THINKING AHEAD: TIME HORIZONS AND THE LEGALIZATION OF INTERNATIONAL INVESTMENT AGREEMENTS

DISTRIBUTION

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ABSTRACT

This dissertation seeks to explain why international investment agreements, despite being created with the same purposes and functions in mind, often display important variation in their degree of legalization. I posit that such variation exists because legalization creates a trade-off - between making credible commitments to foreign investors and retaining autonomous control over investment policies - that governments choose to resolve differently. Therefore, to explain the legalization of investment agreements, I develop a theory which explains how governments resolve the credibility-autonomy trade-off, leading them to conclude agreements with varying levels of legalization.

My core argument is that governments’ willingness to submit to extensive constraints on their policy autonomy is shaped powerfully by their time horizons. Governments with long time horizons prize having greater autonomy to modify policies that shape the effect that foreign investment has on their economies in response to shifts in economic and political conditions that can occur over time. Governments with shorter time horizons, on the other hand, do not anticipate being in power long into the future and therefore are less concerned about maintaining greater policy freedom. Therefore, I hypothesize that when BITs are signed by governments with
long time horizons, their level of legalization will be calibrated to promote greater
policy autonomy than when they are concluded by governments with short time
horizons. In addition, I argue that domestic political and institutional variables such
as regime type, party institutionalization, and autocratic regime structure are crit-
ical in framing leaders’ time horizons, and thus establish a theoretical link between
domestic politics and the legalization of international investment institutions.

To evaluate my argument, I use original data on the design features of a random
sample of 346 bilateral investment treaties (BITs). Using this data, I construct
original measures of the degree of legalization with respect to its three dimensions -
obligation, delegation and precision. Using quantitative methods of analysis, I find
a robust relationship between the time horizons of governments and the degree of
legalization of the BITs they conclude. Specifically, governments with long time
horizons are more likely to conclude BITs at a level of legalization that promotes
greater policy autonomy. In the case of obligation and precision, this holds with
respect to net importers of dyadic FDI, and in the case of delegation, I find that
the time horizons of net exporters display a statistically stronger relationship with
legalization. These results hold across regime types and are robust to controlling for
selection into BITs and a range of control variables.
For Mum
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My path towards completion of this dissertation began, in many respects, a decade ago when I was a first year undergraduate at the Australian National University. It was at this time that I decided I wanted to go to graduate school and that I wanted to do so in the U.S. Since then, I have been very fortunate to have received incredible support, encouragement, friendship and volumes of constructive criticism that have enabled me to first get into graduate school at Ohio State, and then to successfully complete my course of study and this dissertation.

From my years as an undergraduate I am indebted to Neil Arnwine, a professor of economics at Bilkent University. Not only was Neil a good friend, but his no-nonsense approach to economics got me interested in a field that now greatly influences my research. I am also grateful to professors Ersel Aydinli and Paul Williams, and other faculty at Bilkent for supporting me in my ambition to study in the U.S.

I arrived at Ohio State as a raw scholar, just months removed from college, and have benefited greatly from the instruction and advice of many excellent faculty members at the Department of Political Science. I am particularly grateful to Brian Pollins for his steady, guiding hand and encouragement in the often bewildering early stages of graduate school. In helping me develop my ideas and guide me through the
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Finally, I dedicate this dissertation to a lady whose strength, dignity and compassion have never failed to inspire me and whose support and encouragement have been ever-present throughout my academic life: my mum.

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CHAPTER 1
INTRODUCTION

1.1 Introduction

Today more than 82,000 multinational enterprises (MNEs) are engaged in foreign direct investment (FDI) worldwide. These firms are responsible for the movement abroad of capital and assets exceeding 12 trillion dollars, and for the employment of 77 million individuals (UNCTAD 2009). FDI also accounts for one quarter of the world’s economic output and one-third of world trade (Jensen 2006), making it one of the core dimensions of the current era of globalization.

At the center of the international political regime governing FDI is a growing network of bilateral investment treaties (BITs). Since 1959, when the first BIT was signed between Pakistan and Germany, over 2700 BITs have been concluded by over 170 countries. Attempts to consolidate these agreements into a single institution have been unsuccessful and the prospects of a robust multilateral regime for investment emerging in the near future are slim (Sauvé 2006, Young & Tavares 2004).[1] Therefore,

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[1] The abortive attempt led by the Organization for Economic Cooperation and Development (OECD) to develop a Multilateral Agreement on Investment, abandoned in 1997, is the most prominent example of this (Kobrin 1998).
BITs are the primary institutions governing foreign direct investment today and for the foreseeable future.

BITs seek to protect the interests of firms investing abroad by legally binding signatory governments to afford foreign investors fair and non-discriminatory treatment, and guaranteeing payment of compensation in the event of expropriation. Most treaties also afford investors the right to initiate international arbitration proceedings if they believe their legal rights have been violated by governments in territories where they have established operations. Although governments may conclude BITs for multiple reasons, the literature has focused on them as tools to help governments attract foreign investment. Due to the illiquid nature of much FDI, MNEs are wary about investing in locations where their property rights and a favorable policy climate are not guaranteed. Thus, governments seeking FDI use BITs to make their commitments to create a stable and profitable investment climate for foreign firms more credible.

Existing research into BITs has focused primarily on their effects and how successful they have been in helping governments attract foreign investment (e.g. Sauvant & Sachs 2009, Kerner 2009). Others have sought to uncover the factors that lead governments to sign BITs with one another and have highlighted the role that competitive diffusion dynamics can play in this regard (Elkins, Guzman & Simmons 2006). What these studies have in common is that they view BITs as substantively homogenous.

Throughout the dissertation I refer to these governments as “host” governments. This is not to be confused with host and home states, which I define later.
and observationally equivalent. In this study, I show that while BITs are undoubtedly similar in terms of their purpose and the issues they address, current research in political science has greatly exaggerated their homogeneity. In particular, BITs vary significantly in their level of legalization. Furthermore, these variations are not trivial for the legalization of BITs directly shapes the amount of credibility they contribute to governments’ commits to MNEs and the severity of the constraints they impose on government policy.

What explains this variation in investment treaty legalization? This is the central question that drives this dissertation and in order to answer it I develop a theory that focuses on explaining government preferences over legalization. My core argument is that governments’ time horizons play a critical role in shaping their legalization preferences. Governments with long time horizons anticipate governing long into the future and therefore prize having autonomous control over investment-related policies. Such autonomy is incompatible with higher levels of legalization and thus governments with longer time horizons will prefer to conclude less legalized BITs. Governments with short time horizons, on the other hand, do not expect to govern in the future and are therefore more willing to forego control over policy and conclude highly legalized BITs.

I apply and test this argument in the context of three dimensions of legalization: obligation, delegation and precision. In each case, I show that the degree of legalization shapes the level of freedom that governments have to institute policies.

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3Notable exceptions include Allee and Peinhardt (2010), Crisp et al. (2010) and Poulsen (2010).
that affect foreign investors. I then use original data to construct measures of obligation, delegation and precision to evaluate the relationship between governments’ time horizons and the legalization of the treaties they conclude. I find that across all three dimensions governments with longer time horizons calibrate the degree of legalization to promote greater policy autonomy and that this relationship holds for both democratic and autocratic governments. In the cases of obligation and precision, the link between time horizons and legalization is more robust for governments that anticipate being net importers of dyadic FDI while in the case of delegation, the relationship is stronger for net exporters of investment.

1.2 Governments & FDI

BITs are created to regulate the relationship between foreign investors and host governments. There is a dominant narrative regarding this relationship in political science. Governments regard inward FDI as generally beneficial because it helps stimulate economic growth by increasing the capital base, promoting employment, raising wages, and transferring modern technology and managerial know-how (e.g. Jensen 2006). This leads governments to attempt to attract FDI by offering foreign investors a stable and profitable investment policy environment. This often includes promises of low capital taxation, minimal regulation of MNE activities and few performance requirements. Governments can also offer inducements such as wage subsidies and export duty exemptions. The desirability of FDI leads governments to compete with one another to attract it, thus increasing the pressure on governments to develop an investor friendly policy framework.
The problem for investors and governments alike is that FDI is liquid before location, and illiquid after it has established operations in a particular host. This makes relocation of production facilities costly for MNEs and leaves them vulnerable to policy reversals by their host governments. As it is rational for governments to promise favorable terms of investment before location, and then renege on such promises after MNEs have sunk costs, their preferences are inconsistent over time and their initial commitments of favorable treatment are not credible. This dynamic is commonly referred to as the “obsolescing bargain”.

The solution to the time-inconsistency problem is a mechanism that will raise the costs and/or difficulty of reneging on commitments to foreign investors such that governments will cease to find it in their interests to break their commitments. Extant studies have focused on the role of domestic institutions such as veto players, the rule of law, and constraints on the executive as mechanisms that achieve this aim (e.g. Jensen 2003, Li & Resnick 2003). However, researchers have also highlighted that international trade and investment agreements, such as BITs, can play an important role in helping governments make more credible commitments and attract FDI (e.g. Büthe & Milner 2008, Kerner 2009). It is this perspective that has led most BIT scholars to focus on the question of how effective BITs are in achieving this aim by studying the effects of BITs on FDI flows.

Thus, to summarize, governments sign BITs to make commitments to foreign investors more credible and attract greater FDI. While this common explanation for why governments sign BITs is informative, it provides us with little information as to why they choose to legalize BITs to differing degrees. I argue that this is
because current research often oversimplifies the relationship between FDI and host
governments. While governments often desire greater FDI inflows for the benefits it
can bring, there is little evidence that FDI is universally beneficial. Indeed, there is
much research to justify the conclusion that FDI has the potential to benefit host
economies but that the extent to which this potential is met depends on a range of
factors. Indeed, under certain conditions, FDI can have a negative impact on the host
economy and/or on the welfare of politically important domestic groups within the
local economy. Thus, one should not assume that governments will always benefit
from greater inward FDI and that governments will therefore pursue any and all
direct investment. Rather, governments will seek to attract FDI under conditions
that ensure a steady stream of benefits to their local economies and to their core
constituencies.

One of the most important factors that shapes the impact of FDI on host economies
is government policy, and through the use of appropriate policy tools, governments
are able to regulate foreign investment and maximize the likelihood that its potential
benefits will be realized. However, MNEs seldom welcome significant regulation of
their activities as it forces them to deviate from optimal production strategies. This
is precisely why an obsolescing bargain exists: governments wish to employ invest-
ment policies to channel greater benefits of FDI to their economies, but they need
to promise to refrain from such policies in order to attract FDI.\footnote{If an investment
policy environment that MNEs considered optimal allowed FDI to consistently
provide substantial benefits to host economies, then host governments would have little desire to
renege on their policy commitments to FDI.}
As extant scholarship has focused on how governments make credible policy commitments to foreign investors and attract FDI, often implicitly assuming that FDI is always desirable and positive for host economies, they have neglected why governments have incentives to renege on those commitments. Credible commitment devices, such as BITs, that are designed to attract investment diminish the ease with which governments can renege on their commitments and use policies to shape the effects of FDI. It is how governments evaluate this downside of gaining credibility through BITs that, I argue, holds the key to explaining why governments legalize their BITs to differing degrees.

1.3 Legalization of BITs: Theory

The focus on BITs as tools to attract FDI and make commitments more credible is emblematic of a broader trend in the study of international institutions that focuses on the benefits they generate rather than the costs. Admittedly, scholars are often aware of the trade-offs inherent in the creation and design of different institutions, but too often they seek to explain their emergence and structure only in terms of the benefits they confer. This holds true particularly for functionalist explanations that see institutions as solving structural problems that prevent states from achieving pareto-optimal outcomes (e.g. Keohane 1984, Koremenos, Lipson & Snidal 2001). Such approaches struggle to explain variation in the degree of legalization of BITs because BITs are functionally similar; all BITs help governments overcome the time-inconsistency problem and convey the benefit of greater credibility. Therefore, variation in their design cannot be explained in terms of the functions
they perform. This perspective leads me to shift focus from the functional benefits to the costs of BITs.

What are these costs and how are they associated with legalization? Legalization of international institutions creates a core trade-off that governments cannot avoid. When governments legalize their institutional commitments to a high degree these commitments become more credible because they increase the costs of commitment violations. In the case of BITs, I show that high levels of legalization can cause governments to pay high audience, reputation and financial costs from breaking commitments to foreign investors. The other side of the trade-off is that high legalization is costly to governments, even when they adhere to their commitments because it constrains their policy autonomy. In the case of BITs, the freedom that governments have to implement economic and social policies that affect the activities of foreign firms becomes highly limited. Thus, highly legalized BITs can deprive governments of the very tools they need to manipulate FDI and ensure that its net effect on their economies and important interest groups is positive.

An appreciation of the costs associated with legalization alone does not explain why there is variation in the legalization of BITs. What is required is an understanding how governments’ preferences with respect to such costs vary. Indeed one of the shortcomings of many extant explanations of institutional design is that the preferences of governments (or states) are assumed to be relatively homogenous. Therefore, I develop a theory of preference formation over the legalization of international institutions that focuses on how governments react to the costs of institutional design.
My main argument is that governments’ sensitivity to constraints on their policy autonomy generated by high levels of legalization is shaped powerfully by their time horizons. Governments with longer time horizons, I argue, prize maintaining control over their policy toolkit because they anticipate that circumstances can change over time and they will need appropriate policy tools at their disposal to respond effectively. With respect to FDI and BITs, governments with long time horizons anticipate that the effects of inward FDI on their economies can change over time, particularly in response to economic shocks, and therefore wish to have sufficient autonomy to use government policies to ensure that FDI continues to have a positive effect on their economies. Therefore, such governments are more likely to resolve the credibility - autonomy trade-off associated with legalization in favor of levels of legalization that preserve greater policy space for them. Governments with short time horizons, on the other hand, do not expect to govern in the future under the constraints of the BITs they have concluded and therefore are less concerned about preserving policy autonomy and are more likely to conclude more legalized BITs. While I develop and evaluate this core argument in the context of BITs, it is potentially generalizable to other instances of legalization in international politics.

While my main argument focuses on time horizons, a second theme of my dissertation is that time horizons are shaped domestic politics and institutions. In particular, factors such as regime type, party institutionalization, and autocratic regime structure help determine the time horizons of governments. The links between domestic and international institutions, particularly with respect to the design of international institutions, have been remarkably understudied (Martin & Simmons 1998).
However, drawing on literature in Comparative Politics, I am able to illustrate how domestic politics directly shapes governments’ time horizons, and thus how it indirectly shapes their legalization preferences.

Furthermore, this focus on time horizons, domestic politics and legalization preferences brings into relief a further departure from most studies of international institutional design and legalization: a focus on governments key actors. Most scholars of international institutions focus on the state instead of political leaderships or governments. While this approach is certainly useful, it has limitations because it is governments and their representatives, not states, that negotiate the design and creation of international institutions. Thus, developing theories that focus on the state can mask the incentives and pressures that governments face, such as the drive to stay in office, that are likely to shape their preferences over the design of international institutions such as BITs.

Indeed, while there is a growing literature on how government time horizons shape a range of policies and institutional choices at the domestic level, a consideration of time horizons is incompatible with extant state-based theories of the design and legalization of international institutions. This is because states’ time horizons

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5 There are several notable exceptions (e.g. Oatley & Nabors 1998, Rosendorff & Milner 2001, Goldstein, Kahler, Keohane & Moravcsik 2000).

6 State-based approaches focus on the state as a unitary actor. I regard governments as sub-state actors composed of those individuals with executive responsibility for: framing and approving foreign and domestic policy, setting the agenda for international treaty negotiations, and signing international agreements such as BITs. In democratic regimes this is often the prime minister or president’s cabinet, while in non-democratic regimes it may be the executive council of the ruling party in a single-party state, or the high command in a military dictatorship.
vary to a minimal degree. States, once created, seldom die and thus scholarship that focuses on the state must assume long time horizons. This has been the foundation for critiques of rationalist/functionalist explanations of institutional design by scholars who argue that governments are more typically short-sighted, and therefore institutions cannot be explained in terms of their long-term functions. What I aim to do, in this dissertation, is neither assume long nor short time horizons on the part of governments in the process of designing legalization in BITs. Rather, I theoretically integrate time horizons and allow them to vary.

1.4 Dimensions of Legalization

My empirical strategy in the dissertation is to apply the general theory regarding time horizons and their effect on governments' legalization preferences to three core dimensions of legalization: obligation, delegation and precision (Abbott, Keohane, Moravcsik, Slaughter & Snidal 2000). For each dimension, I illustrate how the degree of legalization varies in the case of BITs and explain how the trade-off between credibility and autonomy manifests itself. I then derive hypotheses that are specific to each aspect of legalization in the context of BITs but that are based on the theory outlined above.

To empirically evaluate these hypotheses, I employ original measures of the degree of legalization that are designed to adhere closely to conceptualizations of legalization in the extant literature. The empirical basis for these measures is an original data set of systematically hand-coded design features in a random sample of 346 BITs concluded between 1960 and 2006. This strategy represents a particularly robust and
structured evaluation of the theory that is uncommon in extant studies of legalization, and, to a lesser extent, institutional design more generally. This is because much research into the legalization of international institutions is empirically “light”. Often conjectures are offered and possible relationships highlighted without any attempt at empirical evaluation. Alternatively, some studies use illustrative examples or cases without using systematic measures of core concepts such as a legalization. Finally, those studies that are more empirically robust, typically focus on only one dimension of legalization. Thus, the analysis in this dissertation pushes the frontier of empirical research into institutional legalization and design forward. Below, I briefly outline how the main argument applies to each dimension of legalization and summarize the main empirical findings.

1.4.1 Obligation

When governments express their commitments in a formal international treaty or agreement they take on the character of legal obligations. The legalization of obligations makes their interpretation and effects less a matter driven by the interests and power of states, and more influenced by legal practice and principle. For example, when obligations are highly legalized, they allow actors to assert legal claims and pursue legal remedies when there is a dispute over their application and observance. While there exist multiple degrees of legalization, the highest levels of legalization entail legally binding commitments that are unconditional, without reservation and broad in scope. As such, the more legalized obligations are, the more they take on the character of national laws. Less legalized commitments are those that are
either implicitly or explicitly non-binding and thus similar to guidelines and recommendations. The binding and comprehensive nature of highly legalized obligations makes them more credible as governments have less scope to avoid adhering to their policy commitments. However, the more legalized obligations are, the greater constraint they place on government policy as governments are expected to abide by their commitments in all circumstances.

While obligations in BITs are typically legally binding, governments manage to scale back the degree of legalization of obligation through the use of carve outs - the exemption of certain categories of policy from treaty obligations. This has the effect of creating areas of policy where governments have greater policy autonomy, free from the constraints of their treaty commitments. It follows, therefore, that as I expect governments with longer time horizons to prefer greater policy autonomy, I expect them to conclude treaties that contain more carve outs. I evaluate this proposition with respect to national treatment commitments in BITs - the commitment to non-discrimination between foreign and domestic investors. I find that governments of states that are likely to be net importers of FDI are more likely to conclude BITs with more national treatment carve outs and that this relationship holds across both democratic and non-democratic regimes.

1.4.2 Delegation

While the subject of delegation has been widely studied throughout political science and other disciplines, my treatment of delegation in this dissertation is necessarily confined to the legalization of delegation in international politics. In this context,
delegation is the transfer of authority to third parties to implement international agreements. Third parties may be called upon to facilitate implementation by settling disputes or by elaborating, developing and enforcing rules and principles outlined in these agreements. These forms of delegation are highly legalized when the third parties take decisions, on the basis of general rules, that are binding on governments. In addition, with respect to dispute settlement, high legalization is associated with private actors having direct access to the dispute resolution process. Delegation is less legalized when decisions taken by third parties are not binding on states and implementation of agreements is facilitated primarily through negotiation and bargaining.

Delegation in the context of BITs is confined to the delegation of authority for the settlement of disputes between foreign investors and host governments to international arbitrators. This delegation is highly legalized when governments pre-consent to binding arbitration in the BIT and allow foreign investors to directly initiate dispute settlement procedures. Delegation is less legalized when governments do not pre-consent to international arbitration or only pre-consent to the arbitration of a very small number of types of disputes.

Greater legalization of delegation makes commitments to foreign investors more credible because it allows foreign investors to inflict costs on governments who violate their commitments. By allowing investors the opportunity to initiate dispute settlement proceedings, governments face the risk that their non-compliance will be identified and publicized, generating audience costs at home and reputation costs within the MNE community. Furthermore, arbitrators can instruct governments to
pay investors compensation which generates financial costs for governments. Highly legalized delegation also creates firm constraints on government policy because it transfers the final right of interpretation of both governments’ commitments to MNEs and how well government policy adheres to those commitments to international arbitrators. Thus, governments may find that what they perceive as legitimate policies and regulation of FDI are interpreted by arbitrators as inconsistent with their BIT commitments.

My broader argument would predict that governments with longer time horizons would prefer to scale back the delegation of dispute settlement authority by withholding pre-consent to arbitration or only granting arbitration to a small number of issues. In my empirical analysis, I find that this relationship holds in the case of net exporters of FDI but not for states that are likely to be net importers of FDI.

1.4.3 Precision

The final dimension of legalization that I examine is precision, which refers to the degree of detail and elaboration with which legal obligations are established. Greater precision is typically associated with a higher level of legalization, and better enables governments to make credible commitments. This is because vague and general commitments are open to self-serving interpretations by governments, allowing them to wriggle out of their policy commitments. The other side of the coin is that precise commitments, by minimizing the potential for self-serving interpretations, constrain the policy space that governments have because it becomes harder for them to interpret a wide range of policies as being compatible with their commitments.
Thus, as I argue that governments with long time horizons prize policy autonomy, I should expect that they will conclude less precise BITs than governments with short time horizons.

