

Preface

The curious case of Pakistan

In October 2001 Pakistan's Secretary of Law received a letter. It related to a dispute between the Pakistani government and a Swiss company, Société Générale de Surveillance (SGS). The dispute had begun in 1996 after the Sharif government terminated a contract with SGS due to suspicions that it had been obtained through bribes. SGS objected and began a series of legal proceedings in both Switzerland and Pakistan. All failed. The letter received five years after the dispute had begun was not from Switzerland or the Pakistani courts. This time it was from Washington DC. It came from a World Bank institution called the International Centre for the Settlement of Investment Disputes. ICSID said SGS was claiming more than US \$110 million in compensation based on a so-called bilateral investment treaty (BIT). This puzzled the Secretary, as neither ICSID nor the BIT had been mentioned by SGS while the contractual dispute had lasted.¹ He therefore called up his Attorney General to ask what he knew about ICSID, and how SGS could possibly use a BIT to file such a claim. Although one of the most notable experts on international public and commercial law in Pakistan, the attorney general couldn't give him an answer. 'To be perfectly honest,' he later said to me, 'I did not have a clue.'² After hanging up, the attorney general therefore went on to Google. Here he typed in two questions: 'What is ICSID?' and 'What is a BIT?' And that is how he learned of these instruments for the first time.

It didn't take long before the attorney general realized that the letter from ICSID was serious indeed. Unlike the contract with SGS, which involved specific commercial rights, the six-page BIT provided SGS a right to compensation for a wide range of regulatory conduct based on

¹ ICSID Case No. ARB/01/13, Decision on Jurisdiction, 6 August 2003, par. 63.

² Interview, Karachi, January 2009.

very vague treaty language. Pakistan was obliged to fully compensate Swiss investors for expropriation, indirect expropriation, or any other measures having the same nature or effect. What that meant remained unspecified. Swiss investors could also claim damages owing to war, revolts, states of emergency or other armed conflicts, none of which were strangers in a Pakistani context. They were promised free repatriation of their profits and other capital out of Pakistan, which again was a very significant obligation for a country facing serious foreign exchange shortages at the time. The treaty also obliged Pakistan to treat Swiss investors in the same way as Pakistani investors (national treatment) or investors from other third countries (most-favoured-nation treatment), whichever was more favourable. Finally, it included a vague – but potentially far-reaching – clause providing for fair and equitable treatment, which again remained unspecified. In essence, the BIT provided SGS something akin to an ‘economic constitution’ while operating in Pakistan that was independent of Pakistan’s own laws and regulations.

As important, it gave Swiss investors the right to settle disputes with the Pakistani government outside Pakistan’s own legal system, for instance by using ICSID as the arbitration forum. This was in contrast to the usual procedure of international arbitrations, where foreign investors traditionally needed to go through domestic courts before international proceedings could be initiated. The tribunal had the authority to admit SGS’s claim, rule on its own jurisdiction, as well as award damages binding upon Pakistan and with no real options for appeal.

Some corners of the Pakistani bureaucracy proposed to stay away from the proceedings and not comply with any potential arbitral awards, but the attorney general realized this was a bad idea. Like the vast majority of investment arbitration claims, SGS had asked for monetary compensation as a remedy. In case of non-compliance, the award would be enforceable against Pakistan’s commercial assets around the world. Courts in enforcing states would have only limited options to refuse execution. Even more important, Pakistan was crucially dependent on financial assistance from the International Financial Institutions, so renegeing on international legal obligations within a World Bank forum like ICSID would be imprudent.

Clearly, this was not a claim to be taken lightly, so the attorney general wanted more information on the BIT and why it had been signed in 1995. But when inquiring with the relevant ministries, he was unable to trace any records of negotiations ever taking place with Switzerland. There were no files or documentation and no indication that the treaty had ever been discussed in Parliament. In fact, no one could find the treaty itself, so Pakistan had to ask Switzerland for a copy through formal channels. For a treaty with such a considerable scope, this was somewhat

of a mystery. Yet, the attorney general later learned that this was no exception, as hardly any records existed of Pakistan's past BIT negotiations.

This was peculiar. For although Pakistan was no stranger to allowing *individual* investors a right to international arbitration based on specific contracts, its BITs had provided a 'standing offer' to international arbitration to foreign investors *as a group*. When signing BITs Pakistan had given all existing *and* future investors covered by the treaties the option of taking their disputes to international arbitration. Combined with their vague and broad treaty language, this not only gave investors a second chance at adjudicating contract disputes, as in the SGS case, but also implied a potentially infinite number of claims involving Pakistan's regulatory conduct. But even though Pakistan had actually been the first country to ever sign a BIT in 1959 with West Germany, and had concluded a total of 40 similar treaties since then, no one could seem to find any documentation that they had been carefully negotiated.

This was not because the negotiations were considered too sensitive to document in written form. On the contrary, when foreign delegations had come to the country, or the Pakistani leadership went abroad, BITs had merely been considered a diplomatic token of goodwill. There was an expectation that the treaties would lead to increased inflows of foreign investment, something Pakistan desperately needed, but they were not thought to have any potential liabilities or regulatory constraints. The claim by SGS made it obvious to the attorney general that this view was mistaken.

For many, however, this probably sounds a little too convenient: now that Pakistan had to adhere to her international legal obligations, it appears opportunistic of a bureaucrat to claim ignorance on behalf of his former colleagues. So to corroborate the story, I contacted a considerable number of officials involved in Pakistan's BIT program in the past. All confirmed more or less the same narrative, and today even government files admit to this view: 'BITs were initially instruments that were signed during visits of high level delegations to provide for photo opportunities'.³ It was thereby not until Pakistan was hit by a multimillion-dollar arbitration claim that officials realized the implications of treaties signed by shifting governments since 1959.

This book will show that Pakistan's experiences have not been unique. During the 1990s and early 2000s, only few developing country governments realized that by consenting to investment treaty arbitration, they

³ Communication between Pakistan's Board of Investment and Ministry of Law concerning re-negotiation of German-Pakistan BIT, 23 November 2009. On file with author.

agreed to offer international investors enforceable protections with the potential for costly and far-reaching implications. The majority of developing countries thereby signed up to one of the most potent international legal regimes underwriting economic globalization without even realizing it at the time.

This not only means that the history of the international investment regime has to be rewritten; it also provides more general lessons for our understanding of economic diplomacy. For even if policy-makers try to pursue their own preferences when designing the rules that shape global economic governance, they are not always as careful and sophisticated as much international relations literature would have us believe. Instead, economic diplomats are no different from the rest of us by often struggling to make sense of their surroundings due to limited problem-solving capabilities. It is only through studying the nature and role of these cognitive constraints that we will understand the often irrational, yet predictable, nature of international economic relations.

1 Unanticipated consequences

The bilateral investment treaty (BIT) between Pakistan and Switzerland is one of more than 3,000 investment treaties signed by practically all countries in the world, particularly during the 1990s and early 2000s (Figure 1.1). The vast majority are bilateral and closely follow decade-old provisions going back to the 1959 agreement between West Germany and Pakistan – with one key exception. For whereas early investment treaties referred disputes to inter-state adjudication, BITs adopted in recent decades have included a broad and binding consent to investor–state arbitration. As realized by the attorney general of Pakistan, this made the treaties some of the most potent legal instruments in the global economy.

