5. DO BITs REALLY WORK?: AN EVALUATION OF BILATERAL INVESTMENT TREATIES AND THEIR GRAND BARGAIN*

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INTRODUCTION

International investment law has undergone a remarkable transformation in a relatively short time. The fundamental tool for effecting that transformation has been the bilateral investment treaty (BIT), an international legal instrument through which two countries set down rules that will govern investments by their respective nationals in the other's territory.[1] From 1959 to 2002, nearly 2,200 individual BITs were formed,[2] making the BIT one of the most widely used types of international agreement for protecting and influencing foreign investment.[3]

As the twenty-first century begins, the time has come to evaluate whether BITs have achieved their objectives.[4] To answer this question, Part A examines

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1. The literature and doctrinal commentary on Bilateral Investment Treaties (BITs) are abundant and have expanded over the years as the number of BITs has grown. *See generally, e.g.*, Rudolf Dolzer & Margrete Stevens, Bilateral Investment Treaties (1995); M. Sornarajah, The International Law on Foreign Investment 225–76 (1994); UN Conf. on Trade and Dev. (UNCTAD), Bilateral Investment Treaties, 1959–1999, UN Doc UNCTAD/ITE/IIA/2 (2000), *at* http://www.unctad.org/en/docs//poiteiiad2.en.pdf (last visited Nov. 29, 2004); UNCTAD, Bilateral Investment Treaties in the Mid-1990s, UN Doc. UNCTAD/ITE/IIT/7 (1998); K. J. Vandevelde, United States Investment Treaties: Policy and Practice (1992); Antonio R. Parra, *The Scope of New Investment Laws and International Instruments in Economic Development*, in Economic Development, Foreign Investment and Law 27 (R. Pritchard ed., 1996). In addition, see the Web site of the International Centre for Settlement of Investment Disputes (ICSID) for materials on BITs, including the texts of many BITs, arbitration awards that have interpreted and applied them, and a bibliography of books and articles commenting on BITs. *See* ICSID, *ICSID Bilateral Investment Treaties*, *at* http://www.worldbank.org/icsid/treaties/treaties.htm (last visited Nov. 30, 2004).

2. *See* UNCTAD, World Investment Report 2003: FDI Policies For Development: National and International Perspectives 89, UN Doc. UNCTAD/WIR/2003 (Sept. 4, 2003) (stating that 2,181 BITs were in effect as of the end of 2002).

3. *See id.*

4. For earlier speculation on this question, see Jeswald W. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 Int'l Law. 655, 656–61 (1990).

the historical movement to form BITs. Part B explores the goals motivating BITs, namely foreign investment protection, market liberalization, and foreign investment promotion. The three succeeding parts assess the success of BITs in achieving each of these goals. Finally, we conclude by considering the implications of the BIT movement for the further development of international investment law.

A. History of the BIT movement

1. Impetus for the BIT movement As recently as 1970, the International Court of Justice in the *Barcelona Traction* case found it "surprising" that the evolution of international investment law had not gone further and that no generally accepted rules had yet crystallized in light of the growth of foreign investments and the expansion of international activities by corporations in the previous half-century.[5] International law, as stated in Article 38(1) of the Statute of the International Court of Justice, consists of three primary sources: treaties, customs that the international community considers binding, and general principles of law common to the world's legal systems.[6] In the period after World War II, as foreign investment gained momentum as an increasingly important international economic activity, foreign investors who sought the protection of international investment law encountered an ephemeral structure consisting largely of scattered treaty provisions, a few questionable customs, and contested general principles of law. This legal structure was seriously deficient in several respects. First, applicable international law failed to take account of contemporary investment practices and address important issues of concern to foreign investors.[7] For example, customary international law had virtually nothing to say about the right of foreign investors to make monetary transfers from the

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5. *See* Barcelona Traction, Light and Power Co., Ltd. (*Belg. v. Spain*), 1970 I.C.J. 3, 46–47 (Feb. 5).

6. Article 38 (1) states that:

1. The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:
   a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
   b. international custom, as evidence of a general practice accepted as law;
   c. the general principles of law recognized by civilized nations;
   d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

Statute of the International Court of Justice, art. 38(1), June 26, 1945, 59 Stat. 1055, 33 U.N.T.S. 993, *reprinted in* 55 Yale L.J. 1318, 1326 (1946).

7. Indeed, as late as 1994, a leading commentator on international investment law stated: "There are few customs in this sense in the field of foreign investment." Sornarajah, *supra* note 1, at 74.

host country. Second, the principles that did exist were often vague and subject to varying interpretations. Thus, although there was strong evidence that customary international law required the payment of compensation upon nationalization of an investor's property, no principles had crystallized on how that compensation was to be calculated.[8]

Third, this existing framework prompted disagreement between industrialized countries and newly decolonized developing nations. For example, capital-exporting states claimed that international law imposed an obligation on host countries to accord foreign investors a minimum standard of protection and required states expropriating property of foreign investors to provide compensation.[9] Many developing countries, believing that the existing international rules served only to maintain their poverty, rejected this view and, beginning in the 1970s, demanded that their particular needs and circumstances be taken into account.[10] Their position on foreign investment was incorporated[11] into Article 2 of the 1974 United Nations Charter of Economic Rights and Duties of States, adopted by the United Nations General Assembly.[12]

Finally, existing international law offered foreign investors no effective enforcement mechanism to pursue their claims against host countries that had injured or seized their investments or refused to respect their contractual obligations. As a result, investors had no assurance that investment contracts and arrangements made with host country governments would not be subject to

8. *See id.*

9. *See* Restatement (Third) of the Foreign Relations Law of the United States § 712 (1987).

10. Inspired by the success of the oil-producing countries in raising petroleum prices in 1973–74, developing countries had hoped that by building a numerically strong coalition amongst themselves, they would be able to bring about desired change in various international fora. As a result of the debt crisis in the early 1980s, the internal economic restructuring demanded by international financial institutions, such as the International Monetary Fund (IMF) and the World Bank, and the abandonment of command economy models by developing countries, the movement for a "New International Economic Order" lost steam and was virtually dead by 1990. *See* Thomas Waelde, *Requiem for the "New International Economic Order," in* Festschrift Fuer Ignaz Seidl-Hohenveldern 771 (Gerhard Hafner *et al.* eds., 1998). *See generally* Jeffrey Hart, The New International Economic Order (1983); The New International Economic Order: The North-South Debate (Jagdish N. Bhagwati ed., 1977).

11. *See* Robert F. Meagher, An International Redistribution of Wealth and Power: A Study of the Charter of Economic Rights and Duties of States (1979).

12. UN Charter of Economic Rights and Duties of States, G.A. Res. 3281, UN GAOR, 29th Sess., Supp. No.31, at 50, UN Doc. A/9946 (Jan. 15, 1974); UN Doc. A/9631 (1974), *reprinted in* 14 I.L.M. 251, 255 (1975). Article 2 provides that each state has the right to expropriate foreign property, subject to the duty to pay "appropriate" compensation, is not required to give foreign companies preferential treatment, and has the right to revise and renegotiate contracts it has made with foreign companies.

unilateral change by those governments at some later time. Although the International Centre for Settlement of Investment Disputes (ICSID) had been formally established in 1965 as an affiliate of the World Bank to resolve disputes between host countries and foreign private investors,[13] the Centre did not hear its first case until 1972.[14] Injured foreign investors who were unable to negotiate a satisfactory settlement, secure an arbitration agreement with a host government, or find satisfaction in the local courts had few options other than to seek espousal of their claims by their source country governments, a process that by its very nature was more political than legal.

A short three decades later, the legal architecture for the protection of foreign investment has changed dramatically. From the point of view of the foreign investor, this structure has become a far more protective shelter than it was in the 1970s. In most cases, a foreign investor benefiting from a BIT may now look to a comprehensive, specific, and largely uncontested set of international legal rules, with recourse to international tribunals for enforcement.[15] Equally important to the change in the content of international investment law has been the change in its sources. Today, unlike the situation that prevailed in the early 1970s, foreign investors are protected primarily by international treaties, rather than by customary international law alone.[16] For all practical purposes, BIT law has become the fundamental source of international law in the area of foreign investment.[17]

In addition to largely displacing customary law as a source of controlling legal principles in specific investment cases, and perhaps even beginning to influence the formation of a new customary international law of investment, BITs have also displaced, and in some cases replaced, the relevant domestic law of the host country in many important respects. It is this latter aspect of the development of international investment law that has generated, and is continuing to generate, significant controversy within both developed and developing countries, as it

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13. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159.

14. *See* ICSID, *List of Concluded Cases*, *at* http://www.worldbank.org/icsid/cases/conclude.htm (last visited Nov. 30, 2004) (listing concluded cases in chronological order).

15. As of October 2004, for example, ICSID's docket consisted of eighty-two pending cases brought by foreign investors against host countries. Since its creation, ICSID has handled 170 foreign investment cases, including 83 pending and 87 completed cases. *See* ICSID, *ICSID Cases*, *at* http://www.worldbank.org/icsid/cases/cases.htm (last visited Nov. 30, 2004). In 2003 alone, a record number of 26 cases were registered with ICSID. For a listing of these disputes before the Centre, see ICSID, ICSID 2003 Annual Report 9–31 (2003). *See also* ICSID, *at* http://www.worldbank.org/icsid (last visited Nov. 30, 2004) (providing information and awards relating to many of these cases).

16. *See* UNCTAD, *supra* note 2, at 89.

17. *See* Patrick Juillard, *L'Evolution des Sources du Droit des Investissements*, 250 Recueil des Cours de L'Académie de Droit International 74 (1994).

places host country concerns about national sovereignty and the right to control the activities of foreign investors in opposition to investor concerns about protection from unjustified interference in their investments.[18]

BITs may also have an impact in creating or shaping law outside of their specific texts. In ratifying a BIT, a country makes the treaty part of its legal system. In order to meet the demands of both the letter and intent of a BIT, a country may modify internal legislation affecting investment. With the proliferation of BITs and the great expansion of the number of countries that have signed them, one may consider whether the BITs themselves are evidence of a new international consensus on investment law—an evolving set of customs that the international community is coming to consider obligatory. Even if they cannot yet be seen as custom, perhaps at least they provide evidence of another source of international law—general principles of law common to the world's legal systems. We shall attempt to address both possibilities in the conclusion of this chapter.

2. Evolution of the BIT movement The movement to create an international law of investment began in the 1950s with the rapid expansion of international investment in the post–World War II era. Over the past three decades in particular, BITs have proliferated as foreign direct investment (FDI) has experienced phenomenal growth. Total annual FDI reached $1.1 trillion in 2000, a drastic increase from $25 billion in 1973.[19] For much of this period, FDI grew faster than international trade. During the period between 1973–1995, the estimated value of FDI outflows increased twelvefold while the value of merchandise exports increased less than ninefold.[20]

This international flow of capital has both driven and been driven by the development of international investment law. Investors seeing profitable economic opportunities for their capital and technology abroad have pushed their governments to enter into arrangements with other countries to facilitate and protect their investments.[21] At the same time, the development of new

18. *See, e.g.*, Aaron Cosbey et. al., Investment and Sustainable Development: A Guide to the Use and Potential of International Investment Agreements 12–15 (2004) (discussing expropriation and the balancing of host, public, and foreign investor interests), *available at* http://www.iisd.org/pdf/2004/investment_invest_and_sd.pdf (last visited Nov. 21, 2004); Konrad von Moltke & Howard Mann, Towards a Southern Agenda on International Investment: Discussion Paper on the Role of International Investment Agreements 29–30 (2004) (discussing "regulatory chill" that BITs can induce), *available at* http://www.iisd.org/pdf/2004/investment_sai.pdf (last visited Nov. 19, 2004).

19. *See* UNCTAD, *supra* note 2, at 9.

20. *See* World Trade Org. (WTO), 1 Annual Report 1996, 46 (1996).

21. *See, e.g.*, Statement, International Chamber of Commerce (ICC), ICC Statement on Behalf of World Business to the Heads of State and Government attending the Evian Summit (June 1–3, 2003), *available at* http://www.iccwbo.org/home/statements_rules/statements/2003/G8.asp (last visited Nov. 19, 2004).

international investment rules may also have had the effect of encouraging new capital flows to the countries concerned, a proposition that this chapter specifically seeks to address.

Due to the inadequacy of customary international law, capital-exporting nations since World War II have made efforts to create international rules to facilitate and protect the investments of their nationals and companies abroad. These efforts have taken place at both the bilateral and multilateral levels, which, though separate, have tended to inform and reinforce each other.[22] Early attempts to create an international investment law for the post–World War II era sought to create multilateral treaties. The first such effort was the Havana Charter of 1948, which would have created the International Trade Organization with powers to promulgate rules on international investment.[23] Due partly to opposition from the business community, the Havana Charter failed to gain support from a sufficient number of states.[24] Subsequent efforts included the International Chamber of Commerce's International Code of Fair Treatment of Foreign Investment (1949), the International Convention for the Mutual Protection of Private Property Rights in Foreign Countries (1957), a private effort known as the Abs-Shawcross Convention, and the Organization for Economic Cooperation and Development (OECD) Draft Convention on the Protection of Foreign Property (1967).[25] Although none of these proposals was ever adopted, they did inform and influence the development of the BIT movement that was to come.[26]

The most immediate and practical impact of such bilateral efforts was the creation of enforceable rules to govern international investment. Bilateral commercial treaties had existed for centuries, but the primary purpose of these

22. *See, e.g.*, Thomas W. Walde, *Introductory Note*, European Energy Conference: Final Act, Energy Charter Treaty, Decisions, and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects, 34 I.L.M. 360, 360 (1995) (noting the strong influence of BITs on the trade provisions of a multilateral energy treaty); Patrick Juillard, *Le Réseau Français des Conventions Bilatérales d'Investissement: á la Recherche d'un Droit Perdu?*, 13 Droit et Pratique du Commerce Internationale 9, 16 (1987) (noting that France based its model BIT on the 1967 Organization for Economic Cooperation and Development (OECD) Draft Convention on the Protection of Foreign Property).

23. Havana Charter for an International Trade Organization, March 24, 1948, UN Doc. E/ Conf. 2/78.

24. *See* William Diebold, Jr., The End of the ITO 9 (Princeton Essays in International Finance No. 16, 1952), *cited in* Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving toward a Multilateral Investment Treaty*, 55 U. Pitt. L. Rev. 541, 555 n.68 (1994).

25. *See generally* Franziska Tschofen, *Multilateral Approaches to the Treatment of Foreign Investment*, 7 ICSID Rev.-Foreign Inv. L.J. 384, 385–86 (1992) (surveying various efforts to prepare multilateral treaties on foreign investment).

26. *See* Juillard, *supra* note 22, at 16.

earlier agreements was to facilitate trade, rather than investment.[27] In its early history, the United States made large numbers of such agreements—known as treaties of friendship, commerce, and navigation[28]—and their geographic spread reflected the expansion of U.S. foreign trade.[29] Though these treaties were intended to facilitate trade and shipping, they occasionally contained provisions affecting the ability of one country's nationals to own property or do business in the territory of the other contracting state.[30]

Responding to the increase of U.S. foreign investment after World War II, the United States undertook a program to conclude a network of bilateral treaties of friendship, commerce, and navigation that, in addition to other commercial matters, specifically sought to facilitate and protect U.S. direct investment abroad.[31] Although the United States signed twenty-three such treaties between 1946 and 1966,[32] this effort soon lost momentum as developing countries, increasingly skeptical of the benefits of foreign investment, grew reluctant to agree to the guarantees that the United States requested to protect American investments abroad.[33]

A new and important phase in the historical development of modern international investment law began in the late 1950s, as individual European countries negotiated bilateral treaties that, unlike the previous commercial agreements, dealt exclusively with foreign investment. These countries sought to create a basic international legal framework to govern investments by nationals of one country in the territory of another. The modern BIT was thus born. Germany, which had lost all of its foreign investments as a result of its defeat in World War II, took the lead in this new phase of bilateral treaty-making. Starting with an

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27. *See, e.g.*, Shenkin, *supra* note 24, at 570 ("The early [U.S. treaties of friendship, commerce, and navigation] were concerned primarily with the trade and shipping rights of individuals.").

28. *See* Robert R. Wilson, United States Commercial Treaties and International Law (1960). For a history of U.S. treaties of friendship, commerce, and navigation, see Herman Walker Jr., *Modern Treaties of Friendship, Commerce and Navigation*, 42 Minn. L. Rev. 805 (1958).

29. *See* Kenneth J. Vandevelde, *The Bilateral Investment Treaty Program of the United States*, 21 Cornell Int'l L.J. 201, 204 n.29 (1988) (recounting how the United States made bilateral commercial treaties first with Western Europe, then with Latin America, later with Asia, and still later with Africa).

30. *See* Shenkin, *supra* note 24, at 570.

31. *See Sumitomo Shoji America v. Avagliano*, 457 U.S. 176, 185–90 (1982) (discussing history of U.S. BITs). *See also* Salacuse, *supra* note 4, at 656–61.

32. *See* Shenkin, *supra* note 24, at 573.

33. *See* K. Scott Gudgeon, *United States Bilateral Investment Treaties: Comments on their Origin, Purposes, and General Treatment Standards*, 4 Int'l Tax & Bus. L. 105, 111 (1986), *cited in* Shenkin, *supra* note 24, at 573.

agreement with Pakistan in 1959,[34] Germany proceeded to negotiate similar investment treaties with countries throughout the developing world.[35] Switzerland, France, the United Kingdom, the Netherlands, and Belgium followed in relatively short order.[36] By 1977, European countries had concluded approximately 130 BITs with a broad array of developing countries.[37] Several factors may have contributed to the relative success of the European programs. Compared to the United States, European countries generally were less demanding with respect to guarantees on such matters as free conversion of local currency, abolition of performance requirements, and protection against expropriation. Moreover, specific foreign aid relationships between certain European countries and the European Community, on the one hand, and individual developing countries, on the other, may have predisposed some of the latter to look favorably on concluding BITs with European states.[38] Spurred in part by the experience of the Europeans, the United States launched its own BIT program in 1981.[39] By September 2004, it had signed forty-five BITs with developing countries and emerging markets.[40] As non-Western countries began

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34. *See* UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 177–79 (reporting historical data on the BITs entered into by Germany).

