

BARGAINING OVER BITS, ARBITRATING AWARDS

The Regime for Protection and Promotion of International Investment

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THE past three decades have seen the spectacular development and spread of international rules governing foreign direct investment (FDI). Research on why states have signed on to these rules and their effect on investment flows abounds. This article takes a more critical approach than most to the development and consequences of the “regime” for international investment. It examines the bargaining dynamics that have led to broad and asymmetrical rights for private economic agents, considers some of the consequences of such rights, and documents states’ efforts to renegotiate some of the central aspects of the regime. It also speaks to the conditions under which states make exceptionally constraining legal commitments and some of the governance consequences of such commitments. States have begun to push back against the investment regime, often attempting to guard their policy space in the face of the legal arrangements that constrain them. Credible commitment making is not exclusively about attracting capital; it is also a choice about economic governance more generally.

The nature and operation of this international legal regime is potentially relevant to global flows of foreign direct investment, estimated to reach \$1.45 trillion in 2013 and applicable to a worldwide stock of FDI in

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2012 of about \$20 trillion.¹ Yet, little research in international relations has taken a close look at it. Investment treaties should be examined in a broader context and be compared with, for example, institutions for the protection and promotion of trade. Bilateralism and a private right of standing for private corporate actors imbues the international investment regime with a peculiar character that stimulates competition for capital, weakens the bargaining position of states when they are in a vulnerable economic position, and exposes them to legal liabilities that they may not have anticipated when they “tied their hands” under these agreements in the first place. While investment treaties may indeed have facilitated some capital imports, researchers have neglected the other side of the coin: pushback from public actors who increasingly view the investment regime as currently constituted as not in their interest. A result has been, as one legal scholar puts it, “one of the most dynamic and controversial areas of international law today.”²

This article focuses on the international investment regime—from the negotiation of treaties to dispute settlement. By “international investment regime,” I mean the collection of often decentralized (even sometimes incoherent) rules about the promotion and protection of foreign direct investment.³ The first section puts the investment regime in context by comparing it with the regime for international trade. While space constraints do not allow for full testing of a range of explanations here, I suggest one reason for the differences between the two may be differences in dynamic contracting for trade and investment. Section II reviews existing explanations for the spread of bilateral investment agreements. It supplements existing research that characterizes the ratification of bilateral agreements as competition for capital and hard bargaining. The finding that bilateral investment treaties (BITs)—and especially their more delegative forms of dispute settlement—are associated with declining economic conditions supplements the findings of Todd Allee and Clint Peinhart in this symposium.⁴ Section III explores the sovereignty consequences of the spread of BITs. Evidence suggests that they may have underdelivered investment and served up an unexpectedly large wave of litigation. Moreover, new evidence is beginning to suggest that this litigation is contributing to expansion of

¹ See *World Investment Report 2013: Global Value Chains: Investment and Trade for Development*. Geneva, Switzerland: United Nations Conference on Trade and Development. Available at http://unctad.org/en/PublicationsLibrary/wir2013_en.pdf.

² Yackee 2012.

³ For an explicit application of the regimes concept to international investment law, see Salacuse 2010.

⁴ Allee and Peinhart 2014.

the already asymmetrical legal rights of investors. In Section IV, I present evidence that states are beginning to resist and renegotiate the rules that seem increasingly to threaten their sovereignty. The international investment regime is under pressure to change, reflecting push-back from states who feel the balance of advantages favoring investors has gone a little too far.

I. BACKGROUND: A TALE OF TWO REGIMES— TRADE AND INVESTMENT

International economic cooperation is characterized by one obvious fact without a clear explanation: even though international trade and international investment agreements both purport to facilitate economic relations across borders, and even though they are sometimes even addressed in the same treaties, these two clusters of law are *substantially* different. The differences are hardly appreciated by social scientists largely because the legal regime for FDI has developed under the radar of most international relations and international political economy scholars.⁵ There are at least two stark contrasts between the international institutions governing trade and investment: their respective degrees of centralization and the nature of rights given to private actors.

DECENTRALIZATION OF THE INVESTMENT REGIME

The international investment regime has no single institutional core; rather, it is comprised of a relatively decentralized system of rules, norms, and dispute resolution procedures. In contrast to international laws governing trade, which are influenced overwhelmingly by the laws of the General Agreement on Tariffs and Trade/World Trade Organization (GATT/WTO), investment rules developed first through customary international law, and more recently through a system of bilateral and regional treaties whose primary purpose is to encourage international investment by protecting property rights of investors in foreign jurisdictions.⁶

⁵ A JSTOR search of economics and political science journals produced 219 articles whose abstracts include “WTO” and only four that include “ICSID.” Another JSTOR search of these two disciplines turned up 569 articles with “international trade” in the abstract compared to only twenty-seven with “international investment” in the abstract. Interestingly, international investment treaties have also escaped much public political scrutiny: while congressional votes over trade agreements often make the news, the US Senate does not even register roll-call votes on bilateral investment treaties. By comparison, international lawyers have written voluminously in this area, likely because of the demand for their services as counsel and arbitrators.

⁶ There may be some tendency for countries with BITs also to agree to preferential trade agreements (Tobin and Busch 2010), but such a relationship is by no means linear and hardly undercuts the observation that the core of the trade regime is the multilateral WTO system.

These institutional differences are puzzling. As Allee and Peinhardt show, at the level of individual treaties the design of the international investment regime is not completely explicable from a rational design point of view.⁷ One might think that uncertainty about the security of investment and coordination problems among investors and hosts could encourage centralization.⁸ One might also expect a higher degree of centralization in investment rules, since the major players are multinational and would benefit from consistent rules around the world. But these conjectures do not explain why the investment regime tends to be more decentralized than is the case for the trade regime (although the latter is decentralizing as preferential and regional trade agreements become more common).

Despite the fact that the major capital-exporting countries have historically converged on general principles of customary international law,⁹ they have not been able to agree on multilateral treaty provisions among themselves, and certainly not with developing countries. Twice in modern history (in discussions of the International Trade Organization in 1947 and the Multilateral Agreement on Investment in 1995–98), notable efforts were made to multilateralize the international investment regime, and both failed. Even the GATT's Uruguay Round (1986–94), noted for its sweeping accomplishments codified in fifty major new agreements, touched on investment in a relatively minor way.¹⁰ By the end of the Uruguay Round, attention to FDI amounted to little more than a patchwork of international rules.¹¹

While multilateralism languished, bilateral investment agreements flourished. Capital-exporting countries did not respond to the growing risks to investment in the 1950s and 1960s and to ITO and Organization for Economic Cooperation and Development (OECD) failures by sitting on their diplomatic hands. The governments of these countries

⁷ Allee and Peinhardt 2014.

⁸ Koremenos, Lipson, and Snidal 2001, 771.

⁹ The basic premise was reflected in customary international law of the time; no government was entitled to expropriate private property, for whatever purpose, without providing prompt, adequate, and effective payment. See then-US Secretary of State Cordell Hull's note to the Mexican Minister of Foreign Affairs during the 1938 dispute over land expropriations, reprinted in Green H. Hackworth's *Digest of International Law*, vol. 3, sec. 228 (1942). The rule itself predates Hull's statement, and it was restated in various decisions from the early part of the twentieth century. See *Concerning the Factory at Chorzow* (Ger. v. Pol.), 1926–29 P.C.I.L. (ser. A), Nos. 7, 9, 17, 19; *Norwegian Shipowners Claims Arbitration* (U.S. v. Nor.) 1 Rep. Int'l Arb. Awards 307 (1922).

¹⁰ Trade Related Investment Measures (TRIMs), whose express purpose it was to facilitate international investment but that were clearly limited to "investment measures related to goods only;" TRIMs article 1 and the General Agreement on Trade in Services (GATS), which introduced the idea of "commercial presence"—via investment—to the WTO; and Trade Related Intellectual Property (TRIPS), which protected intellectual property and technology transfers. Dattu 2000.

¹¹ Kurtz 2003, 723.

began quietly at first to negotiate a series of agreements with potential host states to address any ambiguity in the law of investment protection. BITs were innovative in a number of respects. In general, they offer a wider array of substantive protections than the customary rule. For example, BITs typically require national treatment and most-favored-nation (MFN) treatment of foreign investments in the host country.¹² They usually protect contractual rights,¹³ guarantee the right to transfer profits in hard currency, and prohibit or restrict the use of performance requirements.¹⁴ Perhaps most importantly, BITs provide for international arbitration of disputes between the investor and the host country.¹⁵ This is an unusual arrangement in international law and is discussed in greater detail below.

Judged by their spread, BITs appear to have been spectacularly successful. Today there are some 2,600 known bilateral agreements governing foreign investment in every region of the world and an increasing number of free trade agreements that include analogous investment provisions as well.¹⁶ Their growth was exceptionally explosive in the 1990s.¹⁷ But clearly, an international consensus has never existed for the development of a “World Investment Organization.” Rather, rules are negotiated largely bilaterally and disputes settled in a much more ad hoc fashion than is the case with trade in goods and services. Arguably, bilateralism has exacerbated the competitive rush to sign BITs and contributed to bargaining concessions by developing countries when and where their bargaining power has been weakest.

THE PRIVILEGED POSITION OF PRIVATE ACTORS: A PRIVATE RIGHT OF STANDING IN THE INVESTMENT REGIME

The trade regime and the investment regime have another interesting difference. Trade agreements are generally enforced by official state actions through public mechanisms such as sanctions, while investment rules—at least as they have developed in the past fifty years of treaty law—are generally enforced by firms exercising a private right of action, typically granted in the treaties themselves, which may result in monetary compensation for damages.¹⁸

¹² E.g., the 1994 US Prototype Bilateral Investment Treaty, Office of the Chief Counsel for International Commerce, US Department of Commerce; Article 2(1), 2(2)(a).

