Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties

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CONCEPTUAL DIFFICULTIES IN THE EMPIRICAL STUDY OF BILATERAL INVESTMENT TREATIES

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Abstract: Bilateral investment treaties (BITs) have emerged as one of the most visible aspects of the legalization of host state-foreign investor relations. They have unsurprisingly attracted the attention of empirical researchers, who attempt to explain the treaties’ causes and consequences. I argue that extant studies typically ignore two important conceptual difficulties that render the studies’ conclusions suspect. First, analysts routinely fail to appropriately define the relevant universe of treaties, automatically relying on a theoretically flawed United Nations compilation that ignores important differences in the procedural content of the treaties. I present an empirical examination of the investor-state dispute settlement provisions of nearly 1000 BITs that demonstrates significant variation in the extent to which the treaties might meaningfully serve to credibly commit host states to treat investors favorably. Second, analysts fail to consider whether alternative policy instruments might serve as reasonably effective substitutes for BITs. I argue that BITs are hardly the inevitable solution to the supposedly insoluble problem of the “obsolescing bargain” that they are frequently held out to be.

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I: Introduction

Developing countries have historically viewed foreign investment with deep ambivalence. As William L. Thorp, a United States Assistant Secretary of State, observed in 1948:

As engineers and technicians we are more than welcome; our skills are eagerly sought; but as businessmen, as entrepreneurs, we are often not so welcome. Sometimes we feel that at the same moment that our capital is sought, every obstacle is being put in the way of its use on a fair and equitable basis.

Among the many complex reasons for this attitude is the feeling that the foreign investor is an 'exploiter and not a contributor, that his interest is not in the local welfare, that his allegiance is to a distant stockholder, and that when he has won the highest return possible he and his enterprise will withdraw.

The history of developing country policies toward foreign investors reflects this ambivalence. They seek, on the one hand, to encourage the “right kinds” of foreign investment while also attempting to maintain the ability to “control” it, to subjugate it to national development or regulatory priorities.

The level of ambivalence ebbs and flows with time, of course. In some eras, where ambivalence shades into hostility, developing countries may emphasize subjugation over encouragement. In other eras, where ambivalence shades into affection, systems of control may be dismantled in order to attract more investment through an improved “investment climate.” In this current era of seemingly relentless FDI promotion, FDI competition, and, perhaps not coincidentally, increasingly massive foreign capital flows, the idea of host state ambivalence toward foreign investment must seem rather strange. But not so

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1 Quoted in L.H. Woolsey, The Problem of Foreign Investment, 42 AMER. J. INT’L L. 121 (1948) (internal quotations omitted).
long ago ambivalence, if not outright hostility, was the norm rather than the exception. After World War II, and especially by the 1960s and early 1970s, analysts and policymakers in the Third World, and their sympathizers in the First, had pushed Argentine economist Raul Prebisch’s ideas about the plight of the economic “periphery” into a reasonably coherent set of propositions about the “dependency” of the Third World on the First. One of the chief villains in dependencia thought was the multinational corporation, whose investments, if left unchecked, would perpetuate a “world system” in which the Third World would remain exploited and immiserated. The overall mood was such that, by 1974, C. Fred Bergsten could plausibly claim that

Virtually every country in the world... is levying increasingly stringent requirements on foreign firms... Few countries ask any longer the simplistic question: ‘Do we want foreign investment?’ The issue is how to get foreign investment on the terms which are best for them, and indeed how to use the power of the firms to promote their own national goals.²

Bergsten went on to warn, not so accurately it turned out, that then-current ideas about the proper role of foreign investors in national development strategies would lead to “investment wars” in which host states would increasingly regulate and limit the activities of multinational corporations.³

Like most grandiose predictions, Bergsten’s was quite wrong. What is so surprising is how quickly it was wrong. By the early 1980s developing and developed countries alike were having serious second thoughts about the wisdom of restricting and controlling foreign investment. In a 1985 article, Encarnation and Wells documented the rise of “competition” for foreign investment among developing countries, in which the focus was increasingly on offering investment “incentives” rather than on imposing investment controls.⁴ And indeed, over the following years many developing countries began dismantling the elaborate systems of national control of foreign investment that had been painstakingly and painfully erected just a few years before.

Either causally or coincidentally, the volume of worldwide foreign direct investment flows has increased by tremendous leaps and bounds. The following two Figures illustrate the trend. In real terms,

³ Id. at 151-52.
and as of the year 2000, the worldwide annual volume of FDI inflows has increased by a factor of nearly 48 from its 1970 level.

**Figure 1: Annual FDI Inflows, World vs. LDC**
The Figures taken together illustrate the well-observed fact that the vast majority of FDI takes place between the world’s richest countries, with relatively little going to the developing world, and hardly any originating from it. (The apparent difference in total volume of world inflows illustrated in Figure 1 and world outflows in Figure 2 is an artifact of the fact that Figure 1 relies on statistics compiled by the World Bank, while Figure 2 relies on statistics compiled by UNCTAD). For example, over the 1990s approximately ¼ of total world FDI inflows went to less-developed countries, or LDCs, with the rest going to (and an even higher percentage coming from) the developed world. But in absolute terms the increase in FDI flows to LDCs remains quite impressive. For example, annual inflows to LDCs increased by a factor of almost 18 over the period 1970-2000.5

From a formal policy perspective, the most observable and in some ways the most striking aspect of the widespread change of heart regarding the value of FDI has been the diffusion of bilateral

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5 In Figure 1 LDCs include those countries defined by the World Bank as “low and medium income”; in Figure 2 LDCs include those countries identified as such by UNCTAD. The two lists overlap considerably.
investment treaties as an important means of attracting foreign capital. The solid line in Figure 3, below, shows the cumulative number of new BITs signed over the years 1970s-2001. The dashed line shows the numbed of new BITs signed annually. I discuss the mechanics of counting BITs in much more detail in the following Sections of this Article, but for the moment I should point out that the count illustrated below includes only those BITs signed between the top 18 capital-exporting countries (the United States, France, and so on) and the remaining capital-importing countries. If we were to include investment treaties signed between pairs of capital-importing countries, the count would be approximately twice as high.6

Figure 3: Cumulative and Annual Count of BITs Signed between Major Capital-Exporting and Capital-Importing Countries, 1970-2001

At least since Fatorous’s exceptionally useful 1962 study of “Government Guarantees to Foreign Investors”,7 it has been suggested that the primary problem facing would-be foreign investors is the


7 A.A. FATOUROS, GOVERNMENT GUARANTEES TO FOREIGN INVESTORS (1962).
problem of effectively guaranteeing the investor that the host state will not act opportunistically once the investment has been sunk. As Snyder, writing in this Review, put it in the same year,

There seems to be considerable consensus—indeed, one might say virtual unanimity—on the position that one of the deterrents to a greater flow of investment capital to newly developing countries is the high incidence of non-business risk (e.g. “creeping” or outright expropriation without adequate, prompt and effective compensation, currency controls and inconvertibility, export and import controls, political and social instability.8

This problem has been described as one of “obsolescing bargain” in the business-school literature of the 1970s,9 and as one of “credible commitment” in the transaction-cost-economics literature of the 1980s, which is most closely associated with Williamson.10 It is not simply a problem for foreign investors. It is also a problem for host states that desire foreign investment. The host state that is unable to convince investors that it will not unduly interfere with the investment’s profitability post-establishment will presumably be denied needed investment, or will have to pay a risk premium for it. It is widely argued that BITs are appropriate and potentially quite effective solutions to the obsolescing bargain/credible commitment problem because they allow developing countries to use international law to make more credible promises that their “bargains” with foreign investors will not obsolesce. This is the standard story, and it is one that is widely echoed by analysts interested in explaining why states sign BITs,11 by

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10 See, e.g., OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE 377 (1996) (defining “credible commitment” as “a contract in which a promisee is reliably compensated should the promisor prematurely terminate or otherwise alter the agreement. This should be contrasted with noncredible commitments, which are empty promises, and semi-credible commitments, in which there is a residual hazard. Credible commitments are pertinent to contracts in which one or both parties invest in specific assets.”). Ideas of credible commitment, often explicitly drawn from Williamson’s work, permeate the broader “political risk” literature and the much broader literature on the institutional origins of economic growth. See, e.g., WITOLD JERZY HENISZ, POLITICS AND INTERNATIONAL INVESTMENT: MEASURING RISKS AND PROTECTING PROFITS (2002); DOUGLAS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 50 (1990).

those interested in exploring whether BITs succeed in encouraging foreign direct investment (FDI), and by those interested in studying the doctrinal evolution of BITs.

In the Sections that follow I make two principle claims. First, I argue that while some BITs have the meaningful potential to act as credible commitment devices, they are not uniform in their ability to do so. In particular, BITs that lack guaranteed access to investor-initiated arbitration have little theoretical potential to meaningfully circumscribe host state incentives to treat investors poorly. Second, I argue that BITs are by no means unique in their ability, such as it is, to function as effective credible commitment devices. BITs are typically assumed to fill a large hole in the international institutional infrastructure, broadly construed, that protects investors. In fact, and as I show, investors and investment-seeking states have long had the ability, through alternative informal and formal means, to reasonably secure the property rights of foreign investors. BITs add very little to what was already on the “credible commitment” table, and as such we should be very suspicious of theoretical claims that BITs will necessarily lead to great rather than marginal increases in investor confidence and, ultimately, in investment flows.

I make these claims within the context of an extended critique of the tendency of empirical BIT scholars to uncritically rely on a list of BITs drawn up by UNCTAD. UNCTAD has long taken a role in promoting BITs, and in the year 2000 the organization published what was intended to be a comprehensive, chronological listing of the treaties, updating two earlier such compendia. The central thrust of my critique is that the persuasiveness—or what might be called the internal validity—of empirical tests of the credible commitment thesis necessarily depends in significant part on whether the analysts (and by direct implication, UNCTAD) have accurately and comprehensively identified the relevant instances of “credible commitment” that are theoretically likely to provide the particular host state involved with a competitive advantage at attracting foreign capital. The argument is modest, but not unimportant. Quasi-experimental statistical studies of investment treaties are by design intended to confirm or disconfirm theoretical expectations through the identification of empirical correlations

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13 See, e.g., Thomas W. Wälde, The “Umbrella” Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases, 6 J. World Invest. & Trade 183, 185 (2005) (discussing BITs as part of a “culture of commitment”).

between key variables. As the old saw goes, correlation does not equal causation, and whether the former really does confirm the latter depends in part on the internal validity of the particular study, and particularly on the study’s measurements of the underlying theoretical concepts. In other words, a study may be usefully described as internally valid if we can have confidence that the researcher has isolated the true cause of any observed correlation.\textsuperscript{15} Whether confidence is warranted depends in turn on whether the study’s measurement techniques are accurate in the sense of correctly identifying the phenomena of theoretical interest, and complete in the sense of controlling for plausible alternative explanations.\textsuperscript{16} Of course, whether a particular study of BITs is internally valid necessarily depends on what the study is attempting to explain, and it is perfectly conceivable that UNCTAD’s list of BITs might be appropriate or adequate for certain research questions. But for the research questions that most BIT analysts seem interested in asking, the list is problematic. I conclude, in short, that BIT analysts need to do a much better job then they have so far done of convincingly “linking [their] abstract concepts to empirical indicators” of those concepts.\textsuperscript{17} Until they do, credible commitment stories of the causes and consequences of BITs will remain far less persuasive than it otherwise might be.

II: BITs and Self-Enforcement

BITs are typically understood, most basically, as serving two functions. On the one hand, the treaties provide states with a means of making what might be called “substantive” promises to treat investors well. On the other hand, they can provide states with a means of making those substantive promises more credible. One of the first conceptual concerns of any BIT analyst should be whether the treaties identified by UNCTAD are sufficiently similar in terms of both the favorableness of the substantive promises extended to investors and the credibility of those promises. The potential value of a given treaty to an investor will naturally depend on the values taken by these two logically separate parameters. A treaty that advances wholly credible but relatively stingy substantive promises is not necessarily more valuable to the investor than less credible promises of significantly more favorable treatment.

\textsuperscript{15} As Carmines and Zeller put it, “In a very general sense, any measuring device is valid is it does what it is intended to do. An indicator of some abstract concept is valid to the extent that it measures what it purports to measure.” \textsc{Edward G. Carmines \& Richard A. Zeller, Reliability and Validity Assessment} 12 (1979).


\textsuperscript{17} Carmines \& Zeller, \textit{supra} note 15, at 10.
BIT analysts commonly assume that the treaties’ substantive promises are indeed equivalently favorable, and that these equally favorable promises are identically credible. The first assumption is, with one major exception, not an entirely unreasonable one. The second assumption can be highly problematic.