However, I do not expect this to always be the case because while precision constrains interpretation, it is important to identify whose interpretations are being constrained when determining if precision limits or liberates government policy. Normally, governments are chiefly responsible for interpreting their states’ international commitments and thus precision constrains policy autonomy. However, when delegation is highly legalized, as is often the case in BITs, third parties such as international arbitrators have the final duty of interpretation. Thus, precision constrains their interpretations, thus limiting the ability of arbitrators to adopt expansive understandings of governments’ commitments and impose wide-ranging limits on their policy space. Thus, when legalization of delegation is high, precision preserves, rather than constrains, policy autonomy.

This complex interaction between precision and delegation leads to the development of conditional hypotheses regarding the relationship between government time horizons and precision. Specifically, I expect that governments with long time horizons will conclude more precise investment treaties than governments with short time horizons when the legalization of delegation is high, but they will conclude less precise treaties when the legalization of delegation is low. I test this argument using treaty length - measured as the number of words - as a proxy for precision. I find that as governments’ time horizons lengthen, all else equal, they conclude longer treaties when the legalization of delegation is high and shorter treaties when it is
low. This relationship is most robust for governments in states that are likely to be net importers of FDI and holds even when controlling for the effects of treaty content and scope on treaty length.

1.5 Conclusion

The strong results I find linking governments’ time horizons to the legalization of BITs provide firm evidence that variation in the legalization of institutions such as BITs can be traced back to the preferences of the governments who create and design them and that such preferences vary. Explaining such variance, I argue, will often require incorporating domestic political factors, such as time horizons, that structure how governments assess and resolve the trade-offs presented by different institutional designs. While any attempt at theory development necessitates simplifying assumptions and the bracketing of important phenomena, my dissertation shows that when scholars consistently assume homogeneity in areas where there is variation, they ignore potentially important outcomes of interest and explanatory factors. In short, they see constants where variables exist.

In this study, I identify and incorporate into my analysis hitherto largely neglected variation in the effects of FDI on host economies, the legalization of BITs, the preferences of governments over the legalization of functionally similar institutions, and
the time horizons of governments. Doing so allows me to identify important variation in the design of BITs which should inform future research into their effects on FDI and the relationship between governments and investors. It also allow me to develop a rich theory of institutional legalization that not only explains variation in the legalization of BITs, but can also be generalized to explain legalization in other institutional settings.

The dissertation is structured as follows. In the next chapter, I establish the micro-foundations of my theoretical analysis through a discussion of the effects of FDI, the relationship between MNEs and governments, and how the legalization of government commitments to foreign investors in BITs affects that relationship. In the following chapter I build on this discussion to develop the main theoretical argument linking governments’ time horizons to the the legalizations of BITs. I also discuss the manner in which domestic politics and institutions shape the time horizons of autocratic and democratic governments, before deriving general hypotheses. In the three chapters that follow I apply and test these hypotheses in the context of the obligation, delegation and precision dimensions of legalization. In the final chapter, I discuss the pattern of results that emerge from the three empirical chapters and discuss future directions of research with respect to both my time horizons based theoretical argument, and variation in the legalization of BITs.

7To be sure, I do not suggest that the variation in the effects of FDI and the time horizons of governments has not been discussed elsewhere. Rather, with respect to time horizons, I refer here to the implicit assumption of universally long time horizons in state based theories of institutional design and, in the case of the effects of FDI, I am highlighting the tendency for scholars in political science to assume that FDI is generally positive for host states.
CHAPTER 2
MICROFOUNDATIONS: FDI, CREDIBLE COMMITMENTS & LEGALIZATION

2.1 Introduction

Bilateral investment treaties (BITs) are the primary international institutions governing FDI and regulating the treatment of foreign investors by host governments. As the introductory chapter established, this dissertation seeks to explain why governments choose to legalize these institutions to differing degrees. In order to adequately address the issue of government preferences over BIT legalization, one must first consider why governments would wish to sign a BIT at all. This requires an understanding of the potential political and economic costs and benefits of FDI, as well as the nature of the relationship between host governments and foreign investors. It also requires an understanding of the elements of legalization and how they can help governments achieve their objectives vis-à-vis FDI. It is this foundational understanding of the political economy of FDI and the legalization of government commitments that this chapter aims to establish and in doing so lay the groundwork for the theoretical and empirical analysis that follows in subsequent chapters.
One of the core themes of this chapter is that the economic effects of FDI on the countries that host foreign investment is seldom straightforward. Governments often seek FDI because it can bring many benefits to a host economy such as technology, employment and economic growth. However, the extent to which these benefits materialize is contingent on a wide range of factors and under certain conditions FDI can even have a negative economic impact on host countries. Furthermore, the distributitional effects of FDI can also vary significantly making it difficult for governments to anticipate how core supporters will be affected by increased investment flows. The variable and contingent nature of the effects of FDI creates powerful incentives for governments to use policy tools such as performance requirements and taxation to regulate foreign investment and thereby ensure that the host country and the governments’ core supporters reap many of the potential benefits of inward FDI. The problem for governments is that such policies interfere with the efficient operation of MNEs and therefore act as a deterrent to potential foreign investors. Thus, in order to attract foreign investors, governments must often commit to minimizing taxation of foreign capital and refraining from the implementation of regulatory policies that detract from MNE profitability. Such commitments on their own are seldom credible in the eyes of foreign investors because governments can renege on their policy commitments after foreign investors have established their investments and sunk considerable costs. Thus, government promises to create a stable and profitable investment environment for MNEs will often be unsuccessful in attracting FDI.

A second core theme is that institutional legalization of government commitments
to FDI can make those commitments more credible to foreign investors. Legalization consists of three core components - delegation, obligation and precision - each of which deters commitment violations by increasing the costs to governments of reneging on commitments. BITs are the most prominent examples of legalized international institutions governing government-MNE relations and in this chapter I illustrate how they make governments’ commitments to foreign investors more credible by promoting audience, reputation and material costs for governments who violate their commitments to foreign investors.

2.2 Foreign Direct Investment & the MNE

The International Monetary Fund defines foreign direct investment (FDI) as the purchase of 10 percent or more of equity in a firm located in a foreign country with the intent of influencing the management of that firm (International Finance Corporation 1997). The intent to manage is what sets FDI apart from portfolio capital and what makes direct investment long-term in nature. FDI is undertaken by multinational enterprises (MNEs), many of which are the world’s largest corporations such as General Motors, Hewlett-Packard and Shell. MNEs possess three core areas of advantage - ownership, location and internalization - that both distinguish them from regular firms and that also help to explain their emergence (Dunning 1988)\textsuperscript{1}. Ownership advantages refer to firm characteristics based on knowledge (e.g. product and process innovations, marketing/management skills, patents, brand name).

\textsuperscript{1}These are the three pillars of Dunning’s OLI paradigm, through which much analysis of MNEs has been achieved.
or factors associated with oligopolistic market structures (e.g. economies of scale, privileged access to resources). Internalization advantages derive from MNEs’ abilities to internalize market imperfections, reducing transactions costs and uncertainty. Locational advantages are country related and are the truly international aspect of MNEs; by locating in multiple countries, MNEs are able to exploit the advantages of ownership and operation in different locations.

Several attempts have been made to categorize the investment activities of MNEs in order to better explain their behavior. One of the most enduring approaches has been the classification of FDI as “vertical” or “horizontal” (e.g. Caves 2007). Horizontal FDI involves replication of production facilities in multiple locations, while vertical FDI entails the establishment of different parts of a product’s value chain in different international locations. Both types of FDI internalize within a single firm transactions that could be accomplished through arms length contracting between firms under different management in order to avoid the market imperfections highlighted by Dunning. In the case of horizontal FDI, the market for proprietary assets is internalized. A proprietary asset is a durable asset, tangible or intangible, that is firm specific and mobile across markets (e.g. a brand name or trademark). With respect to vertical FDI, the market for intermediate goods is internalized in a manner similar to vertical integration within a firm (see Coase 1937, Williamson 1985).

Another classification of MNEs focuses on the direct motivations MNEs have for locating production abroad. This approach grew out of the strategic management research program in business studies that emerged in the 1980s and exposed the strategic nature of MNE behavior. Decisions made about the length and shape of
the firm’s value chain, such as the number of products to produce, the number of value adding activities to be brought under the umbrella of the firm, and the number of geographical areas to locate in where all understood as part of a broader strategic approach taken by the management of MNEs (1991). This focus on strategy helped to expose three motivations behind MNEs’ decisions to locate abroad (UNCTAD 1998b, Dunning 1998, Blonigen 2005). First, firms may move abroad to service foreign markets. One important category of such FDI is tariff-jumping FDI, which overcomes high tariffs on imports into a country by locating production facilities in that country. A second motivation is to access natural resources. Resources such as oil, natural gas, and iron ore are available in limited quantities in most countries and therefore firms specializing the extraction and processing of natural resources must locate operations in foreign countries if they wish to expand their operations. The third motivation is to access cheap factors of production. Such FDI is also often referred to as export-platform FDI because it seeks to locate production in countries where inputs are cheap and then export final products to other markets where production costs are higher.

2.3 The Effects of FDI on Host Economies

2.3.1 Potential Benefits of FDI

While an increasing number of firms have sought to capture the advantages of internationalization of production and have located production facilities abroad to better access markets, resources and inputs, governments have become increasingly keen to
host foreign direct investment, anticipating that it will bring a range of economic benefits to their own economies. FDI can indeed have a positive impact on the local/host economy in multiple ways (Blomström & Kokko 2003). Most directly, by establishing new production facilities and expanding the capital stock available in the host country that can be put towards productive use, MNEs can promote higher levels of economic growth in the countries hosting them (Jensen 2006). Secondly, FDI can increase domestic employment directly by hiring local workers and indirectly by creating demand for intermediate goods and services in the local economy and thereby generating employment in the sectors producing those goods (Markusen & Venables 1999). Thirdly, MNEs can also raise wages (Pandya 2010). MNEs do this directly by paying workers more than local firms do as is often the case when MNEs from developed countries invest in developing economies (Caves 2007). Wages are also raised indirectly by multinationals because they can create new demand for local workers and drive up the price of labor (Hiscox 2004). The rise in employment and wages can have broader benefits for the whole economy through a multiplier effect of increased demand and consumption triggered by employees of MNEs. A fourth benefit of FDI, particularly resource and factor seeking FDI, is that it increases a host state’s exports (Jensen 2003, Hanson 2001). This is an especially important benefit for countries experiencing current account deficits and for developing countries seeking foreign exchange.

A further benefit, and perhaps the most important, is that MNEs tend to be amongst the most technologically advanced companies in the world and engage in high levels of research and development (Markusen 1995). Therefore, when they
invest abroad they are able to bring new technologies and managerial techniques that will spillover into the host country’s economy and enable local firms to become more efficient and productive (Wang 1990, Grossman & Helpman 1991, Lall 1980). Indeed, Balasubramanyam et al. (1999) identify technology and skill diffusion as the primary pathway through which MNEs can promote economic growth in host state economies. Such diffusion, or productivity spillovers, are facilitated through upstream and downstream linkages (also called backward and forward linkages) with firms in the local economy (Blomström 1989, Rodriguez-Clare 1996, Javorcik & Spatareanu 2008, Lall 1980). Such linkages exist when subsidiaries of an MNE form cooperative agreements with local firms “upstream” to supply inputs into the MNE’s production or provide low-cost or specialized inputs and knowledge for local firms using the MNE’s products as intermediate goods “downstream”. These linkages offer channels through which local firms can learn better production techniques from the MNE and become more productive. Upstream linkages also offer more direct avenues for productivity spillovers in that by increasing the demand for locally manufactured intermediate goods, MNEs can help intermediate goods producers achieve better economies of scale. Alternatively, MNEs can promote the productivity of downstream industries by supplying them with more efficiently manufactured and advanced intermediate goods for use in their own production processes. Technology can also spread “horizontally” to firms operating in the same sector as, and often competing against, the MNE. This can be done through observation and emulation of the MNE or by poaching the MNE’s employees (Gorg & Greenaway 2003).

An additional benefit of FDI is that unlike other forms of international capital
flows, it is comparatively stable and countries are much less likely to experience
damagingly high volatility of FDI inflows and outflows, in contrast to the relatively
footloose nature of portfolio capital flows (Lipsey 1999). A final benefit of FDI is
that by expanding the overall stock of capital in the host country, FDI increases the
tax base and thus is a source of increased revenue for the government.

Given FDI’s potential as a potent source of growth, employment, technological
development and production efficiency, it is unsurprising that many developing coun-
try governments have made attracting foreign investment an integral part of their
development strategies (UNCTAD 2004) and governments in both the North and
South compete against one another to attract FDI. However, FDI’s potential to pro-
mote growth and development is not always fulfilled, nor are the effects of FDI on
the host state’s domestic economy universally positive.

2.3.2 Benefits of FDI: No Guarantees

While there is an emerging consensus that FDI can have a positive impact on host
economies, extant research has found that simply attracting FDI is not a guarantee
that the aforementioned benefits will materialize. Indeed, many of the benefits high-
lighted above are highly contingent on the nature of the investment and/or require
certain conditions to hold in order for the benefits to fully materialize (Nunnenkamp
& Spatz 2004, Lim 2001). This is particularly so with respect to technological and
productivity spillovers. For example, research has found that FDI in the manufac-
turing sector is more likely to promote economic growth than FDI in the resource
extraction and services sectors (Alfaro 2003, Aykut & Sayek 2007). This is because
manufacturing FDI is the most likely to involve significant transfers of new capital and to develop the linkages with local firms that generate greater employment, economic activity and spillovers of skills. While resource-seeking FDI is often a source of large capital flows, its effect on development is tempered by the fact that it establishes few linkages to the local economy. And while FDI in the service sector often builds linkages with the local economy, most service sector FDI in developing countries is effected through mergers and acquisitions as well as privatization schemes, none of which constitute “new” investment (Klein, Aaron & Hadjimichael 2001).

Another factor that has been highlighted as shaping the extent to which FDI develops linkages and effects spillovers into the local economy is the development of host state financial markets. This is because in the presence of developed financial markets, local firms are better able to finance the development and expansion of their production facilities necessary to take full advantage of productivity spillovers from MNEs (Alfaro, Chanda, Şebnem Kalemli-Özcan & Sayek 2004).

A further concern, particularly in less developed countries, is that domestic firms may not be sufficiently advanced technologically to absorb productivity and technological spillovers from MNEs. Thus, to the extent that any beneficial spillovers occur, they will tend to concentrate in those local firms and industries that have a high quality of physical and human capital and are capable of absorbing spillovers effectively (Gorg & Greenaway 2003, Li & Resnick 2003). In addition, an MNE’s ownership structure shapes the extent to which spillovers materialize. MNE’s will often seek to avoid losing their technological and knowledge advantages to local firms.
(Javorcik 2004). However, this becomes much harder to achieve when an MNE’s foreign subsidiary is jointly owned by the local firm, as is the case in joint-ventures, as the local firm has greater access to the MNE’s technology and know-how. There is some tentative evidence that knowledge dissipates more easily when there is joint local-foreign ownership of MNE subsidiaries (Aitken & Harrison 1999, Javorcik & Spatareanu 2008).

The beneficial employment and spillover effects of FDI can also be limited, or indeed cancelled out entirely, if FDI crowds out local investment. Crowding out occurs when MNE’s reduce or replace local firms’ market share. Aitken and Harrison (1999) point out that crowding out causes local producers to spread their fixed costs over a smaller volume of production which ultimately diminishes their productivity. Some studies find a negative relationship between FDI and the performance of local firms operating the same sector indicating that the crowding out effects of FDI can outweigh the benefits that accrue from productivity spillovers (Aitken & Harrison 1999, Djankov & Hoekman 2000, Konings 2001). The negative effects of crowding out are not necessarily concentrated within the sector in which FDI occurs. Markusen and Venables (1999) point out that upstream and downstream spillovers are contingent on MNEs forming links with upstream and downstream sectors. The stronger these links, the more spillovers local firms will experience. However, if MNEs crowd out local firms who source their intermediate goods locally while choosing to source their intermediate products internationally, the MNEs effect a net reduction in the demand for domestically produced intermediate goods resulting in reduced profits and employment for domestic suppliers. There is great potential for this to
be the case when one considers that MNEs, particularly those engaged in vertical FDI, have a worldwide production and supply network and will often prefer to source some of their intermediate goods from production locations in other countries.

Another consideration is that if foreign MNEs fully displace local firms, and they are more efficient than their local predecessors, they not only put local capital owners out of business but can also reduce the demand for labor because they are able to use labor more efficiently (Hanson 2001). A decrease in the demand for labor could lead to falling wages, thus offsetting the positive wage effects of MNEs that pay higher wages. In addition, if local firms are crowded out, FDI’s contribution to expansion of the tax base may be minimal, or even negligible when one considers that governments often offer foreign investors tax breaks in order to entice them to invest in their states. Finally, FDI’s propensity to crowd out local investment appears to be greatest in the manufacturing sector (Cohen 2007) thus potentially counterbalancing manufacturing FDI’s tendency to form greater linkages with the local economy.\(^2\)

Extant theoretical and empirical scholarship thus finds that FDI can have a positive impact on growth, productivity, employment and wages in the host state’s economy, but that FDI can also have a negligible or even negative impact depending on factors such as its sectoral composition, the nature and extent of linkages it develops with firms in the local economy, the absorptive capacity of local firms, the structure of ownership of MNE subsidiaries in the host state, the rate at which foreign capital is taxed and the extent to which FDI displaces local production. The the effects of

\(^2\)Some have found that the propensity for FDI to crowd out varies across considerably across regions with crowding out occurring most in Latin America, crowding in occurring in Asia and FDI having a mixed effect in Africa (Agosin & Mayer 2000).
FDI can thus be described as variable and contingent, making it difficult for analysts and government policy makers to accurately predict what the long term costs and benefits of individual investment projects, and FDI more generally, will be for their economies.

2.3.3 Distributive Consequences of FDI

Thus far, my discussion has highlighted the variable and contingent nature of the aggregate effects of FDI on the host economy. However, it is also important to realize that the effects of FDI across domestic groups in the host country are also not uniform. Indeed, in many instances FDI will have a redistributive effect on the host state’s political economy. FDI entails the augmentation of the capital stock in the host country. Thus, from a purely factor based perspective, FDI decreases the price of capital relative to labor. This perspective has led some to argue that local labor should therefore support greater inward FDI while local capital should oppose it (Pandya 2010). Indeed, the propensity for MNEs to pay higher wages and to crowd out local firms lends further credence to this argument. Moreover, if FDI is successful in increasing employment, the associated rise in demand for labor should raise wages for local firms (Hiscox 2004).

While this factor based analysis is certainly neat and insightful, it masks the complexity of the effects of FDI on both labor and capital. There are genuine reasons for local capital to look favorably on FDI and for local labor to be wary of MNEs. For instance, capital owners that are not crowded out by local FDI, such as those in upstream and downstream sectors, may experience efficiency gains as a result
of productivity and technological spillovers from MNEs. Furthermore, local capital engaged in joint ventures with foreign MNEs may experience a gain in market share through the MNEs capture of part of the local market. These local firms will also have primary access to the technology and know-how of the MNE and also the MNE’s global production network. The latter may allow local firms to access export markets that they previously were unable to serve. On the other hand, the net effects of FDI on employment can be negative. As outlined above, FDI can crowd out local production which may diminish demand for labor both in the sectors in which MNEs operate, as well as upstream and downstream sectors. Furthermore, FDI often seeks skilled labor and therefore unskilled labor may experience little of the wage benefits associated FDI. Indeed, Feenstra and Hanson (1997) argue that FDI, particularly into developing countries, raises the demand for skilled labor only and is therefore a source of growing wage inequality.\(^3\)

The inconsistent class effects of FDI has led some to favor an approach which divides FDI along sectoral lines into those sectors that complement domestic capital in the host state and those that complement domestic labor (Pinto & Pinto 2008). FDI that complements capital does not substitute for it and therefore does not crowd it out and drive down the rents that domestic capital owners receive. FDI that complements labor is investment with a high demand for workers and willing to pay higher wages. Thus, we should expect that when FDI is concentrated in labor-complementing sectors, wages will rise, but such expectations may not hold when FDI

\(^3\)It is worth noting that Pandya’s (2010) empirical analysis of whether or not labor supports greater FDI focuses primarily on skilled labor and the effect of skill level/education on FDI preferences.
flows into those sectors where it complements capital. While there is evidence that the sectoral mix of FDI varies depending on the executive’s partisanship (Pinto & Pinto 2008), over time with leadership turnover and shifts in government partisanship countries will receive FDI that is both labor and capital complementing.

Thus, much as the aggregate effects of FDI on the host economy are conditioned on a wide variety of factors and therefore difficult to predict, so too are its overall long-run distributive effects. Undoubtedly there are winners and losers from FDI, but whether they fall easily along traditional class, industry or interest group lines is difficult to determine ex ante. Again, the distributive consequences are highly dependent on the structure of ownership of FDI, the extent to which it crowds out local firms and the extent and directions of productivity spillovers to local producers. What is important to the note is that governments are not helpless in the face of the uncertain aggregate and distributive effects of FDI. Rather, they can play a role in determining the extent and distribution of the costs and benefits of FDI.

2.3.4 Government Policy Shaping the Effects of FDI

FDI constitutes a significant and growing percentage of total capital investment in both developed and developing countries (see Figure 2.1) and as the foregoing discussion makes plain, it has wide-ranging and complex effects on local economies, influencing the viability and productivity of local firms as well as local employment and wages. The significance of effects, coupled with their highly contingent nature creates a strong incentive for governments to attempt to influence how
MNE’s conduct business within their territories. Governments will seek to regulate FDI because economic outcomes influence support for governments (Duch & Stevenson 2008, Geddes 1999, Wright 2008b). Workers and capital owners who experience (or expect to experience) a rise in income as a result of FDI are more likely to reward governments that facilitate FDI with greater political support. On the other hand, firms that are crowded out by MNEs, or workers that see their wages fall or unemployment rise due to FDI, are likely to punish governments that have enabled FDI to have these effects on the domestic economy. Thus, one should expect that office-seeking political leaders will endeavor to regulate FDI in order to ensure that its net aggregate effects on the economy are positive and that key constituencies benefit, or are at least not harmed, by inward investment.