¹³ E.g., 1994 US Prototype BIT, Article I(d)(ii).

¹⁴ E.g., 1994 US Prototype BIT, Article V(1–2).

¹⁵ E.g., 1994 US Prototype BIT, Article IX.

¹⁶ NAFTA, chap. 11. It is interesting that while bilateral BITs have spread, few if any have expanded to take on more members.

¹⁷ Elkins, Guzman, and Simmons 2006.

¹⁸ Historically, by contrast, customary international legal protection for investors was generally mediated by state-to-state relationships, Schill 2010, 36. Furthermore, friendship, commerce, and navi-

Giving investors a right to sue states for compensatory damages directly before an international tribunal represented a paradigm shift from the prevailing customary international law (CIL) relating to foreign direct investment. The state-to-state system of dispute settlement on which CIL was premised¹⁹ was replaced by a system in which investors could seek compensation for losses due to host government actions without the support or even the approval of their home governments. This private right to sue a government for damages and to choose the forum in which to do so²⁰ constitutes the most revolutionary aspect of the international law relating to foreign investment in the past half-century.²¹ It is reflected not only in almost all BITS, but also in several important regional and sector-specific investment agreements, such as the Energy Charter Treaty (ECT), the North American Free Trade Agreement (NAFTA), and the Central American Free Trade Agreement (CAFTA).²²

The comparison between BITS and the WTO and the trade provisions of CAFTA and NAFTA is stark. These latter agreements allow *states only* to initiate disputes over trade practices,²³ although firms can of course lobby their governments to take up their cause. Outside of the EU, trade treaties do not provide for monetary remedies for firms in case of trade law violation.²⁴ Trade and investment rules are sharply different with respect to their duration as well: whereas a state can exit the WTO with a mere six months' notice of intent to withdraw, BITS typically continue to bind for ten to fifteen years after their termination.²⁵

While it is beyond the scope of this article to test fully a satisfying

gation agreements negotiated by many governments to protect investments prior to the rise of BITS typically did not explicitly contain such a right. See Sykes 2005, 4.

¹⁹ Schill 2010, 34–6. For example see the Case Concerning the Payment of Various Serbian Loans Issued in France. Available at: http://www.worldcourts.com/pcij/eng/decisions/1929.07.12_payment1.htm.

²⁰ BITS typically apply the rules of the International Center for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL). See the 2012 US Model BIT, Article 24. Available at: <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>.

²¹ Schill 2010. Similarly, investors' direct access to international tribunals represents a "normative breakthrough" according to Grazzini 2012.

²² The ECT has investment dispute settlement provisions for both investor-state and state-state disputes (Part V). While twenty-three claims have been initiated by investors against host states, to date there have been no state-state disputes under the ECT. Hobér 2010.

²³ The EU is more complicated in that individuals can petition the European Court of Justice if their government is thought to have violated European law; individuals thereby indirectly have standing to enforce international trade agreements in the EU context.

²⁴ Under NAFTA and the WTO, parties are not prohibited in cases of a trade violation from agreeing to a settlement that includes monetary damages, but they rarely do so. Sykes 2005, 8.

²⁵ WTO withdrawal procedures are in Article XV of the Marrakesh Agreement, available at http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_005545.asp. On typical BIT obligations, see Grazzini 2012.

explanation, the basic distinctions between these regimes may result in part from the different risks faced by traders and investors. One possibility is that investment poses a greater credibility problem for potential hosts than trade in goods does for potential importers.²⁶ It might be necessary for hosts to tie their hands more tightly to attract investment because they are likely to have more time-inconsistent preferences than importing countries, with respect to trade liberalization. It may be rational to promise investors special tax, zoning, or regulatory concessions to encourage them to make an investment that would be costly to withdraw. But once the investment is made, it may be rational for the host country to withdraw those concessions and to impose other costs up to and including expropriation. As has long been recognized in the obsolescing bargaining literature,²⁷ the greater the sunk cost of investment, the greater the dynamic risk for investors. Time-inconsistent preferences are far less acute in the trade area: once allowed entry, competitive goods are likely to weaken domestic producers, erode their political opposition, and develop a consumer-based constituency. Once goods are imported, changing political pressures may actually make importing governments' ex ante and ex post preferences more consistent over time.²⁸

Furthermore, the logic of credible commitment making is reinforced by a weaker logic of reciprocity in the investment area than in trade. Traditionally, investment flows have been lopsided: developing countries want to attract capital but they are rarely capital exporters themselves on a significant scale. That is one reason why investor protections contained in BITs historically may have tended to involve a highly developed and developing dyad (though this is changing),²⁹ and why defendants in the trade regime (GATT and WTO cases) are overwhelmingly rich developed states while defendants in the investment regime (cases registered with the International Center for Settlement of Investment Disputes [ICSID]) are overwhelmingly middle or lower income states (Figure 1). Reciprocity is most useful as an enforcement mechanism where the players' interactions are symmetrical: where reciprocity is weak (across the developmental divide), legal hands-tying may be useful.

In short, private investing actors have special privileges in international law compared to any other private actors, and they are increas-

²⁶ Sykes 2005, 17.

²⁷ Kobrin 1987; Vernon 1971.

²⁸ Rogowski 1989.

²⁹ Elkins, Guzman, and Simmons 2006.

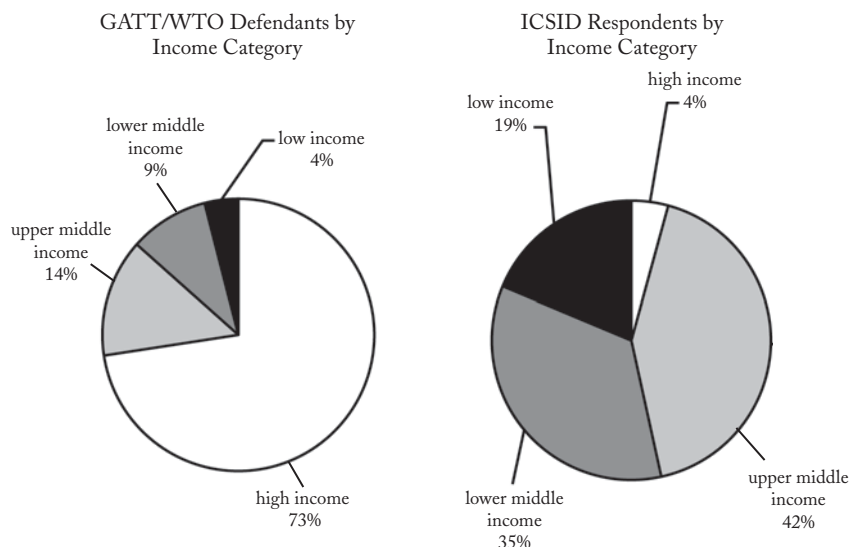


FIGURE 1

COMPARISON OF DEFENDANTS IN TRADE AND INVESTMENT DISPUTES

ingly exercising these privileges against developing and middle income countries, many of whom may lack the legal capacity and experience to counter the claims effectively. Interestingly, over the past three decades, the number of cases registered with the ICSID has grown much more rapidly than the number of cases registered with the WTO. New disputes registered with the GATT/WTO grew 96 percent from the 1980s to the 1990s but fell about 16 percent from the 1990s to the 2000s. New mixed (firm-state) arbitration cases registered with the ICSID grew 153 percent and a whopping 449 percent, respectively, over the same decades.³⁰ Keep in mind that private actors' access to enforceable³¹ compensatory damages, typically without the need to first exhaust domestic remedies,³² is unusual in public international law. Private traders

³⁰ Author's calculations, based on WTO data available at http://www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm, and on ICSID data, available at <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ListCases>.

³¹ According to international law, dispute settlement awards are enforced by national legislation and judiciaries, as stipulated through international agreements such as the New York and the Washington conventions. Washington Convention (1965), Section 6, Article. 54(1): "Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State."

³² Exhaustion of local remedies is not common in BITS (Douglas 2009), as it is for human rights claims in most international contexts.

have no such rights, nor do noncommercial individuals whose human rights (as opposed to property rights) have been violated, at least not outside of Europe.

II. WHY RATIFY BITs? THE COMPETITIVE AND CYCLICAL ROOTS OF HANDS-TYING

In the absence of multilateral rules, states have proceeded to construct a distinctive regime for investment, treaty by bilateral treaty. Decentralized regime creation has enhanced competitive dynamics as potential host states have attempted to attract capital in the context of stagnating bank lending. Bilateral negotiations have been affected by the relative bargaining power of host states: the weaker their bargaining power, the tighter they may be willing to tie their hands to satisfy investors—a point made by Allee and Peinhardt.³³ This section explores the competitive pressures to ratify BITs and then tests the proposition that hands-tying has been influenced by an important source of eroding bargaining power—weak economic growth in the potential host country.

THE SETTING: COMPETING FOR CAPITAL

The late 1980s and first half of the 1990s was a time of extremely slow growth in international bank lending, which, on the heels of the debt crisis of the 1980s, was contracting in many parts of the world. Foreign direct investment was a potential way to borrow internationally in this period of stagnant bank finance. Figure 2 illustrates the relationship between the falling ratio of foreign bank debt and FDI inflows for low income and developing countries on the one hand, and the accumulation of new BITs on the other. As the pool of available global FDI increased and international bank loans held steady or in some cases decreased, the ratification of BITs followed. This context suggests that many governments were likely motivated to sign BITs in order to compete more successfully for FDI at a time when alternative forms of international borrowing were stagnant or on the decline.

