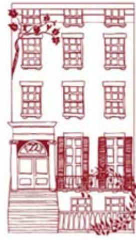

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The International Investment Regime
Sovereignty, Investor Security, and Dispute Settlement since the 1980s

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THE INTERNATIONAL INVESTMENT REGIME SOVEREIGNTY, INVESTOR SECURITY, AND DISPUTE SETTLEMENT SINCE THE 1980S

By Beth A. Simmons*

Abstract

The international legal regime for the protection of international investments is an extraordinary set of arrangements that gives investors unique rights in public international law. These rights are contained in a large body of mostly bilateral investment treaties (BITs) whose numbers exploded in the 1990s. This article argues that the spread and development of this regime can be understood in a bargaining context: the more developing countries want to attract capital, the higher the sovereignty costs they are willing to pay for it. This is reflected in the timing of BIT ratification, as well as their content. While there is little evidence to suggest that BITs attract more capital, it is pretty clear they do attract litigation, if the cases before ICSID are any measure. In a number of ways – including efforts to get awards annulled, non-payment of awards, and the renegotiation or even termination of treaties themselves – there seems to be a growing evidence of backlash against the system. However, change may be underway as states reassert their interests in a wider policy space vis-à-vis investors' rights.

* Director, Weatherhead Center for International Affairs, Clarence Dillon Professor of International Affairs, Department of Government, Harvard University. bsimmons@wcfia.harvard.edu

Much attention has been given to the impact of economic crises for stimulating innovation in the international financial architecture. And a good deal of research has also been devoted to the stresses of economic downturns on international trade rules and policies. But the emerging regime for the facilitation and protection of foreign direct investment has almost completely escaped the attention of social scientists. By “international regime” I mean the collection of often decentralized (even sometimes contradictory) rules about the promotion and protection of international direct investment. This is not a regime with a single clear institutional core; rather, it is one with a much more decentralized system of rule promulgation and development than is the case in other areas of international economic relations. In contrast to international laws governing international trade, which are influenced overwhelmingly by the law of the GATT/WTO, international investment rules have developed in the first instance through customary international law and more recently through a system of bilateral treaties whose primary purpose is to encourage international investment by protecting property rights of investors in foreign jurisdictions. Crucially, it is a system in which dispute settlement awards are enforced by national legislation and judiciaries, as stipulated through international agreements such at the New York and the Washington Conventions.

The central argument of this essay is that hard times have stimulated the development and spread of this regime, and economic stress in developing countries has contributed to its emerging rules, practices and institutions. The evidence suggests that a significant number of developing countries committed themselves to the bilateral architecture of the global regime to protect foreign direct investment under economically stressful conditions. The ratification of a growing number of bilateral investment treaties was a gamble to attract capital and to improve the prospects for growth and development. In some cases, the gamble has paid dividends, but on average the outcome has been disappointing. Moreover, ratifying formal treaties to protect foreign investors has encouraged a spurt of costly international arbitration. Of course, not every disgruntled investor sues in every case of an investment undermined by official “takings,” but a growing number of claims of investors against governments have been registered with the International Center for the Settlement of Investment Disputes (ICSID), over the past decade.

For many governments the dream of attracting capital has dissolved into an ugly reality of litigation.

Hard times have intensified this harsh reality. As I will show, troubled economies are a good predictor of disgruntled foreign investors. This is because hard times sometimes encourage or even constrain governments to take policy actions that may alter the value of assets of foreign investors. These policy actions have their roots in domestic political considerations, at least in the more democratic polities. As economic conditions deteriorate, the probability that a foreign investor will file a suit with ICSID claiming the impact of government regulation or contractual breach had a negative impact on the value of their investment increases as well. One consequence is that rules are being elaborated through international arbitration that address the fair and just treatment of foreign investors. But critical voices are increasingly expressing reservations about the substance of these new rules as well as the process through which they are being elaborated. Hard times have stimulated a hard look at the way in which international rules are developed, interpreted and promulgated. This essay describes some aspects of this process and predicts that some changes are in the offing. The decentralized system has a good deal of built-in resilience. Major actors – the United States Government for example – themselves have incentives to address the legitimacy issues before they erupt in a truly damaging way.

This essay proceeds as follows. The first section will provide some basic background on the system of rules and practices developed to protect foreign investors and promote investment. The second section will make the case that the legal regime to protect investors was promulgated under stressful economic conditions, especially for developing countries. The third section will review the evidence that the gamble of attracting capital through a treaty commitment to protect foreign investors (if necessary, taking disputes to international arbitration) has paid off. It will also show that one of the most predictable consequences of committing to a BIT has not been a burst of new investment, but rather litigation, especially when economic conditions deteriorate. The fourth section will argue that dashed hopes and exploding litigation in the form of mixed investor-state arbitration has led to frustration and even backlash against the emerging system of rules. The final section will conclude on a somewhat optimistic note: there is already evidence

that actors with incentives to do so are "righting" the norms and practices of the regime so as to avoid calamity.

I. Background: The Rise of the Modern Treaty-based International Investment Regime

Foreign direct investment has always been subject to contractual and political hazards that raise the expected costs of investing.[1] The saga of how rules and practices have developed to address these risks is centuries old.[2] In the nineteenth century, governments sometimes chose to enforce property rights on behalf of their investors overseas through a mix of diplomatic pressure and coercion. "Extraterritorial courts" sometimes protected property rights in countries such as China and Turkey, which were too large to colonize but not "civilized" enough to consider sovereign.[3] The basic premise was reflected in customary international law of the time: no government was entitled to expropriate private property, for whatever purpose, without providing prompt, adequate, and effective payment.[4] Efforts to counter this norm developed – most famously in the form of the Calvo Doctrine, which emphasized that jurisdiction in the case of international investment disputes should reside with the courts of the host country – but if the majority of international law texts are any indication, the preferences of capital exporters trumped those of capital importers in the historical skirmish over the definition of "custom." Fair and effective compensation has come to be known as the customary international law standard.

A flurry of nationalizations by host governments flew in the face of this standard beginning in the 1950s. The nationalization of British oil assets by Iran in 1951, the expropriation of Liamco's concessions in Libya in 1955, and the nationalization of the Suez by

[1] Henisz 2000.
[2] For a discussion of the historical protection of foreign investment see Lipson 1985.
[3] Raustiala 2006.
[4] See Cordell Hull's note to the Mexican Minister of Foreign Affairs during 1938 dispute over land expropriations, reprinted in Green H. Hackworth, Digest of International Law v. 3, § 228 (1942). The Rule itself predates Cordell Hull's statement, and various statements of it can be found in decisions from the early part of the 20th century. See "Concerning the Factory at Chorzow" (Ger. v. Pol.), 1926-29 P.C.I.L. (ser. A), Nos. 7, 9, 17, 19; Norwegian Shipowners Claims Arbitration (U.S. v. Nor.) 1 Rep. Int'l Arb. Awards 307 (1922).

Egypt a year later gave notice of a growing militancy on the part of investment hosts. The nationalization of sugar interests by Cuba in the 1960s further undercut assumptions about the security of international investments.[5] Meanwhile, collective resistance to CIL in the United Nations was on the rise. In 1962 the UN General Assembly adopted the "Resolution on Permanent Sovereignty over Natural Resources" which provided for merely "appropriate" compensation in the event of expropriation. Several more United Nations resolutions followed in the 1970s,[6] along with a string of under-compensated expropriations around the world.[7]

The governments of capital exporting countries began quietly at first to negotiate a series of agreements with potential host states to address any ambiguity in the law of investment protection. Germany and Switzerland – two countries without the baggage of recent empirical relationships – began the practice with a few states in South Asia and Africa. The first of many such agreements was concluded between Germany and Pakistan in 1959; Germany followed up with BITs in the Dominican Republic (1959), Malaysia (1960), and Tunisia (1961). Switzerland built legal beachheads with similar agreements in Tunisia (1961), Niger (1962) and Cote d'Ivoire (1962). A trickle of BITs in the 1970s was followed by an avalanche in the late 1980s and especially the 1990s.

BITs were innovative in a number of respects.[8] The typical BIT offered a wider array of substantive protections than did the customary rule. For example, BITs typically require national

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[5] Guzman 1998.

[6] These are discussed in Lipson 1985. In 1966 the General Assembly reaffirmed states' rights to nationalize resources without reference to international legal principles. In 1972 the general Assembly passed Resolution 3041 (XXVII), which contained an endorsement of the Trade and Development Board's resolution 88 (XII) of October 19, 1972 regarding permanent sovereignty over natural resources, and claimed that compensation of natural resource nationalization cases was to be fixed by the nationalizing state with jurisdiction for such cases falling within the sole jurisdiction of the nationalizing country's courts. The 1973 Resolution on Permanent Sovereignty over Natural Resources (Resolution 3171) stated that in the event of nationalization, "each State is entitled to determine the amount of possible compensation and the mode of payment." The Charter of Economic Rights and Duties of States (GA Res. 3281(xxix), UN GAOR, 29th Sess., Supp. No. 31 (1974) 50) which specified the right of each state "To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent" with national courts taking jurisdiction in case of disputes (Art. 2(c)).