35. Germany remains one of the leaders in BIT formation, having concluded 119 treaties as of June 2004. *See* UNCTAD, *Investment Instruments Online, at* http://www.unctadxi.org/templates/DocSearch.aspx?id=779 (last updated June 15, 2004) (last visited Nov. 19, 2004).

36. *See generally id.* (providing current statistics on BITs).

37. *See* International Chamber of Commerce, Bilateral Investment Treaties for International Investment 13–16 (1977).

38. Foreign aid to developing countries has been a function of numerous factors, including strategic, commercial, political, and humanitarian considerations. Peter Hjertholm and Howard White, *Foreign Aid in Historical Perspective: Background and Trends, in* Foreign Aid and Development: Lessons Learnt and Directions for the Future 99–100 (Finn Tarp ed., 2000). As a result, it is difficult to know precisely the impact of a donor country's aid policies on its BIT negotiations with a specific aid recipient. From the point of view of a recipient country, one indicator of the quality of aid is the percentage that is "untied," i.e. not required to be spent on acquiring goods and services from the donor country. It is interesting to note that European countries whose aid was the least "tied" were among the countries that had concluded the largest number of BITs in 1981. In that year, when the percentage of untied aid given by the United States was only 33%, Germany, with untied aid of 74%, had signed 49 BITs; Switzerland with untied aid of 50% had signed 33 BITs; the Netherlands with untied aid of 57% had signed 16 BITs; and Sweden with untied aid of 84% had signed 8 BITs. Hjertholm and White, *supra* at 96. UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 159–217.

39. For additional background on U.S. BITs, see Vandevelde, *supra* note 1; Pamela B. Gann, *The U.S. Bilateral Investment Treaty Program*, 21 Stan. J. Int'l L. 373 (1985); Gudgeon, *supra* note 33, at 107–11 Salacuse, *supra* note 4.

40. *See* Fact Sheet, Bureau of Economic and Business Affairs, U.S. Dep't of State, U.S. Bilateral Investment Treaty Program (Sept. 15, 2004) (listing all U.S. BITs as of Sept. 15, 2004), *available at* http://www.state.gov/e/eb/rls/fs/22422.htm (last visited Nov. 19, 2004).

to export capital, they too negotiated BITs to create a legal framework for their nationals' investments in specific countries. Thus, by 1997, Japan had signed four BITs, and Kuwait had signed twenty-two.[41] While BITs are usually between capital-exporting states and developing countries, on occasion, two developing countries or two industrialized countries have formed such agreements. Examples of the former include BITs between Thailand and China and between Egypt and Morocco.[42] The most notable example of the latter is the 1988 agreement between the United States and Canada that created a free trade area between the two countries.[43] This agreement included a special chapter that in effect functions as a BIT, considering how closely its provisions parallels those of BITs that the United States has negotiated with other countries.[44] By 1994, the agreement evolved into the North American Free Trade Agreement (NAFTA) between Canada, Mexico, and the United States.[45] For all intents and purposes, NAFTA's section on investment, Chapter Eleven, constitutes a BIT between the three countries.

The late 1980s witnessed a new phase in the history of the BIT movement with the end of the Communist era and the abandonment of command economies in many parts of the world. The emerging economies of Eastern and Central Europe, as well as of certain Latin American, African, and Asian countries that had previously been hostile to foreign investment, now actively sought foreign capital to finance their development. This dramatic transformation entailed sweeping changes in law and policy.[46] Reflecting this policy shift, countries with emerging markets entered into BITs with industrialized states from which they hoped to receive capital and technology to advance their development, and they did so at an accelerating pace. Whereas some 309 BITs had been concluded by the end of 1988,[47] 2,181 BITs were concluded by 2002.[48] This dramatic change in so short a period of time represents a substantial feat of international lawmaking. In 2001 alone, a total of ninety-seven countries concluded some 158 BITs,

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41. *See* UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 185–86.

42. Agreement for the Promotion and Protection of Investments, P.R.C.-Thail., Mar. 12, 1985, *available at* http://www.unctad.org/sections/dite/iia/docs/bits/china_thailand.pdf (last visited Nov. 19, 2004); Agreement Regarding the Encouragement and Protectionof Investment, Egypt-Morocco, June 6, 1976, *available at* http://www.unctad.org/sections/dite/iia/docs/bits/egypt_morocco_arb.pdf (last visited Nov. 19, 2004).

43. *Se*e Free Trade Agreement, U.S.-Can., Jan. 2, 1988, 27 I.L.M. 281 (1988).

44. *See* i*d.* at 373–80.

45. North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993).

46. *See* Jeswald W. Salacuse, *From Developing Countries to Emerging Markets: A Changing Role for Law in the Third World,* 33 Int'l Law. 875, 875–77 (1999).

47. *See* Athena J. Pappas, *References on Bilateral Investment Treaties,* 4 ICSID Rev.-Foreign. Inv. L.J. 189, 194–203 (1989).

48. *See* UNCTAD, *supra* note 2, at 89.

a numerical record for any single year since the BIT movement began in 1959.[49] The result of this effort has been the creation of an increasingly dense BIT network linking more than 170 different countries.[50]

Meanwhile, the number of BITs involving two developing countries has been increasing steadily. China, for example, had concluded ninety-nine BITs with both developed and developing countries by June 2004.[51] Overall, however, developed countries have signed relatively few BITs with one another.[52]

B. The Goals of the BIT Movement

The impetus behind the rapid expansion of BITs rests in the desire of companies of industrialized states to invest safely and securely in developing countries, as well as the consequent need to create a stable international legal framework to facilitate and protect those investments. Without a BIT, international investors are forced to rely on host country law alone for protection, which entails a variety of risks to their investments. Host governments can easily change their own domestic law after a foreign investment is made, and host country officials may not always act fairly or impartially toward foreign investors and their enterprises. Investor recourse to local courts for protection may prove to be of little value in the face of prejudice against foreigners or governmental interference in the judicial process.[53] Indeed, these fears were realized in the 1960s and 1970s when numerous instances of interference and expropriation of foreign investments by host country governments occurred. The number of expropriations of foreign-owned property grew steadily each year from 1960 and reached its peak in the mid-1970s.[54]

The lack of consensus on the customary international law applicable to foreign investments also created uncertainty in the minds of investors as to the degree of protection they could expect under international law. To gain greater certainty and to counter the threat of adverse national law and regulation, the host countries of these investors sought to conclude a series of BITs that would

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49. *See* UNCTAD, World Investment Report 2002: Transnational Corporations & Export Competitiveness 8, UN Doc. UNCTAD/WIR/2002 (2002).

50. *See, e.g.*, Press Release, UNCTAD, Bilateral Investment Treaties Signed in Bangkok, UN Doc. UNCTAD/INF/PR/025X (Feb. 18, 2000) (indicating that 174 countries had entered into BITs by the end of 1998), *available at* http://www.unctad.org/Templates/Webflyer.asp?docID=308&intItemID=2527&lang=1.

51. *See* UNCTAD, *supra* note 35.

52. *See* UNCTAD, Lessons from the MAI at 22 n.9, UN Doc. UNCTAD/ITE/IIT/Misc.22 (1999) (reporting that, as of 1999, fewer than 10 percent of BITs were between OECD countries).

53. *See* UNCTAD, *supra* note 2, at 114–18.

54. The United Nations identified 875 distinct acts of governmental taking of foreign property in sixty-two countries during the period between 1960–1974. Don L. Piper, *New Directions in the Protection of American-Owned Property Abroad*, 4 Int'l Trade L.J. 315, 330 (1979).

provide clear rules and effective enforcement mechanisms, at least with regard to their treaty partners. Their primary goal, therefore, was *protection* of investments made by their nationals and companies in foreign countries.[55]

In addition to protecting the investments of their nationals, some countries, especially the United States, have had another objective in negotiating BITs: to *facilitate* the entry and operation of these investments by inducing host countries to remove various impediments in their regulatory systems. They have sought to encourage or induce investment and market liberalization within their negotiating partners.[56] Moreover, in the view of certain developed countries, BITs will have the effect of liberalizing the developing country's economy as a whole, by facilitating the entry of a treaty partner's investment and creating conditions favoring their operations. In the process of reforming their economies to foster private enterprise, some developing countries have realized that creating favorable conditions for foreign investment can be integral to their success.[57] Although the BITs themselves do not specifically enunciate the goal of investment and market liberalization, that goal has clearly been in the minds of developed country negotiators and is sometimes reflected in background documents.[58]

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55. Virtually all BITs are titled: "A Treaty Concerning . . . the Protection of Investment." *See, e.g.*, Treaty Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Arm., Sept. 23, 1992, S. Treaty Doc. No. 103-11 (1993); Treaty Concerning the Promotion and Reciprocal Protection of Investments, F.R.G.-Pol., Nov. 10, 1989, 29 I.L.M. 333 (1990).

56. The Deputy United States Trade Representative stated the U.S. goals in negotiating BITs as follows:

> The BIT program's basic aims are to: (1) protect U.S. investment abroad in those countries where U.S. investors' rights are not protected through existing agreements; (2) encourage adoption in foreign countries of market-oriented domestic policies that treat private investment fairly; and (3) support the development of international law standards consistent with these objectives.

Jeffrey Lang, *Keynote Address*, 31 Cornell Int'l L.J. 455, 457 (1998). *See also* United States Trade Representative, *USTR Focus on Investment*, *at* http://ustr.gov/Trade_Sectors/Investment/Section_Index.html. (last visited Nov. 6, 2004).

57. *See generally* Salacuse, *supra* note 46, at 875–77.

58. *See, e.g.*, Investment Treaty With Albania, U.S.-Alb., Jan. 11, 1995, S. Treaty Doc. No. 104-19 (1995). (In the Message from the President of the United States Transmitting The Treaty Between the Government of the United States of America and the Government of the Republic of Albania Concerning the Encouragement and Reciprocal Protection of Investment With Annex and Protocol Signed at Washington on January 11, 1995, President Clinton stated: "The bilateral investment treaty (BIT) with Albania will protect U.S. investment and assist the Republic of Albania in its efforts to develop its economy by creating conditions more favorable for U.S. private investment and thus strengthen the development of its private sector.").

See also United States Trade Representative Web site, *supra* note 56.

Concluding and maintaining a treaty requires a bargain from which both parties believe they will derive benefits. An investment treaty between two developed countries, both of whose nationals expect to invest in the territory of the other, would be based on the notion of reciprocity and mutual protection; however, this bargain would not seem applicable in the context of a treaty between a developed, capital-exporting state and a poor, developing country whose nationals are unlikely to invest abroad. One might therefore ask, Why would developing countries enter into such agreements? Why would they constrain their sovereignty by entering into treaties that specifically limit their ability to take necessary legislative and administrative actions to advance and protect their national interests?[59]

The answer to these questions is that developing countries sign BITs to *promote* foreign investment, thereby increasing the amount of capital and associated technology that flows to their territories. The basic assumption behind BITs is that a bilateral treaty with clear and enforceable rules to protect and facilitate foreign investment reduces risks that the investor would otherwise face, and that such reductions in risks, all things being equal, encourage investment. In the 1980s and 1990s, as other forms of financial assistance became less available from commercial banks and official aid institutions, developing countries increasingly felt the need to promote foreign investment in order to foster economic development; they saw BITs as one means of pursuing a campaign of investment promotion and therefore signed them in increasing numbers.[60] Thus, a BIT between a developed and a developing country is founded on a grand bargain: a *promise* of protection of capital in return for the *prospect* of more capital in the future.

An interesting question is why the nations of the world have been willing to conclude BITs in growing numbers over the last fifty years but have steadfastly refused to join multilateral agreements on investment.[61] One technical

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59. This question assumes that the developing country is not expecting other benefits from its developed country treaty partner, such as increased foreign aid or enhanced security guarantees, which are extraneous to a BIT relationship.

60. *See* UNCTAD, *supra* note 2, at 85.

61. One partial exception is the European Energy Charter Treaty, art. 16, *opened for signature* Feb. 1, 1995, 34 I.L.M. 360 (1995)(ratified by forty-five states as of 2002). The basic aim of the treaty is to create a legal framework that will encourage the development of a secure international energy supply through liberalized trade and investment among the member states. It includes an investment chapter that has undeniably been influenced by the BIT movement. *See* Jeswald W. Salacuse, *The Energy Charter Treaty and Bilateral Investment Treaty Regimes, in* The Energy Charter Treaty: An East-West Gateway for Investment & Trade 321–48 (Thomas Walde ed., 1996). One of the unique features of this treaty, which distinguishes it from other international investment agreements, is that it is a *sectoral* agreement, that is, it only applies to investments in a particular economic sector. Its scope is limited to investments associated with economic activities concerning

explanation is that a bilateral treaty must accommodate the interests of only two parties and is therefore far less complicated to negotiate than a multilateral global treaty, which must accommodate the interests of many countries.[62] Politically, given the asymmetric nature of BIT negotiations between a strong developed country and a usually much weaker developing country, the bilateral setting allows the developed country to use its power more effectively than does a multilateral setting, where that power may be much diluted. For example, in multilateral settings, developing countries have the opportunity to form blocking coalitions with like-minded countries to enhance their power in the negotiations, something that is impossible in bilateral negotiations. On the other hand, the prospects of investment capital from specific developed countries, along with other political and economic benefits arising from a definite bilateral relationship, may make a developing country more willing to enter into a BIT with a specific developed country than it would a multilateral agreement, where those benefits may seem more tenuous and theoretical. Moreover, whereas developed countries would be willing to enter into bilateral treaties with developing countries for investment liberalization, knowing full well that little if any enterprises from the developing country would ever invest in the developed country, they have been unwilling to enter into treaties that would grant such liberalization to investors from other developed countries, which could become strong competitors to the host countries' own enterprises.[63]

It should be noted that investment promotion, a fundamental objective of developing countries, and investment and market liberalization, a subsidiary aim of developed countries, are separate and distinct goals.[64] Within the context

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the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or sale of energy materials and products. Although the United States participated in the negotiations, it chose not to sign the treaty, apparently because it believed that its provisions on investment did not meet the strong international standards that the United States had obtained in its own BITs. William Fox, *The United States and the Energy Charter Treaty: Misgivings and Misperceptions, in* The Energy Charter Treaty: An East-West Gateway for Investment & Trade 194, 196 (Thomas Walde ed., 1996). For information on the current status of the treaty, see Energy Charter Treaty, *at* http://www.encharter.org (last visited Nov. 19, 2004).

62. For a discussion of the differences between bilateral and multilateral negotiations, see Fen Osler Hampson, Multilateral Negotiations: Lessons from Arms Control, Trade and the Environment 1–51, 345–60 (1995); International Multilateral Negotiation: Approaches to the Management of Complexity 1–10, 213–22 (I. William Zartman ed., 1994).

63. Such a problem arose during the negotiation of the failed OECD Multilateral Agreement on Investment, conducted between 1995 and 1998. *See* Glen Kelley, Note, *Multilateral Investment Treaties: A Balanced Approach to Multinational Corporations*, 39 Colum. J. Transnat'l. L. 483, 494–98 (2001).

64. Investment protection and investment liberalization are also distinct concepts. Investment liberalization refers to facilitating the entry and operation of foreign investments in the host country. Investment protection refers to protecting the investment,

of BITs, investment promotion for host countries means the attraction of investment projects that the host country determines are in *its* best interests. Investment liberalization, on the other hand, is a favorite term of capital-exporting countries and generally means creating a climate in which investors may undertake investments that investors judge to be in *their* interests. For example, a host country government might actively seek to promote investments in the electronics industry, which it judged would foster the future development of its economy but which were not yet present in the country. At the same time, it may desire to impede investment in the retail industry, which is already served by politically powerful local entrepreneurs who fear foreign competition. In such a situation, the developing country, through its treaty relationships and its internal legislation, would be following a policy of investment promotion but not one of investment liberalization.

If the three fundamental goals of the BIT movement are investment protection, promotion, and liberalization, one may well ask whether the 2,200 treaties negotiated over the past five decades have achieved these goals. To what extent have BITs actually protected, liberalized, and promoted foreign investment? The answer to this question is important. The continued vitality of the BIT movement and the prospects for creating a global, multilateral legal structure for foreign investment similar to the one that exists for international trade will be influenced by how the concerned countries evaluate the benefits and costs of the BIT process. The following three parts of this chapter will examine each goal separately to determine the extent to which BITs have attained these three objectives.

C. An Evaluation of Bit Goal No. 1: Investment Protection

Most BITs pursue the objective of investment protection by establishing rules about the host country's treatment of foreign investment and processes for enforcing these rules. The rules restrain the ability of host governments in dealing with foreign investors and investments. The enforcement process provides an international mechanism outside the jurisdiction of the host country to enforce the rules in cases of dispute. Although the precise provisions of BITs are not uniform and some BITs restrict host country governmental action more than others, virtually all BITs address the same issues. One of the functions of the BIT movement since its inception has been to define in some detail what an

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once it has entered the country, from actions by governments and others that would interfere with investor property rights and the functioning of the investment in general. For example, in launching negotiations for a Multilateral Agreement on Investment in September 1995, the OECD mandate called for "a broad multilateral framework for international investment with high standards of liberalisation of investment regimes and investment protection." OECD, Multilateral Agreement on Investment: Launch of the Negotiations:1995 CMIT/CIME Report and Mandate, *available at* http://www1.oecd.org/daf/mai/htm/cmitcime95.htm (last visited Nov. 30, 2004).

investment treaty should be in order to create an agreed-upon legal framework for the protection of foreign investment, despite variations of that framework from BIT to BIT.

The basic structure of any BIT encompasses eight topics:

1. Scope of application
2. Conditions for the entry of foreign investment
3. General standards of treatment of foreign investments
4. Monetary transfers
5. Operational conditions of the investment
6. Protection against expropriation and dispossession
7. Compensation for losses
8. Investment dispute settlement

These topics will be examined below through the lens of investment protection in order to illustrate whether BITs have been successful in achieving this goal.

