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Societal benefits and costs of International Investment Agreements: A critical review of aspects and available empirical evidence

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Societal benefits and costs of International Investment Agreements
A critical review of aspects and available empirical evidence

by
Joachim Pohl

This paper reviews alleged societal benefits and costs of International Investment Agreements (IIAs) as suggested by academia, governments, business and civil society. It sets out the wide range of issues that diverse actors have proposed in the context of assessing the societal benefits and costs of IIAs.

The paper analyses and organises the available material generated by these sources to identify and classify the many different issues, summarises available empirical evidence and findings in these sources on the individual aspects, and assesses strengths and weaknesses of the approaches. The paper focuses in particular on the investor protection component of IIAs. The inventory finds that for many claims about the positive or negative impact of IIAs, little robust evidence has been generated to date. The paper highlights methodological challenges and suggests areas where further study would be required to draw firmer conclusions.

Authorised for release by Pierre Poret, Deputy Director, OECD Directorate for Financial and Enterprise Affairs

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EXECUTIVE SUMMARY

Many countries have embraced International Investment Agreements (IIAs) over the past half century on the assumption that their provisions generate benefits to home and host societies. As this assumption is being called into question, the governments that participate in the OECD-hosted Freedom of Investment (FOI) Roundtable asked the OECD to establish an inventory of the societal benefits and costs of IIAs – in particular their investor protection component – based on available evidence.

This paper contains this inventory, up to date as of September 2017. It does not necessarily reflect the views of the OECD or of the governments that participate in the FOI Roundtable, and given the wealth of material available, it does not claim to be exhaustive. The paper identifies and categorises the aspects advanced by academia, governments, business and civil society. It lays out available empirical evidence on different aspects, summarises their findings, and assesses the strengths and weaknesses of each approach.

The breadth and complexity of the issue, lack of empirical evidence, and the conditionality in many areas identified here preclude any definitive overall assessment on the societal benefits and costs of IIAs. However, some key findings emerge from the exercise:

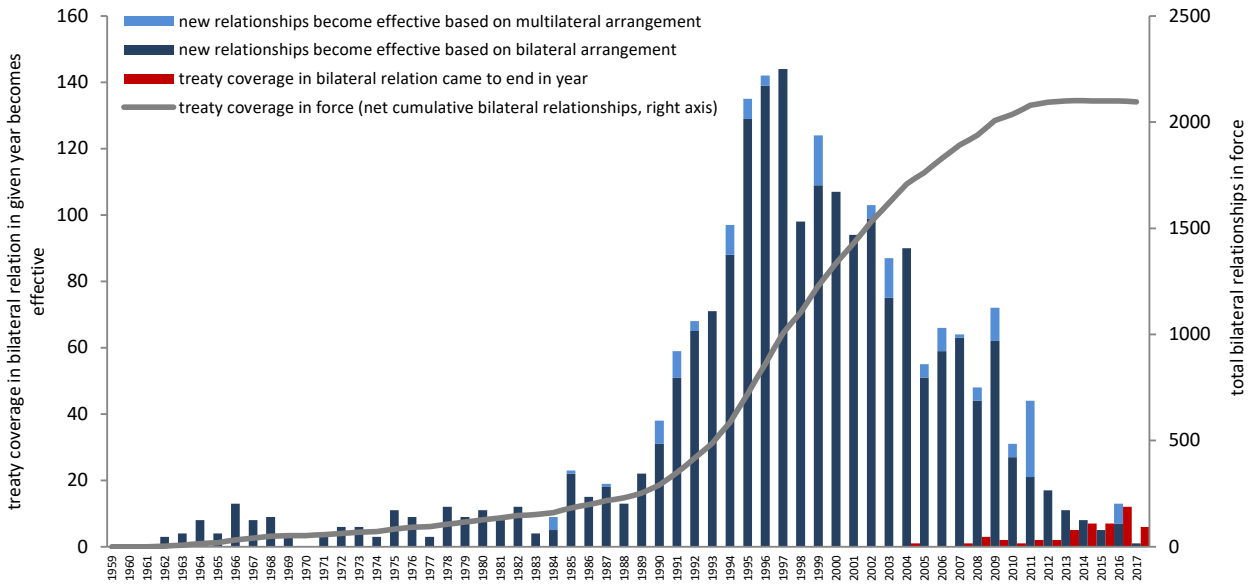
- While a large number of claims have been made with respect to the societal benefits and costs of IIAs, very few of them have been empirically tested, and few of those that have been tested have been confirmed empirically.
- Claims and evidence for individual aspects cover – often implicitly – only the specific scenario to which they may apply, most often related to treaties concluded between an advanced and a developing economy. For many relationships in which IIAs exist, the role and function of treaties is much less explored.
- The availability of empirical information on the various aspects is uneven. For example, with respect to economic benefits and costs, fiscal costs are better and more specifically documented than economic benefits, in part due to methodological challenges. This unevenness of information may lead to biased perceptions of the benefits and costs of IIAs.
- Much information that is relevant for the assessment of societal benefits and costs may not be publicly available. Selective access to this additional, non-public information may contribute to differences in views about benefits and costs of IIAs among different actors.
- Empirical findings on treaty effects necessarily relate to treaties that have been signed or brought into effect years or even decades earlier. The findings in the available literature and reported here are thus primarily associated with outcomes of older IIAs and correspond to older treaty designs. Many recently concluded treaties feature different design elements which are in part intended to alter the societal benefits and costs of these newer-generation IIAs. Whether these more recent design features alter the outcomes of IIAs is not yet comprehensively documented. More generally, specific treaty design features have not played a prominent role in empirical testing, so very little information is available on correlations between individual treaty design features and outcomes.

The findings of this exercise suggest that statements about the societal benefits and costs of IIAs in general, as well as of certain design elements, should be made with great caution. Public discussion on the merits of IIAs in recent years has triggered and accelerated interest in the subject across a broad range of constituents, and more empirical evidence on the issue is likely to emerge in the years to come. This new body of evidence should be considered carefully to close the current large gaps in the understanding of the societal benefits and costs of IIAs.

POLICY CONTEXT AND PURPOSE

Over the past half century, many governments around the globe have established a treaty-based system of international investment protection, based on an ever increasing number of International Investment Agreements (IIAs).[1] Since 1959, when the first modern Bilateral Investment Treaty (BIT) was signed,[2] largely over 3,000 BITs have been negotiated, of which over 2,200 are in force today. In addition, investment protection provisions stemming from multilateral investment agreements or investment chapters integrated in bilateral or multilateral preferential trade agreements (PTAs[3]) cover hundreds of additional bilateral relationships (Figure 1).

Figure 1: **Treaty-based investment protection in force (bilateral relationships 1959-2017)**



Source: OECD IIA database. Counts treaty relationships 8brought into force by the 58 economies invited to the OECD-hosted dialogue on international investment policy. Excludes Energy Charter Treaty. Data for recent years may require updating.

Today, a significant share of foreign investment stock is covered by protections afforded by IIAs. The shares of inward and outward foreign investment stock – and thus the degree of engagement in the treaty

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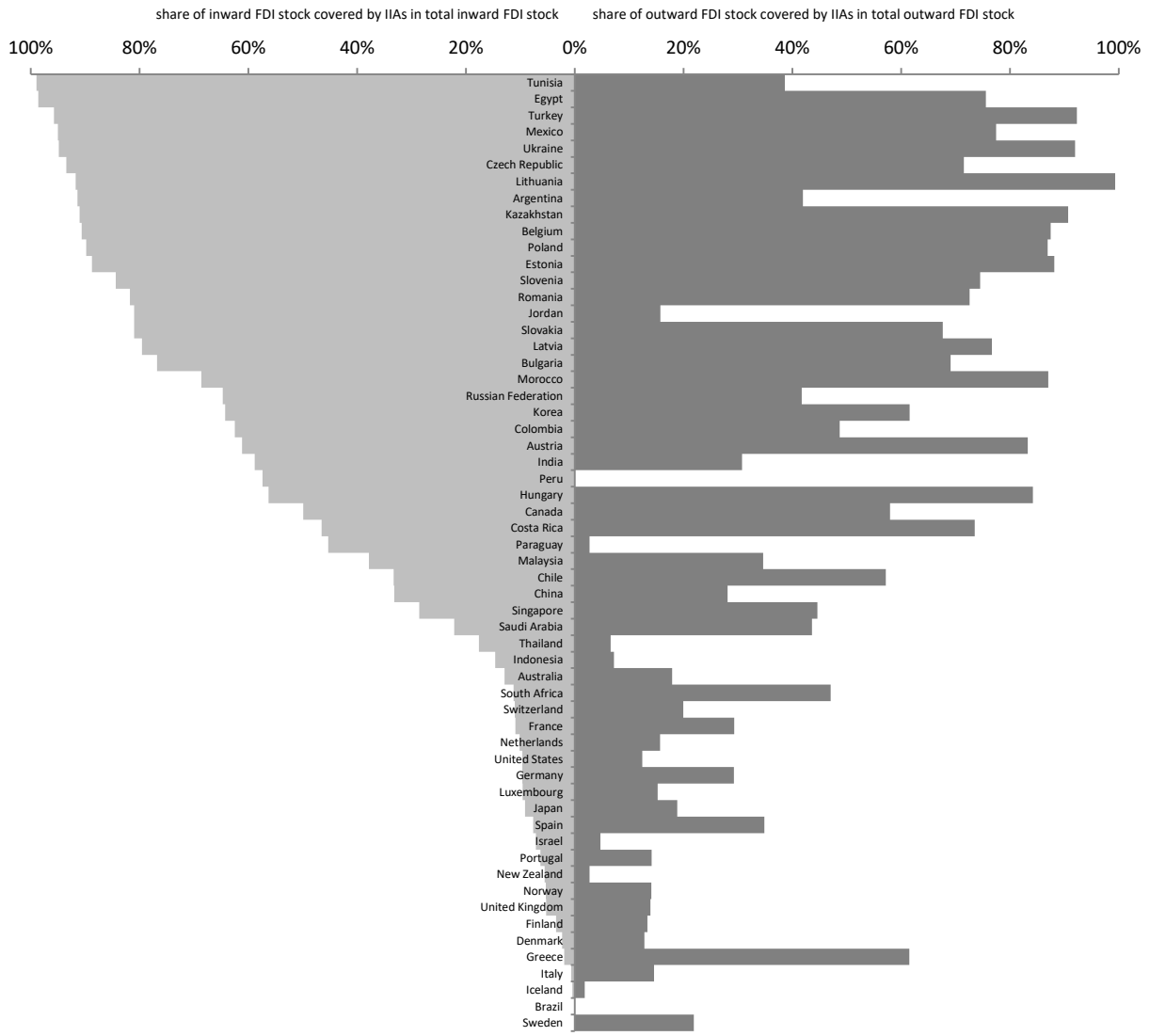
1 The terms "International Investment Agreement" and "IIA" are used for international treaties that contain investment protection content; this includes trade agreements with investment content.

2 Conventionally, the Germany-Pakistan BIT (1959) is considered the starting point of modern BITs. This treaty did not contain a unilateral offer of consent to investor-state dispute settlement, and one could consider that only this additional treaty feature makes the beginning of the modern BIT era.

3 This paper uses the term PTA for the class of bilateral or plurilateral agreements that include trade provisions; this class includes Free Trade Agreements (FTAs), Comprehensive Economic Cooperation Agreements (CECAs), Comprehensive Economic Partnership Agreements (CEPAs), etc. When a specific PTA is cited, the original name is maintained.

system – differ markedly between countries (Figure 2).[4] The different degree of inward and outward FDI treaty coverage reflects less the number of treaties a country has concluded and brought into force, but rather the choice of its treaty partners and the economic relationship among them.

Figure 2: **Share of inward and outward FDI stock under treaty cover in total inward and outward FDI stock of individual countries**



Source: OECD IIA database. Includes bi- or plurilateral IIAs brought into force by any of the 58 economies invited to the OECD-hosted dialogue on international investment policy. Does not include Energy Charter Treaty.

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4 For limitations of the approach of using FDI data for this exercise see section "*b. Do IIAs influence the volume or allocation of international capital flows?*", on p.19. In light of these limitations, the data should be read as an approximation of the order of magnitude rather than a precise assessment. All relationships in which an IIA in force exists – be they based on BITs, PTAs with investment chapters or plurilateral agreements – were considered. For FDI stock data, bilateral FDI stock data gathered from OECD and IMF sources for 2010 to 2014 were overlaid; more recent available data were given priority over older data and available *outward* FDI stock data were given priority over available *inward* FDI stock data. The Energy Charter Treaty is left out as its coverage is limited.

Governments have concluded and keep concluding investment treaties for various reasons, in particular to attract and protect foreign investments. Recent years have witnessed unprecedented public attention to investment treaties, in particular their investor protection component and the closely associated investor-state dispute settlement (ISDS) mechanisms contained in the overwhelming majority of these treaties. This public attention has heightened overall awareness and understanding of these treaties among policy makers, businesses and the public at large, but also generated increasingly vocal criticism and downright rejection of IIAs, in particular the ISDS mechanisms. Some countries have begun to terminate treaties based on their assessment of treaties' benefits and costs, are proposing significant changes to their existing treaties, or design new types of investment treaties in response of these concerns.

The public debate about the merits of treaty-based investment protection has revealed some degree of uncertainty over the benefits and costs of IIAs for societies. Governments participating in the OECD-hosted Freedom of Investment Roundtable – composed of now 59 economies[5] – hence requested the OECD Secretariat in 2014 to establish an inventory of potential societal benefits and costs of IIAs.

In response to this request, the Secretariat has established the present inventory of aspects that may constitute benefits and costs of IIAs for societies in treaty partners or non-parties and that have been raised in an increasingly differentiated and rich academic, public and policy debate. The Secretariat has collected and categorised the available empirical evidence for these aspects to the extent it is publicly available; the methods and findings of this existing research are subjected to a critical evaluation.

The present inventory remains incomplete, because in all likelihood a significant amount of information that would determine the societal benefits and costs of IIAs is not publicly available. This applies to information on investment decisions by companies as well as on aspects of how governments react to the presence of IIAs; while some of these matters can be observed indirectly, much information remains and will remain unavailable to a full assessment.

The widely diverging views on whether IIAs generate societal benefits and costs are partly due to what individuals believe this inaccessible information would tell. This paper will not achieve to overcome this problem and will not offer a broadly shared answer to the question that drives the interest. Merely, the paper seeks to inventories, categorise the issues that come into play in the consideration of societal benefits and costs of IIAs, and lay out to what extent robust empirical evidence supports the arguments and views put forward in the different regards.

The present paper does not necessarily reflect the views of the OECD or of the governments that participate in the FOI Roundtable, and it should not be construed as prejudging ongoing or future negotiations or disputes pertaining to international investment agreements.

The inventory is structured in two parts: Following some methodological considerations, its main section deals with aspects related to investor protection, which is the most prominent and frequent element of IIAs; it has also featured most prominently in public and policy debates; a much shorter section addresses some aspects linked to the market access component that an increasing albeit still small number

[5] The following economies are invited to participate in the Roundtables: Argentina, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Czech Republic, Denmark, Egypt, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, India, Indonesia, Israel, Italy, Japan, Jordan, Kazakhstan, Korea, Latvia, Lithuania, Luxembourg, Malaysia, Mexico, Morocco, Netherlands, New Zealand, Norway, Paraguay, Peru, Poland, Portugal, Romania, Russian Federation, Saudi Arabia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Thailand, Tunisia, Turkey, Ukraine, United Kingdom, United States, and the European Union.

of IIAs contain; these provisions raise different issues from investor protection and are thus considered separately.

This categorisation does not suggest that these issues can be separated but rather serves as an analytical roster to access the many dimensions of the potential effects of IIAs; other categorisations are possible.

The purpose, context and intended audience of this paper implies some differences to academic work. As a contribution to inform public policy, the paper draws on a broader range of material than common in academic papers, and dispenses of completeness of referencing desirable in scholarly work.[6] Also, expectations and needs of its intended audience are different from academic circles, in particular to the extent of prior knowledge of the issues. Those who seek to gain more detailed information will find those in references; the text however is self-contained to allow a quick overview despite the breadth and complexity of the issues.

[6] In order to allow unhindered access to scholarly work for the greatest possible readership, hyperlinks to academic works occasionally point to earlier working paper versions rather than the published versions available behind paywalls. The references nonetheless indicate the final publication reference where known at the time of writing of this paper.

METHODOLOGICAL CONSIDERATIONS

The assessment of potential benefits and costs of IIAs is a complex endeavour. Although several thousand investment agreements have been concluded over more than five decades, and although the stakes for countries involved in the system are potentially high, there have been few attempts to empirically assess the effect of treaty-based investor protection in general or of individual treaties in particular. Most available studies cover only selected areas of the broad range of potential effects of treaty-based investor protection or only specific scenarios, e.g. levels of economic developments of treaty partners, etc. No attempt seems to have been made yet to assess the costs and benefits of the investment treaty system as a whole, that is, beyond individual treaties or limited aggregates of individual treaties.

Establishing an inventory of potential societal benefits and costs of IIAs warrants some methodological considerations on the precise object of the endeavour. They concern the scope of the study; the assumptions about the features of an IIA; and the approach applied to assess benefits and costs of IIAs.

Object of the inventory

While the mandate for the present study states that *societal* benefits and costs are to be assessed, it needs to be clarified which societies are considered for the assessment of costs and benefits, for whom within a society benefits and costs are assessed, and which types of benefits and costs are considered:

- **Which societies are being looked at?** — Benefits and costs of international agreements are likely to accrue to the societies of the States that have concluded an agreement. However, societies of third States are likely also affected in several ways, too. An IIA may for instance divert investment away from a third country to a treaty partner. Also, an enterprise from a State that does not participate in the treaty system may be able to benefit from treaty protections by structuring their investments through third countries. The present inventory considers only effects on treaty Parties, given the limitations of information and empirical evidence of treaty effects on non-Parties; this choice implies no judgement on the importance of considerations of treaty outcomes for non-Parties.

- **For whom within a society are benefits and costs assessed?** — Societal benefits and costs may be assessed for a society as an aggregate. However, as all regulatory interventions have distributional effects, costs and benefits of IIAs are likely to be spread unevenly within the societies of parties to IIAs.[7] Existing studies have largely ignored the distributional effects of IIAs within a given country's society and have rather treated the society of a country – or even a group of countries – as an entity.[8]

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[7] World Bank (2005), "*Analyzing the Distributional Impact of Reforms: A Practioner's Guide to Trade, Monetary and Exchange Rate Policy, Utility Provision, Agricultural Markets, Land Policy and Education, Volume 1*".

[8] Estimated gains of IIAs are often expressed as increase in GDP or average gains per household in USD. Calculations of the benefits of TTIP for instance suggest an (average) income gain per household for EU and United States households, e.g. Joseph FRANCOIS/Miriam MANCHIN/Hanna NORBERG/Olga PINDYUK/Patrick TOMBERGER (2013), "*Reducing Trans-Atlantic Barriers to Trade and Investment*", and Atlantic Council of the United States/Bertelsmann Foundation/British Embassy in Washington (2013), "*TTIP and the Fifty States: Jobs and Growth from Coast to Coast*". Jonathan BONNITCHA (2014), "*Substantive*

The absence of empirical information on distributional effects of IIAs within societies has led to the exclusion of this aspect, again without the expression of judgement on the importance of this aspect for a comprehensive assessment of the societal benefits and costs of IIAs.

– **Which benefits and costs are considered? —** There are multiple layers of benefits and costs that can be considered in the context of IIAs or indeed many policy areas. This inventory focuses on first-order effects, that is, the most immediate effects that the presence of IIAs may have. In the public debate, second order effects come increasingly to the fore (such as a backlash against globalisation or the international economic order; erosion of public trust in government; etc.). While these second-order effects are important for societies and for policy-makers to consider, they are not covered due to their lesser predictability and dependency on multiple additional factors that lay outside the scope of this paper.

Types and features of IIAs

The over 3,000 IIAs that States have negotiated to date exhibit a broad range of different features and designs. Investment content may be contained in bilateral or plurilateral IIAs, and the treaty may cover exclusively investment content or cover a much broader range of issues (e.g. PTAs). The present study addresses all agreements with investment content – and with respect to this content only – regardless of the other formal features of the treaty.

Most IIAs contain substantive protection provisions coupled with access to ISDS. This study focusses essentially on the costs and benefits of treaties' protection content as the most prominent and widespread feature of IIAs.

The protection provisions of treaties exhibit a broad range of characteristics. As the present study seeks to identify elements that could induce benefits and costs IIAs in general, it does not distinguish between different levels of protection afforded by the presence of design of individual treaty clauses. It is important, however, to recognise that the results of an assessment of individual treaties may well vary in relation to the protections that they offer.[9]

A growing albeit still small number of IIAs also contains market-access obligations, such as pre-establishment national treatment provisions. The provisions on "services" under many preferential trade agreements also contain market-access provisions relating to investment as does the General Agreement on Trade in Services (GATS). Services provided under so-called mode 3 (service delivered by a supplier of one country, through commercial presence, in the territory of any other country) can often involve an investment, and market-access content related to mode 3 services under such agreements can imply investment liberalisation. Market-access content raises issues that are distinct from post-establishment protections. Although some arguments and aspects concern IIAs in general, issues related to market-access content are discussed separately in this paper.

IIAs may contain a significant number of other features, such as rules on performance requirements, "umbrella" clauses, etc. These elements, some of which are rather frequent features of IIAs, alter the outcomes of IIAs for societies. However, these clauses are not considered here for practical reasons, given

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Protection under Investment Treaties: A Legal and Economic Analysis" appears to be among the first to include distributive considerations in this area of research.

9 Jonathan BONNITCHA (2014), "*Substantive Protection under Investment Treaties: A Legal and Economic Analysis*" respond to a growing interest in the impact of individual rules in treaties.

that empirical evidence that would show to what extent and how these features influence treaty outcomes has yet to be produced.

Inevitably, the empirical evidence available on the societal benefits and costs of IIAs is based on the outcome of past treaty practice. Efforts undertaken in many countries in recent years to reform the design of treaties is not yet fully reflected in most of the studies exploited for this paper. Future assessments of societal benefits and costs of IIAs may or may not differ from the findings that are available at present and presented here.

Methodology to assess benefits and costs of IIAs

Effects of regulation – including its benefits and costs – are commonly assessed through Regulatory Impact Assessments (RIA). This approach, developed in policy making and social science since the 1970s[10] is today used by almost all OECD Members and some non-OECD countries around the globe to assess all kinds of planned regulation *ex ante* or to evaluate existing regulation *ex post*.[11]

Approaches and focus of RIAs differ substantively among countries,[12] and a number of impact assessments for specific dimensions have been proposed, including for environment, health[13] or human rights.[14] To date, although no one methodology for RIAs has been established, principles on when and how RIAs should be carried out are widely agreed.[15]

IIAs have rarely been subject to RIAs despite the broad use of RIAs by governments as a matter of course. The scope of RIAs for IIAs is thus particularly uncertain,[16] as is the methodology that would apply to assess these treaties' benefits and costs.[17] Publicly available RIAs related to IIAs concern PTAs with

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10 An overview of practice is available in OECD (2012): "*Sustainability in Impact Assessments: A Review of Impact Assessment Systems in Selected OECD Countries and the European Commission*". Further OECD studies on RIA are available at *www.oecd.org/gov/regulatory-policy/ria.htm*.

11 See OECD Recommendation of the Council on Regulatory Policy and Governance (2012), in particular the Recommendation's Annex, item 4.

12 See OECD (2012) "*Sustainability in Impact Assessments: A Review of Impact Assessment Systems in Selected OECD Countries and the European Commission*" and the World Bank Group (2008), "*Regulatory Impact Assessment – Resources*". Further examples include for instance for Australia "*Best Practice Regulation Handbook*", Australian Government, 2014, and "*Better Regulation Handbook – How to Design and Review Regulation, and Prepare a Regulatory Impact Statement*", Government of South Australia (2011). An overview of the rules for RIAs for federal legislation in the United States is available in "*Regulatory Impact Analysis: A Primer*", White House, undated.

13 Health Canada, "Proposed Assignment: Health Impact Assessment of International Trade and Investment Agreements", undated.

14 Olivier DE SCHUTTER "*Guiding principles on human rights impact assessments of trade and investment agreements*", Report of the Special Rapporteur on the right to food, United Nations document A/HRC/19/59/Add.5, 19 December 2011.

15 Recommendation of the Council of the OECD on Regulatory Policy and Governance (2012).

16 See for instance the controversy between the EC and the European Ombudsman on whether a human rights impact assessment is warranted for the EU-Vietnam FTA, which will contain investment provisions.

17 Michael G. PLUMMER/David CHEONG/Shintaro HAMANAKA, "*Methodology for Impact Assessment of Free Trade Agreements*", Asian Development Bank 2010 do explicitly avoid proposing an assessment methodology, as "*the methods to assess the impact of investment and services liberalization have not been well established, unlike the case of goods, and data on services and investment is insufficient to conduct rigorous*

investment provisions, but none of those reviewed consider the agreements' investment protection content in any detail.[18] This gap may be closed progressively in the future, as methodologies for RIAs for IIAs are being proposed or commissioned.[19]

The present study takes no position on these discussions. Rather, it applies the general principle that RIAs seeks to identify potential benefits and costs of IIAs generally, out of a specific country-context and without a specific treaty text in mind.[20]

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analysis". The Australian Productivity Commission, "*Trade&Assistance Review 2013-14–Productivity Commission Annual Report Series*", p.82 voices similar concerns: "*The Commission acknowledges the practical difficulties involved in quantifying the impacts of agreements due to the variable quality and completeness of international services trade and investment statistics and the inherent difficulty in quantifying services and investment trade barriers compared to tariff measures.*" Two appraisals of the European Commission's Impact Assessment of TTIP carried out at the request of the European Parliament demonstrate the divergence on views on how to carry out RIAs of the TTIP: Alexia MANIAKI-GRIVA (2013), "*Initial appraisal of a European Commission Impact Assessment – European Commission proposal to authorise the opening of negotiations on a Transatlantic Trade and Investment Partnership between the European Union and United States of America Impact Assessment", SWD(2013)68final* and Jacques PELKMANS/Arjan LEJOUR/Lorna SCHREFLER/Federica MUSTILLI/Jacopo TIMINITHE (2014) "*Detailed Appraisal by the EP Ex-ante Impact Assessment Unit of the European Commission's Impact Assessment EU-US Transatlantic Trade and Investment Partnership*".

18 E.g. European Commission/Government of Canada (2008), "*Assessing the costs and benefits of a closer EU-Canada economic partnership*". Australian Government (2014), "*Free Trade Agreement between the Government of Australia and the Government of the Republic of Korea – National Interest Analysis [2014] ATNIA 8 with attachments*" and the related "*National Interest Analysis*". Australian Government (2015), "*Free Trade Agreement between the Government of Australia and the Government of the People's Republic of China – National Interest Analysis [2015] ATNIA 7 with attachments*". Gabriel FELBERMAYR/Benedikt HEID/Sybille LEHWALD (2013), "*Transatlantic Trade and Investment Partnership (TTIP): Who Benefits from a Free Trade Deal?*", Bertelsmann Stiftung. Jean-Baptiste VELUT "*NAFTA's Developmental Impact on Mexico: Assessment and prospects*", IdeAs 2011. The World Bank's guide "*Analyzing the Distributional Impact of Reforms*" covers 13 distinct policy areas in its two volumes, but does not mention investment agreements. An example of ex-post assessments, Congress of the United States, Congressional Budget Office (2003), "*The Effects of NAFTA on U.S.-Mexican Trade and GDP*"; this document reserves a box on NAFTA and foreign investment, but this box only focuses on the effect of liberalisation provisions on investment. Mohammed Aly SERGIE (2014), "*NAFTA's Economic Impact*", Council on Foreign Relations.

19 The Australian Productivity Commission, "*Trade&Assistance Review 2013-14–Productivity Commission Annual Report Series*", p.87 proposes an outline of dimensions of a RIA for a PTA as well as potential evaluation indicators.

