion. Since other agencies within governments failed to appreciate the potential liabilities involved, the individuals and agencies that were directly involved in treaty negotiations could conclude many

[31] This is in stark contrast to investment treaty negotiations during the 1960s and 1970s, when the underlying principles enshrined in the treaties were not shared among governments in most developing countries (on the principles of the investment treaty regime, see Chapter 1 and Poulsen 2015).

[32] The WTO agreements do not contain investment protections, aside from the narrowly drafted restrictions on the use of performance requirements contained in the TRIMs agreement.

agreements in a short period—possibly for selfish reasons—with few, if any, questions asked.

Recent developments

As with developed countries, the politics of investment treaties has changed significantly in recent years in many developing countries. This is primarily for three reasons: (i) the rise of investment treaty arbitration; (ii) the growing role of outward investment flows from developing countries; and (iii) the move towards integrating investment protection standards into broader trade and investment agreements.

RESPONDING TO INVESTMENT TREATY ARBITRATION

Developing countries have responded to the rise of investment treaty arbitration in different ways. As Chapter 1 describes, a few countries, such as Indonesia and South Africa, have attempted to terminate existing investment treaties. Yet, these are the exceptions, and many developing countries continue to sign investment treaties, though now typically as part of broader trade agreements and ordinarily with more caution than during the 'heyday' of the BIT movement. Developing countries typically began to slow down their rush to sign investment treaties after they themselves became subject to arbitrations, and the experience of such arbitrations has also resulted in clarifications and restrictions of the content of new investment treaties and, in some cases, led to calls for re-negotiations (Poulsen and Aisbett 2013; Poulsen 2014; 2015; Haftel and Thompson 2015; Henckels 2016). Organizations such as UNCTAD and the International Institute for Sustainable Development (IISD), an NGO, have been instrumental in assisting with these reforms.[33]

Latin America provides a useful illustration of the varied responses to the rise of investment treaty arbitration. While countries in the region rushed to adopt BITs during the late 1980s and the 1990s, some Latin American countries have now turned against the investment treaty regime. Bolivia, Ecuador, and Venezuela have begun to terminate some of their BITs and denounced the ICSID Convention (Waibel et al. 2010). Bolivia left ICSID in 2007, Ecuador in 2009, and Venezuela in 2012.[34] Questions arise as to what exactly denouncing ICSID and cancelling investment treaties imply in the short term, not least

[33] See for example UNCTAD's 2015 Investment Policy Framework for Sustainable Investment (UNCTAD 2015) and IISD's 2005 Model BIT (IISD 2005).

[34] Nicaragua has threatened to leave ICSID as well, but had yet to do so at the time of this writing.

given the survival clauses in the latter (UNCTAD 2010), but the development is undoubtedly important over the long term, politically as well as legally. The parallels to the 1960s and 1970s are clear, when many Latin American states refused to sign the ICSID Convention.

In the case of Ecuador, the government has faced several multi-billion-dollar claims by foreign energy companies. Having spent US$94 million in legal fees attempting to defend an arbitration by US oil company Occidental (Arauz 2013), the tribunal ordered Ecuador to pay US$2.3 billion in compensation to Occidental in 2012.[35] According to the minister of foreign affairs, the ICSID award was 'unjust, illegal, illegitimate and absurd' (quoted from Franck and Wylie 2015, 478). The resulting public anger in Ecuador prompted Ecuador to pull out of some investment treaties and ICSID. Leaving ICSID was necessary, said Ecuadorian president Rafael Correa, as the organization signified 'colonialism, slavery with respect to transnationals, with respect to Washington, with respect to the World Bank' (Bretton Woods Project 2009). As an alternative, Ecuador has proposed an arbitration centre under UNASUR—the Union of South American Nations—based in Latin America instead of Washington (Fiezzoni 2011). Although it is unclear whether the centre will materialize, the proposal is likely to include more comprehensive rules on transparency in investment treaty arbitration than ICSID and exclude party-appointed arbitrators (see also Chapter 9 on how similar features are included in EU's recent policy proposals, CETA, and the EU–Vietnam FTA).