Today, foreign investors increasingly resort to treaty-based arbitration when disputes arise. Not all claims have to be made public, but by 2015 we knew of more than 600 filed against nearly 100 states. Most have been brought in recent years and the majority of respondents are developing countries. The claims have dealt with a very wide range of government activities. For although investment treaties emerged in response to the wave of expropriations during the post-colonial era, outright expropriation of foreign investments came out of fashion in the late 1970s. Instead, the vague terms of investment treaties have been

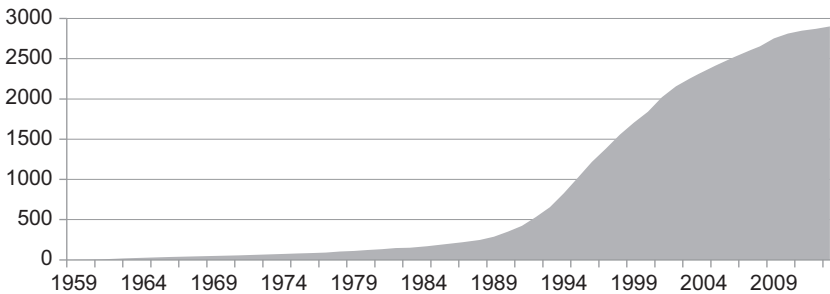


Figure 1.1 The spread of bilateral investment treaties

2 Unanticipated consequences

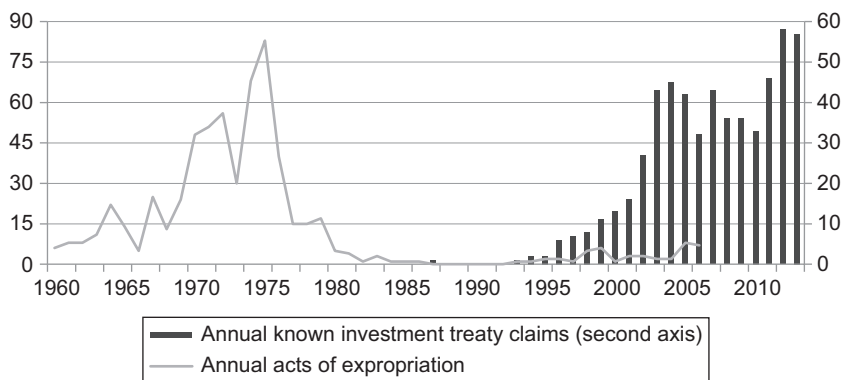


Figure 1.2 Investment treaty arbitration and direct expropriation
Note: Expropriation data, from Hajzler (2012), ends in 2006.

used to raise broader complaints about lacking transparency, stability, and predictability in government decisions affecting a large number of actors apart from claimants themselves. Investors have targeted measures at all levels of government, including legislative and judicial acts, and disputes have often been in vital areas of public regulation, such as environmental protection or the provision of key utilities.

Foreign investors have not always won. In the SGS case, for instance, Pakistan was fortunate to have the tribunal ultimately deny the claim. But almost three out of five concluded cases have been decided against the host state or settled on, typically, unknown terms.¹ This has resulted in considerable controversy in recent years, particularly because some arbitrators have granted compensation for measures that may have been permissible in domestic legal systems of most developed countries.²

Such expansive interpretations have raised eyebrows among critics, who argue that vague treaties have been used to give foreign investors too far-reaching protections. Moreover, the identity of arbitrators themselves has come under scrutiny. For unlike domestic judges, arbitrators have often been private commercial lawyers.³ And should private lawyers really be granted such extensive powers over public regulation made by

¹ UNCTAD 2014a.

² Douglas 2006, pp. 27–8; Johnson and Volkov 2013; Montt 2009; Van Harten 2013.

³ Waibel and Wu 2014; Van Harten 2013.

sovereign states? Can they be trusted not to inflate the judicial scope of the regime in order to boost the number of claims brought by investors?

Also, whereas governments have routinely been told by arbitrators that they are not sufficiently stable and predictable in their dealings with foreign investors, arbitrators themselves have taken inconsistent, and occasionally contradictory, positions. In the SGS case, for instance, one of the clauses appeared to the tribunal 'susceptible of almost indefinite expansion' and it ultimately ruled in favour of Pakistan by taking a narrow interpretation.⁴ Five months later, however, a contradictory interpretation of a largely similar clause went in SGS's favour in a separate claim against the Philippines. This is but one example of how the vague nature of investment treaties combined with an ad hoc dispute settlement process has made investment treaty arbitration often unpredictable, which makes it difficult to foresee exactly which measures violate the treaties, and why.

Another set of concerns relate to the size of the monetary awards.⁵ In 2003, for instance, one dispute led to more than \$350 million in damages against the Czech government including interest, which was equal to the entire health budget of the Czech government and effectively doubled the public-sector deficit for that year.⁶ This was a glimpse of what was yet to come. Nine years later a split tribunal awarded an American company \$2.37 billion in compensation from Ecuador including interest, despite acknowledging that the investor had broken Ecuador's own laws as well as the contract with the Ecuadorian government.⁷ The award amounted to almost 7 per cent of the Ecuadorian government's total government budget⁸ and, adjusted for GDP, an equivalent award against the United Kingdom would be almost \$70 billion and for the United States \$458 billion.

Then finally, in 2014, Russia was asked to pay \$50 billion to shareholders of the defunct oil company Yukos, amounting to 12 per cent of the government's total revenue.⁹ Just the legal fees involved were staggering: the shareholders paid Shearman and Sterling, an American law firm, \$74 million to represent them and the tribunal took almost \$9 million for themselves – \$7.4 million to the three arbitrators and \$1.4 million to their assistant.¹⁰ These cases were extreme, of course, and the

⁴ *S.A. v. Islamic Republic of Pakistan, Decision on Jurisdiction*, Société Générale de Surveillance, 6 August 2003, para. 167–8.

⁵ For statistics, see Franck 2007; Gallagher and Shrestha 2011; Hodgson 2014; Rosert 2014.

⁶ *CME Czech Rep. B.V. v. Czech Republic*, UNCITRAL, Final Award, 14 March 2003; Kellner 2003; Peterson 2004, pp. 25–6.

⁷ ICSID Case No. ARB/06/11, Award, 5 October 2012. ⁸ Rosert 2014. ⁹ *Ibid.*

¹⁰ "The Cost of Yukos," *Global Arbitration Review*, 29 July 2014. About 4 per cent of the arbitrators' costs were to cover personal expenses. On top of that a further \$1.3 million

Yukos claim did in fact involve outright expropriation. Yet, they highlight the potential liabilities that investment arbitration can impose on states.

So given the scope and interpretive practice of investment treaty arbitration, it should come as no surprise that the regime has become one of the most controversial areas of global economic governance. As one arbitrator has lamented: ‘the more [people] find out what we do and what we say, and how we say it, the more appalled they are’.¹¹ This includes policy-makers in a growing number of developing countries. By 2015, several countries had decided to withdraw from the regime after coming on the receiving end of controversial investment treaty claims.¹² South Africa had begun terminating its BITs, and Bolivia, Ecuador, and Venezuela had left the International Centre for the Settlement of Investment Disputes (ICSID) and cancelled some of their investment treaties. Also Indonesia was considering following suit, and India had put a hold to negotiations in order to rethink its investment treaty programme.¹³ Most other developing countries have stayed in the regime for now and instead pursued more incremental reforms, but there is no doubt that the legitimacy of investment treaty arbitration has been put to the test in recent years.

Yet, the vast majority of respondent governments have nevertheless complied with awards promptly and voluntarily. The main calculus has been that in the absence of overriding political concerns it would be imprudent to sign up to investment treaties and the ICSID Convention to attract investment and then proceed to scare away the same investors by refusing to comply with awards. Also, the very few states that have postponed payment of awards have faced significant political and legal challenges. For instance, when Argentina initially refused to pay a number of outstanding ICSID awards owed to American companies, Washington suspended trade benefits to the country and sought to block international credit from the World Bank and the IMF. President Kirchner finally relented and decided to settle the outstanding ICSID awards, paying out half a billion dollars to five American companies.