Most BITs mimic, at least in broad strokes, the 1959 Draft International Convention on Investments Abroad (commonly known as the Abs-Shawcross Convention) and on the OECD’s 1967 Draft Convention on the Protection of Foreign Property. Because of their common origins, the language used and the subjects covered in BITs can appear remarkably similar, both over time and across countries. For example, capital exporting states have long been “preoccu[ped]” with convincing host states to provide certain generally applicable standards of treatment for established investments. BITs accordingly, and largely to a tee, promise that investors shall be “treated” in any number of imperfectly distinguishable ways. The most common examples include promises of “non-discriminatory” treatment; treatment that is not “unreasonable” or “arbitrary”; “fair and equitable” treatment; treatment including “full protection and security”; treatment as favorable as provided to domestic investors (“national treatment”); and “most-favored-nation” (MFN) treatment. Investors have also long been concerned with maintaining their ability to repatriate investment proceeds out of the host country, and with receiving compensation in the event that their property is expropriated. Most BITs unsurprisingly contain somewhat more specific guarantees as to both subjects.

This set of promises form what might usefully be called the “substantive core” of modern BITs, and they are what begin to make it possible to analyze the treaties as a conceptually cohesive group. That task is made easier by the widespread promise of MFN treatment. A promise of MFN treatment means that when a host state offers more favorable substantive promises to investors in a later BIT, those more favorable promises will automatically apply to investors covered by the first, less favorable BIT. The ubiquity of the MFN clause also makes it a largely useless and virtually impossible task for the analyst to construct any sort of index of the relative substantive favorableness of the various treaties, just as it can make it rather difficult for an investor to determine just what exactly he has been promised.

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18 The Abs-Shawcross Convention is reprinted in The Proposed Convention to Protect Private Foreign Investment: A Round Table, 9 J. PUB. L. 115 (1960).

19 UNCTC 1988, supra note 14, at 40.

20 The difficulty is compounded by the fact that “MFN clauses do not have a universal meaning. Indeed, the formulation and application of MFN clauses varies widely among investment treaties….The proper application and
United States BITs provide the principle exception to this general rule of substantive sameness. The point is a small one, and tangential to the larger argument, but it is worth emphasizing that U.S. BITs, unlike the BITs of other capital-exporting countries, consistently extend promises of favorable treatment to investors at the “pre-establishment” stage of the investment process. Generally, this means that host states that enter into BITs with the U.S. promise to allow investors to enter the country and make an investment under the same procedures and on the same terms as domestic investors—a significant relinquishment of a host state’s well-recognized (and for much of history jealously guarded) sovereign right to exert largely absolute control over the entry of foreigners. And because promises of MFN treatment usually apply only to post-establishment phases of the investment process, this particularly liberal aspect of the U.S. treaties is not incorporated by reference into the treaties of other capital-exporting countries. Analysts, and especially those interested in the effects of BITs on FDI flows, will necessarily have to adjust the conceptual “weight” of the value of signing or ratifying a U.S. BIT versus signing or ratifying a BIT with another state. Signing a U.S. bit represents a substantively different commitment than signing a BIT with a European capital-exporting state.

The larger point, however, is that BIT promises, even if we assume them to be equally favorable, are not equally credible. To see why, note that the idea that BITs have the capacity to function as credible commitment devices implies that something about the treaties makes it particularly unattractive—e.g. costly—for states to renege on favorable promises to investors. It has long been argued that in some instances treaty-based promises may be “self-enforcing” in the sense that a breach of the treaty will lead “automatically” or nearly so to the imposition of significant costs on the breaching state. In most cases those costs will be of the reputational sort. Third parties will observe the breach and update their interpretation of a particular MFN clause in a particular case requires careful examination of the text of that provision”. OECD, “Most-Favoured-Nation Treatment in International Investment Law,” Working Paper on International Investment Number 2004/2.

21 Many Canadian BITs also apply at the pre-establishment stage, but unlike U.S. BITs, Canadian BITs expressly exclude disputes over the breach of pre-establishment rights from the treaties’ investor-state dispute settlement provisions.


23 That reputation might play a role in promoting host state compliance with international obligations (investment related or otherwise) is an old and rather obvious idea. See, e.g., Roy Preiswerk, New Developments in Bilateral Investment Protection (With Special Reference to Belgian Practice), 3 REV. BELGE DR. INT’L 173, 195 (1967); Guzman provides a recent recycling of the idea. Andrew T. Guzman, A Compliance-Based Theory of International Law, 90 CALIF. L. REV. 1823 (2002). The real question is whether reputational concerns alone are sufficient to promote widespread
beliefs about the breaching state’s willingness to honor its commitments. In the case of foreign investment, the host state that breaches an investment treaty can expect perceptions of its investment climate to worsen, making it more difficult for the state to attract desired investment in the future. The prudent host state will thus weigh the short-term benefits of breaching the treaty (say, for example, the domestic political benefits of seizing a foreign-owned mining operation) against the long-term costs of forgone future foreign capital.

It is very difficult to argue, however, that the substantive promises contained in BITs are meaningfully self-enforcing. The difficulty arises from the fact that these core substantive promises are extended as relatively vague standards, and what the promises of favorable treatment actually mean or how they will apply in a given instance can be highly uncertain. This is particularly the case for the treaties’ generally applicable standards of treatment, which have been described as “otiose” and “vague and open to different interpretations” or as “offer[ing only] a general point of departure in formulating an argument that the foreign investor has not been well treated.”

Even where the promise is relatively specific, such that in theory an observer might be able to tell with a reasonable degree of confidence and without too much effort that if fact “X” has occurred then promise “Y” will have been breached, whether fact “X” has indeed occurred will often be both highly contestable and highly contested. For example, the common guarantee of “prompt, adequate, and effective” compensation in the event of expropriation can be surprisingly difficult to implement to particular facts. And hiding behind even that modestly specific rule of law lurk immensely important legal questions, such as the proper application of expropriation law to “normal” government regulatory activity. That particular question is left almost completely unaddressed in most treaties and remains far

compliance with BIT obligations. Preiswerk takes the position that they are; my own views, as developed below, are much more skeptical.


from settled theoretically or jurisprudentially, creating enormous legal uncertainty and fostering a growing political backlash against investment treaties.27

This means that in most foreign investment disputes, save the most obvious and egregious, it will be quite difficult for the parties to the dispute or for outside observers to determine whether or not a breach of a given promise has objectively occurred. It is even difficult for international arbitral tribunals to consistently construe and apply BIT promises.28 And where a breach is not easily identified either because of legal or factual uncertainty, reputational concerns are unlikely to dissuade the state from acting in ways that might objectively be considered contrary to its treaty or other international legal promises.29

The investor, of course, is sure to claim the treaty has been violated, but the investor’s self-serving rhetoric, like the host state’s own, should not be counted upon to reflect the true state of affairs, especially where it simply isn’t certain what a particular promise actually means.30

It is worthwhile to briefly address in the current context Guzman’s more general argument (though one that he has also applied specifically to international investment law) that treaties are “[t]he most formal and reliable international commitment” in large part because they “represent clear and well-defined obligations of states.”31 The real question is “in comparison to what”, and the “what” in Guzman’s analysis is, for the most part, customary international law. It would be misguided to argue that BITs offer no improvement over customary international in terms of what might be called the “international legal coverage” of investment issues. BITs typically contain many promises that simply have never been incorporated (or never claimed to have been incorporated) into customary international


29 As Douglas North has emphasized more generally, “the costs of measurement and enforcement, discovering who is cheating whom, when free-riding will occur, and who should bear the cost of punishing defectors make self-enforcement ineffective in many situations.” NORTH, supra note 10, at 50. A major part of the difficulty arises from the high costs of “measuring the multiple margins that constitute contract performance.” Id. at 54.

30 I leave aside the possibility that what matters for reputational purposes is the mere fact that the host state and a particular investor are publicly feuding. In that case, the existence of the dispute might be taken as powerful prima facie evidence of a poor investment climate, regardless of the objective merits of any associated legal arguments or of the “true” factual state of affairs. The ultimate question is one of the informational value of an investor’s (or its home state’s) public claims of breach. Given inherent legal and factual uncertainties and strategic incentives to exaggerate and mislead, I assume that most third-party observers will in most cases attach little value to rhetorical claims of breach absent authoritative adjudication of the underlying claims.

31 Guzman, supra note 23 at 1873.
law: promises to permit investors to transfer funds out of the host country, promises of MFN treatment, promises to recognize the subrogation rights of home states, promises to restrain from imposing performance requirements on investors, and so on. But in an absolute sense, and as I have already argued, these additional promises are typically framed in language that is far from clear and precise. And in a relative sense, it is quite difficult to argue that customary law was less clear. Indeed, it is perfectly clear that custom has nothing to say on these topics, and that whatever obligations might exist would necessarily have to derive from other sources, such as municipal law or investment contracts.

Even where BITs do treat topics traditionally covered by customary international law (such as expropriation), the treaties typically add little in the way of meaningful additional content, clarity, or precision. Indeed, the United States argues that the most important treaty promises, such as those requiring “prompt, adequate, and effective” compensation or those requiring “fair and equitable” treatment or “full protection and security”, merely incorporate by reference the same protections that were already available under custom. The position is not unreasonable. UNCTAD agrees that “[m]ost [BITs] tend to restate traditional principles of customary international law with respect to the treatment of foreign property abroad.” The consequence is that international arbitrators have great latitude to “make” law when interpreting and applying the treaties. As Snyder put it,

the transnational standard of protection for foreign property is controversial and unsettled. . . .

...arbitral tribunals engaged in resolving foreign investment disputes have an opportunity to fashion a ‘jurisprudence’ in much the same way pioneering juridical or quasi-juridical bodies in the past have had to do so. It is a challenge which requires the apt welding of theory and reality.

The fundamental issue, then, is one of distinguishing between the existence of an obligation and its clarity of meaning or application. BITs certainly commit host states to something. That something

32 At the instigation of the U.S. Government, NAFTA’s Free Trade Commission issued a legally binding “clarification” that Chapter 11’s promises of “fair and equitable” treatment and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens,” and that the “minimum standard” of treatment imposed by NAFTA was no more than that same customary standard. Statement on NAFTA Article 1105 and the Availability of Arbitration Documents, 31 July 2001, available at http://www.naftaclaims.com/commission.htm. And it has long been recognized that one of the primary aims of the U.S. BIT program has been to codify U.S. understandings of customary international law, particularly in regard to compensation for expropriation. Kenneth J. Vandevelde, The Bilateral Investment Treaty Program of the United States, 21 CORNELL INT’L L.J. 201, 212 (1988).

33 UNCTC 1988, supra note 14 at 9.

34 Snyder, supra note 8, at 683.
appears to be largely investor-friendly, but what exactly the obligation will entail in particular cases can be quite obscure. For that reason, it is not theoretically plausible to consider investment treaties’ core substantive promises to be meaningfully “credible” in and of themselves. Indeed, there is good reason to suspect that investment treaties, by making broad and vague promises to indiscriminate classes of investors, may make disputes even more likely.

III: BITs, Credible Commitment, and the Role of Arbitration

What is theoretically necessary to render BIT promises meaningfully credible is investor access to authoritative adjudication. As North has argued, effective institutional solutions to the credible commitment problem entail “not only creating the formal rules but creating and implementing a judicial system that will impartially enforce such rules.”35 It is through adjudication that vague standards of treatment are given useful legal content,36 and that inevitable factual disputes are resolved. And access to international arbitration, as opposed to access to municipal courts in the host state, is essential because investors typically assume that municipal courts in developing countries will lack the technical competence or neutrality to adequately and fairly resolve investment disputes.37 Wälde’s recent and quite forceful statement of the point is worth quoting at length:

It is the ability to access a tribunal outside the sway of the Host State which is the principal advantage of a modern investment treaty. This advantage is much more significant than the applicability to the dispute of substantive international law rules. The remedy trumps in terms of practical effectiveness the definition of the right.