In Venezuela and Bolivia, the turn against the regime has also had populist overtones, with ICSID and investment treaties regarded as part of a broader capitalist—and US—imperial project. '[W]e are not going to bow down to imperialism and its tentacles!', President Hugo Chavez said in a televised speech on ICSID in 2012 (quoted in Garcia 2012). In Bolivia, the denouncement of ICSID came after President Morales nationalized the entire hydrocarbon industry—one of his first initiatives as president. Even before the election of Morales, however, the investment treaty regime had become highly politicized in Bolivia after a foreign company brought an ICSID arbitration following a failed privatization of the water sector in the country (de Gramont 2006; Spronk and Crespo 2008). Morales was clear: '(We) emphatically reject the legal, media and diplomatic pressure of some multinationals that . . . resist the sovereign rulings of countries, making threats and initiating suits in international arbitration' (Investment Treaty News, May 9, 2008).

Importantly, however, the removal from the regime has remained only partial (Peinhardt and Wellhausen 2016). Bolivia has not terminated any of its investment treaties to date; Venezuela has only cancelled some, and has even signed others; and in Ecuador some investment treaties were also kept in

[35] This amount was subsequently reduced to just over US$1 billion in ICSID annulment proceedings (2015).

place—partly because the national assembly insisted and partly because of pressure from other states with significant investments in the country (such as China). This potentially leaves open the possibility for investors to restructure their operations to seek treaty protections through the remaining treaties. Recall also that, even for those few states that have withdrawn from ICSID, most investment treaties give foreign investors a choice of pursuing investment treaty arbitration under several different sets of procedural rules, of which the ICSID Convention is only one (see Chapter 3).

In other Latin American countries, the reaction to investment treaties and the experience of defending arbitrations brought under such treaties has been different. In Peru, the government has gone to great lengths to distance itself from the resource nationalism of its neighbours, and instead reacted to the claims by setting up domestic institutional structures to manage investment disputes (UNCTAD 2010). Other countries, such as Colombia, the Dominican Republic, and Guatemala, have considered similar initiatives. Chile and Mexico have continued their support for investment treaties and investment treaty arbitration, albeit with greater clarifications and restrictions for the scope of key substantive provisions. Argentina too has yet to cancel any of its investment treaties despite having to defend itself in almost sixty arbitrations, most of which were filed after its 2001 financial crisis. Whether this is because Argentina remains dependent on FDI and expects a pull-out from the regime to have significant reputation costs,[36] or because it wants to distance itself from more populist regimes in the region, it is notable that the country subject to by far the largest number of investment treaty arbitrations remains a rank and file member of the regime (Haftel and Levi 2016).[37]

Finally, Brazil has recently decided to initiate an investment treaty program, yet with a radically different type of agreement. After conducting a survey of Brazilian companies, the government found that they sought different, and more practical, assistance from their government, rather than protections against political risks traditionally provided by investment treaties (Gomes 2013). In contrast to almost all other investment treaties, the resulting Brazilian model is focused on practical investment facilitation initiatives, such as visas and investment logistics. Its coverage is limited to FDI, and its investment protection provisions only require compensation for direct forms of expropriation. Investor obligations are included as well—again in contrast to traditional investment treaties—and disputes are to be settled through state-to-state

[36] Note that even if an investment treaty is not an effective positive signal to promote investment—partly because of the thousands of treaties already in place—cancelling an investment could still send a strong negative signal, and thus have significant reputation costs among foreign investors. This is an important subject for future research.

[37] Recall from Chapters 1 and 3, however, how Argentina dragged its feet in paying several awards.

procedures.[38] At the time of going to press, Brazil had already signed two new BITs based on its model treaty with Angola and Mozambique, respectively.

