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The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence

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ABSTRACT

Bilateral investment treaties (BITs) are typically presented as vital risk-mitigating instruments providing foreign investors with “credible commitments” that their assets will not be expropriated, discriminated against, or otherwise maltreated post-establishment. Accordingly, developing countries wanting to attract foreign investment should become more attractive destinations for multinationals when signing the treaties. A great number of studies and surveys indicate, however, that the vast majority of multinationals do not appear to take BITs into account when determining where - and how much - to invest abroad. Apart from reviewing such evidence, this chapter will discuss the feedback from a series of interviews. Firstly, BIT-negotiators from capital exporting states report that investors very rarely inquire about BITs, and when they do it is typically when disputes have arisen and not when they plan their investments. Secondly – and remarkably – the treaties have very little impact on political risk insurance (PRI) providers’ coverage and pricing policies. This is the case for both private companies as well as (almost) all public PRI programs, including the Multilateral Investment Guarantee Agency (MIGA). The chapter will conclude by offering some reflections on why the standard narrative of BITs as credible commitments should perhaps be reconsidered.

Introduction*

The purpose of bilateral investment treaties (BITs) is to protect and promote foreign investments. A rising number of BIT-claims show that the first part of this objective can be fulfilled. In 2008, at least 73 governments had been subject to investment treaty arbitrations.¹ While energy and other resource industries have been involved in the highest number of claims, investors from virtually every economic sector have sought and won awards under BITs.² Disputes can cover both tangible and intangible investments - including intellectual property, bonds and shares, contracts, and concessions and relate to a wide range of state measures apart from direct or indirect forms of expropriation. So while a few claims have resulted in prudent domestic reforms doing away with blatant maltreatment of foreign investors³, the broad scope of investment treaty adjudication has raised concerns of “regulatory chill” at the expense of broader public welfare concerns. The extent to which that is the case is naturally difficult to examine, but the relatively short history of investment treaty adjudication undoubtedly shows that “... in light of the sheer breadth of the standards of review, the state makes a major policy decision in its own right by adopting investment treaty arbitration as part of its governing apparatus.”⁴

This is particularly the case for developing countries. Even though claims against the US⁵, Canada⁶, Spain⁷, and the UK⁸ show that countries with prudent and stable investment climates are not insulated from investment-treaty adjudication, the overwhelming majority of claims involve Western investors suing governments from the developing world. So whereas the dispute settlement mechanism in BITs might be reciprocal in principle, it is

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¹ UNCTAD, “Latest developments in investor-state dispute settlement,” *IIA Monitor* 1 (2008a), p. 2.

² See for instance the sectoral distribution of cases administered by the International Centre for Settlement of Investment Disputes (ICSID); ICSID, *The ICSID caseload – statistics*, (Washington DC: ICSID, 2010), figure 6, available at: <http://icsid.worldbank.org> (last visited February 8, 2010) (note, though, that the figure also covers the 38% of ICSID cases, where consent was not based on a BIT).

³ One example is the tort reforms in the state of Mississippi after the infamous Loewen case, see, Robert P. Wise, *Mississippi commercial litigation after tort reform*, available at: http://www.msllawyer.com/rwise/articles/MS_Com_Lit_Tort_Reform.pdf (last visited February 5, 2010); See generally, Michael Krauss “NAFTA meets the American torts process: O’Keefe v. Loewen,” 9 *George Mason Law Review* 69 (2000).

⁴ Gus van Harten, *Investment treaty arbitration and public law* (New York: Oxford University Press, 2007), p. 93.

⁵ See e.g. *Methanex Corp. v. United States*, UNCITRAL, *final award* (August 3, 2005).

⁶ E.g. *Pope & Talbot Inc. v. Government of Canada*, UNCITRAL, *final award and dissenting opinion* (December 30, 2002).

⁷ *Emilio Agustín Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, *final award* (November 11, 2000).

⁸ Damon Vis-Dunbar, “Indian lawyer pursues claim against the United Kingdom under the India-UK BIT,” *Investment Treaty News*, November 28, 2008.

typically highly unilateral in its practical implications.⁹ Also, whereas many developing countries have yet to experience their first BIT-dispute, others have been on the respondent end of a disproportionately high number of claims. Argentina, for instance, became subject to more than forty investment treaty claims as a result of the government's measures to confront its 2001 financial crisis.¹⁰ Bearing in mind the treaties' potential costs for developing countries; the question therefore is whether the second part of their purpose – promoting investments – is being fulfilled?

That BITs can be important for some investors establishing investments abroad is indisputable. This is confirmed by reports of treaty shopping, for instance, where investors choose to invest from countries that have a BIT with the host country rather than investing from their home country.¹¹ But the fact that BITs at times can impact how investments are structured does not necessarily imply that these investments would not have taken place in the absence of BITs. Similarly, anecdotal reports that some investors have postponed already planned investments until BITs were in place¹² do not tell us much about the treaties' impact on the decision to invest in the first place. For host countries wanting to attract investments, therefore, the relevant question is not whether BITs have an impact on the legal structure or timing of investments, but whether they have an impact on their destination and volume.

In theory, there are two main reasons why this should be the case. First of all, there is Andrew Guzman's often-quoted claim that BITs may constitute "credible commitments" by insuring investors that their assets will not be expropriated, discriminated against, or otherwise maltreated post-establishment.¹³ According to Guzman, BITs overcome problems

⁹ William S. Dodge, "Investor-state dispute settlement between developed countries: reflections on the Australia-United States free trade agreement," 39 *Vanderbilt Journal of Transnational Law* 1 (2006), pp. 3. See also ICSID, *The ICSID caseload – statistics*, op.cit., figure 5.

¹⁰ Jose E. Alvarez & Kathryn Khamsi, "The Argentine crisis and foreign investors. a glimpse into the heart of the investment regime," in Karl Sauvant, ed., *The yearbook on international investment law and policy 2008/2009* (New York: Oxford University Press, 2009), p. 379

¹¹ Karl Sauvant & Lisa Sachs, "BITs, DTTs, and FDI flows: an overview," in Karl Sauvant & Lisa Sachs, eds., *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows* (New York: Oxford University Press, 2009), p. lv. Some notable investment treaty claims have dealt with this issue, see e.g., *Aguas del Tunari S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, *decision on jurisdiction* (21 October 2005); *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, *decision on jurisdiction* (29 April 2005); *Phoenix Action, Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, *award* (15 April 2009). In practice, though, double taxation treaties will probably be much more important than BITs for most investors' "choice" of home country. A well-known case in point is the considerable investments into India made through Mauritius, due to the favorable double taxation treaty between the two countries. See e.g. Eduardo Baistrocchi, "The structure of the asymmetric tax treaty network: theory and implications," *Bepress Legal Series, Working Paper 1991* (2007).

¹² UNCTAD quotes a report from Germany suggesting this to be the case; UNCTAD, *The impact on foreign direct investment of BITs*, op.cit., at 323

¹³ Andrew Guzman, "Why LDCs sign treaties that hurt them: explaining the popularity of bilateral investment treaties," 38 *Virginia Journal of International Law* 639 (1998) [updated version included in Sauvant & Sachs, *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*, op. cit., at 73]. See also, Zachary Elkins, Andrew T. Guzman, & Beth A. Simmons, "Competing for capital: the diffusion of bilateral investment treaties, 1960-2000," 60 *International Organization* 811 (2006), pp. 823-4.

of “obsolescent bargaining” as they (i) clarify the legal obligations vis-à-vis foreign investors compared to customary international law; (ii) involve the home country as a treaty partner thereby exerting indirect diplomatic pressure on host countries to uphold their commitments; and (iii) provide a powerful enforcement mechanism through investor-state arbitration. A second way BITs may impact investment flows, is if they more generally signal to imperfectly informed multinationals that host country governments are committed to an open and safe investment climate.¹⁴ So whether it is by “trading sovereignty for credibility”¹⁵ or providing a general signal to foreign investors, BITs could in theory make developing countries more attractive investment destinations.

The argument presented in this study is that common assumptions about the role of BITs in attracting foreign investment are unsupported by a considerable amount of quantitative and qualitative evidence. For the vast majority of investors, BITs do not appear to be important – directly or indirectly – when determining where, and how much, to invest abroad. This is not the first publication to make this point. However, by drawing on both econometric evidence and a range of qualitative data (old and new), the study aims to provide a more comprehensive, and thus hopefully more convincing, account than other literature on the subject, which often overlooks evidence based on different or alternative methodologies.

The chapter is structured as follows. The first section will review the econometric literature. The second section will review the (small number of) surveys on the role of BITs for investors’ investment decisions and provide further insights by discussing my interviews with BIT-negotiators from capital exporting countries. The third section will discuss the role of BITs for public and private political risk insurance (PRI) agencies, again with substantial interview feedback from practitioners. To my knowledge no other contribution has attempted to assess the role of BITs for these important actors, even though one would expect that if any of the abovementioned hypotheses are correct, then BITs would clearly impact the pricing and availability of PRI. Yet, as this study will show, it is probably very rare that BITs play this role in practise. On this basis, the fourth section will compare the role of BITs to alternative risk mitigating instruments for multinationals, such as investor-state contracts; and finally, the last section will conclude.

¹⁴ Eric Neumayer & Laura Spess, “Do bilateral investment treaties increase foreign direct investment to developing countries?,” 33 *World Development* 1567 (2005).

¹⁵ Term is from: Zachary Elkins, Andrew T. Guzman, & Beth A. Simmons, “Competing for capital: the diffusion of bilateral investment treaties, 1960-2000,” *Working paper. University of Illinois, University of California at Berkeley and Harvard University*, p. 4.

A. Econometric evidence¹⁶

Practically all studies that investigate the economic impact of BITs apply econometric techniques. Yet, while most authors may share a quantitative approach as their methodological foundation, many differ starkly in conclusions: a few studies find that BITs have a strong effect on international investment flows, some find only a weak effect, and other still find no effect at all.

The most widely quoted study that finds a strong effect is that of Neumayer and Spess who, based on their panel data analysis, conclude that BITs not only have a substantial impact on investment but can also provide a substitute for poor institutional quality in host countries.¹⁷ According to them:

“The message to developing countries therefore is that succumbing to the obligations of BITs does have the desired payoff of higher FDI inflows ... BITs fulfill their purpose, and those developing countries that have signed more BITs with major capital exporting developed countries are likely to have received more FDI in return.”¹⁸

This naturally provides a strong argument in favor of signing the treaties and appears to back up the claim that BITs are in fact useful legal instruments to attract investment. In his doctoral dissertation, however, Yackee replicates the analysis and shows that the results disappear after conducting slight, but justified, changes in estimation strategy.¹⁹ Similarly, using more comprehensive tests than that of Neumayer and Spess, Hallward-Driemeier²⁰ and

¹⁶ In order to not be misguided by the existence of “publication bias” – the fact that journals systematically favor papers finding positive and significant results – the review below also include high-quality studies not published in peer-reviewed journals. Parts of the section are based on: Lauge S. Poulsen, “The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows,” 20 *European Journal of International Law* 3 (2009) (book review). Space constraints naturally prevent a thorough assessment of all the different results and underlying model specifications in the expanding literature. A more detailed review of several of the studies below can be found in UNCTAD, *The role of international investment agreements in attracting foreign direct investment to developing countries* (New York, United Nations, 2009), ch. 2.