20 Recommendation of the Council of the OECD on Regulatory Policy and Governance (2012), item 4.

INVESTOR PROTECTION IN IIAS

Investor protection is the historically first, most prominent and most widespread function of IIAs; the function is also explicitly expressed in most treaty names. The protection component has received by far the greatest, if not almost exclusive coverage in relation to considerations of societal benefits of costs of IIAs, both in public discourse and academic research.

Among the aspects identified with respect to the investor protection component of IIAs, three main areas for which societal benefits or costs are claimed can be distinguished: (A.) economic outcomes; (B.) effects on domestic and global governance; and (C.) IIAs role in relation to the pursuit of broader foreign policy objectives.

A. Economic benefits and costs of the investor protection component of IIAs for host-, home- and third country societies

IIAs' explicit primary purpose is to yield economic benefits for the societies of the concluding States. The preambles of most IIAs state this assumption, e.g. in the following terms:

"RECOGNIZING that the promotion and the protection of investments of investors of one Party in the territory of the other Party will be conducive to the stimulation of mutually beneficial business activity, to the development of economic cooperation between them and to the promotion of sustainable development […]"[21]

While IIAs almost invariably contain this or a similar affirmation of economic benefits in their preamble, surprisingly little evidence is available on its validity. Much of the evidence that has been produced only covers treaties concluded between an advanced and a developing economy, despite the large and growing number of IIAs concluded in exclusively advanced or exclusively developing country pairs. Furthermore, no agreed list of aspects that would need to be considered in a comprehensive economic assessment of IIAs has been established.[22]

Until recently, research has been concentrated essentially on two discrete questions: whether capital flows to developing countries make a positive economic contribution in recipient countries; and whether the presence of an IIA is correlated with greater capital flows to the developing-country treaty partner. Several aspects have received much less consideration, in particular

- whether IIAs have a selective function and encourage "better FDI" to flow among treaty partners;
- to what extent IIAs remedy or induce market distortions. Market distortions are generally considered to induce inefficiencies; were IIAs to reduce or increase such distortions, they could incur benefits or costs regardless of whether they produce nominally higher capital flows.

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[21] Extract from the Preamble of Canada-Kuwait BIT (2011).

[22] A most recent publication, BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", constitutes an exception to this general finding.

- What fiscal costs do IIAs generate. Such fiscal costs include for instance expenses for negotiating and administering IIAs as well as costs arising from litigation and the associated legal infrastructure.

The following sections present all aspects that have been found with regards to economic aspects that could constitute or generate societal benefits or costs and are associated with the protection content of IIAs.

1. Do host or home societies benefit from international capital flows and do IIAs influence such flows?

The most common hypothesis advanced to assess the (beneficial) economic effect of IIAs is based on a double assumption: that foreign capital flows yield economic benefits for home and host societies (below a.), and that IIAs encourage such capital flows to recipient countries (below b.). The claimed beneficial effect requires at a minimum that both hypotheses are found to apply cumulatively.[23]

a. Benefits and costs of foreign capital flows for host and home societies

Economic effects of trans-border capital flows for origin and destination countries have been studied extensively for several decades. The literature covers different categories of financial flows, and flows into both advanced and developing countries. This paper does not seek to absorb or review this vast amount of literature because the extent to which IIAs actually influence the allocation of capital remains uncertain (see below subsection b.). The section thus limits itself to general aspects, especially as regards the different types of capital flows that are typically covered by IIAs.

(1) Economic effects of capital inflows

The economic effects of capital flows in host economies have been assessed for several decades. Research suggests that capital inflows can have various effects in host societies – both welfare-enhancing and detrimental –, and that the specific effects of an individual capital flow depend on several factors related to the host economy and the nature and purpose of the transaction.

As regards foreign direct investment, the literature generally distinguishes macro-level effects – foreign exchange and tax revenues, employment, enhanced international trade integration – and spill-over effects, in particular knowledge, technology and know-how spillovers.[24] Further benefits could result from

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[23] Jason Webb YACKEE (2005), "*Are BITs Such a Bright Idea? Exploring the Ideational Basis of Investment Treaty Enthusiasm*", 12 UC Davis J Intl L Pol, p.195 (202). A more recent strand in the literature – Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", Chapter 5 – argue that these cumulative conditions are *necessary* but *not sufficient* to conclude on benefits: treaty protections may lead to overinvestment or inefficient investment, which may not be beneficial. The issue has not yet been explored empirically and is thus not taken up here, with the exception of the related topic of market distortions.

[24] For recent overviews of the empirical literature see Laura ALFARO (2016), "*Gains from Foreign Direct Investment: Macro and Micro Approaches*" *World Bank Economic Review* (2016), p.1. Laura ALFARO (2014), "*Foreign Direct Investment: Effects, Complementarities, and Promotion*", Harvard Business School Working Paper 15-006. Roberto ECHANDI/Jana KRAJCOVICOVA/Christine Zhenwei QIANG (2015), "*The impact of investment policy in a changing global economy: a review of the literature*", World Bank Group policy research working paper WPS 7437. Thomas FAROLE and Deborah WINKLER (Eds.) (2014), "*Making Foreign Direct Investment Work for Sub-Saharan Africa, Local Spillovers and Competitiveness in Global Value Chains*", The World Bank Group. With a focus on effects for developing countries: Lisbeth COLEN/Miet MAERTENS/Johan SWINNEN, "*Foreign Direct investment as an engine for economic growth and human development*", in *Foreign Direct investment and human development* (2013), p.70. Peter NUNNENKAMP (2012), "*Foreign*

an improvement of environmental and social conditions in the host country by, for example, transferring 'cleaner' technologies, disseminating more socially responsible corporate policies, improve human rights practices or by binding states together.[25] Whether this latter element materialises depends on a series of conditions, for example whether enterprise practice and standards in the home State are higher than in the host State.

Concerns vis-à-vis inward foreign direct investment relate, especially in less developed countries, to: effects on domestic entrepreneurship, especially on available skilled workers and access to credit;[26] competition;[27] environmental impact, especially in extractive and heavy industries; and social disruptions of accelerated commercialisation. In advanced economies, concerns about inward foreign investment are occasionally expressed on a potential erosion of the tax base as a result of foreign takeovers; these may bring revenues of the acquisition target under taxation in the acquirer's home country.[28]

Although many questions in this area are not settled, there is a growing consensus that effects of foreign direct investment are contingent on multiple parameters in the host country – e.g. varying levels of indigenous human resources, private-sector sophistication, competition, and host-country policies[29] including trade- and investment policies.

Direct Investment in a Globalized World", in: Bertelsmann Stiftung (ed.) *Shaping Globalization*, p.14 (19). New Zealand Ministry of Economic Development (2011), "*Evaluation of NZTE investment support activities*" August 2011. Theodore MORAN/Edward GRAHAM/Magnus BLOMSTRÖM (ed.) "*Does Foreign Direct Investment Promote Development?*" Robert E. LIPSEY (2002), "*Home and Host Country Effects of FDI*". NBER Working Paper, No. 9293. More seasoned literature includes OECD (2002) "*Foreign Direct Investment for Development – maximising benefits, minimising costs*", pp. 5-6. Prakash LOUNGANI/Assaf RAZIN (2001), "*How Beneficial Is Foreign Direct Investment for Developing Countries?*", IMF Finance and Development June 2001. On specific issues see for instance Carol NEWMAN/John RAND/Theodore TALBOT/Finn TARP (2015), "*Technology transfers, foreign investment and productivity spillovers*", European Economic Review, 76, p.168-187.

25 References to studies assessing these issues in Andrew KERNER (2014), "*What We Talk About When We Talk About Foreign Direct Investment*", International Studies Quarterly 58, p.804.

26 On this specific aspect see, for Ivory Coast, Ann E. HARRISON/Margaret S. MCMILLAN (2003), "*Does Foreign Direct Investment Affect Domestic Firm Credit Constraints?*" Journal of International Economics 61, 1 (2003), p.73 (working paper available as NBER Working Paper No. 8438).

27 OECD (2002) "*Foreign Direct Investment for Development – maximising benefits, minimising costs*", pp.5-6. Specific for extractive industries, see OECD (2002), "*Foreign Direct Investment and the Environment – Lessons from the Mining Sector*".

28 The potential erosion of the tax base resulting from foreign takeovers or the effect of international mergers for the purpose of tax inversion has been an issue in Australia and the United States: In February 2014, the then Australian Treasurer was quoted as stating "*If you're advised that an Australian company is a major taxpayer and if it is purchased by someone overseas and therefore its tax liability would be reduced domestically to zero, that feeds into a decision about what is contrary to the national interest – you'd lose potentially a substantial lick of revenue. And that does have an impact on the national interest.*", in: "*New tax test on foreign takeovers*" by David Crowe and David Uren, The Australian, 25 February 2014. On 3 May 2016, the Australian Foreign Investment Review Board (FIRB) announced clarifications on the applications of FIRB reviews ("*Taxation conditions – clarifying requirements for foreign investment*", undated), following an announcement by the Treasurer on 22 February 2016 on the matter. In 2014, the United States responded to a series of attempts to use international mergers for corporate inversions by changes to tax rules, "*Fact Sheet: Treasury Actions to Rein in Corporate Tax Inversions*", United States Treasury press release 22 September 2014.

29 See THEODORE H. MORAN (1999), "*Foreign Direct Investment and development: A reassessment of the evidence and policy implication*".

Treaty protections typically cover many forms of non-FDI capital flows, too. The literature on the effects of non-FDI capital flows has focused on a different set of issues, in particular the effect on balance-of-payments issues, inflation, financial stability and asset prices. Although typically covered by IIA protections, non-FDI capital flows have received only minimal attention in the context of investor protection.

(2) Economic benefits and costs of capital outflows to home societies

Whether capital outflows from home societies generate benefits or are rather economically detrimental for home societies has also been subject to broad discussion in the literature. It is held that outward investment benefits primarily the investing firms – as measured by greater performance in: productivity, technology, profitability, wages, skills and growth relative to companies that operate only domestically.[30] Which indirect benefits of these effects on firms accrue to home societies has not been directly and assessed; such indirect benefits could include tax revenues and employment opportunities, among others.[31] Among the direct effects of outward FDI on home states that have received attention are the effect on domestic capital stock.[32]

b. Do IIAs influence the volume or allocation of international capital flows?

Many studies have sought to assess whether the presence of an IIA and increased capital flows or stocks, an in particular aggregated FDI flows or stocks, are correlated. The hypothesis underlying these studies, developed in the early 1970s,[33] is that the treaties' substantive protection standards (and an associated enforcement mechanism) provide for credible and enforceable protection to overcome "hold-up" or "obsolescing bargain" problems and reduce foreign investors' risks,[34] or that the agreement to IIAs

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30 Peter NUNNENKAMP (2012), "*Foreign Direct Investment in a Globalized World*", in: Bertelsmann Stiftung (ed.) *Shaping Globalization*, p.14 (28) and, much earlier, Peter J. BUCKLEY/M. CASSON (1976) "*The future of the multinational enterprise*".

31 Theodore MORAN (2011), "*Globalization of Industry via FDI: Consequences for Developed-Country Home Economies*", in: "*Foreign Direct Investment and Development: Launching a Second Generation of Policy Research: Avoiding the Mistakes of the First, Reevaluating Policies for Developed and Developing Countries*", Peterson Institute for International Economics, found that United States MNEs increased employment and output in the home economy between 1984 and 2004; Stefano FEDERICO/Gaetano Alfredo MINERVA (2008), "*Outward FDI and Local Employment Growth in Italy*", *Review of World Economics*, vol. 144, pp.295-324 find in a study on Italian outward FDI between 1996 and 2001 for 12 manufacturing industries that this outward FDI was associated with faster local employment growth relatively to the national industry average; Eunsuk HONG/In Hyeock LEE/Shige MAKINO, "*Does Outbound FDI Affect Domestic Employment? – The Role of Investment Motivations*" found that whether domestic employment of Japanese MNEs shrunk or grew depended on the motivation for the foreign investment.

32 Martin FELDSTEIN (1994) "*The Effects of Outbound Foreign Direct Investment on the Domestic Capital Stock*", NBER working paper 4668, March 1994 for the United States and – with contrasting findings for India – Sourafel GIRMA/Ila PATNAIK/Ajay SHAH (2010) "*The impact of outbound FDI on domestic investment*" for India.

33 Raymond VERNON (1971), "*Sovereignty at bay: The multinational spread of U.S. enterprises*".

34 The hypothesis of "credible commitment", which is central to the argument, was introduced by Andrew T. GUZMAN in "*Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties.*" Virginia Journal of International Law 38 (1998), p.639.

"signals cooperation".[35] This in turn is thought to enable, encourage or attract foreign investment that would not be implemented in the host country in the absence of an IIA. Of recent interest appears to be the related aspect of whether IIAs play a role in the "retention" of investment, that is, whether IIAs play a role in delaying or preventing divestment decisions (on this aspect see a separate section below).

The "hold-up" and "obsolescing bargain" hypotheses state that an investor loses the leverage to hold a government to the representations and promises that it made to attract the investment once this investment is sunk. The plausibility of this hypothesis – at least for contemporary conditions – is increasingly debated for a number of reasons: Its focus on an individual investment to explain the behaviour of governments and working mechanisms of treaties ignores that in reality, governments care about the reputational risk for future investments, rather than consider just one (implemented) investment in isolation.[36] Further, the degree to which investments are illiquid or "sunk" depends on industry sector, and not all are as immobile as investments in the extractive industries, in relation to which the hypothesis was initially developed, or some infrastructure projects.[37] Also, investors are thought to be able to make arrangements that attenuate the extent of a potential hold-up.[38] Finally, it is argued that the antagonistic, "obsolescing bargaining" model of relations between developing host-States and foreign investors does not – and at least no longer – correspond to realities.[39]

In defence of the hypothesis, it is still being suggested that investors today may remain under the impression of historical experiences made during the de-colonialisation half a century ago, when newly independent States nationalised foreign firms.[40]

The hypothesis that treaties "signal cooperation" suggests that treaties' effects stem from the public, formal, and enforceable commitment of States to subject themselves to international rules, allowing investors to conclude that their investment will be protected.[41] The signalling hypothesis suggests that the

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35 NEUMAYER, Eric/SPESS, Laura, "*Do Bilateral Investment Treaties Increase Foreign Direct Investment To Developing Countries?*", in Karl SAUVANT/Lisa SACHS (Eds., 2009), "*The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows"*, p.248.

36 BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.133.

37 Andrew KERNER/Jane LAWRENCE (2012), "*What's the Risk? Bilateral Investment Treaties, Political Risk and Fixed Capital Accumulation*", British Journal of Political Science, 44, p.107. Jason Webb YACKEE (2016), "*Do BITs 'Work'? Empirical Evidence from France*", Journal of International Dispute Settlement, 2016, p.55. Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.132. Rachel L. WELLHAUSEN (2016), "*Recent Trends in Investor–State Dispute Settlement*", Journal of International Dispute Settlement, 2016, p.1 points out that services – often more mobile than extractive industries or infrastructure – now account for a significant proportion of treaty-based claims.

38 Leslie JOHNS/Rachel WELLHAUSEN (2016), "*Under One Roof: Supply Chains and the Protection of Foreign Investment*", American Political Science Review Vol.110, No.1, p.31. Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.132.

39 Ravi RAMAMURTI (2001), "*The obsolescing 'bargaining model'? MNC-host developing country relations revisited*", *Journal of International Business Studies*, 32(1), p.23. Lorraine EDEN/Stefanie LENWAY/Douglas Schuler (2004), "*From the obsolescing bargain to the political bargaining model*", Bush School Working Paper No.403. Simon LESTER (2015), "*Rethinking the International Investment Law System*", Journal of World Trade 49, no.2, p.214.

40 Sarah DANZMAN (2016), "*Contracting with whom? The differential effects of investment treaties on FDI*", International Interactions 42, p.452 (455) referencing literature of the 1970s and 1980s.

41 NEUMAYER, Eric/SPESS, Laura, "*Do Bilateral Investment Treaties Increase Foreign Direct Investment To Developing Countries?*", in Karl SAUVANT/Lisa SACHS (Eds., 2009), "*The Effect of Treaties on Foreign*

signal fills an information gap; if a prospective investor has sufficient information about the treatment it can expect in a country, the IIA *as a signal* does not provide additional information.[42] With ever more detailed information available on many host countries, the compelling force of this theory may be declining.

Both hypotheses – treaties resolving hold-up problems or treaties as signalling devices – should not be seen out of context of the econometric approaches of studies in which context they were developed or used, and which rely on monadic and dyadic FDI datasets, respectively.

Both hypotheses have been tested in relation to investments originating in advanced economies and made in developing or emerging host economies. The narrative that treaties resolve hold-up problems or signal cooperation is less convincing for IIAs concluded between advanced economies. Although hold-up or political risk may also exist – and materialise – in advanced economies, it is not suggested in the literature or by stakeholders that this risk holds back foreign investment in the advanced economies that conclude IIAs. The rarity of studies of the effect of IIAs among advanced economies leaves an important gap, as an increasing number of IIAs is concluded in such relationships,[43] and an increasing number of claims are brought against advanced economies.[44] The impact of IIAs concluded between two developing economies seems to have received just as little attention despite their growing number, leaving a similarly important research gap.

With respect to IIAs concluded between an advanced and a developing country, empirical evidence has been generated through five different approaches:

- econometric analysis seeks to determine whether the presence of an IIAs is correlated to aggregated international capital flows between jurisdictions between which IIAs are signed or in force – this is the by far most frequent study design;
- other types of quantitative approaches seek to determine whether the presence of IIAs has an impact on investment decisions;
- qualitative studies that involve research on business attitudes towards the role of IIAs seek to determine to what extent decision makers know and value the presence of IIAs as a basis for their investment decisions in order to estimate treaties' role in levelling barriers to investment abroad;
- qualitative studies seek to determine recipient governments' and their investment promotion agencies' (IPA) attitudes about IIAs. This approach, mirroring somewhat the research on business attitudes, constitutes an indirect observation of business attitudes;

Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows", p.248. Chia-yi LEE/Noel P. JOHNSTON (2016), "*Improving Reputation BIT by BIT: Bilateral Investment Treaties and Foreign Accountability*", International Interactions 42, p.429 present a recent variant, hypothesising that the strength of the signalling effect depends on how "powerful" the treaty partner is.

42 See Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.158.

43 While only 4% of the 50 relationships covered by the first IIAs were among high income countries, 50% of the 50 relationships that we most recently covered by bilateral IIAs are between two high-income countries (calculation based on the OECD IIA database, covering around 2500 IIAs involving at least one of the 59 economies participating in the Freedom of Investment Roundtables).

44 Thomas SCHULTZ/Cédric DUPONT (2014). "*Investment Arbitration: Promoting the rule of law or over-empowering investors? A Quantitative Empirical Study*", European Journal of International Law, 25(4): 1147-1168. Krzysztof PELC (2016), "*Does the international investment regime induce frivolous litigation?*"

- finally, analysis of underwriting and pricing policies of political risk insurers seeks to shed light on how these institutions assess treaties' role in reducing risk. These studies follow a rationale similar to analysis of business attitudes but rely on pricing data rather than expressions of perception.

The following sections describe the approaches, findings and challenges of the studies carried out to assess whether IIAs influence the allocation of capital.

(1) Econometric approaches to determine a correlation between IIAs and capital allocation

Over 30 studies have been published in the past two decades on whether the presence of IIAs is correlated to increased FDI flows or stocks in a country that has concluded IIAs or whether flows increased in relation to the signature or entry into force of a new IIA.[45] Most of these studies operate with highly aggregated data, thus revealing at most whether IIAs have an effect, but revealing little about the conditions under which this effect occurs. More recently, econometric analysis has explored more differentiated or related questions, notably whether FDI flows or stocks correlate with specific treaty features, with the presence of trade or market access provisions, and a few recent studies have assessed the impact of treaty-based litigation on FDI flows or stocks.

While the econometric analysis using IIA and FDI datasets seems appealing – not least because the used data are readily and freely available –, the vast majority of the existing studies do not offer a satisfying answer to the question whether IIAs influence capital allocation in treaty partners. This is due to conceptual problems regarding the notions of FDI on the one hand, and IIA-based investment protection on the other, which are common to all reviewed studies.[46] Many of these problems are likely to be non-randomly associated with variables of interest, thus leading to important bias and invalid results for the research question.

Given that these econometric studies have left a lasting impression on the perceptions of the effect of IIAs among policymakers, and given the continued popularity of the approach despite increasing criticism,[47] these studies and in particular the problems associated with their approach justify a discussion

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45 See for literature reviews Karl P. SAUVANT/Lisa E. SACHS (Eds). "*The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*", 2009; and Liesbeth COLEN/Miet MARTENS/Johan SWINNEN, "*Determinants of foreign direct investment flows to developing countries – the role of international investment agreements*", in: De SCHUTTER/SWINNEN/WOUTERS, "*Foreign Direct Investment and Human Development*" (2013), p.116. UNCTAD (2014), "*The Impact of International Investment Agreements on Foreign Direct Investment: An Overview of Empirical Studies 1998-2014*", IIA Issues Note September 2014. Martin H. THELLE/Eva R. SUNESEN/Joseph FRANCOIS (Copenhagen Economics) (2012), "*EU-China Investment Study – Final Report*", p.45. Roberto ECHANDI/Jana KRAJCOVICOVA/Christine Zhenwei QIANG (2015), "*The Impact of Investment Policy in a Changing Global Economy: A Review of the Literature*", World Bank Group Policy Research Working Paper 7437, p.21. Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.179.

46 Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.158 point out that the quality of the study designs differ for various reasons. There aspects are not discussed here, but would need to be added to the common shortcomings that this paper focuses on.

47 Comprehensive attempts to identify some of the problems of the use of FDI statistics for this exercise were made by Robert E. LIPSEY (2007), "*Defining and measuring the location of FDI output*", NBER Working Paper Series, Working Paper 12996, p.5. Sjoerd BEUGELSDIJK/Jean-François HENNART/Arjen SLANGEN/Roger SMEETS (2010), "*Why and how FDI stocks are a biased measure of MNE affiliate activity*", Journal of International Business Studies (2010) 41, 1444–1459. Andrew KERNER (2014), "*What We Talk About When We Talk About Foreign Direct Investment*", International Studies Quarterly 58, p.804. Andrew KERNER/Jane LAWRENCE (2012), "*What's the Risk? Bilateral Investment Treaties, Political Risk and Fixed*

in some detail – despite their ultimately limited value for the question they seek to answer. Very few studies have recently been undertaken that have used an alternative, more promising approach; these studies and their findings are discussed in a separate section below.

(a) Conceptualising the notion of foreign investment

The notion of foreign investment, and in the context of the econometric studies discussed here typically of foreign direct investment, is an ambivalent concept:[48] FDI as a *commercial* phenomenon describes an enterprise's creation or acquisition of productive capacity in a foreign host country. Studies that identify the potential benefits of FDI – reported in the previous section – refer to FDI in this sense and study or describe its effect on employment, production, technology transfer, etc. on the society in the host country. Almost all econometric studies that seek to establish whether a correlation exists between IIAs and FDI however refer to FDI as a *financial* phenomenon: a measure of the value of a border-crossing financial flow or stock, which is implicit by their use of FDI stock or flow data.

The commercial and financial concepts of FDI are not interchangeable, and for a series of reasons set out below, FDI stocks or flows in a financial sense are not a valid measure, or even proxy, for the commercial operations of companies that are assumed to trigger the effects in host and home countries described in the preceding section. This confusion of the different concepts of "FDI" effectively breaks the link between the two hypotheses mentioned earlier – about the effects of international capital flows on the one hand and the effect of IIAs on capital allocation on the other – that both need to be valid as a condition to affirm economic effects of investment treaties on involved societies.

FDI data are compiled according to criteria that serve a purpose in the context of economic accounts and balance of payments statements. As a result, these FDI data:

- are not indicative of the size of engagement or exposure of an enterprise in the host country;
- do not attribute "foreignness" according to the nationality of an investor; and
- do not reflect the origin and destination of a given investment as associated to "home" and "host" country of that investment.

All three aspects have been recognised in the literature for many years and are summarised again in the following.

Capital Accumulation", British Journal of Political Science, 44, p.107. Jason Webb YACKEE (2016), "*Do BITs 'Work'? Empirical Evidence from France*", Journal of International Dispute Settlement, 7, p.62. Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.158. Earlier examples of some degree of awareness of some of the problems include Tim BÜTHE/Helen V. MILNER: "*Bilateral investment treaties and foreign direct investment: a political analysis*" in Karl SAUVANT (Ed.), Yearbook of International Investment Law and Policy 2009/2010, p.190 and J Anthony VANDUZER/Penelope SIMONS/Graham MAYEDA (2012), "*Integrating Sustainable Development into International Investment Agreements: A Guide for Developing Countries*", p.513.

48 Andrew KERNER (2014), "*What We Talk About When We Talk About Foreign Direct Investment*", International Studies Quarterly 58, p.804. Sjoerd BEUGELSDIJK/Jean-François HENNART/Arjen SLANGEN/Roger SMEETS (2010), "*Why and how FDI stocks are a biased measure of MNE affiliate activity*", Journal of International Business Studies (2010) 41, 1444–1459. Robert E. LIPSEY (2007), "*Defining and measuring the location of FDI output*", NBER Working Paper Series, Working Paper 12996, p.5.

FDI data are not indicative of the size of an engagement or the exposure of an enterprise in another country

Most countries compile and report FDI data in accordance with international standards – the benchmark definition for foreign direct investment (BMD) –, a standard that is developed at the OECD.[49] This standard describes which financial flow between two countries is to be included in the statistics. The standard qualifies a trans-border investment as a *direct* investment if the investor owns at least 10% of the voting power in an enterprise. This threshold is not linked in any way to the liquidity of the investment, a criterion that is often advanced when considering FDI data in the context of IIAs, or its exposure to adverse state behaviour.[50] It has been shown that an important share of what is measured as FDI is in fact highly liquid.[51]

The benchmark definition for foreign direct investment in turn excludes investments that do not reach the 10% threshold. However, portfolio flows are an important source of foreign capital in host economies. Portfolio investment is also typically covered by the investment definition of IIAs and thus the related protections; portfolio investments have also played a role in investment disputes.[52]

That econometric studies focus on FDI data may be understood as an implicit use of a proxy. However, the validity of this proxy is very uncertain. Without having studied the matter for individual countries, it appears likely that the validity of FDI as a proxy for overall capital flows varies: in host countries where smaller companies dominate and where foreign capital is limited to or concentrated in sectors associated with controlling stakes, FDI may be a relatively valid proxy for the overall inflow of foreign capital; in turn, in host countries that have mature and deeper capital markets, larger companies, and industry sectors where minority shareholdings are more common, non-FDI inflows are likely to constitute an important share of overall capital inflows. The ratio between liquid and illiquid assets also depends on the sector, which again introduces country characteristics.[53]

Furthermore, the rules on the compilation of FDI statistics imply that certain transactions – such as repatriation of earnings and intercompany loans that the investment grants its parent enterprise – increase

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[49] FDI is defined as a category of cross-border investment made by a resident entity in one economy with the objective of establishing a lasting interest in an enterprise that is resident in an economy other than that of the direct investor. Direct investment is considered evident when the direct investor owns directly or indirectly at least 10% of the voting power of the direct investment enterprise. OECD Benchmark Definition of Foreign Direct Investment - 4th Edition, paragraphs 29 and 31.

[50] Andrew KERNER/Jane LAWRENCE (2012), "*What's the Risk? Bilateral Investment Treaties, Political Risk and Fixed Capital Accumulation*", British Journal of Political Science, 44, p. 107 (108).

[51] Andrew KERNER/Jane LAWRENCE (2012), "*What's the Risk? Bilateral Investment Treaties, Political Risk and Fixed Capital Accumulation*", British Journal of Political Science, 44, p. 107 (109) reports that according to BEA data, on average only 24% of total assets of foreign affiliates of U.S. multinational enterprises were invested in plant, property and equipment, while 43% were current – hence liquid – assets.