[7] See Kobrin 1980.

[8] Other mechanisms have been used to try to protect foreign investment, of course. One possibility since 1988 is to apply for insurance through the World Bank's Multilateral Insurance Guarantee Agency (MIGA). MIGA covers

treatment and most-favored-nation treatment of foreign investments in the host country.[9] They usually protect contractual rights,[10] guarantee the right to transfer profits in hard currency to the home country, and prohibit or restrict the use of performance requirements.[11] Finally, and perhaps most importantly, BITs provide for international arbitration of disputes between the *investor* and the host country,[12] typically by applying the rules of the International Center for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL). Giving investors a right to sue states directly before an international tribunal represented a real paradigm shift from the prevailing custom. The state-to-state system of dispute settlement on which CIL was premised[13] was replaced by a system in which investors could seek compensation for losses due to host government actions *without the support or even the approval of their home governments*. If there is anything "revolutionary" about the international law of investment as reflected in BITs, it is the *private right* to sue a government for damages in an international tribunal.[14]

Judged by their spread, BITs have been spectacularly successful. Today there are some 2600 or so known bilateral agreements governing foreign investment in every region of the world, and a growing number of free trade agreements that include analogous investment provisions as well.[15] These treaties represent important incursions into state control over economic activities within their borders. So one real puzzle is why this form of interstate

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risks associated with transfer restriction, expropriation, breach of contract, and risks relating to war and civil disturbances. See http://www.miga.org/. US businesses can also insure against risks associated with currency inconvertibility, expropriation, and political violence by applying for investment insurance from the Overseas Private Investment Corporation (OPIC), a U.S. government agency. See http://www.opic.gov/Insurance/.

[9] E.g., The 1994 U.S. Prototype Bilateral Investment Treaty, Office of the Chief Counsel for International Commerce, U.S. Department of Commerce; Article 2(1), 2(2)(a). For convenience throughout this article we label the more developed partner in a BIT the "home" country (meaning the home of investors) and the less developed partner the "host." The treaty obligations bind both parties, but in the vast majority of treaties there is a developed country that will be the source of most FDI and a developing country that will be the recipient.

[10] E.g., 1994 U.S. Prototype BIT, Article I(d)(ii).

[11] E.g., 1994 U.S. Prototype BIT, Article V(1-2).

[12] E.g., 1994 U.S. Prototype BIT, Article IX.

[13] Schill 2010: 34-36. See, for example, the Serbian Loans case: Payment of Various Serbian Loans.

[14] On the notion that this represents a revolutionary shift in the legal regime for investor protection internationally, see Schill 2010 P. 30.

[15] NAFTA Ch. 11.

agreement has apparently been so seductive. One view is simply that these agreements are Pareto improving: they benefit investors, home and host states substantially, though not necessarily in equal measure. In this view, BITs are credible commitments host states make to treat foreign investment fairly. They are credible because the decision as to what is fair and whether and how much compensation is to be paid is in the hands of a neutral third party, rather than the host country's courts. The bargain, simply put, is an exchange of the host's sovereign control over important aspects of economic and regulatory policy (as well as juridical sovereignty in the event of a dispute) for more incoming investment. This seemed like a Pareto improving bargain, especially given the growing shift in development ideas away from socialist and statist models and toward neo-liberal models of economic development that privilege market actors and reduce the scope for state interference in the economy.[16] Whether this bargain has paid the expected dividends will be discussed below. In the following section, I argue that the spread of BITs was likely far more stressful than these benign interpretations suggest.

II. High Stakes, Tough Competition, and Hard Times: Understanding the Context of BIT Ratification

Few studies have seriously examined the conditions under which governments committed themselves to the system of treaties that give broad and asymmetrical rights to private foreign investors. Why did states often accept to (1) broaden significantly substantive investor rights compared to the prevailing CIL; (2) give investors a new right to international arbitration, circumventing both national courts of the host and the diplomatic sponsorship of the home country; and (3) agree to both of the above *asymmetrically*, concurring that it is the investor and not the host state that has a right to pursue damages when "legitimate expectations" are dashed? In short, it is important to understand, in Andrew Guzman's words at the height of the BITs signing frenzy of the 1990s, "why LDCs sign treaties that hurt them."[17]

[16] Jason Yackee, for example, has noted that a large proportion of the treaties signed in the 1990s involve countries that had recently transitioned from communist to capitalist economic (dis)organization. Yackee 2005-2006.

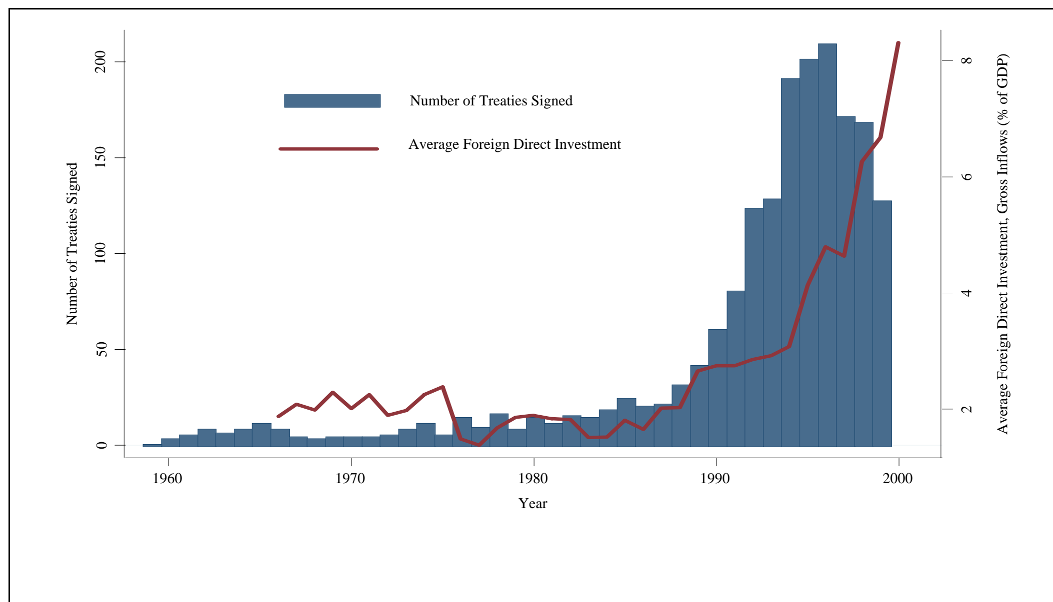
[17] Guzman 1998.

High Stakes

BITs have been ratified under conditions far short of traditional coercion, but nonetheless under considerable stress. BITs proliferated largely in response to a boom in available foreign direct investment world wide. The late 1980s and first half of the 1990s was a time of astronomical growth in the flow of foreign direct investment globally. Figure 1 demonstrates the relationship between world wide FDI flows and the accumulation of new BITs. As the pool of available global FDI increased, BITs ratification followed. The evidence suggests that governments were motivated to sign BITs in order to more successfully chase after a slice of a growing global FDI pie. Statistical work by Elkins, Guzman and Simmons confirms that ratification of a new BIT through the 1990s was positively associated with growth in world FDI flows in the previous period.[18] The higher the potential payoff – the larger the pie – the more willing governments become to sell off certain aspects of their economic and juridical sovereignty.

Figure 1:

Number of Bilateral Investment Treaties Signed and Mean Global Foreign Direct Investment as a proportion of GDP, by year (1959-1999)



[18] Elkins, et al. 2006.

Tough Competition

The sense that there was more and more at stake fed into the second motivation for host countries to ratify BITs: competition for international capital. BITs were designed to attract capital, but from where? One possibility was *diversion*: capital could potentially be wooed away from other investment venues in which governments refused to provide investors the advantages contained in BITs. Of course, the Sudan is not likely to draw Japanese capital away from Tennessee, whether Sudan signs a BIT or not. Rather, it competes for investment with the likes of Chad. Elkins et. al. found that controlling for a broad range of other factors, developing countries were far more willing to sign a BIT with a richer country if close competitors – those with similar infrastructures, similarly skilled work forces, and comparable export profiles – had done so.[19] A dynamic of competition has the potential to encourage countries to sign treaties on terms that they otherwise might not have done.

Hard Times

Finally, the economics and politics of hard times may have contributed to the turn to BITs. Figure 2 illustrates the temporal relationship between the rate of growth globally and the cumulative number of treaties signed. It shows that the *beginning* of the global diffusion of BITs coincided with the economic downturn of the late 1980s and early 1990s. (Five year moving averages are used in this illustration both to smooth the growth curve and also to account for the fact that BITs can take years to negotiate.)