Some investors have also taken the matter in their own hands and used the ICSID and New York Conventions to confiscate assets of the

went towards ‘tribunal costs’ and a \$1.2 million fee to the Permanent Court of Arbitration for administering the proceedings.

¹¹ Comments by Johnny Veeder QC at Wilmer Hale seminar on international arbitration, 23 April 2014.

¹² On investment treaties and investment treaty arbitration as a ‘regime’, see Salacuse 2010. *A contrario*, Wells 2010.

¹³ See ‘Indonesia to terminate more than 60 bilateral investment treaties’, *Financial Times*, 26 March 2014; Ranjan 2014.

respondent government.¹⁴ This is neither easy nor cheap due to sovereign immunity laws, but it is possible, and at the time this book went to press, President Putin could expect Yukos shareholders to try to enforce their award around the globe for years to come. Yet, in the vast majority of cases this hasn't been necessary as international investment law is no different from other international regimes, where 'almost all nations observe almost all principles of international law and almost all of their obligations almost all of the time'.¹⁵

This raises a significant puzzle. For why did practically all developing countries suddenly rush to sign largely identical treaties, which significantly constrained their sovereignty? Why did they expose themselves to expensive investment claims and give such a remarkable degree of flexibility to private lawyers to determine the scope of their regulatory autonomy? This is the core question of this book.

Traditional accounts

Crucial credible commitments

The standard answer from political scientists and a large number of legal practitioners is straightforward: if developing countries wanted to attract investment they *had* to sign the treaties. Because without offering recourse to investment treaty arbitration, developing countries couldn't give risk-averse foreign investors a credible commitment that their investments would be safe. The theory is simple. As a starting point, developing country governments are expected to not fully internalize the costs of regulating foreign investors. They favour local firms at the expense of foreigners, even when the latter are more efficient.¹⁶ This is typically explained in terms of a dynamic inconsistency problem, where governments have an incentive to renege on promises made to foreign investors after their investments have been sunk in the host state.¹⁷ This could be through outright expropriation or more indirectly through changes in tax codes, requirements for local content requirements, repatriation restrictions, introducing new operation fees, and so forth. Although rational ex post this has negative ex ante implications, as foreign investors are aware of these risks and therefore refrain from otherwise efficient investment

¹⁴ See e.g. Peterson and Balcerzak 2014.

¹⁵ Henkin 1979, p. 47. See generally; von Stein 2013.

¹⁶ See discussion in Bonnitcha and Aisbett 2013.

¹⁷ Guzman 1998. On obsolescent bargains and foreign investment, see generally, Vernon 1971; Woodhouse 2006.

decisions.¹⁸ According to the standard narrative, investment treaties credibly commit against such behaviour by raising the costs of existing and future governments to extract value from foreign investors, which in turn should make them more attractive investment decisions. By signing investment treaties, developing countries thereby traded their sovereignty for credibility as this was the 'cost of seeking additional FDI inflows'.¹⁹

Although this assumption underlies a large share of political science literature on the international investment regime, it is unconvincing. First of all, during the time investment treaties spread rapidly, the long-term reputational costs of mistreating foreign investors prevented (most) developing countries from taking the types of measures foreseen by obsolescent bargaining models. Although there were, of course, examples of egregious conduct against foreign investors during the 1990s, most developing countries were strongly committed to attracting foreign capital, which meant regulatory risk premiums were often quite limited even in 'high-risk' sectors with major sunk investments.²⁰

In cases where uncompensated expropriation or other regulatory abuses of foreign investors were a genuine concern, political risk management could often be effectively handled through market-based strategies. Investors could enter into joint ventures with local companies, obtain financing from local creditors, structure investments over long time periods, or bring in powerful partners such as major foreign banks or public aid agencies.²¹ Such options ensure that the host country has a long-term interest in protecting foreign capital. And even if these business strategies were deemed insufficient, investors could still obtain investment insurance. Political risk insurance covers many of the same risks as investment treaties and is often a more direct, quick, and straightforward option of investment protection than the prospect of going through lengthy and expensive arbitration proceedings.²² Particularly when insurance providers are state sponsored, the host government has a strong incentive to protect the assets of foreign investors, as they may otherwise risk future aid and loans. As a result, 'once the full cost of prospective action against an insured investor is realized, these

¹⁸ Markusen 2001.

¹⁹ Montt 2009, p. 128. Although not deal with here, it is important to note that investment treaty protections could also, in theory, encourage inefficient investment decisions by preventing efficiency-improving government measures; Aisbett, Karp, and McAusland 2010.

²⁰ See Yackee 2008, pp. 125–7.

²¹ Ramamurti 2003; Wells and Ahmed 2006; West 1999; Woodhouse 2006.

²² See e.g. Bekker and Ogawa 2013; Jensen 2005.

disputes often become “misunderstandings” which are quietly and successfully resolved’.²³

Finally, the notion that investment treaties were the only instruments that could ‘tie governments to the mast’ of international law is inaccurate. Although they are not necessarily perfect substitutes for investment treaties, carefully drafted investment contracts can secure many investments with the same – or greater – standards, including recourse to international arbitration backed by the New York or ICSID Conventions.²⁴ Throughout the post-war era, international tribunals have recognized their jurisdiction over contractual disputes and relied on international law principles to provide meaningful compensation for both expropriation and other contractual breaches.²⁵ Contracts do not *guarantee* that host countries will uphold their commitments, of course, but neither do investment treaties.²⁶ Also, it is true that some investment treaty claims have been pursued by medium-size investors, who may not be in a position to negotiate advantageous contracts, but the majority of claims have involved investors in a contractual relationship with the host state, where the contracts have often included their own dispute settlement clause.²⁷ In those cases, the effect of investment treaties is mainly to provide investors yet another avenue to adjudicate the same dispute. Just like the claim by SGS against Pakistan.

In short, there is a wide range of options available to foreign investors concerned with political risks, including market-based mechanisms, political risk insurance offered by governments and private providers, as well as contracts with recourse to international arbitration. None of these instruments can eliminate political risks entirely, but they do make investment treaties less crucial commitment devices than typically assumed by political scientists.

It is therefore not surprising that only a few investors seem to have found the treaties critical when considering whether to invest in developing countries. Sophisticated firms occasionally set up holding companies in third countries to obtain protection,²⁸ but the treaties have hardly ever influenced where the investments are going in the first place. It can

²³ West 1999. ²⁴ See generally; Yackee 2008b; 2009b. ²⁵ Yackee 2009b, pp. 61–2.

²⁶ On why, and when, governments breach investor–state contracts, see e.g. Wellhausen 2014; Wellhausen and Johns 2014.

²⁷ Bonnitca 2014, pp. 76–7; OECD 2012a, p. 17; Van Harten 2013, pp. 122–4.