…

The effectiveness of substantive rights is everywhere – but nowhere more so than in investment disputes – linked to the availability of an effective enforcement (i.e. independent) enforcement procedure. This link is so close that the best way to emasculate an investor’s right against a host State is to sever the link between an international-law-based right and an


36 Indeed, some would say that by definition standards are given useful content after the fact through adjudication. Louis Kaplow, Rules Versus Standards, 42 DUKE L.J. 557 (1992).

international enforcement procedure and to compel the investor to seek justice before domestic courts. *Right and procedural remedy are, in practical and effective terms, one.*

The immediate benefits of authoritative interpretation are twofold. Most immediately, an investor in possession of a favorable international arbitral award has the very real ability to enforce the terms of the award *even in the face of continued host-state resistance.* This is because a network of important international treaties, including most prominently the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention), empower investors to seek award enforcement against host state property located in third-party states. For example, the New York Convention requires the courts of contracting states to enforce international arbitral awards unless one of several relatively strict conditions are met. The New York Convention currently has well over 100 member-states and is widely viewed as the most successful treaty of its kind, as it has encouraged national courts to give far greater deference to international arbitral awards than they did in the past. The ICSID Convention creates a specialized international arbitral institution, situated within the World Bank and designed exclusively to mediate and decide investment disputes between foreign investors and host states. The ICSID Convention currently has over 150 signatories, and the terms of the Convention obligate the domestic courts of those contracting states to enforce ICSID awards as if they were final judgments by a domestic court, with no possibility of collateral attack. These treaty-based judgment-enforcement provisions are far from worthless. To cite just one recent example, a German investor who won an investment treaty award against the Russian government has been able to enforce the award by seizing “a $40 million Russian-owned apartment complex in Cologne that once served as the local KGB outpost.”

More abstractly, but perhaps even more importantly, authoritative, impartial arbitration awards have the tremendous potential to increase the reputation costs of the host state’s breach by publicly clarifying both the facts surrounding the dispute and the content of the relevant legal rules, and by applying those facts to the rules. While it is true that most arbitral awards are “confidential” in the sense that they are not regularly published by the tribunals themselves, there is a very real possibility that an

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38 Wälde, *supra* note 13, at 194. Wälde is not alone in viewing access to arbitration as the “greatest innovation” of BITs. A recent arbitral decision makes the point as well. *Enron Corp. v. Arg. Rep.*, Decision on Jurisdiction (Ancillary Claim), Aug. 2, 2004, ICSID Case No. ARB/01/03, ¶ 37.


An investor possessing a favorable award will circulate it widely among his fellow investors in the event that the host state attempts to avoid respecting it.

The problem for BIT analysts is that not all BITs provide access to international arbitration, or provide it comprehensively, or provide it with absolute certainty. These extremely important differences in “procedural” (or perhaps more properly “remedial”) content suggest that BITs, as potential credible commitment devices, are not created equal, and that some treaties are likely to have far less value to investors than others.

Let me add an important caveat. The basic argument—that procedural distinctions matter conceptually—is premised on the assumption that an MFN clause in a investment treaty that does not contain an effective, comprehensive pre-consent to arbitration cannot be used to take advantage of a pre-consent provided in another treaty. This is admittedly a “delicate” question currently subject to substantial debate, but the limited jurisprudence on the issue suggests that arbitral tribunals are very unlikely to premise jurisdiction on an MFN clause where the treaty otherwise provides the investor with no right to unilaterally initiate arbitration as to the particular dispute at hand.

Figure 4, below, illustrates the results of a comprehensive analysis of the investor-state dispute settlement provisions (or lack thereof) in the BITs or BIT-like FCNs of 18 of the most important capital-exporting states: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Historically these states have supplied between 84 and 99 percent of annual world FDI flows over the past 30-some years. (The numbers are for the years 1993 and 1970 respectively). And when share of FDI outflows is considered on an annual basis, the identity of the top countries remains remarkably

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42 I am aware of three recent arbitral decisions that have taken a very restrictive view of the applicability of MFN clauses to dispute settlement provisions: Vladimir Berschader and Michael Berschader v. Russian Federation, Telenor Mobile Communications A.S. v. Republic of Hungary, and Plama Consortium Limited v. Republic of Bulgaria all rejected the investors’ claims that an MFN clause should be allowed to transform a “partial pre-consent”, as defined below, into a “comprehensive pre-consent” that would allow the investor to force arbitration of non-expropriation treaty claims. The three cases are discussed in UNCTAD, Latest Developments in Investor-State Dispute Settlement, UNCTAD/WEB/ITE/HA/2006/11 (2006).

43 These percentages are based on my calculations from FDI data compiled by UNCTAD’s Division on Investment, Technology and Enterprise Development and available on UNCTAD’s website, www.unctad.org.
stable; only those countries at the very bottom of the ranking, such as Austria, tend to fall in or out of the top 18 in any given year.

I obtained full-text copies of the various treaties, and where possible I evaluated each treaty’s content in its official language or as professionally translated by the United Nations. Where a treaty was available only in a language which I do not read (in nearly all cases Italian or German) I had a native speaker evaluate or translate the relevant passages. Drawing heavily on Schreuer’s authoritative discussion of the topic, I placed each treaty each of the four categories described immediately below. The texts of many of the treaties are available on either on UNCTAD’s website or in the Oceana Publications Inc. looseleaf series “Investment Treaties.” But neither source independently or jointly provides a universally comprehensive selection of treaties. Where a treaty was not available in either source, I was typically able to locate a copy by contacting the relevant home country foreign ministry. But in seven instances I was unable to obtain a full text of the relevant treaty, despite repeated contacts with the appropriate foreign officials. In each of these seven cases I evaluated the treaty as containing an effective and comprehensive pre-consent based on each treaty partner’s contemporaneous BIT practice, though in truth the evaluation is at best an educated guess. The full texts of investment treaties between pairs of developing countries are available on a very spotty basis. It is mainly for that reason that I do not include developing country BITs in this Article’s analysis.

I should also caution that I only code the dispute settlement provisions of treaties that have entered into force, and that the statistical analyses that follow in later chapters also rely primarily on treaties that are in force and not merely signed. This focus contrasts with the overriding tendency of most other empirical BIT analysts, who count the presence or absence of BITs on the basis of dates of signature rather than dates of entry into force, and who do not take into account whether a signed BIT is in fact eventually ratified by both parties.

I focus on treaties that have entered into force mainly for practical reasons, but there are also good theoretical reasons for doing so. As a practical matter, it can be difficult or impossible for the analyst to determine whether a signed treaty that has not entered into force actually exists, and if it exists, what it might contain. States supply copies of their treaties to the United Nations for publication in the United Nations Treaty Series very haphazardly and only after entry into force (and sometimes long after entry into force). States also tend to publish the texts of treaties in their national legislative gazettes only after ratification. Only very recently have capital exporting states, but rarely developing countries, begun

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to post reasonably up-to-date, comprehensive and accessible lists of their BITs online. And even in these fortunate cases, links to treaty texts may not be provided, especially if the treaty is not yet ratified or in force.

More theoretically, it would seem quite relevant for purposes of credible commitment that, as a formal legal matter, a signed treaty that has not entered into force commits the host state to nothing of value to the investor. Almost all investment treaties are subject to ratification procedures by one or both parties, and the treaties almost always explicitly provide that they will not enter into force until some short period after those domestic procedures are fulfilled and the ratified documents have been formally exchanged or deposited. The act of signing the treaty neither creates an obligation to ratify the instrument nor establishes the signing parties’ consent to be bound by the treaty. Where a treaty has failed to enter into force, neither the substantive nor procedural provisions contained therein will likely have any legal force. Most critically for the foreign investor, arbitral tribunals are highly unlikely to accept jurisdiction on the basis of a treaty-based state pre-consent where the treaty has only been signed. Even where a BIT eventually does enter into force, the treaties almost always specify that disputes arising prior to entry into force do not benefit from treaty protections.

This is not merely an academic point. Most investment treaties are ultimately ratified and do enter into force, but some do so only after long delays, and some not at all. Brazil, perhaps Latin America’s greatest success story in terms of attracting FDI, has signed 14 BITs as counted by UNCTAD, but ratified none. None of Colombia’s four UNCTAD-identified BITs has entered into force. A number of United States BITs have also failed to enter into force, including the 1994 treaty with Russia. More generally, a recent UNCTAD study found that of 2,392 BITs signed by 2004, 674 had not entered into force; of those 674 treaties, more than 300 had been signed five or more years earlier. And only 44% of African BITs signed by 2004 had entered into force, a percentage significantly lower than the equivalent figures for other regions.

45 See, e.g., IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 582-83 (6th ed. 2003). I am aware of any serious evidence that a state’s failure to ratify a signed treaty imposes upon it any significant reputation costs, either in the eyes of investors or other states.


47 Id. at 4.

48 Id. at 4 Table 2.
These are problematic truths for extant analyses that rely on credible commitment explanations, because the core idea of the credible commitment thesis is that investors are aware of the relevant treaties, reasonably view the treaties as formally committing host states to something of significant value to the investor, and take the presence of that formal commitment into account when making investment decisions. In fact, there is slim direct evidence that investors have historically had any significant awareness of the existence or potential significance of treaties that have entered into force, let alone treaties that have merely been signed and which have no formal power of commitment. For example, a small survey of business executives conducted in 1976 found that only 16 percent of respondents were “familiar” with ICSID, that only one quarter of that 16 percent felt that ICSID provided “adequate safeguards.” These results led the authors to conclude that ICSID needed to mount a major promotional campaign. It is highly unlikely that investor awareness or appreciation of specific BITs was any higher. I would wager it was strikingly lower. Perhaps even more revealing is the title of a recent practitioner-oriented publication, “Arbitration under Bilateral Investment Treaties: An often overlooked tool,” which suggests that additional promotional efforts may still be needed. And while anecdotes should always be approached with extreme caution, my own informal conversations with practicing international lawyers suggest that BITs rarely enter into the investment-making process in any concrete and significant way, and that far more important are rather mundane considerations relating to what might be called the “ease of doing business.” Along the same lines, an analyst at a major state-sponsored investment insurance agency told me that the impression of his agency colleagues was that, with the possible exception of investors in the oil and gas sectors, investors are often “unaware of or unfamiliar with BITs and their existence or lack thereof in their countries of interest.” In short, the point is that it seems quite doubtful—that this is admittedly an assertion of opinion and not of fact—that the mere signing of a treaty is either a public or confidence-inspiring enough an event to decisively influence investment decisions.


51 In some cases, the date on which a particular party has ratified a BIT may be the most theoretically date. Unfortunately, dates of ratification are typically very difficult to obtain, and where a treaty has been signed but has failed to enter into force, or only entered into force after a long delay, it will usually be impossible for the analyst to determine if the delay is due to one party or the other (or both) without conducting expensive and time-consuming research into the bowels of difficult-to-obtain national legal gazettes. It seems fair to admit that in some cases, constitutionally mandated procedures may delay ratification by the capital-exporting state, which otherwise would seem to have no rational reason to resist ratification. There have been some complaints, for instance, that Belgium’s federal system needlessly delays the entry into force of that state’s BITs. Willem Van de Voorde, Belgian Bilateral Investment Treaties as a Means for Promoting and Protecting Foreign Investment, 44 STUDIA DIPLOMATICA 87, 92 (1991). In other instances (and I suspect these to be the most common) BITs that fail to enter into force fail
highly publicized investor-state arbitrations.\textsuperscript{52} The rise of litigation and its prominence in the major newspapers makes it likely that many more investors are aware of ICSID and BITs than they were just a few years ago. Even if this is the case, however, it remains to be seen whether greater awareness decisively influences investment decisions.\textsuperscript{53}

\textit{Comprehensive, Effective Pre-Consents.} BITs that have the greatest capacity to function as meaningful credible commitment devices are those that contain comprehensive, effective pre-consents to investor-initiated arbitration. In these truly “modern” treaties, each state agrees in advance of any particular dispute to allow future investors to unilaterally initiate arbitration in the event of an “investment dispute,” broadly defined, before particular arbitral tribunals. These pre-consents can be very explicit, but they can also be implicit if still very clear in their implications. For example, an explicit pre-consent might provide that “Each Contracting Party hereby consents to the submission of an investment dispute to international arbitration [as specified above].”\textsuperscript{54} Implicit pre-consents include those that contain “formulations to the effect that a dispute ‘shall be submitted’ to [arbitration] or that [the investor has] the right to initiate proceedings”.\textsuperscript{55} The German Model BIT provides a typical example: “If the divergency [sic] cannot be settled within six months…it shall, at the request of the [investor], be submitted for arbitration. Unless the parties to the dispute agree otherwise, the divergency shall be submitted [to ICSID].”\textsuperscript{56}


\textsuperscript{53} Swenson takes a contrary view, arguing that “[i]n some cases…it is likely that investors may invest in the host country before the BIT signing takes place, since the investors confidently anticipate that their [pre-BIT] investment will soon receive further protections when the signing occurs.” Deborah L. Swenson, \textit{Why Do Developing Countries Sign BITs?}, 12 U.C. DAVIS J. INT’L L. & POL’Y 131, 147 (2005). The extent to which this might be true is left for the reader to judge; I suspect that the mere possibility that a host state will sometime in the future sign a BIT is rarely if ever a decisive factor in actual foreign investment decisions, even assuming that investors have the wherewithal to identify, monitor, and evaluate the prospects of ongoing and often secret diplomatic negotiations.