[19] Elkins, et al. 2006

Figure 2:

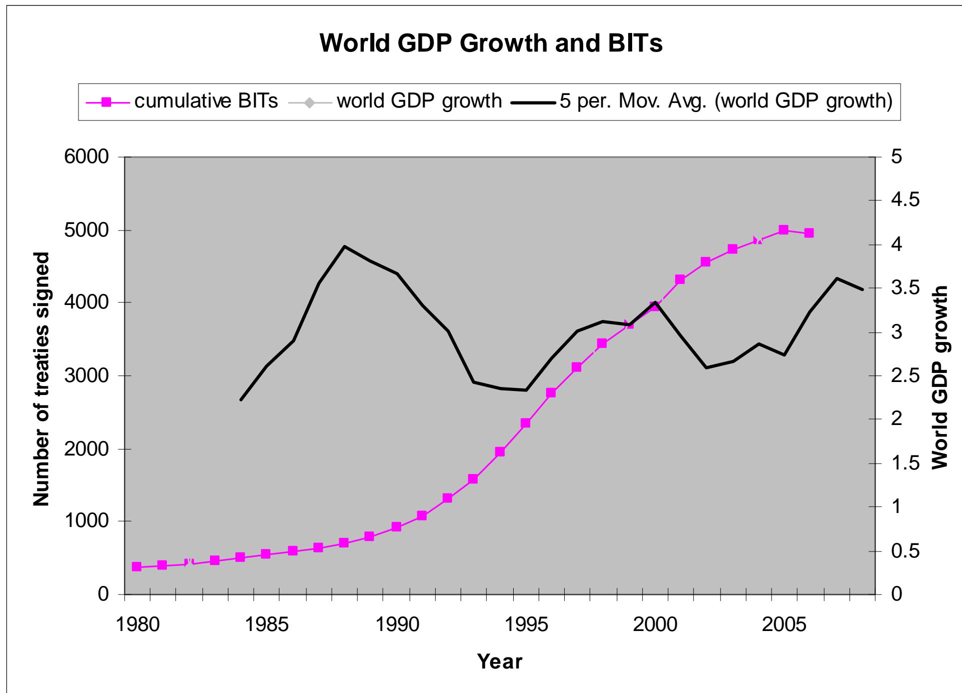


Figure 3 displays growth rates specific to each country in the years surrounding a BIT signing (defined as a year in which *any* BIT was signed). It demonstrates that growth rates are significantly lower in the three years preceding the signing of an agreement than they are in the same years for countries who have not signed. The difference in growth rates post-signing, while appearing slightly higher for BITs signers, is not statistically distinguishable from zero. Figure 4 takes an even more detailed look at BIT signing episodes, by looking only at "BIT sprees," defined here as any year in which 5 or more BITs were concluded. One might expect that these were years in which a country was especially eager (possibly desperate) to strike a bargain with foreign investors. Growth rates preceding BIT sprees seem to bear this out. The difference in growth rates in the three years preceding such sprees is even worse than when states sign any BIT at all. Desperate times require more desperate measures, this graph would suggest.

Figure 3:

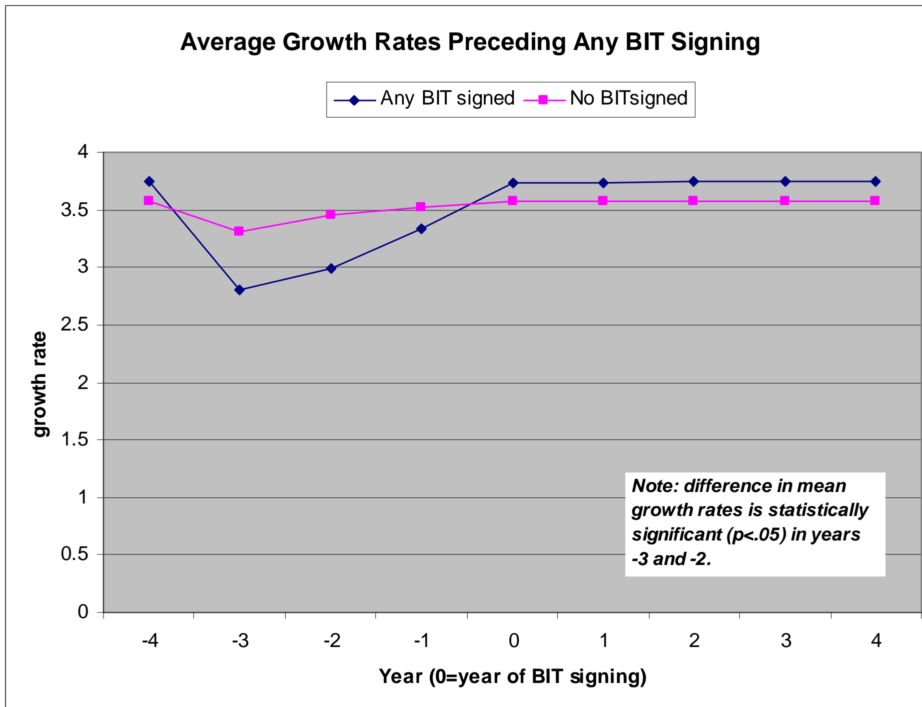
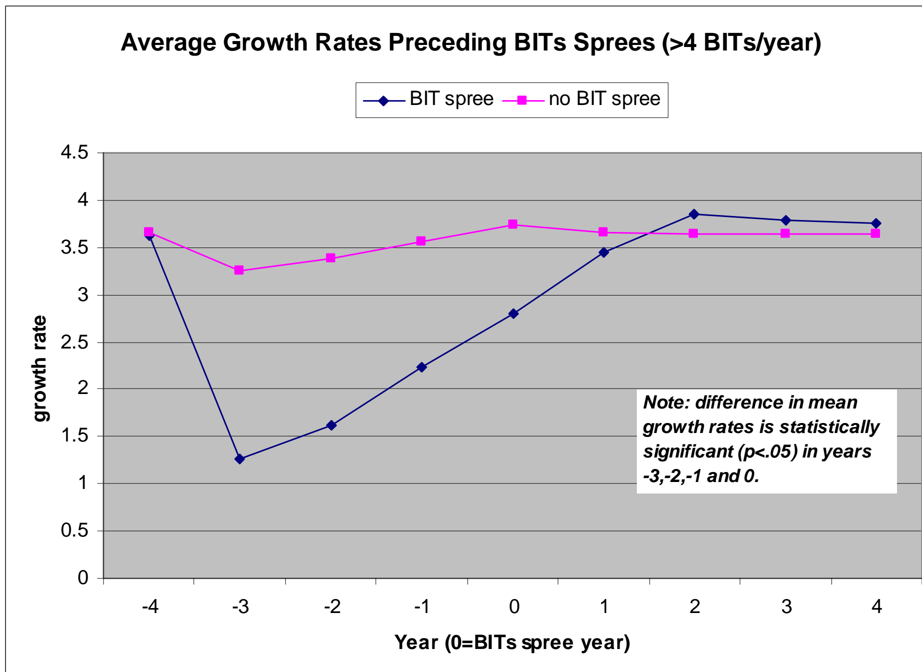


Figure 4:



More generally, Elkins et. al. found in a well controlled model of BIT signings, that the more positive a developing country's GDP growth, the *less* likely it was to ratify a bilateral investment treaty with another country, if it had not done so already.[20] Every percentage point change in growth in the potential host reduced the likelihood that a given country pair would conclude a bilateral investment agreement by about 3 percentage points. To put that finding in perspective, the more than 11 per cent drop in Czechoslovakia's growth rate between 1990 and 1991 (as reported in the World Bank's *World Development Indicators)* would correspond with a 33% increase in their eagerness to conclude a BIT. (The Czechs in fact concluded 8 BITs in 1991 and were up to 28 by 1993, while still hovering around zero growth.) On the other hand, Botswana, which averaged nearly 7% growth from the mid 1990s to the mid 2000s were, according to these finds, about 21% less likely to ratify a BIT each year than they otherwise would have been. By 2006, Botswana had in fact concluded only 8 bilateral investment treaties. There is some reason to believe that hard economic times lead to difficult concessions that governments might otherwise prefer not to have to make.

If BITs are in fact negotiated and concluded under stressful conditions, then we might expect that the more unfavorable the conditions, the more significant the concessions governments are willing to make in order to conclude a treaty. Hard economic times in the potential host country may increase political demands to "do something – anything!" to improve local economic conditions. Moreover hard times increase the impatience of the potential host country for a deal with the prospects of attracting capital. Hard times lower time horizons, making a government more willing to accept the trade off of sovereignty for the ability to attract economic activity in hopes of stimulating the economy.