Patterns of BIT signings seem to confirm the plausibility of a competitive dynamic among developing countries seeking a share of FDI. Such capital could potentially be wooed away from investment venues in which governments refused to provide investors the advantages

³³ Allee and Peinhardt 2014.

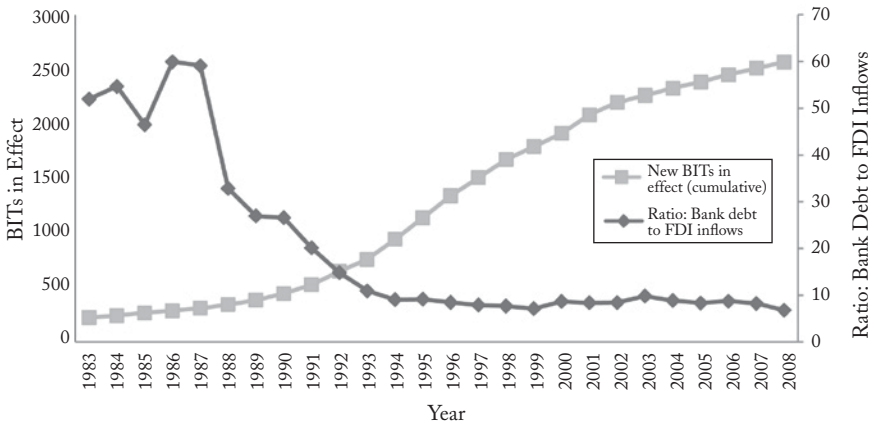


FIGURE 2

NUMBER OF BITS AND THE RELATIVE AVAILABILITY OF FOREIGN BANK CAPITAL
TO FOREIGN DIRECT INVESTMENT

contained in BITS. Zachary Elkins, Andrew Guzman, and Beth Simmons find that controlling for a broad range of other factors, developing countries were far more willing to sign a BIT with a richer country if close competitors—those with similar infrastructures, similarly skilled work forces, and comparable export profiles—had done so.³⁴ A dynamic of competition may not only reduce the marginal ability of each additional BIT to attract capital, as Jennifer Tobin and Susan Rose-Ackerman find,³⁵ it also has the potential to encourage countries to concede more sovereign prerogatives than they otherwise might have done.

HARD ECONOMIC TIMES

In addition to the competitive pressures documented in other studies, economic pressures may have also contributed to the turn toward BITS. Figure 3 illustrates the temporal relationship between the rate of growth globally and the cumulative number of treaties signed. It shows that the beginning of the global diffusion of BITS coincides with the economic downturn of the late 1980s and early 1990s. (Five-year moving averages are used in this figure to smooth the growth curve and to account for the fact that BITS can take years to negotiate.)

³⁴ Elkins, Guzman, and Simmons 2006. See also Jandhyala, Henisz, and Mansfield 2011.

³⁵ Tobin and Rose-Ackerman 2011.

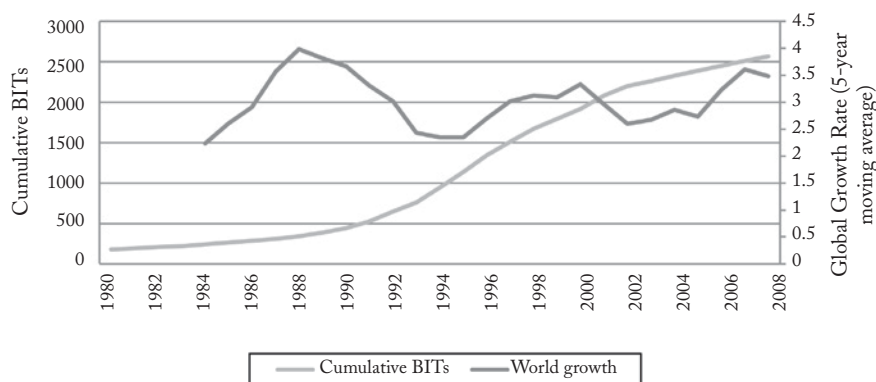


FIGURE 3
WORLD GDP GROWTH AND BITs

Figure 4 displays growth rates specific to each country in the years surrounding a BIT signing (defined as a year in which any BIT was signed). It demonstrates that growth rates are significantly lower in the three years preceding the signing of an agreement than they are in the same years for countries who have not signed. The difference in growth rates after signing, while appearing slightly higher for BIT signers, is not statistically distinguishable from zero. Figure 5 takes an even more detailed look at BIT signing episodes by looking only at “BIT sprees,” defined here as any year in which a country concluded five or more BITs. The difference in growth rates in the three years preceding such sprees is even more noticeable than when states sign any BIT at all. These patterns suggest that periods of slow economic growth render potential host governments more willing to accept constraints on their freedom of action in order to attract capital than they otherwise might have been, as bargaining theory suggests.

More generally, Elkins, Guzman, and Simmons find in a well-controlled model of BIT signings that the more positive a developing country’s gross domestic product (GDP) growth, the less likely it was to ratify a bilateral investment treaty with another country, given that it had not done so already.³⁶ Every percentage point increase in growth in the potential host reduced the likelihood that a given country pair would conclude a bilateral investment agreement by about 3 percentage points. To put that finding in perspective, the more than 11 percent drop in the Czech Republic’s growth rate between 1990

³⁶ Elkins, Guzman, and Simmons 2006.

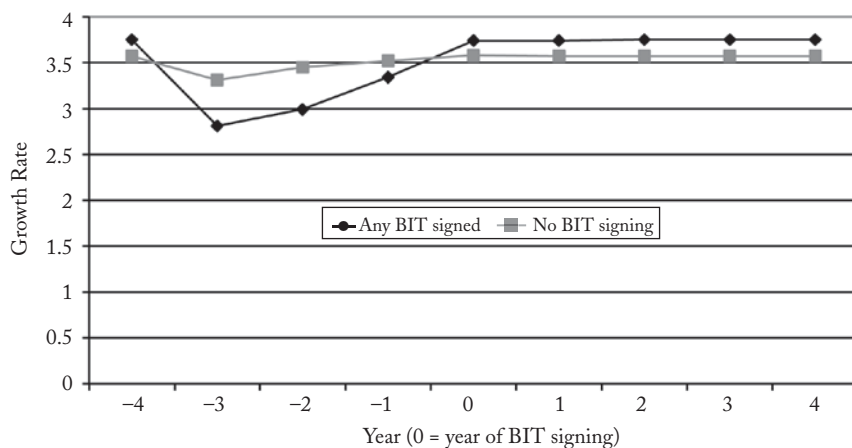


FIGURE 4
AVERAGE GROWTH RATES PRECEDING ANY BIT SIGNING^a

^aDifference in mean growth rates is statistically significant ($p < .05$) in years -3 and -2.

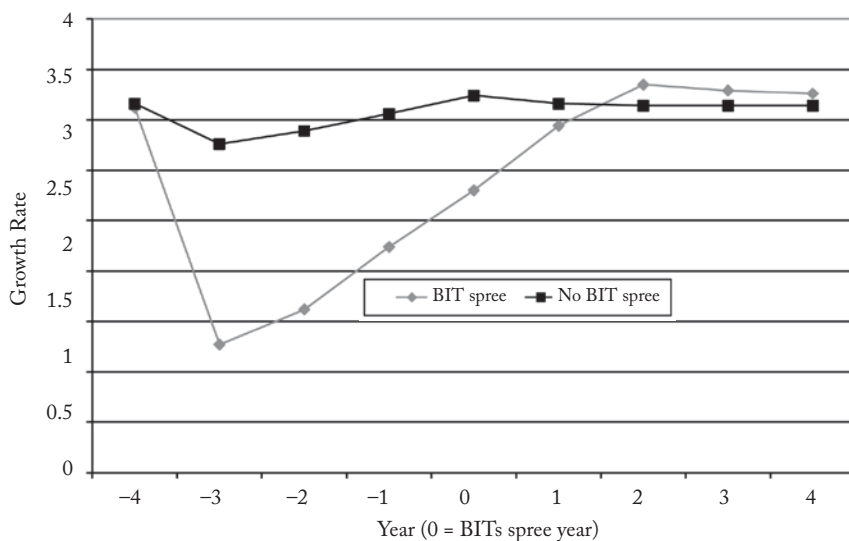


FIGURE 5
AVERAGE GROWTH RATES PRECEDING BIT SPREES (>4 BITs/YEAR)^a

^aDifference in mean growth rates is statistically significant ($p < .05$) in years -3, -2, -1 and 0.

and 1991 (as reported in the World Bank's *World Development Indicators 2010*) would correspond with a 33 percent increase in its eagerness to conclude a BIT. (The Czechs, in fact, concluded eight BITs in 1991. In 1993, while still hovering around zero growth, they were up to twenty-eight.) In contrast, Botswana, which averaged nearly 7 percent growth from the mid-1990s to the mid-2000s were, according to these estimates, about 21 percent less likely to ratify a BIT each year. By 2006, Botswana had in fact concluded only eight bilateral investment treaties. This evidence is consistent with the proposition that hard economic times lead to concessions to investors that governments might otherwise not make when economic growth is strong.