\textsuperscript{54} SCHREUER, supra note 44, at 293 (quoting Art. 12 of the 1991 Switzerland-Ghana BIT).

\textsuperscript{55} Id. at 213.

\textsuperscript{56} Id.
ICSID is a very frequent beneficiary of investment treaty pre-consents, though investment treaties are also used to pre-consent to privately organized institutional arbitration, such as through the International Chamber of Commerce (ICC), or to ad hoc arbitration. I assume here that differences in the forum offered are largely immaterial. The key point is that no matter what the forum, once a standing offer to arbitrate has been accepted by the investor, the host state will find it very difficult to convince the tribunal to decline to authoritatively decide the dispute. Arbitral tribunals tend to interpret state offers to arbitrate generously, and given the very real possibility of an adverse default award, states have an important incentive to participate in proceedings.

**Limited, Effective Pre-Consents (“Partial Pre-Consents”)**. A certain number of BITs contain pre-consents of extremely limited scope. These treaties typically involve a communist state, and offer the state’s consent to arbitrate only certain kinds of disputes – typically disputes over the amount of compensation due in cases of expropriation, and sometimes also including disputes over the freedom to transfer investments and proceeds out of the host state. Left completely uncovered are disputes relating to the treaty’s other substantive promises. The lacuna is conceptually significant for at least two reasons. First, and most importantly, BITs derive much of their credible commitment power from giving investors the ability to threaten the host state with litigation over the meaning and applicability of vague substantive promises, like “fair and equitable treatment,” in order to persuade the host state to abandon or avoid a wide range of potential actions adverse to the investor’s interests. Excluding the possibility of litigation over such matters removes the most important arrow from the investor’s quiver. Second, while protecting against the threat of uncompensated expropriation was the principle concern of investors of an earlier era, today the risk of such expropriation, traditionally understood, is objectively

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57 A state that has ratified the ICSID Convention agrees to abide by ICSID’s rules and is eligible to use the ICSID system to resolve investment disputes. However, merely ratifying the ICSID Convention does not give investors the right to initiate arbitration against the ratifying state; some further expression of state consent to arbitrate is necessary. Thus the need for consents in BITs or elsewhere. See generally Hirsh, Moshe, The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes (1993).

58 Schreuer, supra note 44, at 219.

59 Id. at 213.

60 ICSID Convention, supra note 49, Art. 45.

61 See Preiswerk, supra note 23, at 195.

62 Wälde, supra note 13, at 201.
This suggests that treaties that only provide guaranteed access to arbitration for expropriation disputes fail to cover the most common, modern sources of investor-state tension. And while it is difficult to say precisely how much less valuable these kinds of treaties are compared to those that offer investors comprehensive pre-consents, it is quite reasonable to presume that they are significantly less valuable.

Promissory Pre-Consents. It should be obvious that pre-consenting to investor-initiated, enforceable arbitration for a wide range of investment disputes risks seriously constraining a host state’s policy autonomy. Presumably for that reason a number of states have sought to regulate their potential exposure to crippling adverse awards by offering investors carefully-tailored promises to consent to arbitration rather than actual pre-consents. Article 11 of the 1982 Japan-Sri Lanka BIT provides an excellent example of a promissory pre-consent: “Each Contracting Party shall, at the request of the [investor], consent to submit any legal dispute … to…arbitration.” Lest this distinction strike the reader as so much lawyerly hair-splitting, let me in defense follow Schreuer in suggesting that the difference between a consent and a promise to consent can be quite significant legally, and that a belief that BITs matter is typically a belief that law in all of its formal nuance matters. The significance is this: when a state has promised to consent to arbitration in a treaty, a refusal to actually consent when the investor so demands is indeed a breach of the treaty under international law. But in the face of such a refusal, no matter how illegal, an international arbitral tribunal will not exercise jurisdiction over the dispute, because arbitral jurisdiction always and necessarily depends on the actual consent of the parties. This much is quite clear. Less clear is whether the reputational costs of breaching a promise to arbitrate will typically be so great that a promise to consent is for all practical purposes of as much value to the investor as an actual pre-consent. My own sense, defensible but certainly debatable, is that a promise to consent is worth considerably less to the investor than an actual consent, because it leaves the investor wholly exposed in those instances where the host state sees the most benefit in ignoring its substantive obligations to the investor.

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64 SCHREUER, supra note 44, at 216.
65 But once consent has been given and accepted by the other party, it can be difficult or impossible for one party to withdraw its consent unilaterally. ICSID Convention, supra note 49, Art. 25(1). This rule is what makes a BIT pre-consent effective. Once offered by the host state and accepted by the investor, the host state cannot meaningfully avoid its obligation to arbitrate at the investor's choosing.
No Pre-Consent. Finally, many early BITs contain no investor-state dispute-settlement provisions whatsoever. A handful of these early treaties contain mere hortatory expressions of a willingness to consider arbitration. For example, the Netherlands-Yugoslavia BIT of 1976 provides that the host state “shall give sympathetic consideration to any request” by the investor to arbitrate a dispute. These kinds of treaties have no theoretical potential to credibly commit host states to treat investors favorably.

Figure 4: Comparing UNCTAD’s Count of Signed, Undifferentiated BITs to BITs in Force, Differentiated by Dispute Settlement

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66 Schreuer, supra note 44, at 217.
The solid gray line in Figure 4 shows the cumulative number of signed BITs through 1999 as listed on UNCTAD’s year 2000 list. UNCTAD’s list contains a number of obvious errors and omissions which most empirical BIT analysts neither notice nor correct. I leave these errors and omissions uncorrected in constructing UNCTAD’s count, but I correct them in constructing my own BIT counts. For example, UNCTAD erroneously includes a number of treaties that are not properly considered to be “BITs” because they do not contain the core substantive provisions discussed above. Most notably, UNCTAD includes a number of conceptually distinct “investment guarantee treaties,” which apply largely or wholly to the capital-exporting states’ investment insurance programs, and a number of “establishment treaties” between France and its ex-colonies that relate to the creation of the Communauté Française d’Afrique (CFA) and which are essentially distinct in character and content from modern BITs. I have deleted those non-BIT treaties from my own count.

UNCTAD’s list also inexplicably fails to include a relatively large number of Germany’s initial BITs, including treaties with Kenya, the Philippines, Ghana, Colombia, and Chile. This absence is puzzling because UNCTAD’s list does include other German BITs that failed to enter into force, such as its 1964 BIT with Ethiopia. UNCTAD’s list also leaves out a BIT-equivalent 1964 “exchange of letters”
between Germany and India. I have included these missing German BITs in my own counts where conceptually appropriate.

We see a steady rise in the number of signed BITs (beginning with Germany’s 1959 treaty with Pakistan) up until the late 1980s and early 1990s, with a fairly dramatic increase in the rate of new signings beginning about that time. This general pattern has, of course, been well-documented by others. What makes Figure 4 interesting is its rather dramatic illustration of the extent to which the standard way of counting of BITs both misstates the timing of the BIT phenomenon, understood as a credible commitment phenomenon, and grossly overstates its importance, especially in the early years. The solid dashed line shows the cumulative number of (1) in-force BITs that (2) contain comprehensive, effective pre-consents, through the year 2002. By these two criteria the BIT phenomenon did not begin until 1969, when a BIT between Italy and Chad, signed that same year, entered into force. Furthermore, the rate of modern (e.g. strong) treaties entering into force remained remarkably low until the early 1990s.

In order to better examine trends in the different kinds of BITs that are obscured by the scale of the previous figure, Figure 5, below, reproduces the disaggregated annual count of in-force BITs for the years 1967-2002 omitting the UNCTAD count of signed BITs.

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67 For a comprehensive list and detailed discussion of the early German BITs, see generally Klebes, supra note 25.
We see again that the BIT phenomenon, understood as a credible commitment phenomenon, by which I mean strong, in-force BITs, is primarily a phenomenon of the 1990s. The majority of BITs in force until the early- to mid-1990s were weak BITs—those containing no trace of investor-state dispute settlement provisions—and BITs with highly imperfect such provisions. Strong BITs, illustrated by the solid black line, did not become numerically important in a relative sense until approximately 1993. Furthermore, we see quite clearly that a large number of non-strong BITs remained in force over the 1990s. In 2002, for instance, 66 “partial pre-consent” treaties, which grant investors enforceable rights to arbitrate only a limited class of disputes, remained in force. We also see that BITs with promissory pre-consents are relatively rare; in 2002 only 28 of these kinds of treaties were in force. What the figures don’t show, however, is that particular capital-exporting states are especially prone to use them. For example, six of Japan’s nine BITs contain promissory pre-consents, as do ten of Australia’s 18 BITs. Australia’s BITs are very subtle in this regard. They generally contain a comprehensive, effective pre-consent to ad hoc arbitration, but only if Australia and its treaty partner have not joined the ICSID Convention. Where they both have done so, the ad hoc pre-consent becomes invalid, leaving the investor with the
sole option of seeking ICSID arbitration. But as to ICSID arbitration, each state party to the Australian treaties promises only that it “shall consent in writing to the submission of the dispute to the Centre within forty-five days of receiving such a request from the investor”—with the words “shall consent” indicating that the consent has not yet been given, but is only promised.68

The take-away point from Figure 5 is that our understanding of the timing and extent of the BIT phenomenon depends crucially on whether we disaggregate BITs by dispute settlement procedures. Figure 6, below, considers this point in more detail for two particularly important cases: the BIT programs of France and Germany. (The Dutch and Swiss BIT programs would show a similar pattern). France and Germany were at the forefront of the BIT phenomenon as UNCTAD identifies it, signing large numbers of treaties in the 1960s and 1970s, and historically both states have been very important sources of investment capital. But few if any of these states’ early treaties contain comprehensive, effective pre-consents to arbitration. (For clarity of presentation I have not included in Figure 6 French and German BITs that contain mere promissory pre-consents or pre-consents of limited scope; doing so adds only six BITs to either state’s count.) Again, the impact of the exercise is relatively dramatic: Germany and France’s “modern” BIT programs appear far less ambitious than they are commonly portrayed to be; they also appear to have commenced far more recently than is typically appreciated. It is particularly striking to note that German investors did not enjoy the protections of a modern BIT until 1988, when Germany’s treaty with Nepal entered into force. This is striking precisely because it is so often claimed that Germany initiated the BIT phenomenon, with the “success” of its early BIT program regarded with something approaching awe, envy, or both. In fact, however, measured by the presence of comprehensive, effective pre-consents, Germany’s BIT program appears to be neither all that “first” nor all that awesome. Note that for the entire period of study, France had more modern BITs in force than did Germany.

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68 See, e.g., Art. 11(4)(a) of the 1993 BIT between Australia and Indonesia.
Figure 6: Comparing Counts of BITs in France & Germany

Figure 7, below, compares the annual number of LDCs with at least one strong BIT in force versus the annual number of LDCs with no strong BITs in force, beginning with the first strong BIT to enter into force, Chad’s 1969 treaty with Italy, which entered into force that same year. The Figure provides further evidence that (strong) BITs did not become a numerically significant phenomenon until the late 1980s and early 1990s. Until 1993, a majority of capital-importing states had not entered into a strong BIT with a major capital-exporting country. But by the end of the sample (2002) we see that 117 out of 149 developing countries—79 percent!—had at least one strong BIT in force.
Differentiating BITs on the basis of dispute settlement provisions also has huge effects on what we might call the “effective” BIT count of particular capital-importing states. Hungary, for instance, has been one of the most economically successful Eastern European states but has never bothered to update its 15 outmoded BITs, most of which it signed in the 1980s and all but one of which limit investors’ access to arbitration to expropriation-type disputes. China’s 13 BITs also uniformly provide very limited pre-consents, a trend that has only just recently begun to change as China begins to anticipate relying on strong BITs to protect its own investments abroad, rather than primarily as a tool to attract inward investment.⁶⁹

What is the upshot of the argument so far? UNCTAD’s list of BITs, by failing to account for key procedural differences in treaty content and entry into force, provides a conceptually inadequate “count” of the degree to which states have credibly committed through bilateral treaties to treat investors well. Disaggregating BITs by dispute settlement provisions, and counting only BITs that have entered


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Figure 7: LDCs with One Strong BIT In Force vs. No Strong BITs in Force
into force, gives us a quite different picture of the chronology and scope of the BIT phenomenon, both
generally and as to particular states.