²⁸ In the absence of ratified Brazilian BITs, for instance, Petrobras is reported to have invested abroad via third countries to obtain investment treaty protection; see wikileaks.org/cable/2007/05/07BRASILIA833.html. Accessed on 10 June 2013. See also ICSID Case No. ARB/02/18, Decision on Jurisdiction, 29 April 2004; ICSID Case No. ARB/06/5, Award on Jurisdiction, 15 April 2009; ICSID Case No. ARB/07/27, Decision on Jurisdiction, 10 June 2010.

happen,²⁹ but it is exceedingly rare. For instance, the World Bank published a survey of foreign investors in 1991 and concluded that BITs had a negligible, if any, role for investment decisions. Only '[p]rofessional advisors, such as accountants or merchant bankers, would be people to concern themselves with such minutia, only after detailed project planning was already underway'.³⁰ The report noted that UK investors 'rarely if ever take into account the existence of [a BIT] when deciding whether or not to invest'.³¹ Similarly, although German public institutions considered BITs to be effective investment promotion tools, the World Bank noted that 'empirical evidence does not necessarily support this',³² and evidence to sustain that the treaties promoted investment was 'limited'.³³ Interviews with Swedish investors similarly revealed that BITs were 'relatively unknown and therefore have little to no impact on FDI flows'.³⁴ American investors didn't find BITs that important either. This was in contrast with double taxation treaties, which were considered crucial for FDI decisions.³⁵

Later surveys have largely confirmed this view.³⁶ Nor have investment treaties been crucial for the financing of the vast majority of foreign investment projects, as even political risk insurers have rarely found them relevant when determining the availability and pricing of insurance for expropriation and other political risks. Germany's tying of state-backed insurance to investment treaties has been important for German investors

²⁹ When Venezuela ratified the Dutch BIT in 1993, for instance, the Dutch ambassador reported to his Danish counterpart that recourse to investor-state arbitration in the treaty was instrumental for Royal Dutch Shell's participation in a large natural gas project, Cristóbal Colon; UM.400.E.13.Venezuela.12. It is unclear from the report whether a binding arbitration clause in a contract could have been sufficient for Shell.

³⁰ MIGA PAS 1991, p. 92. ³¹ *Ibid.*, p. 89. ³² *Ibid.*, p. 135. ³³ *Ibid.*, p. 140.

³⁴ *Ibid.*, p. 199. ³⁵ *Ibid.*, p. 41.

³⁶ For a review, see Poulsen 2010. See also Yackee 2010 (in-house legal counsel in American multinationals report that BITs are ineffective in protecting against political risks and the treaties are unlikely to be important for the vast majority of establishment decisions as senior executives are rarely aware of their existence); Economist Intelligence Unit 2011 (only a small minority of 316 executives find BITs very important for expropriation risk, though with somewhat higher figures for large investors and investors from industries with large sunk costs); Copenhagen Economics 2012 (European investors in China are rarely familiar with their relevant BITs and only a few find the treaties relevant for investment decisions); Economist Intelligence Unit 2015 (even the relatively small number of investors who said they found the treaties crucial had nevertheless invested in risky jurisdictions without treaty protections. BITs were found to be very important for investing in China, in stark contrast with 2012 Copenhagen Economics survey, but the authors suggest that much feedback was likely aspirational rather than reflecting real investment decisions, as the questionnaire was sent out during highly politicized discussions over the future of European investment treaties.)

on occasion, as we shall see, but most public and private providers of insurance rarely find the treaties crucial. As noted by this underwriter:

While they should perhaps have a role to play, I would say [BITs] are likely to be considered completely irrelevant by underwriters today and thus irrelevant for the pricing of risk insurance. . . Rather than having a role in the investment decision, they are just an extra arrow in the lawyer's quiver on the occasions where disputes arise.³⁷

All in all, investment treaties have undoubtedly been significant for some establishment decisions of some investors – particularly when it comes to the legal structure of their investments – but the impact of the treaties on investment flows to the developing world has been small.³⁸

At least to date. Because even if surveys indicated that BITs were less than crucial for establishment decisions in the past, a growing number of investors and underwriters could find the treaties to be increasingly important as they realize the potential of investment treaty arbitration. The spike in claims in recent years indicates that this is not unlikely. Yet, even if investment treaties are becoming slightly more important for investment flows, it still leaves the question of why governments in developing countries signed the treaties in such great numbers from the late 1980s to early 2000s. There were many ways in which developing countries could attract investment, so why did these agreements become so widespread? If only few investors cared about BITs, and that too only 'after detailed project planning was already underway', why were the treaties so popular?

Coercion

One answer could be that developing countries were somehow coerced into the regime. Critics of BITs occasionally argue that Western states relied on power-asymmetries to get developing countries to sign the treaties and that explains why there is no multilateral investment agreement.³⁹ This is misleading. During the 1960s and 1970s the sceptical attitude towards foreign investment in large parts of the developing world meant Western states had difficulties getting the vast majority of developing country governments to sign on to BITs. When invited to negotiate,

³⁷ Quoted in Poulsen 2010.

³⁸ There is a large amount of econometric literature on these questions, but findings are often conflicting because of the limited data available. For a review of studies until 2010, see Poulsen 2010. See also Berger, Busse, Nunnemkamp, and Roy 2011 (finding a positive effect from 'strong' BITs); Peinhardt and Allee 2012 (finding no effect of American treaties); Jandhyala and Weiner 2012 (finding a positive effect on pricing of oil reserves); Kerner and Lawrence 2014 (finding a positive, but very limited, effect).

³⁹ See e.g. Kaushal 2009.

most governments responded that protections enshrined in domestic laws were sufficient to protect foreign investors, and the book will present archival records showing that even small and weak capital importing states were able to resist Western pressure.

Rather than external imposition, it was internal reforms that led the way for the investment treaty movement. With the Latin American debt crisis and the drying up of official aid flows during the 1980s, a consensus emerged that attracting foreign direct investment (FDI) was key to economic development. In John Williamson's 10-point list summarizing the 'Washington Consensus' towards development policies, a restrictive attitude towards FDI was considered outright 'foolish'.⁴⁰ Many developing countries agreed, and governments in practically all corners of the world began to liberalize their investment regimes. Fair and equitable treatment of foreign investors, compensation for expropriation at fair market value, and non-discrimination – all are principles that were not just enshrined in Western BIT templates, but also in many national investment codes and practices during this period.⁴¹

Investment treaties seemed like the perfect instrument to complement domestic investment reforms. A judge from Sri Lanka's Court of Appeal accurately summarized the attitude like this:

Although substantial aid is given by the developed countries and their agencies to the Third World countries, the latter are unhappy about the conditions attached to such aid programs. Thus, they prefer foreign direct investments, in which they are equal partners with the investors . . . The concept upon which [BITs] are based, namely reciprocity, accords well with that thinking; the principle of reciprocity is in conformity with the concept of sovereignty.⁴²

So after they had begun liberalizing their investment regimes at home, practically every developing country began signing treaties enshrining the very protections they had resisted just decades before (Figure 1.3). This included Latin American countries as well as governments in the former Socialist block. Immediately before the end of the Cold War even the Kremlin had begun to negotiate investment treaties after Gorbachev embraced the virtues of international law⁴³ and the Soviet leadership no longer saw foreign investors as 'the last poisonous flowers on the dung-heap of capitalism'.⁴⁴

⁴⁰ Williamson 1990, ch. 2. ⁴¹ Alvarez 2009, pp. 52–6; Montt 2009, p. 129.

⁴² Gunawardana 1992, p. 546.

⁴³ See e.g. comments made by Gorbachev in the UN in Koh 1997, fn. 156.

⁴⁴ Sahlgren quoted in Sagafi-Nejad 2008, p. 92. Foreign investors were invited to enter into joint ventures governed by Soviet laws and regulations, but 'with exceptions provided for by inter-state and intergovernmental agreements, which the USSR is part to'; Decree No. 49 of the USSR Council of Ministers 13 January 1987.