If BITs are in fact negotiated and concluded under stressful economic conditions—a situation that would naturally tend to reduce potential hosts' bargaining power vis-à-vis capital-exporting states—then it might be expected that the more unfavorable the conditions, the more significant the concessions governments are willing to make in order to conclude a treaty. Moreover, slow economic growth can be expected to increase the impatience of the potential host country, lowering time horizons and making a government more willing to relinquish increments of sovereignty for the ability to attract economic activity in hopes of stimulating the economy.

Allee and Peinhardt's data on dispute settlement make it possible to test the proposition that BIT dispute settlement provisions reflect the eroding bargaining position of would-be host governments in periods of weak economic growth.³⁷ Simply stated, developing countries in dire economic conditions are expected to concede more of their sovereignty in these agreements than they might otherwise. The following indicators are useful: (1) Is ICSID mentioned at all as an option for international arbitration between the investor and the contracting party? Is it the sole option mentioned in the treaty? and (2) Is the United Nations Commission on International Trade Law (UNCITRAL) mentioned as an option? From this information one can infer whether either of the two major institutions for international arbitration is mentioned in the treaty. Allee and Peinhardt code whether there is any explicit mention of investors' ability to choose a local tribunal or court to settle a dispute. They also code whether or not there is a requirement for local remedies for dispute settlement to be fully pursued before submission to international arbitration, and whether or not the treaty contains an explicit statement to the effect that the parties are consenting in

³⁷ Allee and Peinhardt 2014.

advance to international arbitration.³⁸ If potential host governments make more concessions to investors in their BITS when growth is weak, then as economic conditions in the host country deteriorate, the expected tilt would be in favor of international arbitration and away from local remedies.

Table 1 displays results that are very suggestive in this regard. It shows the results of a probit model that tests the hypothesis that weak GDP growth in a potential host country in the three years leading up to the conclusion of a BIT makes it much more likely to agree to arrangements that provide for disputes to bypass local institutions and go to international arbitration.

The results are quite striking; in almost every case, the stronger the economic growth in the less developed BIT partner, the stronger the domestic provisions and the weaker the international provisions contained in the dispute settlement section of a BIT. The lone exception is a provision to use the ICSID for dispute settlement, which has no consistent relationship with the developing country's business cycle (model 1). In addition, strong economic growth in the less developed partner is strongly and consistently correlated with a much lower likelihood that the signed BIT will contain a provision to use UNCITRAL rules should a dispute erupt (model 2). Treaties that do not contain references to the ICSID or to UNCITRAL rules (model 3) are also convincingly correlated with positive growth in the less developed partner (but there are relatively few of these). Conversely, slow growth in a developing country makes it less likely to negotiate a treaty without any references to one or more of these dispute settlement institutions/rules. Pre-consent clauses—general but explicit statements that commit the parties in advance to arbitrate a dispute—may be mildly associated with stronger developing country growth rates during the negotiation phase (model 6), but the result is not statistically significant in either version of model 6.

To get a substantive sense of the effect of the business cycle on the probability of negotiating an agreement without any ICSID or UNCITRAL clauses, imagine two states, a high-growth state and a low-growth state at two different points in time, 1985 and 2000. The results in Table 1 work out to a probability that a high-growth (10 percent per annum) developing country in 1985 stood about a 31 percent chance of signing a BIT without any references to the ICSID or to UNCITRAL. A low-growth country suffering a -10 percent growth rate for the three years lead-

³⁸ Allee and Peinhardt 2010.

TABLE 1
ECONOMIC DOWNTURNS AND DISPUTE SETTLEMENT CLAUSES CONTAINED IN BITs

	Model 1		Model 2		Model 3		Model 4		Model 5		Model 6	
	ICSID Provision	UNCITRAL Provision	UNCITRAL Provision	Neither ICSID nor UNCITRAL	Local Body Provision	Exhaust Local Remedies	Explicit Preconsent to Arbitrate					
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
Growth Past 3-yr. Average (Host)	-.005 (p = .422)	.007 (p = .295)	-.021*** (p = .003)	-.021*** (p = .004)	.027** (p = .012)	.010 (p = .127)	.024*** (p = .000)	.019*** (p = .001)	.028** (p = .028)	.016 (p = .160)	.005 (p = .473)	.011 (p = .149)
Joint Democracy	.038*** (p = .000)	.031*** (p = .000)	.011 (p = .112)	.010 (p = .177)	-.034*** (p = .000)	-.024*** (p = .000)	-.005 (p = .315)	.007 (p = .303)	-.007 (p = .477)	.003 (p = .778)	.018*** (p = .007)	.013* (p = .095)
Difference in Developmental level	.096 (p = .102)	.112* (p = .071)	-.054 (p = .427)	.025 (p = .704)	-.078 (p = .261)	-.124 (p = .106)	-.283*** (p = .000)	-.179*** (p = .001)	-.203** (p = .015)	-.236*** (p = .007)	.052 (p = .473)	.035 (p = .631)
Year	.061*** (p = .000)	.059*** (p = .000)	.093*** (p = .000)	.092*** (p = .000)	-.061*** (p = .000)	-.060*** (p = .006)	.050*** (p = .001)	.053*** (p = .001)	-.037* (p = .098)	-.037 (p = .127)	.010 (p = .479)	.009 (p = .434)
US	—	.892*** (p = .000)	—	.575*** (p = .000)	—	-.480*** (p = .000)	—	-.020 (p = .896)	—	-.273 (p = .160)	—	1.46*** (p = .000)
UK	—	.121 (p = .238)	—	-.114 (p = .434)	—	-.973*** (p = .000)	—	-.184 (p = .237)	—	—	—	.339* (p = .071)
Germany	—	-.187* (p = .057)	—	-.161*** (p = .000)	—	.483*** (p = .000)	—	-.146*** (p = .000)	—	—	—	-.277 (p = .112)
Switzerland	—	-.453*** (p = .000)	—	-.118 (p = .395)	—	.560*** (p = .000)	—	-.112*** (p = .000)	—	—	—	-.088 (p = .597)
France	—	-.140 (p = .108)	—	-.860*** (p = .000)	—	.376*** (p = .001)	—	-.15*** (p = .000)	—	.393*** (p = .007)	—	-.104*** (p = .000)
Netherlands	—	-.210*** (p = .008)	—	-.686*** (p = .000)	—	.563*** (p = .000)	—	-.906*** (p = .000)	—	.123 (p = .336)	—	.452*** (p = .006)
China	—	-.116*** (p = .000)	—	-.549* (p = .0730)	—	1.33*** (p = .000)	—	1.18*** (p = .000)	—	.824*** (p = .007)	—	-.714*** (p = .004)
constant	-.121.*** (p = .000)	-.117.*** (p = .000)	-.184.*** (p = .000)	-.184.*** (p = .000)	121.2*** (p = .000)	119.2*** (p = .001)	-.99.3*** (p = .001)	-104*** (p = .002)	71.37 (p = .107)	72.01 (p = .138)	-19.59 (p = .469)	-19.13 (p = .425)
Observations	1213	1213	1213	1213	1213	1213	1204	1204	1205	1205	1205	1205
Pseudo R ²	.120	.172	.091	.149	.135	.228	.082	.195	.053	.090	.014	.073

Dependent variable: presence or absence of a particular kind of clause (Allee and Peinhardt 2010); probit coefficients (probability).

ing to the signing of a BIT had only about a 15 percent chance of that outcome. Over time, however (and consistent with theories that emphasize intensification of competition for capital) progressively fewer states were able to secure such clauses. By 2000, a country with 10 percent growth had only about a 7 percent chance of negotiating a BIT without such a clause, but a country with -10 percent growth had only a miniscule chance (less than 2 percent) of achieving this result, controlling for all factors in model 3(a).

Models 4 and 5 test for the conditions conducive to adding local solutions to the dispute settlement sections of treaties. The likelihood that a BIT will contain some reference to the investor's ability to choose a local tribunal or court is positively associated with growth in the less developed BIT partner (model 4). A provision that requires an investor to exhaust local remedies is also positively associated with the developing country's business cycle (model 5). Taken together, these results support the general tendency for developing countries with strong positive growth to maintain somewhat greater national control over how investment disputes will be settled. Downturns in the business cycle, by contrast, are consistently associated with much greater delegation to international tribunals in the event of a dispute. Figure 6(a-c) illustrates the substantive impact of the business cycle when a potential host experiences 10 percent growth versus -10 percent growth, holding all other conditions constant (that is, at their means).

Slower growth is associated with tighter hands-tying, even when several other conditions are controlled for. Democratic countries tend to negotiate agreements with ICSID clauses and avoid concluding treaties that contain neither ICSID nor UNCITRAL provisions. They are also much more likely, according to these results, to agree to treaties that contain explicit clauses that pre-commit them to arbitration in the event of a dispute. Somewhat surprisingly, democracies do not tend to insist on local remedies (models 4 and 5). Consistent with studies on other areas of international law,³⁹ democracies tend to delegate authority with greater regularity to international institutions than do nondemocratic states.

A bargaining framework might lead one to suspect that the greater the developmental difference between partners, the greater the tendency for BITS to reflect international delegation for the settlement of disputes. The evidence in Table 1 is consistent with that hypothesis. When the difference between treaty partners is greater, there is a slight

³⁹ Simmons 2008.