[52] *Ping An Life Insurance Company of China, Ltd and Ping An Insurance (Group) Company of China, Ltd* for instance brought a case against Belgium over a measure related to *Fortis*, in which the investor held a 4,81% stake (Award in ICSID Case No. ARB/12/29, para 57). On shareholder claims under IIAs more generally see David GAUKRODGER (2014), "*Investment treaties and shareholder claims: analysis of treaty practice*", and David GAUKRODGER (2014), "*Investment treaties and shareholder claims for reflective loss: insights from advanced systems of corporate law*".

[53] Information on proportions for United States MNEs are available in Andrew KERNER/Jane LAWRENCE (2012), "*What's the Risk? Bilateral Investment Treaties, Political Risk and Fixed Capital Accumulation*", British Journal of Political Science, 44, p. 107 (115).

or decrease measured FDI volumes, at times turning the value of the FDI negative for individual investments or even countries' aggregates.[54] Many of these transactions may not be relevant for the importance of an investment in or for the host country, as they do not affect the operation of the enterprise.[55] This is a particular problem for analysis that relies on more volatile FDI flow data. These forms of detachment of the stated value of FDI make FDI statistics a poor measure of a company's engagement: even a company that is recorded to contribute *negative* FDI stock to the host country may still generate employment, transfer know-how, and have spill-over effects, for instance.

FDI data do not attribute foreignness according to nationality

A further feature of FDI data is that it designates investment as "foreign" if it involves a trans-border capital flow; the beneficial ownership of the capital in question does not matter. For this reason, even capital originating in the host country itself may still be recorded as "foreign", provided it has transited through one or more other jurisdictions. This practice, known as round-tripping,[56] is far from trivial: in some jurisdictions, round-tripping domestic investment counts among the largest sources of "foreign" investment.[57]

Inversely, if a foreigner raises capital locally in the host country to invest it in an enterprise there, no FDI flow is recorded, but such investments remain nonetheless protected by an IIA. Again here, the proportion of local borrowing by foreign companies to finance their investment – and thus the disconnect between FDI data and foreign-controlled assets – is not trivial. For instance, United States majority-owned foreign affiliates in 53 countries over the period 1983 to 2001 were found to have total balance sheets about four times as large as the cross-border component of foreign direct investment (FDI), but the degree to which they drew on local capital markets for financing of their investment varied in relation to whether

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54 A matrix of bilateral FDI stock data based on OECD and IMF data for the years 2010 to 2014 among 248 economies shows negative values for 4% of these relationships for which data are available; it is likely that a non-negligible share of individual investments are recorded as negative stock. There is no disaggregate data available on investment level that would allow an estimate of how individual investments are recorded in FDI statistics.

55 Andrew KERNER (2014), "*What We Talk About When We Talk About Foreign Direct Investment*", International Studies Quarterly 58, pp.804 provides a series of illustrative examples of the disconnect between FDI data and economic activity of multinational enterprises.

56 Gus VAN HARTEN (2010), "*Five Justifications for Investment Treaties: A Critical Discussion*", Trade, Law and Development, p.19 (29). The availability of IIA protections depends on the definitions of the covered investor in each individual treaty. In most cases, an investor is covered if it is incorporated in one of the treaty parties, regardless of the nationality of the beneficial owner. As incorporation is easy to arrange in many jurisdictions, even beneficial owners from the host country itself can benefit from treaty protections if they invest through an entity incorporated in the other treaty partner. Arbitral decisions on the protection in round-tripping cases is uneven; the tribunal in *TSA Spectrum de Argentina SA v. Argentina* denied protection under the ARG-NL BIT, see TSA Spectrum de Argentina S.A. v. Argentine Republic, Award, 19 December 2008, ICSID Case No. ARB/05/5, Para 39; the tribunal in *The Rompetrol Group N.V. v. Romania*, Decision on Respondents Preliminary Objections on Jurisdiction and Admissibility, 18 April 2008, ICSID Case No. ARB/06/3 accorded treaty protection; in both cases, a national of the host country had incorporated the claimant in the Netherlands, where it had no employees.

57 Recent FDI statistics developed under the new BMD4 standard show that in every country publishing these statistics, investors from that country are among the top 10 sources of FDI into that country, see OECD, "*FDI statistics by the ultimate investing country*", March 2015, p.5.

revenues are denominated in local or foreign currency – which depends largely on the purpose of the investment abroad –, the development of local financial markets, and a range of other factors.[58]

As one of the assumed benefits commonly associated with foreign investment are spill-over effects related to the transfer of technology and know-how between economies, especially where these competencies lack in the host country, the attribution of "foreignness" matters, and so do the misalignment between FDI data and exposure of foreigners.

FDI data do not reflect the origin and destination of a given investment as home and host country

FDI data used for the extant econometric studies are at best compiled under the standard set out in Benchmark Definition of Foreign Direct Investment 3rd edition (BMD3), [59] which was applied until very recently.[60] FDI data compiled under this standard record flows between immediate counterpart countries rather than between the ultimate investing country (UIC) – the residence of the beneficial owner (*home country*) – and the final destination country (DC) of the investment (*host country*). Investments that are channelled through multiple jurisdictions for business, tax, or other regulatory motives are thus recorded as several separate transactions for each step in the chain from the home to the host country.[61] In turn, the flow between home and host country is not recorded as having happened between these countries.

The structuring of investment through transit countries is now a significant phenomenon. Special Purpose Entities (SPEs) – which can be used to channel investments through a jurisdiction – account for over 90% of FDI into Luxembourg and for around 80% of FDI into the Netherlands, for instance.[62] In terms of absolute volume, outward FDI stock of the Netherlands, for instance, is almost the same volume as outward FDI stock of the United States, and four times that of Germany. Luxembourg's FDI outward stock is double that of Germany, and the third largest in the world for a single country. While SPEs typically can[63] and do use IIAs to bring claims,[64] the resident country of the SPE does not experience the

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58 Alexander LEHMANN/Selin SAYEK/Hyoung Goo KANG (2004), "*Multinational Affiliates and Local Financial Markets*". IMF Working Paper 04/107.

59 Some countries, especially those with weak institutional capacity, may not be in a position to report or apply the BMD3 standard. Advanced economies and some transition economies have very recently begun to compile FDI data under the Benchmark Definition for FDI 4th edition (BMD4), which makes recommendations for supplemental FDI statistics. However, not all countries, and especially very few or no developing countries, the focus of the econometric studies, apply these standards yet.

60 While the new standard, the Benchmark Definition 4th edition (BMD4) was completed in 2008, most of those countries following this recommendation only started reporting under the new standard since 2014.

61 For details, see "*Implementing the latest international standards for compiling foreign direct investment statistics – FDI statistics by the ultimate investing country*", OECD 2015.

62 OECD (2015), "*FDI in figures – April 2015*", p.5 and OECD (2015), "*How multinational enterprises channel investments through multiple countries*", p.3.

63 Some treaties may not offer this possibility as they require a substantial economic bond with the home State or apply additional criteria beyond formal incorporation, see examples in Christoph SCHREUER (2009), "*Nationality of Investors: Legitimate Restrictions vs. Business Interests*", ICSID review 24 (2), p.521.

64 See for the Netherlands Roos VAN OS/Roeline KNOTTNERUS (2011), "*Dutch Bilateral Investment Treaties – A gateway to 'treaty shopping' for investment protection by multinational companies*", SOMO, p.29, according to which 41 claims that had been brought under Dutch IIAs and were known as of June 2011; in 29 of them, , the ultimate controlling parent was not Dutch, and 25 of the claimants had no staff in the Netherlands.

benefits or costs associated with FDI in "home" or "host" countries, but may experience other benefits or costs as discussed below.[65]

Box 1 shows schematically four scenarios of an FDI flow or stock between two or more countries and the presence of IIAs.

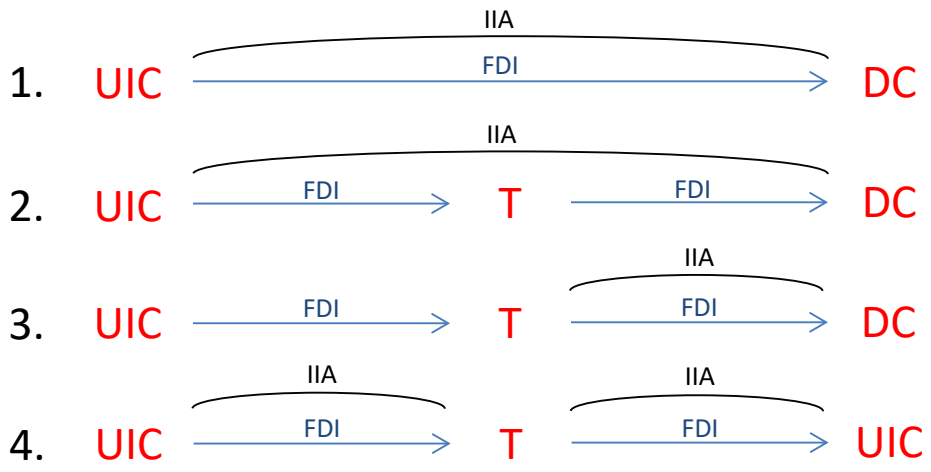
Box 1: **FDI data and IIAs: shortcomings of econometric studies relying on FDI data compiled under BMD3**

This figure represents schematically four scenarios of an FDI flow or stock between two or more countries, and various possibilities for the existence of IIAs between one or more countries. In scenario 1, the foreign direct investment is made between the ultimate investing country (UIC) and the destination country (DC). It will be recorded as FDI flow or stock between UIC and DC, and this relation is covered by an IIA. To the extent that methodological descriptions allow to assume, this is the (sole) scenario that econometric studies have in mind when they seek to assess correlation between presence of IIA and FDI stock/flow. These studies still ignore the fact that treaty-protected capital may have been raised in the host State rather than having flown across the border and is not included in the measured FDI volume.

In scenario 2, the investment is structured through a subsidiary, special purpose entity or the like in transit country T. Here, traditional FDI statistics will record two FDI flows or stocks: UIC—T and T—DC. An IIA exists between UIC and DC, but not between T and DC. The FDI flow, considered twice in the data, will *not* be associated to an IIA.

In scenario 3, the investment is again structured through country T; here, the flow is considered twice, and the flow T—DC will be associated to an IIA, although it is economically unrelated to T.

Scenario 4 shows the situation in which the home and host country of an investment are the same (round-tripping), but the investment is structured through a jurisdiction T, with which an IIA exists. Here, the flow is considered twice as foreign investment despite the absence of any genuinely foreign capital flow, and both the outward and inward movement of capital is associated with the IIA.



To the extent that methodological descriptions in the econometric analysis reveal their approach, almost none considers the impact of round-tripping or transiting capital on the validity of the econometric

[65] Karl SAUVANT (2016), "*The Evolving International Investment Law and Policy Regime: Ways Forward*" E15 Task Force on Investment Policy – Policy Options Paper, p.20.

analysis, or even mentions the implications of transiting capital.[66] A few studies recognise the misalignment of dyadic FDI data and IIAs and use monadic data instead; monadic data aggregates all inflows into a given country from any foreign source and dissociates specific flows from the presence of IIAs.[67] Even monadic data, however, does not address round-tripping.

Some of these problems associated with the use of traditional FDI data are addressed by the new OECD Benchmark Definition of Foreign Direct Investment – 4th Edition (BMD4), which is now being implemented by OECD and some non-OECD jurisdictions. Under this standard, additional FDI data are compiled by the ultimate investing country, thus identifying round-tripping flows.[68] However, for years to come, such more complete data are unlikely to be available, especially for less developed countries. Also, while statistics established under BMD4 will show a more reliable picture of the true origin and destination of international capital flows, they do not address the misalignment of flows and treaty protections, nor will they alter the way repatriation of assets or intercompany loans are accounted for in FDI data.

(b) Conceptualising IIAs protections

The second major area that challenges the validity of extant econometric analysis of treaty effects on investment activity is the conception of treaty protection of investments. Two problems can be identified:

- disregard of IIA protections included in PTAs and multilateral arrangements; and
- the possibility of claims in the absence of a treaty in the relationship between the host country and the country from which the investment is recorded.

Disregard of investment protection stemming from multilateral arrangements and PTAs

In earlier years, IIA protections were most often agreed in bilateral agreements, especially in BITs. Today however, a large part of treaty relationships – both signed and in force – are based on multilateral arrangements or on PTAs[69] both of which are typically equivalent to investment protection mechanisms in BITs. Multilateral arrangements and PTAs also play an important role for claims; the Energy Charter Treaty, a multilateral agreement, alone is the basis for over 12% of known ISDS claims,[70] and more than

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66 Exceptions – to some extent – include Tim BÜTHE/Helen V. MILNER: "*Bilateral investment treaties and foreign direct investment: a political analysis*" in Karl SAUVANT (Ed.), Yearbook of International Investment Law and Policy 2009/2010, p.190; J Anthony VANDUZER/Penelope SIMONS/Graham MAYEDA (2012), "*Integrating Sustainable Development into International Investment Agreements: A Guide for Developing Countries*", p.513, which are among the few papers that explicitly mention at least one of the several issues. Martin H. THELLE/Eva R. SUNESEN/Joseph FRANCOIS (Copenhagen Economics) (2012), "*EU-China Investment Study–Final Report*", p.46 express general scepticism about the value of FDI data for the analysis of BITs, given the high aggregation.

67 Tim BÜTHE/Helen V. MILNER: "*Bilateral investment treaties and foreign direct investment: a political analysis*" in Karl SAUVANT (Ed.), Yearbook of International Investment Law and Policy 2009/2010, Oxford, pp.188-190 argue that monadic approaches are not affected.

68 For details, see "*Implementing the latest international standards for compiling foreign direct investment statistics–FDI statistics by the ultimate investing country*", OECD 2015.

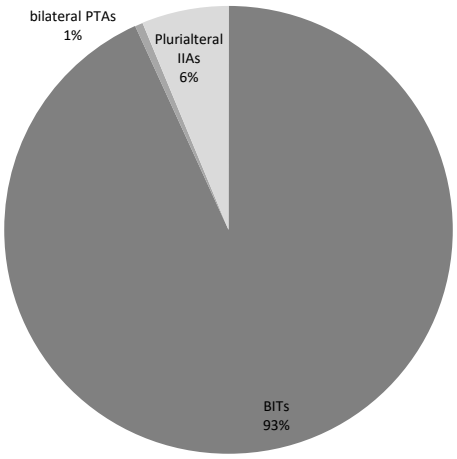
69 The Energy Charter Treaty contributes in an important way to this result, even though it applies only to a limited scope of investments. Other multilateral arrangements, e.g. covering ASEAN, Caribbean or Arab League States etc., are examples of IIAs that generate a great number of bilateral relationships outside BITs.

70 As of mid-September 2017, the Energy Charter Secretariat listed 108 known cases brought under the ECT; at the same time, slightly over 800 IIA-based investor claims had become known.

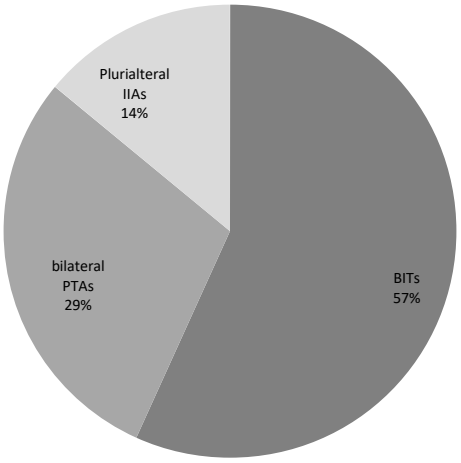
5% of known claims were brought under NAFTA, a trilateral agreement.[71] PTAs and multilateral arrangements are also significant in terms of treaty-covered FDI stock.

Figure 3 below shows the share of bilateral investment protection arrangements involving at least one participant in the FOI Roundtable in the overall number of arrangements in force as of mid-2017 (the Energy Charter Treaty is not included because of its sectoral coverage); at the time of writing, BITs made up 93% of treaty relations that were in force and involved at least one Roundtable participant. In terms of cover of FDI stock, BITs play a much lesser role in comparison to other types of arrangements; only slightly more than half of the FDI stock covered under investment protection agreements are covered by BITs, while the remainder is covered by PTAs or multilateral arrangements.[72]

Figure 3: **Role of BITs in providing treaty coverage: absolute numbers and relative contributions to coverage of FDI stock**



Number of bilateral relationships with BIT-based investment protection in force compared to number of bilateral relationships where protection is based on other types of arrangements



Relative contribution of different arrangements to procure treaty coverage of FDI stock

Source: OECD IIA database. Does not include Energy Charter Treaty. In-force status is assessed as of mid-2017; the proportions may have been different when earlier studies were conducted.

Despite the importance of multilateral arrangements and investment chapters in PTAs, many if not most econometric studies reviewed for this paper take exclusively BITs into consideration.[73] This approach is likely to distort the results significantly. The extent of this distortion depends on the model used for the econometric analysis and the country sample. Many studies that focus exclusively on the role of BITs or of bilateral arrangements are likely to be affected because the absence of a bilateral treaty is confounded with the absence of investment protection, while in reality an equivalent arrangement is in place; this "pollutes"

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71 Cases filed under NAFTA against Canada are listed here.

72 The calculations use FDI stock data despite the problems associated with this data for the present purpose. The reference to treaty-covered FDI stock is only meant in an indicative sense to demonstrate the importance of the issue and its likely impact on the validity of the econometric studies that focus exclusively on BITs.

73 See for an exception Andrew KERNER/Jane LAWRENCE (2012), "*What's the Risk? Bilateral Investment Treaties, Political Risk and Fixed Capital Accumulation*", British Journal of Political Science, 44, p. 107. It is admitted that some studies specifically assess the impact of BITs. On this problem see immediately below.

the control group. Even where studies only focus on the relationship between a developed and a developing country – where PTAs have so far been rare –, such relationships are often covered by multilateral arrangements, especially in South-East Asia, in the MENA region, and under the Energy Charter Treaty.

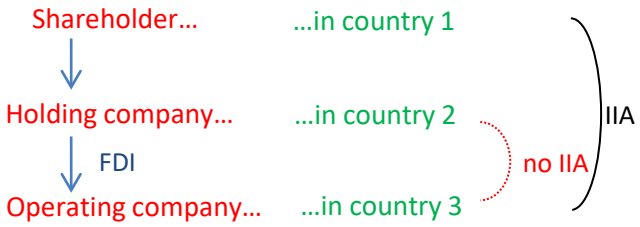
Possibility of treaty-based claims in the absence of a treaty

All of the reviewed studies appear to overlook that IIA benefits are often available – under their current interpretation – even in the absence of a treaty between the countries for which an investment flow is recorded, further adding to the problem of associating IIAs relationships with FDI data.

The availability of treaty protections without a treaty in the relationship in which FDI is measured results from the interpretation that arbitral tribunals have given to the scope of recoverable losses by shareholders including indirect shareholders.[74] Indirect shareholders are typically owners of shares in a company that owns an operating company. Under many treaties as interpreted by arbitral tribunals in ISDS, indirect shareholders can seek damages for a drop in the value of their shares ("reflective loss") if the operating company in a third country is affected by host government measures – provided that they are themselves covered by a treaty in force between their country of nationality and the host country (see Box 2.) This scenario occurs for instance where investments are made through a subsidiary in a low-tax jurisdiction that has not concluded an applicable IIA. It is by no means a marginal phenomenon, and many, especially larger companies, are actively structuring their investments to benefit from this possibility.

Box 2: **Shareholder claims and mismatch between recorded FDI flow and IIA protection**

This figure represents schematically how under many treaties a shareholder in a holding company resident in country 1 that owns an interest in an operating company resident in country 3 through a holding company in country 2 can bring claims for (reflective) losses resulting from measures taken by country 3, even in the absence of an IIA between countries 2 and 3: The shareholder can claim that the measure has damaged the value of its indirect investment in the operating company, and that under the IIA between countries 1 and 3, this damage must be compensated.



In this scenario, the recorded investment and the IIA relationship do not lie in parallel. Again here, econometric studies such as those reviewed for this paper would not "see" the IIA between countries 1 and 3 – the flow to the host country (country 3) is recorded to originate in country 2, affecting measurement in the control group, among problems.

[74] Participants in the Freedom of Investment Roundtable have extensively discussed the unique treatment of shareholder claims under Investor-State Dispute Settlement and many investment treaties as interpreted. See, e.g., David GAUKRODGER (2013), "*Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency*", OECD Working Papers on International Investment, 2013/03; Summary of discussions of Roundtable on Freedom of Investment 19 (15-16 October 2013); Presentation by Eilís FERRAN on reflective loss in corporate law and ISDS, (October 2013). For a recent discussion see OECD (2016), "*The impact of investment treaties on companies, shareholders and creditors*", in: OECD Business and Finance Outlook 2016.

Another – probably narrow – avenue under which a claim can be brought even though no IIA exists in the bilateral relationship in which the investment is recorded is opened through Investment Incentive Agreements that some countries have concluded in the context of state-sponsored investment insurance and guarantee mechanisms. Even though the insured and injured enterprise may not be able to benefit from IIA protections, the Investment Incentive Agreement may provide the insurer access to arbitration to bring a claim against the host country if the insurance was called.[75]

Conclusions on econometric assessments of the relationship between IIAs and FDI

Given these methodological issues, most of which affect all or almost all studies, it is unsurprising that the several dozen econometric studies[76] that have tested whether there is a correlation between the existence of IIAs and FDI inflows to developing countries show diverse and at time contradicting results. Some studies found positive correlation, at least in certain configurations,[77] some found a very weak, no, or

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[75] The claim announced by the Unites States *Overseas Private Investment Corporation* (OPIC) against India in the case of the *Dabhol Power Company* illustrates the use of this mechanism. The initial investors had structured their investment through Mauritius, thus benefiting from the India-Mauritius BIT (1998) in the absence of an India-United States IIA. OPIC, which had incurred losses but was itself not covered by an IIA, announced the claim under the India-United States Investment Incentive Agreement (1997) using a subrogation clause of that agreement.

[76] Christian BELLAK (2015), "*Economic Impact of Investment Agreements*", Vienna University of Economics and Business Department of Economics Working Paper No.200, counts 42 published studies on the issue published between 1998 and 2015, and BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.179, lists 34 studies.

[77] Matthias BUSSE/Jens KÖNIGER/Peter NUNNENKAMP (2008), "*FDI Promotion through Bilateral Investment Treaties More Than a Bit?*", Proceedings of the German Development Economics Conference, Zürich 2008, No. 4. Max BÜGE "*Do Preferential Trade Agreements Increase Their Members' Foreign Direct Investment?*", d.i.e. Discussion Paper 37/2014 (BÜGE finds a positive correlation between PTAs and bilateral FDI flows, and for BITs between developing and developed countries, but not for BITs between two developed countries). Andrew KERNER (2009), "*Why Should I Believe You? The Costs and Consequences of Bilateral Investment Treaties*." International Studies Quarterly, 53(1), p.73. Eric NEUMAYER/Laura SPESS (2005), "*Do Bilateral Investment Treaties Increase Foreign Direct Investment To Developing Countries?*", in Karl SAUVANT/Lisa SACHS (Eds.), "*The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows"*, Oxford University Press, 2009, p.248. Peter H. EGGER /Michael PFAFFERMAYR (2004), "*The Impact of Bilateral Investment Treaties on Foreign Direct Investment*" Journal of Comparative Economics, Vol. 32, No. 4, pp.788-804, December 2004 find positive correlation with ratified BITs. Jeswald SALACUSE/Nicholas SULLIVAN, "*Do BITs really work? An Evaluation of BITs and Their Grand Bargain*" Harvard International Law Journal, 2005 (SALACUSE/SULLIVAN find the positive correlation only for United States BITs however, not for BITs concluded by other OECD members). Arjan LEJOUR/Maria SALFI (2015), "*The Regional Impact of Bilateral Investment Treaties on Foreign Direct Investment*", Netherlands Bureau for Economic Policy Analysis find a significant increase in FDI stocks for BITs in developed-developing country pairs, but not between developed economies. Rod FALVEY/Neil FOSTER-MCGREGOR (2017), "*Heterogeneous effects of bilateral investment treaties*", Rev World Econ (2017) 153:631–656 find a positive correlation that grows when source and host have larger differences in economic institutions, but disappears when there are relatively large differences in the strength of political institutions between source and host countries. Yoram HAFTEL (2010) "*Ratification Counts: US Investment Treaties and FDI Flows into Developing Countries.*" *Review of International Political Economy* 17, No.2, p.348-77, also finds a positive correlation for United States BITs that are in force; according to HAFTEL, such IIAs in force increase United States investment in developing host countries from 0.07% of host country GDP to 0.24% of host-country GDP; to put this into perspective, the *total* inward FDI stock/GDP ratio of United States treaty partners – considering only bilateral IIAs in force as of mid-2016 – ranges between 2% and 243%, with a median value of 30% (calculated on treaty data recorded in the OECD IIA database and on OECD and IMF inward FDI stock data as of 2014).

even negative correlation with IIAs,[78] and some studies found correlation between IIAs and greater inflows, but not necessarily from the States with which a treaty has been concluded.[79]

Greater sophistication or modified approaches of later studies[80] – to control for endogeneity; to use monadic instead of dyadic FDI data; to use outflow data from capital exporters rather than inflow data of predominantly capital-importing countries;[81] or to differentiate along various treaty characteristics (e.g. in-force status of treaties, more or less stringent dispute settlement provisions[82] or 'strength' of a given treaty,[83] liberalisation obligations, or nature of the treaty[84]) – have not brought about more unambiguous

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78 Emma AISBETT (2007), "*Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation*". Molly LESHER/Sébastien MIROUDOT (2006), "*Analysis of the Economic Impact of Investment Provisions in Regional Trade Agreements*", OECD Trade Policy Papers, No. 36 find a positive correlation with RTAs, but no significant correlation with BITs. Jason Webb YACKEE (2008), "*Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?*", Law&Society Review Volume 42 (2008), p.805. Jason Webb YACKEE (2010), "*Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*", Virginia Journal of International Law, Volume 51, Number 2, p.397. Susan ROSE-ACKERMAN/Jennifer TOBIN (2005), "*Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties*", Yale Law&Economics Research Paper No. 293 (2005). Mary HALLWARD-DRIEMEIER, "*Do BITs attract FDI? Only a bit… and they could bite*", World Bank Working Paper, (2003). Specifically for the United States, Clint PEINHARDT/Todd ALLEE (2012). "*Failure to Deliver: The Investment Effects of US Preferential Economic Agreements*", *The World Economy* 35:6, show that very few countries that have signed PTAs, TIFAs and BITs with the United States have increased investment inflows from the United States.

79 Andrew KERNER (2009), "*Why Should I Believe You? The Costs and Consequences of Bilateral Investment Treaties*." *International Studies Quarterly*, 53(1), p.73. Eric NEUMAYER/Laura SPESS (2005), "*Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?*".

80 A summary of the approaches and findings of some of the cited studies is available in: Liesbeth COLEN/Miet MARTENS/Johan SWINNEN, "*Determinants of foreign direct investment flows to developing countries – the role of international investment agreements*", in: De SCHUTTER/SWINNEN/WOUTERS: "*Foreign Direct Investment and Human Development*" (2013), p.130. Tim BÜTHE/Helen V. MILNER: "*Bilateral investment treaties and foreign direct investment: a political analysis*" in Karl SAUVANT (Ed.), Yearbook of International Investment Law and Policy 2009/2010, p.171. A more detailed critique of the shortcomings of individual studies' designs is available in Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", Chapter 6.

81 Jason Webb YACKEE (2016), "*Do BITs 'Work'? Empirical Evidence from France*", Journal of International Dispute Settlement, 2016, p.7.

82 Jason Webb YACKEE (2008), "*Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?*", Law&Society Review Volume 42, Issue 4, pp.805-832. Additional recent studies that differentiate analysis in relation to IIA content include: Axel BERGER/Matthias BUSSE/Peter NUNNENKAMP/Martin ROY, "*More Stringent BITs, Less Ambiguous Effects on FDI? Not a Bit!*", Kiel working papers No. 1621, April 2010. Axel BERGER/Matthias BUSSE/Peter NUNNENKAMP/Martin ROY (2010), "*Do Trade and Investment Agreements Lead to More FDI? Accounting for Key Provisions Inside the Black Box*", Kiel Working Paper No. 1647. Ka Zeng/Yue Lu (2016), "*Variation in Bilateral Investment Treaty Provisions and Foreign Direct Investment Flows to China, 1997–2011*", International Interactions 2016, p.820.