¹⁷ See Neumayer & Spess, Do bilateral investment treaties increase foreign direct investment to developing countries?, op. cit.

¹⁸ Neumayer & Spess, Do bilateral investment treaties increase foreign direct investment to developing countries?, op. cit., pp. 1582-3.

¹⁹ Jason Webb Yackee, “Sacrificing sovereignty: bilateral investment treaties, international arbitration, and the quest for capital,” PhD-dissertation, University of North Carolina at Chapel Hill, 2007, ch. 4; see also Jason Webb Yackee (2009a) “Do BITs really work? Revisiting the empirical link between investment treaties and foreign direct investment,” in Sauvants & Sachs, *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*, op. cit.

²⁰ Mary Hallward-Driemeier, “Do bilateral investment treaties attract FDI? Only a bit ... and they could bite,” in Sauvants & Sachs, *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*, op. cit., p. 349. Note that Hallward-Driemeier also rejects the suggestion by Neumayer and Spess, - that BITs ‘substitute’ for poor institutional quality in host countries. See Neumayer & Spess, Do bilateral investment treaties increase foreign direct investment to developing countries?, op. cit.

UNCTAD²¹ find little evidence that BITs have stimulated investment flows to developing countries. In contrast to Neumayer and Spess, as well as studies by Grosse and Trevino²² and Gallagher and Birch²³, the results of Hallward-Diremeier and UNCTAD are based on bilateral flows and bilateral treaties rather than aggregate flows and the total number of BITs. This is a superior econometric strategy for several reasons, the most important being that it allows for a more accurate separation of the effects of BITs from the strong upward trend in FDI over time. Finally, in a sophisticated study, Aisbett shows that Neumayer and Spess, as well as an earlier study by Salacuse and Sullivan,²⁴ fail to properly take into account the endogenous relationship between BITs and investment flows.²⁵ When more carefully considering the possibility of reverse causality – that BITs may be signed among countries already exchanging large investment flows – developing countries do not appear to become more attractive investment destinations as a result of signing BITs. Indeed, a former U.S. BIT-negotiator, Kenneth Vandervelde, suggests that the priority by capital-exporting states to sign BITs with states that were already hosts to large stocks of investments mean that: “... *BITs may be caused by investment flows and not the other way around.*”²⁶ Also, in a Granger-type analysis, Aisbett changes the dependent variable from FDI flows to an index measure of expropriation risk and finds that while decreases in expropriation risk ratings are negatively correlated with the number of BITs a country enters into, the reverse is not true; BITs do not appear to decrease subsequent expropriation risk ratings.²⁷

²¹ UNCTAD concludes: “BITs appear to play a minor and secondary role in influencing FDI flows. ... since some two-thirds of BITs have been concluded in the 1990s, the distinctive influence of a BIT as a competitive signal to attract investments may have been eroded,” UNCTAD, *The impact on foreign direct investment of BITs*, op. cit., pp. 347-8. Incidentally, as an organization UNCTAD promoted the signature of BITs on a number of ‘mini-conferences’ in the past; see Elkins, Guzman, & Simmons, *Competing for capital: the diffusion of bilateral investment treaties, 1960-2000*, op. cit.; and Lauge S. Poulsen, “The significance of south-south BITs for the international investment regime: a quantitative analysis,” *30 Northwestern Journal of International Law and Business* 1 (2010).

²² Robert Grosse & Len J. Trevino, “New institutional economics and FDI location in Central and Eastern Europe,” in Sauviant & Sachs, *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*, op. cit., p. 273.

²³ Kevin P. Gallagher & Melissa B. L. Birch, “Do investment agreements attract investment? Evidence from Latin America,” in Sauviant & Sachs, *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*, op. cit., p. 295. Note that in a separate set of regressions, Gallagher and Birch do look at the impact of U.S. BITs on bilateral flows between Latin American countries and the U.S. (see *infra* note 31).

²⁴ Jeswald Salacuse & Nicholas Sullivan, “Do BITs really work? An evaluation of bilateral investment treaties and their grand bargain,” *46 Harvard International Law Journal* 67 (2005).

²⁵ Emma Aisbett, “Bilateral investment treaties and foreign direct investment: correlation versus causation,” in Sauviant & Sachs, *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*, op. cit.

²⁶ Kenneth Vandervelde, “Investment liberalization and economic development: the role of bilateral investment treaties,” *36 Columbia Journal of Transnational Law* 501 (1998), pp. 524–25; See also Deborah L. Swenson, “Why do developing countries sign bilateral investment treaties?,” *12 U.C. Davis Journal of International Law and Policy* 131 (2005).

²⁷ It should be mentioned that in their equally refined contribution Egger and Pfaffermayr find BITs to have positive and significant effect on outward FDI stock from OECD countries; Peter Egger & Michael Pfaffermayr, “The impact of bilateral investment treaties on foreign direct investment,” in Sauviant & Sachs, *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*, op. cit. However, the 30% effect of ratified BITs in their preferred model-specifications

BITs, however, can differ markedly in their substantive and procedural provisions. So perhaps “strong” BITs may have a stronger impact on investment flows? For instance, one would expect that BITs with market access provisions would have a greater impact on investment flows than BITs covering only the post-establishment phase. Similarly, BITs which incorporate a legally binding consent to arbitrate a wide range of investment disputes with private investors are likely to be valued higher by investors than BITs where such consent is limited or absent. Both of these propositions have been tested, however, and none have been convincingly confirmed to date. While Haftel finds that U.S. BITs – which include liberalization provisions – do impact investments²⁸, Tobin and Rose-Ackerman²⁹ as well as Peinhardt and Allee³⁰ come to the opposite result, and Gallagher and Birch³¹ find no effects of U.S. BITs on FDI inflows to Latin American and Caribbean countries.³² Similarly, Yackee shows that even BITs with “strong” arbitration provisions do not appear to impact international investments³³, which is remarkable if one accepts that arbitration clauses should be the most attractive feature of a BIT from the perspective of foreign investors.³⁴

appears exceptionally high, particularly in light of the above-mentioned studies of FDI flows and the qualitative evidence presented below. The same applies to Kerner’s result that a BIT between two countries should somehow increase their dyadic flows by more than US\$620 million each year; Andrew Kerner, “Why should I believe you? The costs and consequences of bilateral investment treaties,” 53 *International Studies Quarterly* 73 (2009), table 2.

²⁸ Yoram Z. Haftel, “Ratification counts: U.S. investment treaties and FDI flows into developing countries,” *Review of International Political Economy* (forth).

²⁹ Jennifer Tobin & Susan Rose-Ackerman, “Foreign direct investment and the business environment in developing countries: the impact of bilateral investment treaties,” *Yale Law & Economics Research Paper*, No. 293 (May 2 2005).

³⁰ Clint Peinhardt & Todd Allee, “The costs of treaty participation and their effects on U.S. foreign direct investment,” paper presented at American Society for International Law’s International Economic Law Interest Group Meeting, Washington, DC, USA, November 2008.

³¹ Gallagher & Birch, Do investment agreements attract investment? Evidence from Latin America, op. cit.

³² This is surprising as it would make intuitive sense if BITs are more likely to be considered by U.S. firms. Apart from U.S. BITs’ legally binding liberalization provisions, the inclusive and open debates in Washington on these issues are likely to lead to a greater awareness of the treaties among U.S. multinationals (see e.g. references in *infra* notes 47 and 48). This contrasts with Europe, where my interviews with BIT-negotiators referred to below all confirmed that BITs have hardly ever been politicized (this may change, of course, if the competence to enter into BITs is shifted away from EU Member States as a result of the Lisbon Treaty). Finally, the U.S. has been on the respondent end of a number very controversial and, eventually, very public investment claims under NAFTA, which are also likely to have raised the awareness of investment treaties. That said; the share of U.S. BITs in the global population of BITs is of course quite small, and it is unclear the extent to which the expertise of some U.S. multinationals with respect to BITs has translated into actual corporate decision making. Also, despite the wide range of their BITs, U.S. negotiators have traditionally reminded developing countries that concluding a BIT with the U.S. would not necessarily result in an increase of U.S. investment flows. On the U.S. BIT program, see Kenneth J. Vandavelde, *United States investment treaties* (Deventer: Kluwer 1992), p. 32; Kenneth J. Vandavelde, “Investment liberalization and economic development: the role of bilateral investment treaties,” 36 *Columbia Journal of Transnational Law* 501 (1998).

³³ Yackee (2009a), Do BITs really work? Revisiting the empirical link between investment treaties and foreign direct investment, op. cit. For the full version see Jason W. Yackee, “Bilateral investment treaties, credible commitment, and the rule of (international) law: do BITs promote foreign direct investment?,” 42 *Law and Society Review* 805 (2008a).

³⁴ Thomas Wälde, “The ‘umbrella’ clause in investment arbitration: a comment on original intentions and recent cases,” 6 *Journal of World Investment & Trade* 183 (2005), p. 194.

But while much econometric evidence suggests that BITs are unlikely to have a substantial impact on investments, there are still many questions the quantitative literature has yet to answer. BITs are, for instance, likely to be more important in certain sectors than others. Historical experience, as well as recent developments in parts of Latin America, shows that resource extraction sectors are particularly prone to discriminatory or even predatory government interference. Accordingly, natural resource investors may take more notice of BITs than investors in less politicized sectors. Similarly, the importance of BITs for investors' decision-making process is likely to depend on the size of the investment, as the enforcement mechanism can involve significant arbitration costs for the investor should it come to a dispute with the host country. In turn, this may make the treaties more or less redundant for small investors.³⁵ On the other hand, very large multinationals can often rely on diplomatic protection by their home country and are moreover able to bargain for investor-state contracts with similar or greater legal guarantees than those provided in BITs (see below). It follows that if BITs are important in the pre-establishment phase of foreign investment decisions, it would most likely be for medium-scale investors. Unfortunately, these hypotheses are inherently difficult to test using international investment data, which are too incomplete and often incomparable at disaggregated levels, whether measured as flows or stocks.³⁶

These are not the only challenges for the econometric literature.³⁷ For instance, the effects of BITs are likely to depend on a range of political and social conditions which can be difficult to measure. Irrespective of recent advances in quantitative indexes measuring ambiguous concepts such as governance or institutions, it remains a challenge to carefully control for such intangible variables. Another challenge is that developing countries have often entered into BITs as part of broader economic reform packages, which means the treaties often come into effect alongside a number of other domestic and international economic instruments. To the extent that simultaneous initiatives, such as preferential trade agreements (PTAs) or reforms in domestic investment and taxation codes have an impact on investment flows, they would have to be taken into account. With respect to PTAs, some literature suggests that they have a substantial effect on FDI flows between the contracting parties,³⁸ which

³⁵ Roberto Daniño, Secretary-General of ICSID, Opening remarks at "Making the most of international investment agreements: a common agenda" (December 12, 2005, Paris), available at: <http://www.oecd.org/dataoecd/5/8/36053800.pdf> (last visited January 30, 2010); Jack J. Coe, Jr., "Taking stock of NAFTA Chapter 11 in its tenth year: an interim sketch of selected, themes, issues and methods," 36 *Vanderbilt Journal of Transnational Law* 1381 (2003), pp. 1400-1. For a different view, see Wälde, Making the most of international investment agreements: a common agenda, op. cit., pp. 204-6.