1. Scope of application Key elements in any BIT are its provisions on the scope of application, that is, the definition of the investors and the investments that may benefit from the treaty. The rules on scope of application are generally found at the beginning of the BIT in sections defining "investors," "companies," "nationals," "investments," and "territory."[65] As a result of entering a BIT, a contracting country owes obligations only to investors of other contracting countries that make investments in its territory. A contracting country, therefore, owes no obligations under a BIT to people or investments that do not come within the definitions of these terms as defined in the treaty document.

In defining the nature of covered investments, most BITs take four basic definitional dimensions into consideration: (1) the form of the investment; (2) the area of the investment's economic activity; (3) the time when the investment is made; and (4) the investor's connection with the other contracting country. Most BITs define the concept of investment broadly so as to include various investment forms: tangible and intangible assets, property, and rights. Their approach is to give the term "investment" a broad, nonexclusive definition, recognizing that investment forms are constantly evolving in response to the creativity of investors and the rapidly changing world of international finance. The effect is

65. *See, e.g.*, Agreement for the Liberalization, Promotion and Protection of Investment, Japan-Vietnam, art. 1, Nov. 14, 2003 (defining "investor," "investments," and "Area"), *available at* http://www.unctad.org/sections/dite/iia/docs/bits/japan_vietnam.pdf (last visited Nov. 19, 2004); Treaty Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Czech Rep., arts. 1(a)–(b), Oct. 22, 1991 (defining "investment" and "company of a Party"), *available at* http://www.unctad.org/sections/dite/iia/docs/bits/czech_us.pdf (last visited Nov. 19, 2004); Treaty concerning the Reciprocal Encouragement and Protection of Investments, U.S.-Turk., arts. 1(a), (c), (e), Dec. 3, 1985 (defining "company," "Investment," and "national"), *available at* http://www.unctad.org/sections/dite/iia/docs/bits/us_turkey.pdf (last visited Nov. 19, 2004).

to provide an expanding umbrella of protection to investors and investments. Despite the breadth of language, the issue of what is and is not an investment is important. In a recent case, the ICSID tribunal found that expenditures made in Sri Lanka by a U.S. firm in furtherance of a contemplated investment that did not materialize were not investments for purposes of either the United States-Sri Lanka BIT or the ICSID Convention.[66]

A further issue faced in BIT negotiations is whether investments made prior to the treaty will benefit from its provisions. Developing countries have sometimes sought to limit a BIT's application to future investment only or at least to those investments made in the relatively recent past.[67] Viewing the BIT primarily as an investment promotion mechanism, they have claimed to see little purpose in granting additional protection to investments already in the host country. Moreover, they argue that their governmental authorities might not have approved such investments had they realized that the investor's rights and privileges would later be expanded by a BIT.[68] Capital-exporting countries, on the other hand, have generally sought to protect all investments made by their nationals and companies, regardless of when they were made. For example, Article XII of the model BIT used by the United States in its negotiations provides: "[This Treaty] shall apply to investments existing at the time of entry into force as well as to investments made or acquired thereafter."[69]

Most BITs seek to continue to provide protection to an investor once a host country has terminated or withdrawn from the treaty. This continuing effects provision protects investors who have made investments based on the expectation

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66. *See Mihaly Int'l Corp. v. Sri Lanka*, ICSID Case No. ARB/00/2 (Mar. 5, 2002), 17 ICSID Rev.—Foreign Inv. L.J. 142, 159 (2002).

67. *See, e.g.*, Agreement for the Promotion and Protection of Investments, U.K.-Indon., art. 2(3), Apr. 27, 1976, 1074 U.N.T.S. 195 ("The rights and obligations of both Contracting Parties with respect to investments made before 10 January 1967 shall be in no way affected by the provisions of this Agreement."), *available at* http://www.unctad.org/sections/dite/iia/docs/bits/uk_indonesia.pdf (last visited Nov. 19, 2004).

68. UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 42.

69. *Model Bilateral Investment Treaty (BIT) and Sample Provisions From Negotiated BITs*, *in* 1 Basic Documents in International Economic Law 655, 662 (Stephen Zamora & Ronald Brand eds., 1990) [hereinafter *Model BIT*]. In February 2004, the U.S. State Department released a new and more detailed model BIT. *See* Press Release, U.S. State Dep't, Update of U.S. Model Bilateral Investment Treaty (Feb. 5, 2004), *available at* http://www.state.gov/e/eb/rls/prsrl/2004/28923.htm (last visited Nov. 19, 2004). The new model BIT follows the approach of its predecessor, providing that, "'covered investment' means, with respect to a Party, an investment in its territory of an investor of the other Party in existence as of the date of entry into force of this Treaty or established, acquired, or expanded thereafter." *See* U.S. State Department, 2004 Model BIT (DRAFT), § A, art. 1 (2004), *available at* http://www.state.gov/documents/organization/29030.doc (last visited Nov. 6, 2004) [hereinafter *New Model BIT*].

of treaty protection. The usual period of continued protection is between fifteen and twenty years.

Defining which investors can benefit from the treaty is an important issue, since the goal of the contracting country is to secure benefits for its own nationals, companies, and investors, rather than those of other countries. The problem is essentially one of determining what link needs to exist between an investor and a party to a treaty in order for the investor to benefit from the treaty's provisions. In the case of physical persons, the task is not difficult because virtually all BITs rely on nationality or citizenship, a status that generally is easily determined. For investors that are companies or other legal entities, the problem of determining an appropriate link with a contracting country is more complex. Such legal forms may be created and owned by people who have no real connection with either country that is a party to the treaty. In particular, three types of cases raise problems in this respect: (1) companies organized in a treaty country by nationals of a nontreaty country; (2) companies organized in a nontreaty country by nationals of a treaty country; and (3) companies in which nationals of a nontreaty country hold a substantial interest. For a company to be covered by the treaty, most BITs require that a treaty partner is at least one of the following: (1) country of the company's incorporation;[70] (2) country of the company's seat, registered office, or principal place of business;[71] or (3) country whose nationals have control over, or a substantial interest in, the company making the investment.[72] Sometimes these requirements are combined so that an investing company must satisfy two or more to qualify for coverage under the BIT.

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70. *See, e.g.*, Treaty Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Sri Lanka, art. 1(b), Sept. 20, 1991 ("'[C]ompany' of a Party means any kind of corporation, company, association, partnership or other organization, legally constituted under the laws and regulations of a Party or a political subdivision thereof."), *available at* http://www.unctad.org/sections/dite/iia/docs/bits/us_srilanka.pdf (last visited Nov. 19, 2004). BITs concluded by Denmark, the Netherlands, the United Kingdom and the United States are frequently of this type. *See* UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 39.

71. *See, e.g.*, Treaty Concerning the Encouragement and Reciprocal Protection of Investments, F.R.G.-Swaz., art. 1(4)(a), Apr. 5, 1990 ("The term 'companies' means . . . in respect of the Federal Republic of Germany: any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the German area of application of this Treaty, irrespective of whether or not its activities are directed at profit."), *available at* http://www.unctad.org/sections/dite/iia/docs/bits/germany_swaziland.pdf (last visited Nov. 19, 2004). BITs concluded by Belgium, Germany and Sweden are frequently of this type. *See* UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 40.

72. *See, e.g.*, Agreement on Encouragement and Reciprocal Protection of Investments, Lith.-Neth., art. 1(b)(iii), Jan. 26, 1994:

> The term 'investor' shall comprise with regard to either contracting party: . . . (iii). legal persons not constituted under the law of that Contracting Party but controlled, directly

2. Conditions for the entry of foreign investment The conditions of entry are matters more closely related to investment promotion and investment liberalization than to investment protection. Conse-quently, this aspect of BITs will be considered below in the context of investment liberalization.

3. General standards of treatment of foreign investments The totality of obligations that a host country owes a foreign investor or investment after the investment is made is generally referred to in BITs as the *treatment* owed to the investor or the investment. BITs stipulate the standard of treatment that a host country must accord to a foreign investment in two respects. They define certain general standards of treatment and also state specific standards for particular matters, such as monetary transfers, the employment of foreign personnel, and the resolution of disputes with the host government. This section of the chapter will examine the general treatment standards, while succeeding sections will discuss treatment with regard to specific matters.

One may divide the general standards of treatment of most BITs into six component parts: a) fair and equitable treatment; b) the provision of full protection and security; c) protection from unreasonable or discriminatory measures; d) treatment no less than that accorded by international law; e) requirement to respect obligations made to investors and investments; and f) national and/or most-favored-nation treatment. An individual BIT may provide for some or all of these treatment standards.

a. Fair and equitable treatment. One of the most common standards of treatment found in BITs is an obligation that the host country accord foreign investment "fair and equitable treatment."[73] This is a classic formulation of international law and has been the subject of much commentary and country practice.[74] Nonetheless, its precise meaning in a specific situation has been open to varying interpretations.

b. Full protection and security. Another general standard of treatment found in most BITs is the obligation of the host country to accord "full protection and security" or "constant protection and security" to investments made by nationals and companies of its treaty partners. Two cases interpreting BIT

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or indirectly, by natural persons as defined in (i) [of the Contracting Party's nationality] or by legal persons as defined in (ii) [legal persons constituted under the law of the Contracting Party] above, who invest in the territory of either Contracting Party.

available at http://www.unctad.org/sections/dite/iia/docs/bits/netherlands_lithuania.pdf (last visited Nov. 13, 2004). "Ownership or control," as these provisions are called, are used in BITs concluded by the Netherlands, Sweden and Switzerland. UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 39.

73. Mohamed I. Khalil, *Treatment of Foreign Investment in Bilateral Investment Treaties,* 7 ICSID Rev.-Foreign Inv. L.J. 339, 351 (1992).

74. UN Ctr. on Transnational Corp. ("UNCTC"), Bilateral Investment Treaties 41–45, UN Doc. ST/CTC/65 (1988).

provisions on this point held that this standard does not make the host country responsible for all injuries that befall the investment.[75] Thus, although the host country is not a guarantor, it is liable when it fails to show due diligence in protecting the investor from harm. A definition of due diligence that was cited favorably by an ICSID arbitral tribunal defines it as "reasonable measures of prevention which a well-administered government could be expected to exercise under similar circumstances."[76] Consequently, the failure by a host country to take reasonable measures to protect the investment against threats, such as those from brigands or from violence by police and security officers, might render the country liable for compensation of an injured investor under a BIT.

c. Unreasonable or discriminatory measures. Many BITs contain language to the effect that "no Contracting Party shall in any way impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal" of an investment.[77] The specific application of this provision to the individual case will depend on the facts involved; however, it is worth noting that the use of the term "unreasonable" may give host countries grounds to defend actions that they may take against foreign investors.

d. International law. Many BITs provide that in no case should foreign investments be given less favorable treatment than that required by international law. Thus, this constitutes the very minimum standard of treatment. Its application in individual cases will also be subject to a variety of interpretations, particularly on those issues where there is significant dispute by developing countries, such as those that occurred during the efforts to secure a New International Economic Order.[78] A further question is whether the reference to "international law" is limited only to customary international law or whether treaty provisions and general principles on investments are also to be considered.

e. Contractual obligations. To the extent that a contracting party has entered into obligations with an investor or investment, many BITs require a signatory country to respect those obligations. This provision then acts as counter to the claim, advanced during the era of the New International Economic Order,[79] that host

75. *Compare Asian Agric. Prod. Ltd. v. Sri Lanka,* ICSID Case No. ARB/87/3 (June 27, 1990), 6 ICSID Rev.–Foreign Inv. L.J. 526 (1991)(interpreting the words "full protection and security" in the U.K.-Sri Lanka BIT), *with* Elettronica Sicula S.P.A.(Elsi) (*U.S. v. Italy*), 1989 I.C.J. 15 (July 20) (interpreting the words "constant protection and security" in the United States-Italy Treaty of Friendship, Commerce and Navigation).

76. *Asian Agric. Prod. Ltd.*, 6 ICSID Rev.–Foreign Inv. L.J., at 558. (citing Alwyn V. Freeman, Responsibility of States for Unlawful Acts of Their Armed Forces 15–16 (1957)).

77. *See, e.g.*, Treaty concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Turk., *supra* note 65, art. 2(3) ("Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments.").

78. *See* Waelde, *supra* note 10, at 771; *see also supra* text accompanying note 10.

79. *See id.*

countries should be able to unilaterally revise contracts that they have made with foreign investors. It may also mean that, as a result of the BIT, contracts between the foreign investor and the host government, which are normally subject only to host country law, are also to be governed by international law.[80]

f. National and/or most-favored-nation treatment. In addition to these general standards, many BITs also contain a further refinement—nondiscrimination in relation to other investors, both foreign and national. Thus, they provide for *national treatment*, which requires that a host country treat an investor or an investment once made, no less favorably than they treat their own national investors or investments made by their own nationals.

As a result, a BIT may also provide for *most-favored-nation treatment*, which means that a host country may not treat an investor or investment from a BIT partner any less favorably than it treats investors or investments from any other country. One consequence of such a provision is that it allows the foreign investor to take advantage of the highest standard of treatment provided to a country in any BIT to which the host country is a party.[81]

Certain BITs, like those contracted by the United States, combine both of these standards and require host countries to grant investors national treatment or most-favored-nation treatment, *whichever is the more favorable*. Some developing countries, recognizing the disparity in financial and technological resources between their national enterprises and those of foreign companies, have resisted or sought to limit the scope of the national treatment guarantee in BITs. In particular, they have tried to avoid giving foreign investors the benefits and subsidies designed to strengthen national industries.[82]

4. Monetary transfers For any foreign investment project, the ability to repatriate income and capital, to pay foreign obligations in another currency, and to purchase raw materials and spare parts from abroad is crucial to a project's success. For this reason, capital-exporting countries in BIT negotiations have pressed for unrestricted freedom for investors to undertake these monetary operations. Such operations are collectively referred to as "transfers."[83] The monetary transfer provisions of most BITs deal with five basic issues: (1) the general nature of the investor's rights to make monetary transfers; (2) the types of payments that are covered by the right to make transfers; (3) the currency with which the payment

80. *See* UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 56–57.

81. *See, e.g., Emilio Agustín Maffezini v. Spain*, ICSID Case No. ARB/97/7 (Nov. 13, 2000), 16 ICSID Rev.—Foreign Inv. L.J. 248 (2001) (permitting Argentine national bringing claim against Spain under Argentina-Spain BIT to have benefit of less stringent procedural requirements of Chile-Spain BIT).

82. *See, e.g.*, UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 64–65.

83. Khalil, *supra* note 73, at 360.

may be made; (4) the applicable exchange rate; and (5) the time within which the host country must allow the investor to make transfers.

However, developing countries that face chronic balance-of-payments difficulties and the need to conserve foreign exchange to pay for essential goods and services have considerably reduced their ability and willingness to grant foreign investors the unrestricted right to make such monetary transfers.[84] Accordingly, many developing countries have exchange-control laws to regulate the conversion and transfers of currency abroad.[85] As a result of this fundamental conflict in goals, the negotiation of BIT provisions on monetary transfers has often been among the most difficult to conclude. Capital-exporting countries seek broad, unrestricted guarantees on monetary transfers, while developing countries press for limited guarantees subject to a variety of exceptions.

5. Operational conditions BITs sometimes provide treatment standards with respect to certain operational conditions, such as the investor's right to enter the country, employ foreign nationals, and be free of performance requirements. One of the most important conditions, of course, is for the investor's employees to be able to enter the host country and to manage and operate the investment. Most BITs do not grant the investor an automatic right to enter and stay in the host country. German BITs, for example, provide that each contracting party will give "sympathetic consideration" to applications for entry,[86] and U.S. BITs give "nationals" of contracting parties the right to enter the other contracting country for purposes of establishing or operating investments subject to the laws of the host country.[87]

6. Compensation for losses from armed conflict or internal disorder Many BITs also deal with losses to an investment due to armed conflict or internal disorder; however, they do not normally establish an absolute right to compensation. Instead, many promise that foreign investors will be treated in the same manner as nationals of the host country with respect to compensation.[88] Some treaties may also provide for most-favored-nation treatment on this question. The ICSID case of *Asian Agricultural Products Ltd. v. Sri Lanka*[89] is one of the few

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84. *See, e.g.*, *Time to Turn off the Tap?*, Economist, Sept. 12, 1998, at 83.

85. Jeswald W. Salacuse, *Host Country Regulation and Promotion of Joint Ventures and Foreign Investment, in* International Joint Ventures: A Practical Approach to Working with Foreign Investors in the U.S. and Abroad 107, 122–23 (David N. Goldsweig & Roger H. Cummings eds., 1990).

86. Treaty Concerning the Encouragement and Reciprocal Protection of Investments, F.R.G.-Swaz., *supra* note 71, ad art. (3)(c).

87. *See, e.g.*, Treaty Concerning the Encouragement and Reciprocal Protection of Investment, U.S.-Sri Lanka, *supra* note 70, art. 2(3).

88. *See, e.g.*, Agreement for the Promotion and Reciprocal Protection of Investments, U.K.-Ukr., art. 5, Feb. 10, 1993, *available at* http://www.unctad.org/sections/dite/iia/docs/bits/uk_ukraine.pdf (last visited Nov. 19, 2004).

89. Asian Agric. Prod. Ltd., *supra* note 75, at 526.

cases that have considered this provision in detail in connection with a dispute between an injured investor and a host country government. The tribunal concluded that in addition to any specific compensatory actions taken for the benefit of other investors, this provision would also make applicable to an injured investor any *promised* higher standard, for example in another BIT, granted to investors from other countries.

7. Protection against dispossession One of the primary functions of any BIT is to protect foreign investments against nationalization, expropriation, or other forms of interference with property rights by host country governmental authorities. Despite opposition by some developing nations in various multilateral forums, virtually all BITs with developing countries adopt some variation of the traditional Western view of international law that a country may not expropriate property of an alien except: (1) for a public purpose; (2) in a nondiscriminatory manner; (3) upon payment of just compensation, and in most instances; (4) with provision for some form of judicial review. The various elements of the traditional rule have taken different formulations in different treaties, some more and some less protective of investor interests.