IV: Alternatives to BITs

Whatever the merits of the argument made in the previous Section, there are a number of other
reasons to be extremely wary of the use of UNCTAD’s list for theoretically driven empirical inquiry of
foreign investment policy. These additional problems stems from UNCTAD’s focus on treaties that are
bilateral and that deal exclusively with investment. The italics indicate the three problems to be discussed
below.

Multilateral Treaties as BIT Alternatives. That an investment treaty is bilateral rather than
multilateral has no relevance to the treaty’s potential value as a credible commitment device. It is true
that the most ambitious attempts to create investment treaties of world-wide scope have failed.70 But
there are important multilateral success stories. Chapter 11 of the North American Free Trade
Agreement (NAFTA) is the most obvious example. Other noteworthy examples include the Association
of Southeast Asian Nations’ (ASEAN) 1987 “Agreement for the Promotion and Protection of
Investments”;71 the 1994 Colonia Protocol for the Reciprocal Promotion and Protection of Investments
in MERCOSUR;72 and Chapter 17 of the 1994 free trade agreement between Colombia, Venezuela, and
Mexico.73 There is also the hugely important 1994 Energy Charter Treaty (ECT), a multilateral
agreement regulating energy-sector investments, broadly defined, between over 50 states.74 Analysts are
hard-pressed to justify the exclusion of these multilateral treaties from their samples, since it is beyond
cavil that these treaties offer investors substantive and procedural promises that are formally and
functionally equivalent to those provided in modern BITs.

70 The failed OECD Multilateral Agreement on Investment being the most recent example. A text of the agreement
and various other related documents are available on the OECD website, www.oecd.org.

71 The original parties to the 1987 ASEAN agreement were Brunei Darussalam, Indonesia, the Philippines,
Singapore, and Thailand. Laos, Myanmar, and Vietnam later joined as well. The text of the agreement, as amended
and with various protocols, is available on the ASEAN website at www.aseansec.org/12799.htm.

72 The MERCOSUR text is available at www.sice.oas.org. MERCOSUR comprises Argentina, Brazil, Paraguay, and
Uruguay.

73 This and other Latin American FTAs are available at www.sice.oas.org.

74 The ECT and associated documents and information are available at www.encharter.org/index.jsp.
There are more difficult cases. Take, for example, the 1982 League of Arab States’ “Unified Agreement for the Investment of Arab Capital in the Arab States”, signed by 22 states and ratified by 20.\textsuperscript{75} While the tone and content of this particular agreement are undeniably less investor-friendly than modern BITs, the treaty does offer investors (sometimes carefully hedged) promises of MFN and non-discriminatory treatment, freedom to transfer investment proceeds, the right to “fair” compensation in the event of non-discriminatory expropriation, and the right to “compensation…equivalent to damages” in the event the host state breaches the treaty. The treaty also offers investors the possibility of bringing suit against a breaching host state before the “Arab Investment Court”, a specialized dispute settlement body that came into being in 1988. Whether the Unified Agreement should or should not be considered a BIT equivalent is a question that I need not answer definitively here; the larger point is that the careful analyst will need to (carefully) consider whether it should be counted as one for the particular analysis at hand.

Incorporating multilateral investment agreements into extant analyses of BITs can present a number of other subtle considerations. For example, several ASEAN members have signed BITs between themselves, both prior to and even after signing on to ASEAN’s BIT-like investment provisions. To cite just two cases, Vietnam joined ASEAN in 1995, but had already signed BITs with Indonesia, Thailand, Malaysia, and the Philippines as of 1992. Thailand, an original member of ASEAN, signed the 1987 ASEAN investment agreement, yet subsequently signed BITs with the Philippines and Indonesia in 1995 and 1998 respectively. This practice raises a rather obvious potential problem of double-counting that must be taken into account before blindly adding an additional seven BITs to each ASEAN member country’s total count.

Incorporating the ECT into extant analyses poses a particularly significant challenge, because unlike most BITs the ECT is a sector-specific agreement. An ECT between France and Poland is clearly not of the same import as a BIT of general application between those two states, and the presence or absence of a sector-specific agreement like the ECT necessarily needs to be appropriately weighted. The most obvious weighting scheme might consider the relative importance of the energy sector to the member states’ total potential supply of FDI. But whatever scheme is ultimately adopted, it is clear that

\textsuperscript{75} A copy of the Arab League treaty is provided in UNCTAD’s INTERNATIONAL INVESTMENT INSTRUMENTS: A COMPRENDIUM, Vol. II, p. 211. The treaty has been signed by Algeria, Bahrain, Comoros, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Oman, Qatar, Saudi Arabia, Syria, Somalia, Sudan, Tunisia, the UAE, and Yemen, and has been ratified by all of these states except Algeria and Comoros. \textit{Id.}
weight of some sort should usually be given. Because of the sheer number of countries that have bound
themselves to it,\textsuperscript{76} ignoring the ECT’s existence should not be an option.

\textbf{Commercial Treaties as Alternatives to BITs.} UNCTAD identifies a 1959 Germany-Pakistan
treaty as the “first” BIT because the treaty is indeed the first to deal with investment-related issues both
in a sustained way and exclusively and independently of other commercial issues.\textsuperscript{77} The claim that the
Germany-Pakistan treaty is meaningfully considered to be the first BIT has been repeated by many others. The conceptual problem is that exclusivity of subject matter is hardly sufficient to distinguish the
Germany-Pakistan treaty from a host of other previous and contemporaneous “commercial” treaties.
These treaties were often entered into under the label of “friendship, commerce, and navigation” or
something similar, and provide investors with certain guarantees while also dealing in the same document
with issues of more immediate concern to traders and ship captains.

To appreciate the potential scope of the issue, note that the United States has negotiated FCN-
type treaties since the early days of the Republic.\textsuperscript{78} France, Germany,\textsuperscript{79} Japan,\textsuperscript{80} and the United
Kingdom\textsuperscript{81} have pursued roughly similar commercial treaty programs. The primary focus of the earliest
commercial treaties was on regulating trading and merchant relations, with issues of interest primarily to
investors covered only accidentally or incidentally.\textsuperscript{82} But over time the treaties became significantly more

\textsuperscript{76} Fifty-one states have currently signed the ECT; using the standard mathematical formula for calculating
combinations of pairs, \(\frac{N!}{(N-2)!2!}\), the ECT might be viewed as representing the rough equivalent of 1275
BITs! Of course, that number ignores the need to take into account the ECT’s limited sectoral coverage. Many
ECT states have also already signed full-fledged BITs with other ECT states, raising an issue of double-counting.

\textsuperscript{77} See, e.g., UNCTC 1988, \textit{supra} note 14 at 6 (emphasis added). \textit{See also} UNCTAD, Trends in International
Investment Agreements: An Overview, Doc. \# UNCTAD/ITE/ITT/13 (1999), at page 21. UNCTAD’s claim that
the Germany-Pakistan treaty is the first BIT has been widely echoed.

\textsuperscript{78} Wilson notes that the “first treaty of this type signed by the United States was the Treaty of Amity and Commerce
with France (1778)”. \textsc{Robert Renbert Wilson}, \textsc{U.S. Commercial Treaties and International Law} 2
(1960).

\textsuperscript{79} For a list and discussion of early French and German FCN-type “establishment” treaties, see \textsc{Roy Preiswerk},


\textsuperscript{81} Robin Burnett, \textit{Negotiation of International Agreements in the Field of Commerce and Investment—Problems of Relevance to

\textsuperscript{82} Herman Walker, Jr., \textit{Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice}, 5 \textit{Am.
concerned with addressing investment-specific needs, and after World War II the United States concluded a series of 21 modern FCNs with a wide variety of developed and developing countries. One of the “major purpose[s]” of the post-war FCNs was to “to protect…investment abroad.” Many FCN-type treaties are still in force, and they are occasionally invoked by or on behalf on investors before municipal and international tribunals. Most importantly, the guarantees provided to investors in the FCNs are in many cases identical in form and substance to investment-only treaties.

It is particularly instructive to compare the main investor-related provisions of the 1959 United States-Pakistan FCN with the Germany-Pakistan BIT from the same year, as Table 1 does below.

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86 This is a point very well made by Sachs in regard to the United States BIT program. Wayne Sachs, The “New” U.S. Bilateral Investment Treaties, 2 Int’l Tax & Bus. Law. 192 (1984). The inverted commas indicate Sachs’ deep skepticism about the novelty of the U.S. effort, which, as Sachs demonstrates convincingly, draws much more deeply on the U.S. FCN treaties than most observers acknowledge.
### Table 1: FCNs vs. BITs

<table>
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<th>Subject</th>
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<th>1959 Germany-Pakistan BIT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Preamble/Object &amp; Purpose</strong></td>
<td>“encouraging mutually beneficial investments, promoting mutually advantageous commercial intercourse and otherwise establishing mutual rights and privileges”</td>
<td>“Desiring to intensify economic cooperation…, Intending to create favorable conditions for investments… promoting investment, encouraging private industrial and financial enterprise”</td>
</tr>
<tr>
<td><strong>General Standard of Treatment</strong></td>
<td>Treatment “no less favorable than other enterprises of whatever nationality engaged in similar activities” (Art. VII); freedom from “unreasonable or discriminatory measures” (Art. VI(3)); “the most constant protection and security” (Art. VI(1)).</td>
<td>“non-discrimination” (Arts. 1(2) &amp; 2); “protection and security” (Art. 3(1)).</td>
</tr>
<tr>
<td><strong>Expropriation</strong></td>
<td>Allowed only for “public purpose” and against “prompt payment of just compensation” that is “effectively realizable” (Art. VI(4)).</td>
<td>Allowed only for “public benefit” and against “compensation” that is “actually realizable” and “equivalent of [sic] the investment affected” (Art. 3(2)).</td>
</tr>
<tr>
<td><strong>Transfers</strong></td>
<td>Freedom to transfer “funds” on national treatment or most favored nation basis (Art. XII(1)).</td>
<td>Freedom to transfer “invested capital and returns” “without undue delay” and at “just and reasonable” rate of exchange (Arts. 4 &amp; 6).</td>
</tr>
<tr>
<td><strong>Dispute Settlement (State-State Only)</strong></td>
<td>Disputes between states “as to interpretation or application” subject to compulsory arbitration before the International Court of Justice (ICJ) (Art. XXIII(2)).</td>
<td>Disputes between states as to “interpretation or application” subject to compulsory ad hoc international arbitration (Art. 11).</td>
</tr>
</tbody>
</table>

The similarities are undeniably striking, and the conclusion, I think, is unavoidable: if the Germany-Pakistan treaty is a conceptually relevant BIT, then the United States version must be considered one as well.

The practical importance of this point will, of course, vary according to the particular analysis. Many of the United States’ post-war FCNs were concluded with what today are considered to be firmly “developed” countries: Belgium, Denmark, Germany, Greece, France, Japan, Italy, Ireland, Luxembourg, and the Netherlands. Most analyses of the BIT phenomenon are primarily concerned with explaining the treaties’ causes and consequences only as to developing countries. That a potentially equivalent treaty might exist between developed countries is, in those circumstances, arguably irrelevant. But the United States and several other capital-exporting states did sign BIT-like FCNs with a number of developing countries, and the failure of extant analyses to consider these FCNs as BIT-equivalent treaties is indefensible as long as the Germany-Pakistan BIT and others like it are also included in the analysis.
Indeed, that UNCTAD’s exclusion of the United States-Pakistan FCN (and other equivalent post-war FCNs) is entirely arbitrary is best illustrated by the fact that UNCTAD’s list of BITs inexplicably includes a host of FCN-type commercial treaties concluded by Switzerland, France, and Sweden in the years immediately following 1959. Why these treaties should be included on UNCTAD’s list, but not the United States-Pakistan FCN or others like it, is difficult to fathom.

How many BIT-like FCNs are at issue here? Not a great number, but not an insignificant number either. Table 2 lists the principle candidates for inclusion for four of the most important capital exporting countries. All of the FCN treaties listed below contain something arguably approximating what I have defined as the “substantive core” of modern BITs and involve “developing countries” (or countries that might fairly have suffered the name until quite recently).