83 E.g. Jay DIXON/Paul Alexander HASLAM (2015), "*Does the Quality of Investment Protection Affect FDI Flows to Developing Countries? Evidence from Latin America*", The World Economy.

84 Some research shows that FDI flows increase in the presence of an PTA, e.g.: Tim BÜTHE/Helen V. MILNER (2008), "*The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements?*", American Journal of Political Science, Vol. 52, p.741 find positive correlation for WTO membership and for PTAs. Molly LESHER/Sébastien MIROUDOT (2006), "*Analysis of*

findings; a recent meta-analysis of a large number of econometric studies concludes, after correcting notably for publication selection bias, that there is no empirical confirmation that BITs increase FDI flows or stocks.[85] This finding does not account for the conceptual problems identified above, that are present throughout the set of econometric studies, and that undermine validity and relevance for the question whether the presence of IIAs influences allocation of foreign investment; even if investment treaties were correlated with larger amounts of measured investment, this could result from their effect on the legal structure of foreign investments, not on their destination and volume.[86]

For completeness, it should be mentioned that similar studies relying on the same kind of approach have been carried out to assess the impact of treaty-based litigation on FDI flows to the concerned respondent countries. They found that respondents to claims experience substantial losses in FDI inflows, regardless of whether or not they prevail in the case; furthermore, loss of a treaty-based arbitration case has been found to lead to further, large losses in FDI inflows.[87] It was also found that a claim against a country leads to a greater fall in FDI from sources with a BIT in place than from unprotected sources.[88]

It is possible that different data would lead to a different, potentially more accurate picture on the effect of IIAs on investment decisions. Data on Activities of Multinational Enterprises or data collected by commercial providers[89] may provide information on the activities of foreign affiliates in host countries

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the Economic Impact of Investment Provisions in Regional Trade Agreements", OECD Trade Policy Papers, No.36 find positive correlation with RTAs. Tom KENYON/Yotam MARGALIT (2014), "*Does Joining International Treaties Attract Foreign Investment? Experimental Firm-Level Evidence*" find positive correlation with the presence of international economic agreements and attribute this to market-enhancing opportunities rather than "credible commitment" or "signalling" effects of IIAs. Arslan Tariq RANA/Mazen KEBEWAR, "*The Political Economy of FDI flows into Developing Countries: Does the depth of International Trade Agreements Matter?*", find a positive correlation between FDI flows and comprehensive trade agreements, but none with "partial scope agreements" such as BITs; RANA/KEBEWAR explain the correlation with the former treaties' stronger "credibility of commitments" compared to those made in "partial scope agreements". Max BÜGE "*Do Preferential Trade Agreements Increase Their Members' Foreign Direct Investment?*", d.i.e. discussion paper 37/2014 finds a strong and robust positive correlation between PTAs and bilateral FDI between their members. Congress of the United States, Congressional Budget Office (2003) "*The Effects of NAFTA on U.S.-Mexican Trade and GDP*", p.4 suggests that an increase in FDI flows to Mexico resulted from a reduction of trade barriers. Jean-Baptiste VELUT "*NAFTA's Developmental Impact on Mexico: Assessment and prospects*", IdeAs 2011, para 14. In turn, some research points rather to the opposite: Yong Joon JANG (2011), "*The Impact of Bilateral Free Trade Agreements on Bilateral Foreign Direct Investment among Developed Countries*", The World Economy 34(9), 1628-1651. Cristina LIRA/Junsoo LEE/Byung Ki LEE/Robert REED (2010) "*The Impact of Free Trade Agreements on Foreign Direct Investment: Controlling for Endogeneity through a Dynamic Model Specification*" find that FDI is either unrelated to participation in an PTA or is negatively affected.

85 Christina BELLAK (2015), "*Economic Impact of Investment Agreements*", Vienna University of Economics and Business, Department of Economics Working Paper No.200.

86 Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.178.

87 Todd ALLEE/Clint PEINHARDT (2011), "*Contingent Credibility: The Impact of Investment Treaty Violations on Foreign Direct Investment*". Emma AISBETT/Matthias BUSSE/Peter NUNNENKAMP (2016), "*Bilateral Investment Treaties Do Work; Until They Don't*", Kiel Working Paper No. 2021.

88 Emma AISBETT/Matthias BUSSE/Peter NUNNENKAMP (2016), "*Bilateral Investment Treaties Do Work; Until They Don't*", Kiel Working Paper No. 2021.

89 E.g. Andrew MYBURGH/Jordi PANIAGUA (2016), "*Does International Commercial Arbitration Promote FDI?*" Journal of Law and Economics, use firm-level data of greenfield investment collected by the Financial Times for an econometric study on a related topic.

(e.g. production, employment, value added, research and development, labour compensation, exports, etc.), but are available for a lower number of countries or shorter time series, or at cost.

(2) Alternative econometric measurement of the impact of the presence of IIAs

The focus of researchers on attempts to establish through econometric analysis whether a correlation exists between the presence of IIAs and an FDI flows may have detracted from or crowded out alternative quantitative approaches to determine the effect that IIAs may or may not have on investment decisions.

Only a few studies have been carried out that use different quantitative approaches or datasets: One study uses micro-level data on the foreign activity of German MNEs in the context of BIT signature and ratification to generate descriptive and econometric evidence on changes in firm activity in this timeframe.[90] The study found that in the timeframe around (+/- 2 years) the signature or ratification of a BIT that falls between 1996 and 2005, the number of firms per country and the number of affiliates augments in a different pattern compared to a control group. While the approach of using micro-level data has potential, the study design and conclusion leave a number of questions open.[91]

A second study that uses alternative econometric measurement relies on aggregate but differentiated survey data collected by the United States Bureau of Economic Analysis (BEA) on the activities of United States multinational companies.[92] The study considers only illiquid assets that United States MNEs hold abroad – instead of FDI data – and seeks to establish econometrically whether a correlation exists between the presence of BITs and several measurements of MNE activity abroad. This study finds that there is a positive, albeit small correlation between the ratification of an IIA between the United States and a partner country and investment in fixed assets by United States MNEs in the partner country.

(3) Business awareness and attitudes about IIAs

Studies of business awareness and attitudes towards IIAs test the same hypothesis as econometric measurements of the role of IIAs in allocating FDI, but take a different approach. While aggregate FDI flow data measures to some extent the outcome of multiple individual business decisions quantitatively, business attitudes provide qualitative insights on how individual businesses perceive the risk-reducing role of IIAs and thus potentially positively affect their investment decisions.[93] Business attitudes also

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[90] Peter EGGER/Valeria MERLO (2012), "*BITs Bite: An Anatomy of the Impact of Bilateral Investment Treaties on Multinational Firms*", *Scand. J. of Economics* 114(4), 1240.

[91] These issues, which would require more detailed discussion, include: a strong suggestion of endogeneity of BIT signature, which is also widely recognised in the literature, but which the study does not seem to control for. Further, the study does not explain the rationale for the composition of the 91-strong country sample, which includes some but by far not all countries with which Germany has concluded BITs – but which are all developing or transition countries –, and a few other countries, essentially advanced economies. The observed effect may thus be linked to the development status of the country rather than the presence of a BIT; nonetheless, it appears that the study only controls for GDP, not GDP per capita. Also, the control group in the study contains a high proportion of countries with which BITs were in place *before* the chosen study interval. The study thus appears to test whether *new* BITs have a different effect than an older one, rather than no BIT at all. Further, at least in the case of Germany, neither signature nor entry into force of a BIT is typically an event that is widely publicised or known outside very well informed circles, so that a noticeable response by German businesses to BIT signature would be rather unusual.

[92] Andrew KERNER/Jane LAWRENCE (2012), "*What's the Risk? Bilateral Investment Treaties, Political Risk and Fixed Capital Accumulation*", British Journal of Political Science, 44, p. 107.

[93] A recent econometric study on the petroleum sector found that prices of treaty protected petroleum assets are higher than prices of similar, unprotected assets (Srividya JANDHYALA (2014), "*Institutions sans frontières: International agreements and foreign investment*", Journal of International Business Studies 45(6) , p.649- 669

potentially reveal *why* and *how* IIAs influence investment decisions, and they may reveal effects that may not show as statistically significant changes in FDI statistics.

Surveys of investors' awareness and appreciation of IIAs have been carried out for several decades. Earlier studies consistently showed little or no awareness about BITs among decision-makers,[94] and even little interest of businesses that investment protection agreements be concluded in the first place.[95] These findings are consistent with the economic literature throughout the 1990s, which did not appear to consider IIA-based investment protection a determinant for magnitude and localisation of FDI by MNEs.[96]

Even the increasing number of treaty-based disputes and the vivid public debate over the merits of the system in the past decade have not induced a marked boost of investors' awareness and appreciation of IIAs. Results of several recent surveys suggest that decision-makers' knowledge and valuation of IIAs for investment decisions remains limited. A study published in 2000 showed that just over half of the surveyed enterprises had working knowledge or general awareness of BITs, and that medium-sized enterprises (turnover under one billion EUR) had far less knowledge than larger enterprises.[97] A survey conducted in 2006, found that almost half of respondents stated that IIAs influenced investment decisions "to a limited extent", and another 20% of businesses stated that the existence of an IIA between their home country and other markets "strongly" affected their decisions to invest abroad.[98] The Australian Productivity Commission reported in 2010 that it had received no feedback from Australian businesses or industry associations indicating that ISDS provisions were of much value or importance to them,[99] a finding replicated beyond Australia in the same year.[100] A further study published in 2010 showed that business decision makers as well as legal counsel of United States corporations viewed the presence of IIAs as a positive albeit not an important or predominant factor when businesses make decisions where to allocate

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(a freely available paper by the same author with the same abstract is available at http://economics.ca/cree2012/paper/018.pdf). This could be interpreted to suggest that business value treaty protection, but would not allow to conclude that IIAs foster flows; the only permitted conclusion is that treaty protection raises prices.

94 Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.189 summarises similar studies covering earlier decades.

95 Robert BASEDOW (2014), "*Business lobbying and international investment agreements - The bureaucratic politics behind the international investment regime*", ETSG Annual Conference 2014 paper.

96 Bruce A. BLONIGEN (2005) "*A review of the empirical literature on FDI determinants*", Atlantic Economic Journal, 2005, pp.383-403

97 TN SOFRES Consulting (2000), "*Attitudes of the European Business Community to International Investment Rules–Final Report*" [prepared on behalf of the European Commission].

98 Matthew SHINKMAN, *"The investors' view: economic opportunities versus political risks in 2007-11*", in: World Investment Prospects to 2011, p.90 and 96. The survey does not reveal what "influence on an investment decision means", and specifically whether the presence of an IIA was a condition for a positive decision, whether the presence of an IIAs resulted in a specific structuring to reach the same destination, or whether the influence of the decision was mere circumstantial.

99 Australian Productivity Commission (2010), "*Bilateral and Regional Trade Agreements, Productivity Commission Research Report*", November 2010, p.270.

100 Lauge POULSEN, (2010) "*The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence*", in: Karl SAUVANT (Ed.), Yearbook of International Investment Law and Policy 2009/2010, pp.539-574.

investment abroad.[101] Similar results were found in 2012 for European investors' attitudes in relation to China.[102]

A different, not fully comparable survey-based study that focuses on risk perception of investors in developing countries, suggests that "political risk" in 2013 ranked second among the constraints to FDI in developing economies.[103] "Political risk" is understood to include issues such as regulatory changes, breach of contract and civil disturbance, thus covering potentially more issues that would normally be considered to be covered by IIAs. 40% of the respondents to this Multilateral Investment Guarantee Agency (MIGA) study reported financial losses due to regulatory changes, and 6% suffered losses due to expropriation in the past three years. It also reported that 8% of the investment claims paid by members of the Berne Union – an international organisation of the export and investment insurance industry – were made for expropriation.

Business associations have also communicated how businesses supposedly see the role of IIAs and in particular ISDS. The *Business and Industry Advisory Committee to the OECD* (BIAC), a business association has stated that its members attach great importance to IIAs.[104] A national business organisation representing SMEs has stated that ISDS is of little value to its members.[105] Some academic studies find different impacts of treaty-based ISDS for different categories of companies.[106]

Governments have also reported on businesses' views on the importance of IIAs and ISDS. Brazil for instance reported that surveys conducted in the preparation of its CFIA showed that arbitration-based ISDS was not a priority for foreign businesses operating in Brazil.[107]

One of the principal shortcomings of survey-based assessments is that the expressed views may not necessarily match action when it comes to investment decisions. IIAs come at no cost to companies,[108] but

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101 Jason Webb YACKEE (2010), "*Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*", Virginia Journal of International Law, Volume 51, Number 2, p.397.

102 Martin H. THELLE/Eva R. SUNESEN/Joseph FRANCOIS (Copenhagen Economics) (2012), "*EU-China Investment Study – Final Report*", pp.51 found that awareness of existing BITs that covered the investments of 200 European companies that had already established investments in China or were in the process of doing so was low, that knowledge and confidence that the IIA protected their investment was even lower and that almost 70% of the respondents stated that the presence of a BIT was not at all or only somewhat important for their investment decision.

103 *World Investment and Political Risk 2013*. MIGA, World Bank Group, p.18.

104 Investor-State Dispute Settlement - An indispensable element of investment protection, BIAC, January 2015.

105 BVMW Positionspapier (2014), "*Stellungnahme im Rahmen des Konsultationsverfahrens der EU-Kommission zum Investitionsschutz im geplanten Transatlantischen Freihandelsabkommen TTIP*", p.1 for the perspective of the German SME association; the position paper was no longer available from the BVMW website in late 2017.

106 Gus VAN HARTEN/Pavel MALYSHEUSKI (2016), "*Who has benefited financially from investment treaty arbitration? An evaluation of the size and wealth of claimants*", Osgoode Legal Studies Research Paper No.14.

107 Oral presentation by Erivaldo GOMES at Freedom of Investment Roundtable 22, held on 17 March 2015.

108 C. Ignacio Suarez ANZORENA/William K. PERRY, "*Protecting Foreign Investments and Arbitration*", In-House Defense Quarterly, Summer 2010: "*What makes BITs unique [among mechanisms to manage political risk], however, is that they are available at no cost and with no strings attached, other than fulfilling their nationality requirements.*"

may still be desirable under certain circumstances – hence the classification of their "importance" can be made lightly.[109]

(4) Investment promotion agencies' attitudes about IIAs

While the two previously mentioned approaches seek to measure the role IIAs may play for investors' decisions, a third approach to determine whether IIAs are likely to influence such decisions is based on the views of potential host governments and their investment promotion agencies (IPAs) regarding the role IIAs play in their efforts to attract foreign capital. If IIAs were an important means in this regard, one would expect that countries that seek to attract investment would actively inform potential investors about their IIAs and make them publicly available; if the specific features of IIAs were to play a role for businesses that ponder whether to invest in a specific country,[110] access to actual authentic treaty is an obvious necessity.

A recent empirical study on this question, based on an assessment of the websites of 155 IPAs and conducted in 2013, found that two thirds of IPAs websites fail to mention BITs at all and, only 6% of the websites offer full texts.[111] Further qualitative findings of this study of the IPA's websites suggest widespread indifference within IPAs on the role that IIAs could play for foreign investors' decisions.

These findings are not limited to IPAs: It has proven difficult or even impossible to get hold of reliable information on IIAs from government websites more generally, let alone full texts or information about in-force status of IIAs, in particular in the context of treaty denunciations. This includes governments of G20 members and those that would be expected to seek to attract foreign capital.[112] Even though some countries may suffer from serious resource constraints or bureaucratic deficiencies, the lack of access to IIAs could suggest that these countries consider that they play a marginal, if any, role in attracting foreign capital. In contrast, countries that are more likely home States of international investors more often make treaty texts available, but even here, access to the treaty texts often require knowledge of the local languages; at times, treaty texts are only available in local languages, even if they exist in principle in other, more accessible, authentic languages.

(5) Political risk insurance policies

Political risk insurance (PRI) policies could also shed light on the perceived effect of IIAs for business decisions: a lower insurance premium in the presence of an IIA could indicate lower perceived risk. This approach is not without problems, as the scope of coverage of political risk insurance and IIAs differs.[113] Also, given a relatively low number of claims, the criteria chosen for insurability and pricing

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[109] The Australian Productivity Commission stated that: "*Of course, such provisions could still benefit particular investors to the extent that they shift political risks associated with investments to host governments and/or provide an avenue for compensation 'after the event'.*" Australian Productivity Commission (2010), "*Bilateral and Regional Trade Agreements, Research Report*", p.270.

[110] Suggested and tested in several econometric studies, e.g. Jay DIXON/Paul Alexander HASLAM (2015), "*Does the Quality of Investment Protection Affect FDI Flows to Developing Countries? Evidence from Latin America*", The World Economy.

[111] Jason Webb YACKEE (2010), "*Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence*", Virginia Journal of International Law, Volume 51, Number 2, p.397.

[112] The OECD Secretariat has not been able to access the full texts of IIAs on official websites of a number of FOI participant countries including those of these countries' investment promotion agencies. Texts of agreements that have been terminated or await entry into force are unavailable for an even greater number of countries.

[113] Jason Webb YACKEE (2014), "*Political Risk and Foreign Investment Law*", Duke Journal of Comparative & International Law Vol.24, p.477.

may not be driven by empirically supported risk measurement but rather by expectations, opinions or policy.[114] The pricing may thus not reflect actual risk.

A non-representative review of policies of some State-backed PRI providers suggests that some institutions take IIAs into account for insurability and pricing, especially State-backed insurers in countries that have large treaty networks:[115] The French and German investment insurance providers explicitly mention the presence of an IIA among the aspects considered for insurance; an IIA is a sufficient – but not a necessary – condition to establish "adequate legal protection".[116] MIGA follows a similar approach.[117] Political risk insurers from other countries, including some countries with large treaty networks – Finland or Italy, for instance – do not explicitly mention the presence of an IIA as a factor for insurance against non-commercial risk.[118]

Data on whether there is a price differential associated with IIA protection is hard to come by even in countries whose institutions take account of the presence of IIAs. Almost no details are publicly available on this issue.[119] A recent interview-based study that sought to determine how the presence of IIAs

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[114] On Germany's historic link between government-sponsored PRI and IIAs see Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.186.

[115] An earlier OECD study on the issue found that "*In many cases (Belgium, Germany, Netherlands) the assessment takes into account the existence of "investment protection agreements" (basically a bilateral investment treaty) between the home and host country*", Kathryn GORDON, "*Investment guarantees and political risk insurance: Institutions, incentives and development*", OECD Investment Policy Perspectives 2008, p.91 (at p.100).

[116] See the website on investment guarantees provided by the German government; revised General Terms of Conditions as of 1 July 2017 also mention in § 14 as a special obligation of the policyholder that "*If the host country terminates an agreement with the Federal Republic of Germany on the promotion and the mutual protection of direct investments and the guaranteed capital investment thereby loses the protection provided by the agreement prior to the expiry of the guarantee period, then the policyholder, in consultation with the Federal Government and due to the now lacking protection under the respective agreement, has to take the necessary measures to protect the capital investment.*"

The website of France's COFACE states that insurance is "in principle" conditional on the presence of an IIA.

[117] Multilateral Investment Guarantee Agency (MIGA) Operational Regulations (As amended by the Board of Directors through December 5, 2012): "*3.16 An investment will be regarded as having adequate legal protection if it is protected under the terms of a bilateral investment treaty between the Host Country and the home country of the investor. When there is no such treaty, adequate legal protection should be ascertained by the Agency in the light of the consistency of the law and practice of the Host Country with international law. Such assessment shall be conducted in strict confidentiality and its outcome shall be shared only with the government concerned with a view to enabling it to improve the investment conditions in its territory.*"

[118] FINNVERA, Finland's export credit and investment insurer, does not suggest that an IIA was a condition for a host country's eligibility; the General Conditions for Equity Investment Guarantees of 2002, which were apparently still current in late 2017, do not mention IIAs in the context of the premium (article 3). Likewise, Italia's SACE website on investment insurance and the website of Japan's NEXI do not indicate that insurance would be conditional on the presence of an IIA. The United States' OPIC does not mention IIAs as determining insurability (OPIC webpage "Doing business with us – where we operate") or as influencing pricing (OPIC webpage "details and costs"). Canada's Export Development Canada (EDC) does also not specify whether IIAs play a role for insurability or pricing.

[119] Germany's investment guarantee provider specifies that "the premium *may* be subject to an increase" if no bilateral IIA has been concluded with a given host country (emphasis added). In correspondence with the OECD Secretariat in 2015, the German government stated that the annual insurance premium is increased by 10% in the absence of an IIA.

influence actual underwriting or pricing practice suggests, however, that IIAs play a marginal role for insurability or pricing for State-sponsored and private political risk insurers as well as MIGA.[120]

(6) Borrowing cost for invested capital

It has been suggested, but not been empirically tested, that IIAs reduce the cost of capital for new investment abroad. Investment treaties' role in lowering risk would drive down the borrowing costs that investors face in their home countries or on international financial markets when planning or implementing such investments. The differential between borrowing costs with or without IIA coverage of the investment could be used as a proxy for IIAs' perceived capacity to lower default risk.[121]

For the time being, no study seems to have used this approach to determine the degree to which IIAs lower perceived risk. Whether lenders would consider the presence of an IIA at all, or whether they would rather consider factors such as: risk rating of the borrower, availability of collateral outside the invested capital, would need to be explored. Challenges resulting from different degrees of debt and equity financing and availability of data may contribute to making this observation method particularly challenging and may explain why this method has yet to be explored.

c. Economic benefits and costs of FDI flows through transit countries for their societies

The previous sections have indicated that transit countries play a role in the context of IIAs. These countries, which are neither home nor host countries of an individual investments but intermediate steps of a financial flow, potentially obtain benefits and may incur costs as a consequence of their IIAs. These are different though from those identified for home and host countries. Of particular interest in this regard are the few jurisdictions through which large volumes of FDI transit, typically without any business presence other than formal incorporation.

Motivations for the inclusion of transit countries in ownership structures include their attractive tax or regulatory regimes, including occasionally investment treaty protections, coupled with attractive rules for the setup of special purpose entities (SPEs).

Transit countries draw a number of benefits from their role, including revenue from legal, accounting and financial services, and tax revenue. The large networks of investment treaties that some of them have concluded contribute to their perceived attractiveness,[122] as most treaties cover investments by SPEs without regard to actual local business activity. The more generous the IIA protections are for investors, the more attractive the jurisdiction may be seen as a residence for SPEs. Law firms and financial service providers who gain from the structuring business have publicised the advantages of structuring FDI through the jurisdiction in which they operate.[123]

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[120] Lauge POULSEN, "*The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence*", in: Karl SAUVANT (Ed.), Yearbook of International Investment Law and Policy 2009/2010, pp.539-574.

[121] It should be noted that lowering of borrowing costs can also be construed as a potential benefit of IIAs in its own right, rather than only an observable indicator. In the absence of any empirical data and limited plausibility of the mechanism, the present paper does not separately assess this aspect as a potential benefit.

[122] Roos VAN OS/Roeline KNOTTNERUS (2011), "*Dutch Bilateral Investment Treaties – A gateway to 'treaty shopping' for investment protection by multinational companies*", SOMO.

[123] Suggested by Loyens&Loeff, in "*The Netherlands: Sound and Proven Gateway to the world*", October 2007 and "*Fund Briefing for Luxembourg, Belgium and the Netherlands–January 2012*", p.14: "In order to remain

It has been suggested that the availability of an IIA in the direct relationship between a home and a prospective host country could *reduce* companies' incentives for structuring through transit countries that offer treaty protections.[124] It is uncertain, however, whether additional IIAs are likely to reduce incentives for structuring through third jurisdictions, in part because tax considerations often play a fundamental role in structuring decisions. Moreover, many existing treaties encourage additional layers of structuring, as multi-tiered structures offer additional options for claims.[125]

2. Do IIAs have a selective function and encourage "better FDI" to flow among treaty partners?

It is occasionally suggested that IIAs help attract "high quality" FDI. No hypothesis has yet been put forward why IIAs would have such a selective function, and criteria for the quality of FDI or its measurement have yet to be agreed. However, if investor protection in IIAs had a selection effect towards "high quality" FDI, IIAs could procure benefits at least to host societies on these grounds.

Where the concept of "high quality FDI" is employed, it is associated with different characteristics. These include:

- investment that encourages physical and human capital formation in the host country or has positive spill-over effects to the host economy;[126] or
- investment that respects standards of responsible business conduct.

IIAs generally do not contain textual features associated with selection of what might be defined as "high quality" FDI. Protections of IIAs typically apply indiscriminately to all kinds of assets listed in the treaty, typically defined in very broad terms and not limited to FDI. Some treaties, e.g. United States BITs extend treaty protections only to investment that fulfils characteristics such as "the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk";[127] these additional characteristics do not, however, represent filters towards what may be understood as "high quality" investment.

The same holds true for the covered investors, which are generally defined according to formal criteria. Even where the protection is limited to investors that fulfil certain criteria, such as having a

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attractive jurisdictions for CIS [collective investments schemes] we have noted, over the last years, the Benelux governments, in particular the Dutch and the Luxembourgish ones, being very active in negotiating DTTs as well as BITs with new countries, especially in emerging markets." Further examples include, specifically for Singapore (VDB-Loi) and Dechert, and, more generally, Clyde&Co. On the benefits and facility of structuring see also C. Ignacio Suarez ANZORENA/William K. PERRY, "*Protecting Foreign Investments and Arbitration*", In-House Defense Quarterly, Summer 2010, p.61.

124 Lauge POULSEN/Jonathan BONNITCHA/Jason Webb YACKEE, "*Analytical framework for assessing costs and benefits of investment protection treaties*", 2013, p.5.

125 See David GAUKRODGER (2013), "*Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency*", OECD Working Papers on International Investment, 2013/03. "*The impact of investment treaties on companies, shareholders and creditors*" in: OECD Business and Finance Outlook 2016.

126 See e.g. "*The development implications of the Multilateral Agreement on Investment, A report commissioned by the Department for International Development*" (1998), p. 15; Thomas FAROLE/Deborah WINKLER (Eds.), *Making Foreign Direct Investment Work for Sub-Saharan Africa, Local Spillovers and Competitiveness in Global Value Chains*, The World Bank Group, 2014; New Zealand Ministry of Economic Development (2011), "*Evaluation of NZTE investment support activities*", p.17.

127 Example taken from United States-Uruguay BIT (2005).

substantial business activity in the host country, these criteria do not appear to have a selective effect in favour of "high quality" investment.

There are rare exceptions to these findings on treaty text, however: Two IIAs in an over 2500-strong treaty sample have been found that appear to contain a discriminating mechanism in favour of "quality" of investment: the Preamble of the China-Peru FTA (2009) states that the concluding governments "RECOGNIZE that this Agreement *should be implemented* with a view toward raising the standard of living, creating new employment opportunities, reducing poverty and […]" (emphasis added). Also, in an exchange of letters to the Germany-Greece BIT (1961), Greece informs the German government that the then required approval of foreign investment would be granted if, in an *ex ante* evaluation by a designated body, the investment "aims at an increase in production or contributes otherwise to the economic progress" of Greece. It appears that no empirical assessment of the selective effect of these clauses has been made.

Some treaty features have been interpreted as actually *prohibiting* host-government efforts to enhance the "quality" of the foreign investment they receive: performance requirements in NAFTA, for instance, were found to forbid host-governments exigencies of research and development or education and training requirements, which could enhance spill-over effects for the host country.[128]

A selective mechanism could also stem from a specific interpretation of the term "investment" under Article 25(1) of the ICSID Convention. Inspired by a phrase in the preamble of this Convention,[129] a tribunal has made the controversial[130] suggestion in passing that a "*contribution to the economic development of the host State*" may be a constituent element of an investment for the purpose of the ICSID Convention and hence condition to jurisdiction *ratione materiae*.[131]. So far, no case has become known in which an ICSID tribunal has denied its jurisdiction on this ground. Were this criterion ever to lead to the denial of jurisdiction, claimants would likely avoid ICSID and bring cases to other tribunals offered as fora in most IIAs[132] to circumvent the additional criterion.