Perhaps the greatest variations in treaty provisions and some of the most difficult negotiations arise with respect to the standard of compensation. Nonetheless, many, if not most, BITs have adopted the traditional rule, expressed in the so-called "Hull Formula"[90] that such compensation must be "prompt, adequate and effective."[91] They then proceed to define the meaning of each of these words.[92]

8. Investment dispute settlement The seven issues discussed above form the protective architecture of the BIT. In theory at least, the scope of protection seems broad in that these seven issues govern most, if not all, of the foreign investor's principal areas of concern with respect to the political risks associated with a foreign investment. A fundamental, practical question, of course, is whether BIT countries actually respect their treaty commitments and, if not, whether an injured investor has effective legal redress against a host country's violations of an applicable BIT. Unfortunately, substantial, systematic evidence on whether proposed or contemplated government actions against foreign investment have actually been constrained or prevented by BIT provisions is not easily accessible. The limited evidence that is available on this point is anecdotal and far from comprehensive, given the vast numbers of governmental actions that one would have to examine. Therefore, the only available information on the

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90. *See* 3 Green H. Hackworth, Digest of International Law 655–64 (1942).

91. *See, e.g.*, UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 69.

92. *See, e.g.*, Agreement for the Promotion and Reciprocal Protection of Investments, U.K.-Costa Rica, art. 5, Sept. 7, 1982, *available at* http://www.unctad.org/sections/dite/iia/docs/bits/costarica_uk_sp.pdf (last visited Nov. 13, 2004).

protective effect of BITs lies in the actual cases brought by investors under BIT provisions against host countries.

For foreign investors and their governments, one of the great deficiencies of customary international law has been its lack of effective and binding mechanisms for the resolution of investment disputes. One aim of the BIT movement has been to remedy this situation.

Most BITs provide for two distinct dispute settlement mechanisms: one for disputes between the two contracting countries, and another for disputes between a host country and an aggrieved foreign investor. With respect to the former, BITs stipulate that in the event of a dispute over the interpretation or application of the treaty, the two countries concerned will first seek to resolve their differences through negotiation and then, if that fails, through *ad hoc* arbitration. With respect to the latter, the trend among more recent BITs is also to provide a separate international arbitration procedure, often under the auspices of ICSID, for the settlement of disputes between an aggrieved foreign investor and the host country government. By concluding a BIT, the two countries, in most cases, give the required consent needed to establish ICSID or other arbitral jurisdiction in the event of a future dispute between one signatory and a national of the other signatory. Although the investor must first try to resolve the conflict through negotiation and may also have to exhaust remedies available locally, it ultimately has the power to invoke compulsory arbitration to secure a binding award.[93]

According a private party the right to bring an action in an international tribunal against a sovereign country with respect to an investment dispute is a revolutionary innovation that now seems to be taken for granted. Yet its uniqueness and power should not be overlooked. The field of international trade law, for example, contains no similar procedure. Violations of trade law, even though they strike at the economic interests of private parties, are matters resolved directly and solely by countries. The World Trade Organization (WTO) does not give a remedy to private persons injured by trade law violations.[94] It should also be noted that BITs grant aggrieved investors the right to prosecute their claims autonomously, without regard to the concerns and interests of their source countries. It is this mechanism that gives important, practical significance to BITs, a mechanism that truly enables these bilateral treaties to afford protection to foreign investment. As a result, foreign investors are bringing increasing numbers of claims in arbitration when they believe that host countries have denied them promised protection under a BIT. BIT cases accounted for five of twelve ICSID arbitrations in 2000, twelve of fourteen the following year, and a full fifteen of

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93. *See, e.g.*, Agreement for the Liberalization, Promotion and Protection of Investment, Japan-Vietnam, *supra* note 65, art. 13.

94. *See, e.g.*, Glen T. Schleyer, *Power to the People: Allowing Private Parties to Raise Claims Before the WTO Dispute Resolution System*, 65 Fordham L. Rev. 2275, 2277 (1997).

nineteen in 2002.[95] As of February 2003, ICSID had registered a total of eighty-seven BIT cases and an additional ten under NAFTA.[96] Of this number, ICSID tribunals had rendered eighteen final awards in BIT cases, of which the investor prevailed in ten, and six final awards in NAFTA cases of which the investor prevailed in two.[97] An additional three BIT cases were concluded through settlement.[98]

To understand the protective force of BITs, one must also take into account numerous non-ICSID institutional and ad hoc arbitrations brought by injured investors claiming a violation of legal rights conferred by BITs. Accurate, systematic data on the number and nature of such non-ICSID arbitrations is unfortunately not available, primarily because of the confidentiality rules of the institutions concerned. Press accounts and anecdotal evidence of individual cases suggest that the number of claims based on BITs is growing.[99] One notable recent example is the case of *CME Czech Republic B.V. v. Czech Republic*,[100] a United Nations Commission on International Trade Law arbitration under the Netherlands-Czech Republic BIT, which resulted in an award and payment of $355 million to an injured investor, one of the largest awards ever made in an arbitration proceeding.[101] One effect of that award, along with others rendered against sovereign countries in favor of individual private investors, is to cause host countries to take their BIT responsibilities more seriously. The BIT treaty provisions, their enforcement mechanisms, and the fact that arbitral tribunals hold host countries accountable, constitute an external discipline upon governments' behavior in their relations with foreign investors. This results in a relatively effective system of foreign investment protection. It is also to be noted that decisions of arbitral tribunals, although not systematically made public, tend to take the form of lengthy, reasoned, and scholarly decisions that form part of the

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95. *See* Luke Eric Peterson, Int'l Inst. for Sustainable Dev., *Research Note: Emerging Bilateral Investment Treaty Arbitration and Sustainable Development,* 3 (2003), *available at* http://www.iisd.org/pdf/2003/trade_bits_disputes.pdf (last visited Nov. 19, 2004).

96. Int'l Bank for Reconstruction and Dev., World Development Report 2005: A Better Investment Climate for Everyone 181 (2004).

97. *Id.*

98. *Id.*

99. *See generally* Int'l Inst. for Sustainable Dev., Invest-SD: Investment and Sustainable Development News Bulletin, (providing information on pending and recent investment arbitration cases), *available at* http://www.iisd.org/investment/invest-sd (last visited Nov. 22, 2004).

100. CME Czech Republic B.V. v. Czech Rep., Mar. 14, 2003, *available at* http://www.cetv-net.com/iFiles/1439-Final_Award_Quantum.pdf (last visited Nov. 19, 2004). The other opinions and awards in this case are available at CME Central European Media Enterprises: Arbitration Awards, *at* http://www.cetv-net.com/arbitration.asp (last visited Nov. 19, 2004).

101. Peter S. Green, *Czech Republic Pays $355 Million to Media Concern*, N.Y. Times, May 16, 2003, at W1.

jurisprudence of this emerging international investment law and serve to solidify and give force to BIT provisions.

Although the more than 2,200 BITs concluded since 1959 tend to cover the same issues, they differ in how they treat those issues. Some are more protective than others. For example, the BITs negotiated by the United States generally exhibit higher standards of protection than the BITs of many other countries.[102] Nonetheless, despite divergences among individual treaties, BITs as a group also demonstrate many commonalities, including their coverage of similar issues and their use of equivalent or comparable legal concepts and vocabulary. It is these commonalities that are contributing to the creation of an international framework for investment. Moreover among more recent BITs, one detects increasing consensus on certain points; for example, all BITs now require the payment of compensation for expropriation; however, the formulas used to determine compensation in recent treaties vary from country to country.[103]

After reviewing the nature and scope of BIT provisions, the strength of related enforcement mechanisms, and the actual cases brought against host countries by aggrieved investors, one may conclude that BITs have achieved their first goal of fostering investment protection. While that protection is not absolute (no legal device provides absolute protection), investors and investments covered by a BIT certainly enjoy a higher degree of protection from the political risks of governmental intervention than those that are not.

D. An evaluation of BIT goal no. 2: investment and market liberalization

The ideal of economic liberalism holds that the market, not governmental laws and regulations, should determine economic decisions.[104] Beginning in the post–World War II period, virtually all developing countries rejected the liberal economic model and believed that their governments had the primary responsibility for bringing about national economic development.[105] As a result, their systems were characterized by: (1) state planning and public ordering of their economies and societies; (2) reliance on state enterprises as economic actors; (3) restriction and regulation of the private sector; and (4) governmental limitation and control of international economic transactions, especially foreign investment.[106] By the mid-1980s, this approach to development began to lose its hold on the minds and actions of policy makers, aid agencies, and international

102. Juillard, *supra* note 17, at 211 (asserting that the level of protection achieved by U.S. BITs is superior to the level of protection achieved by European BITs).

103. UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 69.

104. *See generally* George T. Crane & Abla Amawi, The Theoretical Evolution of International Political Economy (2d ed. 1997) (describing the history and development of the concept of economic liberalism)

105. *See* Int'l Bank for Reconstruction and Dev., World Development Report: The State in a Changing World, 1–2 (1997).

106. Salacuse, *supra* note 46, at 877–80.

financial institutions. Developing countries increasingly privatized their state enterprises, engaged in deregulation, and opened their economies.[107] In short, they embarked on a process of economic liberalization. As indicated earlier in this chapter, one of the goals of many countries, particularly the United States, in negotiating BITs with developing countries was to encourage market and investment liberalization.[108]

An evaluation of the extent to which BITs have achieved the goal of market and investment liberalization depends on one's definition of the concept of liberalization. Two definitional approaches to liberalization present themselves. The first, which could be called the "absolutist approach," seeks to determine how well the actual situation meets the liberal economic model; the second, which could be referred to as "the relativist approach," aims primarily to determine the extent to which the existing situation in a country has moved away from the preexisting command economy system toward the liberal model.

1. An absolutist evaluation of liberalization With respect to foreign investment, applying an absolutist approach to economic liberalization would mean that foreign investors would not be subject to legal or regulatory constraints in undertaking investments in the country concerned. In fact, probably no country, either in the developed or the developing world, has taken the absolutist position,[109] and BITs have not served to deny countries the right to control the entry of foreign investment.

Many BITs make a distinction between the treatment to be accorded an investor in making an investment (preestablishment) and the treatment to be given after the investment is made (postestablishment). With respect to the former, BITs generally contain a provision to the effect that "each Contracting Party shall encourage and create favorable conditions for investors of the other Contracting party to make investments in its territory."[110] Despite the inclusion of such provisions, no BIT requires a host country to admit any and all investments proposed by an investor from the other treaty country. Most countries have special laws governing the entry of foreign capital,[111] and BITs generally provide that host

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107. *Id.* at 882–86.

108. *See supra* text accompanying notes 56–58.

109. Even the United States, which strongly supports the liberal economic model, restricts or limits the ability of foreigners to invest in certain areas, including commercial aviation, telecommunications, and maritime industries. Moreover, several states restrict the ability of foreigners to own real estate. Roger H. Cummings, *United States Regulation of Foreign Joint Ventures and Investment*, *in* International Joint Ventures: A Practical Approach to Working with Foreign Investors in the U.S. and Abroad 137, 139 (David N. Goldsweig & Roger H. Cummings eds., 1990).

110. *E.g.*, Agreement for the Promotion and Protection of Investments, India-U.K., art. 3(1), Mar. 14, 1994, 34 I.L.M. 935, 940 (1995)

111. *See generally* Salacuse, *supra* note 85, at 107–36 (explaining how host countries regulate joint ventures and the effect of such regulation on their operation and formation).

countries may admit investment in their territories in accordance with their laws.[112] In effect, no BIT ever guarantees investors of a contracting country access to the other contracting country's markets.[113] A common provision is that the host country "shall admit investments in conformity with its laws."[114] Consequently, one must conclude that the BIT movement has not been effective in attaining the goal of absolute investment liberalization, if by that term one means establishing by treaty a completely open door to investment from a BIT treaty partner.[115] This is unsurprising when one considers that no BIT has expressly adopted such an objective. Investment and market liberalization are better characterized as consequences the developed country treaty partner hopes for when it enters a BIT. From an absolutist point of view, while the use of BITs "affirm[s] liberal economic theory" and supports the adoption of liberalizing policies, the treaties are not actually designed to create a liberal investment regime; rather, BITs are driven more by motives of economic nationalism than they are economic liberalism.[116] Indeed "[t]he interventionist measures permitted by the BITs are antithetical to economic liberalism."[117]

112. *E.g.*, Agreement for the Promotion and Reciprocal Protection of Investments, Hung.-U.K., art. 2.1, Mar. 9, 1987, 1990 U.K.T.S. 44 (Cm. 1103), *reprinted in* 4 ICSID Rev.-Foreign Inv. L.J. 159, 160 (1989) ("Each Contracting Party . . . , subject to its right to exercise powers conferred by its laws, shall admit . . . capital [of the other contracting party].").

113. Kenneth J. Vandevelde, *Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties*, 36 Colum. J. Transnat'l L. 501, 511 (1998).

114. *See, e.g.*, Free Trade Area of the Americas, Investment Agreements in the Western Hemisphere: A Compendium (Oct. 14, 1999) ("The most representative clause reads as follows: Each Contracting Party shall promote, in its territory, investments of investors of the other Contracting Party and shall admit such investments in accordance with its laws and regulations."), *available at* http://www.ftaa-alca.org/ngroups/ngin/publications/english99/compinv1.asp. (last visited Nov. 22, 2004)

115. Professor Vandevelde has concluded:

> BITs are very limited tools for liberalization. Access provisions are subordinate to local law; nondiscrimination provisions apply only post establishment of investment and are subject to exceptions; security is afforded against certain types of state interference, but generally not against private interference; dispute provisions apply only to public, not private, disputes; and transparency provisions are rare.

Vandevelde, *supra* note 113, at 514.

116. Kenneth J. Vandevelde, *The Political Economy of a Bilateral Investment Treaty*, 92 Am. J. Int'l L. 621, 633 (1998). According to Vandevelde, a liberal economic model of a BIT would do a better job reflecting "investment neutrality" (i.e., state nonintervention in cross-border investment flows) and "market facilitation" (enabling the state to current market failures). *Id.* at 633–35. As they stand now, however, BITs are more about "protecting the interests of home state investors and preserving the political prerogatives of the host state" than they are about improving economic efficiency. *Id.* at 634.

117. *Id.* at 634.

2. A relativist evaluation of liberalization Viewing the significant changes in many developing countries over the last twenty years as they have sought to transform themselves into emerging markets,[118] it is clear that their economies have experienced significant liberalization, even though they have not attained the ideal liberal model. Their laws and regulations governing foreign direct investment, in particular, have been liberalized as a general phenomenon. For example, a study by the U.N. Conference on Trade and Development (UNCTAD) found that during the period between 1991 and 2002, "1,551 (95%) out of 1,641 changes introduced by 165 countries in their FDI laws were in the direction of greater liberalization."[119] At this point, it is difficult to determine the precise role that BITs have played in this liberalization process. A study seeking to correlate the timing and number of BITs signed by individual countries with the timing and number of their liberalizing reforms would shed some important light on this question. In general terms, it is interesting to note, however, that during the period measured by the UNCTAD study, BITs experienced their most significant expansion in both number and geographic coverage.[120]

The link between BITs and liberalization may be both direct and indirect. The direct link may be found in some BIT provisions that have may have a liberalizing effect. For example, in the negotiation of some BITs, capital-exporting countries, with varying degrees of success, have sought to protect their nationals and companies from unfavorable discrimination by securing treatment on admission that is no less favorable than the treatment given investments made by host country nationals or nationals of a third country. For example, Article II(1) of the U.S. BIT Prototype provides:

> Each party shall permit and treat investment, and activities associated therewith, on a basis no less favorable than that accorded in like situations to investment and associated activities of its own nationals or companies, or of nationals and companies of any third party, whichever is the most favorable.[121]

Accordingly, Article II(1) of the United States-Albania BIT grants national treatment or most-favored-nation treatment, whichever is the more favorable (with specified exceptions), "to the establishment, acquisition, [and] expansion . . . of covered investments."[122] The implication of this provision is clear. In deciding on admission of a foreign investment project, the host country must treat

118. *See* Salacuse, *supra* note 46, at 875–90.

119. *See* UNCTAD, *supra* note 2, at 20; *see also* World Bank, World Development Report 2005: A Better Investment Climate for Everyone 111–12 (2004), *available at* http://siteresources.worldbank.org/INTWDR2005/Resources/complete_report.pdf (last visited Nov. 19, 2004).

120. *See* UNCTAD, *supra* note 2, at 159–217.

121. *Model BIT*, *supra* note 69, at 656.

122. *See* Investment Treaty with Albania, *supra* note 58, art. II(1).

applications by investors of its treaty partner in the same way it treats applications by its own national investors or investors from other countries. For countries seeking to encourage investments by their own nationals, such a provision may raise problems. For example, the host country may have closed certain sectors to foreign investment for strategic or political reasons. Additionally, many developing countries give special preference to national investors because of their belief that national investors cannot compete on equal footing with foreign firms.[123] They, therefore, would probably find it easier to grant most-favored-nation treatment on the entry of foreign investment than they would national treatment.

However, applying the concepts of national treatment and most-favored-nation treatment to foreign investment projects, no two of which are exactly alike, is far more difficult than applying them to international trade in fungible goods, where these concepts were first developed. The qualifying words "in like situations" contained in the clause quoted above may allow different treatment with respect to the entry of investments if the projects themselves or the surrounding circumstances are sufficiently dissimilar.[124] Moreover, treaties including this type of entry provision also contain a specific list of areas and sectors where foreign investment may be prohibited.[125] Nonetheless, to the extent that exceptions to these provisions are relatively limited, it can serve to have a liberalizing effect on the foreign investment regime of the host country in that it gives greater scope for market factors to determine investment decisions and proportionately less scope for governmental decisions.

One specific type of discriminatory treatment that host countries often impose in the making and operation of foreign investments is a "performance requirement" or "trade-related investment measure" (TRIM), such as those that require an investment project, as a condition for entry, to export a certain proportion of its production, restrict its imports to a certain level, or purchase a minimum quantity of local goods and services. Although most BITs have not dealt with the question of performance requirements,[126] the United States, with some success recently, has sought to protect its investors from them through its BIT negotiations.[127]

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123. World Bank, *supra* note 119, at 159. *See also* UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 64–65.

124. *See Model BIT, supra* note 69, at 656.

125. *See, e.g.*, Treaty Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Gren., art. II(1), May 2, 1986, *available at* http://www.unctad.org/sections/dite/iia/docs/bits/us_grenada.pdf (last visited November 13, 2004).