Table 2: BIT-Like FCNs between Major Capital-Exporting Countries and Developing Countries

<table>
<thead>
<tr>
<th>United States</th>
<th>Japan</th>
<th>Germany</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethiopia</td>
<td>Argentina</td>
<td>Dominican Rep.*</td>
<td>Cameroon*</td>
</tr>
<tr>
<td>Haiti*</td>
<td>Cuba</td>
<td></td>
<td>Iran</td>
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<tr>
<td>Israel</td>
<td>El Salvador</td>
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<tr>
<td>Iran</td>
<td>India</td>
<td></td>
<td></td>
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<tr>
<td>Nicaragua*</td>
<td>Indonesia</td>
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</tr>
<tr>
<td>Oman</td>
<td>Malaysia</td>
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<tr>
<td>South Korea</td>
<td>Pakistan</td>
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<tr>
<td>Taiwan</td>
<td>Peru</td>
<td></td>
<td></td>
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<tr>
<td>Thailand</td>
<td>Philippines</td>
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<tr>
<td>Togo</td>
<td>Singapore</td>
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<tr>
<td>Vietnam</td>
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<td></td>
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<tr>
<td>Uruguay*</td>
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<td></td>
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<tr>
<td>Colombia*</td>
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</tbody>
</table>

*Never entered into force or no longer appears to be in force

Other commercial treaties are worthy of consideration. I have not included them in Table 2 because they emphasize investment-related issues to a significantly less degree than other FCN treaties. But this does not mean they are analytically irrelevant. Japan in particular entered into at least eight commercial treaties with Communist states that largely ignore investment but which nonetheless promise “nationals” and “legal persons engaged in business activities” MFN “treatment” in regard to their activities in the host state. It is very likely that these MFN provisions operated (and, to the extent these treaties remain in force, continue to operate) to fully extend most substantive BIT promises to Japanese investors operating in those (ex)-Communist states.
What to do about these largely BIT-equivalent FCNs? The solution, I think, is to dispose of the FCN treaties on principled ground. To the extent that the treaties fail to provide investors with guaranteed access to international arbitration (and all of them do) they should not be included in the analysis because they are not properly considered credible commitment devices of any significant potential. But if that is indeed a supportable position, then many other early investment-only treaties, like the Germany-Pakistan example, should be dropped from the analysis as well.

It should also be emphasized that an analytic focus on investment-only treaties ignores the modern trend toward embedding significant investment provisions, including guaranteed investor access to international arbitration, within free trade agreements. NAFTA’s Chapter 11 is the most well-known example, but a host of other multilateral and bilateral free trade agreements contain similar investment chapters. ASEAN and MERCOSUR have already been mentioned, but there are numerous other examples. Mexico, for instance, has signed FTAs containing BIT-equivalent investment chapters with Venezuela, Colombia, Chile, Nicaragua, Costa Rica, Bolivia, Honduras, El Salvador, and Guatemala, none of which are found on UNCTAD’s list.

Finally, note that commercial treaties, whether of the FCN or FTA type, are not the only multi-subject treaty-based source of BIT-like guarantees to investors. The best example is Protocol One of the European Convention for the Protection of Human Rights and Fundamental Freedoms, which provides foreign investors with an explicit guarantee that they shall not suffer expropriation in violation of the “general principles of international law” and legally binds most of Western and Eastern Europe, as well as Russia and Turkey. Other provisions of the ECHR and its associated protocols give covered “natural and legal persons” the right to bring enforcement actions against expropriating states before the European Court of Human Rights; the European Court of Justice can also decide investor-state property rights claims arising under Protocol One. That empirically minded BIT analysts have largely if not wholly failed to consider the European Convention as something approaching a BIT is quite

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87 The Organization of American States (OAS) provides a comprehensive list and links to the full texts of these and other inter-American trade and investment agreements. http://www.sica.oas.org.

88 European Convention for the Protection of Human Rights and Fundamental Freedoms, Protocol No. 1, Mar. 20, 1952, art. 1, 213 U.N.T.S. 262 (“Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law”). For a discussion of international cases brought under Protocol 1, Article 1, see Jon A. Staley, Keeping Big Brother out of Our Backyard: Regulatory Takings as Defined in International Law and Compared to American Fifth Amendment Jurisprudence, 15 EMORY J. INT’L L. REV. 349, 381-380 (2001).

89 Been & Beauvais, supra note 27, at 55.
troublesome. One of the central achievements of BITs is often said to be the reinforcement of customary international law principles of just compensation for expropriation.\(^90\) The European Convention does just that, and it does so on a remarkable scale.

Of course, many international treaties, and even some non-binding international agreements, contain provisions of potential relevance to foreign investors. Among these, the General Agreement on Trade in Services (GATS), the Treaty Establishing the European Community, and the OECD’s various Declarations and Codes on foreign investment\(^91\) stand out in particular, but there are many others of greater or lesser conceptual relevance, and of greater or lesser facial resemblance to the typical BIT. Of significant potential importance are the various “Partnership and Cooperation Agreements” (PCA) that states wishing to accede to the European Union are required to sign and which typically contain provisions promising foreign investors certain rights of establishment, non-discriminatory treatment, freedom to transfer capital, hortatory calls to promote foreign investment and to improve the investment climate, and so on--all very BIT-like promises.\(^92\)

Let me be clear that I am not arguing that these various non-BIT instruments should necessarily be “counted” as BIT equivalents in all studies. But I do think it is important for analysts to consider in a much more careful and theoretically self-conscious manner the extent to which such instruments might make BIT commitments redundant or unnecessary as credible commitment devices.\(^93\) For example, a PCA with the European Union, combined with the property protection provisions of the European Convention, comes perilously close to providing exactly the same guarantees contained in many

\(^90\) This seems to be Guzman’s view, for instance. See generally Guzman, supra note 11.

\(^91\) The OECD Declaration and Decisions on International Investment and Multinational Enterprises commit adhering states to provide national treatment to each other’s foreign investors. Mexico, Korea, the Czech and Slovak Republics, Poland, Hungary, and Turkey, all members of the OECD, have signed on, as have a number of non-OECD developing countries, including Argentina, Brazil and Chile. OECD members have also adhered to “codes” of “Liberalisation of Capital Movements” and of “Liberalisation of Current Invisible Operations.” The codes “constitute legally binding rules, stipulating progressive, non-discriminatory liberalisation of capital movements, the right of establishment and current invisible transactions (mostly services).” Compliance is encouraged through what the OECD calls “peer pressure exercised through policy reviews and country examinations to encourage unilateral rather than negotiated liberalization.” The quote is from the OECD website, www.oecd.org/document/63/0,2340,en_2649_34887_1826559_1_1_1_1,00.html.

\(^92\) See, e.g., Partnership and Cooperation Agreement between the European Communities and their Member States and the Republic of Moldova, signed Nov. 28, 1994, O.J. L181/27.

\(^93\) In some instances the acceptance of an international institutional alternative to BITs may legally preclude a host state from also securing an investment treaty. For example, French law prohibits the French government from signing BITs with African states that have the CFA currency union. See Patrick Juillard, Les conventions bilatérales d’investissement conclues par la France, 106 J. DROIT INT’L 274, 282-83 (1979).
Communist-era BITs, and I think it is exceedingly hard to justify considering the latter treaties to be theoretically meaningful but not the former.

I accordingly include BIT-equivalent commercial treaties, such as NAFTA, ASEAN, and the various FCNs, in the disaggregated counts of in-force BITs presented in the figures above and used in the statistical analyses in later chapters. In those analyses I also separately control for membership in the most important of the other close BIT substitutes discussed above.

The Need to Consider Non-Treaty Means of Credible Commitment. A study seeking to explain why people use umbrellas would surely be suspect if it ignored the possibility of foregoing umbrellas for raincoats or folded-up newspapers. To say that individuals choose to use umbrellas because umbrellas keep them dry begs the question of why they choose umbrellas and not rain slickers or the morning broadsheet. The same goes for any study of the effectiveness of umbrellas at performing their task. To conclude that umbrellas succeed in warding off wet clothes begs the question of whether success is to be measured in terms of the likely outcome of going out of the house unprotected or rain-coated.

The problem is one of identifying the proper comparison. Most BIT analysts seem to presume that the relevant comparison is indeed between going out in the world well-protected – e.g. protected by a BIT – or not protected at all. This presumption is particularly evident in Guzman’s elaboration of his cartel theory of the reasons “why LDCs sign [BITs] that hurt them,”94 but it is a presumption implicit in other BIT studies too. As presumptions go, this one is particularly unfounded. Some reasons have already been mentioned but nonetheless bear repeating: other kinds of treaties—multilateral rather than bilateral, commercial rather than investment-only—may contain provisions largely equivalent to those traditionally provided in BITs. But it is also essential to realize that states can provide BIT-like guarantees, of both a substantive and procedural nature, through formal non-treaty instruments such as municipal law and individual investment contracts. These treaty alternatives also have strong potential to function as substitute credible commitment devices.

Municipal Law. Take municipal law first. Recall that BITs perform two logically separate functions – they are devices through which host states can extend favorable substantive promises, and through which host states can make those promises credible. Non-specialists tend to assume that a host state’s decision to enter a BIT is necessarily a decision to significantly liberalize FDI policy – that is, that signing or ratifying a BIT is to extend to investors significantly more favorable substantive promises than

94 Guzman, supra note 11, at Id. at 644.
were being offered to investors absent the BIT. With the potential exception of U.S. BITs, which, as mentioned earlier in the Chapter, require national treatment at the pre-investment stage, this is simply not the case. Most BITs do not require host states to accept more investment, nor do most BITs prevent host states from imposing burdensome performance requirements on investors as a condition of entry. Instead, what might be called the “liberality” of a host state’s FDI regime is primarily determined by promises extended to investors through municipal law. For example, municipal law defines which sectors of the economy are open to foreign investment and on what particular terms; it determines tax rates, the availability of investment incentives, and conditions of operation. The vast bulk of what matters legally to foreign investors is supplied by municipal law, and indeed, this is unavoidable because BITs, as quite brief and general statements of the law applicable to investments of all types, are necessarily unable to provide investors or host states with a sufficiently detailed and self-contained legal regime. It is unsurprising that for much of recent history investment “framework” laws have been the primary means both of promoting and controlling foreign investment in the developing world.95

Municipal law is thus a necessary complement to BITs. But municipal law can also provide the same substantive guarantees as BITs, and it can provide them much more broadly. For example, domestic laws often contain fairly favorable rules concerning compensation for expropriation. Domestic laws also frequently specify that foreign investors in most sectors shall enjoy “national treatment.” Over the past decade host states have also used domestic law to greatly liberalize their capital accounts, allowing foreign investors much greater freedom to repatriate assets and income.96 And unlike BITs, which provide their guarantees only to investors from a single home state, municipal law guarantees are in principle extended to investors from the world over.

From the investor’s perspective, of course, the main problem with municipal law is the relative ease with which the host state may be able to change the laws in adverse ways. It is reasonable to presume that BITs might usefully serve to reduce state incentives to change municipal law in ways unfavorable to the foreign investor by providing causes of action for “regulatory takings” and the like. But the potential utility of BITs in this regard hardly means that favorable municipal law promises may not be made sufficiently credible by other means.

95 See, e.g., A.A. Fatouros, The Quest for Legal Security of Foreign Investments, Latest Developments, 17 Rutgers L. Rev. 257, 268-69 (1963) (discussing the “great number of statutes relating to the regulation and encouragement of foreign investments” that came into effect in the developing world in the early 1960s).

On the one hand, municipal law itself can make changes in the law formally difficult to achieve. This is particularly the case where, for instance, guarantees of compensation for expropriation are embedded in the national constitution, as they have been in most Latin American countries for some time. A more unusual example is provided by Greece, which in the past has used a special legal procedure to grant investment-related laws “special status” that constrained the government’s ability to amend the laws. On the other hand, host states can use municipal law to explicitly promise investors that the relevant legal regimes will remain stable as to their current investments. Article 9 of Russia’s 1999 Federal Law on Foreign Investment, which bears the unwieldy title of “Guarantees to Foreign Investors and Companies with Foreign Investment Against Unfavorable Changes in the Legislation of the Russian Federation”, is one particular example.

I do not wish to lend any sort of magical power of commitment to a host state’s unilateral legislative declarations that foreign investors are welcome on such and such terms. Bolivia’s very recent announcement of a “nationalization” of the assets of foreign-owned natural gas operations is a powerful reminder that in the law and politics of foreign investment what has gone around often comes around once again, and that a state that greatly values change in the status quo is unlikely to be dissuaded from vigorously pursuing it, though law or contract might inconveniently stand in the way. That said, it is reasonable to presume that a state that has explicitly and publicly made pro-investor promises in an investment law will indeed be more likely to think twice about changing the regulatory regime in ways adverse to foreign investors than one that has not, even absent a binding commitment to international arbitration. In other words, our old friend “reputation” has a potentially great role to play here, especially if breaches of municipal law promises, because of their relative clarity of meaning and application, are more easily detectable than breaches of vague treaty law.