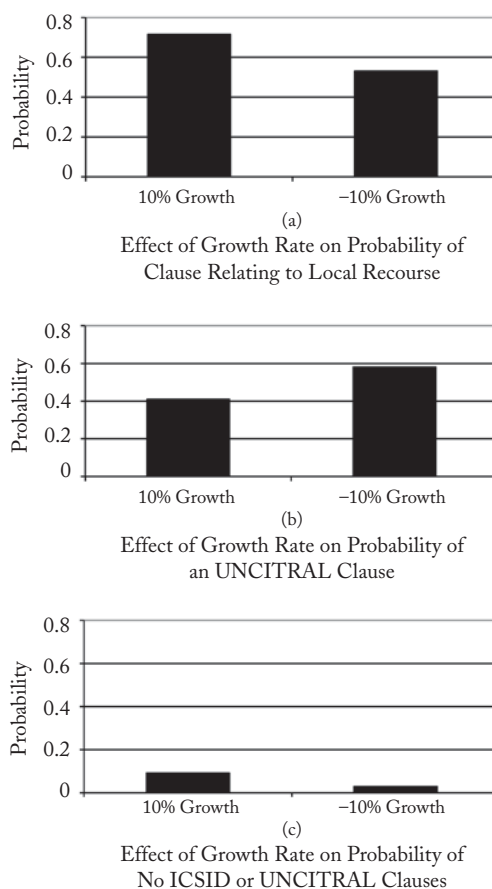


FIGURE 6
IMPACT OF GROWTH RATES ON THREE TYPES OF
BIT DISPUTE SETTLEMENT CLAUSES

tendency for greater delegation to the ICSID (model 1) and a fairly convincing reduction in local provisions (models 4 and 5). In this case “developmental difference” is defined as the difference in World Bank categories: (1) high income, (2) high-middle income, (3) low-middle income, and (4) low income. Taking the absolute value of the difference, this measure ranges from 0, when countries are from the same category, to 3, when they are from opposite extremes.

Finally, capital-exporting countries may also have clear preferences over the kind of dispute settlement provisions they include in their BITs. A US dummy variable suggests the United States favors the ICSID

and is also likely to negotiate treaties with UNCITRAL provisions, but tends to eschew agreements that contain neither. China has been less willing than other countries to delegate explicitly to either the ICSID or the UNCITRAL and is more likely to conclude treaties that make no reference to either and include localist provisions, and to not require pre-consent agreements in their BITS. China's preferences would appear to be closer to those of a capital-importing country than a capital-exporting country, even when changes in dispute resolution provisions over time are controlled for.

Overall, Allee and Peinhardt's model of structural bargaining power can be supplemented with one based on economic cycles. Developing countries not only make more concessions on dispute settlement provisions the more powerful their negotiating partners are, as Allee and Peinhardt have found,⁴⁰ but they may also make more concessions when the economic tide begins to turn against them.

III. THE CONSEQUENCES OF RATIFICATION: FIELD OF DREAMS OR LITIGATION NIGHTMARE?

THE CONSEQUENCES OF HANDS-TYING

The evidence discussed so far suggests that host states sign BITS and accept stronger constraints on their freedom of action when they are in a weak bargaining position. Such constraints on sovereign decision making may be worth it if BITS work—that is, if they attract capital. On this point, the jury is still out.⁴¹ Early studies were able to document very little increased FDI in response to the ratification of BITS.⁴² Other studies attribute positive impacts on investments flows to BIT ratifications.⁴³ And yet the empirical findings are not entirely consistent. Some researchers have found that BITS seem to increase foreign investment in countries that already have fairly good domestic institutions in place, which suggests that BITS alone are not a quick fix for weak domestic institutions.⁴⁴ Other scholars seem to have found precisely the opposite, that BITS have their strongest effects where states are most likely to lack credibility.⁴⁵ Disagreement exists over whether BITS with the United States have been beneficial to developing countries,⁴⁶ with some re-

⁴⁰ Allee and Peinhardt 2010.

⁴¹ See the essays in Sauvart and Sachs 2009.

⁴² Banga 2003.

⁴³ Kerner 2009; Neumayer and Spess 2004; Bütte and Milner 2009; Egger and Merlo 2007.

⁴⁴ Hallward-Driemeier 2003, 21–2; Tobin and Rose-Ackerman 2011.

⁴⁵ Rosendorff and Shin 2012.

⁴⁶ Compare the findings of Gallagher and Birch 2006 and Shadlen, Schrank, and Kurtz 2005.

searchers noting their importance for fixed capital investments for US firms but not for other measures of multinational corporate activity.⁴⁷

One consequence of ratifying bilateral investment treaties that contain dispute settlement provisions seems quite clear: they have led to a burst of litigation, especially since the late 1990s. In addition, they have, in many cases, been quite costly *ex post*. Figure 7(a–c) illustrates the relationship between the signing of BITs and the ensuing registration of new investment cases before the ICSID.⁴⁸ With only three- to five-years' lag, the shapes of the curves measuring the number of BITs worldwide and the number of new cases registered each year with the ICSID are nearly identical (Figure 7(a)). Figure 7(b) and (c) illustrate the same relationship for Latin America and Argentina, respectively. The latter two graphs show the same precipitous climb, but also a fairly swift retreat from the peak in 2003.

A simple generalized least squares model suggests that each additional BIT significantly raises the risk of arbitration (defined in this case as the registration of an investment dispute with ICSID, see Table 2). Three relationships are quite solid. First, arbitration comes in clusters; arbitration in the previous year is a very strong predictor of arbitration in any given year. Whether this represents piling on among investors or the widespread consequences of particular government policies, litigation under the auspices of the ICSID is characterized by a good deal of inertia. Second, the probability of a new case generally increases each year. This system has a lot of built-in momentum, at least for the years examined here (1980 through 2006). Third, independent of time and piling on, the more bilateral investment treaties a country signs, the more likely it will be sued in this venue. "If you build (sign) it, they will come (litigate)."

Litigation seems to come at the worst possible time for many countries—when macroeconomic conditions generally are unstable. Inflationary pressures, a deteriorating external position, and flagging investor confidence in a country's economic performance generally are all correlated with litigation. The higher the (log of) inflation, the greater the probability of arbitration is two years later. A country's deteriorating external position is signaled by reserve losses as a proportion of imports, the outflow of foreign direct investment, and a worsening capacity to service foreign debt. Although it is not quite statistically significant by traditional standards, a country's risk premium—the ex-

⁴⁷ Kerner and Lawrence 2013.

⁴⁸ The ICSID is the only institution that requires public registration of disputes, limiting the ability to analyze disputes of different rules or forums.