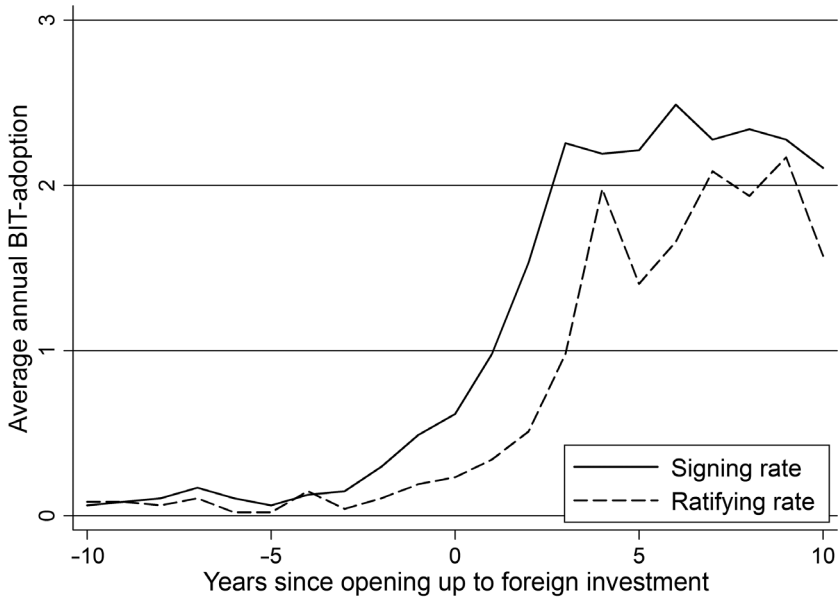


Figure 1.3 Take-off in BIT adoption coincided with domestic FDI liberalization

Note: Figure is based on 46 developing countries; see Appendix 1.

Also regional agreements with investment protection chapters emerged during this period. This included the 1991 Energy Charter Treaty (ECT), signed by a large number of OECD countries as well as countries in Eastern European and the Commonwealth of Independent States. The 1994 North American Free Trade Agreement (NAFTA) was signed as well between the United States, Canada, and Mexico. Yet, the vast majority of treaties remained bilateral. Between 1994 and 1996 an average of four BITs was signed every week⁴⁵ and unlike the early years of the investment treaty movement, it was now typically developing countries that initiated negotiations. European governments could largely pick and choose with whom they wished to sign BITs and the United States also managed to sign a growing number of agreements. Whereas the Reagan administration had significant difficulties getting the American BIT program off the ground, the United States succeeded in signing 28 between 1990 and 1995 alone. Washington even had to

⁴⁵ UNCTAD 2013a, p. xx.

decline some invitations to negotiate during the 1990s,⁴⁶ as was the case for several European countries as well.

During the same period it proved impossible to agree to a multilateral investment agreement, but this was not because developing countries resisted BIT-like protections. In the 1980s and 1990s investment was covered during the Uruguay Round of GATT negotiations, but efforts were focused primarily on investment liberalization – not protection (like BITs).⁴⁷ And although OECD countries tried to negotiate a Multilateral Agreement on Investment (MAI) during the mid 1990s, it was disagreements amongst developed countries themselves that made the project crumble rather than developing country opposition.⁴⁸ When developing countries expressed concerns with the project, it was the forum – not the substance – that was the main lightning rod: for why should rules intended primarily to protect investment in developing countries be negotiated solely by OECD members?

Finally, developing countries did manage to exclude investment from WTO's Doha-Round, but the blocking coalition was small and only few developing countries were active in the discussions.⁴⁹ Supported primarily by Indonesia and Malaysia, India was the main stumbling block – not exactly the most likely candidate to be pushed around in bilateral negotiations – and one of the primary arguments was that BITs were the preferred instruments to deal with investment protection. Delhi's WTO representative said that bilateral treaties were 'favoured by countries like India' and Malaysia agreed that its interests were 'best served by bilateral investment treaties'.⁵⁰

In short, investment treaties were adopted willingly by capital-importing states seeing the treaties as useful supplements to parallel reforms of domestic investment regimes. BITs were 'often a codification, not a source, of pro-foreign-investment policies'.⁵¹ Power was naturally important for the investment treaty movement, as we shall see, and there were instances where unbalanced power relations were important for bilateral negotiations. But the treaties were nothing akin to 'contracts of adhesion'.

⁴⁶ This was the case with Pakistan, for instance, where talks over a BIT began already in the 1980s. But when in 1995, Pakistan asked the United States to take the talks further, the Clinton administration refused until Islamabad signed a treaty on intellectual property right protection. See "United States no to talks to investment treaty before IPR record," *Business Recorder*, 19 March 1995; USAID 1990, p. 17.

⁴⁷ Stewart 1993.

⁴⁸ NGO pressure and failing business support meant there was little political buy-in in Western capitals, so when France walked away from negotiations due to concerns about its cultural industries the project was shelved; Graham 2000; Walter 2001.

⁴⁹ Sauvé 2006. ⁵⁰ WT/WGTI/M/14. ⁵¹ Salacuse and Sullivan 2005, p. 96.

Again, however, this still leaves the question largely unanswered: although investment treaties may have complemented domestic reforms in broad terms, their arbitration clauses invited all existing and future foreign investors to file compensation claims based on exceptionally vague provisions. Chief Justice Roberts of the US Supreme Court wrote in 2014 that by consenting to investment arbitration ‘a state permits private adjudicators to review its public policies and effectively annul the authoritative acts of its legislature, executive, and judiciary’.⁵² Why would so many governments voluntarily agree to such a thing?

Emulation

Perhaps developing countries merely signed BITs based on what political scientists call a logic of appropriateness. Just as ‘civilized’ nations had to adhere to certain standards during the Imperial era, for instance, countries with widely different backgrounds also use a number of policy programmes today to signal their commitment to the norms of political and economic liberalism without necessarily having the capacity, or even inclination, to implement them in practice.⁵³ Along the same lines, some scholars argue that investment treaties were signed by developing countries not because they expected any material benefits or were coerced into adopting them, but rather because state leaders and their bureaucracies thought it was one of those things (self-perceived) modern, liberal, and law-abiding states were *supposed* to do after the end of the Cold War and the rise of neoliberalism.⁵⁴

The claim is backed up by the spread of ‘strange’ BITs among developing countries themselves. Although the process started in 1964 with the Kuwait-Iraq BIT, the share of South-South BITs out of the global BIT landscape remained rather small until the mid 1990s. Today, however, almost 40 per cent of all BITs are between developing countries – an astonishing share given that BITs were initially tailored to protect Western investors in the developing world. With only a few exceptions,⁵⁵ these treaties are very much similar to ‘normal’ North-South BITs. And because many are among countries with few, if any, commercial links, they could indicate that investment treaties were intended as nothing but political symbolism.

⁵² *BG Group plc v. Republic of Argentina*, Supreme Court of the United States, No. 12–138, Dissenting Opinion by Chief Justice Roberts, 5 March 2014.

⁵³ See, e.g. Ramirez, Meyer, Wotipka, and Drori 2002.

⁵⁴ Jandhyala, Henisz, and Mansfield 2011. ⁵⁵ Poulsen 2010.