126. UNCTC, *supra* note 74, at 69.

127. See *Model BIT*, *supra* note 69, art. II(5), at 657 ("Neither Party shall impose performance requirement as a condition of establishment, expansion or maintenance of investments, which require or enforce commitments to export goods produced, or which specify that goods or services must be purchased locally, or which impose any other

The concern with performance requirements as measures that unjustifiably burden trade and investment was further developed in the Uruguay Round of the GATT.[128] That Round produced an Agreement on TRIMs, forbidding the imposition of measures that are inconsistent with GATT's Article III on national treatment[129] and Article XI on the elimination of quantitative restrictions.[130] Its purpose is to prevent WTO members from imposing local content and trade balancing requirements as a condition for the creation or operation of foreign investment projects.

BITs may also have an indirect positive effect on liberalization of host country economies. Under certain circumstances, the introduction of FDI can contribute to that liberalization. The demonstrated economic success of particular foreign enterprises, competitive pressures caused by their presence, the governmental desire to attract even more FDI, and the demands by national entrepreneurs to secure treatment equal to the privileges often given to foreigners may create strong pressures for change in host country regulatory systems.[131] So to the extent that BITs have encouraged foreign investment in developing countries, they have also contributed indirectly and modestly to market liberalization.

Economic liberalization is a complex process that cannot be brought about by any single magic bullet. It requires a host of sound policies, laws, and institutions across a wide domain of human activity.[132] BITs are just one policy instrument among many others that may facilitate the process.

E. An evaluation of BIT goal no. 3: investment promotion

The third declared goal of BITs is investment promotion. A BIT purports to create a symmetrical relationship between the two contracting countries by

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similar requirements.") *See also* Investment Treaty with Albania, *supra* note 58, art. VI (prohibiting four specified types of performance requirements).

128. *See* Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, Legal Instruments—Results of the Uruguay Round, 33 I.L.M. 1125 (1994).

129. General Agreement on Tariffs and Trade, art. III, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194.

130. *Id.* art. XI.

131. Egypt is an excellent example of this phenomenon. During the time of President Gamal Abdel Nasser, the country was virtually closed to foreign investment. After his death, the Sadat government took a first tentative step toward liberalization by seeking only Arab capital in 1971 and then foreign investment in 1974. Gradually, both policy and law evolved to the point that Egypt was encouraging all private investment, both foreign and domestic. *See* Jeswald W. Salacuse, *Back to Contract: Implications of Peace and Openness for Egypt's Legal System,* 28 Am. J. Comp. L. 315 (1980). *See also* Jeswald W. Salacuse, *Foreign Investment and Legislative Exemptions in Egypt: Needed Stimulus or New Capitulations? in* Social Legislation in the Contemporary Middle East 241 (L. Michalak & J. Salacuse eds., 1986).

132. *See generally* World Bank, *supra* note 119 (discussing complexities of developing a liberal investment climate).

providing that the nationals and companies of *either* party to the treaty may invest under the same conditions and be treated in the same way in the territory of the other. In reality, of course, in a BIT between an industrialized country and a developing nation, an asymmetry exists between the parties since one country (the industrialized country) will typically be the source and the other country (the developing country) the recipient of that capital. Some developing countries have assumed that their industrialized treaty partners would take affirmative action to encourage the industrialized country's nationals to invest in the developing country—an expectation no doubt raised by the words "encouragement" and "promotion" in the treaty.[133] Capital-exporting countries have steadfastly refused to agree to any provision in a BIT obligating them to encourage or induce their nationals to invest in the territories of their BIT partners.

The general premise of BITs is that the goal of investment promotion is to be achieved by the host country's creation of a stable legal environment that favors foreign investment. The basic working assumption upon which BITs rest is that clear and enforceable rules that protect foreign investors reduce risk, and a reduction in risk promotes investment. No language in a BIT binds a source country to encourage its investors and companies to invest abroad. That said, it is vital to examine the effects BITs have actually had in promoting investment.

In light of the many variables that influence investment decisions, it is probably impossible to pinpoint the precise effect of a BIT on an investor's decision to invest in a given country.[134] Local economic conditions and government policies are probably more important than BITs in influencing the investment decision. Indeed, industrialized countries probably sign BITs only with those developing countries whose policies and laws are sufficiently protective of and favorable to foreign investment.[135] Thus, the BIT is often a codification, and not a source, of pro-foreign investment policies. On the other hand, by entering into a BIT, an instrument of international law, a signatory country is raising those policies to the level of international law and thereby limiting its ability to change policy easily. BITs therefore have the effect of stabilizing a county's investment policy and its legal and contractual commitments to individual foreign investors.[136]

Developing countries have signed BITs on the assumption that these treaties would result in increased flows of FDI. Policy analysts and scholars have accepted that assumption, despite the lack of compelling evidence.[137] Given how questionable

133. *See supra* Treaty Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Arm.; Treaty concerning the Promotion and reciprocal protection of investments, F.R.G.-Pol., note 55.

134. *See* Vandevelde, *supra* note 113, at 524–25.

135. *Id.* at 523.

136. *Id.* at 522–25.

137. *See, e.g.*, Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 Va. J. Int'l L. 639, 679 (1998) ("Any single

this assumption appears, at a minimum, a plausible case needs to exist that there is some relationship between a BIT and the promotion of investment if the momentum of the BIT movement is to continue and perhaps lead to more global forms of investment protection. To evaluate the BITs' impact on promoting investment, one must turn to empirical econometric research. Without econometric tools, it is impossible to know whether an increase in FDI is a function of a BIT, an improvement in a country's investment opportunities, or a global increase in capital flows. The econometric approach,[138] assuming enough good data, observations, and a logical model that includes all key determinants, allows for comparisons before and after the conclusion of a BIT, or between countries with and without a BIT—while holding all other contributing factors, such as gross domestic product (GDP), exchange rates, and market size, constant.

This chapter presents the authors' own econometric research on this topic, as well as a review of other relevant econometric studies. Before presenting results, we briefly review the basic methods of reading and understanding econometric results.

1. Econometric research Typical econometric analysis begins with the following premise: y and x are two variables, representing some parameters of interest (such as GDP and FDI). We are interested in "explaining y in terms of x," or in "studying how y changes with changes in x."[139] The changes in both x and y can be modeled to reflect linear one-to-one relationships (for example, if gross domestic product increases by $100 million, then FDI increases by $100,000), or percentage changes (if GDP increases by 3%, FDI increases by 1%).

To determine the relationship, one collects as much data as possible (putting a premium on accuracy, consistency, and reliability) and plots it on a graph. Such a graph might indicate, for example, that Argentina, with a certain GDP, attracted a certain FDI in 2000, while Brazil, with a different GDP, attracted a greater or lesser amount of FDI in 2000, and so on. (Another approach, known as "fixed effects" or "time series," which the authors also use and describe in more detail later, is to chart one set of data—say, from Brazil and the United States—across a number of years). The graph will show multiple data points, some bunched together, some outlying. One can see the larger relationship

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capital importing country has an incentive to sign a BIT because such a treaty helps that country attract foreign investment.").

138. Econometric analysis selects a dependent variable (in this case, FDI flows) and a host of explanatory variables, using as many observations of empirical data as possible, to determine which variables have a positive, negative, or neutral effect and with what degree of magnitude. A positive coefficient on an explanatory variable at the 95%–99% confidence level does not prove a positive correlation with the dependent variable. Conversely, it states with a high degree of confidence that the lack of a correlation (known as the "null hypothesis") is statistically highly unlikely.

139. *See, e.g.*, Jeffrey M. Wooldridge, Introductory Econometrics: A Modern Approach 22 (1999).

between GDP and FDI by drawing a line or curve on the graph that comes as close as possible to the mean of all data points. Determining how to achieve the best "fit" for that line is the essence of econometrics. The slope of the line indicates the correlation—positive, negative or zero, and to what degree—between the two variables. It is important to note that no such correlative relationship constitutes a hard-and-fast empirical truth about any one country pair, but is merely the best prediction of how GDP would affect FDI for any two countries selected at random. It is understood that any specific relationship (between, for example, Argentina and the United States) will be unique.

In our study of BITs, we first formulate a hypothesis: The presence of a BIT between the United States and a developing country has a positive impact on FDI outflows from the United States to that developing country. In econometric terms, we are looking at the effect of an explanatory variable *x* (i.e., the presence of a BIT) on a dependent variable *y* (FDI inflows). We postulate the simple econometric equation or "model" as follows:

$$\mathbf{FDI_i = B_0 + B_1 usbit + u}$$

When graphed, the coefficient of the *usbit* parameter (B_1) measures the change in annual FDI inflows (to a given country i) when that country has signed a BIT with the United States. Since we expect the effect to be positive, we expect B_1 to be greater than 0 (i.e., $B_1 > 0$).

In this and other econometric equations, B_0 is a slope intercept that indicates where on the *y* axis the "fitted line" begins, and has no analytical significance for the present analysis; *u* is a catch-all error term that includes the effects of all unobserved parameters. The latter is important because it indicates that we can never fully describe in mathematical terms what happens in the real world.

Econometric analysis cannot prove this or any other hypothesis because it is working with a random sampling of data that is not all inclusive. But it can *reject* the *null hypothesis*—i.e., that there is *no* relationship between a BIT and FDI flows, given enough good data to provide strong significance levels.[140]

Once the equation or model is written out, one collects as much empirical data as possible, since any statistical study requires a large body of data to produce significant results. In this simple hypothetical example, one would collect data for the GDP and FDI inflows for more than 100 countries. Then one would input the data and run the regressions (using a computerized software package, such as *STATA*), which returns a coefficient on each of the measured variables. For example, in our sample equation ($FDI_i = B_0 + B_1$usbit + u), where FDI is

140. Economists generally reject the null hypothesis at a five percent statistical significance level. This means that they are willing to mistakenly reject the null hypothesis when it is true 5 percent of the time. In some cases, where data are hard to gather, a 10 percent significance level is considered acceptable, although it is a minimum threshold. When large amounts of data are available, a 1 percent significance is ideal and gives economists a "high degree of confidence" in rejecting the null hypothesis. In short, "statistically significant" results are those in the 1%–10% significance range. *See generally id.* at 113–52.

measured in millions of U.S. dollars, a coefficient of 5.25 for B_1 would be interpreted as follows: The presence of a BIT between the United States and another country could be correlated with an additional $5.25 million of FDI per year.

The simple equation above, however, is not an accurate reflection of the real world. Numerous other factors besides BITs affect investment flows, and because it would be misleading to ignore them, one includes these variables in the equations to assess their relative impact.[141] We are thus studying the effect of various *x*'s on *y*, in an effort to achieve a situation in which all other relevant factors are considered, which is known as a *ceteris paribus* ("other things equal") effect. These other factors likely include GDP, market size, exports as a percentage of GDP, rule of law, inflation and exchange rates, treaties with other countries, distance between major ports, and cultural or linguistic ties.

For example, if the simple equation ($FDI_i = B_0 + B_1 usbit + u$) showed a strong correlation between a BIT and FDI flows, much of that correlation might be a function of a country's GDP. But what if the United States only signed BITs with countries with large GDPs? Only if GDP is included in the equation would we learn whether the size of a country's GDP or a BIT had more influence on FDI flows; without GDP in the equation, the BIT variable would pick up all the influence. Similarly, education or other labor force factors might drive FDI. So, if the United States only signs BITs with countries that have strong labor forces, and those factors are not measured, it would appear that FDI was merely a function of the BIT, rather than the labor force.

If we could collect data for a large number of countries that all had the same GDP and labor force attributes (and all other important factors), we could then run a simple regression on the BIT variable. Everything else would be the same, except the BIT, and we could measure that impact in a vacuum, as it were. But no two countries are exactly alike. Multiple regression, by employing multiple variables, effectively allows us to mimic this situation.[142] By including a host of factors that might affect FDI flows, we "control" for the possibility that they might exert as much or more influence on FDI as our variable of interest, a BIT. Only in this fashion do we simulate a real-world environment.

The selection of explanatory variables is derived from a wide range of FDI literature. The literature on FDI falls into a number of camps, focusing on countries, firms, location within countries, macro economic effects—and on bilateral versus aggregate studies. The key explanatory variables that show up repeatedly, in our reading of the literature, are host country GDP, population, real exchange rate, infrastructure, human capital, and openness to trade/global integration.

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141. One of the classic examples in econometrics is assessing the impact of education on income. Were we to examine the impact of years of education alone, ignoring native ability, parental occupation, quality of schools and so on, we would not get a true reading of education's impact.

142. *See* Wooldridge, *supra* note 139, at 66.

Often these variables are summed (GDP) or differentiated (wages, for example) to show positive or negative correlation about country differences. Another important factor in attracting FDI is the creation of Special Economic Zones.[143]

Literature evaluating the impact of BITs on FDI is scant, consisting of three UN studies, the last of which is based on econometric analysis, and a recent paper by World Bank Senior Economist Mary Hallward-Driemeier,[144] which is similarly based on econometrics. We review these studies before presenting our own results.

2. Prior UN studies The first UN study[145] was published in 1988, when a mere 265 BITs had been concluded, and thus its value lies more in highlighting the significant transformation of the BIT process in the last fifteen years than in shedding light on BITs' impact. It notes that only half of the Group of 77 were parties to BITs, many had not signed new treaties in more than ten years, and that while some countries had signed one or two BITs, others had concluded many more.[146] "If all the members of the Group of 77 concluded [BITs] with all the members of OECD, one would arrive at a figure of 2,500,"[147] says the report, with no anticipation that the number would grow to 2,200 BITs today.[148] In fact, the report speculates that the 1985 development of investment insurance through the Multilateral Insurance Guarantee Agency (MIGA) might "reduce the attractiveness of bilateral investment treaties to developing countries."[149] In all, the report strikes a number of pessimistic notes about the value of BITs as a protection or promotion device, and it shares the view of a 1985 report about the inconclusiveness of quantitative results.[150] It found "no apparent relationship" between the number of bilateral agreements and the volume of FDI flows, and concludes that the "reasons for the increase or fall in foreign direct investment can be explored in a meaningful way only if each case is examined separately, taking into account all relevant factors."[151] This conclusion would appear to be a clear call for an econometric study.

143. *See* K.C. Fung et al., *Determinants of U.S. and Japanese Direct Investment in China*, 30 J. Comparative Econ. 567, 573 (2002).

144. Mary Hallward-Driemeier, Do Bilateral Investment Treaties Attract FDI? Only a Bit . . . and They Could Bite (World Bank, Working Paper No. 3121, June 2003), *available at* http://econ.worldbank.org/files/29143_wps3121.pdf (last visited Nov. 29, 2004).

145. *See generally* UNCTC, *supra* note 74 (examining FDI flows from OECD countries to thirty-three developing countries).

146. *Id.* at 72, ¶¶ 331–32.

147. *Id.* at 72, ¶ 333.

148. *See* UNCTAD, *supra* note 2, at 89.

149. UNCTC, *supra* note 74, at 72, ¶ 334.

150. *Id.* at 11, ¶ 38.

151. *Id.*

The second UN report,[152] which mainly catalogued BITs through 1991, expressly made no effort "to discuss or assess the merits of bilateral investment treaties as policy instruments on foreign investment."[153]

The third study,[154] published by UNCTAD in 1998, is an econometric study. It takes a two-stage approach—a multi-year study of FDI inflows into 133 host countries at one point in time (using 1995 FDI data), and a study of bilateral FDI flows from fourteen source countries into seventy-two host countries (using data between 1971 and 1994).[155]

The multi-year or "time series" approach, in theory, allows for a more precise identification of FDI determinants, as it compares specific bilateral partners over a period of years, so that anomalies from any one year are discounted and smoothed, and comparisons can be made before-and-after BIT signings. By contrast, the one-year (cross-section) study analyzes aggregate FDI flows to a given country based on the total number of BITs signed, but does not examine bilateral relationships. While sacrificing precision, this data is easier to collect and more consistent. We examine in detail both stages of the 1998 UNCTAD study.

a. Bilateral FDI flows covering 23 years (1971–1994). In the time-series study covering twenty-three years, the coefficients on BITs as a determinant of FDI flows are positive, indicating that a BIT could increase FDI flows between treaty partners, holding constant other factors such as GDP or population growth. The magnitude of the effect varies depending on the specific before-and-after signing time period, with which the authors experiment in attempting to describe a lag period between signing and impact.[156]

However, the results are not statistically robust, showing 5%–10% significance levels; 1%–5% significance would suggest much higher confidence in the results. In addition, the data collected for a twenty-three-year period comes from a variety of sources, suggesting likely discrepancies in collection methods. Furthermore, the bulk of the data comes from the Cold War era (1970s and 1980s), when FDI flows were much lower and BITs far fewer than in the post-Soviet era of the 1990s.[157]

On a more definite note, the authors observe that the most consistently positive dependent variables (y) were FDI/inflows (share of host country in source country's total FDI outflows) and FDI/outflows (share of source country in host country's total FDI inflows), both of which are a better measure of the role of BITs than FDI alone or FDI/GDP.[158] The authors conclude that "BITs may serve,

152. UNCTC, Bilateral Investment Treaties, 1959–1991, UN Doc. ST/CTC/136 (1992).

153. *Id.* at iv.

154. UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1.

155. *Id.* ch. IV.

156. *Id.* at 110.

157. *Id.* at 108.