³⁶ Unfortunately, most econometric contributions have relied on aggregate FDI flows or stocks, and none that I'm aware of have used detailed databases such as "SDC Platinum" or "Zephyr" (mergers and acquisitions) or the more recent "fDi Markets" from the Financial Times' FDI Intelligence (greenfield projects).

³⁷ See generally, Poulsen, The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows, op. cit.; UNCTAD, The role of international investment agreements in attracting foreign direct investment to developing countries, op. cit.

³⁸ See e.g., Eduardo Levy Yeyati, Ernesto Stein & Christian Daude, "Regional integration and the location of FDI," *Inter-American development bank research department working paper 492* (2003); Denis Medvedev, "The impact of preferential trade agreements on FDI inflows," *World Bank Policy Research Working Paper*

implies that studies on BITs could systematically overestimate their effects on FDI if PTAs are not taken into account.

A related point is that developing countries often enter into BITs when heads of state meet at home or abroad. Such high level meetings typically involve many other bilateral economic cooperation initiatives however, and to the extent such initiatives lead to investment projects between the two countries, they could also result in systematic biases if not controlled for. In the case of Pakistan, for instance, most of its BITs were signed in the past as part of a “road-show”, where numerous other investment promotion activities also took place.³⁹ Since interviews with current and past Pakistani BIT-negotiators confirmed in interviews that the BITs played no real role for these simultaneous initiatives.⁴⁰ So if a considerable portion of the projects actually materialized, they would arguably have to be controlled for if one wants to estimate the impact of Pakistani BITs. Assuming this pattern holds for other countries as well, it is unfortunate that no studies have directly confronted it as a possible source of endogeneity between capital flows and the signing of BITs.

Substantial data limitations as well as a range of possible omitted variables therefore continue to hamper the econometric literature. Given these constraints, it is noteworthy that very little work has tried to ask foreign investors themselves whether they take these treaties into account when deciding where, and how much, to invest.

B. Survey evidence and BITs’ indirect investment impacts

The few surveys that do ask about BITs appear to support the conclusion that they are not a particularly important factor in the establishment phase for the vast majority of foreign

4065 (2006). A review of the literature can be found in UNCTAD, The role of international investment agreements in attracting foreign direct investment to developing countries, op. cit.

³⁹ To mention a few examples, see e.g.; “Pak-Romanian collaboration,” *Business Recorder*, 25 January, 1978 (apart from the Romania-Pakistan BIT signed a few days earlier - later to be updated in the 1990s - several investment initiatives were agreed between the governments such the construction of a major cement plant); “9 UK firms sign project agreements,” *Business Recorder*, 1 December, 1994 (apart from the UK-Pakistan BIT, memoranda of understandings for several projects in the oil and gas exploration, hydropower and chemicals sectors were signed with British investors); “Private investment from Singapore,” *Business Recorder*, 12 March, 1995 (apart from the Singapore-Pakistan BIT, memoranda of understandings with Singaporean infrastructure firms were signed with a total expected inflow of investment into Pakistan of about \$500 million); “Turkey, Pakistan discuss setting up export zones,” *Business Recorder*, 17 March, 1995, & “Protocol signed for creation of Turco-Pak Business Council,” *Business Recorder*, 18 March, 1995 (apart from the Turkey-Pakistan BIT, the two governments initiated talks on setting up export zones, and business representatives from the two countries agreed to set up a bilateral business council); “Benazir returns from Malaysia with investment pledges,” *Business Recorder*, 10 July, 1995 (apart from the Malaysia-Pakistan BIT, Prime Minister Bhutto received \$530 million worth of investment pledges from Malaysian companies).

⁴⁰ Not-for-attribution interviews with BIT-negotiators and other officials involved in Pakistan’s BIT-program. The interviews took place in Islamabad, Lahore, and Karachi from January 2009 to June 2009. See also; Lauge S. Poulsen and Damon Vis-Dunbar, “Reflections on Pakistan’s investment-treaty program after 50 years: an interview with the former attorney general of Pakistan, Makhdoom Ali Khan,” *Investment Treaty News*, March 16, 2009.

investors. One survey asked 602 corporate executives to what extent an international investment agreement, such as a BIT, influences which markets their company invests in (figure 1).

-- insert figure 1 around here --

Around one fourth of the survey respondents replied that investment agreements did not at all affect their decisions to invest, slightly less than half said to a limited extent, and a little less than a fifth said investment agreements were very important. Lisa Sachs questions whether some executives may have strategically overestimated the importance of investment treaties here “in order to encourage the granting of such further protections international investment agreements may offer them.”⁴¹ For the purposes of this study it is moreover unfortunate that the survey did not distinguish between BITs and other international investment agreements, such as the Energy Charter Treaty, investment chapters in PTAs, or double taxation agreements, and it is therefore likely to overestimate the importance of BITs. Two surveys thus indicate that double taxation agreements, in particular, are much more important for foreign investors in the establishment phase compared to BITs.⁴² When the European Commission asked only about the role of BITs for European investors, half of the 300 respondents had never heard of them and only 10% had used them in their professional activity (figure 2).

-- insert figure 2 around here --

Note, however, that this 10% cover both investors that take the treaties into account in their establishment phase *as well as* investors that have considered them in case of a dispute. That the later should be a far greater number than the former is supported by the World Bank, which reports evidence that “many investors are not aware that a BIT is in place at the time of considering an investment, and indeed investors may remain oblivious until some issue arises when its provisions may be relevant.”⁴³ Overall, it therefore appears that even if multinationals’ legal experts may be aware of BITs’ potential - which anecdotal evidence

⁴¹ Lisa Sachs, “Bilateral investment treaties and FDI flows,” *World Association of Investment Promotion Agencies (WAIPA) Newsletter* 5 (2009), footnote 5.

⁴² UNCTAD, “Worldwide survey of foreign affiliates,” *occasional note*, 5 November, 2007, available at: www.unctad.org/en/docs/webiteiia20075_en.pdf (last visited January 30, 2010) [note that while UNCTAD elsewhere has used the fact that investors in this survey noted that BITs are important for their investment activities as evidence that BITs impact investment flows (see, UNCTAD, *The role of international investment agreements in attracting foreign direct investment to developing countries*, op. cit.), the question was asked in a way that Lisa Sachs’ above-mentioned critique of the survey by Shrinkman holds for this survey as well. Note also, that while UNCTAD uses the survey for the strong conclusion that BITs are ranked “among the most significant investment decision factors” for transition economies in particular (UNCTAD, *The role of international investment agreements in attracting foreign direct investment to developing countries*, op. cit., p. 52), this is based on feedback from only 14 foreign affiliates (!).]; Wenhua Shan, “Foreign investment in China and the role of law: empirical evidence from EU investors,” *2 Transnational Dispute Management* 3 (2005), chart 9. [Shan’s survey has a very limited sample size (22 investors) and only asks about the role of Chinese investment treaties.] On the relative importance of double taxation treaties and BITs, see also supra note 11.

⁴³ World Bank, *World Development Report 2005: A better investment climate for everyone* (2005), p. 177.

suggests is increasingly the case⁴⁴ - their inputs may often not be taken into account by those who actually decide where and whether to invest.⁴⁵

Given this evidence, it may appear surprising that Bütthe and Milner report that European BIT-negotiators have told them in interviews that investors and investment advisors contact them inquiring about the details about particular BITs.⁴⁶ Bütthe and Milner construe this as indirect evidence that investors do in fact take BITs into account when determining where to invest; why would they otherwise inquire about them? But while qualitative inputs of this kind are welcome in a debate otherwise dominated by statistical discussions over often precarious data-material, it is questionable whether the interviews actually reflect what the authors claim. The relevant question for whether BITs attract investment is not whether they are relevant for investors - which they of course often will be in case of disputes or when contemplating how to legally structure a major investment - but instead whether, and how often, investors refrain from investing in a particular country if their investments cannot be covered by a BIT. Also, the relevant question for the signaling hypothesis is whether and to what extent the fact that host countries have *not* entered into a substantial number of BITs keep multinationals from investing there. Similarly, the fact that multinationals are often involved in the development of capital-exporting states' BIT programs⁴⁷ and may at times lobby for the signing of BITs⁴⁸ does not in itself imply that the absence of BITs would make them invest less or elsewhere. When I interviewed BIT-negotiators in capital-exporting countries, all thus confirmed that while they receive direct requests from investors about

⁴⁴ See for instance comments from investment arbitration practitioners in Ryan J. Orr, "The impact of BITs on FDI: do investors now ignore BITs?," 4 *Transnational Dispute Management* 2 (2007).

⁴⁵ Yackee, *Sacrificing sovereignty: bilateral investment treaties, international arbitration, and the quest for capital*, op. cit., p. 810.

⁴⁶ Tim Bütthe & Helen Milner, "Bilateral investment treaties and foreign direct investment," in Sauvants & Sachs, *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*, op. cit., pp. 209-213.

⁴⁷ See e.g., Eileen Denza & Shelagh Brooks, "Investment protection treaties: United Kingdom experience," 36 *International and Comparative Law Quarterly* 908-912 (1987); Andrew Walter, "British investment treaties in South Asia: current status and future trends," report developed for International Development Center of Japan, (January 2000); Emergency Committee for American Trade (ECAT), *Letter to US Government concerning its model BIT*, (December 18, 2003), available at: www.ecattrade.com/statements/content.asp?ID=408 (last visited January 30, 2010); ECAT, *Written statement of the Emergency Committee for American Trade concerning the Administration's review of the model bilateral investment treaty (BIT)*, (July 31, 2009), available at: www.ecattrade.com/uploads/content/D8E14AD1AD7B4EF196C0E53E710E7925.pdf (last visited January 30, 2010); United States Department of State, *Advisory committee on international economic policy submits report on U.S. model bilateral investment treaty*, (September 30, 2009), available at: www.state.gov/r/pa/prs/ps/2009/sept/130097.htm (last visited January 30, 2010); Confederation of Norwegian Enterprise, *Modell for investeringsavtaler – høring*, (January 7, 2008), available at: <http://www.regjeringen.no/upload/NHD/Vedlegg/hoeringer/2008/Modellavtale/StatoilHydro.pdf> (last visited February 8, 2010)); not-for attribution interviews with BIT-negotiators, April-October 2009.

⁴⁸ See e.g., ECAT, *Business community welcomes launch of U.S.-China BIT negotiations and urges achievement of a high-standard agreement*, (July 22, 2008), available at: www.ecattrade.com/statements/content.asp?ID=743 (last visited January 30, 2010).