While treaties occasionally contain language associated with responsible business conduct (RBC), the clauses that are currently observed in treaties are also not designed to favour individual investments that meet these criteria; rather the clauses contain references in preambles or obligations to home or host

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128 ICSID Case No. ARB(AF)/07/4 (Mobil v. Canada), Decision on Liability and on Principles of Quantum, May 22, 2012, para.221.

129 The preamble of the ICSID Convention mentions in its preamble, among others "[…] considering the need for international cooperation for economic development, and the role of private international investment therein; […]".

130 Christoph SCHREUER (ed.) (2009), "The ICSID Convention: A Commentary (2nd Ed.)", paras. 164-169; Emmanuel GAILLARD/Yas BANIFATEMI (2015), "*The Long March Towards a Jurisprudence Constante on the Notion of Investment*", in: *Building International Investment Law, the First 50 Years of ICSID*A. Rigo SUREDA (2012), "*Investment Treaty Arbitration: Judging Under Certainty*", p.73.

131 *Salini Costruttori S.P.A. and Italstrade S.P.A. v. Kingdom of Morocco,* ICSID Case No. ARB/00/4, Decision on Jurisdiction (23 July 2001), para. 52: "The criteria to be used for the definition of an investment pursuant to the Convention would be easier to define if there were awards denying the Centre's jurisdiction on the basis of the transaction giving rise to the dispute. […] The doctrine generally considers that investment infers: contributions, a certain duration of performance of the contract and a participation in the risks of the transaction. In reading the Convention's preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition."

132 According to Joachim POHL/Kekeletso Mashigo/Alexis NOHEN (2012), "*Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey*", OECD Working Papers on International Investment, 2012/02, p.21, more than 50% of treaties surveyed offered more than one tribunal.

States.[133] No clause has so far been found in treaty practice that would limit the protection to investments that meet certain "quality" standards, in particular with quality criteria often associated with "high quality FDI". It could be argued that certain IIAs condition treaty protection on whether investments have been made "in accordance with domestic law of the host country"; this clause does not in itself select quality investments but refers to host country domestic law.

The absence of a textual basis in treaties does not exclude the presence of a selection mechanism, however. Economic theory would suggest that the subsidy provided by IIAs to covered investors through the equivalent of free insurance against certain political risks may be most valuable for investments in sectors prone to regulatory changes or expropriation, or to sectors with a higher proportion of "sunk" costs;[134] these would notably include a number of sectors such as resource extraction that are often associated with an impact on environment or health, and sectors that are more likely subject to regulation or in which a larger proportion of the investment is immobile.

For the time being, no empirical study has addressed whether IIAs induce selection of investment that is "high quality FDI" or particularly beneficial to host societies. However, three studies have been found that assess the responsiveness of FDI to IIAs in relation to specific industry sectors or parameters: a study on FDI by industry sector in 12 countries of Central and Eastern Europe found that FDI in mining is more responsive to IIAs than FDI in utilities.[135] A recent study suggests that the presence of BITs that contain ISDS provisions is correlated with infrastructure investment in developing countries, but not with FDI in general;[136] the study does not assess the correlation with other specific sectors. An econometric study based on firm-level data of petroleum reserve acquisitions found that, in this sector, the perception of need for IIA protection and the ability to benefit from it depend on firm characteristics, notably state ownership and reserve size.[137]

None of these findings qualify as evidence that IIAs have a selecting effect in favour of "higher quality FDI" investment. The assumption that IIAs generate societal benefits through a selective function in favour of "high quality FDI" hence lacks empirical backing for the time being.

3. Do IIAs delay or prevent potential divestment decisions?

Independent from the effect of *attracting* new investment that IIAs may or may not have, treaties could have an effect on the *retention* of existing foreign investment that would otherwise be withdrawn under circumstances of perceived deterioration of the conditions for foreign investors in a given country.

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133 Kathryn GORDON/Joachim POHL/Marie BOUCHARD (2014), "*Investment Treaty Law, Sustainable Development and Responsible Business Conduct: A Fact Finding Survey*", OECD Working Papers on International Investment, 2014/01.

134 BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.161. Andrew KERNER/Jane LAWRENCE (2012), "*What's the Risk? Bilateral Investment Treaties, Political Risk and Fixed Capital Accumulation*", British Journal of Political Science, 44, p.107 (108).

135 Liesbeth COLEN/Damiaan PERSYN/Andrea GUARISO (2014), "*What type of FDI is attracted by bilateral investment treaties?*", LICOS Discussion Paper 346/2014; the study does not reveal whether the attribution of the economic sector in the study takes into account the parent company or the affiliate in the host country.

136 Sarah DANZMAN (2016), "*Contracting with whom? The differential effects of investment treaties on FDI*", International Interactions: Empirical and Theoretical Research in International Relations 42, p.452.

137 Srividya JANDHYALA/Robert WEINER (2014), "*Institutions sans frontières: International agreements and foreign investment*", Journal of International Business Studies 45(6), 649-669 (a freely available paper by the same author with the same abstract is available at http://economics.ca/cree2012/paper/018.pdf, p.13.

Under this hypothesis – which has been advanced recently in policy discussions at the OECD but not yet explicitly tested empirically –, foreign investors would delay or not implement potential divestment decisions thanks to the presence of an IIA. Treaty-covered investors would hold out for longer as they feel protected by an IIA, so goes the thought, while investors that lack such protection would divest as soon as conditions appear to deteriorate.[138]

Some of the econometric analyses of the correlation between IIAs and FDI referred to above may include in their measurement the impact of IIAs on divestment; this may notably the case for studies that assess the aggregate of FDI stock over a longer term and thus measure net FDI flows or positions.

No attempt has apparently been made however to observe directly the differential behaviour of firms that are under treaty protection as opposed to firms that lack such protection, an approach that would require firm-level data and a comprehensive understanding of their ownership structure and the resulting treaty coverage. There are further obstacles to empirical testing whether treaty coverage influences firm behaviour in a deteriorating environment: the deterioration may be firm-specific,[139] and a cross-the-board deterioration may make divestment difficult without incurring major losses resulting from the price depression and the unavailability to find acquirers for the assets under divestiture. Also, the possibility to sell assets may be sector-specific.

At present, no evidence is available that would support the hypothesis that IIAs delay or prevent divestment by foreign firms in deteriorating environments in host countries.

4. IIAs' role in remedying or creating market distortions

Investor protection in IIAs is at times credited with contributing to correct existing market distortions, specifically diverse forms of nationality-based discrimination[140] or foreigners' absence of political influence[141] that foreign investors allegedly face when investing abroad. It is also held, to the contrary, that

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138 The retroactive protection of existing investment, which features in many IIAs, could be argued to serve this purpose: As this treaty feature does not attract *additional* investment – see Gus VAN HARTEN (2010), "*Five Justifications for Investment Treaties: A Critical Discussion*", Trade, Law and Development, p.19 (30) –, it could be explained by the motive to retain existing investment; there are many other possibilities to explain why treaties included this clause early on.

139 Daniel J. BLAKE/Caterina MOSCHIERI (2017), "*Policy Risk, Strategic Decisions and Contagion Effects: Firm-Specific Considerations*", Strategic Management Journal, 38: 732–750 (at 734) suggest that governments may discriminate among foreign firms in their behaviour.

140 E.g., the United States Trade Representative (USTR) states in "*CAFTA Policy Brief – July 2007*": "U.S. investment agreements reduce or eliminate discrimination against American investors in overseas markets. These agreements help increase economic efficiency and real incomes in the United States, and expand U.S. trade in goods and services." See Rodolphe DESBORDES/Julien VAUDAY (2007), "*The Political Influence of Foreign Firms in Developing Countries*" Economics and Politics, 19(3), pp. 421-451 on the "political liability of foreignness".

141 Charles N. BROWER/Lee A. STEVEN (2001), "*Who Then Should Judge? Developing the International Rule of Law under NAFTA Chapter 11*", Chicago Journal of International Law: Vol.2: No.1, p.196 identify the absence of political participation as the source of foreign investors' vulnerability: "[…] the interests of alien investors are more vulnerable than those of local investors because, as aliens, they are cut off from any direct participation in the host State's political process and are therefore in greater need of protection at the international level." Similarly Andrej AUERSPERGER MATIĆ (2017) "*Transatlantic Trade and the Case for Investment Protection*", The German Marshall Fund of the United States, postulates, p.13: "[…] by any realistic measure, foreign companies are simply not in a comparable situation with domestic ones when they access new

foreigners enjoy privileged treatment by and political sway in host governments due to relocation threat credibility,[142] and that IIAs actually introduce additional market distortions to the detriment of domestic investors.[143]

Market distortions can reduce economic efficiency, as they favour less competitive firms at the expense of more efficient competitors. If IIAs have a role in correcting – or generating – market distortions, they could thus increase – or reduce – economic efficiency, and thus generate societal benefits or costs independent from the actual volume of foreign investment in a given economy.[144]

To ascertain whether IIAs play a role in remedying or creating market distortions, two conditions must be assessed: (1) to what extent the market is tilted against or in favour of foreign investors as compared to domestic firms and (2) whether IIAs are designed to correct any such distortions.

(1) Do market distortions exist against or in favour of foreign investors?

Empirical assessments of whether the playing field is tilted *against* or *in favour* of foreigners – or whether it is actually level – remain rare. While studies on the *absolute* treatment of foreigners in foreign markets has been described in the literature, only a few studies have been identified that assesses *relative* treatment of foreigners vis-à-vis domestic investors.[145] Overall, the yet limited empirical literature suggests that foreign firms are treated better than domestic firms: A study based on the World Bank Enterprise Surveys for instance found that in low and middle-income countries, foreign firms tend to enjoy relatively better treatment than domestic firms. A series of further studies based on the World Business Environment

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markets and start economic operations. They lack the political clout or "voice" in the political process of the host country and the knowledge that is often necessary to build and develop a business in a certain locale."

142 See e.g. Rodolphe DESBORDES/Julien VAUDAY (2007), "*The Political Influence of Foreign Firms in Developing Countries*" Economics and Politics, 19 (3), pp. 421-451.

143 Jonathan BONNITCHA/Emma AISBETT (2010), "*Submission to the Productivity Commission's Review of Bilateral and Regional Trade Agreements*", p.4 with further references; the authors suggest that "Any system of liability that requires government to compensate foreign investors for economic loss that is not coupled with an equivalent system of protection for all other economic actors will encourage decision makers to over-value the interests of foreign investors.", at p.8. Simon LESTER (2013), "*Liberalization or Litigation? Time to Rethink the International Investment Regime*", CATO Institute. Kenneth VANDEVELDE (2000), "*The Economics of Bilateral Investment Treaties*" 41 Harvard International Law Journal 469. Emma AISBETT/Larry KARP/Carol MCAUSLAND (2006), "*Regulatory Takings and Environmental Regulation in NAFTA's Chapter 11*". UC Berkeley: Department of Agricultural and Resource Economics, UCB. CUDARE Working Paper No.1014. Emma AISBETT (2015), "*A Welfare Economic View of International Investment Agreements*", presentation to the 23rd OECD Freedom of Investment Roundtable; see also Summary of Discussions at the 23rd OECD Freedom of Investment Roundtable.

144 Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.135 point out that an increase in foreign investment in the presence of a treaty would be consistent with the hypothesis that IIAs introduce market distortions in favour of foreigners.

145 Emma AISBETT/Lauge POULSEN (2016), "*Relative Treatment of Aliens: Firm-level Evidence from Developing Countries*", GEG Working Paper 122. It should be noted that there is a strand of literature that assesses the *absolute* treatment of foreigners by host governments; this literature is not of interest here as the issue is irrelevant for the question of whether foreigners are disadvantaged when compared to domestic investors. The absolute treatment of foreigners plays a role for the subject of this study, too, but it is assessed in other parts of this paper.

Survey found that in developing countries, foreign firms enjoyed a better business climate – in particular lower fiscal and regulatory constraints – than domestic firms.[146]

Neither of these studies distinguished between the treatment of treaty-covered foreign investors and non-covered investors. Hence, while the studies suggest that the playing field is tilted in favour of foreign investors – at least in developed or transition economies, where IIAs are often thought to have the greatest importance –, it is impossible to determine whether this result from a "corrective" function of IIAs or whether foreign investors enjoy privileges – potentially to a lesser extent – even in the absence of IIAs. Empirical evidence that is currently available does thus not allow to firmly exclude that foreign investors are exposed to disadvantages compared to domestic firms in foreign markets.

(2) Are IIA-designs apt to correct any observed market distortions?

Two features of IIAs are thought to correct alleged market distortions directed against foreign investors: National treatment provisions – present in the overwhelming share of IIAs – require treatment at least as favourable as that accorded to domestic firms.[147] In addition, the availability of international arbitration and thus adjudication outside domestic courts in the host country – "biased against foreigners", as is argued[148] or otherwise dysfunctional –and treaty-guaranteed "fair and equitable" treatment are thought to compensate for the alleged disadvantages.

As to the national treatment provisions, the requirement of *relatively* equal treatment appears in principle an appropriate means to correct any alleged distortions. It has been noted that only a small number of successful investor-State disputes were based on a breach of national treatment obligations,[149] but various reasons unrelated to actual treatment of foreigners may have produced this result.

The establishment of a special regime – involving different substantial rights, different types of remedies, and different procedural rights than those available to domestic investors –, appears less apt to remedy alleged bias, as it does not address specifically those alleged disadvantages. The special regime may create advantages that overshoot potential disadvantages that foreign investors may experience, but it is also conceivable that even this special regime still falls short of compensating any disadvantage foreigners may face.

In conclusion, claims that IIAs either correct or generate market distortions are not currently supported by conclusive empirical evidence.

5. Fiscal costs of IIAs

The creation and existence of individual IIAs – and the IIA system as a whole – generates various direct fiscal costs that would need to be considered as part of economic aspects of societal benefits and

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146 Rodolphe DESBORDES/Julien VAUDAY (2007), "*The Political Influence of Foreign Firms in Developing Countries*" Economics and Politics, 19 (3). pp. 421-451. Yasheng HUANG (2005), "*Are Foreign Firms Privileged By Their Host Governments? Evidence From The 2000 World Business Environment Survey*", MIT Sloan School of Management Working Paper 4538-04.

147 BIAC (2016) "*Why International Investment Agreements Matter*", p.2.

148 Charles N. BROWER/Lee A. STEVEN (2001), "*Who Then Should Judge? Developing the International Rule of Law under NAFTA Chapter 11*", Chicago Journal of International Law: Vol. 2: No. 1, p.196.

149 Lise JOHNSON/Lisa SACHS (2016), "*The Outsized Costs of Investor-State Dispute Settlement*", aib Insights, vol 16, no.1, p.12.

costs of IIAs. These direct fiscal costs are separate from various other "costs" that may arise indirectly from policy choices induced by treaties and that are treated elsewhere in this paper.

Direct fiscal costs include expenses for the negotiation and administration of agreements; current contributions to the legal infrastructure associated with a treaty; and contingent liabilities that may arise from claims brought under the investor protection provisions in an IIA. The latter may include expenses for the defence against a claim, the adjudication mechanism, and for potential damages awards.

Most aspects of fiscal costs associated with IIAs have not been subject to significant study and are poorly documented. Moreover, with few exceptions, governments are not known to have budgeted or publicly accounted for most of the expenses, in particular for contingency costs resulting from litigation, be it *ex ante* or *ex post*. These factors make complete and reliable assessments of these costs difficult; the following considerations may thus be incomplete and approximate.

a. One-off negotiation costs

Negotiating costs of IIAs do not appear to have been studied, and governments have made available little information in this regard. It is safe to say, however, that these negotiating costs vary widely and depend on the countries involved in the negotiations, the complexity of the agreement, whether model agreements are used, and which internal requirements for the conclusion and ratification of treaties are in place.

Supposedly on the lower end of the cost spectrum, some treaties have been concluded through written exchanges or only limited face-to-face negotiations.[150] Other negotiations, especially of investment provisions in more recent BITs and PTAs, have required considerable negotiating efforts by large teams, with corresponding cost implications. For instance, by mid-2016, the negotiation of a potential P.R. China-United States BIT had required 24 negotiating rounds.[151] For the negotiations of the broader Trans-Pacific Partnership agreement, which contains trade and other provisions along with the investment content, New Zealand is thought to have spent the equivalent of USD 2.8 million, of which around USD 1.75 million were travel costs.[152]

In addition to the negotiating costs of individual IIAs, some of the multilateral instruments that are part of the legal infrastructure associated with IIAs have certainly generated negotiating costs, too. These include negotiations of the ICSID Convention and related instruments as well as diverse UNCITRAL rules on arbitration and transparency. Not all these costs are strictly IIA-related, as many of such instruments have other purposes and uses, e.g. for contract-based dispute settlement.

So far, no efforts seem to have been made to estimate of account for these costs beyond isolated cases.

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150 See the parliamentary documentation of Switzerland's treaty negotiations with Serbia and Montenegro, Guyana, Azerbaijan, Saudi Arabia and Colombia. In the case of Guyana, the negotiations did not involve face-to-face meetings, and negotiations with Serbia were concluded at the second meeting of negotiators. Lauge POULSEN/Emma AISBETT (2015), "*Diplomats Want Treaties: Diplomatic Agendas and Perks in the Investment Regime*" GEG Working Paper No.112, p.17, report that the negotiation of the United States-Grenada BIT (1985), was "concluded after one hour of 'negotiations' during a hospital visit to Washington by the Grenadian prime minister". Lauge POULSEN (2014), "*Bounded rationality and the diffusion of modern investment treaties*", *International Studies Quarterly* 58, p.1.

151 At the time of writing in mid-2017, the treaty negotiations were not known to have led to an agreed text.

152 "*MFAT alone spent more than $4m negotiating TPP*", RadioNZ, 27 February 2017.

b. Recurrent expenses for treaty administration, institutions and legal infrastructure

In addition to one-off negotiating costs, IIAs may cause additional continual expenses for the administration of an agreement, associated institutions, and legal infrastructure associated with the agreements.

Some IIAs, especially more recent treaties and in particular PTAs with investment content, establish consultative bodies for the purpose of the implementation of the treaty; these may generate recurrent costs. Further recurrent costs may arise from institutional infrastructure associated to individual agreements, for example the Energy Charter Treaty. Italy decided to withdraw from the Energy Charter Treaty (ECT) in 2015; the rationale publicly set forth was possible savings of EUR 450 000 per year.[153]

c. Costs associated with dispute settlement and awards

Dispute settlement mechanisms – especially investor-state dispute settlement mechanisms[154] – established under IIAs generate additional fiscal costs. These may be recurrent or occasional costs.

(1) Recurrent costs associated with dispute settlement

Recurrent expenses result from the legal and institutional infrastructure associated with dispute settlement mechanisms under IIAs. The dispute settlement mechanisms in operation today are essentially *fee*-based, rather than *contribution*-based: Litigants cover the costs of adjudication bodies on a per-case basis.

Somewhat different arrangements exist for the International Centre for Settlement of Investment Disputes (ICSID). Its expenditure is partially covered by revenues generated by arbitral proceedings, but the International Bank for Reconstruction and Development (IBRD, part of the World Bank Group) provides in kind contributions to ICSID, including facilities, services, staff and consultants. While ICSID did not have to request assessed contributions from Contracting States – which are possible under its statute –,[155] these in-kind contributions are ultimately paid by IBRD Member States. The stated value of these in kind contributions to ICSID's operations has recently been around USD 3 million per year,[156] and the aggregate of these in kind contributions over the 50 years since ICSID's inception stands at around USD 68 million (at 2016 prices).[157]

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153 LEGGE 23 dicembre 2014, n. 190, art 1, comma 318 and Allegato 8).

154 State-to-State dispute settlement mechanisms, although established systematically under IIAs, have been used in very few disputes to date. Fiscal costs associated with this type of proceedings are thus not considered here.

155 The possibility to demand assessed contributions from Contracting States is available according to Regulation 18 of the Administrative and financial regulations of ICSID.

156 Under a "Memorandum of Administrative Arrangements Agreed between the International Bank for Reconstruction and Development and the International Centre for Settlement of Investment Disputes" [AC/66/6] of 1966 and available in annex 5 of ICSID's annual report 1967, the IBRD shall provide certain services and facilities to the Centre, including staff and consultants. Precise figures of the fair-value assessments of these in-kind contributions are available in the individual annual reports.

157 The aggregate was calculated by the OECD Secretariat based on the financial statements of ICSID, contained in the annual reports for the years 1967 to 2016, applying the United States Consumer Price Index (annual averages) drawn from the United States Department of Labor – Bureau of Labour Statistics for the adjustment of nominal USD value to 2016 values.

Recent proposals to establish a court-based adjudication system may change this approach by moving further towards a contribution-based approach.

(2) Occasional costs associated with dispute settlement

In addition to adjudication costs, cases brought under investment treaties trigger additional, at times substantive costs. These costs consist of expenses associated with the defence against disputes and, as the case may be, expenditure to pay awards.

States parties to investment agreements have some degree of control over whether and to what extent such costs arise. Costs for the defence against claims would be minimal if no claims were brought, and if no dispute is lost, no award needs to be paid. However, this control only exists up to a certain point: Defence costs may arise even for cases that are manifestly without merits and that any government could be exposed to.[158] While a few IIAs contain mechanisms that discourage frivolous claims by shifting associated costs to the claimant,[159] and the ICSID Convention allows for early dismissal of obviously meritless claims as a mechanism to limit costs in some cases, the use and effectiveness of these mechanisms have not been assessed empirically.

Even where a government's defence against a claim is successful, it may have to bear at least some of the costs, as cost allocation rules in the context of IIAs do not systematically shift costs to the losing party. Where treaties contain rules on litigation cost allocation at all, most often order parties to bear their own costs irrespective of the outcome of a case.[160] In the absence of such rules in treaties, cost allocation depends on rules set out in the applied arbitration rules. ICSID rules leave the issue to the discretion of arbitrators, who may assign costs due to a variety of factors, including behaviour within the proceedings.[161] The 2010 UNCITRAL Rules require in principle that costs are shifted to the losing party, with tribunal discretion, taking into account the circumstances of the case.[162]

In practice, investment tribunals have often not imposed costs on the losing party. Complete shifts of costs and fees to the losing party only occurred in less than 10% of the cases, but a trend has been observed towards more frequent cost-shifting since 2006.[163] Little coherence has been found in cost allocation

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158 In 2014, 40% of claims were brought against developed States of which many are generally thought to be well-governed, and countries like Australia, Belgium, Canada, Germany, Greece and the United States have been respondents in multi-million USD claims. Diana ROSERT (2014), "*The Stakes Are High: A review of the financial costs of investment treaty arbitration*", IISD, p. 2 and Table A1.

159 A survey of over 1600 IIAs conducted in 2012 – hence not including very recent treaties – found that only 10 treaties in the sample imposed all costs on the claimant of a frivolous claim, see Joachim POHL/Kekeletso MASHIGO/Alexis NOHEN (2012), "*Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey*", *OECD Working Papers on International Investment*, 2012/02, OECD Publishing, p.35.

160 Joachim POHL/Kekeletso MASHIGO/Alexis NOHEN (2012), "*Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey*", *OECD Working Papers on International Investment*, 2012/02, OECD Publishing, p.35.

161 ICSID Convention Art. 61(6).

162 UNCITRAL Rules, Art. 42 and PCA Rules, Art. 42.

163 David GAUKRODGER/Kathryn GORDON (2012), "*Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*", OECD Working Papers on International Investment, 2012/03, p. 22. Matthew HODGSON (2014), "*Counting the costs of investment treaty arbitration*", Global Arbitration Review, 24 March 2014, p.7. Diana ROSERT (2014), "*The Stakes Are High: A review of the financial costs of investment treaty arbitration*", IISD, p.13, with reference to Borzu SABAHI (2011), "Compensation and restitution in investor-state arbitration: Principles and practice", p.163.

decisions,[164] but it has been noted that costs were shifted slightly less frequently when a claimant investor lost as compared with a losing defendant State; thus, losing States were ordered to bear costs more frequently than losing investors.[165]

While cost-shifting can reduce a government's legal and expert costs when it prevails in a case, it can increase its liability for legal and expert costs when it unsuccessfully defends against a claim.

As to the absolute costs of defence against claims, a number of studies have calculated average overall costs of arbitration cases; on an average per-case basis, these were evaluated at over USD 8 million in 2011[166] and almost USD 10 million in 2014[167]. Individual cases have generated significantly higher costs, including a recent case which cost over USD 120 million.[168] Party costs of claimants and respondent states have been found to be quite similar at around USD 4.5 million each per case on average.[169]

On average, between 80%[170] and 90%[171] of the total costs of a case cover fees and expenses for experts and legal counsel; arbitrator fees average about 16% and institutional costs about only 2% of the overall costs. Whether building in-house expertise to defend treaty claims – approaches that a few countries such as Argentina, Canada and the United States have chosen – lowers costs, has not yet been subject to comprehensive assessment.

The aggregate amount spent on treaty-based litigation is unknown. However, if the recent average was to be representative to the over 800 treaty-based ISDS cases that are known as of mid-2017,[172] almost USD 6.5 billion would have been spent on fees and expenses for known ISDS cases so far. A significant

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164 Susan FRANCK (2011), "*Rationalizing Costs in Investment Treaty Arbitration*", Washington University Law Review, 88:4, p.769.

165 Matthew HODGSON (2014), "*Counting the costs of investment treaty arbitration*", Global Arbitration Review, 24 March 2014, p.7.

166 David GAUKRODGER/Kathryn GORDON (2012), "*Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*", OECD Working Papers on International Investment, 2012/03, p.19.

167 Matthew HODGSON (2014), "*Counting the costs of investment treaty arbitration*", Global Arbitration Review, 24 March 2014, pp.2-3; median costs were found to be around USD 6 million per case in this study. Susan FRANCK (2007), "*Empirically evaluating claims about investment treaty arbitration*", North Carolina Law Review, p.68 reports overall lower numbers, but base her findings on a set only 102 awards, of which only 17 contained datasets on costs.

168 In the *Yukos* case, the claimants incurrent costs for legal counsel of USD 80 million and the respondent of USD 31,5 million; the costs for the tribunal amounted to USD 11 million; *Yukos Universal Limited (Isle of Man) and The Russian Federation*, Final Award, 18 July 2014, PCA Case No. AA227, paras 1688, 1827, 1830.

169 Matthew HODGSON (2014), "*Counting the costs of investment treaty arbitration*", Global Arbitration Review, 24 March 2014, p.2.

170 David GAUKRODGER/Kathryn GORDON (2012), "*Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*", OECD Working Papers on International Investment, 2012/03, p.19.

171 Matthew HODGSON (2014), "*Counting the costs of investment treaty arbitration*", Global Arbitration Review, 24 March 2014.

172 A complete list of ISDS cases filed to date does not seem to be available. However, 775 investment arbitration claims have been identified as of 2014 (see Cedric DUPONT/Thomas SCHULTZ/Merih ANGIN (2015) "*Political Risk and Investment Arbitration: An Empirical Study*" Journal of International Dispute Settlement, 2016, Forthcoming King's College London Law School Research Paper No. 2016-03); UNCTAD had recorded 817 treaty-based claims as of 31 July 2017.

share – roughly 50% or over USD 3 billion when applying the estimates mentioned above – of this amount were borne by respondent States.

Disaggregated information is at times available in awards, and, more rarely, in government budgets.[173] Many governments refrain from providing information on legal costs set aside for the defence against ISDS cases. The Australian government for instance has been reluctant to divulge the expenses associated with the defence against the first and so far only known case while the proceedings were ongoing.[174]

Further legal costs and fees may arise for the annulment proceedings, (rarely necessary) attempts to enforce cases, and domestic litigation that occasionally follows in the context of the enforcement of awards and which are not included in the studies cited above. It appears that these costs have not been assessed so far, although they would need to be included in the overall cost calculation of the dispute settlement mechanism.