158. *Id.* at 109.

at the margin, to redirect the share of FDI from/to BIT signatories."[159] Further, BITs signed by African countries appeared to have more effect than BITs in other regions, likely because BITs are more important when host countries are less developed (though this is an untested hypothesis).[160]

The authors conclude that the influence of BITs on FDI is weak; however, they do say:

> [F]ollowing the signing of a BIT, it is more likely than not that the host country will marginally increase its share in the outward FDI of the source country; the same applies to the share of the source country in the FDI inflows of the host country. The effect, however, is usually small.[161]

b. 133 host countries using 1995 FDI data. In the cross-country study, which uses FDI flows in 1995 as the dependent variable, BITs were found to have a positive and statistically significant effect in three of the nine reported regressions.[162] In one regression, "each BIT [signed] in 1993 can be said to be associated with an incremental 162 million U.S. dollars in FDI flows in 1995,"[163] report the authors; however, they note that this is a "statistical abstraction, in the sense of a fitted regression trend line for many countries, and not a policy conclusion."[164]

Overall, the prime explanatory variables for FDI flows were GDP, population, and domestic investment, consistent with other economics literature on FDI flows.[165] In addition, the only BITs that showed statistically significant positive coefficients were those signed one or two years before the measured FDI flows, suggesting a delayed impact. Though not mentioned, the lag between signing and actual ratification by both countries' legislatures is typically two or three years. In its conclusion, the study finds the influence of BITs on bilateral FDI flows to be weak, saying that "BITs appear to play a minor and secondary role in influencing FDI flows."[166]

One reason for the relatively weak influence of BITs is that their signaling power may have eroded during the 1990s as investors increasingly saw them as a "normal feature of the institutional structure."[167] Further, the study notes some evidence that foreign investors encourage governments to conclude BITs with

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159. *Id.*
160. *Id.* at 111.
161. *Id.* at 122.
162. The authors ran 192 regressions overall, testing eight different measures of FDI flows and stock, looking for the variables with the most explanatory power. *See id.* at 118.
163. *Id.* at 120.
164. *Id.*
165. *Id.* at 118–19.
166. *Id.* at 120.
167. *Id.* at 122.

host countries in which they already have FDI, a phenomenon paralleled in findings about multinational corporations lobbying for Double Taxation Treaties.[168]

The fact that BITs play a "minor and secondary role"[169] as a determinant of FDI in the cross-country study, and have a consistently positive if somewhat marginal statistical (90%–95% significance levels) impact in the time-series study, certainly implies that BITs do play a quantifiably positive role in promoting investment.

c. 2003 World Bank econometric study of 537 bilateral pairs from 1980 to 2000. The Hallward-Driemeier World Bank study[170] uses an econometric time-series approach to study the impact of BITs on FDI flows between 537 bilateral country pairs (from twenty OECD countries to thirty-one developing countries) from 1980 to 2000. In many ways, this is an updated version of the UNCTAD time-series study, with the length of the time period allowing for significant analysis of pre- and post-treaty FDI flows.

The various regressions control for the size of the source country, the size of the host country, the host country's macroeconomic stability (represented by its inflation rate), its openness to trade (represented by trade as a percentage of GDP), and the gap in average years of education between source and host.[171] Two other notable factors that are considered are the transition from Soviet to market economies, and the signing of NAFTA.[172]

Due to the complexity of cataloging different types of BITs, the World Bank paper treats all BITs equally, noting the general point that BITs strengthen property rights;[173] however, the author notes that there are significant differences among BITs, and that "it is possible that there would be more of an effect if one looked only at those treaties with the strongest investor protections,"[174] an observation that will be further developed in our own study of U.S. BITs.

Finally, in addition to examining the impact of individual variables on FDI flows, the paper also studies the combined impact of a BIT when assessed along with the quality of the legal system, as well as with the level of corruption. Its assumption in this respect is that, while BITs should signal protection of the

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168. *See* Bruce A. Blonigen & Ronald B. Davies, Do Bilateral Tax Treaties Promote Foreign Direct Investment? 4–7 (Nat'l Bureau of Econ. Research, Working Paper No. 8834, Mar. 2002), *available at* http://dsl.nber.org/papers/w8834.pdf (last visited Nov. 30, 2004).

169. UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 122.

170. Hallward-Driemeier, *supra* note 144.

171. *Id.* at 12–13.

172. *Id.* at 13.

173. *Id.* at 14. While the NAFTA chapter on investment includes language similar to that of a BIT and can thus be considered a BIT for certain purposes, NAFTA as a whole was largely a trade agreement, one that made Mexico a more attractive destination for investment as an export platform to the United States and Canada.

174. *Id.*

property rights of the foreign investor, the credibility of the signal will be affected by the degree of corruption and strength of the legal system.[175]

The findings are more or less in line with most previous studies on BITs. "The larger the source country and the larger the host country, the larger the FDI flows. Flows are also higher to richer host countries. Macroeconomic instability discourages FDI."[176] Not surprisingly, the impact of NAFTA is quite significant on FDI flows—but "it is hard to disentangle which effect [(trade or investment)] really dominates."[177]

On the key issue, the coefficient on the BIT treaty is negative and not significant in most regressions, with some minor exceptions. For example, "only in year five after the ratification is there a positive (and extremely weak) association."[178] In another case, looking at FDI going to a particular host country as a share of the total FDI a source country sends, "one gets the one significant positive result that a BIT could increase FDI."[179]

Finally, the interaction of a BIT with institutional capacity (as measured by the World Bank's Kaufmann, Kraay and Zoido-Lobatón [KKZ] indicators for rule of law, corruption, government effectiveness, and regulatory quality)[180] has either no effect, or a positive interaction. That is, a country with a BIT and a stronger institutional capacity appears to attract slightly more FDI than a country with just a BIT.

Thus, the author concludes, BITs complement rather than substitute for strong domestic institutions; BITs are more effective in settings of higher institutional quality.[181] This conclusion, of course, undermines a central rationale for less developed countries that enter into investment agreements hoping to bypass the need to strengthen property rights and enforcement mechanisms under domestic law.

3. The authors' studies on the impact of U.S. BITs As with the 1998 UNCTAD study,[182] the authors employ two approaches to study the effect of U.S. BITs on FDI flows. The first analyzes aggregate FDI inflows to more than 100 developing countries in a given year, with separate regressions run for 1998, 1999, and 2000. The second examines a dataset of U.S. FDI flows to thirty-one countries repeated over a ten-year period. Overall, the results indicate that U.S. BITs are more likely to induce FDI inflows than those concluded by other OECD[183]

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175. *Id.* at 20–21.
176. *Id.* at 18.
177. *Id.*
178. *Id.* at 19.
179. *Id.* at 20.
180. World Bank, Worldwide Governance Research Indicators Dataset (2002), *at* http://www.worldbank.org/wbi/governance/data.html#dataset2001 (last visited Nov. 18, 2004).
181. Hallward-Driemeier, *supra* note 144, at 21.
182. UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 103.
183. The OECD consists of thirty member countries that have developed economies.

countries, and that a host country with a U.S. BIT is more likely to increase its overall FDI (from all OECD countries) than a country without a U.S. BIT, holding other factors equal.

To our knowledge, this is the first study to examine the impact of BITs negotiated by one specific country (i.e., the United States), rather than an aggregate collection of BITs. Furthermore, as noted above,[184] the U.S. BIT, compared with those negotiated by other countries, offers the strongest investor protections; thus, it is plausible to hypothesize that the U.S. BIT might have a stronger association with FDI flows than less stringent BITs.

a. Effect of U.S. BITs on aggregate FDI flows to developing countries. In this study on aggregate FDI flows (*y variable*), the explanatory (*x*) variables of interest are the presence of a U.S. BIT, the total number of BITs signed with all other OECD countries (excluding the United States), and the number of BITs signed with all other developing countries. Other explanatory variables, included because of their known impact on FDI, are host country GDP, GDP per capita, inflation, real effective exchange rate, population, and rule of law (see Data Appendix A for a list of explanatory variables and sources).

The econometric model[185] measures the percentage change in FDI inflows, which is more meaningful than absolute FDI inflows because it allows for more relevant comparisons between large- and small-market host countries. Data for GDP, exports and inflation are lagged one year, i.e., data for these explanatory variables is for the year previous to the measured FDI flows. The lag is consistent with other econometric FDI studies, on the theory that investors were acting on known information from the year before.[186]

In addition to studying the relationship between a U.S. BIT and overall FDI flows, the dataset provides an opportunity to examine the dynamic interaction of BITs—whether a U.S. BIT has more or less effect than another OECD country's BIT, whether a greater number of OECD BITs increases flows at the margin and by how much, and the difference between a BIT with a developed country and one with a developing country. The UNCTAD study did not address any of

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184. Juillard, *supra* note 17, at 211. *See also supra* note 102 and accompanying text.

185. The estimation used is an ordinary least squares (OLS) multivariate regression specified as follows:

$$\begin{aligned} \text{lnfdi99} = {} & B_0 + B_1\text{lngdp98} + B_2\text{exports98} + B_3\text{pop} + B_4\text{rlaw} + B_5\text{infl98} + \\ & B_6\text{oecdbits} + B_7\text{usbit} + B_8\text{nonoecd} + u_i \end{aligned}$$

The dependent variable is lnflows98, lnflows99, or lnflows00, the natural log of total FDI flowing into a given country in 1998, 1999, or 2000. The explanatory variables of interest are usbit, oecdbits, and nonoecd (BITs)—controlling for the effects of lngdp (the natural log of GDP, lagged one year), population, rule of law, exports per GDP (lagged one year), and infl (inflation rate, lagged one year).

186. *See* Hallward-Driemeier, *supra* note 144; *see also* UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1.

these issues. Instead, it treated all BITs as equal, as the movement toward "South-South" BITs was just gathering momentum at the time of its 1995 study.[187]

The regression results indicate that the presence of a U.S. BIT has a large, positive, and significant association with a country's overall FDI inflows. Coefficients on the U.S. BIT variable range from. 77 to. 85, which translates into increased FDI to a given country in a given year by 77% to 85% (at the 1%–5% significance levels). Because the FDI inflows measured are aggregate and not bilateral with the United States, it is not clear from these regressions whether the correlation is due to increased U.S. flows, or because a U.S. BIT induces flows from other countries. But it is clear that a U.S. BIT is more highly correlated with FDI inflows than other BITs. In each year, the addition of a new OECD BIT has a weak positive effect, and the addition of another BIT with a developing country has a weak negative effect. In both cases, the effects lack statistical significance (see Table 2).

As expected, a country's GDP (lagged one year) was overall the main determinant of FDI flows, with a 1% increase in GDP correlating with a 90%–97% increase in FDI to that country. The "Rule of Law" and "Exports" variables exhibited positive significance in a number of regressions, while inflation showed a weak negative influence, which was statistically significant in just one regression.

The presence of a U.S. BIT appears to exert a huge impact on FDI inflows (correlated with a 112% to 157% increase in the three different years) when a country's overall OECD BITs are below the mean number of OECD BITs (7.3 BITs) (see Table 2). Conversely, a U.S. BIT seems to show a very weak and statistically insignificant effect when OECD BITs are above the mean. The results could describe a certain crowding out of U.S. FDI when other OECD countries have relationships with a developing country—or indicate that flows to these countries are already high and any extra flows from the United States or other OECD countries have marginal effect. The results are in line with previous UNCTAD conclusions on Africa (and, to a lesser extent, transition countries in Central and Eastern Europe), showing that the less developed the country (thus with fewer overall BITs), the more apparent effect any one BIT will have. Our findings, however, conflict with the more recent finding that less developed countries cannot expect BITs to substitute for institutional capacity.[188]

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187. Whereas most BITs have been concluded between a developed and a developing nation, the transformation of some successful developing countries into capital exporters has led to a huge increase in the number of BITs between two developing nations, between developing nations and countries in Eastern Europe, and between Central and Eastern European countries. These BITs have increased from 63 in 1989 to 833 in 1999. *See* Press Release, UNCTAD, Bilateral Investment Treaties Quintupled During the 1990s, New UNCTAD Publication Releases the Latest Data on the Universe of BITs, UN Doc. TAD/INF/PR/077 (Dec. 15, 2000).

188. *See* Hallward-Driemeier, *supra* note 144, at 21.

When OECD BITs are dropped as an explanatory variable (not shown in Tables 1–5), the apparent impact and significance of a U.S. BIT is more extreme. When the U.S. BIT is dropped, the apparent impact of OECD BITs is large and statistically significant. Taken together, these results suggest not only that concluding an additional BIT with an OECD country is likely to increase a given country's FDI flows, *ceteris paribus* (in keeping with the UNCTAD 1998 study that found a redirection of flows at the margin),[189] but also that if the additional BIT is with the United States, the increase in FDI flows is likely to be substantially larger.

Consequently, in the case of U.S. BITs, and to a lesser extent the BITs of other OECD countries, BITs arguably have a positive impact on promoting investment to the signatory country. Thus, it would appear that a BIT could achieve the goal of investment promotion to varying degrees.

Furthermore, comparing our study with the 1998 UNCTAD study,[190] one may make the argument that if a developing country truly wishes to promote foreign investment, it is better to sign a BIT with high protection standards, like those advocated by the United States, than one with weaker standards as evidenced by certain other OECD countries. The basis of this argument is that a BIT with stronger standards creates a less risky investment climate than a BIT with weaker standards of protection and that, all other things being equal, foreign investors will prefer a less risky investment climate. Signing a U.S. BIT may also tend to lead to increased FDI flows from other OECD countries because OECD investors, by virtue of the most-favored-nation clause in OECD treaties, gain the protection of the high protective standards in U.S. BITs. On the other hand, since the United States is the leading foreign direct investor in the world and is likely to sign BITs with countries where U.S. multinational enterprises (MNEs) are engaged in or lobbying for business, other OECD MNEs may match U.S. investors just to remain competitive in certain regions. That is, OECD MNEs may not be influenced as much by the presence of a U.S. BIT as they are by the presence of U.S. MNEs with which they compete.

Finally, the signing of a U.S. BIT may signify a commitment to economic liberalization in line with the Washington Consensus[191] principles of the early

189. *See* UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 109; *supra* text accompanying note 159.

190. UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1.

191. The term "Washington Consensus" was coined in a 1990 paper by John Williamson, which outlined ten policy reforms that Latin America should undertake: fiscal discipline, redirection of public expenditures toward high-yield areas such as health and education, tax reform, interest rate liberalization, competitive exchange rate, trade liberalization, liberalization of inflows of FDI, privatization, deregulation, and secure property rights. John Williamson, *What Washington Means by Policy Reform*, *in* Latin American Adjustment: How Much Has Happened? 5, 5–20 (John Williamson ed., 1990).

1990s, and which U.S. negotiators demand. President Clinton, in a letter asking the Senate to ratify a Free Trade Agreement with Jordan in 2001, wrote:

> This Agreement is a vote of confidence in Jordan's economic reform program, which should serve as a source of growth and opportunity for Jordanians in the coming years.
>
> The United States-Jordan Free Trade Agreement achieves the highest possible commitments from Jordan on behalf of U.S. business on key trade issues, providing significant and extensive liberalization across a wide spectrum of trade issues.[192]

Similarly, U.S. Trade Representative Robert Zoellick, in announcing the beginning of negotiations on a United States-Pakistan BIT, said the BIT "can play an important role in strengthening Pakistan's economy, so as to create new opportunities for exporters and investors in both economies."[193] To the extent that a U.S. BIT helps revamp the overall economic climate, or signals a move in that direction, other OECD investors may be more inclined to invest.

b. Ten-year study on impact of U.S. BITs on bilateral U.S. FDI outflows. Our time-series study uses a dataset of U.S. FDI flows to thirty-one countries[194] over a ten-year period (1991–2000). Data is available from most countries for all years, with the exception of transition countries in the early 1990s (see Table 4). Of the thirty-one countries, eleven, primarily from Latin America and Central Europe,[195] have concluded BITs with the United States. The time-series (or panel data) model pools results from each of the thirty-one country groups to gain close to 300 observations and calculates a coefficient showing the degree to which a U.S. BIT correlates with FDI inflows.

The decision to focus on U.S. FDI, rather than on a "basket" of OECD flows, was based on the robustness of U.S. data. In addition, given the switch to the euro during the covered time-series, the focus on U.S. FDI also had the simplicity of

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192. Letter from the White House Office of the Press Secretary to the Congress of the United States (Jan. 6, 2001), *available at* http://clinton6.nara.gov/2001/01/2001-01-06-letter-from-the-president-on-fta.html (last visited Nov. 19, 2004).

193. Press Release, Office of the United States Trade Representative, Executive Office of the President, Pakistan, United States to Negotiate Bilateral Investment Treaty (Sept. 28, 2004), *available at* http://usinfo.state.gov/ei/Archive/2004/Sep/29-36999.html (last visited Nov. 19, 2004).

194. Countries included in the dataset are those included in *both* the UNCTAD list of developing countries *and* the primary FDI data source for this study. OECD, International Direct Investment Statistics Yearbook 1980–2000 (2001 ed., 2002).

195. These countries are Argentina, Bulgaria, Czech Republic, Egypt, Morocco, Panama, Poland, Romania, Slovakia, Turkey, and Ukraine. *See* Fact Sheet, Bureau of Economic and Business Affairs, U.S. Department of State, U.S. Bilateral Investment Treaty Program (Sept. 15, 2004), *available at* http://www.state.gov/e/eb/rls/fs/22422.htm.

converting one bilateral real exchange rate for each of the thirty-one countries in ten time periods. Furthermore, we felt that focusing on the primary source country, and one whose treaties enforce strong investor protections, might yield more conclusive results than previous time-series studies, which examine a "basket" of source countries (see Table 3 for a list of all U.S. BITs).

Because we are looking at a set of bilateral relationships, we can use a so-called "fixed-effects" technique, which assumes that many of the explanatory variables remain constant over a ten-year period. Thus, rather than controlling for all the explanatory variables that might affect FDI, such as telecom infrastructure, access to deep-water ports, or labor force education, these "fixed effects"[196] (also referred to as "unobserved effects") are not included in the model. As they don't change significantly from year to year, they are by definition held constant.

This time-series model allows us to observe whether U.S. FDI flows to a given country change after a BIT is signed or ratified, holding all other factors about the bilateral pair constant. The constant factors ("fixed effects") in each bilateral pairing that drop out when "differencing" one year from the next (and thus need not be included in the regression) include population, history of trade and political engagement, linguistic ties, rule of law, cultural ties, distance between major ports, quality of the labor pool, savings rate, etc. In the articulated econometric model,[197] we *do* include variables to measure changes in several macroeconomic indicators, such as GDP, GDP growth rate, ratio of private investment, and the bilateral real exchange rate, all of which change from year to year (see Data Appendix B for all variables and sources).