New data on the contents of BIT provisions for dispute settlements collected and coded by Todd Allee and Clint Peinhardt make it possible to test this proposition. In a recent study, they show that the greater the difference in economic size between BIT partners, the more likely

[20] Elkins, et al. 2006.

the final agreement is to have more stringent provisions for dispute settlement.[21] Size asymmetries as measured by differences in GDP, they show, are correlated with clauses that refer disputes to settlement through the International Center for the Settlement of Investment Disputes – a process that removes the dispute from local courts and hands it over to an international arbitral board chosen (in the first instance) by the parties themselves.[22] They conclude that bargaining power has a significant impact on the *contents* of BITs, a proposition that studies of BIT counts and signing patterns have overlooked.

The logic I have sketched above suggests that the *contents* of BITs should also reflect the plight of would-be host governments in economic hard times. Simply stated: developing countries in dire economic conditions make concessions of their sovereignty in these agreements that they otherwise would prefer not to make. Allee's and Peinhardt's data are useful in testing this proposition. They have coded the dispute settlement clauses contained in 1,473 BITs for which they could find the texts, including some unavailable in English which they have translated.[23]

Allee and Peinhardt have coded several possibilities with respect to BITs' dispute settlement provisions. First, was ICSID mentioned at all as an option for international arbitration between an investor and a contracting party? Is it the *sole* option mentioned in the treaty? Second, is UNCITRAL mentioned as an option? From this information we can infer whether *neither* of the two major institutions for international arbitration is mentioned in the treaty. Of course their absence from a treaty does not preclude the use of these institutions by the parties to a dispute, in that case there would be no international obligation to use these means. Allee and Peinhardt have also coded whether there is any explicit mention of investors' ability to choose a *local* tribunal or court to settle a dispute. Since foreign states cannot generally be sued in the national courts of other states, such references typically refer to the use of courts in the host

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[21] Allee and Peinhardt 2010.

[22] If the parties can not agree on arbitrators, the ICSID secretariat is empowered to select arbitrators.

[23] Despite their exhaustive efforts, these may still be a biased sample of all BITs. BIT texts that are difficult to locate are much more likely to be concluded between less democratic countries. The more democratic the BITs partners, the more likely they are to make their treaty texts publicly available.

country to decide on the merits of an investor's complaint against the state. They have also coded treaties as to whether a local remedy for dispute settlement required to be fully pursued before submission to international arbitration, and whether or not the treaty contains an explicit statement to the effect that the parties are consenting in advance to international arbitration.[24]

If governments make more concessions to investors in their BITs during hard times, we would expect the tilt to be in favor of international arbitration and away from local remedies as economic conditions in the host country deteriorate. Table 1 displays results that are very suggestive in this regard. It displays the results of a probit model that assesses the probability that a particular provision, as described above, is contained in the dispute settlement clause of the treaty. Specifically, we are testing the hypothesis that hard economic times in the potential host country in the three years leading up to the conclusion of a BIT makes it much more likely that a potential host will have made more explicit concessions to the home country (and thereby to investors that are nationals of that country) that disputes will bypass local institutions and go to international arbitration. As above, "hard times" are measured by the average change in GDP growth in the previous three years.

[24] Allee and Peinhardt found that delegation to ICSID (as compared to a choice of other forums or no delegation at all) was more likely the larger the disparity in size between the two parties' economies. They also found that ICSID provisions were more likely when the less developed partner was a recipient of development aid – suggestive of a dependent relationship on capital-exporting states. Allee and Peinhardt 2010.

Table 1:
Dispute Settlement Clauses Contained in BITs
Dependent variable: presence or absence of a particular kind of clause (Allee and Peinhardt, 2010)
Probit coefficients (probability)

Table 1 (Models 1-3)

	MODEL 1: ICSID provision		**MODEL 2: UNCITRAL provision**		***MODEL 3: Neither* ICSID *nor* UNCITRAL**	
Growth past	-0.005	0.007	-.021***	-.021***	.027**	0.01
3-yr average (host)	(p=.422)	(p=.295)	(p=.003)	(p=.004)	(p=.012)	(p=.127)
Joint democracy	.038*** (p=.000)	.031*** (p=.000)	0.011 (p=.112)	0.01 (p=.177)	-.034 *** (p=.000)	-.024*** (p=.000)
Difference in develop-mental level	0.096 (p=.102)	.112* (p=.071)	-0.054 (p=.427)	0.025 (p=.704)	-0.078 (p=.261)	-0.124 (p=.106)
Year	.061*** (p=.000)	.059*** (p=.000)	.093*** (p=.000)	.092*** (p=.000)	-.061*** (p=.000)	-.060*** (p=.006)
US	--	.892*** (p=.000)	--	.575*** (p=.0000)	--	-.480*** (p=.000)
UK	--	0.121 (p=.238)	--	-0.114 (p=.434)	--	-.973*** (p=.000)
Germany	--	-.187* (p=.057)	--	-1.61*** (p=.000)	--	.483*** (p=…)
Switzerland	--	-.453*** (p=.000)	--	-0.118 (p=.395)	--	.560*** (p=.000)
France	--	-0.14 (p=.108)	--	-.860*** (p=.000)	--	.376*** (p=.001)
Netherlands	--	-.210*** (p=.008)	--	-.686*** (p=.000)	--	.563*** (p=.000)
China	--	-1.16*** (p=.000)	--	-.549* (p=.0730)	--	1.33*** (p=.000)
constant	-121.*** (p=.000)	-117.*** (p=.000)	-184.*** (p=.000)	-184.*** (p=.000)	121.2*** (p=.000)	119.2*** (p=.001)
# observ'ns	1213	1213	1213	1213	1213	1213
Pseudo R^2	0.12	0.172	0.091	0.149	0.135	0.228

Table 1 (Models 4-6)

	MODEL 4: Local body provision		MODEL 5: Exhaust local remedies		MODEL 6: Preconsent to arbitrate explicit	
Growth past	.024***	.019***	.028**	0.016	0.005	0.011
3-yr average (host)	(p=.000)	(p=.001)	(p=.028)	(p=.160)	(p=.473)	(p=.149)
Joint democracy	-0.005 (p=.315)	0.007 (p=.303)	-0.007 (p=.477)	0.003 (p=.778)	.018*** (p=.007)	.013* (p=.095)
Difference in develop-mental level	-.283*** (p=.000)	-.179*** (p=.001)	-.203** (p=.015)	-.236*** (p=.007)	0.052 (p=.473)	0.035 (p=.631)
Year	.050*** (p=.001)	.053*** (p=.001)	-.037* (p=.098)	-0.037 (p=.127)	0.01 (p=.479)	0.009 (p=.434)
US	--	-0.02 (p=.896)	--	-0.273 (p=.160)	--	1.46*** (p=.000)
UK	--	-0.184 (p=.237)	--	--	--	.339* (p=.071)
Germany	--	-1.46*** (p=.000)	--	--	--	-0.277 (p=.112)
Switzerland	--	-1.12*** (p=.000)	--	--	--	-0.088 (p=.597)
France	--	-1.5*** (p=.000)	--	.393*** (p=.007)	--	-1.04*** (p=.000)
Netherlands	--	-.906*** (p=.000)	--	0.123 (p=.336)	--	.452*** (p=.006)
China	--	1.18*** (p=.000)	--	.824*** (p=.007)	--	-.714*** (p=.004)
constant	-99.3*** (p=.001)	-104*** (p=.002)	71.37 (p=.107)	72.01 (p=.138)	-19.59 (p=.469)	-19.13 (p=.425)
# observ'ns	1204	1204	1205	1205	1205	1205
Pseudo R^2	0.082	0.195	0.053	0.09	0.014	0.073

The results are quite striking: in almost every case, the stronger the economic growth in the less developed BIT partner, the stronger the domestic provisions and the weaker the international provisions contained in the dispute settlement section of a BIT. The lone exception is a provision to use ICSID for dispute settlement, which has no consistent relationship with the developing country's business cycle (Model 1). On the other hand, strong economic growth in the less developed partner is strongly and consistently correlated with a much lower likelihood that the signed BIT will contain a provision to use UNCITRAL rules should a dispute erupt

(Model 2). Treaties that contain neither a reference to ICSID nor to UNCITRAL rules (Model 3) are also convincingly correlated with positive growth in the less developed partner (but there are very few of these). Conversely, the harder the times in the developing country, the less likely they will be able to negotiate a treaty without any references to one or more of these dispute settlement institutions/rules. "Preconsent clauses" – general but explicit statements that commit the parties in advance to arbitrate a dispute – may be mildly associated with stronger developing country growth rates during the negotiation phase (Model 6), but the result is not statistically significant in either version of the model.