Several scholars have argued that the regulatory and policy environment that governments establish is a principal factor shaping the effects of FDI on host state economies (e.g. Moran 2006, Caves 2007, Lipsey 2004, UNCTAD 2003, UNCTAD 2004b). There are many policy tools that governments can use to modify the effects of FDI on the host economy, the most important of which are performance requirements, which set out conditions that foreign firms must fulfill in order to be permitted to establish and/or continue operation in the host state (Cohen 2007). These can related to domestic content, whereby governments require MNEs to source a certain percentage of their intermediate goods locally, thus ensuring FDI is associated with increased demand for goods produced by upstream sectors. Alternatively, governments can require that a certain percentage of an MNE’s workforce, and managerial
staff, are composed of host state nationals. This helps to ensure MNEs boost employment and helps promote technology diffusion by giving nationals access to the managerial decision making process. Governments can ensure technology transfer happens more directly by mandating such transfers take place, or that a minimum amount of research and development be undertaken by MNEs in the host state. Furthermore, in order to ensure that FDI leads to growth in export revenue, host governments can require MNEs to export a minimum level of the goods they produce. In addition, in order to ensure that MNE profits are not re-invested elsewhere, governments can apply limits to the amount of capital that MNEs can repatriate every year.
Beyond performance requirements, government can raise taxes on MNE profits and use the increased revenue to compensate employees and owners of firms that have been crowded out by foreign investors. Alternatively, this increased tax revenue could be used to help local firms adjust to stiffer competition from MNEs or could be put towards other economic growth generating activities. For example, in May 2005 Chile passed a law creating a five percent tax on large mining companies operating in Chile with the revenues to be directed towards finance innovation and R&D activities to help prepare the Chilean economy for the time when mining resources run out (UNCTAD 2005c). Finally, in order to minimize the capacity for crowding out and to promote technology transfer, host governments can require or enable MNEs to form joint ventures when entering the local market. For example, the Investment Promotion and Support Agency of Turkey (ISPAT), a division of the Turkish Prime Ministry, assists foreign firms considering investing in Turkey with finding domestic partners for joint ventures.

While governments have a range of policy tools available to regulate the effects of FDI on their host economies, the varying and contingent nature of these effects make general predictions about governments’ particular preferences over FDI policy difficult. What we can conclude, however, is that the uncertain nature of the effects of FDI - both aggregate and distributive - should lead governments to value having the freedom to regulate the activities of MNEs when necessary, to ensure that important political supporters do not suffer income losses from increased foreign investment and/or that FDI has a net positive impact on growth, employment and
the productivity of local firms. Markusen (2001) refers to this as governments wishing to have the flexibility to “personalize” policies for each investment in order to maximize their benefit to the host economy because “projects differ widely in their potential net benefits to society...[and] carry (real or perceived) positive and negative externalities” (296).

MNEs are unlikely to approve of many of the regulatory policies outlined above because they force MNEs to deviate from their optimal production strategies and lower MNE profits. For example, performance requirements will typically force MNEs to hire more locals than they would otherwise have preferred and joint-venture requirements will cause them to transfer more proprietary technology to local partners than they would like. Meanwhile, raising taxes and fees directly transfers wealth away from the MNE to the government and host state. Thus, the interests of host governments and MNEs vis-à-vis FDI policy come into conflict. It is this conflict, combined with the relative immobility of FDI that gives rise to the credible commitment problem that governments must overcome when seeking to attract new inflows of direct investment.

2.4 Credible Commitments & Obsolescing Bargains

A credible commitment problem exists when decision makers have preferences that are inconsistent over time. This occurs in dynamic environments where actors have incentives to promise one thing and then do another after other actors have made decisions and/or taken actions based on these earlier promises (Milgrom, North &
Weingast 1990, Persson & Tabellini 2000, Kydland & Prescott 1977). As the other actors are aware of this, the initial promise, or commitment, is non-credible.

The relationship between foreign investors and host governments, traditionally referred to as the “obsolescing bargain”, bears the hallmarks of a classic credible commitment problem in which host governments are unable to credibly guarantee investors secure property rights and favorable investment conditions in the long run (see Vernon 1971, Moran 1995). Under the obsolescing bargain, MNEs are in a position to choose to locate operations in one of multiple possible locations around the world. Governments have significant incentives to attempt to attract these enterprises as their investments are, as noted above, a potential source of growth, employment, tax revenue and technology. Moreover, given the potential benefits of inward FDI, governments must often compete to attract MNEs. This gives MNEs considerable bargaining power vis-à-vis potential host state governments which they can use to extract policy concessions from them. These concessions, or inducements, range from tax holidays and export duty exemptions to investment grants and wage subsidies (Li & Resnick 2003, Li 2006b, Mutti 2003). Governments can also pledge to refrain from imposing performance and ownership requirements, and to minimize regulatory interference in the operations of MNEs, thereby leaving MNEs to pursue whichever strategies maximize their profits.

While MNEs are in a strong bargaining position before selecting a location, after they establish their investment bargaining power shifts to the government of the host state. This is because FDI is characterized by some degree of sunk costs and irreversibility (Jensen 2003, Moran 1999, Stasavage 2002) and therefore, “once an
investment is made, the host country no longer needs to offer benefits to attract the
investment, it only needs to treat the investors well enough to keep the investment”
(Guzman 1998, 661). As withdrawal is costly to investors, the policies needed to keep
investment need not be as generous as those needed to attract it (Guzman 1998).
Thus, governments, having made significant concessions in the original bargain with
investors, may be tempted to renege on their promises and establish a new bargain by
introducing new policies that direct greater benefits towards the host state economy
and its firms and workers. This typically involves changes to one or more of the
policy areas discussed above such as performance requirements, capital taxation and
regulation, and tariffs and fees (Büthe & Milner 2008, Henisz 2000, Jodice 1980,
Moran 1995, Guzman 1998). For example, in 2004 the government of Venezuela
raised royalties on extra-heavy oil by 1600 percent and, “announced that 32 oilfield
operation contracts with foreign oil companies, which account for almost one-quarter
of total oil production, would be cancelled by the end of the year and renegotiated
under new terms. Income taxes and royalty levels will be higher...” (UNCTAD 2005c, 72).
Similarly, in 2005 Bolivia more than doubled its tax rate on oil production and
Peru introduced a royalty charge on non-oil mining outputs (UNCTAD 2005c).

The risk of such policy changes in the host state that MNEs face bears the characteristics

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4 The extent to which the bargain between a host state and an MNE obsolesces in this manner is determined by the relative post-entry bargaining power of the host state government and the investor. This depends on a variety of factors such as the ratio of firms’ fixed to variable costs and the availability of alternative investors/investment locations (Tarzi 1991). However, all firms, after locating operations in a foreign country, do face some degree of risk due to the illiquid nature of their investment and the incompleteness of their contract with the host state (Li 2006a).
of what game theorists call “holdup risk” (Markusen 2001) and is referred to by business analysts as “political risk” (Rubins & Kinsella 2005).

The obsolescing bargain thus provides governments with a credible commitment problem. Governments wish to attract FDI and the potential benefits it brings by committing to provide a secure and profitable policy environment for foreign investors. However, the irreversibility of FDI coupled with the ability of governments to reshape the policy environment facing investors in a manner that directs greater benefits to their economies, firms and workers means that governments will be tempted to renege on those commitments once an investment has been established.

Forward-looking investors are aware that governments have incentives to reshape the post-entry policy environment in a manner that adversely affects their profitability. This results in lower levels of foreign investment as MNEs estimate that potential losses from a shifting policy environment are too high to make investing an acceptable risk (Guzman 1998). Consequently, governments are deprived of reaping many of the potential benefits of FDI. Thus, FDI-seeking governments must find a way to credibly guarantee to MNEs that they will provide foreign investors with a stable, secure and profitable investment climate and refrain from excessive ex post shifts in the policy environment.

5 Until the 1970s, political risk was most associated with outright expropriation of foreign-owned assets by host governments (Büthe & Milner 2008). Although some argue that firms still continue to be wary of the risks of expropriation (Li 2006a), expropriation has become much less common over the past three decades and is very rare today (Kobrin 1984, Minor 1994, Büthe & Milner 2008). The main political risks investors face today are the more subtle changes to the policy environment in the host state addressed here.
2.4.1 Solving a Credible Commitment Problem

There exists a vibrant literature in Political Economy and International Relations on the problem of time-inconsistency and how political actors can overcome this problem and make credible commitments. The core characteristic of any “solution” is that it must alter decision makers’ *ex post* incentive structure in a manner that makes them more likely to abide by their commitments. This involves raising the benefits of adhering to commitments and/or raising the costs and difficulty of breaking them.

Manipulation of incentives in this manner is often achieved through institutions at both the domestic and international levels. Snidal and Thompson (2003) note that historically governments have found credibility through domestic institutions that tie their hands, making policy changes more difficult and/or costly. North and Weingast’s (1989) influential analysis of how the English sovereign was able to credibly commit to uphold property rights is an excellent example of this. Specifically, the development of parliamentary power and an independent judiciary in eighteenth century England acted as check on sovereign power preventing him from altering the terms of agreements and violating property rights without the approval of parliament.⁶ A similar perspective has been taken by those that have viewed domestic institutions as a source of credibility at the international level with several scholars arguing that institutional structures that consist of a greater number of veto players - actors that can block government policy - promote transparency and

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⁶Parliamentary influence was preserved through its control of the sovereign’s purse.
make policy reversal more difficult, thereby lending those policies greater credibility (Cowhey 1993, Martin 2000, Leeds 1999, Pevehouse 2002).

Some have also argued that democratic institutions can promote greater credibility at the international level by helping to generate audience costs - the removal of financial, electoral and other forms of support necessary to stay in office - for governments that renge on policy commitments (see Fearon 1994). For example, Mansfield, Milner and Rosendorff (2002) suggest that audience costs are higher in democratic than in non-democratic regimes because “the political survival of democratic leaders hinges more on election outcomes” (480). Yet, one must refrain from concluding that audience costs are absent in non-democracies because, as Bueno de Mesquita et al. (2003) illustrate, leaders in all types of regimes have audiences on whom they must rely for support (see also Henisz & Mansfield 2006). Moreover, the positive association between democratic regimes and audience costs may not always be strong for as Dai (2005) argues, the ability for domestic constituencies to influence decision makers depends on their informational status and electoral leverage. Gartzke and Gleditsch (2004) also warn that democratic institutions can be obstacles to credible commitments because democracies experience regular leadership turnover and that as preferences and policies are subject to cycling, the potential for governments with different winning coalitions and different preferences to emerge is high. However, if leaders who break their commitments are punished and ousted from office, than the possibilities for democratic audiences to effect leadership turnover at the ballot box can help increase credibility.

International institutions can also help governments make credible commitments
to both international and domestic audiences (e.g. Staiger & Tabellini 1999, Drezner 2003, Koremenos, Lipson & Snidal 2001). International institutions do this by increasing the probability that non-compliance with commitments will be detected and punished, thereby making the consequences of reneging on commitments more costly. International institutions promote detection by clearly specifying standards of conduct and facilitating the monitoring of state activity (Keohane 1984, Oye 1986). By identifying and publicizing non-compliance, international institutions increase the likelihood that governments’ non-compliance with their commitments will be met with reputation and audience costs. Institutions can also help generate material costs by enabling states to effectively sanction or retaliate against states that do not comply with their commitments. An international institution can do by facilitating issue-linkage, whereby non-compliance in one issue area is punished through loss of benefits in linked issue areas, all of which fall under the institution’s scope (Martin 1992). Institutions can also facilitate sanctions by establishing procedures which authorize states to sanction governments guilty of non-compliance. For example, the World Trade Organization’s (WTO) dispute settlement procedure authorizes states to use retaliatory protectionism against governments found guilty of violating their WTO commitments.

Building on this body of research into institutional solutions to credible commitment problems, extant scholarship has identified both domestic and international institutions that can ameliorate host governments’ credibility challenges vis-à-vis FDI. In a similar vein to Mansfield, Milner and Rosendorff (2002), Jensen (2006) argues that democratic governments will find it easier to commit to foreign investors
because they face a heightened potential of audience costs at the polls if they renege on commitments to FDI. Meanwhile, Henisz (2000) argues that governments will find it more difficult to shift policy significantly in the presence of a higher number of institutional veto players and therefore investors will find the policy environment in countries with a high number of veto players more stable and government policies more credible. Jensen amends this argument to focus on one category of veto player - sub-national governments in politically federal systems. He argues that a simple count of veto players misleadingly assumes they all have an incentive to stop shifts in national FDI policies, whereas a case can be made that sub-national units will have such incentives. In support of his arguments, Jensen finds that both democracies and politically federal states are more successful in attracting FDI, indicating they find more success in establishing their credibility with MNEs.

Jensen (2003) also acknowledges that strong property rights play a role in making government promises to foreign investors more credible, but the link between democracy and property rights with respect to FDI is made more strongly by Li and Resnick (2003). Drawing on earlier work by North and Weingast (1989) and Olson (1993), they argue that the effective political representation of diverse groups, a meaningful legislature, electoral constraints and independence of the judiciary found in established democracies helps them attain strong property rights and uphold contracts, thereby protecting investments from “predatory banditry” by the executive. It is precisely because democracy itself rests on such institutions that established

7Unlike in a fiscally federal system, in a politically federal system sub-national units do not tax or raise their own revenue. However, they do play a role in the development of national policy and act as a check on the exercise of power by the central government.
democracies display high levels of property rights protection. A property rights-based argument maps well onto a veto players argument when one considers that opposition in the legislature and an independent judiciary are often interpreted as institutional veto players that can block government policy changes (Henisz 2000). Thus, to some extent property rights and veto players are two sides of the same coin.

2.5 Bilateral Investment Treaties: An International Institutional Alternative

2.5.1 BITs: An Introduction

The value of domestic institutions in helping to facilitate credible commitments notwithstanding, many governments clearly believe that they alone are not sufficient to persuade foreign investors that they will face a stable and profitable policy environment. Evidence of this is the network of over 2,700 bilateral investment treaties (BITs) that have been signed by over 170 states representing the entire spectrum of regime types, constellations of veto players and property rights protections. While BITs are concluded between governments, they primarily govern the conduct of governments towards their treaty partners’ private investors engaged in economic activity in their country. There are two primary reasons why governments sign BITs. The first is to attract investment from abroad (Büthe & Milner 2009, Guzman 1998, Elkins, Guzman & Simmons 2006) and the second is

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to protect the interests of their own nationals investing abroad (Schrijver 2001). As I outline in greater detail below, BITs enable governments to reach the first of these objectives by making their commitments to afford foreign investors a stable and profitable policy environment more credible (Büthe & Milner 2009, Kerner 2009).

In terms of issues covered, BITs are remarkably similar with many outlining government obligations to foreign investors in almost all of the following areas (UNCTAD 2007a):

- Promotion of Investment
- Absolute Standards of Treatment
- Relative Standards of Treatment
  - National Treatment
  - Most-favored Nation Treatment
- Transfers of Capital
- Compensation for Losses Due to War and Civil Unrest
- Conditions and Compensation for Acts of Expropriation
- Pledge to Honor All Other Obligations to Foreign Investors (Umbrella Clause)
- State-State Dispute Settlement
- Investor-State Dispute Settlement

The first seven of these areas serve the institutional function of establishing acceptable standards of conduct. They generally aim to afford investors fair and equitable treatment, protect investors’ property rights and promote an environment in which MNEs are free from discriminatory and predatory behavior by host governments.
For example, BIT provisions relating to transfers of capital usually include a commitment by the signatory governments to not raise obstacles to foreign investors to repatriate profits, income and returns on their investments abroad. Commitments of most-favored nation and national treatment constitute a pledge not to treat foreign investors from one’s treaty partner any worse than other foreign investors or local investors, thus guaranteeing MNEs a level, if not more advantageous, playing field with all other investors operating in the host country. Furthermore, expropriation clauses typically guarantee foreign investors prompt and effective compensation for direct and indirect acts of expropriation and nationalization of their assets. Many expropriation clauses also cover measures that are “tantamount” to expropriation, and these can include regulatory, judicial or legislative decisions that cause the value of investments to shrink (Cho & Dubash 2003). The pledge to honor other obligations is present in about 50 percent of BITs and is important because it brings private contracts concluded between investors and governments, and unilateral promises made by host governments but not included in the terms of the BIT, under the protective umbrella of the treaty (Newcombe & Paradell 2009). The last provision listed, investor-state dispute settlement, in most BITs grant private investors the right to take host governments to arbitration if they feel the host government has violated provisions of the BIT or, in some cases, if they have any investment related grievance. If the arbitrators find in favor of the investors, they typically have the power to order the states to pay compensation to the investors and such decisions are binding on governments.
Recent empirical studies have sought to uncover whether or not BITs are successful in helping governments credibly commit to foreign investors by examining whether or not they have an independent effect on the FDI flows. The findings so far are inconclusive with some studies finding a positive relationship between BITs and FDI and others failing to find evidence for such a relationship (e.g. Hallward-Dreimeier 2003, Neumayer & Spess 2005, Sauvant & Sachs 2009, Kerner 2009). The variation in results may be attributed to differences in sample selection, measurement approaches and estimation techniques across the various studies. However, while the success of BITs as a credible commitment tool may be uncertain, the consistent growth in the number of BITs signed since the early 1980s (see Figure 2.2) suggests we can be more confident in asserting that governments perceive BITs as an important tool for overcoming their credible commitment problem and attracting FDI. Indeed, BITs are often considered an important selling point when governments are seeking to attract FDI. For example, the Turkish Investment Support and Promotion Agency’s main briefing book that it distributes to foreign firms in order to familiarize them with the investment environment in Turkey and encourage them to invest there, dedicates a section to international agreements and clearly lists every BIT that Turkey has signed. There is also evidence that governments see concluding BITs as bestowing them with a competitive advantage in attracting FDI over governments that do not conclude them. This has led to the competitive diffusion of BITs as countries seek to keep up with peer competitors by signing BITs with important investment partners (Guzman 1998, Elkins, Guzman & Simmons 2006, Neumayer & Plümper 2010, Jandhyala, Henisz & Mansfield 2007).
While governments seem to find great merit in signing BITs, there is considerable variation in how they choose to design their investment agreements (UNCTAD 1998a, UNCTAD 2007a, Sornarajah 2000). The literature on BITs has traditionally ignored these differences in BIT design and has instead treated them as substantively homogenous.\footnote{Some observers have gone as far as claiming that BITs are virtually identical (e.g. Guzman 1998, Vandevelde 2000).} For example, to empirically evaluate the effect of BITs on FDI inflows Büthe and Milner (2009) simply sum the number of BITs each state has signed. This assumes that one BIT is just as effective as another in attracting FDI. While there are a few noteworthy exceptions to this trend of assuming all BITs are alike (Allee...}
& Peinhardt 2010, Crisp, Jensen, Rosas & Zeitzoff 2010, Yackee 2007), investigation into the determinants of BIT design is remarkably limited when one considers how widespread BITs have become and how important the drafting of their provisions is for how governments, investors and arbitrators interpret the obligations they impose on states (Juillard 2008). In the chapters that follow, I will seek to rectify this shortcoming in the extant literature by identifying and explaining important areas of variation in the design of BITs. In order to accomplish this, I will examine investment treaties through the conceptual prism of “legalization”.

Therefore, to set up my theoretical discussion of variation in the design of investment agreements in the next chapter, I end this chapter with a conceptual discussion of legalization and how its three core components relate to credible commitments in general, and in the particular context of investment agreements.

### 2.5.2 Legalization, Credible Commitments & BITs

Legalization is a set of three characteristics - obligation, precision, delegation - that international institutions may possess to differing degrees (Abbott et al. 2000). **Obligation** can be defined as the degree to which commitments are legally binding. **Precision** refers to the degree of detail with which rules prescribing and proscribing conduct are established. Finally, **delegation** is the extent to which third parties are granted authority to “implement, interpret, and apply the rules; to resolve disputes; and (possibly) to make further rules” (Abbott et al. 2000, 401).

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10For a much more limited discussion of BITs from the perspective of legalization see Nakagawa (2007).
Each component represents a dimension along which institutional design can vary between low and high levels of legalization, with high legalization most closely resembling domestic law. In the case of obligation, low legalization is a nonlegal norm while high legalization is a binding legal rule. With respect to precision, obligations are less legalized when expressed as vague principles and reflect greater legalization when outlined as precise, highly elaborated rules of conduct. Finally, the legalization of delegation is low when there is limited delegation to third parties, while delegation reflects high legalization when provisions are made for independent international courts or organizations to carry out and/or interpret obligations. When the three components are combined, a clear picture of the overall level of legalization of an institution can be formed. It is important to note that the degree of legalization of each component can differ within a single institution. For example, an institution, such as the Helsinki Final Act, may display highly precise obligations which are not legally binding or which are not accompanied by provisions for third parties to play a role in executing and/or interpreting those obligations (Abbott et al. 2000).

In order to make credible commitments to other governments, or domestic and international private actors, governments can elect to pursue highly legalized international agreements. Greater legalization of commitments makes them more credible by raising the difficulty and costs of breaking those commitments directly and indirectly (Abbott & Snidal 2000). Firstly, greater precision of commitments limits

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11The literature offers alternative conceptualizations of “legalization” (e.g. Raustiala 2005, Finnemore & Toope 2001) that overlap to a significant degree with that presented here.
self-serving interpretations of obligations that states who wish to violate those obligations may attempt to adopt. Moreover, a formal, precise expression of commitments creates clear benchmarks for compliance, which in turn makes non-compliance easier to detect and, if possible, punish (Keohane 1984). Thus, for example, if a state’s obligations to foreign investors are expressed in investment treaties with significant detail, it becomes harder for a government to justify pursuing policies that diverge from the spirit of their treaty commitments and the expectations of investors by claiming they simply have a different interpretation of their treaty commitments.