BITs on occasion, such requests are relatively rare and investors typically inquire about BITs only *after* the investment-decision has been made.⁴⁹ The interviewees reported:

“Sometimes those dealing with incorporation of companies contact me to hear if we have a BIT with that country, but it is hardly the most important factor. What is probably really important, though, are double taxation treaties.” (Netherlands)

“In some cases, where there is a major investment the company might approach us. But that is typically where a contract or other instrument has been signed, and therefore probably after the decision for the investment has been made.” (Finland)

“We do get questions about BITs from investors themselves, but as far as I’m aware, they never contact us to get a treaty signed as a precondition for an investment.” (Sweden)

“I don’t think many Danish companies have heard of these treaties, and it is highly unlikely that they will be taken into account when they make their investment decisions. ... In the few cases I have been contacted over the last years, it is when a dispute has arisen.” (Denmark)

“We’ve been told in general terms by business organizations that they value the assurance provided by BITs, but have no direct evidence as to whether or not the presence or absence of a BIT is an important consideration for British companies making investment decisions. We tend to be contacted only by investors who are already established abroad and who have run into difficulties with the host state.” (UK)

“I think it is unlikely that even big German companies take BITs into account in their investment decisions. ... The requests we get from German investors do not appear to be when they decide where to invest. ... We do, however, get a lot of requests about double-taxation treaties, which are probably much more relevant for the investment decision.” (Germany)

“It is the exception that investors contact us directly before making an investment, probably because our BITs don’t include market access. Once the investment is made, investors do contact us when they run into problems with the host state. In these cases, however, the existence of a BIT does not appear to have been the most important element of the investment decision.” (Switzerland)

“It is usually once they have an investment in place or they run into regulatory problems with the host state that companies ask us to get BITs signed.” (Canada)

“It is of course only the very big companies that are even aware of the treaties. ... But since we don’t have as many BITs as the Europeans, what usually happens is that investors first make the decision to invest, and then they lobby the Japanese government to sign a BIT. But even if the BIT doesn’t get signed, the investors will make the investment anyways because their decision has already been made.” (Japan)

So while investors, lawyers, and consultants, do occasionally inquire about BITs, this is generally *not* to decide whether a particular investment should be made or not. That is a

⁴⁹ Not-for-attribution telephone interviews, (April-August 2009). In 2008, the nine countries accounted for almost 40% of the world total outward FDI stock. The interviews were semi-structured with the overall theme being business input when contemplating and negotiating BITs. Three capital-exporting countries I contacted did not respond (Austria, France and Italy). Note that while I interviewed the United States’ Trade Representative (USTR) as well, their feedback is not included as USTR traditionally refrains from making public comments on these matters (in 2008, the US accounted for almost 20% of world total outward FDI stock).

decision which available quantitative and qualitative evidence suggest is unlikely to be driven by the presence or absence of whether a BIT is in place.

However, even if BITs tend to be “an overlooked tool” by investors themselves,⁵⁰ there could be indirect channels through which they may nevertheless affect investment flows. One could be if BITs have an impact on credit rating agencies’ sovereign risk evaluations, as these might affect risk premiums and hence investment decisions. While I doubt credit rating agencies would pay much attention to BITs, there are no publicly available studies on this question. Another indirect channel could be if BITs function as a “stepping stone” for developing countries to enter into a PTA at a later stage.⁵¹ For instance, some developing country diplomats appear to believe that successful BIT-negotiations convince developed country partners that the developing country is “mature” to enter into the often much more complex and time consuming negotiations over a PTA.⁵² But while they may be correct for a country such as Japan - which does use BITs as stepping-stones to PTAs⁵³ - there is no convincing evidence that either European countries or the United States have pursued such a policy.⁵⁴ As a general rule, it therefore appears unlikely that developing countries should

⁵⁰ D. H. Freyer, B. H. Garfinkel, & H. G. Ghavari, “Arbitration under bilateral investment treaties: an often overlooked tool,” 13 *Mealey’s International Arbitration Report* 44 (1998).

⁵¹ On the basis of a thought-provoking econometric paper, Tobin and Busch argue that BITs increase the likelihood of a PTA between a developing and developed country; Jennifer Tobin & Marc L. Busch, “A BIT is better than a lot: bilateral investment treaties and preferential trade agreements,” 62 *World Politics* 1 (2010). As mentioned above, some literature has found an effect of PTAs on FDI flows between the contracting parties; see supra, note 38.

⁵² One Mauritian diplomat interviewed by Tobin and Busch stated that Mauritius signed BITs to set the stage for PTAs (A BIT is better than a lot: bilateral investment treaties and preferential trade agreements, op. cit., pp. 11). Also, several Pakistani officials believed that a BIT with the U.S. would lead to a subsequent PTA (interviews with former Pakistani BIT-negotiators, Lahore and Islamabad, Spring 2009; see also infra, note 54).

⁵³ Not-for-attribution telephone interview with former Japanese BIT-negotiator, July 2009.

⁵⁴ Occasionally, USTR has mentioned in press conferences and policy-documents that a BIT with the United States may lead to a PTA (see e.g. Tobin and Busch, A BIT is better than a lot: bilateral investment treaties and preferential trade agreements, op. cit.). It is, however, not entirely clear whether there has been such a linkage as a matter of actual policy. For instance, Tobin and Busch support their econometric findings with a USTR quote that its BIT-negotiations with Pakistan would lead to a subsequent PTA (A BIT is better than a lot: bilateral investment treaties and preferential trade agreements, op. cit., pp. 6). But it is doubtful whether this was actually the U.S. position. A USTR officials notes: “Since Musharraf had vested so much political capital into the possibility of a PTA, we couldn’t openly state that we found it practically impossible to get through in Washington, so we played along.” (Comment at seminar on Pakistan’s BIT program, Johns Hopkins School of Advanced International Studies’ South Asia Program, 11 May, 2009 [the present author was the speaker]). Also, Peinhardt and Allee fail to identify a sequencing of U.S. BITs and PTAs: “... of those countries that have signed multiple treaties, it is rare for them to proceed in the suspected order. ... Given the lack of generality in these patterns, we believe that the sequence of these agreements is not a foregone conclusion. ... [E]ach agreement should be considered in its own right as having potential to increase economic integration between the signatories.” (Peinhardt and Allee, The costs of treaty participation and their effects on U.S. foreign direct investment, op. cit., p. 4). But even if Peinhardt and Allee are wrong and there has in fact been a considerable linkage between U.S. BITs and PTAs – as suggested by Tobin and Busch - it is important to recall that the share of U.S. BITs in the global BIT-network is miniscule compared to European BITs. In Tobin and Busch’s analysis 14 out of 23 developed countries are EU member states. Yet, the authors quote no official reports, have made no interviews, or found any study of EU trade politics that can support their econometric results in the European context (recall that EU member states have entered into PTAs as a group but signed BITs

expect a PTA with a developed country “in return” for entering into a BIT. I therefore turn to a third – and more likely – indirect channel through which BITs may impact investment flows, namely if PRI agencies take BITs into account when determining the availability and pricing of investment insurance.

C. BITs and political risk insurance

Some (but not all) of the risks covered by BITs are also covered by PRI.⁵⁵ Uncompensated expropriation, breaches of contract, restrictions on repatriation of profits and damages due to political violence are thus covered by most PRI providers. Accordingly, it would only be natural if they took BITs into account when assessing the risk of investment projects. If so, then BITs would indirectly decrease the transaction costs of FDI by lowering the price and increasing the availability of PRI.⁵⁶ Unfortunately, there are practically no publicly available empirical studies investigating this question. The only exception is UNCTAD’s Investment Policy Review of Brazil, where UNCTAD asked PRI providers on their view of BITs, and briefly concluded that some find them important and some do not.⁵⁷ However, the questions seem to have been limited to the case of Brazil and were only asked to six PRI providers. The following section will therefore provide additional evidence based on interviews with a much larger sample of officials in private and public (or mixed private/public) investment guarantee agencies (for a selection of providers, see table 1).

-- insert table 1 around here --

individually). Moreover, it is noteworthy that they find a curve-linear relationship: if a developing country has a high number of BITs with *other* wealthy states this actually *decrease* its chances of a subsequent PTA compared to a developing country that only has a few BITs (up to 5). The implication in the European context is that a developing country with a few BITs with EU countries is *less* likely to obtain an EU PTA than one that has signed BITs with most member states. This is a rather counterintuitive suggestion, and there again appears to be no qualitative evidence to support it. So while Tobin and Busch’s econometrics are sophisticated indeed, developing countries would be well advised to wait for further studies that confirm the authors’ claims using alternative methodologies and sources of data. Given the remarks above, this is likely to be a considerable challenge.

⁵⁵ Paul E. Comeaux & N. Stephan Kinsella, *Protecting foreign investment under international law: legal aspects of political risk* (New York: Oceana Publications, 1997), ch. 6; Tomoko Matsukawa & Odo Habeck, *Review of risk mitigating instruments for infrastructure financing and recent trends and developments* (Washington DC : World Bank, 2007); For an overview of the PRI industry, see, World Bank, *World investment and political risk* (Washington DC: World Bank, 2009), chapters 2 and 3; Kathryn Gordon, “Investment guarantees and political risk insurance: institutions, incentives, and development,” *OECD investment policy perspectives* (2008). For an attempt to use PRI pricing to explore the impact of political factors for multinationals’ operations in developing countries, see e.g., Nathan M. Jensen, “Political regimes and political risk: democratic institutions and expropriation risk for multinational investors,” *70 Journal of Politics* 1040 (2008).

⁵⁶ Yackee finds that MIGA guarantees appear to have increased investment flows to developing countries. See, Yackee, *Sacrificing sovereignty: bilateral investment treaties, international arbitration, and the quest for capital*, op. cit.

⁵⁷ UNCTAD, *Investment policy review of Brazil*, UNCTAD/ITE/IPC/MISC/2005/1 (2005), p. 45. See also UNCTAD, *The role of international investment agreements in attracting foreign direct investment to developing countries*, op. cit., pp. 18-19.

1. Government-sponsored agencies

Several governments provide their investors abroad with insurance against political risks. A few of these programs, such as Germany's, often make investment insurance contingent on the adoption of BITs.⁵⁸ This is notable because practically all BITs allow government-sponsored PRI agencies to "subrogate" insured investors' claims against host countries, thereby providing a legal basis for the government's insurance agency to recover benefits paid out to investors.⁵⁹ Indeed, local newspapers in Pakistan reported that the first ever BIT signed between West Germany and Pakistan was presented to Pakistan as a condition for German investors being able to obtain Federal guarantees of their investments in Pakistan.⁶⁰ As noted by a current German official:

Since the guarantees have a BIT as a precondition, we look at the conditions of the BIT which in turn will impact the condition of the guarantee. So limited substantive provisions will limit the risk the guarantee is covering. ... Remember though, that even if there is no guarantee the investment will be made anyway.⁶¹

This implies, for instance, that the recent upgrade of the same BIT between Pakistan and Germany to now include investor-state arbitration could allow German investors greater opportunities to receive PRI when investing in Pakistan.⁶² The German program is an exception, however, in that most other programs do not incorporate BITs as a precondition for coverage. But if BITs really serve as a crucial risk-reducing instrument, it should not be necessary to have such a precondition to make them important in practice.