Compensation ordered in awards imposes at times significant financial burdens on States. Accounting for these costs of IIAs is challenging for at least two reasons: States mostly but not always honour awards against them; there is hence only incomplete information available on whether the costs actually materialise;[175] Also, infringements of foreign investors' rights could have consequences, including financial consequences, under domestic legislation as well, not only under IIAs. However, IIAs generally accord financial compensation while domestic law most often offers primary remedies that entail lower or at least less visible costs,[176] and IIAs may contain more favourable rules than domestic law that result in greater costs for awards.

Given these difficulties to compare the outcome of claims under domestic law in individual legal systems with the outcomes of ISDS established under IIAs, no definite assessment of the differential of costs resulting from claims is attempted at this stage. It should be noted, however, that the treaty-based litigation mechanism generates very sizable occasional costs in the context of treaty claims that States cannot securely prevent.

d. Offsets from savings and gains

Parts of the abovementioned costs may be considered to be offset by savings or gains: Fiscal costs of international arbitration proceedings may at times replace costs of proceedings that would otherwise have taken place in domestic courts. Also, governments or societies may have occasionally gained something from the measure that triggered a claim for compensation (e.g. ownership of an asset in the context of a

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173 In late 2016, it became known that Korea had supposedly set aside the equivalent of USD 42 million to defend against three ISDS cases over an unspecified period, see "*Korea spends 50 billion won in ISD battles*", Yonhap news agency, 21 November 2016.

174 Australian Productivity Commission, "*Trade&Assistance Review 2013-14*", p.163.

175 Susan FRANCK (2007), "*Empirically evaluating claims about investment treaty arbitration*", North Carolina Law Review, p.65 at footnote 285.

176 David GAUKRODGER/Kathryn GORDON (2012), "*Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*", OECD Working Papers on International Investment, 2012/03, pp.24-27 and Annex 4.

direct expropriation);[177] in these cases, the amount of compensation does not systematically correspond to a net loss.

The assessment of savings and gains is complex and specific to individual cases, and no empirical analysis seems to have been attempted to assess the offsets. Domestic litigation costs may be different from costs of international arbitration; costs may be more systematically shifted to the losing party, depending on the rules applicable in a given domestic context; and costs borne by the parties may not reflect the actual costs of litigation. At times, arbitration may follow or be conducted in parallel with domestic procedures, so that the availability of ISDS produces additional costs rather than offsetting costs of domestic proceedings.

B. The impact of investor protection in IIAs on domestic and global governance

Besides economic effects, IIAs can have a series of consequences for domestic and global governance. IIAs are notably considered to contribute to depoliticise disputes (below 1.) and to influence governance in host countries (below 2.).

1. Depoliticisation of investment disputes

It is widely considered that the international investment law regime, in particular through the investor-State dispute settlement mechanism that is now included in the vast majority of IIAs, has a potential to "depoliticise" disputes.[178] Depoliticising international investment disputes was also among the objectives when the ISDS system was initially established as an alternative to espousal of claims by States in favour of their nationals.[179]

The notion and content of "depoliticisation" however, has remained ambiguous. Occasionally presented as an end in itself,[180] it is most often understood to further one or more of three distinct objectives. These different ends relate to (1) intergovernmental relationships; (2) to relationships between companies and their home governments; and (3) to competition among firms.[181]

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[177] Krzysztof PELC (2016), "*Does the International Investment Regime Induce Frivolous Litigation?*", p.2 notes that in cases of "indirect expropriation", the expropriating state usually derives no revenue from the alleged expropriatory act.

[178] Martins PAPARINSKIS (2010), "*The Limits of Depoliticisation in Contemporary Investor-State Arbitration*" Select Proceedings of the European Society of International Law, Vol. 3, 2010.

[179] According to BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.197, the objective of depoliticisation has not been a major – if any – consideration in BIT programmes of major capital exporters or even in the negotiations of the ICSID Convention.

[180] E.g. Charles N. BROWER/Lee A. STEVEN (2001), "*Who Then Should Judge? Developing the International Rule of Law under NAFTA Chapter 11*", Chicago Journal of International Law: Vol. 2: No. 1, p.195. BIAC, *Investor-State Dispute Settlement - An indispensable element of investment protection* (January 2015), p.3, which states that ISDS "can de-politicise disputes." Decidedly more sceptical about the value and usefulness of the concept of depoliticisation Martins PAPARINSKIS (2010), "*The Limits of Depoliticisation in Contemporary Investor-State Arbitration*", Select Proceedings of the European Society of International Law, Vol.3, 2010.

[181] Other categorisations are possible, and some of these issues have links to other aspects addressed in this paper. BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p. 193 for instance associate depoliticisation only with the first two of the three ends mentioned here.

To what extent international investment law regime has made a contribution to depoliticise disputes has rarely been assessed empirically, and whether depoliticisation – as understood in these terms – is beneficial or desirable has rarely been questioned.

a. The different purposes of "depoliticisation"

(1) Depoliticisation and relations between businesses and home governments

One of the most often cited objectives of depoliticisation is to dispense investors from the need to call upon their home governments to espouse a claim or intervene on their behalf. This consideration was present in the negotiation of the ICSID Convention, as the oft-cited sentence from the *travaux préparatoires* of this convention put it, "the Convention would […] offer a means of settling directly, on the legal plane, investment disputes between the State and the foreign investor and insulate them from the realm of politics and diplomacy."[182] Depoliticisation would also free home government resources, as home governments can legitimately point their investors to a dispute settlement mechanism, thus ridding themselves of the burden to spend bureaucratic resources and political capital on exercising informal or formal diplomatic assistance to individual investors.[183]

(2) Depoliticisation as a means to protect intergovernmental relationships

In the context of ISDS, "depoliticisation" is also credited with a contribution to protecting intergovernmental relationships. The possibility to settle disputes directly between an aggrieved investor and the host State, without involvement of the home State and at low or no political cost,[184] is claimed to avoid diplomatic friction or conflicts between home and host States and to avoid interference of disputes with governments' broader foreign policy goals.[185] In its strongest form, it is claimed that ISDS plays a role in preventing military intervention in favour of a country's national abroad ("gunboat diplomacy"), a narrative whose historical accuracy and transferability to recent decades is increasingly subject to critical analysis.[186]

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182 Consultative Meeting of Legal Experts, Summary Record of Proceedings, 1963, *in* History of the ICSID Convention, Vol. II-1, p.242. While the ICSID Convention was initially conceived with contracts in mind, the idea can be, and is widely, applicable to treaty-based dispute settlement as well.

183 Daniel PRICE (2000), "*Some Observations on Chapter 11 of NAFTA*", 23 Hastings International and Comparative Law Review, p.421 (427). (2000) Charles N. BROWER/Lee A. STEVEN (2001), "*Who Then Should Judge? Developing the International Rule of Law under NAFTA Chapter 11*", Chicago Journal of International Law: Vol. 2: No. 1, p.197. Lauge POULSEN/Jonathan BONNITCHA/Jason Webb YACKEE, "*Analytical framework for assessing costs and benefits of investment protection treaties*", 2013, p.13.

184 For this role as an advantage of hard law generally Kenneth ABBOTT/Duncan SNIDAL (2000) "*Hard and Soft Law in International Governance*", International Organization, Vol. 54, p.421 (432).

185 Kenneth VANDEVELDE (1993), "*Of Politics and Markets: The Shifting Ideology of the BITs*", 11 Int'l Tax&Business Law, p.159 (161). According to SCHREUER, *Investment Protection and International Relations*, p.346, diplomatic protection is a "frequent source of irritation" for developing countries. DUGARD, *Diplomatic Protection*, para. 2, states that the very concept of diplomatic protection was long "associated with actions taken by powerful imperialist States to protect their nationals engaged in commercial activities in weak, developing States."

186 Jason Webb YACKEE (2017), "*Politicized Dispute Settlement in the Pre-Investment Treaty Era: A Micro-Historical Approach*", University of Wisconsin Law School Legal Studies Research Paper No.1412. BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.194.

(3) Depoliticisation as a means to level the playing field between companies in different situations

Depoliticisation also alludes to a levelling of the competitive playing field among companies in different situations. Within a given country, SMEs and private companies, which typically have less access to their home governments than MNEs or State-owned enterprises to seek political support for their case, are given a possibility – at least in theory[187] – to claim in their own name rather than convince their government to demarche the host State of their troubled investment.[188]

Further, investors from less influential States may bring (legal) cases against powerful States that their home governments may be unwilling or unable to bring and win in the diplomatic arena.[189] Also, companies that do not have a clearly associated home State that could support them, are given the same chances to bring a claim as companies that are more closely associated to a specific State or are of strategic value or interest to a government independent of actual ownership or control.

b. Empirical evidence on the realities of "depoliticisation"

The objective to depoliticise disputes has been advanced in the context of preparations of the ICSID Convention in the late 1960s, and it continues to appear in the literature in an almost axiomatic fashion.[190] To what extent depoliticisation has actually taken place, to what extent IIAs play a causal part in this process, and what other factors may contribute to depoliticisation has been subject to little systematic empirical assessment.[191]

A number of indications suggest that a rather mixed picture of the realities of home-State involvement in the undertaking of enterprises in foreign ventures:

- State policy and practice show that investment by "their" companies remains a political matter for home governments, beginning before establishment and not ending with an award by an arbitral tribunal: Business delegations accompany political leaders during State visits to facilitate

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187 On whether or not a cost-barrier eventually hinders SMEs to bring their case in ISDS see BVMW Position Paper (2014), p.1 for the perspective of the German SME association. Empirical analysis on claimants profiles and success rates in relation to claimants profile is available in Gus VAN HARTEN/Pavel MALYSHEUSKI (2016), "*Who has benefited financially from investment treaty arbitration? An evaluation of the size and wealth of claimants*", Osgoode Legal Studies Research Paper No.14 and David GAUKRODGER/Kathryn GORDON (2012), "*Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*", OECD Working Papers on International Investment, 2012/03, p. 17.

188 Christoph SCHREUER, *Investment Protection and International Relations* p.345; International Court of Justice, Barcelona Traction, Light and Power Limited (Belgium v. Spain), 5 February 1970, ICJ Report 1970, Rep. 4, para. 79: "*The State must be viewed as the sole judge to decide whether its protection will be granted, to what extent it is granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the particular case. Since the claim of the State is not identical with that of the individual or corporate person whose cause is espoused, the State enjoys complete freedom of action*".

189 Diplomatic protection in particular has been described as "in essence discriminatory because only powerful States are able to use it against weaker States", Yearbook of the International Law Commission, Volume II, Part One, A/CN.4/SER.A/1998/Add.1 (Part 1), p. 311, para. 8.

190 See for details PAPARINSKIS, Martins (2010), "*The Limits of Depoliticisation in Contemporary Investor-State Arbitration*", Select Proceedings of the European Society of International Law, Vol. 3, 2010.

191 As here BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.196.7

investment decisions; State-owned or State-backed financial institutions facilitate financing of foreign investment; State-backed insurance is made available to absorb non-commercial risk; and sanctions may apply on aid, trade and finance with countries that exhibit certain behaviours vis-à-vis foreign investors.[192]

- A significant number of foreign investments, especially in dispute-prone and extractive industries or utilities, involve a State as investor (through State-owned enterprises and sovereign wealth funds, in particular).[193] A sizable number of treaties explicitly include government-controlled investors and States in the investor definition.[194]
- Some Political Risk Insurance (PRI) programmes, which are an integral part of many countries' foreign direct investment risk mitigation strategies, (re-)align investor interests with those of the home State.[195] Once the insurance is triggered, the State-sponsored insurer typically obtains the claim against the host State through a subrogation clause in the IIA. This mechanism replaces the "private" investor with a home State-linked entity – and ultimately the home State itself. While no case is known in which subrogation under an IIA has led to a State claim qua subrogation,[196] the presence of State-backed or international financing institutions is thought to exert effect on host States' behaviour and increase compliance with obligations.[197] Also, many PRIs explicitly

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192 A report by the U.S. International Trade Commission – "*Overview and Analysis of Current U.S. Unilateral Economic Sanctions – Investigation No. 332-391* – published in August 1998 reports three federal statutes that require unilateral economic sanctions for expropriation of United States property without compensation.

193 Among the 93 known claims brought under the Energy Charter Treaty as of April 2016, an unpublished OECD study shows that at least 18% were initiated by State-owned or State-controlled enterprises; an additional 2% of claims were brought by entities which were formally private but have very close ties to governments. More examples of cases relevant to specific constellations are available in PAPARINSKIS, Martins (2010), "*The Limits of Depoliticisation in Contemporary Investor-State Arbitration*", Select Proceedings of the European Society of International Law, Vol.3, 2010.

194 Yuri SHIMA (2015), "*The Policy Landscape for International Investment by Government-controlled Investors: A Fact Finding Survey*", OECD Working Papers on International Investment, 2015/01, p.13 found that around 16% of the over 1800 IIAs included in a large-sample survey explicitly included government controlled investors, and 6% included States in the "investor" definition; only 3 treaties in the sample explicitly excluded such investors from the coverage of the treaty.

195 Clint PEINHARDT/Todd ALLEE (2016), "*Political Risk Insurance as Dispute Resolution*", *Journal of International Dispute Settlement* 7(1), p.205 (209). Erik WODEHOUSE (2006), "*The Obsolescing Bargain Redux? Foreign Investment in the Electric Power Sector in Developing Countries*", New York University Journal of International Law and Politics, Vol.38, No.121, p.178.

196 The only known case that came relatively close and in which a State-sponsored entity announced a claim against another State concerned the *Dabhol Power Company* in India, which was initially incorporated by three United States companies and insured by OPIC. OPIC brought a claim under the India-United States Investment Incentive Agreement (1997) – which was settled before arbitration began – under a subrogation clause of that agreement, rather than following subrogation set forth in an IIA.

197 Kathryn GORDON (2008), "*Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development*", in: OECD Investment Policy Perspectives 2008, p.94. Erik WODEHOUSE (2006), "*The Obsolescing Bargain Redux? Foreign Investment in the Electric Power Sector in Developing Countries*", New York University Journal of International Law and Politics, Vol. 38, No. 121, p.177. Clint PEINHARDT/Todd ALLEE (2016), "*Political Risk Insurance as Dispute Resolution*", *Journal of International Dispute Settlement* 7(1), p.205 (222) finds mixed evidence for this hypothesis based on empirical evidence related to OPIC.

encourage investors to seek diplomatic assistance when they encounter difficulties in the host State, that calling for home-State involvement on behalf of "their" investors in arising disputes.[198]

- Arbitral awards provide evidence of the involvement of ministers, economic committees and diplomatic missions in trying to settle disputes before the investor brings formal legal proceedings.[199]
- Recent cases have shown that, home and third-country governments at times pursue certain cases in parallel to an investor-State dispute, and that investors seek to mobilise States to bring State-to-State claims in investors' interest: In the Repsol/YPF matter, the Spanish government pursued a number of diplomatic alleys in parallel to Repsol's investor-State claim in ICSID.[200] Australia's

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198 An earlier statement on the German programme's website, no longer available in early 2018, had read: "*As soon as the investor anticipates a political risk he must immediately inform PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft. At this early stage loss prevention measures will be initiated by diplomatic channels. The objective is to save the continuity of the investment. Unlike property insurance the German government does not wait until the loss has actually occurred but becomes active at an early stage.*" This reference is no longer available, but new information as of 1 July 2017 states "*Backed with the political support of the German Government investment guarantees form an important part of the investor's overall risk management*" and "*The Federal Government supports German investors by involving its diplomatic representations to avoid losses in close co-operation with the investors long before the occurrence of cases of loss, […]*".OPIC provides "Examples of Advocacy" that include four cases in which OPIC approached host governments; two examples involve enforcement of awards, while two examples concern interventions to avoid or delay host government action against the investors. MIGA advertises similar features: "*[MIGA] derives its strength from the World Bank Group [...] whose shareholders include most countries in the world. This enables MIGA to provide an umbrella of deterrence against government actions that could disrupt projects, and assist in the resolution of disputes between investors and governments*", MIGA Investment Guarantee Guide, undated. The United States Government programme OPIC states: "*OPIC, in cooperation with the U.S. investor, other U.S. government agencies, the local United States embassy, and the host government, works to avert potential claim situations before they materialize*", OPIC Handbook, undated, p.31. More generally on the interplay of political risk insurance, diplomatic protection and ISDS Geoffrey GERTZ (2015), "*The International Investment Regime is Stronger Than You Think*", Global Economic Governance Working Paper 2015/96, Clint PEINHARDT/Todd ALLEE (2016), "*Political Risk Insurance as Dispute Resolution*", *Journal of International Dispute Settlement* 7(1), p.205 (209) and Kathryn GORDON (2008), "*Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development*", in: OECD Investment Policy Perspectives 2008, p.94..

199 E.g. *Werner Schneider, acting in his capacity as insolvency administrator of Walter Bau AG (In Liquidation) v. The Kingdom of Thailand,* UNCITRAL (formerly *Walter Bau AG (in liquidation) v. The Kingdom of Thailand*), Award, 1 July 2009, paras. 5.54, 5.63, 5.77, 5.78, 5.85, 6.15, 6.19. Christian TIETJE/Freya BAETENS, *The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*, para. 145 reports on this practice based on interviews with Dutch businesses and government. Tim BÜTHE/Helen V. MILNER: "*Bilateral investment treaties and foreign direct investment: a political analysis*" in SAUVANT, K. (Ed.), Yearbook of International Investment Law and Policy 2009/2010, p.186 report individual governments have specified contact points for investors when their interests are threatened by a foreign government.

200 In an interview that the then Spanish Minister of Foreign Affairs and Cooperation gave to "La Gaceta" on 17 June 2012, published in: Discursos y declaraciones del Ministro de asuntos exteriores y de cooperación, D. José Manuel García-Margallo Y Marfil, Enero-diciembre 2012, p.54, the Minister stated: "*Anunció medidas contundentes contra Argentina tras la expropiación de YPF. —Entre las medidas que se podían tomar sin interferir en la población, impulsamos la prohibición de importación de biodiésel y una ofensiva diplomática en todo el mundo. En la UE se ha actuado en la Comisión, en el Parlamento y en el Consejo. La UE ha activado las reclamaciones que tenía contra Argentina en la OMC y se está estudiando la retirada del sistema de preferencias generalizadas. La reacción de EE UU ha sido contundente y estudian la posibilidad de su expulsion del G-20, además de que se le han retirado las exenciones arancelarias. Hemos tenido declaraciones de apoyo de prácticamente todos los países del mundo.*"

tobacco packaging legislation was subject to an ISDS claim by the investor, and parallel claims in the WTO were brought by Honduras, the Ukraine, Indonesia, Dominican Republic, and Cuba, who allegedly received financial support to bring the claims from interested tobacco companies.[201] In both cases, the ISDS mechanism offered additional means of litigation rather than replace – and depoliticise – disputes involving States on both sides.

- Home States continue to be involved – at least if they so wish – even when an investor has filed a claim, although their room for action is temporarily reduced: Art. 27 ICSID Convention as well as around 21% of IIAs[202] prohibit the granting of diplomatic protection when the parties to a dispute have consented to submit a claim to arbitration, whilst still allowing "informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute";[203] sometimes, the limits of this prohibition are interpreted rather loosely,[204] but no case has yet become known in which a tribunal has considered a home State to overstep these boundaries. Some rare IIAs that prohibit diplomatic intervention in pending disputes exclude a broader scope of host State intervention than the ICSID Convention.
- Home States also occasionally intervene with the respondent State once an award has been rendered but is not honoured.[205] Such interventions are relatively rare, however, as respondent States tend to honour awards. In only a fraction of a set of 85 known cases in which host States were ordered to pay compensation,[206] enforcement of awards proved difficult.

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201 For Australia's tobacco packaging legislation, five WTO disputes have been brought by Ukraine (DS434), Honduras (DS435), Indonesia (DS467), Dominican Republic (DS441), and Cuba (DS458); an ISDS case, related to the same Australian legislation, was brought by Philip Morris Asia Ltd. to the PCA (case number 201-12).

202 See Joachim POHL/Kekeletso MASHIGO/Alexis NOHEN (2012), "*Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey*", OECD Working Papers on International Investment, 2012/02, OECD Publishing, p.33.

203 Art.27 ICSID Convention reads:

"1. No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.

2. Diplomatic protection, for the purposes of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute."

The exact scope of allowed informal exchanges and diplomatic protection remains contested, see e.g. Ben JURATOWITCH, *The Relationship between Diplomatic Protection and Investment Treaties*, 23 ICSID Review, p.21.

204 Some anecdotal – and unverified – evidence is reported in Claire PROVOST/Matt KENNARD, "*The obscure legal system that lets corporations sue countries*", The Guardian, 10 June 2015.

205 Limitations on diplomatic support and intervention end when a respondent State fails to honour an award, according to rules contained in the ICSID Convention and in treaties that include language on diplomatic protection. On practical cases in this regard see Catharine TITI (2015), "*Are Investment Tribunals Adjudicating Political Disputes?: Some Reflections on the Repoliticization of Investment Disputes and (New) Forms of Diplomatic Protection*", Journal of International Arbitration, Kluwer Law International 2015, pp.261-288.

206 OECD calculation based on UNCTAD, "*Recent Developments in Investor-State Dispute Settlement*" (2014).

- Finally, ISDS tribunals have been found to be themselves sensitive to political signals from States, especially vocal, influential and developed States, so that even if the disputes may be depoliticised, the dispute resolution mechanism may be less so.[207]

There is little empirical evidence that would shed light on whether the presence of an IIA influences the types and degree of government involvement in the context of tensions between investors and home States. Limited anecdotal evidence, covering several home and host countries, suggests that IIAs tend to increase rather than decrease diplomatic interaction between home and host States.[208] IIAs give home State diplomats an additional and perhaps often a more comfortable tool in pre-claim negotiations – they can refer to a potential investor claim rather than, or in addition to, action by the home State itself. Preliminary research limited to the United States as a home country may suggest that the presence of an IIA does not have a substantial differential impact on the likelihood of diplomatic involvement, and that strong diplomatic pressure is applied only in a minority of investment disputes, and regardless of whether an IIA exists between the concerned countries.[209]

Although policy and practice testify that governments are often involved in investment projects by "their" companies, this involvement is selective and discretionary. Governments decide which cases they wish to pursue and support, and the degree of actual "depoliticisation" remains a political decision.[210] Based on available empirical evidence, IIAs thus do not appear to mechanically depoliticise disputes, but they may provide greater comfort for governments to refrain, at their discretion, from intervening or limiting their intervention. Whether or not IIAs make a positive contribution to any of the ultimate goals of depoliticisation in practice, however, remains uncertain in the absence of sufficient empirical evidence.

To what extent ISDS has kept military intervention, "gunboat diplomacy" and similar behaviours at bay is difficult to assess empirically, and little evidence has been produced in this regard. In the period of the late 19th century to which the language of "gunboat diplomacy" refers – and which is still routinely referred today in justifications of ISDS as an institution – States are known to have refused offers to arbitrate cases of alleged unjust treatment of nationals and have rather used military force.[211] Similar behaviour has been observed – post World War II – where powerful states have more or less overtly intervened in foreign States and government in Central and South America, in Africa, Central and East Asia and the Middle East to ensure that these foreign governments were sympathetic to the economic interest of their country's enterprises, quite independently from the possibility of recourse to ISDS.

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207 Malcolm LANGFORD/Daniel BEHN (2016), "*Managing Backlash – The Evolving Investment Treaty Arbitrator?*", forthcoming in European Journal of International Law.

208 Tim BÜTHE/Helen V. MILNER: "*Bilateral investment treaties and foreign direct investment: a political analysis*" in: Karl SAUVANT (Ed.), Yearbook of International Investment Law and Policy 2009/2010, p. 186. N. MAURER (2013), *The Empire Trap: The Rise and Fall of U.S. Intervention to Protect American Property Overseas, 1893-2013*. Christian TIETJE/Freya BAETENS, "*The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*", para. 147 suggests that "the mere existence of the instrument may give rise to […] disputes in the future" but estimates that the "current good relations between the US and the Netherlands" should not lead to "dramatic effects on the political relation" between the two countries.

209 Srividya JANDHYALA/Geoffrey GERTZ/Lauge POULSEN (2016), "*Legalization and Diplomacy: American Power and the Investment Regime*".

210 Similarly, BIAC, *Investor-State Dispute Settlement - An indispensable element of investment protection* (January 2015), p.3 states that ISDS "can de-politicise disputes."

211 Examples in Hersch LAUTERPACHT (1933), "*The function of law in the international community*", p.160. and Ibrahim SHIHATA (1992), "*Towards a greater depoliticization of investment disputes : the roles of ICSID and MIGA*", World Bank.

Without delving into details or citing individual country praxis or events, it is obvious that at least today, governments would not – independently from ISDS as an available institution – unleash military might only to satisfy an allegedly legitimate monetary interest of an individual aggrieved investor it may consider its "own" – unless the claim does not dovetail with geostrategic interests of the intervening government. Deeper empirical analysis of the influence of ISDS on the likelihood of military intervention would in any event have to assess if any decline in military interventions post-World War II was not predominantly influenced by the geostrategic situation set by the Cold War, rather than by the presence of IIAs and ISDS.

2. *Impact of IIAs on governance, legislation, regulation and enforcement in host States*

It is widely held that IIAs influence legislation, regulation, and enforcement in host States in several ways. For an assessment of societal benefits and costs of IIAs, it needs to be shown empirically whether the presence of IIAs alters governance, legislation, regulation and enforcement in host countries; this issue is addressed in section a. This empirical question needs to be distinguished from the issue whether any such effect constitutes a societal benefit or cost (section b.).[212]

a. Do IIAs alter governance, legislation, regulation, and enforcement in host States?

While the assumption that IIAs influence governance in host states is widely shared, there is still limited conceptual coherence on categories to capture the various nuances of the assumed effect. For the sake of clarity of the aspects that appear in the literature and policy papers, three types of effects of IIAs on governance, legislation, regulation and enforcement are distinguished here:

- Treaty parties may – to the extent that a given new treaty requires this – adapt their regulatory framework to international obligations that they have taken on in an IIA.[213] This effect is part of the intended purpose of investment treaties, its scope is clear from the outset, and adjustments are typically undertaken prior to the entry into force of a given treaty. Adjustments of legislation may be notably required to meet market-access, transparency and similar obligations, but there may also be requirements to generally upgrade governance mechanisms to meet obligations taken on under the treaty (below a.).
- Beyond these legislative changes that translate treaty obligations into domestic law prior to their entry into force, treaties may have effects on legislation or regulation that are driven by *general* awareness of litigation risk and an *ex ante* internalisation of costs of infringements. Such awareness may build many years after the entry into force of a given agreement and lead to regulatory changes at any later time (below b.).

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212 The OECD-hosted Freedom of Investment Roundtable has an ongoing work program addressing the balance of investor protection and the right to regulate in investment treaties. See, e.g., *The Quest for Balance Between Investor Protection and the Right to Regulate in Investment Treaties* (OECD 2016 Investment Treaty Conference); David GAUKRODGER (2017), "*The balance between investor protection and the right to regulate in investment treaties: A scoping paper*", OECD Working Papers on International Investment, 2017/02; David GAUKRODGER (2017), "*Addressing the balance of interests in investment treaties: The limitation of fair and equitable treatment provisions to the minimum standard of treatment under customary international law*", OECD Working Papers on International Investment, 2017/03.

213 Some governments, including for instance Tunisia, have reported to the investment policy community at the OECD that this adaption of domestic legislation to international obligations was among the purpose of new investment legislation.

- A third type of effect that IIAs may have on domestic regulation and enforcement may result from host State efforts to deflect or resolve *specific* emerging or declared conflicts with foreign investors for example through negotiations to avoid a conflict or prevent an existing conflict from turning into a claim. These efforts – implying regulatory adaption – may influence regulation and enforcement in host States (below c.).