Secondly, formal legalization of international commitments makes them public and raises their profile domestically (Lipson 1991). This creates domestic compliance constituencies - private groups and bureaucratic officials that benefit from the commitment and/or adjust their expectations and behavior believing that an international legal commitment signals a government’s genuine intent to abide by those commitments (Simmons 2000, Dai 2005, Hathaway 2007). These groups would suffer costs if their government reneged on its commitments and can respond by inflicting audience costs on the government by withdrawing electoral, financial or physical support. In the case of BITs, such loss of support would primarily emerge from local firms and workers who rely on foreign investment for business and employment, and fear that government behavior that leads to a reputation for not respecting investment treaty commitments deters further foreign investment, and may even lead existing investors to withdraw their investments (see Jensen 2006).

Thirdly, legalization increases the probability that commitments will be enforced, and violations punished. In particular, highly legalized delegation to impartial and
independent international legal institutions increases the probability that broken commitments will be objectively identified and publicized, thus magnifying the reputation costs of commitment violation (Smith 2000, Bradley & Kelley 2008, Alter 2008, Hawkins, Lake, Nielson & Tierney 2006). Furthermore, agreements consisting of state obligations are seldom complete contracts and therefore delegating to impartial agents substantial authority to interpret commitments promotes objective interpretations of agreements and limits the ability of governments to adopt self-serving interpretations of their commitments (Hawkins et al. 2006, Alter 2006, Alter 2008). Crucially, legal institutions that pass judgment on states’ maintenance of legal commitments may authorize punishments such as fines or countermeasures that other states can pursue. International legal commitments may also be enforceable through domestic law and domestic legal processes.

Many investment treaties include highly legalized provisions for the settlement of disputes between foreign investors and their host governments which permit foreign investors to take host governments directly to international arbitration when they feel their rights, as expressed in those treaties, have been violated. Most BITs also give arbitration panels the power to take binding decisions and determine monetary compensation to aggrieved investors, thus raising the financial costs for governments who do not comply with their treaty obligations. These arbitration clauses play a key role in raising the costs of commitment violation and making
commitments to investors more credible. The financial costs of arbitration to governments are real (UNCTAD 2005a). Legal costs alone are tens of millions of dollars which is particularly significant for developing countries with small economies (Peterson 2003a, Peterson 2004). Arbitration awards can also be substantial (Van Harten 2007). For example, in 2003, a Stockholm based tribunal awarded the Dutch-American firm, Central European Media (CME), 350 million dollars in compensation for what it judged was violation of a BIT between the Netherlands and the Czech Republic (Peterson 2003a, Peterson 2003b). This effectively doubled the Czech governments already record budget deficit for that year and led Czech leaders to consider raising the nation’s value added tax (Peterson 2003b).

Moreover, when a judgment is passed by an impartial tribunal, it weakens any attempt by governments to minimize the reputation and associated audience costs surrounding disputes with foreign investors by arguing that investors’ claims are false or that the dispute is simply due to differing opinions or interpretations of the governments’ BIT commitments. A finding by an investment arbitration panel that goes against the host state is an objective, unequivocal, and often public judgment that the host state has broken its commitments to a foreign investor (Elkins, Guzman & Simmons 2006). Through losing arbitration cases a government can acquire a reputation for violating its commitments to FDI, which can make investors reluctant to locate in the host state in question causing governments to forego many of

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12 Guzman (1998) goes as far as arguing, without equivocation, that arbitration solves the time-inconsistency problem that governments face vis-à-vis MNEs.

13 Similarly large awards have been made against several countries including Ecuador (71 million dollars), Slovakia (824 million dollars), and Lebanon (266 million dollars) (UNCTAD 2005a).
the potential benefits of FDI (Allee & Peinhardt 2008a) and to suffer the resulting audience costs discussed earlier. Thus, investment arbitration prevents governments from being able to costlessly wriggle out of commitments by claiming that they have not violated commitments when they in fact have and/or by claiming to have paid appropriate compensation when they have not (Kerner 2009).

Furthermore, violating a commitment made under international law is costly because it potentially leads states to suffer reputation costs that affect all of their future conduct within the international law regime (Simmons 2000, Guzman 2008). In short, they acquire a reputation for not respecting international law and this limits their ability to use international law for their own ends in the future. Thus, for example, if a government uses BITs to make more credible commitments to foreign investors but frequently reneges on commitments undertaken in its investment treaties, potential future investors will take note and will discount those treaty commitments, and BITs will be much less effective in enhancing credibility and promoting investment for the country in question.

2.6 Conclusion

It is clear that greater legalization of commitments through BITs has the potential to alter the ex post incentive structure facing governments with respect to FDI, making it more costly for them to break their commitments to MNEs, and thus making those commitments more credible. The question then is why do all governments not legalize their BITs to the same degree. Why do some governments choose to scale
back the degree of legalization of their BITs while others pursue legalization in its most extreme form? It is this question I will seek to answer in the next chapter.

However, a key part of the answer lies, I argue, in one of the core issues raised in this chapter: the variable and contingent nature of the aggregate and distribu-
tional effects of FDI. The varying effects of FDI mean that government policy is key to ensuring that FDI has a positive impact on the host economy. However, when governments seek to credibly commit to MNEs, they are committing to refrain from implementing policies that may be used to regulate FDI in a manner that bene-
fits the host state economy on aggregate, as well as key government supporters in particular. Thus, while signing a BIT raises the costs of violating commitments to foreign investors, it also limits the range of FDI related policies that governments can pursue to promote greater political support and stay in power while avoiding costly violations of commitments to foreign investors. In the next chapter, I argue that not all governments will be equally enthusiastic about having their freedom to implement investment related policies constrained.
Countries enter into international investment agreements (IIAs) with a view to enhancing their investment climate, attracting more and better quality foreign direct investment (FDI) and benefitting from capital inflows. IIAs can offer a series of benefits in this regard, not least by helping to promote a stable, predictable and transparent enabling framework for investment. However, realizing these potential benefits remains a challenge and host countries need to strike a delicate and complex balance between using IIAs for attracting FDI on the one hand, and preserving the flexibility needed for the pursuit of national developmental objectives on the other hand.

3.1 Introduction

In the previous chapter, I outlined how greater legalization of international institutions is effective in helping states establish credible commitments by raising the costs and difficulty of commitment violations. However, high levels of legalization are not a panacea for credibility seeking governments because legalization can be costly to states even when they do not violate their commitments. This is because when governments craft highly legalized institutions they are intentionally creating constraints on their future behavior including limits on their autonomy to determine policies designed to maintain political support and stay in power (Simmons 2000). Thus, in selecting a level of BIT legalization governments face a trade-off between greater credibility of commitments (offered by high legalization) and greater autonomy to develop and implement FDI related policies (associated with lower legalization). It follows, I argue, that to explain why governments choose to legalize their BITs to differing degrees, one needs to explain how governments resolve this trade-off.

The credibility-autonomy trade-off is inherent in all instances of legalization. However, leading theories of institutional design and legalization fall short of offering a comprehensive explanation as to why different governments may choose to resolve this trade-off differently. Several scholars have suggested that where rationalist explanations of institutional design fall short is that they fail to appreciate that governments’ design preferences can vary (Kahler 2002, Thompson 2010). I agree with this view and in this chapter I develop a theory of government preferences over

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1This curtailing of governments’ autonomy to determine policy is often referred to as “sovereignty costs” (Abbott & Snidal 2000, Simmons 2000, Moravcsik 2000).
legalization that focuses on when and why governments prioritize policy autonomy over credibility.

The key factor in shaping governments’ preferences, I argue, is the length of their time horizons. Governments with longer time horizons will be wary of the potential for economic and political conditions to shift over time and reshape the effect that FDI has on the domestic economy. They will therefore prize having greater autonomy to respond to such changes and implement policies that ensure the benefits of FDI are channeled to their economies and their constituents. Governments with short time horizons on the other hand do not expect to be in power in the future, contending with shifting circumstances, and therefore care less about preserving greater policy space.

Although this theoretical argument seeks to explain the legalization of international institutions, and BITs in particular, it is rooted in domestic politics. The links between domestic politics and international institutional design have been understudied. This shortcoming in the extant literature dovetails with the lack of attention paid to design preferences as domestic political processes and institutions are likely to play a critical role in shaping government preferences over international institutions. In the second half of this chapter, I argue that this is the case with respect to time horizons and, drawing on research in comparative politics, illustrate how domestic institutions such as regime type, party institutionalization and autocratic regime structure frame the time horizons of governments, and thus shape their preferences over the legalization of international institutions such as BITs.
3.2 The Credibility - Autonomy Trade-off

3.2.1 Legalization & Constraints on Policy Autonomy

When states craft highly legalized institutions to make credible commitments, they are intentionally creating institutions that will constrain their future behavior and limit policy autonomy with which they are able to determine policy. Autonomy is limited in two ways. First, states are expected to refrain from pursuing policies that violate the obligations they have agreed to undertake by virtue of institutional membership; to do otherwise risks paying the reputation, audience and other costs discussed earlier. Thus, legal obligations narrow the set of policies states are able to adopt.

In the previous chapter, the different types of obligations typically found in BITs were outlined, each of which narrows governments’ regulatory space vis-à-vis foreign investors (Sornarajah 2004) and constrain governments’ policy freedom by “limit[ing] the choices available to policy makers in designing national investment policies” (UNCTAD 2006, 6). For instance, national treatment obligations prevent governments from affording local firms better treatment than foreign companies. Most-favored nation clauses do not permit governments to discriminate among investors from different countries and transfer obligations may prohibit governments from placing conditions on foreign investors’ transfers of profits and earnings abroad.

2 Marksuen (2001) points out that any mechanism, such as an international treaty, used to credibly commit to foreign investors necessarily brings with it a loss of government discretion and flexibility in dealing with foreign investment.

3 See also Kerner (2009), and Allee and Peinhardt (2010).
Policy autonomy is also limited when an institution is highly legalized with respect to delegation because states cede broad authority over interpretation and implementation of their institutional obligations to a third party. Bradley and Kelley (2008) refer to this as the "displacement" of decision making and control. In some cases, particularly those where dispute settlement authority is delegated, the authority to decide whether or not states’ policies are in compliance with institutional obligations is also delegated (Alter 2008). For example, highly legalized dispute settlement clauses in BITs grant investors the right to submit a wide range of disputes directly to international arbitration. Moreover, governments also pledge to be bound by the interpretations and judgments made by arbitration panels regarding the compatibility of their policy behavior with their treaty commitments, even if those interpretations diverge from their own and from their intentions when they originally concluded the treaty. Thus, governments are not free to govern issues affecting foreign investment completely as they wish; international arbitrators can pass judgment on their policy choices, and their interpretations, not governments’, are final (Van Harten 2007).

The potential for policy autonomy to be limited by greater legalization is a genuine concern for governments seeking to stay in office because of its implications for their political survival. There are multiple strategies available to leaders to enable them to stay in office but the most important is the implementation of policies

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4This applies only if delegation by states is “self-binding” whereby states subject their own behavior to oversight by third parties (see Alter 2008).

5It is a common, and often realistic, assumption that political leaders are office-seeking (e.g. Geddes 1999, Bueno De Mesquita, Smith, Siverson & Morrow 2003).
that will please those whose support they seek. Any constraint on the freedom with which governments can shape policies is therefore politically costly for governments and they will consequently be acutely aware of the potential for greater legalization of commitments to limit the number of policy tools at their disposal (Goodliffe & Hawkins 2006).

3.2.2 The Credibility-Autonomy Trade-off

The preceding discussion illustrates that in determining the degree to which their commitments should be legalized, governments face a trade-off (Kahler 2000). Greater legalization raises the reputation, financial and audience costs of breaking commitments, thereby creating incentives for governments to abide by their commitments, and making those commitments more credible in the eyes others. However, greater credibility of commitment comes at the expense of sovereign control over policy. Limited legalization of commitments, on the other hand, preserves greater autonomy for governments to determine policies but is potentially less effective in enhancing the credibility of commitments.

To be clear, the credibility - autonomy trade-off exists because governments desire both the ability to form credible commitments and autonomous control over policy. This is certainly true in the case of BITs. The potential economic benefits of FDI outlined in the previous chapter speak to why office-seeking governments would seek to create treaties that better enable them to make credible commitments. If a government attracts foreign investment by making a credible commitment to fair treatment of foreign firms, the economic benefits of increased FDI could translate
into a growth of political support. However, governments will also wish to maintain as much freedom as possible to pursue whichever policies they deem will be politically and economically advantageous with respect to FDI. This is because, as illustrated in Chapter 2, the net effects of FDI on a host country’s economy are uncertain and government policy and regulation can channel those effects in such a way that the aggregate and local benefits of FDI are politically advantageous for host governments. This desire for greater policy space in BITs in order to promote economic objectives in the host country, such as greater development, is well put by Sornarajah (2008):

A State may, in the interests of its economic development, seek to change policies and laws so as to direct investment into appropriate areas. Such interferences could be interpreted as violating treatment and expropriation provisions [in BITs. However,]...The conservation of such [sovereign] space is vital for channelling foreign investment into areas that a State thinks is appropriate, and it would be unwise to give up that space...” (76)\(^6\)

While not all BITs are legalized to the same degree, those that are highly legalized significantly limit the scope for government regulation. For example, governments’ natural desire to tailor policies such as performance requirements to different types

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\(^6\)A harder line was taken by the Indian representative at the WTO’s Working Group on Trade and Investment who stated, with respect to the proposed development of multilateral rules governing foreign investment, that developing countries, “must never subscribe to any doctrine that would limit policy flexibility in this important area [i.e. development]”. Quoted in Cho and Dubash (2003, 4).
of investments based on their varying effects on the local economy, which was highlighted in the previous chapter, is frustrated by both highly legalized national and most-favored treatment commitments which impose strict limits on governments’ abilities to discriminate between investment projects. Alternatively, governments may want to increase the stock of local capital by requiring foreign firms to reinvest a higher proportion of their earnings locally instead of repatriating them to their headquarters. However, a highly legalized obligation to allow the free transfers of funds in a BIT means that governments are no longer able to limit the amount of capital that firms can repatriate under any conditions without risking direct recourse to arbitration and the payment of compensation to foreign investors.

Governments may also find that highly legalized BITs frustrate their abilities to pursue social and environmental, as well as economic, objectives. For example, governments may wish to offer subsidies to local firms to develop more environmentally friendly technologies (as the Danish government did in the electricity sector) or to discriminate in favor firms owned by previously oppressed social groups (as the South African government does to promote greater equity in the involvement of Black South Africans in the national economy) (Cho & Dubash 2003). Such measures potentially contravene national treatment commitments in BITs and therefore would not be available to governments seeking to promote environmentally sustainable energy provision and redress economic imbalances of the past.7

Thus, in selecting a level of legalization governments face a genuine trade-off

7See also UNCTAD (2004a), Chapter 2, Haslam (2007) and Cho and Dubash (2003) for further discussion of how investment agreements, both bilateral and multilateral, can affect the policy space available to signatory governments.
between policy autonomy and credibility. I argue that understanding how govern-
ments resolve this trade-off holds the key to understanding why governments choose
to legalize their BITs to differing degrees. When governments choose lower levels
of legalization, they are prioritizing policy autonomy to a greater degree relative to
credibility, and when they choose greater legalization they are prioritizing policy au-
tonomy less. So, why do states resolve the credibility-autonomy trade-off differently?
In the next section, I briefly survey leading extant explanations for institutional de-
sign, particularly with respect to legalization, and illustrate how they fall short in
providing a satisfying explanation before proceeding in the following section to out-
line my own explanation. In this discussion I highlight the role of domestic politics
in international institutional design because domestic politics is at the heart of the
theory of time horizons-based preferences that I develop in this chapter.

3.3 Extant Research: International Institutional Design &
Domestic Politics

Recent scholarship addressing the creation and design of institutions in political
science, and in international relations in particular, has been dominated by the ra-
tionalist/functionalist approach (Pierson 2000). Building on insights from new insti-
tutional economics (Williamson 1985, Williamson 1999, Coase 1937, Moe 1984), this
approach assumes that rational states create institutions to further their individual
and collective goals because institutions allow them to solve problems that could not
otherwise be solved, or could only be solved at much greater cost (Garrett 1992, Oat-
ley & Nabors 1998). Of central interest have been situations resembling “market
failure”, such as that found in a one-shot Prisoner’s Dilemma game, where all actors could be made better off if they could cooperate but the incentives present in their strategic environment mean they are unable to do so. Obstacles to cooperation that scholars have focused on include time-inconsistent preferences, distributional issues, enforcement problems and uncertainty over preferences and over states of the world (Koremenos, Lipson & Snidal 2001). These problems exist due to, or are sharply magnified by, the anarchic nature of world politics and the absence of a world government to enforce cooperative agreements and contracts.

The problem-solving focus of the rationalist/functionalist approach has led theory development to focus on the structure of the cooperation problem in order to explain the design of the institutional solution (Hasenclever, Mayer & Rittberger 1997, Moravcsik 1997).

Such an approach undoubtedly explains an important part of the variation in institutional design that exists in international politics today. However, it struggles to explain important differences in the design of institutions that seek to solve problems that are structurally similar. All institutions designed to dampen incentives to defect are not designed exactly the same, nor are institutions

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8 Many explanations of institutional design in International Relations that assume that states are rational adopt this problem-solving functionalist approach. However, rationalist explanations need not necessarily assume that institutional designs only reflect the (structure of) the problems they are created to remedy.

9 Some critics of this approach have noted that rational actors can produce “dysfunctional” institutions that do not perform as intended (Miller 2000). This is a problem if one wishes to explain an institution’s creation or design based on its performance or functional efficiency. However, this is less of a concern if one is only concerned with explaining institutional design as the product of designers acting rationally to create an institution that performs a particular function.
where uncertainty over states of the world is high. Moreover, variation in the design of BITs illustrates that not all institutions that seek to solve time-inconsistency problems are the same, even in the same issue area. Critics have also questioned the efficiency assumption of the functionalist approach. If the design of an institution is explained by the problem it seeks to solve, this assumes that the institution is an efficient solution to the problem. However, in any particular case, there are many other potential institutional designs that states chose to reject that are arguably just as efficient as the one they selected, and thus researchers need to look beyond the problem to explain choices of institutions and their features (Garrett 1992, Richards 1999).

If problem structure alone does not explain variation in institutional design, what does? Kahler (2002) argues that, in the case of global monetary institutions, existing functionalist explanations “fail to explain a crucial portion of observed institutional variation over time” (42) because they fail to acknowledge that the preferences of states can vary. A similar view is taken by Moravcsik (1997) who argues that functionalist theories of international regimes “take state preferences as fixed or exogenous” and look to the geopolitical environment, and in particular the distribution of and access to information, to explain the emergence of international institutions. In doing so, they ignore the importance of variation in preferences over outcomes as a determinant of state behavior. These are sharp critiques for, as Hendrik Spruyt (2009) argues, “the initial choice for particular institutional arrangements will greatly hinge on the preferences of the agents involved” (1). Kahler and Moravcsik both suggest that scholars turn to domestic politics in order to better understand state preferences and the potential for variation in those preferences to determine state behavior.
and the development of international regimes and institutions. Kal Raustiala (2005) echoes this call to focus on domestic politics with respect to the legalization aspects of institutional design in particular, arguing that domestic preferences and institutions can be used to supplement or amend functionalist accounts of international legalization when they fall short empirically.

Although given comparatively little attention, the role of domestic politics has not been ignored entirely in studies of international institutional design. Rosendorff and Milner (2001) argue that uncertainty regarding future domestic political pressures prompts governments to build flexibility into trade agreements while Solingen (2008) argues that “dominant domestic political coalitions create regional institutions that strengthen their own position in power [domestically]...” (266). Mansfield, Milner and Pevehouse (2005) find that domestic political institutions also play a role, arguing that economic integration is shallower when participating states’ institutions contain a greater number of veto points.

With respect to the legalization of institutions in particular, Abbott and Snidal (2000) highlight the potential for domestic groups to lobby their leaders to pursue (or not pursue) highly legalized agreements with other states (see also Raustiala 2005, Kahler 2000a) and echo Moravcsik’s argument that the preferences of domestic groups over legalization can cause state preferences over the degree of institutional legalization to diverge. Domestic political institutions may also help shape preferences regarding participation in legalized international agreements. Kahler (2000b)
suggests that authoritarian regimes will eschew constraints imposed by highly legal-
ized international treaties and this argument has met with some empirical support
(Pevehouse & Buhr 2005).

While this small collection of works goes some way to illuminating the relation-
ship between domestic politics and the design and legalization of international insti-
tutions, very few of these studies present well-developed theories with clear micro-
foundations that establish links between domestic political processes and the design
of international institutions. Instead, many authors simply draw attention to the
possibility that domestic politics and institutions may be relevant to the design and
legalization of international institutions, or offer intuitive conjectures regarding pos-
sible relationships between domestic phenomena and international institutions that
might exist based on other existing scholarship. In particular, there have been very
few attempts to theoretically link domestic politics to variation in governments’ pref-
ences over institutional design and certainly none that focus on how governments
resolve the core legalization trade-off between credibility and policy autonomy. Yet,
as noted above, domestic politics and their effects on governments may hold the key
to explaining variation in the design of legalization in institutions, particularly when
those institutions perform highly similar functions.

Thus, in the next section I aim to improve upon the current state of research
into the relationship between domestic politics and international institutional design

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10 One partial exception is a study by Rosendorff and Milner (2001) in which they argue that uncer-
tainty at the domestic level will lead states to prefer flexible designs in international institutions.
Although the authors do not address legalization directly, to the extent that flexibility can be
interpreted as limiting the constraints that institutions place on government policy, their study
is relevant to the autonomy side of the credibility-autonomy trade-off.
by developing a theory of preference formation over the legalization of international institutions that focuses on the credibility - autonomy trade-off and that stresses the role of various aspects of domestic politics and the manner in which they shape government time horizons. Although the theory is developed here in the context of the design of legalization in BITs, it can potentially explain legalization in other institutional contexts and therefore this chapter’s theoretical contribution is more broad. Indeed, to promote the generalizability of the theory, I develop core parts of the argument in general terms and then apply them to the BITs context.