PROTECTING OUTWARD INVESTMENTS

Apart from the growth of investment treaty arbitrations, a second important recent development is the growth in outward investments from developing countries. During the 1990s, the number of investment treaties signed among developing countries themselves increased rapidly. By the second half of the 1990s, South–South BITs comprised more than half of all BITs (see generally Poulsen 2010). Although some of these treaties were simply 'photo-ops', others reflected a shift in policy priorities as developing countries gradually became capital exporters themselves and sought to use investment treaties to protect outward investment. Simultaneously, many OECD countries have gradually become significant importers of capital. In 1999, for instance, Austria signed a BIT with India as part of a broader campaign of marketing Austria as an investor-friendly entry-point into the EU for Indian investors.[39]

Over the last decade, the objective of protecting their own investors abroad has been increasingly reflected in the investment treaty practices of developing countries. A good illustration is China (Schill 2007; Gallagher and Shan 2009; Berger 2011). China began negotiating investment treaties in the early 1980s after Deng Xiaoping embraced foreign investment as part of his 'open door' policy. The first 'generation' of Chinese investment treaties were limited in scope. They excluded a broad consent to investment treaty arbitration and did not contain national treatment obligations. Only the amount of compensation for expropriation could be subject to investment treaty arbitration, not whether expropriation had actually occurred. This practice changed in parallel with domestic reforms in China through the 1990s. After adopting the 'going abroad' strategy in 1998, Chinese investment treaty policy began to focus more on protecting the rising stock of Chinese capital abroad. The growing role of Chinese companies in Africa, for instance, has been complemented by more than 25 BITs. Even when negotiating with the European Union and the United States, China is not just a capital importer with defensive interests but also a capital exporter attempting to ensure protections for Chinese outwards investors who are perceived to be subject to unfair restrictions in developed countries—not least when the investors in question are government owned or controlled (Berger 2011). In negotiations with some developed countries, notably Canada, China was even seen as the primary capital exporter (van Harten 2015). The changing objective of China's investment

[38] See Chapter 3.

[39] Kingshuk (1999).

treaty program is also reflected in the content of the treaties. New Chinese BITs now include most of the standard investment protections that were traditionally found in the BITs of developed countries, along with full advance consent to investment treaty arbitration.

China is not alone. Brazil's decision to negotiate some form of investment treaty (mentioned earlier) came after Brazilian companies called upon the Brazilian government to support their interests abroad (Whitsitt and Vis-Dunbar 2008; see the following text). To support the growth of Arab investments, countries such as Qatar, Saudi Arabia, and the United Arab Emirates have negotiated many investment treaties aimed at protecting capital abroad. Countries such as Thailand and Turkey also report that investment treaties are no longer solely used to attract investment but also to protect outgoing investors (Akpinar 2001; Mangklatanakul 2012). And, even after initiating the withdrawal from the investment treaty regime, South Africa still decided to sign a BIT with Zimbabwe to protect South African investments there (Poulsen 2014).

In short, as outward foreign investment from 'developing' countries such as China expands, the reciprocity of the investment treaty regime is no longer a legal fiction, and the traditional developed/developing country divide is becoming progressively less useful in explaining attitudes and policies towards investment treaties in different states.

FROM BITS TO BROADER TRADE AND INVESTMENT AGREEMENTS

Third, and finally, the politics of investment treaties has changed with the inclusion of investment protection rules in broader economic integration agreements. This remains too recent a phenomenon to have been subject to detailed scrutiny in the literature, but we can already now speculate about at least two potential drivers and effects of this development.

First, resistance to enforceable investment protection provisions could, in principle, be addressed through 'issue-linkages', where developing countries agree to accept such provisions in return for tariff reductions or other non-investment concessions. In some cases, the very participation in a major economic integration agreement such as the TPP can bring perceived diplomatic benefits—for instance, by aligning closer with the United States or countering the rise of China—which is a factor that developing countries may weigh against any concerns with the agreement's specific investment provisions.[40] The relationship between concerns about investment provisions and the wider dynamics of PTA negotiations is an important area for further research.

Second, there is the question of whether these broader agreements will be more effective in promoting foreign investment than stand-alone BITs. Developing-country negotiators might believe that foreign investors are more likely to care about investment protection provisions, when they come as part of a package with trade and other investment-related provisions. UNCTAD, for instance, has used existing studies to suggest that this is the case (UNCTAD 2009c, 105–6), despite the difficulty of testing the value added by investment protection provisions in these agreements (see Chapter 6). Insofar as negotiators share this belief about the efficacy of investment provisions in PTAs, another important question for further research is whether those beliefs are derived from careful cost–benefit analyses, or 'gut feelings' similar to those prevailing for BITs during the 1990s.