Yet, it is. A former high ranking official from the United States' Overseas Private Investment Corporation (OPIC) noted in my interview with him that: "the existence of BITs was entirely inconsequential when underwriting risks"⁶³ A current official there concurs, noting that "in OPIC we don't pay much attention to BITs."⁶⁴ However, OPIC is also

⁵⁸ German Federal Ministry of Economics and Technology and PriceWaterhouseCoopers, *Granting of federal guarantees abroad*, (July 2006), p. 3. Historically, the French program has also had BIT-coverage as a condition for the availability of insurance.

⁵⁹ See e.g. Lebanon-Germany BIT (1997), art. 8. Note that the subrogation process would have to take place under UNCITRAL or other ad hoc rules as ICSID does not accept government administered insurance programs as a party to a claim; Christoph Schreuer, *The ICSID convention: a commentary* (Cambridge: Cambridge University Press, 2001), pp. 185-91; Nassib G. Ziade, "ICSID clauses in the subrogation context," *7 News From ICSID* 4 (1990). The extent to which this takes place in practice has not been studied (see below).

⁶⁰ "Pakistan W. German investment accord: way cleared for basic industries' growth," *DAWN News*, 27 November, 1959.

⁶¹ Not-for-attribution telephone interviews, April and August 2009. The official was not sure the extent to which German investors simply don't go to MIGA for coverage, if they can't get a German insurance. Note that while interviews with PRI officials were semi-structured, all were given the question: "to what extent, if any, do BITs impact the pricing and coverage of political risk insurance granted by [organization]." Only the French PRI program did not respond to my request for an interview, and the Swiss program had recently closed (see *infra*).

⁶² See e.g.; "Pakistan, Germany sign upgraded BIT," *The News*, December 2, 2009.

⁶³ Not-for-attribution interview, Washington DC, April 2009.

⁶⁴ Not-for-attribution telephone interview, May 2009.

somewhat special in the family of public investment guarantee agencies, as it has its own set of inter-governmental agreements, which provide for international arbitration and allows OPIC to subrogate covered investors' claims.⁶⁵ Arguably, these OPIC mechanisms substitute whatever need there might have been for BITs in the underwriting process.⁶⁶ Even without such agreements, however, similar responses came from officials within other government-sponsored PRI agencies:⁶⁷

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

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

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

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

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

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

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

"We do not take BITs into account. Even if there is a BIT, it will not impact the premium compared to a similar country without a BIT." (Japan)

In general, there thus appears to be a disconnect between (capital-exporting) countries' political risk guarantee agencies and their BITs. As surprising as this may seem, it is important to note that there are important exceptions, since several respondents do find BITs to be a risk-mitigating factor when dealing with particularly risky jurisdictions. As an example, South Africa and Zimbabwe recently entered into a BIT,⁶⁸ and given the history of government intervention vis-à-vis foreign investors in Zimbabwe - also towards South

⁶⁵ The more than 150 OPIC agreements are available from OPIC's website: www.opic.org. Note that it is for this reason that U.S. BITs do not include subrogation clauses.

⁶⁶ Not-for-attribution telephone interview with current official, May 2009.

⁶⁷ Not-for-attribution telephone interviews, April-August 2009. Note that some of these are mixed private/public agencies.

⁶⁸ Department of Trade and Industry, South Africa, "South Africa-Zimbabwe trade and investment seminar and signing of the bilateral investment treaty," (19 November, 2009), available at: <http://www.info.gov.za/speeches/2009/09111914051001.htm> (last visited February 8, 2010).

African investors⁶⁹ - the Export Credit Insurance Corporation of South Africa notes that while BITs are rarely a determining factor for their operations, this treaty will have considerable implications for their ability to underwrite South African investments in Zimbabwe.⁷⁰ It is therefore probably correct when the Financial Times expect that this particular BIT will “sharply reduce the price of political risk insurance ...”⁷¹ But given the overall feedback above, such situations appear to be the exception rather than the rule. In contrast to what some commentators expect, practitioners in public PRI agencies find it remarkably rare that BITs “reduce the “risk profile” of a covered investment to a level where it can be prudently insured by the investor’s Home state”⁷²

It is worth mentioning, however, that many government PRI agencies do not receive a great deal of attention from investors and some – such as the Swiss program – even had to close due to a lack of demand. Rather than countries’ own government-sponsored programs, the most important public investment insurance program is therefore by far the World Bank’s Multilateral Investment Guarantee Agency (MIGA).

2. MIGA

A quick look at MIGA’s operational regulations show that BITs are of relevance to the underwriting process within MIGA, both directly and indirectly.⁷³ The direct relevance of BITs arises because the regulations stipulate that if the investment is covered by a BIT then it has adequate legal protection for MIGA to insure it.⁷⁴ In that sense, BITs can make parts of the underwriting process much easier.⁷⁵ If the investment is not covered by a BIT, however, it can nevertheless still be covered by MIGA if the agency can “satisfy itself as to the investment conditions in the Host Country, including the availability of fair and equitable treatment and legal protection for the investment.”⁷⁶ Indirectly, BITs could be relevant for this condition too. If the country has signed BITs with countries other than the investor’s home country that could potentially still provide a signal that investment

⁶⁹ See, Luke Peterson, “Court orders South African government ministries to remedy expropriations and violations of rights being suffered in Zimbabwe,” *Investment Arbitration Reporter*, September 8, 2008.

⁷⁰ Not-for-attribution telephone interview, November 2009.

⁷¹ Richard Lapper, “South Africa to sign investment treaty with Zimbabwe,” *Financial Times*, November 7-8, 2009.

⁷² Rudolph Dolzer & Margrete Stevens, *Bilateral investment treaties* (The Hague: Martinus Nijhoff, 1995), p. 156.

⁷³ MIGA, *Operational Regulations, as amended by the Board of Directors through October 1, 2007*. Note also that article 23(b)(iii) of the MIGA Convention states that the Agency shall: “promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investments.”

⁷⁴ Par. 3.16.

⁷⁵ Ibrahim F. I. Shihata, *MIGA and foreign investment* (The Hague: Martinus Nijhoff, 1988), pp. 233.

⁷⁶ Par. 3.15. Finally, if none of these conditions are fulfilled, par. 3.17 stipulates that MIGA can still provide coverage if it has a special agreement with the host country, assuring that with respect to guaranteed investments, MIGA “has treatment at least as favorable as that agreed by the member concerned for the most favored investment guarantee agency or State in an agreement relating to investment ..” (MIGA Convention Article 23(b)(ii)).

conditions in the host country are adequate, particularly since “fair and equitable treatment” is a key standard in most BITs.⁷⁷

Even so, the fact that BITs are relevant to the underwriting process within MIGA does not necessarily mean that the treaties are crucial determinants for coverage or pricing. With respect to coverage, recall that a BIT is a sufficient but far from necessary condition, and with respect to pricing, it is important to take into account Annex A of the operational regulations concerning expropriation risk (table 2). Here, MIGA is advised to consider no less than 57 rating factors when determining the underwriting premium rates and only one of these relates to the existence of an “investment protection agreement”.⁷⁸ This itself is a rather broad term, which apart from BITs for instance covers preferential trade agreements with investment chapters, the European Convention of Human Rights, and the Energy Charter Treaty.

-- insert table 2 around here --

Accordingly, current and past MIGA officials noted in interviews that while they naturally do follow the operational regulations by reviewing relevant BITs before issuing guarantees, the absence of a BIT is never in itself a sufficient reason for MIGA to withhold a guarantee. As one former high-ranking official stated, “BITs were of marginal importance within MIGA, and of no practical importance when covering political risks.”⁷⁹ In his experience, BITs were far from crucial when determining whether an investment was eligible for MIGA insurance or the pricing of such insurance. Similarly, a current senior official there mentioned that, “BITs are naturally important to our underwriting process, as we would like to know which rights we have in case of subrogation, but they are not at essential to underwrite an investment.”⁸⁰ Others concurred: “while we have to look to BITs, they are not important determinants to our perception of the risk of an investment project” and “it is very rare that BITs become crucially important for us in practice.”⁸¹

Suffice it to say that if countries engage in conduct that signals a scale-back of investor protections – such as violating existing BIT-obligations or withdrawing their consent to submit investment disputes to international arbitration - that would naturally be factored into

⁷⁷ Note also that art. 23(b)(iii) of the MIGA Convention states that the Agency shall: “promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investments.”

⁷⁸ Annex A(d)(3).

⁷⁹ Not-for-attribution interview, Washington DC, April 2009.

⁸⁰ Not-for-attribution telephone interview, October 2009. Note that just as government agencies, MIGA does not have standing under ICSID. In case benefits are paid out to investors, MIGA will typically recover its losses by requiring the investor to pursue the claim and be reimbursed by any subsequent proceeds, see, MIGA Convention Article 18(a), and Operational Regulations 4.15(i). For an example, see, K. W. Hansen, “A BIT of insurance,” in Theodore Moran, ed., *International political risk management: needs of the present, challenges for the future* (Washington DC: World Bank, 2007), p. 11.

⁸¹ Not-for-attribution interviews, Washington DC, May 2009.

MIGA's underwriting decisions.⁸² The relevance of this practice for countries such as Bolivia, which recently withdrew from ICSID, is obvious. However, for developing countries that are not planning to expropriate or otherwise maltreat its foreign investors, the message is clear, "provided we can expect a country to remain committed to foreign investments and the rule of law, cancelling all its BITs would not have a substantial impact on whether, and to what extent, MIGA would be willing to underwrite investments to that country."⁸³

3. *Private political risk insurers*

As an alternative to public PRI, private companies (mainly Anglo-Saxon) have offered investment insurance for the last three decades that complements or competes with those offered by government-sponsored programs.⁸⁴ Apart from relying on BITs' arbitration mechanism in case of disputes,⁸⁵ a few innovative companies have also attempted to incorporate BITs into their products. For one major firm "the treaties play a role as a guiding tool to whether we want to take a risk or not,"⁸⁶ and another finds that over the long term, BITs are likely to have an impact on the industry, as investors who manage to obtain favorable arbitration awards through the BIT-mechanism will be more effective in making subsequent claims against their insurers⁸⁷ (something that traditionally has been difficult for events that fall short of outright expropriation⁸⁸). So even if the host country does not honor its award, an arbitration ruling could in itself increase the chances of a favorable result in a

⁸² Not-for-attribution interview, Washington DC, May 2009; and not-for-attribution telephone interview, October 2009. Note also Annex A(f)(5), where the pricing of expropriation insurance is dependent on the "record of host state in honoring arbitral awards".

⁸³ Not-for-attribution interview, Washington DC, May 2009.