Regardless of the role that reputation might or might not play in naturally stabilizing certain kinds of favorable municipal law promises, host states can also use municipal law to provide investors with guaranteed access to international arbitration, where claims of unfair changes in the substantive domestic legal regime (or other claims) can be litigated. Greece appears to be one of the earliest states to

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97 See generally LOWENFELD, supra note 26.

98 See in particular the Greek Investment and Protection of Foreign Capital Act of 1953, LD 2687/1953, which is reprinted in Oceana Publications’ looseleaf series INVESTMENT LAWS OF THE WORLD. The law promised that foreign investors would enjoy non-discriminatory treatment, that expropriation would be accompanied by payment of “full value”, as determined by agreement or by international arbitration.
embed a promise to arbitrate in its foreign investment laws,\textsuperscript{99} but it is certainly not the only example. Fatouros’s excellent 1963 survey of “investment guarantees” finds that states anxious to develop their petroleum resources were especially likely to provide for international arbitration of investment disputes through domestic laws.\textsuperscript{100} A more recent survey has found that approximately 20 national foreign investment laws contain “generic consent provisions offering to submit disputes with investors to arbitration under the ICSID Convention.”\textsuperscript{101}

Why does all this matter? It suggests, on the one hand, that BITs are not a necessary part of the “competition” for capital. To the extent that BIT promises are replicable in municipal law, host states might reasonably respond to a “competitor’s” decision to enter a BIT by offering investors equivalent promises in municipal law. Consider a more subtle point: even if municipal law is congenitally unable to function as a perfect BIT substitute, it nevertheless provides host states with a tool through which concessions can be made to investors that will, from the investor’s perspective, more than make up for the lack of an investment treaty. “Utility” is the currency of the land, and an investor should be willing to accept, as the price paid for the investment, more favorable investment incentives, tax breaks, or the like that will make up for the lack of a BIT. BITs become a necessary part of the “competition” for FDI only if the “competitors” are already offering investors all of the other policy concessions at their disposal. But there is little reason to think that they are.

The relevance of municipal law promises also suggests that disentangling the causal effects of BITs on FDI flows from the causal effects of contemporaneous, favorable changes in the domestic legal regime poses substantial difficulties that the statistically oriented empirical literature on BITs has yet to adequately address. Over the past fifteen years many host states have dramatically modernized and liberalized their foreign investment laws – opening up new sectors to foreign involvement (often by

\textsuperscript{99} FATOUROS, supra note 7, at 186.

\textsuperscript{100} Id. at 187 (discussing municipal law-based promises to arbitrate disputes related to investments in the petroleum sector in India, Pakistan, Greece, Libya, Morocco, Iran, and Mali).

privatizing state-owned enterprises and contracting out the provision of basic governmental services), relaxing joint venture requirements, eliminating investment screening boards and performance requirements, establishing investment promotion agencies and export processing zones (EPZs), and so on. It is undeniable that investors have attached “considerable value” to these changes when they have taken place.102 Take Mexico for instance. In 1993 Mexico enacted an ambitious new Foreign Investment Law – a “crown jewel” achievement representing an unprecedented “repudiation” of Mexico’s historically ambivalent and often hostile policies toward foreign investors.103 At virtually the same time Mexico signed its “BIT” with the United States and Canada – Chapter 11 of NAFTA – and joined the OECD and its international investment instruments. Which policy change is responsible for the resulting increases in Mexico’s foreign investment inflows? Would United States investors have flocked to Mexico absent NAFTA but with the protections and guarantees of the 1993 law? Are the contemporaneous OECD commitments safely ignored? I leave it to others to provide definitive answers, but there is some indication that Mexican authorities, at least, viewed Chapter 11 and the 1993 domestic legal changes as largely substitutable, and Chapter 11 as largely redundant to what Mexico was already ready to do—and ultimately did do—unilaterally. In their in-depth analysis of “how the [NAFTA] deal was done,” Cameron and Tomlin argue that Mexico accepted Chapter 11, and NAFTA more generally, because it “desire[d] to implement a radical agenda of economic restructuring within Mexico. NAFTA was the cornerstone of this policy, and many of the measures that Mexico was called upon to take in the NAFTA were ones that Mexican leaders had already decided to undertake anyway.” They add, “The policies [embedded in NAFTA] were, however, policies that could have been undertaken anyway, if not under the NAFTA, then under the auspices of the GATT, or even in some cases unilaterally. In some ways NAFTA was simply the culmination of a process of dramatic economic and social restructuring that had occurred, or was [already] occurring in Mexico.” 104

Investment Contracts. Municipal law is not the only plausible BIT substitute. Foreign investors, unlike private parties engaged in international trade, are often placed in the position of explicitly bargaining with host states over the terms under which they are allowed to establish their investment and


to continue operations.\textsuperscript{105} This is especially so in the natural resources sector,\textsuperscript{106} where the host state usually own the natural resources to be extracted, and in the public utilities or infrastructure sectors,\textsuperscript{107} where the investor is called upon to provide an essential public service, like the provision of electricity or a passable highway. But it is also true in the manufacturing sector (as more generally), where the foreign investor is typically required to enter into privity with the host state in order to receive special treatment, such as tax incentives or the right to operate in an EPZ.

The opportunity to bargain is important because it provides the foreign investor with the occasion to induce the host state to clarify the terms of the investor’s entry and operation, or to improve upon the promises offered under municipal or international law.\textsuperscript{108} Indeed, there is good reason to view the

\textsuperscript{105} As Sornarajah points out, in the typical international sales transaction the relationship is an arms-length one between private parties that, individually speaking, “has minimum impacts upon policy or other interests of the states with which the transaction would come into contact. It is not an intrusive transaction in that very little conduct relating to it takes place in either country and the duration of the course of that transaction is short.” Thus the importing state typically has little incentive to invest in costly contracting with individual traders as to the importing state’s obligations in regard to that particular trade, and is content to set trade policy on the national level while granting the private parties to the trade transaction relatively complete autonomy to structure their deal in the way the parties see fit. M. SORNARAJAH, THE SETTLEMENT OF FOREIGN INVESTMENT DISPUTES 228 (2000). The one principle exception to this rule was the practice of the socialist states’ state trading entitites of including arbitration agreements in their international trade contracts. HENRY CATTAN, THE LAW OF OIL CONCESSIONS IN THE MIDDLE EAST AND NORTH AFRICA 142 n.8 (1967).

\textsuperscript{106} Burnett, supra note 81 at 237. On natural resources investment contracts generally, see, e.g., DAVID N. SMITH & LOUIS T. WELLS, JR., NEGOTIATING THIRD-WORLD MINERAL AGREEMENTS: PROMISES AS PROLOGUE (1975); E.E. SMITH ET AL., INTERNATIONAL PETROLEUM TRANSACTIONS (2000). Walrond and Kumar argue that “large scale mineral developments have traditionally been accomplished by [contractual] agreements” that attempt to “define clearly the bundle of rights which the concession conveys”. GRANTLEY W. WALROND & RAJ KUMAR, OPTIONS FOR DEVELOPING COUNTRIES IN MINING DEVELOPMENT 105, 107 (1986). Furthermore, mining agreements “generally make provision for the resolution of disputes between the host country and the investor in international courts or according to some rules of international law.” Id. at 105.

\textsuperscript{107} See generally J. LUIS GUASCH, GRANTING AND RENEGOTIATING INFRASTRUCTURE CONCESSIONS: DOING IT RIGHT (2004).

\textsuperscript{108} For example, host states may enact relatively unfavorable national investment laws that are intended only as a prelude to the possibility of more favorable treatment extended on a project-by-project basis. In this case, municipal law represents the first stage in a bargaining process between the host state and the foreign investor. This appears to have been the case for the members of the Andean Common Market in the 1970s, which largely for domestic political reasons adopted an outwardly hostile policy toward foreign investors, but which were willing to grant foreign investors much more favorable terms of entry and operation as an exercise of discretion. See generally FRANCOIS J. LOMBARD, THE FOREIGN INVESTMENT SCREENING PROCESS IN LDCs: THE CASE OF COLOMBIA, 1967-1975 (1979). As Lombard concludes, “foreign investors have to be aware that behind strict rules there exist possible ways to reach operational agreements.” Id. at 126. C. Fred Bergsten has described this situation as one of “carrot and stick” whereby “[i]n essence, a bargaining process is created; both sides probe for maximum advantage until a deal acceptable to both is struck.” 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, p. 14.
investment contract as the most effective formal legal means at the investor’s disposal of securing his investment, by allowing the investor to negotiate for relatively precise substantive terms and to protect those terms through the inclusion of enforceable arbitration, choice of law, and stabilization clauses.\(^{109}\)

Entering into an investment contract, especially one with an arbitration clause, may also provide a number of important side benefits, such as improving the investor’s access to project financing or investment insurance.\(^{110}\) Indeed, in many cases investors may prefer to resolve any problems of credible commitment through contract than through other means. Investment contracts allow investors to fashion a custom-made legal regime much more suited to a project’s complex and particular needs than is a one-size-fits-all BIT that offers promises of questionable clarity. Stockmayer, writing as the BIT phenomenon was beginning to pick up steam in the early 1980s, expressed substantial skepticism as to the inherent risk-reducing value of BITs in the natural resources sector in part for this reason – BIT alternatives like contracts provide greater opportunities to spell out each parties’ “discrete contributions” to the project, thereby providing for “express reciprocity between rights and obligations.”\(^{111}\) Wells has similarly suggested that it is “innovative forms of contracts” that have allowed natural resources investors to overcome the obsolescing bargaining problem.\(^{112}\) His failure to mention BITs is telling.

Early contracts between host states and investors tended to be “rather simple documents,”\(^{113}\) but these contracts have become significantly more detailed and complex over time.\(^{114}\) To cite one example from a recent, prominent international arbitration, the water services concession contract at issue was 111

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\(^{109}\) This is Schaufelberger’s opinion, for instance. As he notes, le juriste tient en ses mains le plus efficace instrument de protection des investissements: la rédaction d’un contrat précis et équitable. Il peut on outre compléter le système de protection par l’insertion dans le contrat de clauses d’arbitrage, d’élection de droit, et de stabilisation.


\(^{110}\) *Id.* at 134.

\(^{111}\) Stockmayer, *supra* note 26, at 256-57.


\(^{114}\) *Id.* at 37-53.
single-spaced pages long, “consisting of 16 articles plus lengthy appendices,” and was the product of two years of negotiation. And lest one think that foreign investment contracts are a phenomenon limited to the infrastructure or natural resources sectors, note that Intel’s practice when deciding whether to construct new semi-conductor manufacturing facilities is to enter into intensive haggling with potential host states over a variety of fine-grained matters, and to insist that any resulting deal be committed to a written contract before the investment will be sunk.

In fact, in many of the early investment framework laws it was explicitly envisioned that most foreign investors would enter into some sort of “establishment agreement” with the host state in the process of gaining state approval to make the investment. Many states still require investments to be “approved” before they will receive the benefits of a BIT. “Approval” does not necessarily mean “contract,” but the approval process does give the investor at least an informal opportunity to ask for a formal agreement. Latin American states in particular have historically preferred to bargain directly with foreign investors rather than to grant foreign investors rights indirectly through treaties with the investors’ home states, and certain of those states still seek to encourage investor-state contracting by making access to favorable guarantees benefits contingent upon it.


117 For example, Article 9 of Côte d’Ivoire’s 1959 foreign investment law provides that an “establishment agreement will set and guarantee the conditions of operations from which of the approved [foreign] enterprise will benefit.” The law, number 59-134 of September 3, 1959, is reprinted in Oceana Publications’ loose-leaf series Investment Laws of the World. Guinea’s 1962 foreign investment law and Cameroon’s 1964 law provide similar examples. Most mining framework laws also allow (if not require) that investors enter into specific agreements with the host state. Walrond & Kumar, supra note 106, at 113

118 See, for example, Article 2 of the 1980 BIT between Singapore and Sri Lanka, which requires “approval in writing” by government officials.

119 As Tawil explains, “En general, los países de la región [of Latin America], han preferido la negociación directa, con los inversiones, aduciendo, que tales tratados con los países industrializados no resultan equilibrados, obligándolos a asumir costosos compromisos a largo plazo, sin imponer responsabilidades similares a sus cocontractantes.” Guido Santiago Tawil, La crisis latinoamericana y algunas perspectivas de cambio en la regulación de las inversiones extranjeras en la región, LA LEY 1988-A, 871 n 17.