To get a substantive sense of the effect of the business cycle on the probability of negotiating an agreement without any ICSID or UNCITRAL clause, imagine two states, a high growth state and a low growth state at two different points in time, 1985 and 2000. The results in Table 1 work out to a probability that a high growth (+10% per annum) developing country in 1985 stood about a 31% chance of signing a BIT without any references to ICSID or to UNCITRAL. A low growth country suffering a -10% growth rate for the three years leading to the signing of a BIT had only about a 15% chance of that outcome. Over time, however, fewer states in any economic situation were able to secure such clauses. By 2000, a country with 10% growth had only about a 7% chance of negotiating a BIT without such a clause. But a country with -10% had only a miniscule chance (less than 2%) of achieving this result, controlling for all factors in Model 3a.

Models 4 and 5 test for the determinants of including more "local" solutions to dispute settlement sections of treaties. The likelihood that a BIT will contain some reference to the investor's ability to choose a local tribunal or court is positively associated with growth in the less developed BIT partner (Model 4). A provision that an investor must exhaust local remedies is also positively associated with the developing country's business cycle (Model 5). Taken together, these results support the general tendency for developing countries with strong positive growth to maintain somewhat greater national control over how investment disputes will be settled. Downturns in the business cycle, by contrast, are fairly consistently associated with much greater delegation to international tribunals in the event of a dispute. Figures 5 a-c

illustrate the substantive impact of the business cycle, when a potential host experiences 10% growth versus -10% growth, holding other conditions constant (i.e., at their means).

Figure 5a:

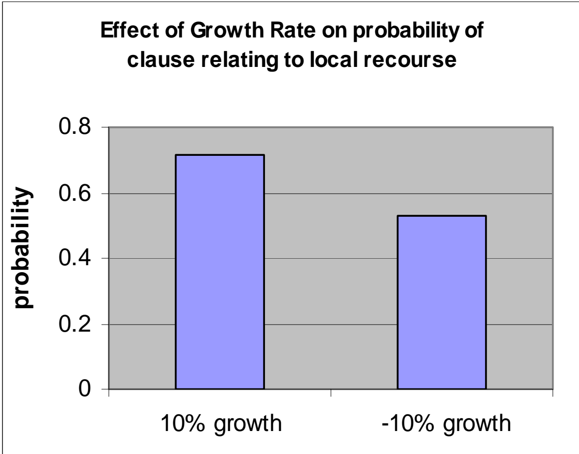


Figure 5b:

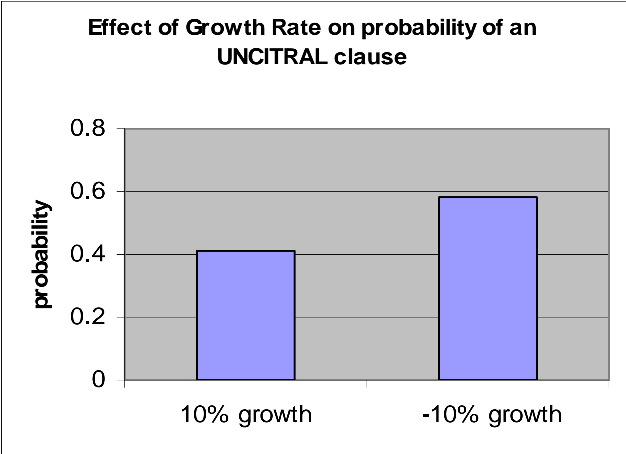
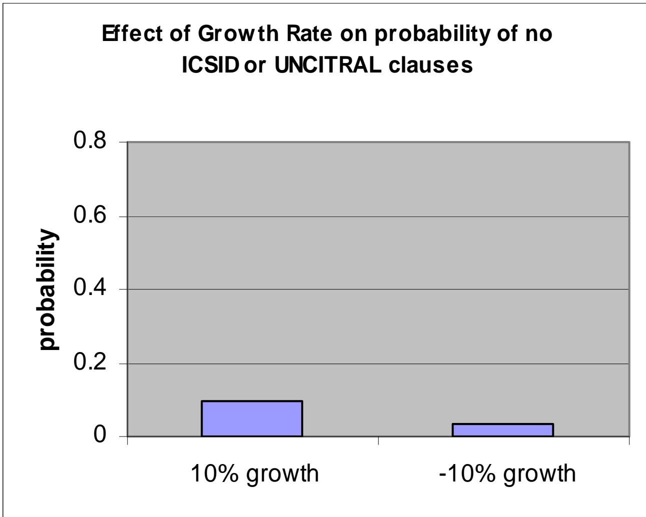


Figure 5c:



Hard times are associated with harder terms for host countries, even when we control for several other conditions. More democratic countries tend to negotiate agreements with ICSID clauses, and avoid concluding treaties that contain neither ICSID nor UNCITRAL provisions.

They are also much more likely, according to these results, to agree to treaties that contain explicit clauses that pre-commit them to arbitration in the event of a dispute. Somewhat surprisingly, democracies do not tend to insist on local remedies (Models 4 and 5). Consistent with studies on other areas of international law,[25] democracies tend to delegate authority with greater regularity to international institutions than do non-democratic states.

The impact of the business cycle on dispute settlement provisions is important, even when we control for differences in the developmental level of the two BIT partners. A bargaining framework might lead one to suspect that the greater the difference between partners, the greater the tendency for BITs to reflect greater international delegation for the settlement of disputes. The evidence in Table 1 is consistent with that hypothesis. There is a slight tendency for greater delegation to ICSID (Model 1), and a fairly convincing reduction in local provisions (Models 4 and 5) the greater the difference between treaty partners. In this case "developmental difference" is defined as the difference in World Bank categories: high income (1), high-middle income (2), low-middle (3) and low income (4). Taking the absolute value of the difference, this measure ranges from 0 when countries are from the same category to 3 when one is from each of the extremes.

There are also clear trends in the type of dispute settlement provisions contained in BITs over time, and this is reflected in the "year" variable included in each model. A positive coefficient indicates the provision type is becoming more common over time; a negative coefficient means the provision type is becoming less common in newer BITs. The results below clearly document the increased movement towards international arbitration in these treaties, and a move away from local provisions.

Finally, it looks like capital exporting countries have clear preferences over the kind of dispute settlement provision they prefer to include in their BITs. Each model is therefore run with country dummies representing the major capital exporters. The United States favors ICSID and is also likely to negotiate treaties with UNCITRAL provisions, and eschews agreements that contain neither. The UK's patterns are far less consistent, but they avoid treaties that contain

[25] Simmons 2008.

neither ICSID nor UNCITRAL provisions, and tend to like pre-commitment clauses. The continental civil law capital exporting countries have a different treaty pattern. They are less likely to conclude treaties referring to ICSID and UNCITRAL, but also are less likely to refer to the possibility of domestic courts or tribunals to settle disputes. France appears more likely to negotiate treaties that require an exhaustion of local remedies, but it is not possible to estimate a similar coefficient for the UK, Germany or Switzerland. None are especially more likely than are othercountries to include a general pre-commitment to arbitrate clause in their BITs. The results for China are strong and consistent across the board: they have been less willing than other countries to delegate explicitly to either ICSID or UNCITRAL, more likely to conclude treaties that make no reference to either of the above, more likely to include localist provisions, and less likely to negotiate pre-consent agreements in their BITs. China's preferences would appear to be closer to those of a capital importing country than a capital exporting county, even when we control for changes in dispute resolution provisions over time.

III. The Consequences of Ratification: Field of Dreams or Litigation Nightmare?

The evidence discussed so far suggests that BITs have generally been negotiated and signed under fairly stressful economic conditions, especially for developing countries. They have spread in the wake of the burgeoning of the availability of foreign direct investment globally, suggesting that as the stakes have increased, pressure has mounted to secure a slice of a growing pie. They have been subject to competitive pressures among developing countries, which apparently negotiate BITs in response to treaties signed by their closest international competitors. They tend to be signed in hard times: the three years preceding the signing of a BIT tend to be business cycle troughs compared to years in which such treaties are not signed. The trough is even deeper when we consider the years preceding a "BIT spree." And finally, there is some evidence that the worse the business cycle in the lesser developed country of a BIT pair, the more willing that country is to make more concessions in dispute settlement clauses that favor foreign investors. *Provisionally*: to some extent, the regime for the protection of international capital seems to have been driven by hard times in poorer countries.

These concessions may be the consequences of a weak bargaining position, but they ultimately could be to the benefit of developing countries, if indeed they attract capital and contribute to growth. The sacrifice of some degree of sovereignty is nothing new in order to achieve the joint welfare gains of increased foreign investment.