⁸⁴ Paul E. Comeaux & Norman S. Kinsella, "Reducing political risk in developing countries: bilateral investment treaties, stabilization clauses, and MIGA & OPIC investment insurance," 15 *New York Law School Journal of International and Comparative Law* 1 (1994), pp. 45. The following section is based on interviews with underwriters and senior managers from sixteen PRI providers and re-insurers. Table 1 above lists the vast majority of firms in the industry and their maximum capacity for "Confiscation, Expropriation, and Nationalization" (CEN) insurance. All firms and Lloyds syndicates on the list were contacted. Several did not respond and a few had policies of not disclosing information on their PRI policies. As a result, I have interviewed representatives from syndicates accounting for almost 50% of Lloyds' CEN capacity and representatives accounting for 50% of the listed firms' CEN capacity. I moreover interviewed representatives from a few additional firms not mentioned on the list, but whose risk-capacity I have not been able to trace or quote (information on the private PRI industry is generally in short supply). The interviews covered firms spread over the three leading insurance centres: the U.S. (primarily New York), Bermuda, and London (for an overview of the industry, see, World Bank, *World investment and political risk*, op. cit.). Interviews were semi-structured, but all were asked the question: "to what extent, if any, do BITs impact the pricing and coverage of political risk insurance of [company]". As was also the case for many BIT-negotiators, interviewees agreed only to be quoted on a not-for-attribution basis.

⁸⁵ As private insurance companies typically can't subrogate BIT-claims directly, some have instead paid for investors' legal expenses; not-for-attribution telephone interview, September 2009.

⁸⁶ Not-for-attribution telephone interview, September 2009.

⁸⁷ Not-for-attribution telephone interview, October 2009.

⁸⁸ One example of an unsuccessful expropriation claim against an insurer arising out of the Argentinian financial crisis is; *Sempra Energy v. National Union Fire Ins., Co. of Pittsburgh, Pa.*, not reported, *F.Supp.2d*, 2006 WL 3147155, S.D.N.Y., 2006, (October 31, 2006).

subsequent claim against an insurer.⁸⁹ Finally, a few firms have begun to insure treaty-based arbitration award defaults, an idea that became the talk of the town among industry leaders after a 2006 MIGA-Georgetown seminar, where it was suggested by a private lawyer.⁹⁰ While some firms continue to do so, the experiment was disappointing for others:

While we initially thought this was a good idea, the problem we found was that in the case of Argentina the BIT-process just didn't work. Arbitrations took much too long, and we were surprised there was not more World Bank pressure to honor arbitration awards. Naturally, this meant that investors are not particularly inclined to rely on the arbitration process, so now there is even less interest from those making FDI to buy such coverage. So in practice, BITs are not particularly important for us today with respect to either pricing or coverage.⁹¹

While such feedback is undoubtedly informative, what is perhaps particularly striking is that it is still the exception rather than the rule that insurance firms take BITs into account. Two experienced industry-representatives state:

“Just as extremely few investors seem to be aware of these treaties, most private insurers don't make them part of their underwriting process.”⁹²

“To take BITs seriously in insurance policies, as we do, is probably rather unusual within the industry.”⁹³

This impression is confirmed by interviews with representatives from large and medium-sized firms, Lloyd's Syndicates, and re-insurers, few of which find BITs of much relevance when determining the risk of investment projects:⁹⁴

“If it is a country we are not that familiar with we will look if they've signed up with MIGA and OPIC regimes, but not so much BITs.”

“While they should perhaps have a role to play, I would say they are likely to be considered completely irrelevant by underwriters today and thus irrelevant for the pricing of risk insurance. ... Rather than having a role in the investment decision, they are just an extra arrow in the lawyer's quiver on the occasions where disputes arise.”

“We do not take the treaties into account, because we are not convinced that they will have an impact on countries' willingness to pay out claims.”

⁸⁹ However, the prospects of having to go through lengthy BIT-arbitrations before being able to lead a successful claim against an insurer is of course not a particularly attractive option for foreign investors.

⁹⁰ Not-for-attribution interview with industry representative, London, August 2009. The presentation has been published: Hansen, A BIT of insurance, op. cit. See also; Robert T. Wray & Felton Johnston, “Treaty-based recourse for investor-host government disputes,” 1 *Political Risk Insurance Newsletter* 1 (April 2005); Felton Johnston & Robert Wray, “Insuring arbitration outcomes,” *Political Risk Insurance Newsletter* 2 (October 2005); Frederick Jenney, “Political risk insurance for collection of arbitral awards,” in Doak R. Bishop, ed., *Enforcement of arbitral awards against sovereigns* (New York: Juris, 2009), p. 223.

⁹¹ Not-for-attribution telephone interview, September 2009.

⁹² Not-for-attribution telephone interview, September 2009.

⁹³ Not-for-attribution telephone interview, October 2009.

⁹⁴ Not-for-attribution telephone interviews, September 2008 – October 2009. See *supra* note 84 on sampling and methodology.

“We do look at BITs occasionally. However, they are one out of so many factors we take into account and we actually don’t have any real experience with them. ... So the fact of the matter is that BITs most often don’t matter much.”

“They are practically never incorporated into decisions concerning the coverage and pricing of risk insurance. ... So while they probably should be taken into account, I’m not aware that they have in fact made any difference at all.”

“Do we look at BITs? Yes, but I have never experienced a risk not taken because the investment was not covered by a BIT, and they probably don’t impact pricing either.”

“For major infrastructure investments in difficult jurisdictions, they could potentially signal that host states are willing to uphold their contractual obligations with the investor. But BITs are never a prerequisite for insurance and I have never experienced that they have factored into an underwriting decision in any material way.”

“In theory, BITs should improve the risks, but in practice the jury is out on the actual value of these treaties, and they are certainly not a primary motivator for us.”

“We have never taken a great deal of notice of them. Governments wanting to expropriate will do it irrespective of their BITs, so they are not a primary consideration at all.”

“While some of the major American firms may take them into account, I think this is the exception. For underwriters, BITs would typically be very far down their checklist, and they are therefore unlikely to play a determining factor in the underwriting process.”

“I would be very surprised if out of a sample of 10 underwriters any of them would mention BITs as being directly relevant for their risk-evaluations. ... While the treaties are part of the backdrop to the investment regime, and will be relevant if claims arise, they don’t play any direct role for the ranking or pricing of investment risks.”

It appears that practitioners themselves find it unlikely that BITs have had a major impact on the private PRI market thus far. However, as with MIGA it is of course important to note that most industry representatives did mention that if cancelling or failing to honor existing BITs can be taken as signals that the host country plans to weaken its investor protections, then this would naturally be noted and taken into account in the underwriting process. But for developing countries that are otherwise in compliance with their international investment law obligations and treat foreign investors fairly and in a non-discriminatory way, BITs very rarely provide a “positive return” in the private industry’s underwriting process.

The conclusion arising from this review is therefore remarkable: BITs are basically aimed at reducing the risk of investing abroad, but the vast majority of public and private agencies that price the risk of foreign investments rarely take them into account to any serious extent. As will be elaborated upon in the conclusion, this does of course not mean that the review is, or should be, the final word in this debate. Indeed, many aspects of the relationship between PRI and BITs remain understudied. But for the purposes of this paper, it does appear to contradict the thesis that BITs are fundamental instruments to decrease the risk of investing abroad. It suggests that only when dealing with exceptionally questionable jurisdictions, or investor-state relations, do BITs have investment-promotion potential. For developing

countries aiming to attract foreign investment, this implies that BITs have a much more limited role to play than that often presented by staunch supporters of the BIT-regime.

D. BITs reconsidered

All in all, it is therefore unlikely that BITs are crucial to the decisions of most foreign investors about where, and how much, to invest abroad. This is implied by both econometric and survey evidence, by the limited interest BIT-negotiations tend to receive from investors themselves, and by the lack of attention of political risk insurers' to the treaties.

However, if the issue is simply a lack of awareness on the part of investors', then the rising awareness of BITs that is likely to follow from the current increase in BIT-claims may make the treaties much more important in the future. The same follows for the insurance industry, where some of the "innovators" in the industry expect that other firms may start taking the treaties into account after realizing their potential.⁹⁵ BITs' risk-reducing role should, as suggested by Wälde, materialize only "over time and [only] once the application [of the treaties] is sufficiently well tested."⁹⁶ Perhaps econometric studies and surveys may soon conclude that while BITs were not important drivers of investment in past decades, they are today. On the other hand, there are reasons other than ignorance that may explain why BITs are not particularly useful for most developing countries to attract investments.

First of all, it is doubtful that "obsolescent bargaining" is as important a strategic problem for investors as is often assumed. Rather than regarding the bargaining relationship between foreign investors and their host countries as a two-step prisoner's dilemma, a substantial body of evidence suggests that host countries are typically aware of the long term reputational costs of mistreating foreign investors.⁹⁷ While uncompensated expropriation (direct or indirect) as well as other regulatory abuses of foreign investors obviously still occur in the developing world, it is in many cases not as substantial a concern as is implied by obsolescent bargaining models. The premiums caused by regulatory risks are often surprisingly limited - even in "high risk" sectors where investments tend to be sunk post-

⁹⁵ Not-for-attribution telephone interview, October 2009.

⁹⁶ Quoted in Jason W. Yackee, "Do we really need BITs? Toward a return to contract in international investment law," 3 *Asian Journal of WTO and Health Law* 121 (2008b), p. 128. Note, that this is arguably what happened in the sphere of international commercial arbitration, when a series of petroleum disputes in the 1970s made multinationals aware of the utility of carefully drafted investment agreements, which in turn led to an increase in the use of such agreements, see, Yves Dezalay & Bryant G. Garth, *Dealing in virtue: international commercial arbitration and the construction of a transnational legal order* (Chicago: University of Chicago Press, 1996), p. 92.

⁹⁷ Yackee, Do we really need BITs? Toward a return to contract in international investment law, op. cit., pp. 125-6.

establishment.⁹⁸ This suggests that the risks which BITs are intended to reduce may often be much lower than is often assumed.⁹⁹

Second, to the extent that BITs do cover risks that are of practical concern to investors, a range of market-based strategies are available to confront them. Entering into joint ventures with local companies, obtaining financing from local creditors, structuring investments over long time periods, or bringing in powerful partners such as major foreign banks, are options for investors to insure that a host country has a long-term interest in treating them fairly.¹⁰⁰ Also, multinationals can finance their investments by borrowing from national or international agencies such as the International Finance Corporation (a World Bank institution), OPIC, the European Bank for Reconstruction and Development, or the Asian Development Bank. Since many developing countries are dependent on these agencies for future funding, they will be deterred from interfering with the investor's assets.¹⁰¹ Rather than using legal protections in treaties, the management of political risk is thus often handled through business strategies on the ground.

Third, obtaining investment insurance as an alternative to reliance on BITs is often a more direct and straightforward option to protect investment against political risks, given that investors can obtain compensation even if the host country refuses to pay damages.¹⁰² The determination and payment of PRI recovery is also likely to be quicker than the BIT arbitration process. Moreover, just as financing by national or international agencies can provide host countries with a greater incentive to treat investors fairly, this is also the case

⁹⁸ See references in; Yackee, Do we really need BITs? Toward a return to contract in international investment law, op. cit., pp. 126-7.