At times, the driver for a specific government action may be difficult to classify or fall into more than one these three categories; the potential mechanisms distinguished here should thus be understood as archetypical categories rather than descriptions of actual realities.[214]

(1) Legislative reform as implementation of treaty obligations

When States take on international obligations, they may need to adjust domestic laws and regulations, a direct consequence and purpose of the agreement that contains the obligations; this general rule applies to IIAs as much as it applies to any other international agreement.

The adjustment of domestic laws and practice may concern situations in which a treaty requires that specific legislative provisions be in place, hence establishing an *obligation of means* (1). Furthermore, a more general revision of governance mechanisms may be required for a State party to meet the substantial standards set out in the agreement – establishing an *obligation of results* (2). In the latter case, the concrete requirements are less defined on the face of the treaty text and may evolve over time with the interpretation given to the treaty content by the parties or adjudicatory bodies.

(a) Legislative adjustments resulting from treaty obligations of means

A very significant proportion of IIAs do not contain substantive provisions that would require specific legislative adjustment in the treaty parties. This concerns specifically the great number of IIAs that only grant post-establishment protection and do not contain market-access provisions or special clauses on transparency, anti-corruption, etc.; the overwhelming majority of treaties in existence today fall in this category.

A limited number of more recently concluded IIAs however contain clauses that oblige treaty parties to have specific substantive or procedural standards in place. Such clauses may require States, for instance, to uphold defined environmental, labour, human rights, anti-corruption, competition or intellectual property protection standards, or to have specific legislation in place. A recent large sample study of over 2,100 IIAs found that slightly over 1% of the treaties included in the survey sample contain provisions under which parties commit to fight corruption, have specific legislation on foreign bribery in place, or implement labour and environmental standards.[215]

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[214] In addition to the possible impacts noted here, foreign investors have been shown to be political actors in host countries that influence institutions and governance. See, e.g., Edmund MALESKY (2009), "*Foreign Direct Investors as Agents of Economic Transition: An Instrumental Variables Analysis*" Quarterly Journal of Political Science, 2009, 4: 59-85 and Rodolphe DESBORDES/Julien VAUDAY (2007), "*The Political Influence of Foreign Firms in Developing Countries*" Economics and Politics, 19(3). p.421. IIAs could contribute to this phenomenon if they influence the allocation of capital. As no conclusive evidence is available today on the latter point, it is not addressed at this stage here.

[215] Kathryn GORDON/Joachim POHL/Marie BOUCHARD (2014), "*Investment Treaty Law, Sustainable Development and Responsible Business Conduct: A Fact Finding Survey*", OECD Working Papers on International Investment, 2014/01, p.16. Clauses related to competition law are not covered by the study but were observed during its preparation.

Some treaties – principally PTAs – also require that treaty parties respect certain procedural minima. These can include standards of governmental transparency including public availability of legislation and regulations[216] or access to judicial review.[217] Some treaties include commitments to build capacity to support treaty partners in implementing these treaty-based obligations.[218]

The effects of this treaty content typically reach beyond the bilateral or plurilateral relationship that the treaty covers. Transparency requirements or obligations to respect international labour standards or fight corruption, for instance, typically affect all investors, including from non-Parties as well as domestic investors, and beyond these potentially domestic societies more broadly. Certain of these treaty obligations may have uneven effects in practice: IIAs that oblige parties to establish possibilities for public participation in the preparation of legislative or regulatory change may extend these benefits only to certain constituents; also, not all constituents may be adequately resourced or organised to exercise these opportunities in a meaningful way. This may lead to imbalanced or underinclusive participation in the policy process.

Some of the abovementioned content is linked specifically to foreign investment as complementary provisions, for example to balance obligations or to mitigate undesirable effects of inward investment. This is not the case for all provisions that have been found in IIAs; rather, at times, the link with foreign investment could be considered to be rather weak.[219] Whether such additional content has societal benefits or costs needs to be assessed on the content of the provisions and should not be factored in the assessment of societal benefits or costs of IIAs on the sole basis that it is textually included in an IIA.

Empirical information on the effectiveness of clauses that establish obligations to have specific legislation, institutions or practice in place remains limited to date.[220] An overall assessment of treaties' performance in this regard is difficult because at least one[221] and sometimes both[222] treaty partners already

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216 Austria-Iran BIT (2001) Art.4 contains a clause on publication of laws that concern foreign investment, as does Australia-Turkey BIT (2005). More generally on this adjacent purpose of the treaties can be found for instance on the website of the United States Trade Representative, which states that "The negotiation and implementation of high-standard BITs and FTAs with investment chapters helps promote economic reforms, improve investment climates, and attract new investment. It also serves broader U.S. policy objectives, such as enhancing regulatory transparency and promoting the rule of law."

217 E.g. ASEAN Comprehensive Investment Agreement (2009), Art. 21, CAFTA-DR Art. 18.2-18.5, Korea-United States FTA, Art. 21.1-21.4, United States Model BIT (2012), Art. 10 and 11.

218 E.g. CAFTA-DR, Art. 16.5.

219 Simon LESTER (2015), "*Using Your Economic Power for Good and/or for Profit*", International Economic Law and Policy Blog, suggests that powerful States may propose the inclusion of almost any content in IIAs because treaty partners are keen on obtaining the benefits from the main trade or other components of the agreement.

220 The "*Fact Sheet: Investor-State Dispute Settlement (ISDS)*" of the United States Trade Representative, dated March 2015, suggests that "in the wake of U.S. trade agreements we typically see increases in public interest regulation […]."

221 An example are clauses in treaties concluded by the United States that require to have legislation in place that criminalise bribery of foreign public officials (for details and examples see Kathryn GORDON/Joachim POHL/Marie BOUCHARD (2014), "*Investment Treaty Law, Sustainable Development and Responsible Business Conduct: A Fact Finding Survey*", OECD Working Papers on International Investment). The United States has had such legislation for decades, and has taken on an international obligation in this regard, unlike some of its treaty partners.

meet the obligation at the time the treaty is concluded. Determining whether a treaty drives change requires an assessment of the differential between required and existing legislation at the time of signature of the treaty.[223]

Only a few insights are available with respect to PTAs – with or without investment chapters. Some of the findings are generated through follow-up mechanisms included in PTAs. None of the available assessments are focused on investment-related content or on exclusively investment-related agreements such as BITs; in the case of European Union treaties, they are explicitly related to non-investment content only. So far, findings in this area are mixed:

With respect to environmental content in PTAs – regardless of the presence of investment content –, environmental content in PTAs has been shown to produce improvements in treaty partners of the United States and the European Union in both regulation and enforcement.[224] The type and depth of the impact depends on – and varies in relation to – the enforcement mechanisms that the United States and the European Union have chosen in their treaties.[225] In investment treaties, comparable enforcement mechanisms have not been observed; the results found for PTAs are thus not directly applicable for IIAs. Specifically for three United Sates PTAs, it has also been shown that the environmental content has led to higher standards and greater enforcement capacity for environmental norms in partner countries.[226] Again

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222 Art. 21.6 of the United States-Korea FTA (2007) on the obligation to adopt or maintain legislative or other measures to establish as criminal offense the bribery of foreign public officials in matters affecting international trade or investment.

223 Lauge POULSEN (2015), "*Bounded Rationality and Economic Diplomacy: The Politics of Investment Treaties in Developing Countries*", shows for the sequencing of domestic liberalisation and treaty conclusions, that domestic liberalisation preceded treaty making in developing countries.

224 Ida BASTIAENS/Evgeny POSTNIKOV (2017), "*Greening up: the effects of environmental standards in EU and US trade agreements*", Environmental Politics, 26:5, 847-869. A separate paper, Marguerite ROSE (2016), "*It's Not Easy Being Green: The Effectiveness of Environmental Provisions in Preferential Trade Agreements*", Undergraduate Honours Theses, paper 1100, found no positive effect of PTAs with environmental provisions on environmental quality of treaty partners according to the metrics used.

225 As described in Evgeny POSTNIKOV/Ida BASTIAENS (2014), "*Does dialogue work? The effectiveness of labor standards in EU preferential trade agreements*", Journal of European Public Policy, Vol. 21:6, p.923-940 (924), United States PTA labour provisions are more legalistic than European Union PTA labour provisions and use withholding trade privileges as enforcement mechanism, while EU agreements rely on consultation and dispute settlement.

226 Sikina JINNAH/Abby LINDSAY (2016), "*Diffusion through issue linkage: environmental norms in U.S. trade agreements*", Global Environmental Politics, 16 (3), p.41-61.

here however, the effect relied on environment chapters of PTAs, a feature that is not found in IIAs.[227] Similar findings have been made with respect to labour content.[228]

Intergovernmental conversations currently ongoing at the OECD with a view to strengthen the effectiveness of certain treaty clauses[229] may lead to greater effectiveness in the future as policy recommendations resulting from these processes influence future treaty design and implementation.

(b) Broader legislative changes driven by efforts to meet treaty obligations of results

Substantive standards set out in IIAs may trigger adjustments in the governance of treaty partners that are conscientiously made in response to newly contracted international obligations to meet specific results.[230] This potential treaty effect attracted broader attention only recently as arbitral awards held host governments liable for alleged failures to meet standards of transparency, stability, predictability, or consistency that were claimed to be part of treaty obligations, in particular as part of almost ubiquitous "fair and equitable" treatment provisions.[231]

Benefits of such efforts could materialise as better governance or contribute to institution building[232] in States that have concluded IIAs; these benefits would typically reach beyond foreign investors, and

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227 Further assessments regard EU PTAs is available at "Sustainable development" on the EC Trade policy website. For the United States, see "Trade and Environmental Protection" on the Department of State site and United States Government Accountability Office (2014), "*U.S. Partners Are Addressing Labor Commitments, but More Monitoring and Enforcement Are Needed*"; United States Government Accountability Office (2009), "*Four Free Trade Agreements GAO Have Reviewed Have Resulted in Commercial Benefits, but Challenges on Labor and Environment Remain*". An overview of mechanisms and experience of implementation is available in Clive GEORGE (2011), "*Regional Trade Agreements and the Environment: Monitoring Implementation and Assessing Impacts: Report on the OECD Workshop*", *OECD Trade and Environment Working Papers*, No.2011/02.

228 Evgeny POSTNIKOV/Ida BASTIAENS (2014), "*Does dialogue work? The effectiveness of labor standards in EU preferential trade agreements*", Journal of European Public Policy, Vol. 21:6, p.923-940. Moonhawk KIM (2012), "Ex ante *due diligence: formation of PTAs and protection of labor rights*" *International Studies Quarterly* 56(4) p.704.

229 E.g. work carried out by the OECD's Joint Working Party on Trade and Environment since 2015.

230 Benedict KINGSBURY/Stephan SCHILL, "*Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality, and the Emerging Global Administrative Law*", Institute for International Law and Justice, NYU Law School, Working Paper 2009/6 (Global Administrative Law Series), p.8. Rudolf DOLZER (2005), "*The Impact of International Investment Treaties on Domestic Administrative Law*", *New York University Journal of International Law and Policy* 37, no.4, p.953(971). Tom GINSBURG (2005), "*International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*", International Review of Law and Economics 25(1), p.107(119).

231 Mavluda SATTOROVA (2015), "*The Impact of Investment treaty Law on Host State Behavior: Some Doctrinal, Empirical, and Interdisciplinary Insights*" In: Lalani/Lazo (Eds), The Role of the State in Investor-State Arbitration, p.164. SATTOROVA, ibid., p.165, points out that a few IIAs, essentially IIAs concluded by Italy, contain specific obligations to "*create and maintain a legal framework that guarantees to investors the continuity of legal treatment*", e.g. in Article 2(4) of Italy-Jordan BIT (1996). On the prevalence of "fair and equitable" treatment clauses in IIAs see DAF/INV/WD(2017)2/REV1.

232 Susan FRANCK (2007), "*Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law*", Global Business and Development Law Journal. Volume 19. p.337(367). Charles BROWER/Sadie BLANCHARD, *What's in a meme? The truth about investor-State arbitration: Why it need not, and must not, be repossessed by States*, p.755. Jeswald W. SALACUSE, "*The Three Laws of International Investment: National, Contractual, and International*", p.359. American Bar Association, ABA Annual Meeting, August 2008, Recommendation adopted by the House of Delegates and Report, item 108B, which states "[…] *Supports*

likewise benefit domestic investors and the population at large as a result of better legislative and administrative practice.[233] This postulated mechanism is similar to – and often not explicitly distinguished from[234] – effects that may be observed a long time after treaty conclusion when governments adjust practices in response to treaty claims; these issues are covered in the next section.

It appears that the such *ex ante* adjustment of general governance arrangements in anticipation or response to treaty obligations has so far only been claimed,[235] but not yet been empirically observed.[236] Endogeneity will keep empirical studies in this regard challenging, as governance improvements may be undertaken concurrently with, rather than as a consequence of, treaty obligations.[237]

It is also claimed – so far based on limited empirical evidence – that IIAs *weaken* incentives and mechanisms for legal and institutional reform in host countries. Three mechanisms are advanced in this regard: Firstly, when foreign investors are given access to a special substitute regime outside domestic institutions, governments' incentives to improve governance in their countries decline.[238] Secondly, foreign investors – who have in principle been shown to be influential drivers of reform[239] – lose interest in

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the contribution that the negotiated liberalization of international trade in goods and services, through government-to-government trade agreements, makes to the spread of the Rule of Law, both at the state-to-state level and within participants' domestic legal systems.".

233 Roberto ECHANDI (2011), "What Do Developing Countries Expect from the International Investment Regime?" in: *The Evolving International Investment Regime: Expectations, Realities, Options,* Jose E. ALVAREZ (Ed.), p.10.

234 Mavluda SATTOROVA (2015), "*The Impact of Investment treaty Law on Host State Behavior: Some Doctrinal, Empirical, and Interdisciplinary Insights*" In: LALANI/LAZO (Eds), The Role of the State in Investor-State Arbitration, p.172 is an exception.

235 Stephan SCHILL (2009), "*The Multilateralization of International Investment Law*". Roberto ECHANDI (2011), "What Do Developing Countries Expect from the International Investment Regime?" in: *The Evolving International Investment Regime: Expectations, Realities, Options,* Jose E. ALVAREZ (Ed.), p.13.

236 A rare anecdotal example of potential corrective action is associated with the case *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3. This case is cited as an example where a tribunal established under NAFTA alleged deficiencies in the rules of appeal in courts in Mississippi; these rules of appeal were changed during the arbitral proceedings, and the changes largely addressed the issues the Canadian investors had encountered regarding the conditions for appeal. The causality of the arbitral proceedings for the legislative reform is not established.

237 BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.216.

238 Tom GINSBURG (2005), "*International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*", International Review of Law and Economics 25(1), p.107(118). Lise JOHNSON/Lisa SACHS (2016), "*The Outsized Costs of Investor-State Dispute Settlement*", aib Insights, vol 16, no.1, p.12.

239 Rodolphe DESBORDES/Julien VAUDAY (2007), "*The Political Influence of Foreign Firms in Developing Countries*" Economics and Politics, 19 (3). pp. 421-451. Yasheng HUANG (2005), "*Are Foreign Firms Privileged By Their Host Governments? Evidence From The 2000 World Business Environment Survey*", MIT Sloan School of Management Working Paper 4538-04. Specifically on the role of investment and trade agreements in overcoming resistance against change by domestic interests The Investor-State Dispute Settlement Mechanism: An Examination of Benefits and Costs, Panel I: *Does ISDS Strengthen or Weaken the Rule of Law?*, CATO Institute, Symposium, 20 May 2014; Michael J. FERRANTINO, *Policy Anchors: Do Free Trade Agreements and WTO Accessions Serve as Vehicles for Developing-Country Policy Reform?*, pp.10-11. Ann CAPLING, "*Preferential trade agreements as instruments of foreign policy: an Australia–Japan free trade agreement and its implications for the Asia Pacific region*", *The Pacific Review* (2008), p. 27 (32).

advocating in favour of governance improvements as they have access to a special regime.[240] Although both propositions appear plausible, no empirical evidence has been found that would support these hypotheses.

Whether legal obligations contained in IIAs drive or hinder general governance improvements in treaty parties in the context of engaging in new IIAs remains an open question as long as empirical evidence in support for the opposing arguments is unavailable.

(2) Effect on legislation and regulation driven by generalised efforts to prevent disputes

In the first decades of the existence of IIAs, the dispute settlement mechanisms enshrined in these treaties has not seen actual use in litigation. It is plausible to assume and supported by a growing body of evidence[241] that governments' awareness of litigation risk under IIAs – in particular in the role of defendants – was low until the number of treaty-based claims started to climb in the latter half of the 1990s; some advanced economies may have become aware of their own exposure even only much later.[242]

It is held that growing awareness of litigation risk may have had effects on legislation or regulation – including many years after the entry into force of a given agreement – as a result of the internalisation of costs of infringements of government obligations under IIAs. These infringement costs include for instance the potential requirement to pay compensation for legislative or regulatory actions, litigation costs, as well as reputational costs linked to the mere claim of infringements. In simple words, the hypothesis states that the threat to attract treaty-based litigation would lead governments to thread more cautiously in general – and hence potentially insufficiently from a public-interest perspective – when planning and designing regulation.

The internalisation of costs of infringements of obligations under IIAs could lead governments to strive for a more comprehensive and effective *ex ante* assessment of compliance of planned regulation with international commitments resulting from IIAs. The effect on regulation is thought to be transmitted through the perceptions and expectations of the likelihood of subsequent liability and other costs, recognising that the treaty does not in itself and directly limit the legislative or regulatory powers of States. It is held that this causality chain may ultimately contribute to one form of what is occasionally labelled "regulatory chill".[243]

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240 Gus VAN HARTEN (2010), "*Investment Treaty Arbitration, Procedural Fairness, and the Rule of Law*", Osgoode Hall Law School Working Paper 13, p.2. Tom GINSBURG (2005), "*International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*", International Review of Law and Economics 25(1), p.107(119). Lise JOHNSON/Lisa SACHS (2016), "*The Outsized Costs of Investor-State Dispute Settlement*", aib Insights, vol.16, no.1, p.10.

241 Lauge POULSEN/Emma AISBETT (2013), "*When the Claim Hit: Bilateral Investment Treaties and Bounded Rational Learning*", *World Politics* 65, p.273-313 (281-282). Eleni METHYMAKI/Antonios TZANAKOPOULOS (2015), "*Masters of puppets? Reassertion of control through joint investment treaty interpretation*", Oxford Legal Studies Research Paper No. 10/2016, p.1.

242 Observations such as a declining cadence of treaty negotiations after a first claim, along with treaty denunciations, or exit from institutions such as ICSID corroborate this assumption.

243 This paper does not the use the concept of "regulatory chill" due to its breadth, connotations and often undifferentiated use. Kyla TIENHAARA (2011), "*Regulatory Chill and the Threat of Arbitration: A View from Political Science*" in: Chester Brown, Kate Miles, eds., *Evolution in investment treaty law and arbitration*, proposes the following working formulation of the regulatory chill hypothesis: "In some circumstances, governments will respond to a high (perceived) threat of investment arbitration by failing to enact or enforce *bona fide* regulatory measures (or by modifying measures to such an extent that their original intent is

For this causality chain to work, two conditions must be satisfied cumulatively:[244]

- relevant government entities or agents must be aware that an IIA may apply and which government behaviour it requires; and
- the potential consequences must be sufficiently compelling or dissuasive on those entities or agents.

To be sure, such incentive mechanisms exist beyond the specific presence of IIAs, as any dissuasive threat on relevant actors, including backed up by domestic law-based claims or other consequences, may influence agents' behaviour.[245] This is an important factor that should not be overlooked when assessing the impact specifically of IIAs on government regulation.

Little effort has been made to date to gather evidence on the extent to which the described effect can be observed in the context of IIAs, and doubts have been expressed on the possibility to empirically observe the effect at all.[246] In the literature, assertions have either been based on anecdotal evidence that suggests that treaties have this effect or on doctrinal arguments that treaties cannot possibly have such effects.[247]

Simple approaches to test the hypothesis empirically is based on statistics of claims or regulatory action. It has for instance been proposed that the decline of cases based on outright expropriations since the 1970s can be at least partly attributed to disciplining effects of IIAs.[248] Many other reasons for this trend could be named, and the steady increase of the number of claims overall, and in particular against countries with a solid reputation for decent governance, is difficult to square with this explanation.[249] It has also been

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undermined or their effectiveness is severely diminished)." This concept of "regulatory chill" covers phenomena described in this as well as the following section. Jonathan BONNITCHA (2014), "*Substantive Protection under Investment Treaties: A Legal and Economic Analysis*", p.118 distinguishes, as here, between "internalisation chill" and "threat chill".

244 Mavluda SATTOROVA (2014), "*International Investment Treaties and the Promise of Good Governance: Norm and Institutional Design, Internalisation, and Domestic Rule-Making*", European Society of International Law Conference Paper No. 11/2014, p.10.

245 Kyla TIENHAARA (2010), "*Regulatory Chill and the Threat of Arbitration: A View from Political Science*" in: Chester Brown, Kate Miles, eds., *Evolution in investment treaty law and arbitration*, Cambridge University Press, 2011, at footnote 11, is explicit about this element in her methodological considerations. Identifying the specific role of *treaties* or *ISDS* requires the isolation of all other factors that may similarly influence a given government.

246 Kyla TIENHAARA (2010), "*Regulatory Chill and the Threat of Arbitration: A View from Political Science*" in: Chester Brown, Kate Miles, eds., *Evolution in investment treaty law and arbitration*, Cambridge University Press, 2011, at footnote 12.

247 E.g. Stephan SCHILL (2007), "*Do Investment Treaties Chill Unilateral State Regulation to Mitigate Climate Change?*" Journal of International Arbitration 24, no.5 (2007), p.469. Julie SOLOWAY (2003), "*NAFTA's Chapter 11: Investor Protection, Integration and the Public Interest*", IRPP: Choices Vol.9.

248 Christopher HAJZLER (2012), "*Expropriation of foreign direct investments: sectoral patterns from 1993 to 2006*", Rev World Econ (2012) 148, p.119 (see also the related University of Otago Economics Discussion Paper No. 1011).

249 Thomas SCHULTZ/Cédric DUPONT (2014). "*Investment Arbitration: Promoting the rule of law or over-empowering investors? A Quantitative Empirical Study*", European Journal of International Law, 25(4): 1147-1168. Krzysztof PELC (2016), "*Does the international investment regime induce frivolous litigation?*"

advanced that the increasing volume of environmental legislation in Canada was a sign that NAFTA did not impact this country's government to regulate in this area.[250]

More sophisticated approaches have attempted to determine whether the individual conditions that would trigger any effect of IIAs on legislation or regulation are likely to be given.

As to the first condition – awareness in relevant parts of government –, it is known that certain countries – such as Canada[251] and Mexico – have undertaken efforts to enhance awareness and respect of international obligations created by IIAs. Some small-scale interview-based studies on the level of awareness about treaty obligations in administrations in several countries – advanced and developing – suggest that the level of awareness about treaty obligations and litigation risk is variable but often remains low, even after repeated exposure of a given country to treaty-based claims.[252]

The second element of the causality chain – whether the consequences on relevant government agents is dissuasive – has received less attention.[253]

At present, is has thus not been observed that governments thread more cautiously due to a generalised internalisation of cost related to IIA-based litigation.

(3) Effect on regulation and enforcement driven by reactions to nascent or expected disputes

A third way in which the presence of IIAs could alter governments' regulatory behaviour relates to governments' response to or anticipation of *specific* nascent, expected, or declared conflicts with treaty-covered foreign investors. This potential effect – also occasionally covered by the ambiguous term "regulatory chill"[254] – differs from the *ex ante* internalisation of the *general* risk of claims brought under IIAs – discussed in the previous subsection – insofar as it is *specific* to an individual measure and an individual investor or group of investors who approach the government with the threat of legal action under an IIA. The investor will typically present its case, formulate what it expects from the government, and specify that it has an investment treaty as a legal means at its disposal.

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250 Julie SOLOWAY (2003), "*NAFTA's Chapter 11: Investor Protection, Integration and the Public Interest*", IRPP: Choices Vol.9, p.19.

251 Summary of Roundtable discussions by the OECD Secretariat, 14th Roundtable on Freedom of Investment (March 2011), p.6.

252 Lauge POULSEN/Emma AISBETT (2013), "*When the Claim Hit: Bilateral Investment Treaties and Bounded Rational Learning*", *World Politics* 65, p.273-313 (281-282). Gus VAN HARTEN/Dayna Nadine SCOTT (2015), "*Investment Treaties and the Internal Vetting of Regulatory Proposals: A Case Study from Canada*", *Osgoode Legal Studies Research Paper Series*. Mavluda SATTOROVA/Ohiocheoya OMIUNU/Mustafa ERKAN (2015), "*How Do Host States Respond to Investment Treaty Law?: Some Empirical Observations*", (covering Nigeria, Turkey and Uzbekistan). Christine CÔTÉ (2014), "*A Chilling Effect? The impact of international investment agreements on national regulatory autonomy in the areas of health, safety and the environment*", London School of Economics and Political Science Doctoral thesis.

253 A legal advisor in the Sri Lankan Ministry of Foreign Affairs, has stated that certain interpretations of regulatory measures in the public interest as constituting indirect expropriation under investment treaties could make governments hesitant to undertake legitimate regulatory measures in the public interest. See Rohan PERERA, "*Technical assistance and capacity building, lessons learned from experiences and the way forward*" in: Making the most of International Investment Agreements: a common agenda, OECD Symposium 2005.

254 Kyla TIENHAARA (2011), "*Regulatory Chill and the Threat of Arbitration: A View from Political Science*" in: Chester Brown, Kate Miles, eds., *Evolution in investment treaty law and arbitration* , p.7.

In this scenario, the first condition named in the previous section – government awareness of treaty obligations –, on which much of the research focuses, is fulfilled.[255] Which reaction governments exhibit in these specific scenarios and in particular whether governments tend to give in to investors' demands when facing a specific threat of treaty-based arbitration, can be empirically observed more easily than any general effect discussed in the previous section, as these arguments occasionally play out in public.

At present, no comprehensive analysis has been undertaken that would deliver a clear answer on whether governments exhibit regulatory self-censorship or compromise on regulatory or enforcement measures when facing threats of treaty-based litigation. However, some anecdotal evidence is reported in the literature on specific countries or specific types of cases.

Such evidence has been collected in relation to two main scenarios:

- firstly, investors may inform governments early on in a policy process about their objection to specific measures, especially legislative measures, and combine this with a threat of future litigation; such behaviour could seek to nudge governments into deferring, abandoning or weakening a given regulatory measure;
- secondly, when the measure has already been taken and treaty-based litigation is threatened or commenced, governments may negotiate one-on-one with the investor to prevent the dispute from turning into a claim or to settle the claim.

It is emphasised again that, treaty-based litigation is not the only threat that may impress governments into changing their course of action, but treaty-based litigation may be particularly compelling due to its specificities in procedural aspects and remedies.[256] It is also emphasised again that the reactions that governments exhibit in these scenarios may be beneficial to the public in individual cases.

Anecdotal evidence on the first group of measures – investors seeking to delay, prevent or otherwise influence government measures by threatening ISDS claims – has recently been presented with respect to tobacco-control measures, which were subject to claims against Australia and Uruguay. Several governments which had planned similar policies as the two defendant countries are reported to have delayed the passing of the contentious policy to await the tribunals' decisions in the cases.[257] Furthermore, an insider has reported that certain governments have begun to explicitly ask legal counsel on the potential adverse implications of planned policies under IIAs.[258]

It has recently been suggested that an increasing number of claims brought against advanced economies, in concurrence with a declining success rate,[259] could be motivated exclusively by the objective

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255 Like here Kyla TIENHAARA (2011), "*Regulatory Chill and the Threat of Arbitration: A View from Political Science*" in: Chester Brown, Kate Miles, eds., *Evolution in investment treaty law and arbitration*.

256 David GAUKRODGER/Kathryn GORDON (2012), "*Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*", OECD Working Papers on International Investment, 2012/03, pp.24, 79.