Whether bilateral investment treaties have had their intended consequence of protecting and attracting capital is much debated.[26] Early studies of their consequences were able to document very little increased FDI in response to the ratification of BITs. Some of these studies were initially quite limited in their geographic scope. One study of fifteen developing countries of South, East and South East Asia for the period 1980-2000 found that BIT agreements did help to attract capital from developed to developing countries.[27] As studies began to expand to include all regions of the globe, their conclusions have been far more conditional. An early study sponsored by the World Bank found BITs seem to increase foreign investment in countries that already have fairly good domestic institutions in place, undermining the possibility that BITs alone could be the "quick fix" for weak domestic institutions that the credible commitments argument supposed.[28] Later studies confirmed this fairly pessimistic finding that BITs are hardly game changers when it comes to foreigners' perceptions of risk and their investment decisions, especially in low- and middle-income countries.[29] On the other hand, a study by Eggera and Pfaffermayr concentrating on outward flows of bilateral FDI from the OECD countries was able to detect a jump in investment that coincides with the ratification (though not the mere signing) of a bilateral investment treaty between two countries of between 15 and 30%.[30] Neumayer and Spess have argued that the cumulative number of BITs racked up by a country positively impacts investment.[31] Andrew Kerner has argued that once one controls for the endogeneity of ratifying

[26] A good source to come up to date on the empirical studies that examine the effects of BITs on investment flows is Sauvant and Sachs 2009.
[27] Banga 2003.
[28] Hallward-Driemeier 2003: 21-22.
[29] Rose-Ackerman and Tobin 2005.
[30] Eggera and Pfaffermayr 2004.
[31] Neumayer and Spess 2004.

the BIT itself, that in fact they do attract significant capital inflows.[32] Still, BITs do not seem uniformly to attract foreign capital. A study by Gallagher and Birch found that Latin American countries had not benefited appreciably from their investment agreements with the United States– although there is somewhat more evidence that this region has used BITs successfully to attract capital from other parts of the world.[33]

None of these studies is very clear on exactly what (if anything) about a bilateral investment treaty attracts foreign capital. One possibility is that the liberalizing provisions are what matter the most – provisions for *facilitating the inflow* of capital. This comports with findings in the literature that BITs work best where there already is a pro-business working environment and domestic legal institutions in place. Another possibility is the ability of BITs to *protect* foreign investment from unfair or arbitrary treatment by host governments. The finding that BITs seem to work best where property rights are already fairly well protected seems to suggest that this is the less important of the two possibilities. Or, if they have effects at all, BITs might exert their attraction to foreign capital by protecting *certain types* of investments that had been only poorly protected prior to signing a specific BIT. According to a study by Schadlen, Schrank and Kurtz, property rights protections have improved in some countries that have ratified bilateral investment treaties with the United States.[34]

One consequence of ratifying bilateral investment treaties that contain dispute settlement provisions seems quite clear: they have led to a burst of (possibly unanticipated) litigation, especially since the late 1990s. Figures 6 a-c illustrate the relationship between the signing of BITs and the ensuing registration of new investment cases before the ICSID. With only three to five years' lag, the shape of the curves measuring the number of BITs world wide and the number of new cases registered each year with the ICSID are nearly identical (Figure 6a). Figures 6b and 6c illustrate the same relationship for Latin America and Argentina, respectively. These latter two graphs show the same precipitous climb, but also a fairly swift retreat from the peak of 2003.

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[32] Kerner 2009.
[33] Gallagher and Birch 2006.
[34] Shadlen, et al. 2005.

Figure 6a:

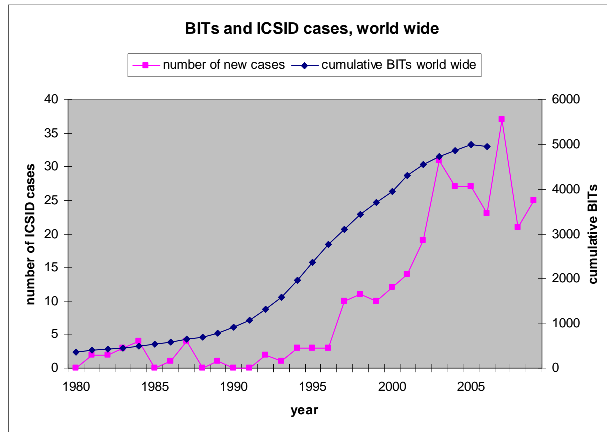


Figure 6b:

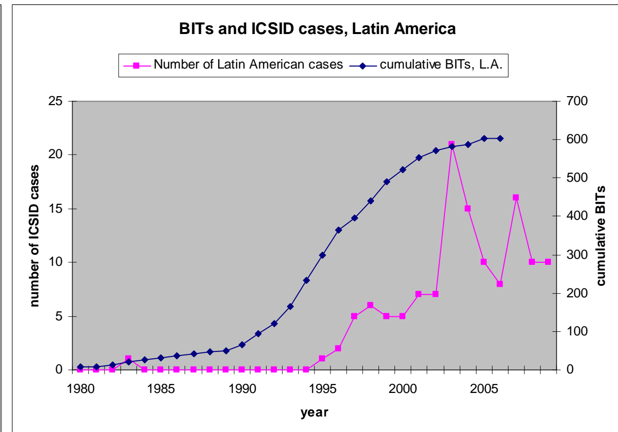
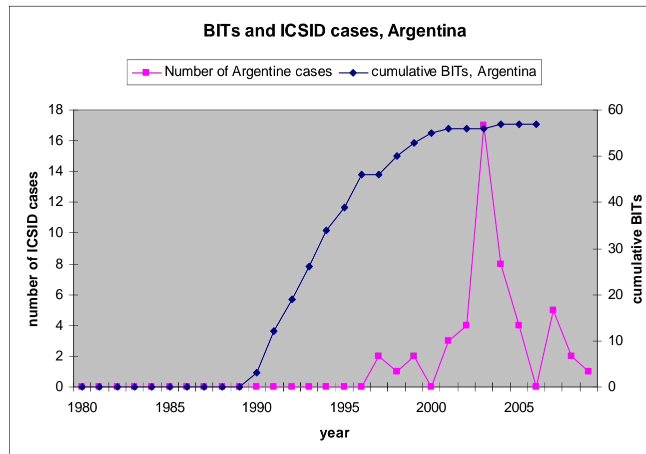


Figure 6c:



According to Neumayer and Spess, the most optimistic study available on the positive impact of BITs, "Moving from a low of zero BITs to the maximum of 23 BITs can raise the flow of FDI by up to 6.14 per cent in very high-risk countries." A simple model of the influence of BITs on arbitration suggests that each additional BIT significantly raises the risk of arbitration as well. Table 2 presents a simple model of the conditions associated with litigation (defined in this case as the registration of an investment dispute with the International Center for the Settlement of Investment Disputes). Three relationships are quite solid. First, arbitrations come in clusters: an arbitration in the previous year is a very strong predictor of an arbitration in any given year.

Whether this represents "piling on" among investors, or whether it represents the widespread consequences of a particular government's policies, litigation under the auspices of ICSID is characterized by a good deal of inertia. Second, the probability of a new case generally increases each year. This is a system with a lot of built-in momentum, at least for the years examined here (through 2006). Third, independent of time and piling on, the more bilateral investment treaties a country signs, the more likely it will be sued in this venue. "If you build (sign) it, they will come (litigate)."

It is also clear that macroeconomic conditions have a significant effect on litigation as well. However, once other variables are controlled, there is no relationship with growth in the two years leading up to the registration of the new complaint with ICSID. Instead, the conditions associated with the run up to arbitration are those that signal inflationary pressures, a deteriorating external position, and flagging investor confidence in government economic management *generally*. The higher the (log of) inflation two years prior, the greater the probability of arbitration. A country's deteriorating external position is signaled by reserve losses as a proportion of imports, the outflow of foreign direct investment, and a worsening capacity to service foreign debt. Although it is not quite statistically significant by traditional standards, a country's risk premium – the excess in government bond yields over the London Interbank Offer Rate, LIBOR – is also positively associated with increased litigation.

Table 2:
BITs in Hard Times: the Correlates of International Arbitration
Dependent Variable: Log of new arbitrations registered with ICSID, yearly
Results of a random-effects GLS regression
Coefficients (p-values based on robust standard errors clustered by country)

Explanatory Variables:	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Log of arbitration, (t-1)	.222*** (p=.000)	.202*** (p=.000)	.215*** (p=.001)	.224*** (p=.001)	.220*** (p=.000)	.143** (p=.025)
log of cumulative # of BITs	.096*** (p=.006)	.133*** (p=.000)	.255*** (p=.000)	.119** (p=.011)	.224*** (p=.000)	.098** (p=.026)
Year	.026*** (p=.000)	.029*** (p=.000)	.024*** (p=.001)	.030*** (p=.000)	.025*** (p=.000)	.023*** (p=.000)
Log GDP growth (t-2)	0.033 (p=.320)	--	--	--	--	--
Log inflation (t-2)	--	.067* (p=.055)	--	--	--	--
Log change in reserves (t-2)	--	--	-.088*** (p=.002)	--	--	--
FDI outflows (t-2)	--	--	--	-.004** (p=.027)	--	--
Change in foreign debt service/GDP (t-3)	--	--	--	--	-.009** (p=.047)	--
Change in risk premium (t-2)	--	--	--	--	--	0.002 (p=.124)
Overall R2	0.076	0.074	0.096	0.079	0.092	0.063
# of countries	172	162	118	155	130	102
Total # observ'ns	2691	2739	2065	2094	2037	1251

*= significant at .10 level
**=significant at .05 level
***= significant at .01 level

IV. Awards and Annulments: Legitimacy in Hard Times

The next step in this research project would be to explore the conditions under which litigants (usually but not always the responding government) decide to try to get an award annulled. Annulment is the only option – other than non-compliance – if a party does not like the decision of an ICSID tribunal. Decisions of the tribunals are final, not appealable, and binding. This is in obvious contrast with the way disputes are settled (among states) in the WTO: the appellate body can correct tribunal decisions, giving an unhappy litigant some satisfaction if the decision was a bad one, and also helping to provide some degree of uniformity to decisions made under WTO law.

