Among the legal frameworks governing economic globalization, bilateral investment treaties (BITs) are some of the most significant but least understood. While emerging in the mid-twentieth century, the modern investment treaty network was not established until after the Cold War. At this point, the movement not only became a truly global phenomenon, most countries also began to include the defining feature of modern investment treaties: the broad consent to international investor-state arbitration. In recent years, foreign investors have realized the potency of this adjudicative mechanism and brought developing countries, in particular, on the respondent end of often costly claims concerning a wide range of regulatory actions. Here, the vague and broad constitution-like promises in investment treaties have given ad hoc tribunals considerable flexibility to determine, when and to what extent regulation of foreign investors requires compensation. This has raised the question, why developing countries adopted treaties that restrict their discretion to regulate and expose them to expensive compensation damages.

One explanation could be that once some countries began signing BITs, others had to follow to avoid losing much needed foreign investment. Other legal instruments could have alleviated investor concerns about political risks, however, yet allowed host states to moderate their commitments on a case-by-case basis. Investor-state contracts governed by international law can secure individual investments with the same standards as investment treaties, including recourse to international arbitration backed by the New York or ICSID Conventions. Combined with the existence of other risk-mitigating instruments – including insurance and various market-based mechanisms – it is no surprise that foreign investors only rarely take investment treaties into account, when deciding where and how much to invest abroad. In practice, it is almost only after disputes have arisen that foreign investors and their insurance agencies begin caring about treaty-protections. Although investment treaties occasionally have an impact on the legal structure of foreign investments, very few seem to have a tangible impact on their destination and size. But while BITs were often promoted by international organizations, Western governments, and the private arbitration industry, developing countries signed them without any signs of coercion or significant side-payments. The question that presents itself, then, is why countries would constrain their sovereignty for the benefit of foreign investors, if the economic benefits have typically been miniscule?

1 By way of introduction to the presentation, the following sections are taken directly from Poulsen (2014).
A second puzzle concerns the content – or design – of investment treaties. Even disregarding the effect of most-favoured-nation (MFN) clauses, developing countries have by and large signed up to treaties which exactly mirror models developed by capitalist-exporting states, despite having less wide-ranging templates available. This is largely the case also for BITs signed among developing countries themselves. Moreover, while ‘incomplete contracting’ is seen in other areas of international law, why did developing countries agree to such broad and open-ended terms? This extensive delegation of interpretive discretion has occasionally resulted in arbitral decisions widely seen as overly ‘investor-friendly’ in sensitive areas of regulation, and is particularly puzzling given the absence of an appeal mechanism. Finally, while the practical implications of differences in investment treaty provisions are easily exaggerated, relevant systematic variation appears difficult to explain with the ‘Rational Design’-paradigm in international relations. But if not rational cost-benefit analyses, what then explains their design?

To address these puzzles, this presentation will advance a new theoretical framework to understand the diffusion of modern investment treaties from the early 1990s onwards. Following recent work on cognitive heuristics and policy diffusion, it will argue that while most developing countries competed for capital when adopting (most) BITs, they were not as rational as often assumed. This builds on two recent papers and a book-length manuscript combining archival work and econometric analyses with close to 200 interviews with key decision-makers around the world. This is the most comprehensive work on why, and how, developing countries came to consent to treaty-based investor-state arbitration. Apart from providing a richer historical understanding of the international investment regime, it suggests that bounded rationality insights from experimental psychology and economics could be important to understand part of the behavior of developing countries when adopting investment treaties.

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