This account is also unconvincing. As will become clear throughout this book, investment treaties were repeatedly justified by their capacity to attract investment by both promoters of the treaties as well as developing country governments themselves. Normative considerations were not irrelevant, but they were rarely at the forefront. Both the discourse trail and interviews with officials themselves show that developing country governments around the world genuinely thought the treaties were important to attract foreign investment and that was the main driver behind their investment treaty programmes.⁵⁶

Also, if BITs were signed primarily as acts of political symbolism, it is peculiar that unlike human rights treaties, for instance, they were typically signed entirely under the radars of public discourse and received little attention by parliaments, the press, or the public at large. Because both the signing and ratification of the treaties were usually very low-profile events, only few paid much attention to BITs before the early 2000s, with the possible exception of treaties entered into with the United States. Figure 1.4 shows that whereas hundreds of BITs were signed annually up through the 1990s, it is not until the claims began that the treaties attracted much attention in the press. By comparison, preferential trade agreements (PTAs) were mentioned almost 70 times more frequently during the 1990s. The spread of BITs was one of those ‘supranational governance activities that go virtually unnoticed’,⁵⁷ and the treaties were therefore rather poor marketing instruments if used to signal adherence to global norms.

Also, despite the ‘poor publicity’ of BITs, developing countries themselves have done very little to advertise the fact that they have signed the treaties, even in recent years.⁵⁸ This, too, is surprising if they were merely signed as ‘ceremonial acts’.⁵⁹ For even if developing countries didn’t care whether the treaties were actually effective,⁶⁰ some amount of publicity was necessary in order for the symbolic content of investment treaties to be recognized and endorsed by international organizations, foreign investors, or other spectators.⁶¹

Finally, most investment treaties very closely follow Western BIT templates, occasionally word for word, but it is notable that during the height of the BIT movement, developing countries primarily followed the templates of European countries. The United States had

⁵⁶ On the relevance of the discourse trail for testing norm-emulation models, see Finnemore and Sikkink 1998, p. 892; Gurowitz 2006.

⁵⁷ Esty 2006, p. 1509; quoted in Montt 2009, p. 143. ⁵⁸ Yackee 2014.

⁵⁹ On ‘ceremonial’ acts in World Polity theory, see Meyer 2000; Strang and Meyer 2009.

⁶⁰ On de-coupling and institutional choice, see again the works of Meyer.

⁶¹ See generally, Lamertz and Heugens 2009.

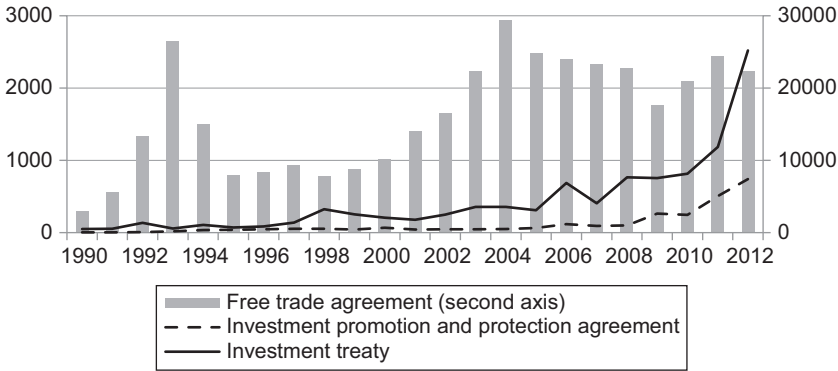


Figure 1.4 Poor publicity stunts

Note: Figure shows number of times the phrases ‘free trade agreement’, ‘investment promotion and protection agreement’ (the British term for a BIT), and ‘investment treaty’ was mentioned in English-speaking newspapers from 1990 to 2012. The latter also covers the number of times ‘bilateral investment treaty’ was mentioned.

Source: FACTIVA

a different model. It was longer and more clearly specified but also significantly more ambitious by including liberalization provisions and prohibitions on performance requirements (such as local contents requirements). These two omissions make a former American negotiator go so far as to argue that European models are in fact somewhat ‘antithetical to economic liberalism’.⁶² Yet, not only was the United States relatively unsuccessful in developing a wide network of investment treaties compared to European countries, it was also not until recently that the American model gained in popularity. This, too, is puzzling if BITs were merely the result of normative emulation during the 1990s; for what better option to show a government’s adherence to the Washington consensus than mimicking the most investor-friendly treaties possible?

So although we shall see that some treaties were indeed signed for ceremonial reasons, it is not a satisfactory explanation overall. For most developing countries, the BIT movement has not been about lofty aspirations of international justice or symbolic attempts to adhere to neoliberal ideals. Rather it was about something as mundane as

⁶² Vandevelde 1998, p. 634.

attracting foreign investment. A former American negotiator is correct to note that during the 1990s, ‘many developing countries [now saw] the BIT [as] a tangible way of signalling their captivity to foreign investment, and thus may seem to assist in attracting capital from the United States and other developed countries’.⁶³ This is what Salacuse has described as the ‘grand bargain’ of BITs: developing countries promised foreign investors extensive protections in return for the prospect of more capital.⁶⁴

But, although foreign investors got their end of the bargain – extensive protections – the treaties have rarely been important to attract investment. So why did so many developing countries radically overestimate the economic benefits of BITs? Also, if it was not because of emulation, why did practically all developing countries almost completely sign off on European BIT templates? Although negotiating around model agreements can be entirely rational, it is puzzling that so many BITs have been practically identical despite diverse institutional, political, economic, and cultural contexts. Why haven’t we seen more tailoring to local circumstances? If not functionalism, coercion, or emulation, what then explains the adoption and design of the treaties?

The argument

Suffice it to say that with more than 3,000 investment treaties signed over more than half a century, any single – or monocausal – explanation is impossible, and it would fall outside the scope of any book to explain why every single developing country has signed and ratified every single investment treaty. The aim with this volume, therefore, is to explain the main factors driving developing countries to sign up to the modern investment treaty regime.⁶⁵ And the core argument is that the way developing countries assessed and negotiated investment treaties fits

⁶³ Vandeveldt 1993, p. 638.

⁶⁴ Salacuse 2013.

⁶⁵ Different organizations use different definitions of developing countries, and any classification is bound to be crude, particularly in studies over time. For the purpose of this book, developing countries are those the World Bank has not classified as ‘high-income’ countries for the majority of the period listed in its World Development Indicators, starting in 1987 and ending in 2013. The ‘developed country’ category therefore includes Andorra, Aruba, Australia, Austria, Bahamas, Bahrain, Belgium, Bermuda, Brunei, Canada, Cyprus, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Israel, Italy, Japan, Korea, Kuwait, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, Qatar, Singapore, Slovenia, Spain, Sweden, Switzerland, Taiwan, United Arab Emirates, the United Kingdom, and the United States. All other countries are grouped under the umbrella term of *developing countries* in this study.

hand-in-glove with expectations on bounded rationality from behavioural psychology and economics. From this perspective, policy-makers are not expected to blindly follow a logic of appropriateness – as in emulation models – but are instead seen as ‘intended rational’, who *try* to strategically pursue their own preferences.⁶⁶ But in contrast with the unrealistic expectations of judgment common to approaches based on ‘comprehensive rationality’, a bounded rationality framework is based on what we actually know about the capacities, and limits, of human decision-making.⁶⁷ It acknowledges that policy-makers are subject to cognitive constraints and often prone to make mistakes. For rather than engaging in sophisticated cost–benefit calculations when assessing the implications of different policies, their inferences are often skewed by systematic information processing biases.

Once we account for these cognition constraints, it is suddenly possible to explain much of the behaviour of developing countries in the international investment regime. BITs were rarely the result of developing countries pursuing ‘optimizing’ behaviour to achieve their national interests, as assumed in models based on unbounded rationality.⁶⁸ Instead, policy-makers often entirely misjudged their environment by failing to factor in and accurately assess relevant information about the agreements. This manifested itself in numerous ways, three of which are worth highlighting now.