The investment regime has no such mechanism. This is because it grows out of a *commercial* arbitration model, the results of which are typically held to be both binding and final. There are only a very narrow set of conditions which can be the basis for annulling an award of an ICSID tribunal, including a complete absence of proper reasoning or a finding that a tribunal had manifestly exceeded its powers.[35] An award is not supposed to be overturned just because the decision was "bad," or even "wrong." There is basically no way to correct the poor judgment of an ICSID tribunal.

And yet, there has been an explosion in the registration of cases seeking annulment of ICSID awards. Figure 7 gives a sense of the burgeoning number of annulment requests. Surprisingly, in 2008 there were more new registrations for annulment proceedings than there were awards on the merits in original cases.[36] Table 3 displays the countries responsible for these cases. Only one country in the high income category – the United Arab Emirates – has ever sought to annul an ICSID award. For the most part, annulments have been sought by middle income countries concentrated in Latin America. Argentina – a country that has certainly

[35] ICSID Convention, Article 52.

[36] That is, if we understand the award tally to exclude awards on the jurisdiction (tribunal decisions either accepting or declining to hear a case), as well as awards that are based solely on a settlement that the parties asked the tribunal to write up in the form of an award. These criteria limit awards to contentious cases based on the merits of particular cases. It is true that a few jurisdictional awards have been the subject of annulment proceedings, but they are only a handful of the cases. I also exclude any decisions of a panel that are not referred to on the ICSID website as "awards."

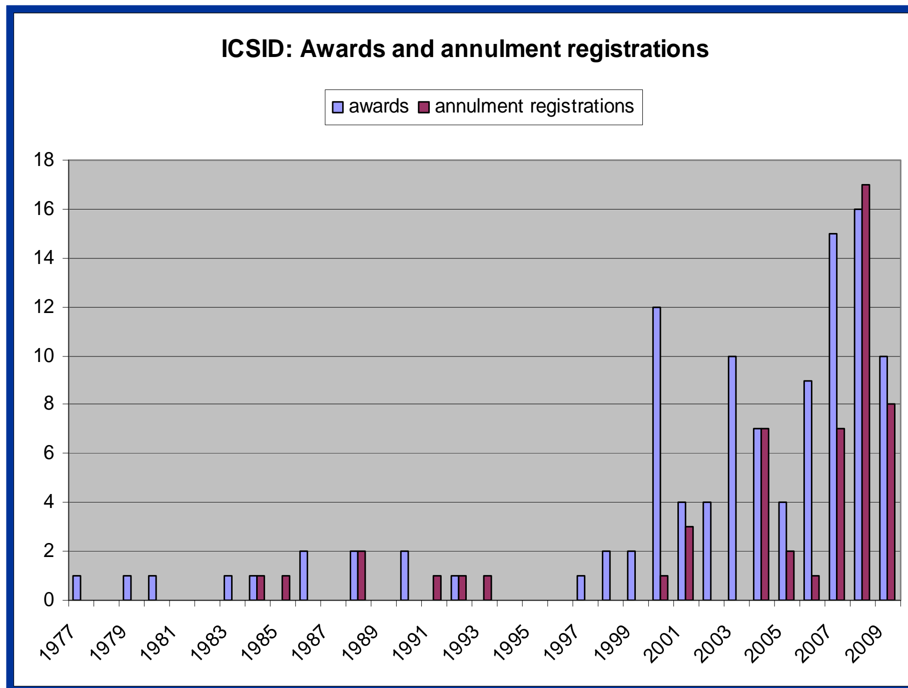
experienced its share of hard times in the last decade – alone accounts for about one-quarter of all annulment requests.

Table 3:
Countries involved in ICSID annulment cases

Argentina	8
Egypt	4
Chile	3
Ecuador	2
Malaysia	2
Peru	2
Cameroon	1
DRC	1
Gabon	1

Guinea	1
Guyana	1
Indonesia	1
Kazakhstan	1
Morocco	1
Philippines	1
Seychelles	1
United Arab Emirates	1

Figure 7:

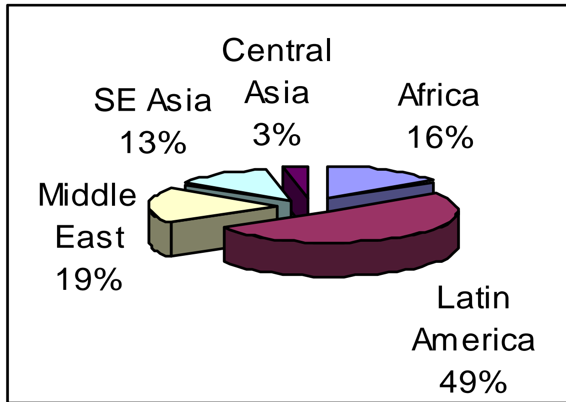


Why do these countries seek to have awards of duly constituted ICSID tribunals annulled? To be clear, the restrictive conditions on annulment make it almost impossible to succeed in this endeavor. Fewer than 10 per cent of annulment attempts actually succeed.[37] One possibility is that annulment proceedings are a symbolic action to express actors' (usually though not exclusively states') growing frustration with the regime. As David Caron has argued, annulment proceedings may be a very good metric of the perceived legitimacy of the regime.[38] They are a way for governments to signal that this award is not acceptable, and to make a principled argument as to why not. Governments usually choose to take this stand on awards that are of special significance to crucial sectors of their economies and their polities. About a quarter of the annulments sought relate to the provision of basic utilities – water, gas and electric power (Figure 8). This is a much higher percentage than prevails in the set of investment disputes that have been initiated through the ICSID.[39] Furthermore, these sectors have particular public significance. They impact the daily lives of thousands of people in a very real, ongoing way. These are the cases where governments have decided to take their stand for sovereignty over "policy space."

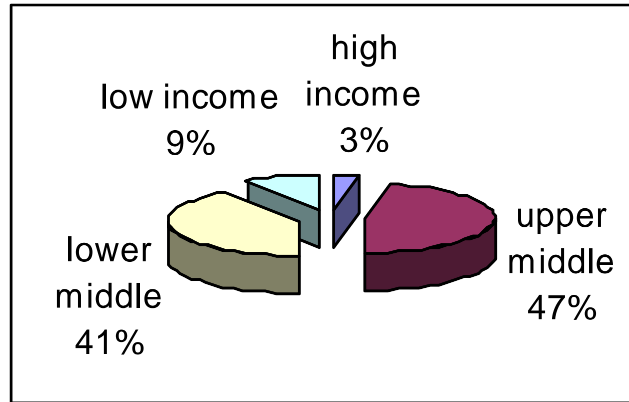
[37] Estimate.
[38] David Caron, "Investment Arbitration and the Distinction between Appeal and Annulment," Investment Law and Policy Speaker Series, Columbia University Law School, April 8th, 2010.
[39] To be confirmed.