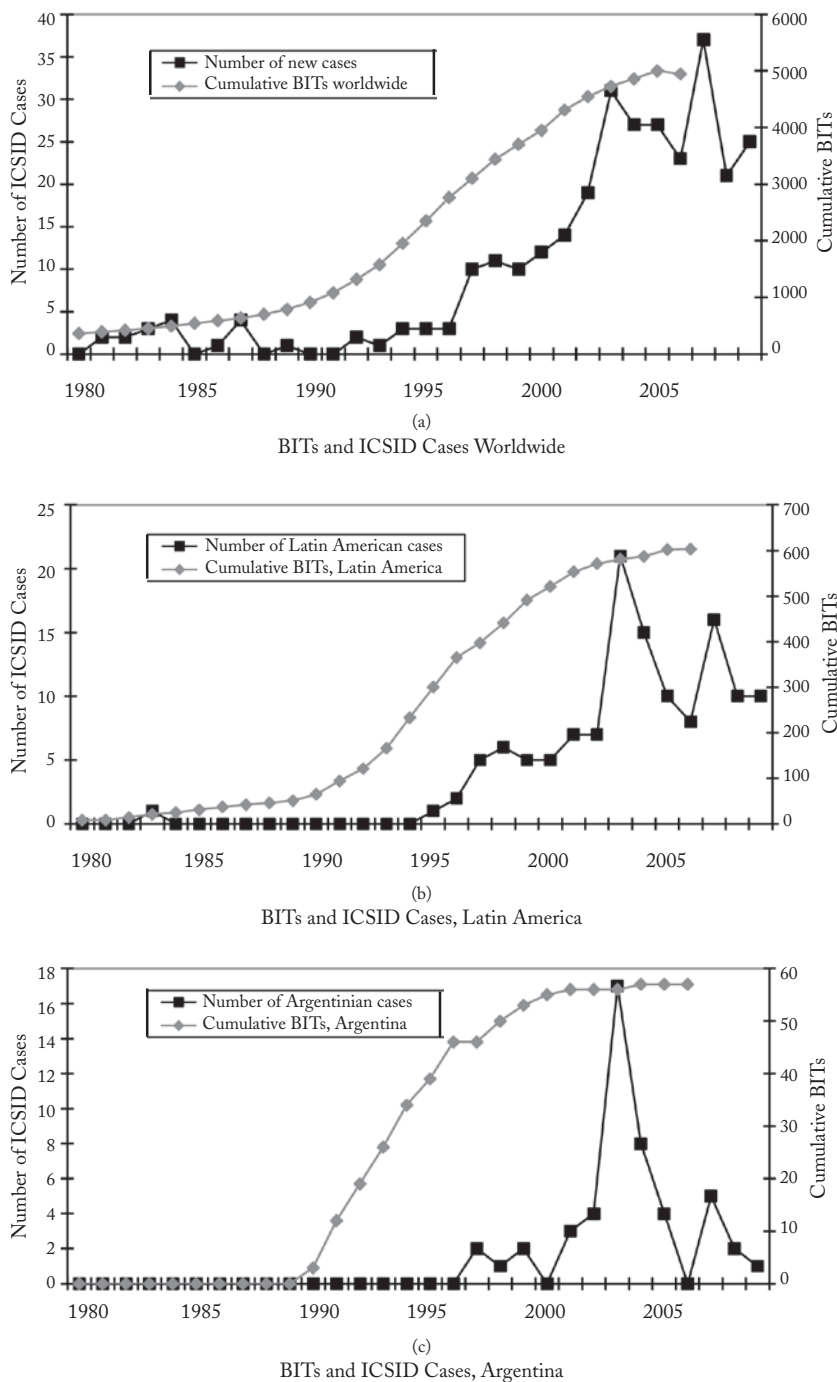


FIGURE 7
RELATIONSHIP BETWEEN BITs AND NEW ARBITRATION CASES BEFORE
THE ICSID

TABLE 2
BITS AND INTERNATIONAL ARBITRATION

<i>Explanatory Variables</i>	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>	<i>Model 5</i>	<i>Model 6</i>
Log of Arbitration, (t-1)	.222*** (p = .000)	.202*** (p = .000)	.215*** (p = .001)	.224*** (p = .001)	.220*** (p = .000)	.143** (p = .025)
Log of Cumulative no. of BITs	.096*** (p = .006)	.133*** (p = .000)	.255*** (p = .000)	.119** (p = .011)	.224*** (p = .000)	.098** (p = .026)
Year	.026*** (p = .000)	.029*** (p = .000)	.024*** (p = .001)	.030*** (p = .000)	.025*** (p = .000)	.023*** (p = .000)
Log GDP Growth (t-2)	.033 (p = .320)	—	—	—	—	—
Log Inflation (t-2)	—	.067* (p = .055)	—	—	—	—
Log Change in Reserves (t-2)	—	—	-.088*** (p = .002)	—	—	—
FDI Outflows (t-2)	—	—	—	-.004** (p = .027)	—	—
Change in Foreign Debt Service/GDP (t-3)	—	—	—	—	-.009** (p = .047)	—
Change in Risk Premium (t-2)	—	—	—	—	—	.002 (p = .124)
Overall R ²	.076	.074	.096	.079	.092	.063
No. of countries	172	162	118	155	130	102
Observations	2691	2739	2065	2094	2037	1251

Dependent variable: log of new arbitrations registered with ICSID, yearly; results of a random-effects generalized least squares regression; coefficients (p-values based on robust standard errors clustered by country); * = significant at .10 level, ** = significant at .05 level, *** = significant at .01 level.

cess in government bond yields over the London Interbank Offer Rate (LIBOR)—is also positively associated with increased litigation. This evidence suggests that litigation may very well be dangerously procyclical. That is, it may flow from broader economic conditions over which governments that have opened up to financial liberalization have little direct ability to control, and aggravate those conditions in the process. Litigation may further complicate the very conditions it is responding to by encouraging further capital flight.

THE CONSEQUENCES OF LEGAL ASYMMETRY: THE POTENTIAL FOR REGIME REINFORCEMENT

That litigation can be costly is of course the core dynamic of credible commitment making. As Tim Büthe and Helen Milner point out, if BITS attract capital—it is “precisely *because* they bite.”⁴⁹ Moreover, “[t]his constraint—on the governments of the FDI host countries that sign them—is not an accidental by-product but *intended* by both sides”⁵⁰ [emphases added]. This is where the asymmetry built into the architecture of most BITS becomes quite important. Giving investors a private right of action allows them to decide when, where, and on what basis to sue public entities for damages. It therefore gives them extraordinary agenda-setting power in future law development.⁵¹ As Jose Alvarez notes, “These firms, not their home states, are the regime’s private attorneys general and are in the driver’s seat . . . in the course of investor-state disputes. . . . [N]on-state parties play a crucial role in enforcing the relevant international legal guarantees and in determining their interpretation and development. . . . [T]he emerging (and ever more abundant) arbitral investment case law is at least as much the creation of corporate investors as it is of the states that enter into BITS.”⁵² (Certainly, the same assessment would never be made of WTO rules and dispute settlement practices, which remain firmly in the hands of the WTO members.) Moreover, investment treaty arbitration is nonreciprocal: it gives investors the right to sue, but does not give states a similar right. This allows for the possibility that law development—interpretation of the rules going forward—will be lopsided, trending toward the interests of the parties with the right to choose the forum, rules, and legal issues, and without the traditional safeguards of judicial independence that are built in to most credible domestic legal systems.⁵³ Even if states could anticipate that they would be sued by private actors in the case of breach—and the history of negotiations for a sophisticated country such as the Czech Republic suggests this eventuality was not well understood⁵⁴—it might be quite difficult to assess how the treaties they signed would be interpreted by arbitration panels over time.

Evidence on the actual pattern of arbitral decision making is very suggestive in this regard. Gus Van Harten, a legal scholar specializ-

⁴⁹ Büthe and Milner 2009.

⁵⁰ Büthe and Milner 2009.

⁵¹ Keohane, Moravcsik, and Slaughter 2000.

⁵² Alvarez 2009 94–5.

⁵³ Van Harten 2012.

⁵⁴ Fecák 2011.

ing in mixed arbitration between investors and states, has examined trends in legal interpretation to test hypotheses about systemic bias in how contentious claims are resolved in known arbitration cases. These claims over jurisdiction provide an opportunity to analyze the drift of legal interpretation over time. They are issues that by definition could go either way and are litigated precisely because the parties care about them and cannot easily anticipate the outcome. Van Harten's painstaking coding of all publicly available awards in English—some 140 cases under investment treaties handed down as of 2010—suggests a clear tendency toward the expansion of investor's rights where jurisdictional matters were at stake. Van Harten considered how broadly and flexibly arbitrators interpreted the terms “corporate person investor” (69 instances); “natural person investor” (6 instances); “investment” (116 instances); “minority shareholder interest” (72 instances); “permissibility of investment” (27 instances); “parallel claims” (165 instances); and “scope of MFN” (60 instances). He finds that more than 76 percent of the time tribunals chose to interpret these contested terms broadly so as to advantage investors over states. Moreover, the primary nationality of the claimant matters as well. Claimant firms from the US, UK, and France were more likely to win expansive interpretations of investor's rights than were firms from Latin America, the European periphery (Cyprus and Turkey) or the Far East (Singapore). This evidence of lopsided law development is consistent with the broader literature that notes that arbitrators have incentives to favor the interests of those who have the power to invoke the use of the system (in this case, the private investor).⁵⁵

Table 3 analyzes Van Harten's data on contentious jurisdictional questions to shed light on the effect of asymmetrical mixed arbitration on law development. The key dichotomous dependent variable is the tribunal's decision on a jurisdictional question—whether “expansive” in favor of the investor-claimant or “restrictive” in favor of the state-respondent. The unit of analysis is the issue, of which there may be as many as five in a single arbitral case. The cases themselves are all those for which Van Harten's team was able to locate a jurisdictional award in English. As such, they use a range of arbitral rules (ICSID, UNCITRAL, International Chamber of Commerce (ICC), Stockholm Chamber of Commerce (SCC), or ad hoc, for example.).

The first line confirms Van Harten's finding; claimants from major capital-exporting countries are about 20 percent more likely to get

⁵⁵ Van Harten 2012.

TABLE 3
LITIGATION AND LAW DEVELOPMENT: INFLUENCES ON “EXPANSIVE” JURISDICTION^a

	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>	<i>Model 5</i> (MFN only)
Claimant from US, UK, France or Germany	.207*** (p = .004)	.191*** (p = .009)	.204*** (p = .003)	.195*** (p = .007)	.326 (p = .242)
Income Category of Respondent	.107** (p = .039)	.089* (p = .083)	.114** (p = .031)	.115** (p = .026)	-.046 (p = .898)
Appointment of Presiding Officer	.083*** (p = .002)	.083*** (p = .002)	.083*** (p = .002)	.083*** (p = .002)	.111 (p = .179)
ICSID Rules	-.141* (p = .066)	—	—	—	—
Commercial Rules	—	-.074 (p = .572)	—	—	—
UNCITRAL Rules	—	—	.195** (p = .012)	.211*** (p = .018)	.089 (p = .707)
Complaint Based on a BIT	—	—	—	.043 (p = .678)	.368* (p = .065)
Observations	513	513	513	513	56
R ²	.097	.077	.110	.111	.176

Dependent variable: resolution of jurisdictional issues (restrictive versus expansive; source: Gus Van Harten; available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2149256). Results of an ordinary least square regression; coefficients (p-values based on robust standard errors clustered by case); * = significant at .10 level, ** = significant at .05 level, *** = significant at .01 level.

^aThe unit of analysis is the jurisdictional issue; each case may have several contentious jurisdictional issues. Cases are all known instances in which an award in English was made public on the basis of jurisdiction.

expansive interpretations of investors' jurisdictional rights. The second line shows that poorer respondent states are also likely to receive awards that expand rather than restrict investors' rights in the jurisdiction award. Each progressive move downward through the World Bank's income categories—upper, upper middle, lower middle, and lower—results in about a 10 percent chance that an arbitration panel will rule expansively, that is, in favor of investors' rights. Unsurprisingly, when the investor appoints the presiding officer of the arbitration panel, expansive rules are more likely.⁵⁶ Using ICSID rules tend slightly to favor restrictive interpretations (favorable to the state), while UNCITRAL rules tend to be associated with more expansive ones (favorable to investors). While space limitations prevent a detailed analysis of arbitration rules here, it is interesting to note a certain consistency with Table 1, which reports that the weaker the economic growth and

⁵⁶ For a full discussion of data coding see Van Harten 2012.

hence bargaining power of developing country hosts, the more likely the hosts were to accept UNCITRAL rules.