⁹⁹ Instead, it is often government regulations not covered by (most) BITs, which are of concern to investors in their establishment phase, such as lack of transparency, performance requirements, or other direct or indirect barriers to market access. On the importance of market access regulations; see T.N. Sofres, "Survey of the attitudes of European business to international investment rules," European Commission DG Trade, (2000); see also, United States Congress Committee on Foreign Relations U.S. policy toward international investment, "Hearing before the subcommittee on international economic policy of the committee on foreign relations," 97th Cong., 1st Sess. (1981).

¹⁰⁰ Comeaux & Kinsella, Protecting foreign investment under international law: legal aspects of political risk, op. cit., pp. 130-1; C. Lipson, *Standing guard: protecting foreign capital in the nineteenth and twentieth centuries* (Berkeley: University of California Press, 1985), pp. 127-30; Erik Woodhouse, "The obsolescing bargain redux? Foreign investment in the electric power sector in developing countries," 31 *New York University Journal of International Law and Politics* 121 (2006); Ravi Ramamurti, "Can governments make credible commitments? Insights from infrastructure projects in developing regions," 9 *Journal of International Management* 253 (2003).

¹⁰¹ Comeaux & Kinsella, Protecting foreign investment under international law: legal aspects of political risk, op. cit., p. 131. See generally Gerald T. West, "Political risk investment insurance: a renaissance," 5 *Journal of Project Finance* 29 (1999); Matsukawa & Habeck, Review of risk mitigating instruments for infrastructure financing and recent trends and developments, op. cit. Note that these considerations are also taken into account when MIGA underwrites investments, see e.g. Annex A(b)(15) and A(b)(16) quoted in table 2.

¹⁰² Note that as it was suggested above in the case of BITs, it also appears to be medium sized investors that have particular use of PRI, see, MIGA, "Survey of political risk insurance providers," report, January 2008, table 8. On the difficulties of enforcement and execution of BIT-obligations, see, Alan Alexandroff & Ian A. Laird, "Compliance and enforcement," in Peter Muchlinski, Federico Ortino, & Christoph Schreuer, eds., *The Oxford handbook of international investment law* (New York: Oxford University Press, 2008).

with investments covered by agencies such MIGA.¹⁰³ If developing countries fail to resolve disputes with MIGA, they may risk a suspension of both future aid and loans from the World Bank.¹⁰⁴ Similar actions may be taken by national governments as well as private insurance companies if their insurance claims are not solved in a satisfactory manner. As a result: "... once the full cost of prospective action against an insured investor is realized, these disputes often become "misunderstandings" which are quietly and successfully resolved."¹⁰⁵ While MIGA, for instance, has issued guarantees for more than US\$17 billion since its inception in 1988, it has only had to pay out five claims to investors, only two of which were based on expropriation.¹⁰⁶ Similarly, while the German government grants guarantees for Euros 6 billion a year, it is exceptionally rare that it has had to pay out damages as the vast majority of disputes are settled diplomatically.¹⁰⁷

Finally, the idea promoted by Guzman and others that BIT's are the *only* investment protection instruments that can "tie governments to the mast" of international law is somewhat peculiar. For if various transaction strategies, insurance products or other instruments cannot provide sufficient protection against political risks, investors still have the option of relying on investment contracts governed by international law.¹⁰⁸ These can secure investments with the same standards as investment treaties, including recourse to international arbitration backed by the New York or ICSID Conventions.¹⁰⁹ And while the question of whether, and to what extent, there exists an "international law of contracts" has been subject to some debate,¹¹⁰ it is nevertheless indisputable that international tribunals have recognized their jurisdiction over the arbitration of investor contracts disputes

¹⁰³ Comeaux & Kinsella, *Protecting foreign investment under international law: legal aspects of political risk*, op. cit., p. 184; West, *Political risk investment insurance: a renaissance*, op. cit.

¹⁰⁴ Note that in the eyes of some private insurers, this is in contrast with the BIT-regime as indicated by the quote pertaining to this issue above. Another representative from the industry notes: "We were surprised to learn that it doesn't seem to have an impact on World Bank lending policy, when a country defaults on its ICSID obligations. It appears the whole BIT-system is lacking teeth," not-for-attribution telephone interview, September 2009.

¹⁰⁵ West, *Political risk investment insurance: a renaissance*, op. cit.

¹⁰⁶ The other three were based on coverage of war and civil disturbance; not-for-attribution telephone interview, October 2009.

¹⁰⁷ Not-for-attribution telephone interview, April 2009.

¹⁰⁸ See generally; Yackee, *Do we really need BITs? Toward a return to contract in international investment law*, op. cit.; Jason W. Yackee "Pacta sunt servanda and state promises to foreign investors before bilateral investment treaties: myth and reality," 32 *Fordham International Law Journal* 1550-1613 (2009b).

¹⁰⁹ Ingrid Delupis, *Finance and protection of investments in developing countries* (Epping: Wiley, 1973), p. 41. Note that many developing countries often also enshrine the right to international arbitration in their domestic investment laws, see, Ibrahim F. I. Shihata & Antonio Parra, "The experience of the international centre for settlement of investment disputes," 14 *ICSID Review- Foreign Investment Law* 299 (1999).

¹¹⁰ For some notable critics, see, Ian Brownlie, *Principles of public international law* (New York: Oxford University Press, 1990), p. 549; Derek William Bowett, "State contracts with aliens: contemporary developments on compensation for termination or breach," 59 *British Yearbook of International Law* 49(1988), p. 54. For a recent discussion, see, A. F. Munir Maniruzzaman, "State contracts in contemporary international law: monist versus dualist controversies," 12 *European Journal of International Law* 309 (2001). See also; The International Law Commission, "Commentaries to the draft articles on responsibility of states for internationally wrongful acts," *Official Records of the GA, 56th Sess, Supp. No. 10 (A/56/10), ch. IV.E.2* (2001), p. 87.

throughout the post-war era and have relied, when necessary, on principles of law outside the host country to provide meaningful compensation for both expropriation and other contractual breaches.¹¹¹ Even the adoption of the Charter of Economic Rights and Duties of States did not dispense with international tribunals' willingness to treat investor-state contracts as enforceable, both in principle and in practice, as well as provide investors with compensation for their losses.¹¹² One of the key assumptions of Guzman's analysis, namely that "[t]he mechanisms for the enforcement of a contract between a state and a private firm is at best extremely weak and at worst altogether non-existent,"¹¹³ therefore appears doubtful. Even in the absence of BITs, investors are quite capable of obtaining credible guarantees from their host countries through carefully drafted contracts.¹¹⁴ In fact, from the perspective of many investors, contracts should be superior legal instruments to protect their assets compared to BITs. Apart from allowing the parties to use much more precise terms than the often vague provisions found in BITs, they also go further in specifying additional rights and obligations. With respect to substantial provisions, they thus typically deal with royalty and tax rates, customs regulations, stabilization of law, and other key issues not dealt with in BITs, and with respect to procedural rights, international law precludes host countries from revoking their consent to arbitrate contractual disputes if the investor does not agree.¹¹⁵ This is in contrast to BITs, where states' can unilaterally revoke their consent to international arbitration, if investors have not yet formally provided their own reciprocal consent (which in the absence of a contract typically doesn't happen before an actual dispute arises). Given these considerations, Yackee is therefore correct when stating that:

... foreign investors engaged in the riskiest investment projects have long had the ability to harness the powers of international law and international adjudication to legally secure their economic relationships with developing country host states. They have done so, and continue to do so, through the institution of contract.¹¹⁶

When considering whether contracts are perfect substitutes for BITs, it is naturally true that smaller investors may have less bargaining power when negotiating contracts with host

¹¹¹ Yackee, *Pacta sunt servanda and state promises to foreign investors before bilateral investment treaties: myth and reality*, op. cit., pp. 61-2. Of course, this does not imply that every breach of contracts amounts to breaches of international law, see American law institute, *Restatement of the law, foreign relations law of the United States* (1986), at 712, Comment h, vol. 2, p. 201 ("... not every repudiation or breach by a state of a contract with a foreign national constitutes a violation of international law.").

¹¹² Yackee, *Pacta sunt servanda and state promises to foreign investors before bilateral investment treaties: myth and reality*, op. cit.

¹¹³ Guzman, *Why LDCs sign treaties that hurt them: explaining the popularity of bilateral investment treaties*, op. cit., pp. 659-60. He continues: "[I]t is reasonable to model investor behavior under the assumption that these rights are of little or no value to the investor. More importantly, because these protections are unreliable, international law does not allow the host to make credible contractual commitments."

¹¹⁴ The best guarantee to 'internationalize' contracts is of course to have it apply stabilization clauses, general principles of law and/or international law, as well as international arbitration.

¹¹⁵ Yackee, *Do we really need BITs? Toward a return to contract in international investment law*, op. cit., p. 136. On the rules of ICSID in this regard, see, Schreuer, op. cit., pp. 206-7.

¹¹⁶ Yackee, *Do we really need BITs? Toward a return to contract in international investment law*, op. cit., pp. 122-3. See also, Jose E. Alvarez, "The once and future foreign investment regime," in Manoush Arsanjani, Jacob Cogan & Siegfried Weissner, eds., *Looking to the future: essays on international law in honor of W. Michael Reisman* (The Hague: Martinus Nijhoff, 2010 forth.).

governments compared to large multinationals. However, BITs are arguably of limited value to them anyway due to the expensive and time-consuming mechanisms of international arbitration.¹¹⁷ Similarly, while it is important to note that the home government of an investor is of course not party to a contract; investors nevertheless often use their governments to assert pressure on the host country to uphold its contractual obligations. Lastly, while the difficulty of enforcing damages against sovereigns of course imply that contractual instruments cannot *guarantee* that host countries will uphold their commitments to investors, neither can BITs.

Apart from obtaining indirect protection through a range of market-based instruments, such as distributing shareholdings or obtaining lending from major lending institutions, PRI and investor-state contracts thus also provide investors with plausible and effective remedies when worried about political risk. The claim that BITs are the only instruments capable of convincing foreign investors that their assets will be safe post-establishment therefore appears somewhat detached from realities on the ground.

Conclusions

Preambles in BITs typically state that the treaty's purpose is to protect and promote foreign investments between the contracting parties. While the rising number of BIT awards to investors show that the first part of this objective can be fulfilled, this study has shown that it is probably only a very small share of the global BIT network that actually helps developing countries attract foreign capital to any significant extent.

The case of Brazil is a useful reminder that BITs should not be necessary for developing countries aiming to attract capital from abroad. Brazil is the only developing country that has not ratified any BITs, regional or multilateral investment treaties, or the ICSID convention itself. Shifting Brazilian governments have nevertheless been very successful in attracting foreign investments over the last couple of decades, and Brazil remains among the most attractive investment locations for multinationals.¹¹⁸ According to UNCTAD – an organization which has otherwise encouraged developing countries to sign BITs¹¹⁹ – FDI to Brazil has not been impeded by its lack of BITs, as Brazil's domestic regulation and practice already accords foreign investors favorable standards.¹²⁰ Since all other developing countries have jumped on the BIT-bandwagon, it remains an open question whether the extent to which Brazil's experience is relevant to countries with smaller markets and less stable and investor-friendly political and legal institutions. However, in the context of the evidence

¹¹⁷ See Danião, Opening remarks, op. cit.