257 E.g. for New Zealand's decision to defer the introduction of plain packaging legislation until the claim against Australia had been resolved see Tariana TURIA [then New Zealand's Health Secretary], "*Government moves forward with plain packaging of tobacco products*", New Zealand Government media release, 19 February 2013.

258 Toby LANDAU in: Australian Broadcasting Corporation, transcript of "*Background briefing, ISDS: The devil in the trade deal*", broadcast on 14 September 2014.

259 Malcolm LANGFORD/Daniel BEHN (2016), "*Managing Backlash – The Evolving Investment Treaty Arbitrator?*", forthcoming in European Journal of International Law, p.16.

to delay or discourage regulation in the defendant country or third countries.[260] It has been empirically shown that different degrees of ISDS-litigiousness are closely associated with undisclosed settlements, a finding that could be interpreted as supporting this hypothesis: For these repeat claimants – with up to six ICSID claims by the same investor over their lifetime – the greatest value may lie in publicly filing cases to coerce the respondent government to agree on new terms for an investment in dispute – a hypothesis significantly different from the narrative of ISDS as a last resort to recover compensation when all other means have failed.[261]

More empirical research would be required to draw firmer conclusion on whether enterprises use threats of treaty-based disputes to delay, prevent or otherwise influence government regulation, and to what extent such attempts are successful.

The second group of cases is associated with growing interest by governments to prevent, manage, and settle nascent or pending disputes.[262] Settlements are possible and often encouraged in domestic legal systems around the world, and most treaties explicitly require attempts to settle disputes in amicable ways.[263] Settlements and negotiations also allow for the use of agreed primary remedies, which are typically not available as final remedies under the existing ISDS system.[264]

However, a series of concerns are advanced in relation to settlements in this and similar contexts.[265] They relate to transparency, respect of procedural and substantive rules, among others. As in domestic law settings, negotiations to settle threatened or pending treaty-based claims are typically non-transparent in procedure and outcome. On which public interests governments decide to compromise to settle a dispute – lenience in regulation or supervision, approval of other projects by the same investor, taxation or subsidies, for instance – remains typically unknown even in high-profile cases in countries otherwise known for rather transparent government.[266]

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260 Krzysztof PELC (2016), "*Does the international investment regime induce frivolous litigation?*".

261 Emilie HAFNER-BURTON/Sergio PUIG/David Victor (2016), "*Against international settlement? The social cost of secrecy in international adjudication*", ILAR Working Paper no.26, p.46.

262 See, for examples and further references Mavluda SATTOROVA (2016), "*Reassertion of Control and Contracting Parties' Domestic Law Responses to Investment Treaty Arbitration: Between Reform, Reticence and Resistance*" (forthcoming in Andreas Kulick (Ed.), *Reassertion of Control over the Investment Treaty Regime*, p.53).

263 Joachim POHL/Kekeletso Mashigo/Alexis NOHEN (2012), "*Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey*", OECD Working Papers on International Investment, 2012/02, p.17.

264 David GAUKRODGER/Kathryn GORDON (2012), "*Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community*", OECD Working Papers on International Investment, 2012/03, pp.24, 79.

265 Emilie HAFNER-BURTON/Sergio PUIG/David Victor (2016), "*Against international settlement? The social cost of secrecy in international adjudication*", ILAR Working Paper no.26. Lise JOHNSON/Brooke Skartvedt GUVEN (2017), "*The Settlement of Investment Disputes: A Discussion of Democratic Accountability and the Public Interest*", IISD Investment Treaty News, March 2017. On the parallel implications at domestic level – for the example of the United States – U.S. Chamber of Commerce (2013), "*Sue and Settle – Regulating behind closed doors*".

266 Little is known for instance as to why Swedish wholly state-owned enterprise *Vattenfall* has settled in 2011 a multi-million EUR claim against Germany, brought in relation to environmental measures concerning a coal-fired power plant in Hamburg (ICSID case ARB/09/6). Similar uncertainty about the drivers of settlement has been pointed out in other cases, some of which are listed in Kyla TIENHAARA (2011), "

Absence of transparency diminishes accountability of governments and hides potential costs and forgone public interests of these settlements; procedural rights of non-disputing parties, separations of powers and competencies of specialised agencies of the host state may be overridden.[267] More vulnerable or less vocal parts of society, as well as diffuse or long-term public interests may be particularly exposed to be bargaining chip in settlements. Furthermore, as governments may favour this way of settlement – for reasons such as absence of budgets to settle costs for legal proceedings and damages payments, lower public scrutiny etc. –[268] their negotiating position may lead to greater-than-necessary concessions.

A recent empirical study has shown that the proportion of ISDS cases brought to ICSID and settled in secret has grown over time, despite efforts to enhance transparency at ISCID.[269] This finding could be interpreted as a sign that claims are brought purposefully to compel defending governments into concessions in the context of settlements. The European Union-Singapore FTA now contains an explicit clause requiring transparency of settlements.[270]

Many questions remain open on whether and how governments respond when specifically approached with a threat to escalate a conflict or bring a treaty-based claim, and in particular whether governments tend delay, abandon, or alter regulatory projects or compromise on regulation and enforcement. These issues do not only interest in the context of the governance implications, but also for aspect of discrimination among foreign and domestic investors that do not have the same access to these mechanisms.[271] Most probably, this area has been disproportionally underexplored in relation to its importance and would rank predominantly in any assessment of societal benefits and costs of IIAs.

b. Do treaty effects on governance, legislation, regulation and enforcement in host States present societal benefits or costs?

Given the absence of sufficient information on whether, to what extent, and how IIAs influence, governance, legislation, regulation or enforcement in host States, a definitive assessment of whether any of the discussed phenomena present societal benefits of costs is impossible. Nonetheless, some of the identified aspects merit particular consideration, not least because identifying them as benefits or costs may be controversial.

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the Threat of Arbitration: A View from Political Science" in: Chester BROWN, Kate MILES (Ed.), *Evolution in investment treaty law and arbitration*, p.14.

267 Emilie HAFNER-BURTON/Sergio PUIG/David Victor (2016), "*Against international settlement? The social cost of secrecy in international adjudication*", ILAR Working Paper no.26.

268 Australian Productivity Commission, "*Trade&Assistance Review 2013-14–Productivity Commission Annual Report Series*", p.78. The first known explicit consideration on budgeting costs to defend or pay IIA-based awards occurred in Regulation (EU) 912/2014 of the European Parliament and of the Council of 23 July 2014; it is concerned, among other issues, with the apportionment of financial responsibility resulting from ISDS under IIAs to which the European Union is party.

269 Emilie HAFNER-BURTON/Sergio PUIG/David VICTOR (2016), "*Against international settlement? The social cost of secrecy in international adjudication*", ILAR Working Paper no.26, p.41.

270 EU-Singapore free trade agreement, annex 9-E, art. 4(6).

271 Jonathan BONNITCHA/Emma AISBETT (2010), "*Submission to the Productivity Commission's Review of Bilateral and Regional Trade Agreements*", for instance suggest that "Any system of liability that requires government to compensate foreign investors for economic loss that is not coupled with an equivalent system of protection for all other economic actors will encourage decision makers to over-value the interests of foreign investors.", p.8.

As to the adjustment of domestic law and regulation to treaty obligations, mentioned first in the above categorisation, it is likely uncontroversial that whether they represent benefits or costs for societies depends on the individual obligations contained in the treaty.

Whether more diffuse effects, as mentioned in the second group – adjustments of governance to prevent disputes generally – represent benefits or costs is likely to be more controversial. For once, preferential treatment in law or practice based on the criterion of foreignness and treaty coverage contradicts the principle of non-discrimination, which treaties supposedly advocate for; any such discrimination would need at a minimum to be justified if it were to be considered as a benefit. Whether a generally more cautious handling of public affairs and regulation is beneficial for societies is a yet unresolved question, and any answer will depend on country-specific factors, among others.

As to the third category – effects on regulation and enforcement driven by reactions to nascent or expected disputes –, many would argue that this could represent a societal cost in many circumstances, given the impact on regulation, transparency, accountability, etc. These issues add to concerns about discrimination, as the additional level for negotiation is exclusively available to treaty covered foreign investors. At times, such retractions may also be beneficial to societies, however.

It should be noted that recent treaties contain explicit attempts to counter some of the effects that have raised concerns. These include attempts to balance the right to regulate with treaty protections in certain clauses (fair and equitable treatment;[272] indirect expropriation; etc.) or transparency measures[273]. Whether these adjustments resolve the issues comprehensively – at least for these newest treaties – as some claim, remains an open question.

3. Improvements or damages to the domestic or global "rule of law"

Beyond the specific aspects covered in the preceding sections – in particular those that relate to government efforts to strengthen the institutions, enhance predictability of government action, or transparency of legislation – there is a broader debate on whether IIAs further or undermine the "rule of law" domestically or internationally.

There is no established consensus on what constitutes the "rule of law" at either level, and no exhaustive discussion of this matter is required or attempted here. Almost all of the effects that treaties supposedly have on the "rule of law" can be associated with categories at lower levels of abstraction and are treated under these more concrete categories. The following subsections link the individual claims to these more specific items and discusses the few elements that overshoot the more specific categories that are discussed elsewhere in this paper.

a. Do IIAs contribute to strengthening or weakening the "rule of law" domestically?

Many commentators have expressed views on diverse impacts of IIAs on the domestic rule of law of host states. While investment treaties had for long (and implicitly are still) presented as a substitute to

[272] David GAUKRODGER (2017), "*Addressing the balance of interests in investment treaties: The limitation of fair and equitable treatment provisions to the minimum standard of treatment under customary international law*", OECD Working Papers on International Investment, 2017/03.

[273] As in the example of rules on transparency in dispute settlement in European Union-Singapore FTA, annex 9-E, art. 4(6).

domestic institutions in developing countries rather than a driver for change,[274] some voices now claim that treaties have transformative potential to *enhance* the domestic rule of law.[275] Most, if not all of these aspects appear to be congruent with the assertion that (predominantly developing) treaty partners seek to adjust their domestic systems, rules and institutions to the new international obligations as discussed earlier in this paper.[276]

Some alleged *detrimental* effects of IIAs on the domestic rule of law are associated with the potential effect on regulation and enforcement when governments face a specific threat of litigation from a treaty-covered investor; this aspect is discussed above. An additional potentially detrimental effect on the domestic rule of law associated with investment treaties stems from the co-existence and occasional contradiction of domestic institutions and rulesets with parallel rules and adjudication system for a class of individuals.[277] This co-existence and occasional contradiction are thought to raise concerns with respect to (a) their effect on functioning domestic corrective action; and (b) issues of participation in adjudication.

(a) Co-existence of domestic and international rules and adjudication systems

The co-existence of domestic and treaty-based international rules and adjudication systems have attracted attention in cases where functioning domestic corrective action of an initially illegal situation under domestic or other rules (which favoured a treaty-covered investor) has triggered treaty liability; in these cases, treaty based arbitral tribunals restored a domestically illegal and sometimes illegitimately acquired advantage for foreign investors.[278]

No attempt is made here to qualify the idiosyncratic cases and arguments. However, it merits consideration whether suppressing domestic judicial oversight of domestic executive action can promote

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274 Tom GINSBURG (2005), "*International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*", International Review of Law and Economics 25(1), p.107 (119). Mavluda SATTOROVA (2015), "*The Impact of Investment treaty Law on Host State Behavior: Some Doctrinal, Empirical, and Interdisciplinary Insights*" In: Lalani/Lazo (Eds), The Role of the State in Investor-State Arbitration, p.5.

275 Stephan SCHILL (2009), "*The Multilateralization of International Investment Law*".

276 Some authors question principally whether the investment treaty regime possesses the necessary institutional consistency that would enable it to have a transformative impact on domestic governance (e.g. Mavluda SATTOROVA (2014), "*International Investment Treaties and the Promise of Good Governance: Norm and Institutional Design, Internalisation, and Domestic Rule-Making*", European Society of International Law Conference Paper No. 11/2014, p.7) This question is partly driven by ambiguity of the terminology and concepts in this area.

277 Tom GINSBURG (2005), "*International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*", International Review of Law and Economics 25(1), p.107. Susan FRANCK (2007), "*Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law*", Global Business and Development Law Journal. Volume 19. p.337(367) describes the interaction as two systems that complement each other.

278 Two recent examples for this situation: An award in ICSID Case ARB/05/20 (Micula v. Romania) ordered Romania to pay around EUR 178 million in the context of a revoked aid scheme that was found illegal under European Union state aid rules (European Commission, State aid case SA.38517(2014/C)). In an award in ICSID Case ARB/11/23 (Franck Charles Arif v. Moldova), para.547, the tribunal based the treaty breach of "legitimate expectations" under a "fair and equitable treatment" clause on the fact that parts of the executive had encouraged an investment, which was later found to be illegal by Moldovan courts, suggesting that "at the international level, the State has a unitary nature".

the domestic rule of law,[279] especially in cases where the "protected" interests of the investor were acquired by manifestly reprehensible means, in particular corruption.

(b) Participatory rights in rule-making and adjudication

Another aspect that has attracted attention is linked to treaty-based interference with separation of powers, competencies within host governments and participation rights.[280] Such arrangements, undoubtedly elements and instruments of the "rule of law", are occasionally disabled in treaty-based claim contexts. As already mentioned for the context of settlements, inclusive representation of different interests and procedural rights as established in many countries' legal systems have not been found to be replicated in investor-state dispute settlement mechanisms.[281]

b. Improving the global rule of law?

It has been claimed[282] that the investment treaty system generates benefits for the "global" or "international" rule of law. These benefits are circumscribed more specifically as a contribution to the global good "respect of international law", which in turn implies principles such as "no expropriation without compensation" and the "minimum standard of treatment". In the absence of IIAs, investors may not enforce the respect of all of these principles directly.

While the supposition that without investment treaties, not direct remedy would be available in case of certain infringements of international law principles is likely accurate, similar scenarios are rather ubiquitous in international law generally. Many breaches of international law standards, in all areas of international law, are not accompanied by a remedy and enforcement mechanism.

Whether offering a direct remedy for breaches of international law principles advances the global rule of law as suggested is an open question; it would at best be a very selective measure in a wide open field; whether such a selective correction of a perceived shortcoming in international law is a pressing priority in an almost generalised absence of direct remedies for infringements on international law principles in other areas would need to be carefully considered.

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279 Mavluda SATTOROVA (2014), "*International Investment Treaties and the Promise of Good Governance: Norm and Institutional Design, Internalisation, and Domestic Rule-Making*", European Society of International Law Conference Paper No. 11/2014, p.6.

280 Lise JOHNSON/Lisa SACHS (2016), "*The Outsized Costs of Investor-State Dispute Settlement*", aib Insights, vol 16, no.1, p.11.

281 For the situation of the United States Lise JOHNSON/Lisa SACHS/Jeffrey SACHS (2015), "*Investor-State Dispute Settlement, Public Interest and U.S. Domestic Law*", CCSI Policy Paper. Regarding procedural participation rights Gus VAN HARTEN (2010), "*Five Justifications for Investment Treaties: A Critical Discussion*", Trade, Law and Development, p.19(33). BÜTHE/Helen V. MILNER: "*Bilateral investment treaties and foreign direct investment: a political analysis*" in SAUVANT, K. (Ed.), Yearbook of International Investment Law and Policy 2009/2010, p.186 suggest that "treaties indeed constrain policy choices […]. Such constraints may run counter to principles of democratic governance […]. Especially due to the dispute settlement procedures, BITs constitute a kind of international delegation of governance […]."

282 No publication has been found that would make such a claim, but the aspect was proposed by an arbitration practitioner in response to a call for comments on an earlier version of this paper.

C. The role of IIAs in relation to strategic foreign policy objectives

It is sometimes suggested that economic agreements, such as PTAs, can be instrumental or are concluded to advance or achieve strategic foreign policy objectives.[283] This element has long been and remains underexplored, but has received some attention lately in the context of major trade agreements, all of which had investment content. Scholarly work has also proliferated. In these contexts, it has been notably suggested that:

- the economic boost that is associated with PTAs would lead to greater prosperity in the treaty partners and thus stabilise a country or region;[284];
- IIAs can symbolise,[285] reward,[286] or deepen[287] cooperation in a bilateral (or multilateral) relationship in which a senior treaty partner has a strategic interest;[288]
- that developing countries may be motivated to sign BITs with developed countries to obtain benefits and favours – including foreign aid, for example – that such relationship may yield;[289]

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283 Ann CAPLING, "*Preferential trade agreements as instruments of foreign policy: an Australia–Japan free trade agreement and its implications for the Asia Pacific region*", *The Pacific Review* (2008), p.27 and Jo-Ann CRAWFORD/Robert FIORENTINO (2005), "*The Changing Landscape of Regional Trade Agreements*", WTO Discussion Paper No.8, p.16.

284 See literature on this argument quoted in "*Bilateral and Regional Trade Agreements, Productivity Commission Research Report*", Australian Productivity Commission, November 2010, p. 208.

285 BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.220 suggest that treaties signed among countries that have no significant trading or investment relationships with this reason. According to unpublished OECD data that overlays reported FDI stock data with IIA coverage, over 6% of the 1882 bilateral IIAs that are in force between an advanced or emerging economy and any other economy, and for which data is available, cover no reported FDI stock in either direction. While these treaties may still cover investment, the finding suggests that even treaties of major economies may lay idle.

286 Robert ZOELLICK supposedly stated at a speech to the Institute for International Economics in 2003, that "free trade agreements with the United States were a privilege that must be earned through 'cooperation – or better – on foreign policy and security issues'", quoted by Inside US Trade, 16 May 2003, according to Ann CAPLING, "*Preferential trade agreements as instruments of foreign policy: an Australia–Japan free trade agreement and its implications for the Asia Pacific region*", *The Pacific Review* (2008), p. 27.

287 Kenneth VANDEVELDE (2012), "*The First Bilateral Investment Treaties: U.S. Friendship, Commerce and Navigation Treaties in the Truman Administration*". Adam S. CHILTON (2016), "*The political motivations of the United States' bilateral investment treaty program*", Review of International Political Economy, 2016, Vol.23, No.4, p.614-642. Vinod K. AGGARWAL, "*Linking Traditional and Non-Traditional Security in Bilateral Free Trade Agreements: The US Approach*" in: V. K. AGGARWAL/K. GOVELLA (eds.), Linking Trade and Security, The Political Economy of the Asia Pacific (2012). Jo-Ann CRAWFORD/Roberto V. FIORENTINO (2005), "*The Changing Landscape of Regional Trade Agreements*", WTO Discussion Paper No.8, p. 16. Richard E. FEINBERG, "*The political economy of United States' free trade arrangements*", The World Economy 26(7), p.1019 (1028). Further literature is quoted in Chika YAMAMOTO, "*The Logic of Japan's Free Trade Agreements (FTA) with ASEAN*", Journal of Contemporary Eastern Asia, p.27. Cecilia MALMSTRÖM, EU Commissioner for Trade, "*Three Reasons Why TTIP is good for Austria*", 20 January 2015. Cecilia MALMSTRÖM, EU Commissioner for Trade, "*Why TTIP is good for Germany*", 30 January 2015. "*Ships that pass in the night*", The Economist, 13 December 2014.

288 Empirical evidence on all three dimensions in Lauge POULSEN/Emma AISBETT (2015), "*Diplomats Want Treaties: Diplomatic Agendas and Perks in the Investment Regime*" GEG Working Paper No.112 and Jonathan BONNITCHA/Lauge POULSEN/Michael WAIBEL (2017), "*The Political Economy of the Investment Treaty Regime*", p.201.

- PTAs could foster the establishment of global trade rules by emulation[290] or persuade countries in accepting the principles of free trade;[291] and
- PTAs could offer geopolitical benefits.[292]

Many of these assertions have been questioned[293] or met with counterclaims: It is for instance suggested that economic interdependence does not dampen geopolitical rivalry or prevent conflict;[294] that the exclusiveness of PTA membership may generate division rather than foster global cooperation;[295] that the potential frictions that can result from the implementation of an agreement might be damaging for the bilateral relationship;[296] and that the need to retain bargaining chips for bilateral PTAs may hold back rather than spur reform.[297]

While this increasingly rich literature make important contributions on what has and continues to motivate conclusions of IIAs, it offers little information on the extent to which IIAs have actually delivered on these expectations; this information is required to assess societal benefits and costs in this area.

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289 Jeswald W. SALACUSE (2013), "*The Three Laws of International Investment: National, Contractual, and International*", p.359.

290 This latter argument was essentially made in the context of the Transatlantic Trade and Investment Partnership (TTIP), cf. Samuel BENKA (2014) "*What Are the Benefits of TTIP?*" Woodrow Wilson Center, who suggests that "Perhaps the greatest benefit of the TTIP is that it can enable the U.S. and the EU to negotiate a truly 21st century agreement that can be a template for other agreements and even for the World Trade Organization itself." Daniel HAMILTON/Steven BLOCKMANS (2015), "*The geostrategic implications of TTIP*", CEPS Special Report No. 105 (April 2015) claim that TTIP "…is about creating a more strategic, dynamic and holistic US-EU relationship that is better positioned with regard to third countries to open markets and to strengthen the ground rules of the international order." Charles A. KUPCHAN (2014), "*The Geopolitical Implications of the Transatlantic Trade and Investment Partnership*" Transatlantic Academy, June 2014, p.5 writes: "Should TTIP be successfully concluded, it has the potential to have positive knock-on effects in other regions. A transatlantic pact could help set global standards, creating an example that other trade groupings might follow as they seek to advance liberalization."

291 Daniel HAMILTON/Steven BLOCKMANS (2015), "*The geostrategic implications of TTIP*", CEPS Special Report No.105 (April 2015), pp. 6-7.

292 Charles A. KUPCHAN (2014), "*The Geopolitical Implications of the Transatlantic Trade and Investment Partnership*" Transatlantic Academy, June 2014, states that TTIP, by "creating jobs and stimulating growth, would help revitalize the Western democracies and advance the prospects for the West's reclamation of political and strategic purpose."

293 Australian Productivity Commission (2010), "*Bilateral and Regional Trade Agreements, Productivity Commission Research Report*", p.209 expresses scepticism about any such achievements from Australia's agreements

294 Charles A. KUPCHAN, How Enemies Become Friends: The Sources of Stable Peace (Princeton: Princeton University Press, 2010), quoted by the same author in: Charles A. KUPCHAN (2014), "*The Geopolitical Implications of the Transatlantic Trade and Investment Partnership*" Transatlantic Academy, June 2014, p. 1.

295 Charles A. KUPCHAN (2014), "*The Geopolitical Implications of the Transatlantic Trade and Investment Partnership*" Transatlantic Academy, June 2014 states that "The more ambitious and exclusive the "club" constituted by the Atlantic democracies, the higher the barriers to entry, and the less likely it is that emerging powers will want or be able to play by Western rules. In this sense, TTIP could exacerbate dividing lines between the West and rising states."

296 Theodore R. BROMUND/Nile GARDINER/Luke COFFEY (2014), "*The Transatlantic Trade and Investment Partnership (TTIP): The Geopolitical Reality*", Heritage Foundation.

297 Australian Productivity Commission, "*Trade&Assistance Review 2013-14*", p.83.

Furthermore, most of the issues have been advanced for PTAs regardless of whether they contain investment provisions. The role of investment content in such agreements has rarely been considered in isolation, adding further uncertainty on whether investment content has contributed to any potential benefit or cost of these agreements for societies.

Existing empirical evidence does not allow to determine whether IIAs generate any societal benefits or costs with respect to strategic foreign policy objectives, even if such motives may motivate past and present treaties.

ANNEX: MARKET-ACCESS PROVISIONS IN IIAS

A growing number of IIAs contain content beyond post-establishment protections, and in particular various types of market access provisions that lock in or broaden the possibilities of foreigners to invest in a given treaty partner. This pre-establishment content includes obligations to grant pre-establishment national treatment (NT), or liberalisation provisions in the body of the treaty or in schedules specific to the individual treaty partners.

To what extent pre-establishment content should be factored in the overall assessment of societal benefits and costs of IIAs needs to be carefully considered. Pre-establishment content is so far a rarely observed and substantially distinct feature of IIAs. Its societal benefits and costs are different from IIAs' investor-protection content and can be separately assessed. It is for these reasons that the societal benefits and costs of market access content of IIAs receive a somewhat cursory treatment in this paper. The purpose of this section is essentially to contextualise and position pre-establishment content in IIAs in relation to these treaties' investment protection component.

a. The types of market-access content in IIAs

IIAs may play two distinct roles with respect to market-access content: They can lock in an existing or any degree of liberalisation by creating an international obligation that domestic law must meet; or the can create international obligations that go beyond the *status quo* and that require a change in domestic legislation towards greater openness for foreign investment from the treaty partner. Both functions are observed in actual treaty practice.

Pre-establishment content may generate societal benefits or costs that result from potential additional international capital flows between the treaty partners, which are enabled either by precluding future restrictions in domestic legislation or by obliging treaty partners to implement actual liberalisation in accordance with the treaty. To date, it has not been comprehensively established to what extent liberalisation provisions found in IIAs offer market access beyond the *status quo* and grant additional market access compared to the situation without the treaty, or to what extent the treaty obligations even reflect the *status quo* in individual treaty partners.[298] Empirical evidence for the role that IIAs play in generating additional capital flows between treaty partners remains thus limited.[299]

Some empirical information is available on preliminary questions – the frequency to which IIAs contain market-access content, below b. and how this compares to other mechanisms to grant or lock in market access, below c.

[298] Work on this issue has recently begun at the OECD, but at the time of writing in September 2017, results had not been published.

[299] An example is Axel BERGER/Matthias BUSSE/Peter NUNNENKAMP/Martin ROY (2013), "*Do trade and investment agreements lead to more FDI? Accounting for key provisions inside the black box*", International Economics and Economic Policy 10(2), p.247.

b. Few IIAs contain market-access content

Two forms of market-access content are observed in IIAs: The IIA can grant pre-establishment national treatment (NT), often subject to reservations, or contain sector-specific obligations. Such provisions can be symmetric, but are often asymmetric in actual treaties, that is, the individual treaty partners take on different obligations. Furthermore, some IIAs contain most-favoured nation (MFN) rules related to pre-establishment. These latter provisions may result in the extensions of pre-establishment NT or sector-specific obligations to investors from countries that are covered by pre-establishment MFN clauses, but the actual result of pre-establishment MFN clauses depends on the content of other treaties concluded by the treaty partner.

So far, pre-establishment content remains a relative exception in IIAs, both in the stock of existing treaties and in recently concluded agreements. Among the over 2400 bilateral IIAs recorded in the OECD treaty database, only around 4% contain pre-establishment NT provisions. Also, the inclusion of pre-establishment content in IIAs is concentrated in a limited number of countries. Among the 58 countries that are invited to participate in the Roundtable, only 35 have ever included such content in any of their IIAs, and only four countries have included such content in more than half of their IIAs.

c. Market access can be and is for the most part granted or locked in through other mechanisms than IIAs

Rules on market access for foreign investment can be established in many different fashions, notably unilaterally through domestic law. Many countries have established rules on market access for foreign investors in domestic law, and most countries have progressively opened their economies for foreign investment.[300]

International law obligations can hinder backsliding on market openness – which could justify the need for lock-in of a given degree of market-access through an international law instrument. In practice, it has only been observed very rarely that countries reduce market access for foreign investment, especially in recent years.[301] Also, IIAs are not the only international law instrument that locks in market access for foreign investment. Other such instruments include the OECD Code of Liberalisation of Capital Movements and GATS as multilateral instruments. European Union Members are bound by European Union rules in this regard.

Given the large number and breadth of obligations countries have taken on under such plurilateral rules, the role that individual IIAs and IIAs as a whole play in granting or locking in market access for foreign investment appears limited.

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[300] The OECD's *FDI Regulatory Restrictiveness Index*, which measures statutory restrictions on foreign direct investment in 62 countries in 22 sectors has shown a dominant trend towards openness over twenty years since its inception.

[301] For details regarding measures introduced since 2008 by the 58 economies participating in the Roundtable refer to the inventories of investment policy measures established 6-monthly by the OECD.

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