Whether or not the case arises from a BIT (as opposed to agreements that are not bilateral, such as Association of Southeast Asian Nations [ASEAN], CAFTA, the ECT, or NAFTA, or that are ad hoc) does not consistently matter for jurisdictional awards—with an important exception: expansive rulings on MFN clauses that extend the rights contained in a country's most pro-investor BIT to all other foreign investors' home BITs. When claims for jurisdiction based on an expansive notion of a most-favored-nation clause are considered, BITs increased the probability of an expansive ruling by almost 37 percent ($p = .065$). This means that states with BITs may be even more constrained than they might have anticipated. In the case of *MTD Equity Sdn. Bhd. and MTD Chile, S.A. v. Republic of Chile*, for example, American investors used a BIT Chile had negotiated with Malaysia (there is no US-Chile BIT)⁵⁷ to establish a right to fair and equal treatment and relied on Malaysia's treaties with Denmark and Croatia to establish that such a right required land use rezoning, even though the Chilean treaty with Malaysia did not require rezoning at all.⁵⁸ Governments may not expect such expansive interpretations when they sign a bilateral treaty with a specific state. Indeed, broad interpretations of MFN clauses are considered a key mechanism for “ratcheting up” state obligations under BITs.⁵⁹

Finally, there is some evidence consistent with a claim that bilateralism has paid handsome dividends for investors in terms of monetary damages. While very little information is available on the terms of monetary awards, twenty-eight of the cases in Van Harten's database include information on their monetary outcome. It is important to note that these are a subset of cases, and hardly a random one at that: arbitral awards are only made public when both the investor and the state agree to do so. When the nationality of the claimant and the income level of the respondent are controlled for, an ordered logit on the magnitude of the monetary damages awarded in a particular case shows that complaints based on BITs are much more likely to be associated with larger monetary awards than cases based on multilateral agreements (NAFTA and the ECT, for example). Compared to the non-bilateral treaties, BITs reduced the probability that the monetary award would be zero by about 60 percent and increased the probability that an award would be in the \$100 million range or the \$500 million range

⁵⁷ According to the US Department of State; see <http://www.state.gov/e/eb/ifa/bit/117402.htm>.

⁵⁸ For a discussion of this case see http://www.biicl.org/files/3915_2004_mtd_v_chile.pdf.

⁵⁹ McLachlan, Shore, and Weiniger 2007, 254.

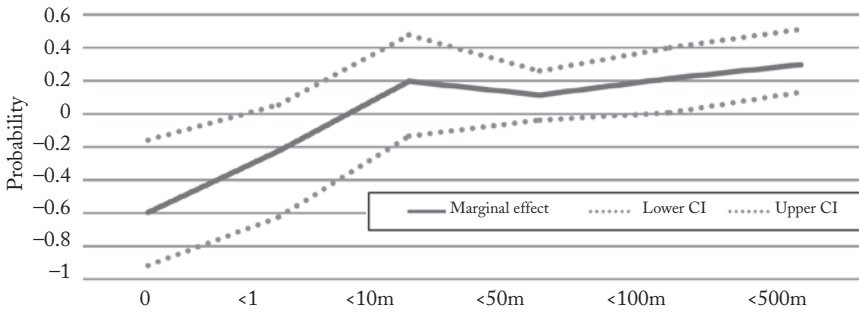


FIGURE 8

MARGINAL EFFECTS OF BIT-BASED LITIGATION ON THE SIZE OF A MONETARY AWARD COMPARED TO ALL OTHER LEGAL BASES FOR ARBITRATION^a

^aBased on an ordered logit analysis of twenty-eight cases; dependent variable “damage category” and controlling for claimant type, commercial rules, and the respondent’s development level; 95 percent confidence interval. Table of results available from the author upon request.

by 20 and 30 percent, respectively, (see the marginal effects of the ordered logit model graphed in Figure 8).

The choice of commercial rules—those of business groups such as the ICC or the SCC—is also associated with larger awards. Indeed, investors were about 60 percent less likely to receive an award of less than \$1 million and 80 percent more likely to get an award over \$500 million when commercial venues, such as the ICC or SCC, were used (for example, compared to the ICSID or UNCITRAL). While causal inference is difficult to assign in this case—the choice of tribunal itself is likely to be quite strategic—it is an interesting finding in light of the fact that in almost all international investment agreements, it is the investor who has the right to choose the rules that govern the case.

IV. PUSH-BACK: ANNULMENTS AND RENEGOTIATION

The international investment regime differs from the trade regime in its degree of centralization and the special protections afforded to private actors who invest. The dispute settlement mechanism contained in most BITS is quite different from those contained in trade agreements in another important way as well: *it is a one-shot deal*. There is no provision in the most widely used arbitration rules for appeal; decisions of the tribunals are final and binding.⁶⁰ Annulment is the only option,

⁶⁰ For this reason, scholars often refer to “the sovereign character of international investment tribunals.” Grazzini 2012.

other than noncompliance, available to a party if it does not like the decision of the arbitration tribunal. This is in obvious contrast with the way disputes are settled among WTO states: the appellate body can correct tribunal decisions, giving an unhappy litigant some satisfaction if the decision was a bad one and also helping to provide some degree of uniformity to decisions made under WTO rules.

The investment regime has no such mechanism; it grew out of a commercial arbitration model,⁶¹ the results of which are typically held to be both binding and final. Only a very narrow set of conditions can be used as the basis for annulling an award of an ICSID tribunal, for example, including the complete absence of proper reasoning or the finding that a tribunal had manifestly exceeded its powers.⁶² An award is not supposed to be overturned just because the decision was “bad” or “wrong.” In general, there is no way to correct the poor judgment of a mixed arbitration investment tribunal.

And yet, there has been an explosion in the registration of cases seeking annulment of ICSID awards (Figure 9). Surprisingly, in 2008 there were more new registrations for ICSID annulment proceedings than there were awards on the merits in original cases.⁶³ Interestingly, to date, only one country in the high income category, the United Arab Emirates, has sought to annul an ICSID award. For the most part, annulments have been sought by middle-income countries concentrated in Latin America. Argentina, a country that has experienced its share of hard economic times in the last decade, alone accounts for about one-quarter of all annulment requests.⁶⁴

Why do these countries seek to have awards of duly constituted ICSID tribunals annulled? To be clear, the restrictive conditions on annulment make it almost impossible to succeed in this endeavor. Only about 8 percent of ICSID awards have been annulled in whole or in part.⁶⁵ One possibility is that annulment proceedings are a symbolic action to express growing frustration with the regime. As David Caron argues,

⁶¹ For a discussion of the influence of commercial law and public law on the investment arbitration system, see Roberts 2013.

⁶² See Annex 6 of “Background Paper on Annulment for the Administrative Council of ICSID” August 10, 2012.” Available at <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDNewsLettersRH&actionVal=ShowDocument&DocId=DCEVENTS11>.

⁶³ Awards based on the merits only; excludes awards on the jurisdiction as well as those based solely on a settlement that the parties asked the tribunal to write up in the form of an award. I also exclude any panel decisions that are not referred to on the ICSID Web site as “awards.”

⁶⁴ The others are as follows: Egypt, 4; Chile, 3; Ecuador, Malaysia and Peru, 2 each; Cameroon, the Democratic Republic of Congo, Gabon, Guinea, Indonesia, Kazakhstan, Morocco, Philippines, and Seychelles, 1 each (as of 2010).

⁶⁵ See figures compiled by the ICSID at <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDNewsLettersRH&actionVal=ShowDocument&DocId=DCEVENTS11>.

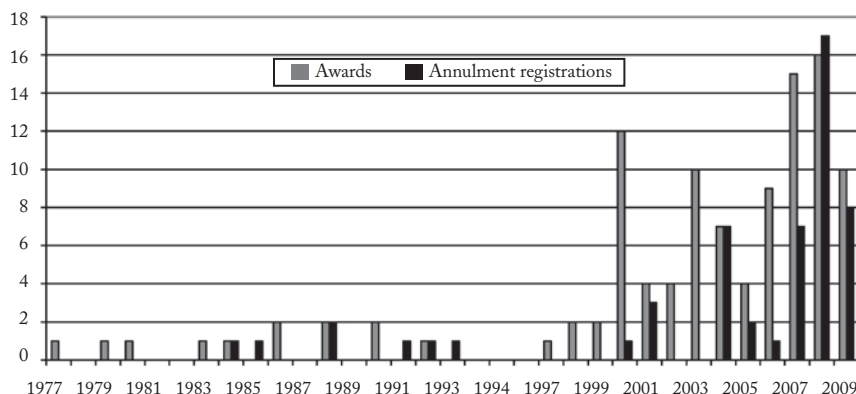


FIGURE 9
ICSID AWARDS AND ANNULMENT REGISTRATIONS^a

^aArgentina, 8; Egypt, 4; Chile, 3; Ecuador, Malaysia, and Peru, 2 each; Cameroon, the Democratic Republic of Congo, Gabon, Guinea, Indonesia, Kazakhstan, Morocco, Philippines, and Seychelles, 1 each (as of 2010).

annulment proceedings may be a very good metric of the perceived legitimacy of the regime.⁶⁶ They are a way for governments to signal that an award is not acceptable and to make a principled argument as to why not. Governments usually choose to take this stand on awards that are of special significance to crucial sectors of their economies and their polities. About a quarter of the annulments sought relate to the provision of basic utilities—water, gas, and electric power. These sectors have particular public significance. They impact the daily lives of thousands, even millions, of people in a very real, ongoing way and are the kind of cases where governments have decided to take their stand for sovereignty over “policy space.”