Conclusion

The vast majority of developing countries entered into investment treaties to attract foreign investment, and, in some cases, the treaties were used to tie in domestic investment reforms. Occasionally, diplomatic considerations were also important, but the perceived need to de-politicize investment disputes was hardly ever a core driver of developing-country investment treaty programmes.

Unlike claims in much early scholarship on the investment treaty regime, developing countries rarely approached the negotiation process strategically or carefully. They often failed to assess whether the treaties in fact mattered for foreign investment flows into their country. More importantly, most entirely overlooked the potential costs of these agreements. This meant they were often negotiated and signed off in a rush, with little—if any—scrutiny. It is also partly for this reason that 'strange' developing-country pairs with few commercial links signed some BITs.

In the last decade, the politics of investment treaties has changed significantly in some developing countries. The rise of investment treaty arbitration has underscored the potential costs and binding nature of the agreements, which has led negotiators and other stakeholders to engage and scrutinize investment treaties more carefully. In a few cases, states have withdrawn from agreements because they entailed, in their view, significant risks without any associated economic benefits. The withdrawal has only been partial so far, however, and most other developing countries have decided to stay within the regime for now and instead pursue only

[40] For empirical studies showing how the investment chapter in TPP is based primarily on US investment treaties, rather than on those of its developing country partners, see Allee and Lugg (2016) and Alschner and Skougarevskiy (2016).

incremental reforms to their investment treaty policies. For some, this is partly because of the changing nature of global investment flows, where companies from developing countries increasingly invest abroad. Finally, the move towards including investment protection in broader economic integration agreements may change the politics of the regime significantly as compared to the politics of stand-alone BITs.

9 Legitimacy and Governance Challenges

Introduction

The previous chapters showed that the rapid growth of investment treaty arbitrations in often sensitive policy areas has focused public attention on the investment treaty regime. Whereas the regime was little known just a few decades ago, it is now the subject of an often-heated debate. Supporters of the regime argue that it promotes the rule of law in international economic relations, and protects foreign investors from arbitrary state action (e.g. Schill 2016). Critics, however, label the regime a 'bill of rights for multinational corporations' (Klein 2001) that limits the ability of states to regulate in the public interest (Sornarajah 2015). They describe investment treaty tribunals as 'secret courts' (DePalma 2001) comprised of 'biased' arbitrators (Eberhardt and Olivet 2012) that empower corporations 'to bend countries to their will' (Hamby 2016a). The system, according to US senator Elizabeth Warren, is 'rigged' in favor of big capital and corporate lawyers (quoted in Hamby 2016d). Taken together, these criticisms are said to amount to a 'legitimacy crisis' of the investment treaty regime (Brower, Brower, and Sharpe 2003; Franck 2005), much like the legitimacy crisis of the international trade regime around the time of the World Trade Organization (WTO) Ministerial Conference in Seattle in 1999 (Keohane and Nye 2001; Esty 2002).

The use of the concept of 'legitimacy' to frame debates about investment treaties reflects the centrality of that concept in global governance literature over the past two decades (e.g. Keohane 2011). However, 'legitimacy' has multiple related meanings, creating potential for confusion (Crawford 2004; Koskenniemi 2009; Thomas 2014). For example, 'legitimacy' in a *normative* sense refers to the desirability or appropriateness of legal rules and institutions. 'Legitimacy' in a *descriptive* sense also refers to desirability or appropriateness but is focused on the beliefs of relevant actors (e.g. Brower and Schill 2009). While the two are related, the distinction is significant. Regardless of whether they are justified, the beliefs of governments are important—for example, in explaining patterns of compliance with international law (see generally Franck 1990; Brunnée and Toope 2010). Similarly, popular beliefs about the investment treaty regime matter, even if they are based on misunderstandings. Some critics argue that investors can win investment treaty arbitrations purely based on lost profits, for instance, which is a