Figure 8:
Annulments registrations by region, income level, and sector

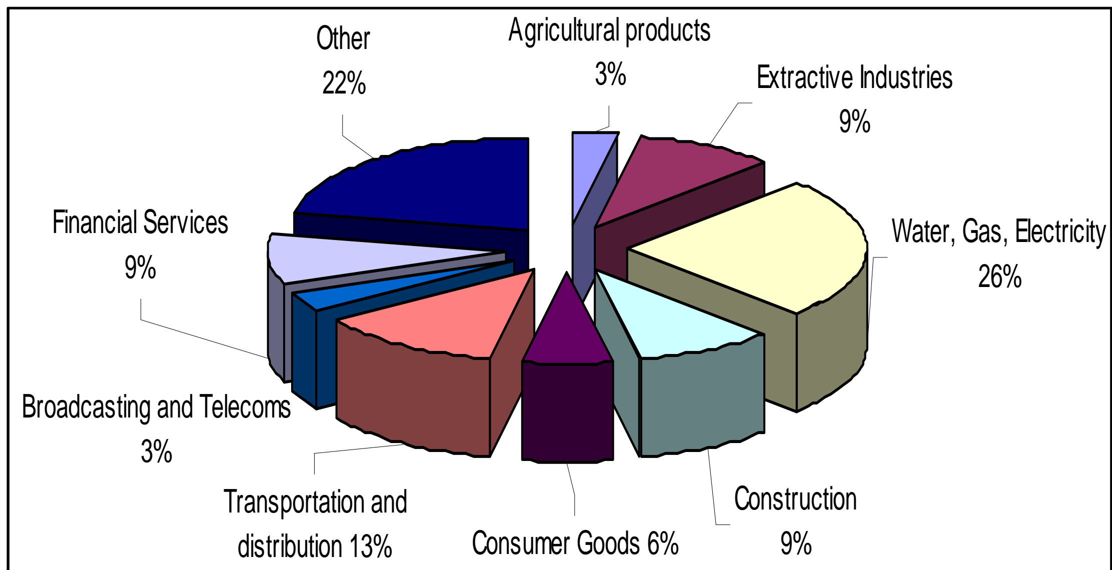
8a: by region:



8b: by income level:



8c: by sector:



One other trend is quite interesting with respect to annulments. There has been a sharp shift in the *type of regime* that has sought to annul the decisions of investment arbitration panels over time. In the 1980s and 1990s, these were mostly defiant autocracies that were loath to relinquish their interests in the name of law. But increasingly, the annulment seekers are highly democratic countries with clear lines of accountability to their domestic publics. In fact, if you

compare the registrations for annulment before and after 2008, it is stunning to realize that the polity score for all annulment seekers before 2008 was a paltry 2 (on a scale of 0 to10). Since 2008, three years of new annulments not only exceed the number for the entire history of the ICSID up to that time, but the polity scores of the governments seeking to turn back a decision of an ICSID tribunal jumped to 6 on the same scale. Increasingly, highly accountable, democratically elected governments are trying to overturn awards that are arguably closely connected to the broader public good – awards flowing from policies taken during highly constrained periods of significant economic downturn. If the investment regime cannot accommodate the legitimate policy space of democratic governments navigating hard times, it may prove quite brittle indeed.

V. Conclusions

Many of the key developments in the recent history of the international regime for foreign direct investment are the result of economic conditions and competitive dynamics that have systematically put capital importing countries in a weak bargaining position. That's international politics, you say, and of course you would be correct. But the very selling point of the modern regime for the protection of FDI has been its purported depoliticization. To depoliticize investment disputes was one of the main reasons for dropping the old system of diplomatic espousal and giving investors the right to the judgment of a neutral third party. The admittedly naïve idea that investment disputes could be depoliticized was one reason states were willing to accept the commercial law model for resolving disputes than a model more firmly anchored in public international law with its legacy of privileging state interests and sovereignty.

The bargaining context that has underwritten the development of the international regime for FDI has been underappreciated. Private actors – those with no other claim to the privilege other than their command of a big chunk of globally investable capital – have a right to demand compensation from governments for taking policies that they may judge are in the public interest, but that unexpectedly impact the value of investors' assets. The agreements that give rise to these claims promise investors access to an international tribunal and to the network of

national courts that have agreed under the Washington Convention to enforce arbitral awards in their jurisdictions. Investors select the timing, control the choice of venue, and set the agenda by developing particular legal arguments and avoiding others. BITs are symmetrical as between state parties, but they are utterly unidirectional in their allocation of rights as between private actors and public authorities. Only the former are protected by BITs. If a private contractor wants to renegotiate a contract with a government, the latter need not look through their dossier of BITs for legal succor; it won't be forthcoming. No other category of private individual – not traders who do not invest, not human beings in their capacity as human rights holders, not even national investors at home – are given such expansive rights in international law.

The dispute settlement mechanisms underlying this regime perform far more than that function; they are also engaged in law elaboration shading in to law development and creation. A generation of legal talent is poring over the decisions of a relatively small group of transnational arbitrators, trying to understand what the international law of FDI is. Treaties and the awards made by international tribunals provide all the authoritative guidance they will get. Although there is still a remarkable legal cacophony flowing from these tribunals, certain key decisions have created clear focal points and serve to guide future claims, defenses, and decisions. Law by litigation is or should be troubling in contexts where accountability and democratic governance are valued. This is especially so where the actions of increasingly democratic governments are being judged by arbitrators without the benefit of public participation or often even information, and without the possibility of appeal.

It is becoming clearer that this system is great for investors, but ill-suited to democratic governance, especially in hard times. As one commentator has written, BITs were consciously designed "to restrain host country action against the interests of investors—in other words, to enable the form of legal commitments made to investor[s] to resist the forces of change often demanded by the political and economic life in host countries."[40] It is obviously difficult to defend such arrangements when the population of restrained hosts has a legitimate mandate from its people to design regulations and take emergency measures in the public interest. More and

[40] Salacuse 2006.

more of the cases dealt with by ICSID panels are directly related to the difficulties democratic yet sometimes fragile regimes have had coping with various macroeconomic shocks. An increasing number of cases center on the sectors for which modern governments are most clearly required by their people to be held accountable: water, power, gas, and basic infrastructure. Hard times only make it even clearer that some serious effort to rethink the nature of the international regime for the protection of foreign direct investment is a must.

Some of the most troublesome aspects of the regime might have been avoided had a multilateral approach been politically possible a couple of decades ago. The failure of the Multilateral Agreement on Investment (MAI) led to this bilateral network of obligations that has fostered competition among potential hosts, with great consequences for the investor, but poor consequences for developing countries. Furthermore, the MAI's failure has meant that obligations toward investors have typically been assumed at the developing countries' more vulnerable moments – at a low ebb in their business cycle. When times get tough, many have found this is a bargain with which it is hard to live. Perhaps they will not have to. Having experienced a huge influx in foreign capital over the past several years, and even more importantly, having been on the respondent end of the arbitration system much more than anticipated (see Figure 8), the United States government has begun to plot out a more balanced approach to the protection of foreign direct investments.[41] The US model BIT of 2004 has many more state protections than did its predecessors. Discussions are currently underway to further re-equilibrate the US model to reflect the legitimate concerns of the world's public authorities.[42]

Among the changes that seem feasible, investing in hard times should encourage the following sorts of changes in the way FDI is protected. First, as there are hints of currently, investment treaties should be renegotiated to tone down some of the most asymmetrical aspects. They should also protect states by carving out clearer policy spaces in the public interest, and by

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[41] Experienced observers attribute the US change in heart to the scare associated with the possibility of losing in the Methanex case, involving environmental regulations in California. See for example Vagts 2010. (The US ended up winning that case, but it was eye-opening.)

[42] For an excellent discussion of the evolution of US thinking on BITs and major changes in the US model, see Alvarez and Weiler 2010.

extending the right to arbitration to the state *as claimant*. Second, in appreciation for macroeconomic pressures under which governments are often struggling, treaties should reflect the idea that contracts are to be interpreted flexibly. Greater play ought to be given to the importance of changed conditions in the performance of an international contractual or treaty obligation, just as is the case in domestic contracts. Third, even if there is little hope at the moment for a fully multilateral FDI regime, perhaps there is hope of a multilateral agreement to amend ICSID rules to provide for the possibility of appeal. This would not only address the crisis of legitimacy reflected in the explosion of annulment claims clogging the ICSID docket, it would also have the benefit of a quality check on tribunal decisions and the possibility of more coherent rule development (an issue that is important in the legal literature but does not flow from the critique I have spelled out above). Fourth, states should think about ways to alter their treaties that encourage investors to insure against risks rather than to litigate them. Contracts for water and gas that could not be honored at reasonable political cost during the 2000 economic crisis in several Latin American countries should have been insured by MIGA and/or OPIC rather than arbitrated and compensated directly by the host government. Modern forms of risk management would seem useful supplements to the current arbitration regime, and some account might be taken of these options in future treaty negotiations.

The embrace of market principles for managing the economy over the past three decades has led to significant market penetration of most economies, and a concomitant reduction in the ability of most governments easily to pull levers that can reverse the conditions associated with arbitration. The current system of BITs does not adequately reflect this complexity. Appropriate for a world of dictators greedily accruing personal wealth by extracting rents from foreign investors, the international regime for the protection of FDI does not meet the needs of highly interdependent economies ruled by accountable democratic governments. Most importantly, it is crucial to note that modern risks to foreign investment often arise from economic troubles that are broadly macroeconomic in nature. They often have more to do with currency convertibility

and capital transfers[43] than they do with the blatant expropriation of foreign extractive interests. Hard times have exposed the flaws in this regime, which needs to be re-equilibrated to better respect the complex demands on public authorities.

[43] Turyn and Perez Aznar 2010.

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