One other trend is quite interesting with respect to annulments. There has been a sharp shift in the type of regime that has sought to annul the decisions of investment arbitration panels over time. In the 1980s and 1990s, they were mostly defiant autocracies that were loath to relinquish their interests in the name of law. But increasingly, the annulment seekers are relatively highly democratic countries with clear lines of accountability to their domestic publics. In fact, when comparing the registrations for annulment before and after 2008, it is stunning to realize that the polity score for all annulment seekers before 2008

⁶⁶ David Caron, “Investment Arbitration and the Distinction between Appeal and Annulment,” lecture, Investment Law and Policy Speaker Series, Columbia University Law School, New York, N.Y., April 8, 2010.

was a paltry 2 (on a scale of 0 to 10). Since 2008, the number of new annulments not only exceeds the number for the entire history of the ICSID from its entry into force in 1966 up to 2008, but the polity scores of the governments seeking to turn back a decision of an ICSID tribunal jumped to 6 on the same scale. Increasingly, relatively accountable democratically elected governments are trying to overturn awards that are arguably closely connected to the broader public good—awards flowing from treaties signed during highly constrained periods of significant economic downturn. If the investment regime cannot accommodate the legitimate policy space of democratic governments navigating hard economic times, it may prove quite brittle indeed.

V. CONCLUSIONS

The codification of international economic relations, including rules for international trade and international investments, has been one of the hallmarks of the post-World War II era. However, the trade and investment regimes are surprisingly different in crucial ways, especially in their degree of centralization (which has implications for the competitive dynamics among developing countries signing BITs) and the extent to which private actors are privileged and protected (which has consequences for the regulatory space in which states operate). Familiar political economy theories, quite likely involving the dynamic contracting issues surrounding investing, may account for these differences. Ex post, governments have an incentive to renege, skim rents from sunk investments, and reclaim their sovereign regulatory space. In the case of trade, domestic resistance eventually is likely to be competed away. If the logic of Ronald Rogowski's *Commerce and Coalitions* underlies the domestic political dynamics of trade, then Raymond Vernon's *Sovereignty at Bay* underlies that of international direct foreign investing.

The purpose of this article has not been to test an explanation of these differences, but rather to explore the consequences for governance. Whether BITs attract capital is an important question, but it is not the only question one might raise about the investment regime. The literature shows theoretically and empirically that the need to make credible commitments in the context of bilateral negotiations has led to a competitive ratification dynamic. Power asymmetries imply pressures on developing countries to make concessions to powerful exporting countries, and I show that business cycles contribute to patterns in concession making as well.

The natural question is, *so what?* If BITS attract capital, this is a win-win outcome. It is not obvious, however, that BITS are responsible for greater investment flows to the countries that have ratified them. The explosion of arbitration suggests some kind of breakdown in expectations: whether BITS have failed to tie the hands of rapacious governments, or whether investors have incentives to gamble on a tribunal that they alone can invoke, few governments anticipated the expansion in investors' rights or the number and size of claims they would soon face as a result of ratifying BITS. Arguably, these are not the results many developing countries anticipated when they signed these agreements.⁶⁷

In addition, is it not clear that many states thought through the possible consequences of acquiescing to asymmetrical arbitration in which the market for legal decisions is driven largely by one side of the dispute. Other scholars have explored the incentives this creates for arbitrators, and especially for repeat arbitrators, who gain financially when selected by firms to represent their interests.⁶⁸ While a causal test has yet to be done, arbitrators in mixed investment disputes have been much more likely to accept the broad jurisdictional claims of investors than the narrower arguments of states. About a third of the time, mixed arbitration panels award no money at all to the complainant,⁶⁹ but an ICSID arbitration panel's recent award of \$1.67 billion to the complainant in the case of Occidental Oil Company v. The Republic of Ecuador, decided October 5, 2012, is a good reminder that the stakes in investment disputes are potentially significant.⁷⁰

The outcome of decentralized rule making and asymmetrical dispute settlement over the past three decades has contributed to a strong pro-investment regime. The array of rights and protections for a specific class of private actors in public international law is quite extraordinary. In contrast to the trade area, where rights and benefits are based on reciprocity among the WTO members party to an agreement, the

⁶⁷ Pakistan's attorney general described the general level of ignorance in his country about the legal liabilities associated with Pakistan's BIT program when the country was sued under a BIT in 2001 by the Swiss multinational Société Générale de Surveillance: "To be perfectly honest, I did not have a clue, so I had to look it up on Google. I typed in 'ICSID' and 'BIT,' and that's how I learned about these instruments for the first time." The interview is available at <http://www.iisd.org/itn/wp-content/uploads/2009/04/ITN-April-2009.pdf>.

⁶⁸ Dezalay and Garth 1996.

⁶⁹ See tables compiled by Susan Franck at <http://law.wlu.edu/faculty/facultydocuments/francks/awardtables.pdf>. According to Franck, thirty-one of the 102 awards in her database result in no monetary compensation.

⁷⁰ See the ICSID Web site, available at https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2672_En&caseId=C80. The award amount can be found on p. 326; Ecuador plans to seek annulment of the award.

international investment regime is largely unidirectional in its allocation of rights between private actors and public authorities. Only the former are protected by BITs. If a private contractor breaches a contract with a government, the latter need not look through its dossier of BITs for legal succor; it won't be forthcoming. No other category of private individuals—not traders (who do not invest), not human beings in their capacity as human rights holders, not even national investors in their home state—is given such expansive rights in international law as are private actors investing across borders.⁷¹

It is becoming clear that this system is great for investors but may be ill-suited to democratic governance generally. As one commentator writes, BITs were consciously designed “to restrain host country action against the interests of investors—in other words, to enable the form of legal commitments made to investor[s] to resist the forces of change often demanded by the political and economic life in host countries.”⁷² Early BITs may have originally been designed to constrain capricious autocrats, but more and more, BITs, and, as a result, more of the cases dealt with by mixed arbitral tribunals, are directly related to the difficulties democratic yet sometimes fragile regimes have had coping with various macroeconomic shocks. Modern investment risks have more to do with currency convertibility and capital transfers⁷³ and with efforts to regulate health, safety, and the environment than they do with the blatant expropriation of foreign extractive interests (the Occidental award noted above notwithstanding). A growing number of investor-state disputes center on the sectors for which modern governments are most clearly required by their people to be held accountable: water, power, gas, and basic infrastructure. To what extent BIT-like hand-tying mechanisms can (or should) constrain public policies in these areas is increasingly a matter of debate. If it is true, as Andrew Kerner asserts, that “public opposition [to a BIT] may increase the incentives governments have for ratifying the treaties in the first place,”⁷⁴ then there may well be some serious tensions built into the international investment regime, at least as it is currently constituted.

The investment regime described in this article is experiencing some pressures to change. The explosion of efforts to annul awards is one

⁷¹ Including the treaty-based right to have a monetary award enforced by domestic courts around the world.

⁷² Salacuse 2006, 156.

⁷³ Turyn and Perez Aznar 2010.

⁷⁴ Kerner 2009, 97.

indicator of resistance. A growing number of countries are beginning to renegotiate or even to terminate their BIT obligations.⁷⁵ Norway has had to shelve negotiations on new BITS due to growing domestic polarization about the proper balance between investor protection and the ability of states to regulate in the public interest.⁷⁶ Australia will no longer agree to mixed arbitration provisions in its new trade and investment agreements, largely because of the difficulties it foresees in maintaining its regulatory prerogatives.⁷⁷ Most importantly, having been on the respondent end of the arbitration system much more than anticipated, the United States government itself has begun to plot out a more balanced approach to the protection of foreign direct investments.⁷⁸ The US Model BIT of 2004 has many more state protections than its predecessors, and the 2012 model stipulates that parties must not waive labor and environmental laws in order to encourage investment.⁷⁹ The ability to make credible commitments has been central to the investment regime, but the terms of such commitment are and always have been determined by the interests and bargaining power of the parties.

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⁷⁵ Bolivia and Ecuador have both withdrawn from the ICSID Convention (in 2007 and 2009, respectively), and Nicaragua has indicated its intention to withdraw, but as of this writing had not done so. Ecuador terminated nine of its BITS in 2009; several more were declared unconstitutional by Ecuador's high court in 2010 and are likely to be terminated. Other denounced BITS include those between El Salvador and Nicaragua, and the Netherlands and Venezuela. See UNCTAD, "Denunciation of the ICSID Convention and BITS: Impact on Investor-State Claims," *IIA Issues Note*, no. 2, December 2010. Available at http://www.unctad.org/en/docs/webdiaeia20106_en.pdf, Accessed January 25, 2011.

⁷⁶ See *Investment Treaty News*, "Norway shelves its draft model bilateral investment treaty," June 8, 2009. Available at <http://www.iisd.org/itn/2009/06/08/norway-shelves-its-proposed-model-bilateral-investment-treaty>. Accessed January 25, 2011.

⁷⁷ See <http://www.iisd.org/itn/2011/07/12/australias-rejection-of-investor-state-dispute-settlement-four-potential-contributing-factors>. Accessed October 9, 2013.

⁷⁸ Experienced observers attribute the US change of heart to the scare associated with the possibility of losing the Methanex case, which involved environmental regulations in California. See Vagts 2010.

⁷⁹ *Financial Times*, London, US edition, World News section, April 21, 2012, 3. On the evolution of US thinking on BITS and major changes in the US model, see Alvarez and Weiler 2010.

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