First of all, developing countries’ strong commitment to attracting foreign investment during the height of the Washington Consensus made policy-makers *want* investment treaties to work. Rather than conducting an unbiased search and assessment of information, they often based their expectations about the economic benefits of the treaties on wishful thinking. This is an example of what experimental psychology calls ‘motivated reasoning’: people tend to be inherently sceptical about evidence that goes against their preferences, whereas evidence they want to believe is accepted with little scrutiny.⁶⁹ We see what we want to see. For instance, we know from experiments that strong political beliefs lead people to seek confirming evidence to sustain their pre-existing conceptions and at the same time strongly resist unwanted information.⁷⁰ Along

⁶⁶ Simon 1957.

⁶⁷ Comprehensive rationality is understood as decision-makers’ having a set of fixed, transitive preferences for alternatives, and the ability to calculate the trade-offs of their choices, both future and present; Jones 2001, p. 35.

⁶⁸ On the care with which rational governments should negotiate binding treaties as opposed to informal agreements, see Abbott and Snidal 2000; Lipson 1991.

⁶⁹ Dawson, Gilovich, and Regan 2002; Gilovich 2000. ⁷⁰ Taber and Lodge 2006.

the same lines, motivated optimism was a core reason for the highly inflated expectations about the economic benefits of BITs.

Similar ‘mistakes’ took place when learning about the risks of the treaties. For although states would normally be expected to exercise careful scrutiny and bureaucratic review when negotiating potentially costly international obligations, this rarely took place when it came to investment treaties. Even while claims began ticking in at ICSID, officials failed to seek and consider relevant information about the liabilities and regulatory constraints that could arise from investment treaty arbitration. When a country hadn’t been subject to a claim itself, officials typically assumed such claims were entirely unlikely – just as in the case of Pakistan.

This may seem peculiar, but it is what we would expect if policy-makers were bounded rational. Because rather than efficiently seeking and processing information to make unbiased judgments, as assumed in fully rational models, countless studies have shown that decisions are often based mostly on information that is particularly salient.⁷¹ Even though this can be useful to form inferences, it can also lead people to ignore highly relevant information if it is not sufficiently ‘vivid’. In the investment regime, the result was that most developing country governments failed to learn from claims against other countries, as only claims against themselves were salient enough to warrant attention.

Saliency biases were aggregated by the fact that officials in charge of considering and negotiating investment treaties often lacked both experience and expertise in the field. Time and again the negotiators of developed countries had to explain to their developing country counterparts the meaning of even simple treaty terms, and stakeholders often mistook the vague and short European templates for soft law. Terms such as *fair and equitable treatment* or *indirect expropriation* were rarely given any attention, as the ‘devils in the details’ were not sufficiently salient for generalist bureaucrats. This meant that agencies and officials with an individual interest in promoting BITs had free reign to adopt them right, left, and centre with little, if any, discussion. Western BIT models were signed off in a rush and the treaties spread like wildfire. Many of the ‘strange’ BITs among developing countries, for instance, were not the result of transnational mimicry but rather bureaucrats and politicians promoting the treaties for their own selfish reasons.

Investment treaties with the United States and Canada were somewhat different. Not only were North American templates much longer and

⁷¹ The starting point was Tversky and Kahneman 1973.

complex, the implications of their market access provisions were also clearer to negotiators and stakeholders. The short and simple European models only covered established investors, however, and were therefore more popular as the potential for costly investment arbitration wasn't realized.

Finally, and related, most developing countries were satisfied with signing off on European BIT templates without considering whether alternative, or revised, provisions might have been more optimal. This, too, is what we would expect from a bounded rationality perspective, as it conforms with what is called the status quo bias.⁷² Although relying on 'focal points' is not necessarily irrational,⁷³ we know from numerous experimental and observational studies that bounded rationality gives decision-makers an excessive preference for whatever solution is the 'default'. Experimental studies on negotiations, for instance, have shown that entirely random offers made in the initial stages of a negotiation can have a considerable impact on both counteroffers and final outcomes.⁷⁴ And again, this deviation from rational decision-making strategies is particularly prevalent in the absence of experience and expertise, as generalists are especially disinclined from opting out of default solutions.⁷⁵ This can be critical for negotiations, and the book will show that an excessive reliance on default rules goes a long way towards explaining the remarkable similarity of investment treaties over time and across countries. Typically, developing countries only tinkered with Western BIT models rather than carefully considering alternatives. After having been asked to pay compensation based on vague treaty provisions, many government today regret that (non-)decision.

Unanticipated consequences are, of course, not unique to the investment area. Just as few were able to predict the current authority that investment arbitral tribunals have over governments' regulatory discretion, few foresaw the wide-ranging role of the European Court of Justice, for instance.⁷⁶ States have also found their sovereignty constrained in ways they didn't anticipate both in the WTO and the International Court of Justice.⁷⁷ Even in the context of human rights treaties, developing countries have occasionally been shocked to realize that what they thought were merely pieces of paper later permitted transnational actors to use them for effective political pressure.⁷⁸ But by contrast with human

⁷² See e.g. Kahneman, Knetsch, and Thaler 1991. ⁷³ Abbott and Snidal 2002.

⁷⁴ E.g. Galinsky and Mussweiler 2001; Neale and Bazerman 1991. ⁷⁵ Sunstein 2013.

⁷⁶ Alter 1998; Burley and Mattli 1993; Mattli and Slaughter 1995. ⁷⁷ Alter 2008.

⁷⁸ Sikkink 1993.

rights treaties, BITs have not merely been useful points of reference for companies and other actors advocating investor-friendly policies; in the vast majority of cases they are actually enforceable in practice. In the spectrum between diplomacy and legalism, the two types of treaties are at separate ends.⁷⁹ Also, the unanticipated consequences of investment treaty arbitration are not (only) a case of tribunals strategically trying to expand their own jurisdiction through creative lawyering. More important is the almost complete lack of attention by developing country negotiators in the 1990s due to bounded rationality. Although incomplete contracting is seen in many other areas of international law, the fact that private tribunals were given such considerable flexibility in ‘filling out the blanks’ of vague and broadly drafted treaties was rarely even considered at the time they proliferated.

Suffice it to say that these conclusions will sound paternalistic to some. One arbitrator, Jan Paulsson, calls this line of reasoning outright insulting to negotiators,⁸⁰ and his colleague Francisco Viciña concurs:

The guns are pointing ... to the vast network of bilateral investment treaties. ... The argument is based on the false assumption that developing countries have been ignorant of what they were actually signing ... Thank you for that paternalistic thought, but with respect I must say that lawyers from developing countries are not dummies.⁸¹

The claim made in this book is not that negotiators were ‘dummies’. However, when arbitrators and political scientists suggest that a great number of developing countries invested considerable expertise to engage in BIT negotiations during the 1980s and 1990s, they are out of touch with realities on the ground. Whereas officials in some countries did manage to appreciate the implications of the treaties, they were the exception – not the rule. Even some colleagues of Paulsson and Viciña concede that BITs were often entirely misunderstood by adopting governments until hit by a claim. In his expert testimony to one case, for instance, Christoph Schreuer was asked whether ‘he really believed that two sovereign States will negotiate, sign and ratify a Bilateral Investment Treaty without caring to consider what was put in it’. Although far from a critic of the treaties, Schreuer replied:

[M]any times, in fact in the majority of times, BITs are among clauses of treaties that are not properly negotiated. ... and I have heard several representatives who

⁷⁹ See generally Smith 2000. ⁸⁰ Paulsson 2010, p. 344. ⁸¹ Viciña 2002, p. 31.

have actually been active in this Treaty-making process . . . say that, ‘We had no idea that this would have real consequences in the real world.’⁸²

This book will show that whereas Schreuer’s impression is in stark contrast to commonly held beliefs about the international investment regime, it is nevertheless accurate. For whatever one may think of BITs as instruments of global economic governance,⁸³ the *process* with which the treaties were adopted was typically bounded rational.