¹¹⁸ UNCTAD, *World Investment Report 2008* (New York, UNCTAD, 2008), p. 28. See also, Elizabeth Whitsitt & Damon Vis-Dunbar "Investment arbitration in Brazil: yes or no?," *Investment Treaty News*, December 2008.

¹¹⁹ See UNCTAD, The impact on foreign direct investment of BITs, op. cit., pp. 347-8; Elkins, Guzman, & Simmons, *Competing for capital: the diffusion of bilateral investment treaties, 1960-2000*, op. cit.; and Poulsen, *The significance of south-south BITs for the international investment regime: a quantitative analysis*, op. cit.

¹²⁰ UNCTAD, *Investment policy review of Brazil*, op. cit., pp. 39.

presented in this chapter, it appears as though the worst-case scenario for developing countries refraining from signing BITs is not as serious as Guzman and others suggest.

That said; there is naturally ample room for taking the debate further by addressing a range of more detailed questions than those raised here. Higher quality FDI data will allow future econometric studies to be more rigorous in their approach and more detailed surveys and in-depth interviews - with for instance multinationals' in-house legal counsel¹²¹ - could provide further specific insights on the role of BITs in investors' decision-making process. Also, while the review of the role of BITs for PRI agencies presented here is the most comprehensive of its kind to date, its simplicity and scope still leaves many questions unresolved. A basic question not addressed, is under what circumstances PRI can provide greater coverage than BITs, and vice versa? While this is of obvious relevance to investors and their advisors, there is unfortunately no (publicly available) examination which in depth juxtaposes the protections of BITs with those granted in various PRI programs. Moreover, empirical work could investigate in more detail those situations where BITs are in fact of practical relevance to the PRI market. While my review suggests that such situations may be rare, they are nevertheless important. For instance, subrogation rights under BITs are often mentioned in the literature, but only in passing. But what role does subrogation really play for public PRI agencies *in practice* given that they are confined to non-ICSID proceedings;¹²² and since BITs typically limit subrogation rights to public PRI programs, how are private insurers involved in the BIT arbitration mechanism?¹²³ Similarly, case studies, surveys, or - data permitting - quantitative methods could more carefully scrutinize under what circumstance the treaties' actually do function as signaling devices when PRI policies are drafted. Apart from whether the insurer is public or private, the answers to these questions are likely to vary depending on investments' sector, size, region, and so forth. It appears there is a whole research agenda here that is almost entirely unexplored, so while it can be difficult for outsiders to access information in the PRI industry, successful attempts could have potential to provide great insights of interest to governments, investors, legal practitioners and academics alike.

For now, however, it does appear as though the answer to the 'big question' – how important are BITs in promoting investment? – is rather clear: quantitative and qualitative data currently available clearly suggests that while BITs undoubtedly play a role in some investment projects, they are highly unlikely to be a determining factor for the vast majority of foreign investors determining where, and how much, to invest. As more and more developing countries begin to review their BIT-policies, this is an important point to keep in mind. First of all, it could serve as a bargaining chip in their favor. Given the miniscule impact BITs typically have on investment flows, arguments by developed countries that wide-ranging treatment and protection standards will help developing countries attract foreign investment would be misguided. Accordingly, if developing countries want to more

¹²¹ This has also been suggested by Yackee, *Sacrificing sovereignty: bilateral investment treaties, international arbitration, and the quest for capital*, op. cit.; and Yackee, *Bilateral investment treaties, credible commitment, and the rule of (international) law: do BITs promote foreign direct investment?*, op. cit.

¹²² See supra note 59.

¹²³ See also supra note 85.

carefully restrict and clarify the scope of post-establishment provisions in future BITs - or renegotiations of existing BITs - they should perhaps insist on doing so. Secondly, depending on developing countries' specific preferences towards admission and establishment of foreign investments, efforts could be made to replace BITs' traditional vague language on investment promotion with legally binding commitments. Rather than purely serving as protection mechanisms for (primarily) Western investors, this could allow BITs to fulfill their intended purpose by also becoming important tools to facilitate investments to the developing world.

FIGURES AND TABLES

Figure 1. The influence of international investment agreements on the locational decisions of corporate executives

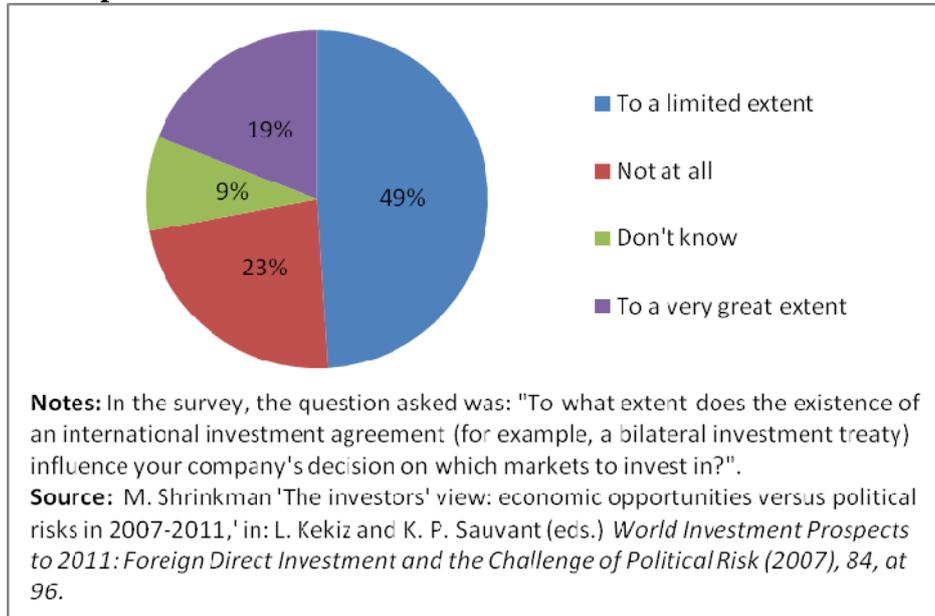


Figure 2. Awareness of BITs among European investors

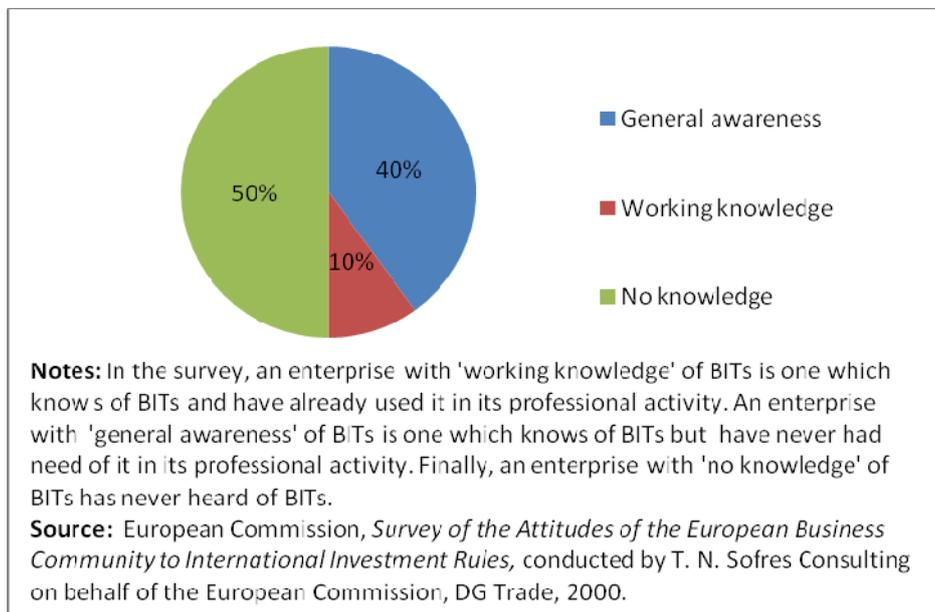


Table 1. Providers of political risk insurance for foreign investors

PROVIDER	MARKET CAPACITY PER PROJECT
SELECTED PUBLIC PROVIDERS	
Atradius Dutch State Business NV (Netherlands)	100 mio EUR (max. compensation), 15 years
ECGD (UK)	No stated limit, 15 years
EDC (Canada)	No stated limit, 15 years
EKF (Denmark)	No stated limit, 15 years
MIGA (Multilateral)	110 mio USD, 15 years
NEXI (Japan)	No stated limit, 15 years
OPIC (United States)	250 mio USD, 20 years
PwC/Euler Hermes (Germany)	No stated limit, 15 years
SACE (Italy)	No stated limit, 15 years
COMPANIES	
ACE European Group Ltd	80 mio USD, 10 years
AIG	120 mio USD, 15 years
Aspen	70 mio USD, 7 years
Atradius	70 mio USD, 6 years
Axis	100 mio, 7 years
Coface	70 mio, 10 years
Chubb	75 mio USD, 10 years
HCC	35 mio USD, 5 years
Sovereign	100 mio USD, 15 years
Zurich	150 mio USD, 15 years
LLOYD'S SYNDICATES (syndicate no.)	
Ace Global Markets (2488)	80 mio USD, 10 years
Amlin (2001)	12,5 mio USD, 3 years
Ark (4020)	32 mio USD, 7 years
Ascot (1414)	15 mio USD, 5 years
Aspen (4711)	70 mio USD, 7 years
Beazley (623)	30 mio USD, 7 years
Catlin (2003)	90 mio USD*, 10 years
Chaucer (1084)	20 mio USD, 5 years
Hardy (382)	20 mio USD, 5 years
Hiscox (33)	25 mio USD, 5 years
Kiln (510)	60 mio USD, 7 years
Liberty Syn Mgmt (4472)	15 mio USD, 5 years
Limit (1036)	10 mio USD, 3 years
Marketform (2468)	15 mio USD, 5 years
MAP (2791)	20 mio USD, 3 years
Novae (2007)	20 mio USD, 5 years
C.V. Starr (1919)	15 mio USD, 7 years
Pembroke (4000)	10 mio USD, 5 years
QBE (1886)	50 mio USD, 7 years
Talbot (1183)	20 mio USD, 5 years
<p>Notes: Figures for private providers are with respect to 'Confiscation, Expropriation, and Nationalization' (CEN) insurance.</p> <p>* Industry representatives state that in practise the maximum line of Catlin's London-platform is only 30 mio USD.</p> <p>Sources: Author's compilation based on publicly available information, industry inputs, and FirstCity, <i>Political Risks Insurance: Report and Market Update</i>, July 2009.</p>	

Table 2. Rating factors for MIGA when considering risk of expropriation and similar measures

A. Investment

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

B. Investment Project

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

C. Guarantee Holder

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

D. Host Country

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

E. Terms and Conditions of Guarantee

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

F. Potential for Recoupment

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

Source: MIGA Convention Annex A.