3.4 Government Preferences Over Legalization

3.4.1 Time Horizons

How do governments resolve the credibility - autonomy trade-off inherent in legalization? I argue that all governments that legalize their commitments through institutions such as BITs seek enhanced credibility and how far they are willing to legalize their BITs depends on how sensitive they are to potentially costly constraints on their policy autonomy. With respect to international investment agreements, Corrales (1999) argues that governments will tailor their agreements in a manner that allows them sufficient policy space to advance their key objective of national development. However, not all investment agreements are tailored in the same way, i.e. not all BITs are legalized to the same degree. Clearly some governments are more concerned about preserving policy space than others and those that place greater importance on policy autonomy will prefer less legalized BIT designs. This raises
the question of what determines government sensitivity to constraints on their policy autonomy. The answer I offer is *government time horizons*.

Several scholars have identified political leaders’ time horizons as a critical factor shaping government policy preferences. Much recent scholarship in this area focuses on how leaders trade off policies that yield short term benefits with those that yield longer term gains. For instance, traditional observers of the political business cycle argue that governments will implement inflationary policies that are damaging in the long run in order to gain support in the short run in the lead up to elections because leaders care only about the short term imperatives of being re-elected (Nordhaus 1975). Others argue that governments will favor policies with short-term payoffs and eschew those with long-term payoffs when their time horizons are short with respect to HIV/AIDS (Dionne 2010), education and technology (Simmons 2008), taxation and revenue (Levi 1988, Olson 1993) and trade openness (Hankla 2006). In the international context, proponents of cooperation theory in international relations have stressed the importance of the shadow of the future and iterated games in helping states to cooperate with one another (Axelrod 1984, Axelrod & Keohane 1986) and have argued that time horizons affect interstate bargaining outcomes (*Bargaining, Enforcement, and International Cooperation* 1998).

There is comparatively little direct investigation of the role of time horizons as an explanatory factor in institutional design. However, government time horizons have been used to critique rationalist/functionalist explanations of institutional design. The leading proponent of this perspective, Paul Pierson (2000), argues that an institution’s long term functioning can rarely explain its design because politicians
have short term horizons and care only for the short term effects of their decisions and not their long-term consequences. Basically, governments are not thinking about the effects of institutions in the long run, although Pierson accepts that if their time horizons are longer, it is more plausible that governments will care about long term effects. Pierson concludes his critique with the following: “the issue of time horizons should be treated as a variable with real implications for questions of institutional origins and change, and therefore as a subject deserving serious study” (483). It is my objective in this chapter to do precisely this, by treating time horizons as a variable and exploring its implications for institutional design.

3.4.2 Time Horizons and International Institutional Legalization

While in a formal, legal sense nation-states create and join international institutions, in a practical sense institutions are designed and created by the governments of the day. Furthermore, because it is governments that must formulate and enact policies, and rely on policy to increase their chances of political survival, governments bear the costs of legal constraints on policy making autonomy. These costs are not entirely paid when a government signs an agreement or joins an institution. Rather, they are paid by governments at moments in the future when they wish to pursue policies that contradict institutional commitments. This means that the governments that design international institutions may face little or no costs related to constrained policy from the institution. Governments will attempt to create institutions that

\[11\] Hathaway (2008) makes a very similar point with respect to states’ decisions to delegate to international courts and institutions.
require them to move very little from their ideal policies and/or current practices (Downs, Rocke & Barsoom 1996). If an institution requires a large change in a state’s behavior and thus carries considerable potential for non-compliance, it is unlikely that the state will join (Hathaway 2007, Von Stein 2008). However, it is possible that in the future circumstances will change causing governments’ preferences over policies to shift in a direction that is incongruent with commitments the state has undertaken in one or more institutions (Koremenos 2005). When this occurs, the constraints on policy autonomy that institutional legalization brings is costly for governments.

I argue that a government’s time horizon is critical to how it assesses the costs of institutional legalization. In political terms, a government’s time horizon is a function of how long into the future it expects to govern. If a government anticipates losing power in the near future with little prospect of returning to power, its time horizon will necessarily be short. In such cases, a government will be less concerned about having to confront changing circumstances and will therefore be less interested in maintaining policy autonomy; whatever costs emerge in the future, they will be paid by future governments. Indeed, a government with a short time horizon may have incentives to design and join international institutions that restrict policy autonomy, provided the behavior prescribed in those institutions closely adheres to the preferences of the government and its supporters.

On the other hand, if a government has a long time horizon and expects to be in power long into the future, it will be wary of the potential for future changes in circumstances to make the constraints on its policy autonomy politically costly. Such
a government will prize maintaining sufficient discretion over its policy toolkit.\footnote{It is important to realize that governments do not value credibility for its own sake. Rather they seek to make credible commitments in order to receive certain political and material benefits that a credible commitment brings. If circumstances change in the future, such that the institution ceases to promote outcomes that are as beneficial politically or materially as originally anticipated, governments would prefer the autonomy to enact policies that allow them to re-capture those gains as much as possible. At a very basic level, if a government makes a commitment through a legalized institution and finds in the future that the commitment does not produce sufficient benefits for its constituents to ensure continued political support, it would prefer to have the autonomy to pursue policies that would allow it to capture that support. An institution with a lower level of legalization provides that autonomy.}

In the context of BITs and FDI, governments seek credible commitments in order to attract investment in the hope that it will increase economic growth and development, promoting the welfare of domestic firms and workers who will respond by increasing their support for the government. However, as noted previously, FDI does not always convey significant benefits to actors and groups in the host state and can harm the interests of some. Thus, FDI’s effects are not guaranteed and host governments may find that political or economic shocks, or more gradual shifts in economic conditions cause FDI to not have the expected positive effects on the local economy. Indeed, shifting economic and political conditions could cause FDI to

\footnote{In their discussion of legalization, Abbott and Snidal (2000) briefly suggest that governments that anticipate staying in power for a long time are less likely to relinquish control over issues than governments with shorter time horizons. However, they do not explain fully why this is so.}
have an unexpectedly negative impact on politically important domestic groups and industries. In this vein, Cho and Dubash (2003) caution that while making credible commitments through international institutions such as BITs help to create a stable policy environment (see also Markusen 2001), it also locks governments into policy commitments and limits their ability to respond to “unforeseen crises or developments”. This also means that governments cannot easily respond to changing political preferences and demands from their citizens which can lead to a drop in support for the government (Cho & Dubash 2003). In such cases, governments will wish to have the greater autonomy found in less legalized BIT designs in order to respond to shifting conditions and demands by their constituents by changing policies in a manner that better channels benefits from FDI to local workers and firms and the economy as a whole.

The potential for circumstances to shift, and therefore the motivation for preserving greater policy autonomy, is considerable in the case of FDI and BITs. Markusen (2001) notes that one of the primary drawbacks of credibly committing to FDI through an institution such as a BIT is that it limits the ease with which governments can “respond to unknown future contingencies, opportunities and crises” (297). Governments cannot be certain how their national economy will perform in the long run, how important domestic producers will fare or what the effect of foreign-owned firms on the local economy will be. FDI is long-term in nature meaning that the full effects of new foreign owned enterprises may not fully reveal themselves for

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13Rosendorff and Milner (2001) make a similar point and highlight the potential for significant shifts to occur in the related areas of trade and exchange rates.
several years and that such effects are potentially dynamic, evolving over time in response to changes in the host country’s economy. It is also important to recall that FDI often occurs in technologically advanced sectors with short product life cycles and that technological change can also result in rapid change in the structure of industries and firms’ modes of operation (Cho & Dubash 2003), and thus ultimately reshape MNEs’ effects on the local economy. As noted in Chapter 2, the effects of FDI on important economic outcomes such as growth and employment are contingent on many factors and all of these factors have the potential to change over time causing the effect of FDI on the host state’s economy to evolve.

The archetypal example of highly legalized provisions in BITs constraining government policy autonomy in the face of changing economic conditions is foreign investment in Argentine public utilities, particularly natural gas. In the early 1990s, several MNEs concluded deals with the Argentine government to supply natural gas to the public according to a dollar based tariff regime in which prices would be adjusted according to the U.S. dollar inflation index. Argentina experienced a severe financial crisis and economic contraction during the 1999-2002 period which forced the government to abandon its fixed exchange rate. The peso devalued rapidly making the dollar based prices of utilities unaffordable for average citizens. As a result, the government transformed its public utilities contracts into national-currency-denominated contracts (UNCTAD 2005c). The government justified this move on the following grounds: “They were instrumented through legislative acts of general scope, non-discriminatory, and therefore applicable to both Argentine and foreign nationals without any distinction. They are temporary in nature and oriented at the
protection of public welfare interests, with a view to normalize the life of the country, to guarantee the continuity of public utilities and to keep rates for customers at an affordable level” (quoted in UNCTAD 2005c, 71).

While the Argentine government was concerned with maintaining public welfare in a time of crisis, affected MNEs were concerned with the dramatic fall in profits they experienced as a result of the abrogation of the dollar based tariff regime and brought a series of claims against Argentina, making Argentina the leading defendant in cases of investor-state arbitration. Despite Argentina’s attempts to claim the measures were a necessary response to a public emergency, several tribunals have found in favor of the MNE claimants. For instance, with respect to natural gas, tribunals have ruled that “the changes Argentina made to its gas regime in the early 2000s to address severe economic conditions breached the fair and equitable treatment guarantee [in its BITs], because the changes destroyed the stability and predictability of the regulatory regime governing the gas sector” (Newcombe & Paradell 2009, 286).

The Argentine case illustrates that shifts in economic conditions can greatly alter the effect of MNEs on the host state’s economy and that BITs can limit host governments’ abilities to respond to these shifts and effectively shape the domestic impact of FDI. If governments choose to break the shackles imposed by BITs, they will, like Argentina, find themselves in court and forced to pay costly arbitration fees and possibly compensation to aggrieved MNEs. A total of 37 cases claiming over 17 billion dollars in compensation have been brought against Argentina in response to
emergency measures it adopted following the financial crisis (Cho & Dubash 2003). Such sums are not insignificant for a country emerging from a severe financial crisis.

The Argentine experience illustrates why a government should approach high levels of legalization with caution and why it should desire to preserve some form of policy autonomy to respond to changing conditions. I argue that this desire for autonomy is markedly stronger in governments with longer time horizons because the longer into the future a government is in power, the more likely it is that economic and political shocks, or more gradual economic changes, will alter the effects of FDI on the domestic economy in an undesirable direction. Governments with short time horizons on the other hand will have much less concern for preserving policy autonomy with respect to matters covered by BITs because they do not expect to be in office in the future, managing the economy and foreign investment whilst under the constraints of the BITs they have signed. Thus, governments with longer time horizons have incentives to scale back the degree of legalization in BITs.

This argument linking time horizons to concerns over constraints on policy autonomy has the potential to inform existing scholarship on the determinants of international institutional design. First, by allowing time horizons to vary, I illustrate one way of accounting for Pierson’s (2000) critique that rationalist explanations of institutional design (falsely) assume that governments design institutions with a view to the long term. Second, the argument I develop introduces a potential qualification to the argument, forwarded by several scholars, that when states face

14The claims estimate include only those that have been made public, many are not.
uncertainty, they will prefer more flexible institutional designs (Koremenos, Lipson & Snidal 2001, Koremenos 2005, Rosendorff & Milner 2001, Koremenos 2001). Flexibility in international institutions can take several forms, but to the extent that institutions are flexible because they allow governments greater discretion over policy, governments are more likely to create flexible institutions in response to uncertainty when they have long time horizons. This is because governments with long time horizons will be more concerned about confronting unexpected outcomes and behavior as they anticipate being in power in the future when such unexpected events occur. Governments with shorter time horizons will not be as concerned with uncertainty as they do not anticipate being in power and needing to respond to unexpected events. Thus, the link between uncertainty and flexibility is more likely to hold when governments have longer time horizons, than when governments’ time horizons are short.\textsuperscript{15}

3.4.3 Time Horizons, Credible Commitment & Reputation

One may argue that in the preceding discussion I have ignored the fact that the issue of time horizons is integral to any credible commitment problem, independent of institutional solutions to that problem. Such an argument would posit that time-inconsistent preferences exist only when governments have short term horizons. This is because governments expect some benefit from committing (otherwise they would

\textsuperscript{15}Rosendorff and Milner (2001) have suggested that the impact of uncertainty is not fixed and can vary across issue area, and when that impact is limited, states will be less concerned about building in flexibility into institutions. Here I am arguing the “impact of uncertainty” on governments’ design preferences varies with their time horizons.
not attempt to do so) and governments that fail to adhere to their commitments suffer reputation costs and will be unable to persuade other actors in the future that their commitments are credible. Thus, opportunistic behavior in the present leads to the sacrifice of the gains from successfully committing in the long run. As only governments with long time horizons are likely to care about the long run and about their reputations (Pierson 2000), the credible commitment problem is much more severe with governments that have short time horizons. In the case of BITs, a government with a long time horizon will anticipate interacting with MNEs over many years in the future and will therefore be wary of violating commitments to MNEs in the present, lest it acquire a reputation as an untrustworthy host which deters foreign investors in the future (see Markusen 2001, Li 2006a, Guzman 1998). The corollary of such an argument is that governments with long time horizons will not sign highly legalized BITs because their credibility challenge is smaller, whereas governments with short time horizons will seek more legalized BITs in an effort to overcome their greater credibility burden. Thus, it is not sensitivity to constraints on policy autonomy, but rather the need for greater credibility that explains why governments with shorter time horizons might conclude more legalized BITs.

16 It could be argued that it is precisely because scholars perceive politicians and leaders as short-sighted (e.g. North 1995, Pierson 2000) that the credible commitment problem has found significant traction in political science over the last two decades.

17 In a similar vein, Thomas and Worrall (1994) suggest host governments and MNEs should construct contracts in which benefits accrue to the host over time, thus providing an incentive for the host government to value continued interaction with the MNE in the future and to therefore wish to refrain from expropriating its assets in the present.
While this argument is certainly plausible, it suffers from a number of shortcomings. First, one of the key ways that international institutions, and BITs in particular, help governments make credible commitments is by raising the reputation costs of commitment violations. It is not a straightforward transition from host government policy changes that adversely effect some MNEs to a bad reputation. The arbitration measures approved by BITs help build and destroy government reputations by sending clear and objectives signals to the MNE community about the host government’s behavior (see Allee & Peinhardt 2008b). Thus, absent BITs, reputation based incentives for compliance with commitments are not likely to sufficiently persuade foreign investors that governments will abide by their commitments.

Second, for reputation preservation concerns to be a sufficient solution to the credible commitment problem, a reputation must be sufficiently valuable. In the case of BITs, the continued inflow of FDI must be valuable enough to host governments that they would wish not to risk deterring further inflows or prompt FDI outflows by reneging on policy commitments made to MNEs and developing a bad reputation. Guzman (1998) makes this point succinctly arguing with respect to contract breach and expropriation that “when the host country considers the reputational effect of its actions, it will weigh the gains from breaching its agreement with the [foreign] firm against any lost benefits caused by...the effect of the action on its reputation. A priori, there is no reason to think that this balancing establishes and efficient set of incentives for the host [to deter breaking of contracts with MNEs]” (665). Indeed, support for this position comes from the discussion in Chapter 2 that noted that the net effects of FDI need not be large or even positive, and FDI can have unpopular
distributional effects. Why should a government with a long time horizon be willing to live with an unsatisfactory return from FDI for the sake of being credible? The question then is, “credibility for what?”

A government with a long time horizon arguably has a strong incentive to see that FDI generates positive spillovers and effects on the host economy in the long-run. If the current policy environment does not facilitate this, it makes more sense to shift that environment, possibly at the cost of some lost inward FDI, than to pursue credibility for its own sake. This logic also extends to governments wanting to respond to changing circumstances to ensure that FDI has a positive effect on the host economy. The Argentine government’s response to the financial crisis is illustrative. The government had a choice between engaging in indirect expropriation by restructuring contracts for public utilities and risking damage to its reputation, or allowing its citizens and local businesses to be unable to afford basic utilities while keeping its reputation with MNEs in tact. The government clearly saw that maintaining FDI while upholding the contracts was deeply damaging for the economy and therefore decided to unilaterally restructure them. Thus, a long time horizon may often not be sufficient to make a government’s concern for its reputation override other incentives it may have to break commitments to policies that affect foreign investors.  

Third, one of the sources of time-inconsistency of government policy preferences

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18 It is worth noting that while Jensen (2003) argues that governments that renge on commitments to MNEs will suffer domestic audience costs, he does not deny that reneging on commitments to FDI may be politically beneficial. This is because FDI does not always generate the expected benefits for a governments’ supporters and when this is so governments will seek to restructure their commitments to investors so that greater benefits can be extracted from MNEs’ activities.
is government turnover; new governing coalitions may have different preferences to their predecessors (Hathaway 2008). Just as different governments may have different policy preferences, so too may their time horizons vary. Therefore, even if FDI is attracted to governments with longer time horizons and a greater concern for their reputations, government turnover may result in a new government with a short time horizon. The long term nature of FDI means that investors need to consider the possibility that future governments with short time horizons may emerge, and thus the time horizon of the present incumbent may not be sufficient to make promises of a secure and profitable investment climate credible in the long run. Thus, one should not assume that reputation concerns alone make commitments by governments with long time horizons more credible thereby allowing them to sign less legalized BITs.

For the reasons stated above, long time horizons are not likely to be a sufficient source of credibility, and therefore highly legalized BITs are likely to be of value to governments with both long and short time horizons as they can raise not only reputation costs of violating commitments, but also audience and material costs. The Argentine case serves to illustrate the added benefit of BITs. Admittedly, Argentina’s BITs did not prevent its government from breaking its contractual and exchange rate policy commitments. However, the BITs prevented Argentina from breaking its commitment to provide prompt and effective compensation if it violated the rights of foreign investors by allowing investors affected by the emergency measures pertaining to utilities to take the government to independent international arbitration.
3.5 Domestic Politics & Time Horizons

Earlier, I defined a government’s time horizon as “how long into the future it expects to be in power”. This definition is admittedly broad and abstract and therefore, in this section, I draw on the literature to provide a more grounded discussion of time horizons. This discussion is the basis for how I empirically measure time horizons in the chapters that follow.

An incumbent government’s expectations of being in power in the future is shaped significantly by the institutions within which it competes for power. Therefore, the nature of time horizons and the factors that shape them are necessarily different in democratic and autocratic systems. Accordingly, I treat democratic and autocratic governments’ time horizons separately.

3.5.1 Democratic Time Horizons

In ascertaining a democratic government’s time horizon there is good reason to focus on parties, rather than individual leaders. This is because in most democracies political competition is centered around elections, which are typically contested by political parties. Candidates are almost always affiliated with a party and political parties often outlive the political careers of their individual members. Parties are also important because they shape the actions and policies of their elected representatives. Through political parties, elected officials from the same party have common policy platforms that are negotiated and agreed upon by party operatives. Thus, government policy preferences in democracies are, to a significant extent, the preferences of parties (as opposed to individuals) in government. It follows that the
time horizon of the parties in government is the critical component of a democratic
governments’ time horizon.

How do party time horizons vary? It is tempting to argue that electoral cycles are
critical in shaping parties’ time horizons and that incumbent parties’ time horizons
shorten as elections approach and the possibility of being removed from power draws
near. However, the regularized nature of elections in democracies often leads to the
 reappearance of familiar faces. Parties in governments that lose power frequently
find a role in opposition, live to fight another day, and potentially return to power
in the future. Consequently, one should expect that political party members will
have some incentive to think beyond the next election and consider the long-term
implications of their decisions when in government for their ability to compete for
office and govern successfully in the future.

However, the extent to which this expectation holds is a function of political
parties’ institutionalization (Simmons 2008). Highly institutionalized parties are
those that are widely regarded as legitimate and effective organizations with roots in
society and that are capable of recruiting members and placing them in positions of
power (Mainwaring 1999). Highly institutionalized parties are long-lasting and bear
the characteristics of overlapping generations (OLG) organizations (Simmons 2008).
Such organizations contain multiple generations of individuals among which the most
senior cohorts are nearing the end of their careers and thus have very short time
horizons. Such short time horizons create strong incentives for those cohorts to
take decisions that may be in their own private interest, but not in the interest of
the younger cohorts or the organization as a whole. As the costs of such behavior
are borne by the younger cohorts, they offer various forms of support and bribes to senior cohorts to deter them from taking such decisions that will adversely affect them (Alesina & Spear 1988, Soskice, Bates & Epstein 1992, Bates & Shepsle 1997). Thus, within an OLG organization, there are always younger cohorts that have an interest in the long term consequences of decisions that are taken by the organization and are willing to work to have that interest taken into account. This causes decisions to be made with a view to long-term effects and consequences, and thus on the basis of a longer time horizon. As highly institutionalized parties are typically OLG organizations composed of multiple generations of cohorts, it follows that they will have long time horizons. Weakly institutionalized parties on the other hand will often be short-lived and will struggle to recruit younger cohorts, shortening their time horizons.

Another perspective linking party institutionalization and time horizons is offered by Hankla (2006). As noted above, highly institutionalized parties possess roots in society and effective organization which translates into have a stable base of support, or core constituency. Hankla argues that parties that possess such reliable bases of support will have longer time horizons because they do not have to worry about cobbled together support at each election from diverse groups through short-term electoral promises. Therefore they can plan for the long term.

### 3.5.2 Autocratic Time Horizons

Compared to democracies, formal opportunities for removing sitting governments are typically much more limited in autocracies, where the process of leadership selection
is closed and less frequent. This means that autocratic governments seldom have a realistic chance of regaining power once they have been removed, or removed themselves, from power. This is most clearly the case in personalist regimes which die out with the removal of the leader in whom power is concentrated (Geddes 1999). If a state transitions into democracy following the fall of an autocratic regime, the outgoing regime will face a very strong challenge to return to power through the ballot box given that it now must openly compete with opposition forces and is no longer able to rely on the same political tools to garner support that it had in the past as an autocratic government. If removal of the incumbent regime is not followed by a democratic transition, then the regime is replaced by another autocratic regime and the closed nature of political competition in autocracies mean that its members are unable to compete effectively for access to political power. Thus when an autocratic government falls, it is in most cases the end of its members’ effective participation in domestic government. It follows that an autocratic governments’ time horizon will be closely aligned with its assessment of its likelihood of being removed from power. When an autocratic government perceives that its hold on power has begun to weaken irreversibly its time horizon contracts severely. This is why when the end of an autocratic regime approaches, its leaders often seek to secure personal wealth, move it abroad and then flee the country (Wright 2008b).