Apart from providing a better understanding of the international investment regime, the findings of the book also have broader theoretical implications. For although experimental studies on bounded rationality have spurred a large and rapidly growing body of work throughout the social sciences, the findings have thus far been largely ignored in international relations and particularly in studies on international political economy (IPE).⁸⁴ When bounded rationality is factored into international relations scholarship on occasion, it has typically been rooted in organizational studies instead of the rigorous micro-foundation from behavioural psychology and economics.⁸⁵ This is unfortunate. For although questions of external validity should be carefully considered when using insights from experimental studies,⁸⁶ experiments on bounded rationality were not started in a vacuum but due to the existence of biased judgments in the real world.⁸⁷ Similar to the assertions of any other theoretical framework, studies may prove them wrong in various contexts, but at least they are derived through empirically grounded observations rather than hypothetical speculation. And their growing application to understand political and social processes outside experimental settings imply that studies in IPE are missing out on considerable insights about the role of bounded rationality in international economic relations.

This study is one of the few works that is beginning to fill this gap.⁸⁸ Through its analysis of the international investment regime it will

⁸² ICSID Case No ARB/04/14, Award, 8 December 2008, par 85.

⁸³ For normative discussions of investment treaty arbitration, see e.g. Bonnitcha 2014; Schwebel 2008.

⁸⁴ For behavioural legal scholarship, see e.g. Sunstein 2000; and for recent calls to draw on behavioural economics in international law, see Broude 2013; Galbraith 2013; Van Aaken 2014. For seminal studies in political science, see Jones 2001; Jones and Baumgartner 2005.

⁸⁵ See Jupille, Mattli, and Snidal 2013; Keohane 1984, ch. 7. For the security realm, see Allison 1971; Jervis 1976; Reiter 1996; Vertzberger 1998. Even prospect theory – now a standard reference in international security studies – has been largely ignored by IPE scholars: Elms 2013, p. 104.

⁸⁶ Levy 1992, pp. 98–100; McDermott 2004, p. 27; Shafir 1992, pp. 320–1.

⁸⁷ Gilovich and Griffin 2002, p. 11.

⁸⁸ Bamert, Gilardi, and Wasserfallen 2014; Hafner-Burton, Leveck, Victor, and Fowler 2012; Mintz 2007; Odell 2000, ch. 5; Walter and Willett 2012; Weyland 2006; 2009; 2010.

hopefully remind scholars of IPE that deviations from fully rational behaviour should not always be treated as ‘noise’ that cancels out in the aggregate. Instead, our theoretical models need to address, rather than ignore, the fact that economic diplomats are ‘predictably irrational’ – just like the rest of us.⁸⁹

Strategy

Ascertaining why developing countries entered into investment treaties is no easy task. One approach typically taken by legal scholars is to rely primarily on comparing treaty texts. Yet, this has obvious limitations, as it does little to identify policy processes or actor motivations. Also, the negotiating history of investment treaties is rarely documented: with the exception of the ICSID Convention itself and BITs signed with the United States, even tribunals wanting to resort to investment treaties’ negotiating records often go away empty-handed. In developing countries there are rarely *any* files available, as in the case of Pakistan, and in developed countries, archives still remain classified for the period in which investment treaties spread like wildfire. Even if they had been more readily available, official negotiating histories would certainly not have been sufficient to understand why governments pursued BITs. But the absence of considerable written documentation after the 1970s does present a considerable challenge.

As an alternative, political scientists have tended to rely on statistical techniques. This follows the dominant trend in mainstream IPE studies, which increasingly rely on econometric models as their methodological foundation. But whereas such an empirical strategy is often helpful, a challenge is the often considerable gap between underlying concepts, such as ‘competition’, and the quantitative indicators actually available. Past literature on BITs is no exception. Here, the increasing complexity of the statistical models used stands in stark contrast to the dearth of quantitative data needed. Also, even if they had the necessary data, studies purely based on statistics tend to have difficulties identifying plausible underlying causal mechanisms. This book will therefore complement econometrics with a wide range of other evidence.

This is particularly important when studying information processing biases. Because to take insights on bounded rationality seriously, one needs to discuss not only substantive issues of opportunities and constraints – including constraints on information – but also procedural

⁸⁹ Term is from Ariely 2008.

questions essentially relating to human cognition.⁹⁰ Rationalist studies of IPE tend to include information solely on actors' goals (e.g. attracting investment) and the objective characteristics of their situation, namely the costs and benefits of the policy (e.g. to sign a BIT) compared to alternative causes of action.⁹¹ This is a useful starting point, but to understand if, and under what circumstances, cognitive constraints intervene between preferences and contexts, one would often have to apply qualitative methodologies. Throughout the book, illustrations will thus be included from developing countries around the world, where I have been able to trace relevant officials involved in investment treaty negotiations.

This, of course, is not a strategy without risks. Just as there are perils with quantitative research, qualitative methods involve their own pitfalls. Practically all interviewees spoke on the condition of anonymity, so rather than detailed information on interviewees the book will merely refer to them in footnotes as 'official from Ghana' or 'official from Germany'. Suffice it to say, this reduces the transparency of the information gathering. More importantly, individuals may have forgotten key events or slant them in ways that serve their own preferences. This is a particular challenge as investment treaty negotiations were typically done by just a single or a couple of individuals in developing countries. Whenever possible, attempts were therefore made to corroborate the narratives with alternative sources – such as archival records – as well as testimony of interviewees from developed countries. And the main conclusions in the book were indeed confirmed by a very large number of officials around the world independently of each other. It is very unlikely all were disingenuous, not least because narratives from developing country officials rarely did them any favours in terms of portraying their decisions as sophisticated and informed (which is the typical bias associated with interview work).

So for all the potential biases associated with using personal testimonies, this book will show that they are crucial if we want a better understanding of the political history of the international investment regime. More broadly, by combining elite interviews from all corners of the world with quantitative analyses and archival sources, the study will provide a much-needed reminder to international relations scholars that instead of relying exclusively on either qualitative or quantitative evidence, their work would often benefit from engaging rigorously with both.

⁹⁰ Simon 1997, pp.18–19.

⁹¹ See generally Simon 1985, p. 294; Simon 1982, ch. 8.

The book will proceed as follows. The next chapter will develop the theoretical framework briefly summarized above by drawing on insights from both rationalist literature on policy diffusion, negotiation studies, as well as behavioural economics and psychology. Chapter 3 will provide the necessary historical context and show that early investment treaty negotiations had some puzzling characteristics if developing country policy-makers were fully rational. As negotiation records are more than scarce, however, I will refrain from making strong inferences about the role of bounded rationality in the early years of the investment treaty movement. This will be left for the remaining chapters, which will focus on the 1980s until September 2014, when the book was sent to press. Chapter 4 will show that although Western 'BIT entrepreneurs' promoted the treaties as easy and simple instruments to attract foreign investment, developing countries didn't seem to adopt them in ways expected from standard rationalist models. Taking this perspective further, Chapters 5 and 6 will use a range of qualitative and quantitative evidence to show that the competition for capital in the international investment regime corresponds with the predictions of a bounded rationality approach. Chapter 7 will complement these aggregate findings with a detailed case study of South Africa, and the concluding chapter will outline the implications for the arbitration community and policy-makers themselves.