Our finding is that a U.S. BIT is correlated with a major increase in (at a 1% significance level) U.S. FDI outflows to a given country, *ceteris paribus*, compared to U.S. flows to a country without a U.S. BIT (see Table 5). In fact, the study suggests that a U.S. BIT is correlated with an extra $1 billion (approximately)

196. Wooldridge, *supra* note 139, at 420.

197. The estimation used is a fixed effect model specified as follows:

$$\begin{aligned} usfdi_{it} = {} & B_0 + B_1 lngdp_{it-1} + B_2 gdppercap_{it-1} + B_3 oecdbits + \\ & B_4 lnRER_{it-1} + B_5 inflows_{it-1} + B_6 Usbit_{it} + e_{it} + u_i \end{aligned}$$

The dependent variable is usfdi (U.S. FDI flows to country *i* at time *t*). Ordinarily, the measure of FDI flows is logged to identify their elasticity (percentage change), but in this case there are numerous years when flows to a given country are negative, and it's important to capture that data rather than treating it as 0 or missing data.

The key economic explanatory variables include lngdp1 (the natural log of total GDP (lagged one year), gdppercap (lagged), lnrer (the natural log of bilateral real exchange rate, lagged), inflows (total FDI inflows to a given country in time t), oecdbits (the number of OECD BITs), usbit (the presence of a U.S. BIT), bitsign (the year a U.S. BIT was signed), bitforce (the year a U.S. BIT was ratified), and treatage (the number of years since the BIT was signed, up to a maximum of 10).

in increased FDI per year. As does the UNCTAD study,[198] we would also caution that this is a statistical abstraction, factoring in data from many countries grouped together, and not necessarily a policy conclusion about any single treaty partner. In addition, we measure solely the level of FDI, and not the increase or decrease in the *share* of FDI that flows from the United States to the host.

The timing variables (the date of signing, the date of ratification, and the number of years since the signing) have no coefficients that are statistically significant; however, the correlations indicate that ratification has a positive effect on FDI flows (and much more effect than the mere signing of a BIT), as does the passage of each year after the treaty is signed. Again, this is in keeping with both the UNCTAD study, which tentatively concludes that "the response lag after the signing of a BIT may be as little as zero but is more likely to be two years,"[199] and the Hallward-Driemeier study, which finds a positive (but very minor) correlation in FDI in year five after ratification.[200]

GDP and GDP per capita both have a positive and statistically significant correlation, as expected. Also as expected, an appreciation of the bilateral real exchange rate in the host country (resulting in greater expense for foreigners to do business) has a large and significant negative correlation. Total FDI inflows have virtually no effect in either direction on U.S. flows, so there is no indication that FDI from other OECD countries crowds out U.S. FDI, or that FDI from other OECD countries attracts U.S. FDI.

One variable that we did not control for is "policy effects," which includes NAFTA and its impact on flows to Mexico, and WTO accession and its impact on flows to China. In the Hallward-Driemeier study, NAFTA's impact on OECD flows was large and significant, although the policy change in the transition countries of Eastern Europe was generally negative or negligible.[201] Sorting out the impact of various trade and investment pacts on FDI may be fodder for a future study.

Due to data constraints, not every country with a U.S. BIT is included in the study. Although Chile, Colombia, Costa Rica, and Venezuela have BITs with the United States, the only Latin American countries included are Argentina, Mexico, and Panama. Moreover, while the United States has a number of treaties with the transition countries of Eastern and Central Europe, FDI was scarce or the data nonexistent in the early 1990s.[202] There is no published OECD data on FDI inflows for some small countries that have signed BITs with the United States,

198. *See* UNCTAD, Bilateral Investment Treaties in the Mid-1990s, *supra* note 1, at 120; *supra* text accompanying note 164.

199. *Id.* at 111.

200. *See* Hallward-Driemeier, *supra* note 144, at 33.

201. *Id.* at 31–36.

202. The impact of a U.S. BIT on flows to Eastern and Central Europe is negative, but statistically insignificant; perhaps with more data, this uncertainty may be resolved.

such as Mongolia, Moldova, Bangladesh, Cameroon, and Mozambique; thus, these countries are not included in our dataset. Finally, the United States has no BIT with China, which has attracted an increasing level of FDI from the United States in recent years. In a future study, we may expand the analysis to compare several other sets of bilateral partners that include key source countries such as Japan (which has largely abstained from the BIT movement), the United Kingdom, Germany, Belgium, Luxembourg, and others. This approach may begin to refine the analysis of the impact of different OECD BITs on FDI flows.

To better test the dynamics of other OECD BITs on U.S. BITs and FDI flows, it would also make sense to control for OECD BITs in each year, as we did in the cross-country study; however, data on signing dates for individual BITs beyond 1996 has not been published by UNCTAD or the World Bank,[203] making application of such data more difficult.

It is hard to make broad generalizations regarding U.S. BIT/FDI dynamics with certainty, as such a huge proportion of FDI to developing countries goes to China, Brazil, and Mexico, and of these only Mexico has a BIT (NAFTA) with the United States. Nonetheless, the two econometric studies are large enough (with about 100 and 300 observations, respectively), and tested with enough variables to assure that there were no key omissions. Nor is any variable constant or a perfect linear combination of the others ("no perfect collinearity"), a required assumption for a clean econometric model. We can be confident in concluding that:

a. A U.S. BIT is more likely than not to exert a strong and positive role in promoting U.S. investment.
b. A U.S. BIT is more likely than not to exert a strong and positive role in promoting overall investment.
c. A U.S. BIT is likely to exert more of an impact than other OECD BITs in promoting overall investment.

After reviewing both the literature, which makes note of the potential impact of BITs with strong investor protections, and our own econometric study on the promotional effects of a U.S. BIT, we find strong evidence that BITs have, to a significant extent, attained their stated goal of promoting investment.

203. ICSID Web site, *supra* note 1 (listing individual parties to BITs through 1996). The UNCTAD database that the authors relied on for their econometric analysis did not list individual BIT signatories, but grouped signatories as developed or developing countries, and by region. However, the most recent UNCTAD database does list individual BIT signatories. *See* UNCTAD, *Country-Specific Lists of BITs, available at* http://www.unctad.org/Templates/Page.asp?intItemID=2344&lang=1 (last visited Nov. 28, 2004).

CONCLUSION: A GRAND BARGAIN REALIZED

This chapter has sought to answer the basic question of whether BITs really work. Has the expanding network of 2,200 BITs concluded over the last five decades produced the effects intended by the countries that have signed them? This chapter has tried to answer that question by evaluating the impact of BITs in relation to their intended goals: foreign investment protection, investment and market liberalization, and investment protection. In this regard, it concludes that while BITs, in and of themselves, may have not directly and substantially liberalized FDI, there is strong evidence to show that they both protect and promote FDI in developing countries and the United States. BITs have a particularly strong effect on encouraging FDI in developing countries. In short, the grand bargain between developing and developed countries that underlies BITs, the bargain of investment promotion in return for investment protection, seems to have been achieved, although the effect of the bargain is only realized slowly after the BIT is signed.

The fact that many nations have realized that bargain with respect to foreign investment has important implications for the future. First, it may give added impetus to future negotiations of still more BITs in the years ahead. With evidence that BITs really do protect and promote investment, both developed and developing countries may display an increased willingness to negotiate new BITs with new partners. Developing country governments that may have been reluctant to sign BITs because of concerns that BITs would prove costly and bring them little additional investment may now see evidence of increased capital flows as reason to justify treaty participation, particularly if other countries with whom they compete for foreign capital have signed BITs and obtained substantial foreign investment. Although BIT critics[204] in developing countries point to the increased number of arbitration awards against developing countries as justification for their opposition, evidence of substantially increased investment flows severely weakens their position.

Second, evidence that the bargain implicit in the BITs has advanced the interests of both developed and developing countries may serve to give renewed impetus to multilateral efforts to negotiate a global treaty on international investment. Such efforts were thwarted at the end of the 1990s with the failure of the OECD to negotiate a multilateral investment agreement[205] but may now be renewed in the current Doha Round of Negotiations of the WTO.[206]

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204. For an example of criticism of current arbitration procedures, see von Moltke & Mann, *supra* note 18, at 30–31.

205. *See* Kelley, *supra* note 63, at 484.

206. World Trade Organization, Ministerial Declaration of 14 November 2001, WT/MIN(01)/DEC/1, 41 I.L.M. 746, 749 (2002).

Finally, and admittedly most problematically, in light of the proliferation of BITs and the perception that they really do work, one may speculate on the role of BITs as a source of international law applicable beyond the two parties to the BIT itself. The potential for this wider application is crucially important because it could portend the development—indeed perhaps the current existence—of a multilateral international investment regime built on sources of law other than treaties. BITs could provide such a source if they are seen in one of two ways:[207] (1) as influences on and evidence of customary international law, or (2) as embodiments of general principles of law common to the world's legal systems.[208]

A. BITs as Customary International Law

Virtually since the beginning of the BIT movement, scholars have debated the extent to which BITs constitute or form customary international law with respect to foreign investment. One argument is that BITs "establish and accept and thus enlarge the force of traditional conceptions" of the law of state responsibility for foreign investment.[209] Others have countered that, despite their prevalence, BITs are *lex specialis*, and have effect only between the parties to the BIT.[210] According to this view, BIT provisions are not sufficiently uniform to establish custom accepted by the international community.

In order to qualify as customary international law, BITs must have "result[ed] from a general and consistent practice of states followed by them from a sense of legal obligation."[211] The first requirement, "state practice," is likely not difficult to prove, given that the common structure and language of certain BITs provisions, particularly those of more recent vintage, as well as their widespread adoption, arguably reflect a practice "both extensive and virtually uniform."[212] With more than 2,200 BITs with similar language and obligations in operation around the world, state practice seems readily demonstrable. Although only a relatively short period of time has passed since BITs were widely adopted, "the passage of only

207. In both cases, practices would need to be looked at on an individual basis; that is, one would have to go through the following analysis for each area in question (e.g. expropriation), and could not simply assume that the content of *all* BITs is necessarily law if *any* of it is.

208. *See generally* Statute of the International Court of Justice, *supra* note 6 (identifying the major sources of international law).

209. F. A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 Brit. Y.B. Int'l L. 241, 249 (1981).

210. *See* Bernard Kishoiyian, *The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law*, 14 Nw. J. Int'l L. & Bus. 327, 329 (1994). *See also* Sornarajah, *supra* note 1, at 276.

211. Restatement (Third) of the Foreign Relations Law of the United States, *supra* note 9, § 102.

212. North Sea Continental Shelf (*F.R.G. v. Den.*), 1969 I.C.J. 3, 43 (Feb. 20).

a short period of time is not necessarily, or of itself, a bar to the formation of a new rule of customary international law."[213]

The second requirement of *opinion juris sive necessitatis*, that the state practice "should have occurred in such a way as to show a general recognition that a rule of legal obligation is involved,"[214] could prove to be more problematic to satisfy. Are the principles embodied in the BITs *lex specialis,* constituting specially agreed upon rules between treaty partners? Or have the principles embodied in more than 2,200 BITs become sufficiently generalized that countries respect them because they recognize that a legal obligation is involved? Certainly as the number of countries involved in BITs increases and the total number of BITs grows, certain BIT provisions, if sufficiently common, approach the status of custom and seem less and less like mere *lex specialis*. Moreover, if the BITs have proved their effectiveness, as this chapter has argued, then arguably, countries desiring to have an effective legal system to attract foreign investment would follow certain basic BIT provisions as the goal of having an effective foreign investment legal regime encourages them to do so.

Beyond this purely theoretical argument is the much more powerful persuasion of actual practice. Two recent arbitration awards have taken the view that BITs do indeed constitute or at least contribute to international custom. In *Pope & Talbot, Inc. v. Canada*,[215] the tribunal interpreted NAFTA Article 1105(1)[216] to be similar to many BITs in providing that: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."[217] In making the interpretation, the tribunal took account of the evolution of investor rights caused by the BIT movement and found that the current content of international custom reflects the provisions of the many BITs concluded by the nations of the world, stating that:

> [A]ll parties agree, that the language of Article 1105 grew out of the provisions of bilateral commercial treaties negotiated by the United States and other industrialized countries. As Canada points out, *these treaties are a 'principal source' of the general obligations of states with respect to their treatment of foreign investment.*[218]

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213. *Id.*

214. *Id.*

215. *Pope & Talbot, Inc. v. Canada*, Award on the Merits, Phase Two (NAFTA Ch. 11 Arb. Trib. Apr. 10, 2001), *available at* http://www.dfait-maeci.gc.ca/tna-nac/documents/Award_Merits-e.pdf (last visited Nov. 22, 2004).

216. NAFTA, *supra* note 45, at 639.

217. The tribunal cites the Model Bilateral Investment Treaty of 1987, *reprinted in* Vandevelde, *supra* note 1, as particularly similar, which is important because it influenced a number of countries' BITs. *See* Pope & Talbot, Award on the Merits, Phase Two, at ¶ 111.

218. *Id.* at ¶ 110 (emphasis added) (citation omitted).

In *Mondev Int'l Ltd. v. United States,*[219] all three NAFTA member countries made submissions challenging *Pope & Talbot, Inc.*, particularly because the *Pope & Talbot, Inc.* tribunal did not consider the necessary element of *opinio juris* in establishing the asserted custom.[220] A three-member tribunal, which included a former president of the International Court of Justice, found the issue to be "entirely legitimate" in making its own interpretation of NAFTA's Article 1105.[221] It also had to take into account a July 31, 2001, interpretation by the NAFTA Free Trade Commission[222] that found that Article 1105(1) "prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded investments of investors of another Party" and that "the concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."[223] Canada had suggested that the meaning of those provisions in customary international law should be interpreted by reference to the standard set down in the decision of the Mexican Claims Commission in the 1926 *Neer* case.[224] After lengthy discussion, the tribunal rejected that view, holding that the Free Trade Commission's interpretation of Article 1105(1) "incorporate[s] current international law, whose content is shaped by the conclusion of more than two thousand bilateral investment treaties."[225] Thus, the process of creating an international law of investment has seemingly evolved from a situation where the absence of appropriate custom prompted the creation of more than 2,200 BITs, which in turn has led to the creation of custom.

B. BITs as General Principles of Law

The notion that the principles embodied in BITs could represent "general principles of law"[226] and thus constitute a source of international law has not received

219. Mondev Int'l Ltd. v. United States, Case No. ARB(AF)/99/2 (NAFTA Ch. 11 Arb. Trib. Oct. 11, 2002), 42 I.L.M. 85 (2003). The members of the tribunal were Sir Ninian Joseph (President), Professor James Crawford, and Judge Stephen Schwebel.

220. *See* Pope & Talbot, Inc. v. Canada, Award on the Merits, Phase Two, at ¶ 110.

221. *Id.* at ¶ 111.

222. Under NAFTA article 1131, interpretations by the Free Trade Commission of NAFTA provisions are binding on investment arbitration tribunals. NAFTA, *supra* note 45, at 645.

223. NAFTA Free Trade Commission, NAFTA Commission Notes of Interpretation of Certain Chapter 11 Provisions (2001), *available at* http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp (last modified May 17, 2002) (last visited Nov. 22, 2004).

224. Counter-Memorial of Canada, Pope & Talbot, Inc. v. Canada, Phase Two, at ¶¶ 256 – 61 (NAFTA Ch. 11 Arb. Trib. 2000), *available at* http://www.dfait-maeci.gc.ca/tna-nac/documents/b-2.pdf (last visited Nov. 6, 2004).

225. *See* Mondev Int'l Ltd. v. United States, Case No. ARB(AF)/99/2 (NAFTA Ch. 11 Arb. Trib. Oct. 11, 2002), 42 I.L.M. 85 (2003), at ¶ 125.

226. *See* Mann, *supra* note 209, at 249.

extensive consideration by scholars; however, as BITs proliferate, more and more countries incorporate BITs into their domestic legal systems. Thus, there is scope for arguing that BITs manifest certain concepts on the treatment of investors and investments that represent general principles of law. The argument is strengthened to the extent that individual countries have adopted foreign investment codes and laws that embody and amplify the rights accorded to investors in the BITs that host countries have signed.[227] In a more recent formulation concerning general principles of law as a source of international law other than the Statute of the International Court of Justice, the Restatement (Third) of the Foreign Relations Law of the United States provides that "a rule of international law is one that has been accepted as such by the international community of states . . . by derivation from general principles of law common to the major legal systems of the world."[228] In search for those general principles of law with respect to investment, it would seem that a court or arbitral tribunal should be able to take into account the common principles found in BITs as well as domestic legislation influenced by the BITs individual countries have signed. Given the commonalities among BITs, this final approach to developing an international law of investment is a tantalizing, unexplored possibility for the creation of a more comprehensive international investment law regime.

Whether or not BIT provisions will find their way into customary international law or general principles of law is not yet clear. What is clear is that BITs, despite early misgivings, are here to stay for the foreseeable future, as they have become a permanent part of the international system. Evidence that BITs are attaining their goals, that they really do work, will only add impetus to the movement to create the international investment law that the International Court of Justice could not discern in 1970. As a result, government officials, international executives, lawyers, and financiers will increasingly have to take them into account in planning, negotiating, undertaking, and managing international investment transactions.

227. *See* Jeswald W. Salacuse, *Direct Foreign Investment and the Law in Developing Countries*, 15 ICSID Rev.-Foreign Inv. L.J. 382, 382–400 (2000).

228. Restatement (Third) of the Foreign Relations Law of the United States, *supra* note 9, § 102.

DATA APPENDIX A

Effect of U.S. BITs on Aggregate FDI Flows to Developing Countries (results in Tables 1 and 2)

OECD BITS (AND NONOECD)

numeric variables indicating how many BITs a given country has signed with OECD countries *other than the United States*. Data are taken from UNCTAD and World Bank databases, which list specific treaties from 1959 to 1996. Post-1996, BITs are collected in aggregate form, divided into United States, Developed, Developing, and Central/Eastern European countries.