120 Peru, for instance, gives investors who enter an investment contract with the state the right to benefit from a special legal regime guaranteeing “legal stability” as to tax, currency repatriation, and national-treatment laws for ten years from the date of contract execution. See Title II of Peru’s 1991 Foreign Investment Promotion Law (Legislative Decree 662). The availability of the “stability regime” depends on the investor’s willingness to contractually undertake certain obligations relating to the size of the investment and its employment and export effects.
Home states have also long encouraged investor-host state contracting. For example, investors will often be legally precluded from accessing home-state sponsored investment insurance absent the host state’s formal “approval” of the investment.121 Some home state investment insurance programs go even further in requiring an actual investment “agreement.”122 Unsurprisingly, these investment agreements routinely contain state pre-consents to international arbitration. Arbitration clauses began to appear regularly in petroleum concessions in the middle of the last century,123 and quickly came to be viewed as a necessary complement to contracts made in that sector.124 Today arbitration clauses are standard across the board. Indeed, investment framework laws often expressly provide that investment contracts shall contain arbitration clauses.125 The availability of foreign investment insurance also again has a role to play here. French investment guarantee treaties, for instance, require host states to insert investor-state arbitration clauses in investment contracts as a condition for insuring the project.126 French BITs have also required host states to promise to insert arbitration clauses into investment contracts upon the investor’s request.127

Obtaining an accurate and comprehensive indicator of the use or content of investment contracts is impossible because the contracts are not systematically collected and published. But best-guess estimates suggest that investment contracts have been and remain an essential component of the modern regime of

121 Meron notes this particular requirement in regard to the United States and Canadian investment insurance programs. Theodor Meron, Investment Insurance and International Law 62, 126.

122 France, for example, has conditioned availability of its insurance on a host state’s willingness to enter a “specific engagement” with the investor which must contain the host state’s consent to ICSID arbitration. See, for example, Article 2 of the 1972 France-Tunisia Treaty Concerning the Protection of Investments, reprinted in Oceana Publication’s looseleaf series “Investment Treaties of the World.”

123 See generally Cattan, supra note 105, at Chapter VI.


125 The Côte d’Ivoire law cited supra note 117, is again indicative but by no means unique. Article 10 provides that “the resolution of disputes resulting from the application of provisions of an establishment agreement and the eventual determination of any indemnity owed because of a breach of engagements undertaken will be governed by an arbitral procedure which will be set out in each [establishment] agreement.”

126 See the France-Tunisia treaty cited supra note 122.

127 See, e.g., France’s 1973 BIT with Indonesia.
foreign investment protection, and that many of those contracts do indeed contain host state pre-consents to investor-initiated international arbitration. Even Latin American states, which have long insisted on inserting “Calvo clauses” into investment agreements that require the investor to submit to the exclusive jurisdiction of municipal courts, appear to have relaxed their attachment to that particular contractual term. The continuing relevance of investment contracts matters for BIT analysts for much the same reason that the continuing relevance of municipal law matters: it suggests that the presence or absence of a BIT, by itself, is a lousy measure of the extent to which a host state has extended credible and favorable promises to investors.

V: Concluding Thoughts: Placing BITs in a Bargaining Framework

In this Article I have tried to make two modest but important points. The first, which is essentially that all BITs are not created equal and that analysts need to do a much better job sorting wheat from chaff, is sufficiently simple that further comment should not be necessary. The second point—of the existence of numerous BIT substitutes—deserves a bit of further explication. We have seen that BIT analysts tend to adopt a predominantly rational-functionalist view of the treaties that produces, in summary form, something like the following arguments: we can expect signing treaties to lead to increases in FDI flows because the treaties function as credible commitment devices, and many investors won’t invest absent this particular form of commitment; host states are competing for these commitment-sensitive investments, and will naturally want to sign the treaties that the investors require.

What is lacking in the standard functionalist story is any sustained comparative analysis of why the treaties, as one potential credible commitment device among at least several others, are any better suited to performing the task at hand than their primary competitors. This is a curious failing because one of the central lessons of the transaction-cost economics literature from which the credible commitment story is in part drawn is that careful comparison is essential to understand the development

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128 For example, UNCTAD reports that Peru “has concluded over 400” state-investor contracts, and that the practice of extending substantive and procedural promises to investors through investment-specific agreements “may be increase[ing]”. UNCTAD, Issues related to international agreements: Investor-State disputes and policy implications 16 n.9, TD/B/COM.2/62.

129 Fatouros suggests that by the early 1960s, investor-state arbitration clauses were “frequently included in agreements between states and foreign nationals or companies…usually describ[ing] in detail the procedures to be followed in case of dispute.” FATOUROS, supra note 7, at 187.

of new institutional arrangements. The discussion above focused on several relatively formal ways in which host states might effectively make such commitments even in the absence of a BIT. In particular, domestic laws and investment contracts might be used to make favorable substantive promises; to the extent that reputational concerns alone are not up to the task, binding commitments to arbitrate disputes can be appended. Other mechanisms for coping with the problem of the obsolescing bargain, although not discussed in detail above, should not be forgotten. The widespread availability of home state-sponsored investment insurance is especially significant, as is the availability of private ordering types of solutions, in which the investor structures its relationship with the host state, perhaps by creating an economic “hostage,” to make breach less attractive an option.131

And we should not forget the power of reputational concerns to curb opportunistic assaults by host states on investment profitability. This may seem a curious caveat given my arguments above that we can not expect reputational concerns alone to render treaty-based legal promises to investors especially credible. That was indeed the argument. Treaty-based legal promises are generally too ambiguous and too vague in content and application to reliably cause host states to suffer reputational costs in the eyes of other investors as “breakers” of international law. In other words, in the absence of authoritative adjudication, the reputational value of an investment treaty is purely rhetorical—it gives an aggrieved investor an opportunity to declare to the world that the particular host state not only treats investors badly, but that it does so in a way that is “illegal” under international law. But the added benefit of a rhetorical (and, in the absence of authoritative adjudication, unverifiable) claim of “international illegality” is likely to be quite slight. Foreign investors undoubtedly care about whether host states have a reputation for treating investors “fairly” (in a non-technical, non-legalistic sense), for making their lives relatively easy, and their investments profitable, and so on. And they are able to verify the spotlessness of that general, non-legal reputation by talking to other investors. Indeed, there is strong evidence that investors do talk about precisely such things. For example, in her well-researched case study of Intel’s surprising selection of Costa Rica as the site for a $300 million semiconductor assembly and testing plant, Spar describes Intel’s practice of consulting with existing foreign investors in Costa Rica. These interviews, upon which Intel “relied heavily,” allowed Intel to “assess Costa Rica’s record in delivering on its promises.”132 Spar concludes that

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Costa Rica got on Intel’s list because other investors had already gone there and were beginning to spread word of the country’s attractions. This follow-the-leader process supports what the data on FDI already suggest: it is highly concentrated in a handful of top recipient. Because companies such as Intel rely so extensively on word-of-mouth reports from existing investors, each round of investment seems to generate its own offspring, and success in attracting FDI begets success.

The implication of this practice is that as long as developing countries desire additional FDI in the future, they have a very strong incentive to ensure that these “word-of-mouth reports” are favorable. This basic point points to a fundamental weakness of the “obsolescing bargain” (OB) theory that underlies most analyses of BITs. OB theory models the interactions between host states and investors as a two-player, two-shot game. The state and the investor bargain at Time One, and reach a bargain very favorable to the investor because the host state wants to encourage the investor to sink the investment. At Time Two, once the investment is sunk, the host state uses its leverage, borne of the fact that it holds the sunk investment hostage, to revise the original bargain. The investor, suckered, accepts his fate. What OB theory entirely fails to explore is how this theory fits into a multi-investor world, in which multiple decisions to invest are spread across time. We might expect the first investor to be suckered, but why would we expect the second, third, and fourth investors to similarly fall for the host state’s ruse?

The fundamental question, then, is what do BITs add to what was already available to protect investments from problems of obsolescing bargain and of credible commitment? My own suspicion is “not much.” BITs are hardly the inevitable solution to an insoluble problem of obsolescing bargain that they are often made out to be. Once we recognize the plethora of alternatives to BITs, including informal alternatives such as “reputation”, it seems quite likely that the obsolescing bargaining problem is not nearly as big a problem for investors as it is typically said to be.

“Not much” is not the same thing as “nothing,” of course. In one of the more subtle and perceptive evaluations of the treaties, and one that is worth quoting at length, Wälde has argued that

Before the advent of [modern BITs], the treaty drafters expected investors to be able to negotiate their own dispute settlement method by way of agreement with the host State.

… the treaties, in effect, added a direct investor right without regard relation to underlying dispute settlement arrangements in order to create an investor right that was independent of the Ḣ ad Ḫ  or, individual negotiation, licensing or other parts of the investment process. This was done under the assumption that investors should not have to rely on their own negotiating strength and ability but be able to rely on a general treaty-provided remedy…granted by law, not waivable and not dependent on an individual jurisdiction agreement with the state.
In other words, what BITs bring to the table is something different from what BIT analysts typically assume. Take, for instance, Guzman’s claim that BITs are of great theoretical importance principally because they “allow potential investors to negotiate for whatever protections and safeguards they feel are needed. In other words, BITs provide the investor with protections that are superior, in all forms of investor-host conflicts, to those of customary international law.” It should be obvious that this claim is highly suspect, in large part because host states have long had the capacity to credibly bind themselves through municipal law and contract, a capacity that the BIT phenomenon has done little directly to enhance or promote. Investors were “allow[ed]” to negotiate with states well before BITs rose to prominence, and other institutional innovations (particularly the New York and ICSID Conventions)—allowed investors to secure the fruits of those negotiations with access to effective dispute settlement procedures.

But even more fundamentally, BITs can interfere with investor-state negotiation by granting investors “protections and safeguards” that they are unable to waive, and that they may or may not have been able to convince a host state to grant them in direct negotiations. This is the point that Wälde’s analysis brings to the forefront, and it is immensely important because it suggests that the main function of BITs is not to facilitate bargains that would otherwise not have occurred, or to check states from acting unfairly upon post-contract shifts in their bargaining power, but to limit host state bargaining power from the outset through the mandatory and universal application of potentially rigid doctrine. The obsolescing bargain theory, which posits that host state power is at its weakest at the time of initial contracting, and that the investor will usually have no trouble convincing the host state to promise it the world and more, is truly turned on its head, because it is precisely at this point that there should be the least objective need for a treaty to specify the particular terms of the deal. If an investor cares enough about a particular promise, procedural or substantive, he can bargain for it. BITs remove a good part of

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133 Wälde, supra note 13, at 204-06 (emphasis added).

134 Guzman, supra note 11, at 644.
the bargaining space by forcing the host state to offer particular terms to all comers, even those who would have invested without those particular promises contained in the BIT.

Given this understanding of the logic of the treaties, it is worth considering whether their primary useful and relatively unique function might be one of reducing bargaining costs rather than of permitting credible commitment. The treaties eliminate the need for investors and host states to engage in costly direct bargaining by providing the parties with default, off-the-shelf rules to govern their relationship. These are rules the parties would have agreed to anyway (the argument would go), and incorporating the rules into a treaty eliminates the need to go through the motions of formal contracting on a project-by-project basis.

The notion of BITs as default rules is attractive in large part because many host states have recently begun dismantling or scaling back their investment-approval institutions (often under pressure from the United States), thereby eliminating opportunities for investors and states to easily enter into direct privity. But a default rules-based understanding of BITs faces a number of conceptual problems. First, and as we have seen, the default rules provided by BITs are too vague for the most important foreign investment projects, such as mining ventures or semi-conductor or automobile manufacturing facilities. In those cases the foreign investor will almost always be in dialogue, and indeed in a true bargaining situation, with host state authorities, and will be well-positioned to demand what BITs have to offer. Second, from a default-rules perspective it is quite difficult to justify the tendency of BITs to prevent host states and investors from bargaining around BIT rules. If BITs require host states to extend to investors offers richer than the value of the investment to the host state, the host state will simply not allow the investment to take place. The surprising implication is that in some cases BITs might actually be expected to discourage investment by preventing host states and investors from reaching a mutually acceptable bargain. Third, if BITs are best viewed as reducing bargaining costs, and if bargaining costs in the absence of a BIT are rather slight compared to the overall value of the typical investment project (as I imagine they must be), then the competitive advantage that BITs can be expected to provide to developing states is correspondingly slight, and BITs should not be associated with very significant increases in investment flows. And if this is indeed the case, we should be extremely suspicious of empirical studies that purport to find otherwise.