Some scholars have argued that the early years of autocratic rule are typically

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19 Autocratic governments are typically removed from power not by elections but by force, or the threat of force, or they choose to resign from power themselves.

20 This approach to approximating an autocratic government time horizon follows Levi’s (1988, 33) assertion that the principal determinant of a ruler’s time horizon is “security of office”.

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less secure and therefore time horizons lengthen for autocrats the longer they stay in power (e.g. Clague, Keefer, Knack & Olson 1996). This approach makes the potentially erroneous assumption that all autocrats face the same (short) time horizon in their early years (Wright 2008b). It is likely, for instance, that new autocratic leaders of popular independence movements, well-established monarchies, and strong single-party states will feel more secure and have longer time horizons than a military leader that has taken power by force and has no established infrastructure for rule and governance and/or lacks popular support (Wright 2008b). Moreover, when autocratic regimes begin to weaken and their hold on power appears increasingly untenable, their time horizons will be shorter than at other times during their stay in power and their policy behavior will alter accordingly (Wright 2008b).

To more accurately tap into autocrats’ time horizons it is important to identify factors that increase or diminish the likelihood of leadership survival and use those to proxy for a leader’s time horizons (Wright 2008b). Extant scholarship has identified a series of institutional and economic variables that influence the likelihood of autocratic survival. Gandhi and Przeworski (2007) find that autocratic leaders with legislatures survive longer as they are able to use legislatures to diffuse opposition pressure and co-opt opponents, giving them a stake in the leadership’s survival. Przeworski et al. (2000) also find that institutionalized autocracies, those possessing legislatures, are associated with long leadership tenure. Wright (2008a) has similarly argued that legislatures in authoritarian regimes can be a vehicle for the leadership to bribe and split opponents and weaken any opposition. However, this only applies to nonbinding legislatures in regimes that are dependent on resource revenue.
Scholars have also drawn a link between the type of authoritarian regime and the likelihood of regime survival, finding that military dictatorships experience shorter tenures while single-party states are likely to endure for longer than other types of authoritarian systems (Geddes 1999, Wright 2008b). Geddes argues that military dictatorships are more short-lived because middle and lower ranking military officers are reluctant to participate in intra-regime factionalism and readily “return to the barracks” when open disagreement emerges rather than attempt to keep the military in power. On the other hand, single-party regimes are more long-lasting as party members are sufficiently rewarded by the parties rule for party factions to keep disagreements “in-house” and ensure the continuity of party rule. Studies have also shown that economic performance is an important determinant of autocratic regime survival, regardless of its type (Geddes 1999, Wright 2008b).

If we assume that autocratic leaders are sensitive to the vulnerability of their regimes to collapse, this knowledge of the institutional and environmental factors that affect regime survival can provide was with some insight into autocratic governments’ time horizons. This is possible if we use the probability of regime survival as a proxy for time horizons and posit that autocratic leaders’ time horizons will be longer when their regime possesses the institutional characteristics associated with lower probabilities of regime failure. In contrast, if a regime possesses those characteristics associated positively with regime collapse, we can infer that its leaders will have shorter time horizons. This reasoning would allow one to assert, for example, that
because military dictatorships are more short-lived than single-party regimes, the former will have shorter time horizons than the latter, all else equal.\footnote{Such an approach is taken by Wright (2008\textit{b}) in his study of the effect of autocratic time horizons on aid effectiveness.}

### 3.6 Hypotheses

My argument in summary is as follows. Governments’ preferences over the legalization of BITs are a function of how sensitive they are to constraints imposed on their policy autonomy by higher levels of legalization. Governments that have longer time horizons will prize policy autonomy to a greater degree because they are wary of the potential for changes to occur in political and economic conditions that will reshape the economic, political, social and environmental effects of FDI, and they wish to preserve sufficient policy autonomy to respond effectively to those changes.

In light of the preceding discussion of how greater legalization constrains policy autonomy, and how democratic and autocratic governments’ time horizons form, the main hypotheses emerging from the argument with respect to BITs are:

**Hypothesis 1**: Governments with longer time horizon will conclude less legalized BITs.

- **Hypothesis 1a**: Autocratic governments with a secure hold on power will conclude less legalized BITs.
- **Hypothesis 1b**: Democratic governments led by a highly institutionalized party will conclude less legalized BITs.
It is important to note that while the hypotheses presented here address legalization as a whole, how they apply to each of the three components of legalization I address in the chapters that follow may be quite complex. One must always bear in mind that what links together governments’ time horizons to their preferences over legalization is concerns over policy autonomy. While in most cases greater obligation, delegation and precision are each associated with greater constraints on policy autonomy, the extent to which this is the case may depend on how the three dimensions of legalization interact with one another in practice. In particular, in Chapter 6 I illustrate how the legalization of delegation has different implications for whether or not greater precision magnifies or diminishes constraints on policy. To be clear, I do not suggest that no relationship exists between each dimension of legalization and policy autonomy. Instead, I caution that the nature of that relationship with respect to a particular aspect of legalization may depend on design decisions made with respect to other legalization features. That design decisions over different aspects of institutions may be related should not be surprising for it is unlikely that institutional designers treat each dimension of legalization in a vacuum. Interestingly, most studies of legalization pay little theoretical or empirical attention to how different dimensions of legalization may be related. In an effort avoid making the same mistake here, and to stress once more the importance of the constraints on policy autonomy generated by institutional design in framing governments institutional preferences, I introduce a second hypothesis:

**Hypothesis 2**: The expectations regarding the level of legalization in Hypothesis 1 will be reversed in the case of a particular dimension of legalization if design
choices made with respect to other dimensions of legalization cause a lower level of legalization of the dimension in question to impose greater constraints on governments’ policy autonomy than higher levels of legalization.

3.6.1 The Functionalist Alternative: Needing Credibility

An alternative explanation for the legalization of international commitments is the purely functionalist one: greater legalization of obligations is more likely to be employed when governments suffer from a lack of credibility and therefore seek BIT designs that effect the greatest marginal increase in credibility. A version of this argument was acknowledged above with respect to time horizons in particular and the notion that reputation concerns mean that governments with long time horizons have less need for the credibility enhancing effects of highly legalized BITs.

While this is a plausible argument, there is reason to be skeptical that the need to fill the credibility gap explains all of the variation in BIT legalization. First, governments that perceive they do not suffer from a lack of credibility in the eyes of MNEs do not need to sign an investment agreement and many dyads have not signed a BIT. Therefore, I posit that states that do sign BITs share similarly strong preferences for making their commitments more credible or similarly perceive they suffer from a credibility shortfall. After all, why should states give up their policy autonomy through BITs if they are able to convince MNEs of the credibility of their commitments without a BIT? Second, the desire to achieve greater credibility does not necessarily cancel out the concerns governments will have about policy autonomy that I have highlighted so far. I reiterate a point made earlier, which is
that governments seek credibility gains not for their own sake, or simply to attract FDI, but to attract investment that promotes the welfare of their own citizens and key economic groups. If a government suffers from low credibility, then signing a BIT with a lower level of legalization is likely to effect a marked increase in its credibility because even less legalized BITs help make commitments more credible than the absence of a BIT. So a government can still reap the credibility gains from a BIT without necessarily maximizing that gain and its reason for not seeking the maximum level of credibility would be, I argue, a concern for maintaining policy autonomy. Nevertheless, I endeavor to control for the “need” for credibility in the empirical analysis that follows by including the number of domestic institutional constraints on the executive - a variable often associated with a government’s ability to make credible commitments - as a control variable in my statistical tests.

3.6.2 Alternative BIT Logics

The discussion so far has stressed the credible commitment role that BITs play, and has assumed that governments sign BITs in order to gain credibility in the eyes of MNEs. In the growing literature on BITs, two other logics have be suggested for signing investment treaties. The first is that BITs can serve as a signal to investors that a country possesses a friendly investment environment because its government is willing to tie its hands (UNCTAD 2005b). The signal applies not only to investors from a BIT partner but also more broadly to investors from countries who are not protected by a BIT with the host state in question (Neumayer & Spess 2005, Tobin &
Rose-Ackerman 2005). One could argue, therefore, that governments seeking to send a strong signal will seek highly legalized, and therefore highly constraining, BITs.

The problems with the “BITs as signals” argument are twofold. First, as Kerner (2009) points out, if an investor is not protected by a BIT, it does not benefit from the same tying hands protections that those investors protected by BITs receive. Thus, it is unclear what the signaling value is to unprotected investors. Second, the signaling value of a BIT for those investors protected by it is derived entirely from the ex post costs it generates as a credible commitment device and therefore there is no signaling effect independent of the BIT’s credible commitment capacity. Kerner suggests that BITs may have an independent signaling effect by generating sunk costs for governments. While admitting that BITs have typically “held a low profile for much of their history” (80), he suggests signing BITs has become increasingly costly due to political opposition. His main evidence for growing political obstacles are development non-governmental organizations (NGOs) and groups associated with the “anti-globalization” movement’s opposition to stringent BITs, and domestic groups’ objections in Australia and South Korea to certain investment provisions in their preferential trading agreements with the U.S.

The first thing to be noted is that much of this protest is occurring in developed countries and there is little, if any, evidence of governments in developing countries facing strong domestic resistance to signing BITs.\footnote{It is worth noting in this regard that as of 2005, developing and transition countries were one or both parties to 92 percent of BITs.} Considering that it is developing countries that are typically regarded as possessing weak property rights and in more
need of BIT protections to attract FDI, the signaling value of BITs is therefore still highly limited. Furthermore, government turnover diminishes the effect of signaling. Costly signals are designed to reveal an actor’s type, and BITs may reveal the type of the government that signs the agreement but not necessarily the governments that succeed it because those governments have not incurred the costs associated with BIT signing. Third, development and anti-globalization NGOs are seldom an important domestic constituency that governments wish to avoid upsetting as they are small in membership and typically possess few resources to reward governments that do their bidding. Thus, BITs can be best viewed as commitment, rather than signaling devices.

A further alternative logic for BITs is that governments perceive them as treaties that help strengthen political ties and are symbols of goodwill and friendship between nations, and that any attendant increases in FDI are simply a bonus. While there may be cases of BITs created for mainly diplomatic purposes, in truth, there is little systematic evidence to indicate this is a widespread phenomenon. It could be argued that BITs between developing countries are examples of symbolic agreements and driven by cultural and political affinities rather than the prospect of investment flows being increased and protected (Jandhyala, Henisz & Mansfield 2007). However, there is strong evidence to suggest that many of the BITs between developing countries reflect the growth in FDI exports from countries in the South and that these “South-South BITs” map onto patterns of FDI flows between developing countries (UNCTAD 2005b).23

23For a discussion of growing FDI between countries in the South see Aykut and Ratha (2004).
These reservations regarding diplomatic and signaling motivations for signing a BIT notwithstanding, the argument laid out above is not incompatible with either of these alternative perspectives. This is because regardless of the motivations for signing a BIT, governments face a design choice when deciding how legalized the BIT should be and those with longer time horizons will be more concerned about the constraints on policy autonomy imposed by greater legalization. Thus, even if a government is tempted to signal its investment friendly credentials with a highly legalized BIT, if its time horizon is long, it will still be reluctant to do so because of the long term consequences for policy autonomy.

3.6.3 Host States and Home States

BITs are frequently signed by states that have asymmetric FDI flows. Often one BIT partner is a developed and/or large economy that exports a significant amount of FDI while the other is a smaller economy that exports less FDI. It is common to refer to the principal FDI exporter in the relationship as the “home” state and the net importer as a the “host” state (e.g. Guzman 1998, Allee & Peinhardt 2010). Therefore, although the majority of BIT provisions are reciprocal, applying equally to both parties, one might wonder if the asymmetric nature of FDI flows causes host and home states to approach treaty design differently.

24 The host-home distinction is dyad specific. The same country can be a host in one dyad and a home state in another depending on whether it is more likely to be a net importer or exporter of dyadic FDI.

25 This is certainly the perspective adopted by Allee and Peinhardt (2010) in their study of delegation in BITs.
The answer is: to some extent. The potential constraints on policy autonomy imposed by legalization are likely to increase in salience with the amount of FDI that one receives from one’s treaty partner. The more FDI a state receives, the greater its impact on the host economy and the more incentive that governments will have to regulate its effects. Thus, as the host state is likely to receive more FDI from its BIT partner than it exports, it will feel the impact of BIT legalization on its policy autonomy to a greater degree. The home state government, in contrast, anticipates less FDI flows from the host and therefore expects fewer constraints on its policy autonomy as a result of greater legalization.

However, it is important not to overstate the absence of constraint on home state policy autonomy. As noted above, many developing countries are increasingly active as exporters of FDI and this increase in outward FDI has coincided with the surge in the number of BITs experienced in the mid 1990s and early 2000s (see Figure 2.2). Moreover, countries that export significant volumes of FDI and are almost always home states in their BITs such as the U.S., Canada, Chile, Spain, Germany, France and the U.K. have found themselves defendants before international arbitration in cases brought by MNEs under dispute settlement clauses in BITs or NAFTA’s investment chapter (UNCTAD 2005a). Thus, it would be misleading to suggest that governments in home states won’t find some of their preferred policies coming into conflict with their investment treaty commitments. Moreover, the time horizons argument I present above fits with the home state’s perspective on the asymmetric nature of investment relations between itself and the host state. When a treaty is signed the home state may receive little FDI from the host state. However,
a home state government with a longer time horizon will be wary of the potential for the host’s FDI exporting capacity to develop in the future, as has happened for many developing countries in the past two decades (UNCTAD 2005b). Thus, one possible area where conditions can change in the future that home state governments with long time horizons would in particular pay attention to would be the potential for less developed treaty partners to develop and become significant exporters of FDI.

A potential further distinction between host and home states is raised by Sornarajah (2004) and others who suggest that as net exporters of dyadic FDI, home state governments have an interest in protecting the interests of their investors abroad. As greater legalization deters violations of commitments to investors, this is likely to lead home state governments to be more amenable to greater legalization.

As the asymmetric nature of FDI flows between BIT partners does cause host states and home states to approach BITs from slightly different perspectives, it affects how I expect the hypotheses to apply to home and host state governments. Both types of BIT partners will potentially receive FDI and therefore both host and home governments with longer time horizons are likely to prefer less legalized BITs in order to preserve policy autonomy. However, this preference is likely to be milder in the case of home states because they will be more accepting of greater legalization as it protects their investors abroad and home states will expect to receive comparatively less FDI than host states, thus attenuating the constraints on policy that high legalization effects. Therefore, I expect the relationship outlined above between time horizons and BIT legalization to apply more strongly for host states than home states.
3.7 Conclusion

In this chapter, I have outlined the dissertation’s main theoretical argument in which I seek to explain variation in the legalization of BITs by illustrating how governments’ time horizons shape their preferences over the degree of legalization. While the discussion has focused on BITs, the argument linking time horizons to institutional design preferences is potentially applicable to any case or dimension of institutional design that creates constraints on policy autonomy that governments may find politically costly. Indeed, the presence of potentially significant and unavoidable costs in this respect is an important scope condition for the theory. If the costs of policy constraints can be avoided through withdrawal from the institution, for instance, then governments with long time horizons will be less concerned about preserving policy autonomy in an institution’s design. Several studies have suggested that governments will seek greater flexibility in institutional designs to make those institutions durable in the face of uncertainty, particularly when governments face uncertainty regarding demands from domestic constituents (Rosendorff & Milner 2001, Koremenos 2005). The implicit assumption in this view is that if adhering to institutional commitments becomes too costly, governments will seek to avoid them by reneging on those commitments and withdrawing from the institution.

What if states are unable to withdraw from institutional commitments easily or without considerable cost? For example, governments cannot easily or costlessly abandon their BIT obligations. This is because most BITs have binding dispute resolution mechanisms that authorize international arbitrators to award investors
compensation if government policy is found to be inconsistent with treaty and con-
tractual obligations. And even if states wish to withdraw, BITs typically allow their
 treaty commitments to remain in force for a decade or longer after the treaty is
abrogated. In such cases, governments will be held to their commitments and will
pay the political costs of being unable to adjust their policies to shifting circum-
stances. Consequently, governments, particularly those with long time horizons, will
take care to select institutional designs that preserve greater policy autonomy. Their
motivation for doing so will not necessarily be promoting institutional durability, but
avoiding the loss of political support that comes with being unable to adapt policies
with changing times or to withdraw easily and costlessly from policy commitments.

In the next three chapters, I turn to empirical evaluation of the argument pre-
sented here. Many extant studies of international institutional design and legaliza-
tion, and particularly those that consider the role played by domestic politics in the
design process, are empirically limited. Some focus on surveying the literature, con-
ceptual clarification or identifying potentially fruitful paths of research and therefore
are not concerned with systematic empirical analysis. Other studies simply mention
a handful of examples to support conjectures they offer regarding possible relation-
ships between domestic politics and international institutions. Many of those studies
that do attempt a detailed empirical evaluation of posited theoretical relationships
limit their evidence to a single case or handful of cases.\footnote{26} Moreover, associated with

\footnote{26}Although there are notable exceptions, this has been a shortcoming of many contributions to the
rational design of institutions research program in particular (Thompson 2010).
these limited empirical strategies is a consistent lack of precise measurement of concepts with authors often preferring to simply assert that certain design features are typically absent or present in certain circumstances, or positing differences in degree of those features, without establishing systematic rules for measurement or justifying case selection.\footnote{27}

In the chapters that follow, I attempt to improve upon the current state of much empirical research into international institutional design and legalization. I use original data on a large sample of BITs and undertake rigorous empirical tests of the argument presented here on all three components of legalization - delegation, precision and obligation. This original data was compiled using systematic coding rules and the measures used in the empirical analyses are explained and justified. Finally, the quantitative techniques that I employ allow me to control for alternative explanations of BIT legalization and to control for factors such as selection into treaties.

\footnote{27There are noteworthy and empirically rigorous exceptions to these general trends (e.g. Smith 2000, Haftel & Thompson 2006).}
CHAPTER 4
OBLIGATION: LEGALIZATION OF NATIONAL TREATMENT PROVISIONS IN BITS

4.1 Introduction

When states sign a bilateral investment treaty (BIT), they undertake a series of legalized obligations to abide by certain standards of treatment of foreign investors. However, the degree of legalization of these obligations across the universe of BITs is not uniform. Focusing on national treatment provisions - the commitment to treat foreign investors at least as well as local investors - this chapter investigates the extent to which variation in the degree of legalization of obligations across BITs can be explained by differences in the time horizons of the governments that sign them.

To this end, the empirical analysis in the chapter meets several objectives. Firstly, a detailed account is given of how the legalization of obligation varies across BITs. In this regard, I argue that while BIT obligations are typically highly legalized, the degree of legalization of certain provisions is frequently softened through the use of contingencies, carve outs, and reservations.
Secondly, I show that the theoretical argument developed in Chapter 3 can be applied to national treatment obligations in BITs. In doing so, I illustrate how greater legalization of obligation in national treatment commitments creates a credibility - autonomy trade-off for governments. Specifically, greater legalization of national treatment commitments through the inclusion of fewer policy carve outs makes commitments to afford foreign investors equal or better treatment than local investors credible. However, greater legalization also limits the scope of issues in which governments can introduce policies that privilege domestic investors over foreign-owned enterprises. Such constraints can be costly to governments because policies that involve differential treatment of foreign and local firms can be important tools in the pursuit of economic and social objectives as well as helping maintain the competitiveness and survival, and thereby the political support of, important domestic firms and industries.

Thirdly, I develop original quantitative measures of the degree of legalization of national treatment obligations in a random sample of 346 BITs. These measures reveal significant variation in the legalization of national treatment obligations, indicating that governments resolve the credibility - autonomy trade-off differently with respect to national treatment. I use these measures to evaluate how well the time horizons argument developed in the previous chapter explain this variation. Using the probability of regime failure and party age as measures of time horizons for autocratic and democratic states respectively, I find that host state governments with long time horizons conclude BITs with less legalized national treatment obligations than governments with short time horizons. Moreover, this relationship holds across
autocratic and democratic host states, and is robust to controlling for governments’ “need” for credibility and selection into BITs, as well as a range of other covariates. These results lend credence to the argument that governments with long time horizons are more concerned about preserving autonomous control over policies that matter to their political survival and therefore prefer less legalized BIT provisions.

4.2 Obligation in Investment Treaties

4.2.1 Obligation

When states choose to legalize their commitments to one another they undertake a legal obligation. Legal obligations are often binding and differ from obligations that are based on coercion, comity or morality as they engage a distinct set of norms and procedures that are unique to the international legal system (Abbott et al. 2000). Importantly, an international legal obligation undertaken in a treaty or formal legal agreement invokes the principle of *pacta sunt servanda*, meaning that states are bound legally to comply with their treaty commitments even in the face of shifting circumstances, preferences and governing coalitions. Furthermore, legalization of commitments has the capacity to modify the nature of debates about state policy and behavior, shifting focus partly away from state interests and power towards legal interpretations of the appropriateness of state conduct in light of the word and spirit of those commitments (Abbott et al. 2000). In particular, when obligations are expressed in legally binding terms, they allow states, or other actors, to assert legal claims and resort to legal remedies in cases where non-compliance with obligations
is perceived. In this regard, the texts of international legal agreements and treaties take on considerable importance.