EXPORTS OF GOODS AND SERVICES (% OF GDP)

Value of all goods and other market services provided to the rest of the world, as a percent of GDP.[229]

NET FDI INFLOWS, (BOP, CURRENT U.S.$)

Represents the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor, and is defined as the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital, as shown in the balance of payments. Data are in current U.S. dollars.[230]

GDP

Data are in current U.S. dollars (for any given year). Dollar figures for GDP are converted from domestic currencies using single year official exchange rates. For a few countries where the official exchange rate does not reflect the rate effectively applied to actual foreign exchange transactions, an alternative conversion factor is used.[231]

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229. World Bank, *World Development Indicators (WDI) Data Query, available at* http://www.worldbank.org/data/dataquery.html (last visited Nov. 29, 2004) (Annual data reported in this site are derived, either directly or indirectly, from official statistical systems organized and financed by national governments).

230. *Id.*

231. *Id.*

GDP PER CAPITA, PPP (CURRENT INTERNATIONAL $)

Gross domestic product converted to international dollars using purchasing power parity rates, where an international dollar has the same purchasing power over GDP as the U.S. dollar has in the United States. Data are in current international dollars (for each year in question).[232]

INFLATION, CONSUMER PRICES (ANNUAL PERCENT)

Measured by the consumer price index, which reflects the annual percentage change in the cost to the average consumer of acquiring a fixed basket of goods and services that may be set or changed at specified intervals, such as yearly.[233]

REAL EFFECTIVE EXCHANGE RATE INDEX (1995 = 100)

The nominal effective exchange rate (a measure of the value of a currency against a weighted average of several foreign currencies) divided by a price deflator or index of costs.[234]

POPULATION

Statistics from 1998 are used for years 1998, 1999, 2000.[235]

RULE OF LAW

Measure from –2.5 to 2.5 (worst to best) of a country's ability to enforce laws and regulations without bribery and corruption, and of the independence of the judiciary.[236]

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232. World Bank Group Online Media Briefing Center, *World Development Indicators (WDI) Data Query*, *at* http://media.worldbank.org/secure/data/qquery.php (last visited Nov. 29, 2004).

233. *Id.*

234. *Id.*

235. *Id.*

236. Daniel Kaufmann et al., Aggregating Governance Indicators 35 (World Bank, Working Paper No. 2195, Oct. 1999), *available at* http://econ.worldbank.org/docs/918.pdf (last visited Nov. 14, 2004).

DATA APPENDIX B
Ten-Year Study on Impact of U.S. BITs on Bilateral U.S. FDI Outflows (results in Table 5)

GDP

Data are in current U.S. dollars for each of 10 years (1991–2000). Dollar figures for GDP are converted from domestic currencies using single year official exchange rates. For a few countries where the official exchange rate does not reflect the rate effectively applied to actual foreign exchange transactions, an alternative conversion factor is used.[237]

GDP PER CAPITA, PPP (CURRENT INTERNATIONAL $)

Gross domestic product converted to international dollars using purchasing power parity rates, where an international dollar has the same purchasing power over GDP as the U.S. dollar has in the United States. Data are in current international dollars for each year, 1991–2000.[238]

BILATERAL REAL EXCHANGE RATE (*lnrer*)

Calculated using the Ep*/p ratio, where E is the United States equivalent to a given foreign currency (i.e., .05 U.S. dollars per peso), p* is the foreign producer price index, and p is the U.S. producer price index for a given year. In cases where the producer price index was not available, the best available substitute was used (wholesale price index, industrial price index, or domestic and import goods index). These indices are designed to monitor changes in prices of items at the first important commercial transaction, covering agricultural and industrial sectors (but not services). *IMF International Statistics Yearbook*[239] (scaled so 1995 = 100).

An increase in the real exchange rate is equivalent to a depreciation of the dollar, making it more expensive to do business in a foreign country. Transition countries, as well as China, with no reliable data until the early 1990s, presented a problem, as both nominal exchange rates and producer and wholesaler prices

237. World Bank, *supra* note 229.

238. World Bank Group Online Media Briefing Center, *supra* note 232.

239. International Monetary Fund, International Financial Statistics Yearbook 2000 (2000).

are often presented as a percentage increase over the previous year, with no base year. Thus, we set values in year 1995 to 100 as the base, mirroring the International Monetary Fund (IMF) model, and created an index showing the percentage increase or decrease from that base.

BITs

The BIT variables used are usbit (U.S. BIT), bitsign (date of signature by U.S.), bitforce (date of ratification by U.S. Congress), and treaty age (age of BIT from date of signature). Data come from the U.S. Department of State.[240] Mexico is listed as having signed a BIT in 1994, the year the NAFTA agreement was ratified, as Chapter 11 of NAFTA is modeled closely on a typical BIT.

U.S. FDI

Indicates outflows from the United States into a given country. Data come from *OECD International Direct Investment Statistics Yearbook 1980–2000*,[241] which includes comparable data from all OECD countries divided into a select group of host countries. Data from the U.S. Bureau of Economic Analysis are considerably different (and not used), but the assumption is that OECD data are somewhat more reliable as they cross-check FDI inflows and outflows to achieve consistency across countries.

COUNTRIES

Countries both on the *UNCTAD World Investment Report 2002*[242] of developing countries and in the *OECD International Direct Investment Statistics Yearbook 1980–2000*.[243]

These countries include: Algeria, Argentina, Brazil, Bulgaria, Chile, China, Colombia, Costa Rica, Czech Republic, Egypt, Greece, Hong Kong, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Panama, Philippines, Poland, Romania, Russia, Singapore, Slovakia, South Africa, Thailand, Turkey, Ukraine, Venezuela. (Hong Kong and Singapore are considered developing countries by UNCTAD, although as international money centers with relatively high per capita incomes, they are clear outliers.)

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240. *See* U.S. Department of State, *supra* note 195.
241. *See* OECD, *supra* note 194.
242. *See* UNCTAD, *supra* note 49.
243. *See* OECD, *supra* note 194.

Countries with which United States has signed (but not necessarily concluded) BITs that are *not* included are: Albania, Armenia, Azerbaijan, Bahrain, Bangladesh, Belarus, Bolivia, Cameroon, Congo (D.R)., Congo (Republic), Croatia, Ecuador, El Salvador, Estonia, Georgia, Grenada, Haiti, Honduras, Jamaica, Jordan, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Mongolia, Mozambique, Nicaragua, Senegal, Sri Lanka, Trinidad & Tobago, Tunisia, and Uzbekistan.

TABLE 1. FDI INFLOWS TO NEARLY 100 DEVELOPING COUNTRIES (1998, 1999, 2000)

Dependent variable: total FDI inflows
Variable of interest: U.S. BIT

Using the natural log on the dependent variable (FDI inflows) allows us to chart percentage changes, rather than absolute dollar amounts. The regression results indicate that the presence of a U.S. BIT has a large, positive, and significant impact on a country's overall FDI inflows. Coefficients on the U.S. BIT variable range from.77 to.85—which correlates with increased *global* FDI to a given country in a given year by 77% to 85% (at 1%–5% significance levels).

As expected, a country's GDP (lagged one year) was overall the main determinant of FDI flows, with a 1% increase in GDP correlating with a 90%–97% increase in FDI to that country. The "Rule of Law" (a measure of a country's ability to enforce laws and regulations without bribery and the independence of the judiciary) and "Exports/GDP" (a proxy for openness to trade) variables exhibited positive significance in a number of regressions, while inflation showed a weak negative influence.

OECD BITs (not including a U.S. BIT) showed a positive correlation, but without statistical significance. Non-OECD BITs showed a slight negative correlation, again without significance.

	1998	1999	2000
LnGDP	.9075312	.9738132	.9133896
(lagged 1 yr.)	(.1204325)*	(.110394)*	(.1009)*
Exports/GDP	.005873	.0131968	.0124008
(lagged 1 yr.)	(.0084271)**	(.00772)***	(.0064984)***
Population	7.01e-10	7.02e-10	7.31e-10
(1998 data)	(1.09e-09)	(1.03e-09)	(8.78e-10)
Rule of law	.5803937	.3462706	.2947284
1998 data	(.2958015)**	(.2928306)	(.2470544)
Inflation (lagged 1 yr.)	–.0002231	–.0019812	–.0039564
	(.0014893)	(.0116331)	(.003992)
non-OECD BITs	–.0161399	–.0198837	-.0167696
	(.0168424)	(.0155609)	(.013368)
U.S. BIT	.7735253	.8580597	.7910127
	(.3769416)**	(.3515354)*	(.3116577)*

	1998	1999	2000
OECD BITs	.0432709	.0309769	.0332509
	(.0430122)	(.0376993)	(.0323745)
Constant	−2.429067	−4.174583	−2.679342
	(2.714293)	(2.510826)	(2.297455)
R-squared (adj.)	.58	.63	.66
Observations	99	97	94

* = 1% significance ** = 5% significance *** = 10% significance

TABLE 2. FDI INFLOWS TO NEARLY 100 DEVELOPING COUNTRIES (1998, 1999, 2000) WHEN OECD BITS ARE BELOW OR ABOVE THE MEAN (7.3)

Dependent variable: Total FDI Inflows (natural log)
Variable of Interest: U.S. BIT

The presence of a U.S. BIT has a strong positive correlation with FDI inflows (associated with a 112% to 157% increase in the three different years) when a country's overall OECD BITs are below the mean (7.3 BITs). Conversely, a U.S. BIT has a very weak and statistically insignificant correlation when OECD BITs are above the mean. In both cases, a host country's GDP has a positive (71% to 90% increase) and significant correlation (1% significance) on FDI inflows.

WHEN OECD BITS ARE BELOW MEAN (7.3)

	1998	1999	2000
lnGDP	.9043972	.7193307	.8482358
(lagged 1 yr.)	(.2500843)*	(.2067879)*	(.2166589)*
Exports/GDP	.0013238	.7193307	.0140727
(lagged 1 yr.)	(.0117836)	(.2067879)*	(.0091637)
Population	1.01e-08	1.37e-08	5.21e-09
(1998 date)	(1.42e-08)	(1.21e-08)	(1.11e-08)
Rule of Law	.8577123	.857234	.532797
(1998 data)	(.4782312)***	(.4066552)**	(.3704629)
Inflation	−.0210193	.0236987	.0147427
(lagged 1 yr.)	(.0104127)**	(.0338313)	(.0234731)
non-OECD BITs	−.0412004	−.0206846	−.0386053
(total #)	(.0498417)	(.0390781)	(.0398685)
U.S BIT	1.573043	1.848765	1.12411
(yes or no)	(.5958077)*	(.5258377)*	(.4920293)**
constant	−2.018528	1.195825	−1.258251
–	(5.350241)	(4.435875)	(4.654583)
R-squared (adj.)	.46	.55	.52
Observations	54	53	50

Continued

	1998	1999	2000
lnGDP	.7440917	1.051477	.923907
(lagged 1 yr.)	(.1468008)*	(.1771252)*	(.1465855)*
Exports/GDP	.0096643	.0084455	.0101457
(lagged 1 yr.)	(.0112118)	(.0118909)	(.0098827)
Population	5.73e-10	−2.65e-10	2.68e-10
(1998 data)	(8.80e-10)	(1.06e-09)	(8.78e-10)
Rule of Law	.0181132	−.0321905	.053219
(1998 data)	(.3634513)	(.4679818)	(.3821787)
Inflation	.0002231	−.0082241	−.0060239
(lagged 1 yr.)	(.0011608)	(.0126935)	(.0041829)
non-OECD BITs	−.0042503	−.0051649	−.0079657
(total #)	(.0128175)	(.0154286)	(.0125828)
U.S. BIT	.0054703	.3042012	.5381399
	(.4080991)	(.4916508)	(.4144613)
Constant	2.303778	−5.306884	−2.285846
	(3.678956)	(4.402117)	(3.631881)
R-squared (adj.)	.49	.53	.58
Observations	45	44	44

* = 1% significance ** = 5% significance *** = 10% significance

TABLE 3. UNITED STATES BILATERAL INVESTMENT TREATIES THROUGH 2003[244]

Country	Date of signature	Date entered into force
Albania	January 11, 1995	January 4, 1998
Argentina	November 14, 1991	October 20, 1994
Armenia	September 23, 1992	March 29, 1996
Azerbaijan	August 1, 1997	August 2, 2001
Bahrain	September 29, 1999	May 30, 2001
Bangladesh	March 12, 1986	July 25, 1989
Belarus	January 15, 1994	N/A[245]

244. U.S. investment in Canada and Mexico is covered by Chapter Eleven of the North American Free Trade Agreement (NAFTA) which contains provisions similar to BIT obligations.

245. Entry into force pending exchange of instruments of ratification.

Country	Date of signature	Date entered into force
Bolivia	April 17, 1998	June 6, 2001
Bulgaria	September 23, 1992	June 2, 1994
Cameroon	February 26, 1986	April 6, 1989
Congo, Democratic Republic of the[246]	August 3, 1984	July 28, 1989
Congo, Republic of the (Brazzaville)	February 12, 1990	August 13, 1994
Croatia	July 13, 1996	June 20, 2001
Czech Republic[247]	October 22, 1991	December 19, 1992
Ecuador	August 27, 1993	May 11, 1997
Egypt	March 11, 1986	June 27, 1992
El Salvador	March 10, 1999	N/A[248]
Estonia	April 19, 1994	February 16, 1997
Georgia	March 7, 1994	August 17, 1997
Grenada	May 2, 1986	March 3, 1989
Haiti	December 13, 1983	N/A[249]
Honduras	July 1, 1995	July 11, 2001
Jamaica	February 4, 1994	March 7, 1997
Jordan	July 2, 1997	June 12, 2003
Kazakhstan	May 19, 1992	January 12, 1994
Kyrgyzstan	January 19, 1993	January 12, 1994
Latvia	January 13, 1995	December 26, 1996
Lithuania	January 14, 1998	November 22, 2001
Moldova	April 21, 1993	November 25, 1994
Mongolia	October 6, 1994	January 1, 1997
Morocco	July 22, 1985	May 29, 1991
Mozambique	December 1, 1998	N/A[250]
Nicaragua	July 1, 1995	N/A[251]

Continued

246. Formerly Zaire.

247. Treaty signed on October 22, 1991, with the Czech and Slovak Federal Republic and has been in force for the Czech Republic and Slovakia as separate states since January 1, 1993.

248. Entry into force pending exchange of instruments of ratification. Entry into force pending ratification by both Parties and exchange of instruments of ratification.

249. Entry into force pending exchange of instruments of ratification.

250. Entry into force pending other Party's ratification and exchange of instruments of ratification.

251. Entry into force pending U.S. ratification and exchange of instruments of ratification.

TABLE 3. UNITED STATES BILATERAL INVESTMENT TREATIES THROUGH 2003 (CONT'D...)

Country	Date of signature	Date entered into force
Panama	October 27, 1982	May 30, 1991
Panama (Amendment)	June 1, 2000	May 14, 2001
Poland	March 21, 1990	August 6, 1994
Romania	May 28, 1992	January 15, 1994
Russia	June 17, 1992	N/A[252]
Senegal	December 6, 1983	October 25, 1990
Slovakia[253]	October 22, 1991	December 19, 1992
Sri Lanka	September 20, 1991	May 1, 1993
Trinidad & Tobago	September 26, 1994	December 26, 1996
Tunisia	May 15, 1990	February 7, 1993
Turkey	December 3, 1985	May 18, 1990
Ukraine	March 4, 1994	November 16, 1996
Uzbekistan	December 16, 1994	N/A[254]

Source: U.S. Department of State, Bureau of Economic and Business Affairs, http://www.state.gov/e/eb/rls/fs/22422.htm (last visited Nov. 22, 2004)

TABLE 4. TIME SERIES DATA (1991–2000)

U.S. FDI, total FDI, U.S. BITs (and treaty age[255]) for thirty-one countries (year 2000)

Country	U.S. FDI (in $U.S. millions)	Non-U.S. FDI (in $U.S. millions)	U.S. BIT (Y or N)	Treaty age
Algeria	418	438	N	0
Argentina	676	11152	Y	9
Brazil	2285	32779	N	0
Bulgaria	11	1002	Y	8
Chile	855	3674	N	0
China	1245	40772	N	0
Colombia	693	2374	N	0

Continued

252. Entry into force pending other Party's ratification and exchange of instruments of ratification.

253. Treaty signed on October 22, 1991, with the Czech and Slovak Federal Republic and has been in force for the Czech Republic and Slovakia as separate states since January 1, 1993.

254. Entry info force pending exchange of instruments of ratification.

255. Number of years since signing of treaty.

Country	U.S. FDI (in $U.S. millions)	Non-U.S. FDI (in $U.S. millions)	U.S. BIT (Y or N)	Treaty age
Czech Republic	274	4986	Y	9
Egypt	603	1235	Y	11
Greece	98	–	N	0
Hong Kong	–67	61938	N	0
Hungary	–1882	1643	N	0
India	-67	2319	N	0
Indonesia	1182	–4550	N	0
Israel	972	–	N	0
Korea	1244	9283	N	0
Malaysia	260	3788	N	0
Mexico	3542	14706	Y	7
Morocco	8	201	Y	10
Panama	1819	603	Y	11
Philippines	49	1241	N	0
Poland	432	9342	Y	10
Romania	33	1025	Y	8
Russia	–257	2714	N	0
Singapore	2690	5407	N	0
Slovakia	32	2075	Y	9
South Africa	74	888	N	0
Thailand	539	2813	N	0
Turkey	225	982	Y	10
Ukraine	24	595	N	6
Venezuela	1256	4464	N	0

TABLE 5. IMPACT OF U.S. BIT ON U.S. FDI FLOWS TO 31 DEVELOPING COUNTRIES, 1991–2000

Dependent Variable: U.S. FDI inflows ($U.S. millions)

Variables of interest: U.S. BIT, date of signing, date of ratification, age of treaty

A U.S. BIT exhibits a very strong correlation (at a 1% significance level) with U.S. FDI outflows to a developing country, *ceteris paribus*, compared to U.S. flows to developing countries with no U.S. BIT. The results suggest that a U.S. BIT is correlated with an extra 1 billion U.S. dollars (see below, the coefficient on a U.S. BIT is 1019, or $1.02 billion) in increased FDI per year.

Conversely, an appreciation in the bilateral exchange rate, making it more expensive for foreigners to do business, is correlated with a drop of approximately $200 million U.S. FDI per year (coefficients range from –191 to –263, at 5%–10% significance levels).

The timing variables (the date of signing, the date of ratification, and the number of years since the signing) have no coefficients that are statistically significant.