International legal instruments vary widely in the degree of obligation they impose on states. At the high legalization end of the spectrum, international treaties contain legally binding commitments that are expressed in unconditional terms, without reservation. At the other end are international agreements which contain commitments that are explicitly non-binding on states. While there exist many ways in which states can vary the degree of legal obligation, one of the most common is to word the text of a legally binding agreement such that its obligatory force is circumscribed to some degree. In general, this is most commonly done through making obligations contingent, including escape clauses or allowing for states to file reservations (Abbott et al. 2000). A useful scale of indicators of the degree of legal obligation, adapted from Abbott et al., is presented in Table 4.1.

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<tr>
<th>High</th>
<th>1 Unconditional obligation; explicit intention of legal obligation</th>
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<tr>
<td></td>
<td>2 Political treaty: implicit conditions on obligation</td>
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<td></td>
<td>3 National reservations on specific obligations;</td>
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<tr>
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<td>contingent obligations and escape clauses</td>
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<tr>
<td></td>
<td>4 Hortatory obligations</td>
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<td>5 Norms adopted without law-making authority; recommendations</td>
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<td>and guidelines</td>
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<td>6 Explicit negation of intent to be legally bound</td>
</tr>
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| Low  | 104 |

4.2.2 Legal Obligation in BITs

Bilateral investment treaties (BITs) are international agreements consisting of legally binding obligations (McLachlan, Shore & Weiniger 2007, Salacuse 1990). Testament to their legal character is the fact that they almost always include provisions for a legal solution to disagreements over the interpretation of treaty commitments, whether those disagreements occur between treaty parties, or between treaty parties and private investors (Sornarajah 2004). However, the legal character of BITs notwithstanding, many treaty drafters find ways to limit the scope and legalization of states’ obligations and build in greater policy autonomy.

For example, many treaties include “carve outs” and reservations (Dolzer & Schreuer 2008, UNCTAD 2006). A carve out exists when both treaty partners choose to exempt certain activities or categories of phenomena from their treaty obligations. Carve outs in BITs typically involve exempting certain classes of government policy, such as acts taken in the interests of national security and public order, protection of health or the environment (Rubins & Kinsella 2005). The BIT between Japan and Vietnam provides a particularly comprehensive example of this as it carves out policy measures related to the environment, security, public order and health from the entire treaty.\footnote{Article 15, Japan - Vietnam BIT.} A reservation is similar in character to a carve out except the exemptions only apply to one of the treaty signatories. Reservations are more likely to be used than carve outs to exclude particular geographical areas.
or sectors of a state’s economy from part, or all, of an investment treaty’s obligations (UNCTAD 2006). For example, in the BIT between Finland and Lebanon, the treatment accorded to investments in Lebanon by Arab investors in real estate are exempt from Lebanon’s BIT commitments to afford Finnish investors national and most-favored nation treatment. \(^2\)

In addition to carve outs and reservations, some treaty commitments are accompanied by escape-clauses which outline conditions under which a temporary suspension of obligations is permitted. This is most common in provisions related to investors rights to transfer funds abroad freely. One type of condition under which these rights can be suspended are extreme balance of payments problems for the host state. For example, Article 7.1 of the BIT between Jamaica and the United Kingdom states that, “Each Contracting Party shall in respect of investments guarantee to nationals or companies of the other Contracting Party the unrestricted transfer to the country where they reside of their investments and returns, subject to the right of each Contracting Party in exceptional balance of payments difficulties and for a limited period to exercise equitably and in good faith powers conferred by its laws...”.

Not all treaties include reservations, carve outs or identify conditions under which certain commitments can be suspended leading to variation in the degree of legalization of obligation across BITs. This variation primarily occurs between levels 2 and 3 on the scale presented in Table 4.1. Where a BIT’s obligations fall on the scale in Table 4.1 between these two levels may seem insignificant but it is not. In fact, as

\(^2\) Article 4(b), Finland - Lebanon BIT.
will become clear, it has genuine implications for host governments’ policy autonomy (see also UNCTAD 2005b).

4.3 Legalization of National Treatment Commitments in BITs

4.3.1 National Treatment and Constraints on Policy Autonomy

Although there is variation in the legalization of several types of BIT provisions, the focus of this chapter is on national treatment commitments. The principle underlying the national treatment commitment is that a host state must “make no negative differentiation between foreign and national investors when enacting and applying its rules and regulations and thus to [sic] promote the position of the foreign investor to the level accorded to nationals” (Dolzer & Schreuer 2008, 178). Such an obligation prevents governments from affording local firms better treatment than foreign companies.

I single out national treatment for close attention because the area of policy autonomy it constrains - the ability to discriminate between foreign and local investors - is arguably the most important to governments from the perspective of maintaining domestic political support. Most notably, a commitment to non-discrimination limits a government’s ability to protect and privilege domestic firms whose owners and

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3The focus here is on national treatment after an investment has been established, not national treatment with respect to the entry and establishment of enterprises as national treatment vis-à-vis establishment is extremely rare among BITs.

4National treatment commitments typically do not preclude governments offering foreign firms better treatment than domestic firms.
workers’ political support they value and/or who play an important role in domestic society. Furthermore, policies that discriminate between foreign and domestic firms in a manner that promotes the success of domestic firms can also be an important part of development strategies for developing countries (UNCTAD 2005b) as governments seek to help local firms succeed. In this context, there may be sound economic as well as political reasons to discriminate between foreign and local firms, however, as Sornarajah (2004) cautions, “the inclusion of national treatment...mean[s] that the existence of an economically valid reason for discrimination between nationals and foreign investors may not provide a justification for the discrimination” (235).

For example, in the mid-1990s, a U.S. firm based in Ohio, S.D. Meyers, sought contracts in Canada to destroy a poisonous chemical called polychlorinated biphenyl (PCB). The Canadian government refused to allow the chemicals to be transported to Ohio for destruction in order to protect and promote the competitiveness of Canadian firms involved in the destruction of PCBs at the expense of S.D. Meyers. Although the Canadian government claimed its actions were due to certain international environmental commitments, the arbitration panel hearing the case brought by S.D. Meyers against Canada was unequivocal in its view that Canada’s border policy was driven by protectionist motivations:

The evidence establishes that Canada’s policy was shaped to a very great extent by the desire and intent to protect and promote the market share of enterprises that would carry out the destruction of PCBs in Canada and that were owned by Canadian nationals. Other factors were considered, particularly at the bureaucratic level, but the protectionist
intent of the lead minister in this matter was reflected in decision-making at every stage that led to the [export] ban.

Accordingly, the panel found the Canadian government guilty of favoring Canadian owned firms, in violation of its national treatment obligations under Chapter 11 of the North American Free Trade Agreement (NAFTA)\(^5\).

The case of *S.D. Meyers v. Canada* illustrates vividly that national treatment commitments limit the policy measures that governments can adopt to respond to demands from domestic firms for protection and for assistance to become more competitive when foreign firms threaten to out-compete them or crowd them out of the domestic market. In addition, national treatment commitments can prevent governments from helping key domestic firms survive during difficult economic times if governments cannot afford to lend equal support, through measures such as low interest loans, to the both domestic and foreign firms. When the domestic firms in question are important to the domestic economy, the political costs of not employing discriminatory policies to help domestic firms be more competitive or to survive may be very high.

National treatment commitments also insulate foreign investors from any policies that are specially targeted at them and that diminish the returns on their investment. This aspect of national treatment is most likely to concern developing country

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\(^5\) *S.D.Meyers v. Canada* (First Partial Award, 13 Nov., 2000), para 162.

\(^6\) Chapter 11 of NAFTA is a trilateral investment agreement that very closely resembles BITs in form and content (Soloway 2003), and its national treatment clauses in particular are almost identical to national treatment clauses found in BITs.
governments who may wish to manage the role of foreign enterprises in their local economy in a way that is distinct from how they treat local firms. For example, governments may want to implement performance requirements targeted exclusively at some or all foreign firms to promote the transfer of advanced technologies or the location of production in certain underdeveloped territories as one way to promote employment and economic development (Schrijver 2001). They may also wish to require foreign investors to use a minimum amount of local products or labor in their operations in order to increase local employment and demand for businesses producing those products, and to export a certain proportion of their output to generate foreign exchange (Sornarajah 2004). In the very likely case that such performance requirements are not imposed on local firms, they are a violation of national treatment.\footnote{See section 2.3 for further discussion of why governments may wish to use performance requirements and other policy tools to extract benefits from FDI.} Finally, as noted in the previous chapter, national treatment obligations also constrain policies geared towards social and environmental objectives that provide support and incentives to domestic groups and firms that are not extended to foreign owned enterprises (Cho & Dubash 2003).

In sum, national treatment obligations constrain the space governments have to implement policies that can: a) improve the competitiveness and ensure the survival of domestic firms, especially vis-à-vis foreign competitors; b) appease demands from domestic firms and industries for greater protection; c) channel the effects of MNEs towards economic goals such as development and employment; d) promote
social and environmental objectives. Such policies are important tools that governments will wish to call upon to increase their popularity with both capital and labor in the host economy. Thus, while FDI-seeking governments have incentives to tie their hands through highly legalized national treatment obligations to increase the credibility of their commitment to non-discrimination between domestic and foreign firms, they also have an incentive to maintain freedom to discriminate when it is economically and politically expedient. In the next section I discuss how governments create greater policy autonomy by scaling back the degree of legalization of national treatment obligations in BITs.

4.3.2 Building in Freedom to Discriminate

The extent to which national treatment obligations constrain government policy is determined by their degree of legalization. Greater legalization entails a more substantial narrowing of the range of policies available to governments, whereas expressing the same obligations with lower levels of legalization affords governments greater discretion to fashion state policy. In the case of national treatment commitments, the degree of legalization of obligation is lowered through the use of carve outs and reservations. Thus, when national treatment commitments undertaken in BITs are more legalized, they are stated in general terms, without carve outs, as in the BIT between Slovenia and the Netherlands:

Article 3.2 More particularly, each Contracting Party shall accord to such investments treatment which in any case shall not be less favourable than that accorded either to investments of its own nationals or to investments
of nationals of any third State, whichever is more favourable to the na-
tional concerned.

When national treatment commitments are framed in this way, governments’ policy options are highly constrained because they are bound, in *all* circumstances, to treat foreign investors at least as well as they treat local investors. However, if national treatment obligations are expressed along with carve outs, governments have greater discretion in policy making. This is because these carve-outs create spaces within which governments can develop policies free from the constraints of their treaty obligations.

The BIT between Germany and Poland provides a good example of how certain classes of policy - in this case measures relating to public security and order, protection of life and public health, and certain tax privileges - can be carved out of a national treatment commitment. The commitment is first expressed in general terms:

> Article 3.1 Neither Contracting Party shall subject investments by in-
vestors of the other Contracting Party or investments in which investors from the other Contracting Party have a holding less favourably in its ter-
ritory than investments by its own investors or investments by investors of any third State. Article 3.2 Neither Contracting Party shall subject investors of the other Contracting Party, as regards their activity in con-
nection with investments in its territory, to treatment less favourable than it accords to its own investors or investors from any third State.
Then the carve outs are made in the protocol to the treaty:

Protocol 2. Ad Article 3 (b) Measures that have to be taken for reasons of public security and order, for the protection of life and health or public morality shall not be deemed “treatment less favourable” within the meaning of Article 3. (c) The provisions of Article 3 do not oblige a Contracting Party to extend to natural persons or companies resident in the territory of the other Contracting Party tax privileges, tax exemptions and tax reductions which according to its tax laws are granted only to natural persons and companies resident in its territory.

Thus, both German and Polish governments have the autonomy to craft tax laws that specify benefits only for residents of the host state, allowing all domestic firms to benefit from special tax laws and only some foreign firms, depending on their organizational structure and tax residency status in the host state.

4.3.3 Time Horizons and Preferences Over National Treatment

In the legalization of national treatment obligations, governments are not able to escape the credibility - policy autonomy trade-off. When more policy areas are carved out of national treatment commitments, BIT signatories will have greater freedom to adopt policies that privilege domestic firms over foreign-owned enterprises in a wider range of issues areas. This greater policy autonomy, however, comes at the expense of the credibility of the commitment to treat foreign firms at least as well as domestic firms. When national treatment commitments are accompanied by numerous carve
outs, foreign investors will be aware that governments will have considerable policy space to distort the playing field in favor of local firms should they find doing so in their political and economic interests. In contrast, when national treatment commitments are highly legalized, and thus not watered down by numerous carve outs, governments will be less able to circumscribe their commitment to equal or better treatment for MNEs without incurring the audience, reputation and material costs associated with violating BIT obligations, thereby making such a commitment more credible.

Figure 4.1: Distribution of the Number of National Treatment Carve Outs in a Sample of 279 Treaties
Figure 4.1 illustrates that the distribution of the number of national treatment carve outs is not uniform across a random sample of 279 BITs. While the majority of investment agreements contain no carve outs, just less than half of the treaties in the sample contain one or more carve outs. Governments, it would seem, choose to resolve the credibility - autonomy trade off with respect to national treatment obligations differently, with some prioritizing policy autonomy through a greater number of carve outs, while others care less about constraints on their policy freedom. Who are these different governments and why do some lower legalization more than others?

The theory outlined in the previous chapter offers an answer; governments with longer time horizons will prize greater policy autonomy more than governments with shorter time horizons and therefore will sign BITs with whose national treatment obligations are less legalized. A key motivation underlying governments with longer time horizons’ reluctance to cede control over policy is the potential for unexpected outcomes and changes in circumstances to make legalized commitments politically costly. Applying this argument in the context of obligation in national treatment provisions, we should expect that governments with longer time horizons will conclude BITs whose national treatment provisions contain more carve outs than governments with shorter time horizons because governments with long time horizons will anticipate that conditions in the future may make discriminating between foreign and local investors politically expedient. For example, governments with long time horizons may anticipate that during periods of slow economic growth in the future they will wish to be able to respond to demands for support such as tax breaks or subsidies.
from struggling local firms, especially if their owners/employees form part of the
government’s core political support, without having to use their finite resources to
assist foreign firms as well. This would be especially so if the MNEs in question
are large corporations with extensive global financial resources at their disposal to
help them weather the economic storm and whose need for government assistance is
therefore less acute.

Thus, in light of the preceding discussion of how greater legalization of national
treatment commitments places potentially unwanted constraints on policy auton-
omy and how the legalization of national treatment is reduced and policy autonomy
promoted through carve outs, the hypotheses emerging from the application of the
theory developed in Chapter 3 to the legalization of national treatment obligations
in BITs are:

Obligation Hypothesis : Governments with longer time horizons will conclude
BITs with more national treatment related carve outs than governments with
shorter time horizons.

Obligation Hypothesis (a) : Autocratic governments whose regimes are
less vulnerable to collapse will conclude BITs with more national treat-
ment related carve outs than autocratic governments whose regimes are
more vulnerable.

Obligation Hypothesis (b) : Democratic governments led by a more highly
institutionalized party will conclude BITs with more national treatment
related carve outs than democratic governments led by a less institution-
alized party.
A Brief Comment on Most-Favored Nation Clauses

It may be argued that the widespread presence of most-favored nation clauses renders the variations in the contents of BITs meaningless because investors can simply select among a country’s BITs to find the most favorable commitment (see Yackee 2007, Freyer & Herlihy 2005). Indeed, in a handful of cases, investors have successfully used the most-favored nation clause to invoke more favorable clauses in other treaties. However, to use the most-favored nation obligation to simply dismiss differences across BITs is unwise for several reasons.

Firstly, most-favored nation provisions in many treaties do not apply universally, with many treaties exempting certain categories of policy and economic activity from the most-favored nation commitment. Second, most-favored nation provisions in BITs only require that signatories grant investors from their treaty partner treatment no less favorable than they grant to investors from any third state. This does not preclude the existence of meaningful variation in the content and design of BITs across pairs of states where no treaty partners overlap. Third, the literature on investment law stresses that it is seldom straightforward to pluck clauses from other treaties on the basis of most-favored nation guarantees. This is firstly because BITs are representative of a negotiated bargain over substantive obligations and it is often unclear if the parties to the treaty intended that most-favored nation provisions should lead to the replacement of the contents of that negotiated bargain with another (Dolzer & Schreuer 2008). It is also because the precise wording of the most-favored nation commitment and the context in which it is being invoked are very important to determining whether or not provisions from other treaties can be borrowed (e.g.
Newcombe & Paradell 2009). Both treaty negotiators and legal scholars express the same point which is that the most-favored nation principle is “easy to state but difficult to apply” (Newcombe & Paradell 2009, 204). Thus, there is a clear legal and substantive difference between including a commitment in a particular treaty and allowing that same commitment to apply to one’s investors through that commitment being established in another BIT signed by one’s treaty partner and the invocation of the most-favored nation clause.

With regard to the aspects of investment treaty design discussed in this dissertation, it is worth noting that in all but a handful of the 279 BITs with national treatment provisions investigated here, most-favored nation carve outs accompany national treatment carve outs. This means that those areas of state policy that are carved out of national treatment commitments, are also not bound by most-favored nation commitments. Thus, investors cannot use most-favored nation clauses to get around national treatment carve outs. With respect to delegation of dispute settlement authority, which is the discussed in Chapter 5, there is great skepticism in the legal community that investor-state dispute settlement provisions can be invoked by the most-favored nation commitment under any conditions (e.g. McLachlan, Shore & Weiniger 2007).

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8When questioned about the use of most-favored nation clauses to borrow provisions from other treaties, a Turkish investment treaty negotiator expressed this same sentiment to the author, stating that the ”most-favored nation principle is one of the most simple principles in BITs to state, but it is always more complex to to apply and interpret in practice”. Interview with Author, Ankara, Turkey, December 2009.
4.4 Evaluating the Argument

4.4.1 Data and Measurement

Dependent Variable: Legalization of National Treatment

In order to evaluate the hypotheses developed above, the contents of a sample of 346 BITs signed between 1960 and 2006 were hand coded. These BITs consist of all treaties signed by the members of a random sample of 3600 dyads, taken from the universe of dyads in 2006, whose treaty texts are publicly available. Information on the universe of BITs, the dates of BIT signings and BIT texts were obtained from UNCTAD’s online treaty database, Kluwer Arbitration Online’s investment treaty database, the United States Department of State’s Website and WorldTradeLaw.net’s trade agreement depository.

With respect to legalization of national treatment obligations, I identified six possible policy categories that can be carved out of national treatment commitments and counted the number carved out of each treaty in the sample that contained a

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9 Data availability regarding several key measures constrain the sample used in the statistical tests that follow to those BITs concluded between 1975 and 2002 for autocratic host governments and between 1975 and 2006 for democratic host governments.

10 The purpose of taking a sample of dyads, as opposed to a sample of BITs, was to enable me to control for selection into BITs when evaluating the determinants of the legalization of BIT obligations. Investment chapters in bilateral trade agreements that are similar in structure and content to BITs are also included in the sample.

national treatment commitment. The possible policy areas that can be carved out are as follows:

1. Tax
2. Security/Public Order
3. Public Health
4. Environment
5. Sectoral
6. Miscellaneous

A tax carve out is coded as present only if taxation or fiscal matters other than or beyond double taxation treaties or other international agreements pertaining to taxation are carved out. Sectoral carve outs apply to particular industries or sectors of the economy and miscellaneous carve outs are those that do not fall into one of the other five categories. The coding approach was holistic and involved examination of the entire treaty, and not just national treatment clauses. Accordingly, not only were carve outs specific to national treatment included in the count, but so were carve outs that applied to the whole treaty or to parts of the treaty in which the national treatment clause was present. The logic behind this approach is that if a policy area

12 Among the BITs in the sample, 67 treaties did not contain a national treatment obligation.

13 A sectoral carve out is coded as present if both parties to the treaty exempt at least one industry/sector. They do not need to exempt the same sector. Thus, if both parties attach sectoral reservations to the national treatment commitment, a sectoral carve out is coded as present.
is carved out of these broader parts of the treaty, it follows that they are carved out of national treatment obligations as well. Thus, the dependent variable is a count of the number of policy categories carved out of national treatment obligations.\footnote{See Figure 4.1 for an illustration of how this variable is distributed.}

\textbf{Independent Variable: Time Horizons}

As the factors shaping governments’ time horizons are different in democracies and autocracies, I pursue different approaches to measure the time horizons of autocratic and democratic governments. I differentiate between democracies and autocracies using Przeworski et al.’s dichotomous conceptualization and operationalization of regime type. As their categorization of regimes is updated only to 2002, for the years 2003 to 2006 I use a dichotomous measure of regime type calculated from the Polity IV data set with the cut point set to 4 on the combined polity scale (Przeworski, Alvarez, Cheibub & Limongi 2000, Marshall & Jaggers 2006).\footnote{States with a combined polity score less than or equal to 4 are considered autocracies. Several cut points were tried and using a combined polity score of 4 to distinguish regimes types correlated most closely with the Przeworski et al. measure ($r = 0.89$) and thus maximized conceptual continuity between the two measures.}

As outlined above, an autocratic government’s time horizon is directly linked to its expectations regarding the stability and durability of its regime. Therefore to measure autocrats’ time horizons, I follow Wright’s (2008b) approach and use estimates of the \textit{probability of autocratic regime failure} as a proxy for autocratic time horizons. These estimates are derived from a survival model of autocratic regime duration including political, economic and institutional predictors of regime
survival that have been identified in extant scholarship and several of which were discussed in Chapter 3.\textsuperscript{16}

To measure a democratic government’s time horizon, I focus on party institutionalization. Party institutionalization is a complex phenomenon engaging legitimacy, societal roots and organizational strength. To measure these factors, I follow Simmons (2008) and use party age as a proxy for party institutionalization, because, as he cogently argues, “Illegitimate, poorly organized, and ideologically unattached parties are unlikely to persist over time” (93). Thus, the older a party is, the more institutionalized we can assume it to be and the longer time horizon its members should have. Accordingly, I measure a democratic government’s time horizon as the logarithmic transformation of the age of the largest party in the governing coalition. In presidential systems, I consider the president’s party to be the largest party in the government. Data on party age and type of government (presidential vs. parliamentary) are obtained from the World Bank’s Database of Political Institutions (DPI) (Beck, Clarke, Groff, Keefer & Walsh 2001).\textsuperscript{17}

As noted before, it is possible to divide BIT partners into a “home” state and a “host” state with the former a likely net exporter and the latter a net importer of dyadic FDI. I identify a host and home state based on the level of economic development with the host state being the treaty partner that has the lower GDP

\textsuperscript{16}I am most grateful to Joseph Wright for sharing his data and results.

\textsuperscript{17}There is missing data for some countries and some years in the DPI. Through research in online databases, I was able to fill in some of these missing observations.
per capita (Elkins, Guzman & Simmons 2006). I measure monadic independent and control variables, for the host and home state separately.

**Control Variables**

A recent study found a strong relationship between the relative bargaining power of the host and home states and the design of dispute settlement provisions in BITs (Allee & Peinhardt 2010). Although my argument does not identify distinctive effects of time horizons on the preferences of home and host states, I noted earlier that host states are likely to feel the constraining effects of BITs more than home states as they are net recipients of FDI. Therefore, one might expect the level of legalization and constraint on policy autonomy to decrease in BITs as the bargaining power of the host increases relative to the home state. I measure bargaining power using a variable called *host share of dyadic wealth*, which is the host state’s GDP divided by the host and home state’s combined GDP. The larger the value for this variable, the greater the bargaining power of the host relative to the home state. I also follow Allee and Peinhardt and include a measure of the host state’s GDP per capita growth. One could argue that when host governments are faced with low growth, they are more willing to concede to greater constraints on policy autonomy in BIT negotiations as they seek to attract FDI to stimulate their economy. GDP data is obtained from Gleditsch’s (2002) *Expanded Trade and GDP Data v5.0*.

I also control for the possibility that the legalization of national treatment reflects different credibility enhancing “needs” among governments (see section 3.6.1).

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18I do not employ dyadic measures of FDI flows or stocks to determine the host and home state as data availability regarding dyadic FDI is highly limited.
Several scholars have argued that domestic institutional constraints on the executive help make commitments to MNEs more credible (Henisz 2000, Jensen 2003). Functionalist logic suggests that governments with fewer domestic constraints may therefore seek more legalized provisions in BITs to overcome their credibility shortfall. To test this alternative explanation, I include a measure of constraints on the executive taken from the Polity IV data set (Marshall & Jaggers 2006). This measure gauges the level of constraint an executive faces by looking at the presence and influence of “accountability groups” such as the legislature.

It is likely that the age of a democracy and the age of its largest party in government will be highly correlated (Simmons 2008). To ensure that the effects of party institutionalization and not regime institutionalization are being captured with the party age variable, I control for the log of the age of the regime (in years) for democratic states using data on regime age from Przeworski et al. (2000) and Polity (for the years 2003-2006) (2006). I also control for the log of the number of years that a host state has been independent as others have argued that newly independent states are more likely to be sensitive to the sovereignty costs of constraints on policy making autonomy (Kahler 2000b, Allee & Peinhardt 2010). I do not control for years since independence for home states as most are former colonial powers instead of former colonies. Dates of independence are obtained from the ICOW Colonial History Data Set (ICOW N.d.)

The design of BITs has evolved over time and it is possible that variation in the

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19For host countries that have never been formally colonized, such as China and Turkey, I date their independence to 1818, the beginning of the modern state system.
legalization of BIT obligations is a product of secular trends towards greater legalization as BITs have become more prevalent, and the global investment climate has become more liberal (UNCTAD 2004a, UNCTAD 2007a, UNCTAD 2007b, Schrijver 2001). Therefore, I also control for potential trends in the legalization of BITs over time through an annual time counter.

Finally, some studies have asserted that a qualitative difference exists between treaties that developing countries at similar levels of development conclude with each other and those they conclude with developed states (Poulsen 2010). To control for this, I include a dummy variable that takes the value of 1 when the BIT is signed between a country in the developed North and in the developing South.

4.4.2 Results

The different approaches I adopt for measuring time horizons for democracies and autocracies necessitates estimating separate models for BIT signatories of different regime types. Therefore, I estimate two negative binomial regression models of the number of national treatment carve outs for autocratic and democratic host states respectively. In both models the home state is democratic. No results are available for when the home state is autocratic because autocracies are a small minority of home states and there are not enough observations in the sample to produce stable

\[ \text{Few BITs exist between countries in the North.} \]

\[ \text{I follow Poulsen’s categorization of countries into North and South.} \]
estimates. The results are presented in Table 4.2 and to avoid confusion when interpreting the different scales used for measuring autocratic and democratic time horizons, + and - signs have been included in parentheses next to the host and home state time horizon variable names to indicate the expected signs of the coefficients.

In the first model, the host state is autocratic and the measure of host state government time horizons is the probability of regime failure. The sign on the host state time horizon coefficient is negative and statistically significant at the 0.05 level. This means that for autocratic host states, as the government’s time horizon shortens (the probability of regime failure increases), it concludes BITs with fewer national treatment carve outs. Substantively, an increase in the probability of regime failure for autocratic host states from 1 percent to 15 percent causes the expected number of carve outs to drop from 0.9 to 0.2, holding all other variables at their mean and mode values (for dichotomous covariates). The results for democratic host state governments are presented in the second column of Table 4.2 and indicate a positive and statistically significant relationship (at the 0.01 level) between party age and the number of national treatment carve outs in BITs. As party age is my proxy for democratic time horizons, these results indicate that older parties with longer time horizons are likely to conclude BITs with more national treatment carve outs. In substantive terms, the expected number of carve outs when the governing party is a mature forty years old is one, while this number drops by fifty percent to 0.5 when

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\[22\] The main results for host state time horizons do not change if the models are re-estimated with both democratic and autocratic home states included. However, in such cases no measure of home state time horizons can be included as home states of both regime types are present.
Table 4.2: Negative Binomial Regression Models of National Treatment Carve Outs

<table>
<thead>
<tr>
<th>Host Regime Type</th>
<th>Autocracy</th>
<th>Democracy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Autocratic Time Horizon (Host)</td>
<td>-0.105**</td>
<td></td>
</tr>
<tr>
<td>(Pr(\text{Regime Failure})) (-)</td>
<td>(0.051)</td>
<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Host)</td>
<td>0.369***</td>
<td></td>
</tr>
<tr>
<td>(Party\ Age\ (+))</td>
<td>(0.107)</td>
<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Home)</td>
<td>0.029</td>
<td>-0.010</td>
</tr>
<tr>
<td>(Party\ Age\ (+))</td>
<td>(0.280)</td>
<td>(0.194)</td>
</tr>
<tr>
<td>Age of Democracy (Home)</td>
<td>0.328</td>
<td>0.532**</td>
</tr>
<tr>
<td></td>
<td>(0.437)</td>
<td>(0.249)</td>
</tr>
<tr>
<td>Age of Democracy (Host)</td>
<td>0.315**</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.159)</td>
<td></td>
</tr>
<tr>
<td>North-South BIT</td>
<td>-1.249**</td>
<td>-0.044</td>
</tr>
<tr>
<td></td>
<td>(0.543)</td>
<td>(0.415)</td>
</tr>
<tr>
<td>Years Since Independence (Host)</td>
<td>0.174</td>
<td>-0.204**</td>
</tr>
<tr>
<td></td>
<td>(0.163)</td>
<td>(0.099)</td>
</tr>
<tr>
<td>Host Share of Dyadic Wealth</td>
<td>-0.757</td>
<td>0.117</td>
</tr>
<tr>
<td></td>
<td>(0.993)</td>
<td>(0.59)</td>
</tr>
<tr>
<td>GDP p.c. Growth (Host)</td>
<td>-0.013</td>
<td>0.007</td>
</tr>
<tr>
<td></td>
<td>(0.025)</td>
<td>(0.016)</td>
</tr>
<tr>
<td>Time Counter</td>
<td>-0.007</td>
<td>0.040</td>
</tr>
<tr>
<td></td>
<td>(0.026)</td>
<td>(0.029)</td>
</tr>
<tr>
<td>Executive Constraints (Host)</td>
<td>-0.207*</td>
<td>-0.066**</td>
</tr>
<tr>
<td></td>
<td>(0.125)</td>
<td>(0.032)</td>
</tr>
<tr>
<td>Executive Constraints (Home)</td>
<td>0.379</td>
<td>0.529*</td>
</tr>
<tr>
<td></td>
<td>(0.428)</td>
<td>(0.305)</td>
</tr>
<tr>
<td>Constant</td>
<td>-2.662</td>
<td>-7.819***</td>
</tr>
<tr>
<td></td>
<td>(3.518)</td>
<td>(2.271)</td>
</tr>
</tbody>
</table>

\[ N = 79 \quad 122 \]
\[ \text{AIC} = 205 \quad 330 \]

Two-way clustered (on host and home state) robust standard errors in parentheses

* \(p < 0.1\), ** \(p < 0.05\), *** \(p < 0.01\)
the governing party in the host state is only a relatively young five years old, holding all other covariates fixed at their mean or mode values.

The empirical results for host state government time horizons, in the case of both autocratic and democratic host governments, provide strong support for the argument that governments with longer time horizons will seek to build in greater policy autonomy through more national treatment carve outs. The results with respect to home state government time horizons, however, provide no such support. In neither model does the age of the largest party in the home state’s government display a statistically significant relationship with the number of carve outs. This result is not entirely surprising because, as outlined in Chapter 3, as a net exporter of dyadic FDI, the home state is likely to be less concerned than the host state about preserving policy autonomy vis-à-vis FDI.

Across both models, the coefficients for the host’s constraints on the executive are negative and are statistically significant at the 0.1 or 0.05 levels. These results offer support against the argument that a host state’s need for credibility influences the number of national treatment carve outs in its BITs. This is because a negative coefficient indicates that a less constrained host government will sign BITs with less legalized national treatment obligations. This strongly suggests that it is a concern with the political costs of greater legalization, rather than the need for credibility of commitments to MNEs, that drives host state governments’ preferences over the legalization of national treatment provisions. The opposite relationship however is found for home states concluding treaties with democratic hosts. A positive coefficient that is statistically significant at the 0.1 level suggests that a more constrained
home state executive will conclude BITs with more carve outs. However, there is no statistically significant relationship between constraints on the home state executive and the number of national treatment carve outs when the host state is an autocracy. Thus, one cannot confidently conclude that home state executive constraints have a strong and systematic relationship with the number of national treatment carve outs. Interestingly, beyond host state executive constraints, none of the other control variables in Table 4.2 display a consistently statistically significant relationship with the number of national treatment carve outs. Thus, one can conclude that domestic political and institutional factors pertaining to the host state - time horizons and executive constraints - are the main drivers of the legalization of national treatment in BITs.

Robustness Checks
To test the robustness of my initial results, I undertake two additional statistical analyses. First, I estimate a hurdle model of national treatment in BITs. While national treatment is typically regarded as one of the standard commitments found in BITs, a minority of treaties contain no national treatment provisions at all (UNCTAD 2007a). Therefore, one might be concerned that focusing only on national treatment carve outs represents a truncated analysis and that ignoring whether or not a national treatment clause is present introduces bias into the results. A hurdle model helps to overcome this by jointly estimating a logistic regression model of whether or not a national treatment commitment is present and a truncated negative binomial regression model of the number of national treatment carve outs for those treaties.
in which a national treatment clause exists. A conventional hurdle model typically
distinguishes between zero and any positive count value (Cameron & Trivedi 2005).
However, it is possible to have a national treatment commitment and zero carve outs.
Thus, I create a new dependent variable for the hurdle model that takes the value of
zero if there is no national treatment commitment, and the value of the number of
national treatment carve outs plus one if there is a national treatment commitment.
Thus, the measure takes a value of one if a national treatment commitment is present
but there are no carve outs. When the dependent variable is set up this way, a hurdle
model is appropriate because, in order to get a count of carve outs, a treaty must
“jump the hurdle” of having a national treatment commitment in the first place.

Results for the hurdle model using the covariates from Table 4.2 are presented in
Table 4.3. No model is estimated for democratic host states as a very small number
of BITs signed by democratic hosts do not possess a national treatment commitment
which makes model estimates unstable. After accounting for the decision to include
a national treatment provision in the treaty, autocratic host state government time
horizons continue to exert a statistically significant effect in the expected direction on
the number of carve outs. However, under the hurdle model statistical significance
weakens and this relationship is significant only at the 0.1 level. Host state time
horizons do not have a significant effect on whether or not a national treatment
commitment is present. Meanwhile, the home state government’s time horizon does
not display a statistically significant relationship with the number of carve outs or
with the decision to include a national treatment obligation.

Among the control variables, whether or not the BIT is signed by a North-South
dyad exerts a negative and statistically significant effect on the number of national treatment carve outs. Thus, when controlling for the decision to include a national treatment obligation at all, North-South BITs contain fewer national treatment carve outs than BITs signed between countries at similar levels of development. With respect to the decision to include a national treatment commitment, host share of dyadic wealth exerts a negative and statistically significant effect. Thus, as the host state is wealthier relative to the home state, their BIT is less likely to contain any national treatment commitment. This suggests that the effect of host state bargaining power exhibits itself in the decision over the inclusion of a national treatment commitment, rather than negotiation over the number of policy carve outs to be associated with such a commitment.

The positive and significant coefficient for the time measure indicates that national treatment commitments have become more prevalent over time, even if the pattern of carve outs attached those commitments displays no clear trend across time. Furthermore, the host state’s GDP per capita growth is negatively correlated with the presence of a national treatment commitment and this relationship is significant at the 0.1 level. It is worth noting that once the decision over whether or not to include a national treatment commitment is accounted for, the effect of executive constraints on the number of national treatment carve outs ceases to be statistically significant.

As a further robustness check, I take up the issue of selection. Existing studies have shown that several factors systematically influence whether or not dyads choose to conclude a BIT (Elkins, Guzman & Simmons 2006, Neumayer & Plümper 2010).
Table 4.3: Hurdle Model of National Treatment Commitments and Carve Outs

<table>
<thead>
<tr>
<th></th>
<th>Neg. Bin. Model of Carve Outs</th>
<th>Logit Model of National Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Autocratic Time Horizon (Host)</strong></td>
<td>-0.086*</td>
<td>0.108</td>
</tr>
<tr>
<td><strong>Pr(Regime Failure) (-)</strong></td>
<td>(0.050)</td>
<td>(0.115)</td>
</tr>
<tr>
<td><strong>Democratic Time Horizon (Home)</strong></td>
<td>0.005</td>
<td>0.309</td>
</tr>
<tr>
<td><strong>Party Age (+)</strong></td>
<td>(0.143)</td>
<td>(0.297)</td>
</tr>
<tr>
<td><strong>Age of Democracy (Home)</strong></td>
<td>0.300</td>
<td>-0.448</td>
</tr>
<tr>
<td></td>
<td>(0.224)</td>
<td>(0.450)</td>
</tr>
<tr>
<td><strong>North-South BIT</strong></td>
<td>-1.062***</td>
<td>-0.138</td>
</tr>
<tr>
<td></td>
<td>(0.361)</td>
<td>(0.932)</td>
</tr>
<tr>
<td><strong>Years Since Independence (Host)</strong></td>
<td>0.159</td>
<td>-0.037</td>
</tr>
<tr>
<td></td>
<td>(0.135)</td>
<td>(0.285)</td>
</tr>
<tr>
<td><strong>Host Share of Dyadic Wealth</strong></td>
<td>-0.608</td>
<td>-3.873***</td>
</tr>
<tr>
<td></td>
<td>(0.697)</td>
<td>(1.223)</td>
</tr>
<tr>
<td><strong>GDP p.c. Growth (Host)</strong></td>
<td>-0.012</td>
<td>-0.072*</td>
</tr>
<tr>
<td></td>
<td>(0.018)</td>
<td>(0.039)</td>
</tr>
<tr>
<td><strong>Time Counter</strong></td>
<td>-0.006</td>
<td>0.104***</td>
</tr>
<tr>
<td></td>
<td>(0.018)</td>
<td>(0.039)</td>
</tr>
<tr>
<td><strong>Executive Constraints (Host)</strong></td>
<td>-0.158</td>
<td>-0.006</td>
</tr>
<tr>
<td></td>
<td>(0.114)</td>
<td>(0.235)</td>
</tr>
<tr>
<td><strong>Executive Constraints (Home)</strong></td>
<td>0.370</td>
<td>0.498</td>
</tr>
<tr>
<td></td>
<td>(0.300)</td>
<td>(0.401)</td>
</tr>
<tr>
<td><strong>Constant</strong></td>
<td>-2.253</td>
<td>-3.543</td>
</tr>
<tr>
<td></td>
<td>(2.299)</td>
<td>(3.169)</td>
</tr>
<tr>
<td><strong>log(θ)</strong></td>
<td>4.334</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(14.23)</td>
<td></td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>79</td>
<td></td>
</tr>
<tr>
<td><strong>Log-likelihood</strong></td>
<td>-138.5</td>
<td></td>
</tr>
</tbody>
</table>

Standard errors in parentheses

* p < 0.1, ** p < 0.05, *** p < 0.01
Time horizons may also play a role in this decision for if governments with long time horizons are sensitive to the constraints of highly legalized agreements on their policy autonomy, they may choose to avoid concluding BITs altogether. Therefore, it may be important to control for selection into BITs in order to accurately gauge the effect of time horizons on the degree of legalization of national treatment obligations. To this end, I follow the approach taken by Randall Stone (2008) in his study of the design of IMF agreements by first estimating a partial observability bivariate probit model of BIT signing, modeling the decisions of the host state and home state to sign a BIT separately. I use the random sample of 3600 dyads noted above to estimate the model and the unit of observation is the dyad-year for the years 1960-2006. Following Stone, when a BIT is signed between the two members of a dyad the dyad is dropped from the estimation for subsequent years. I then replicate the models presented in Table 4.2 including marginal predicted probabilities of the home and host state signing a BIT with each other, derived from the bivariate probit model of BIT signing.

23See also Vreeland (2003) and Vreeland and Przeworski (2000, 2002).

24To ensure accuracy of inference, bootstrapped standard errors with 2000 replications are employed.
I estimate two bivariate probit models of BIT signing for democratic and autocratic host states respectively. These models include the time horizon, regime type, regime age, years since independence and economic growth variables used in the main models above, as well as several other covariates that other studies have found to be associated with BIT signing: whether or not the host state has a common law system, whether or not dyad members have diplomatic representations with each other, and whether or not the host state was a former colony of the home state or they share an alliance (Allee & Peinhardt 2010, Elkins, Guzman & Simmons 2006). I also include two measures to capture competitive diffusion effects: the total number of BITs one’s potential treaty partner has concluded, and the share of countries in one’s region with whom one’s potential BIT partner has already concluded a treaty. The results and further discussion of the bivariate probit models are presented in Appendix A.

The re-estimated models from Table 4.2 with predicted probabilities of BIT signing are presented in Table 4.4. The signs on the host state government time horizon variables remain unchanged but statistical significance weakens slightly for autocratic home state time horizons as the estimated coefficient is only significant at 0.1 level. However, the estimates for government time horizons in democratic host states continue to be significant at the 0.01 level. Thus, even after controlling for selection, government time horizons of host states exert a statistically significant effect on the the legalization of national treatment provisions in BITs. The results for

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25 As above, host and home states for all dyad years are identified according to GDP per capita.

26 For an extensive discussion of the competitive diffusion effects of BITs see Elkins, Guzman and Simmons (2006).
home state government time horizons do not change significantly after controlling for selection; home state governments with time long horizons are more likely to sign BITs with more national treatment carve outs than governments with short time horizons, however this relationship is not statistically significant.

Among the control variables, the age of democracy of the host state now exerts a positive and statistically significant effect on the number of carve outs, suggesting that more mature democracies will sign BITs with more carve outs. Support for this perspective is found in the positive coefficient for home state’s age of democracy, however this result is only significant in one of the two models. The estimates for North-South BITs have different signs depending on whether or not the host state is a democracy or an autocracy and attain significance only when the host state is an autocracy. Based on this evidence, and the results of previous models, it is difficult to draw firm conclusions about any consistent effect of the North-South character of a BIT’s partners on the number of national treatment carve outs.27

27 One of the carve out areas is tax policy and one could plausibly argue that the rationale for tax carve outs is not to increase policy space but to avoid conflicts with commitments undertaken by BIT partners in tax treaties. Therefore, as a final robustness check I estimated logistic regression models (results presented in Appendix B, Table B.1) of whether or not taxation is carved out of a treaty using identical covariate profiles those in Table 4.3 along with an additional dummy variable indicating whether or not the treaty partners had signed a double taxation treaty. No statistically significant relationship in any of the models between whether or not two states have signed a tax treaty and whether or not they choose to carve out taxation from the national treatment provisions in their BIT. Data on double taxation treaties was collated from the UNCTAD website: http://www.unctad.org/Templates/Page.asp?intItemID=4505&lang=1.
4.5 Conclusion

This chapter presented the first empirical application and evaluation of the argument, advanced in Chapter 3, that governments with long time horizons prize policy autonomy to a greater degree than governments with short time horizons and therefore conclude less legalized BITs. The context for this application was the legalization of obligation in national treatment commitments. These commitments are an appropriate testing ground for the argument because they constrain governments’ autonomy to pursue a range of policies that can help promote economic and social objectives, as well as the welfare of important domestic producers and firms. Such constraints are therefore costly to governments seeking to maintain domestic political support and remain in power. However, while governments may be tempted to weaken such constraints through decreasing the legalization of their national treatment obligations, doing so weakens the credibility of their commitment to afford foreign investors equal or better treatment than local investors. Thus, as in other areas of legalization, governments face a credibility - autonomy trade-off when determining the legalization of their national treatment obligations.

BIT obligations are significantly legal in character. However, the discussion in this chapter illustrates that BIT signatories use several devices, and particularly policy carve outs, to soften the legal character of their obligations and create greater space for government policy. Using an original data set measuring the legalization of obligation in national treatment provisions, I am able to show that there is variation in the legalization of obligations in BITs and submit my argument linking government time horizons to BIT legalization to rigorous statistical analysis.
Overall, the results of this analysis provide considerable support for the argument that governments with longer time horizons will seek to legalize their BITs in a manner that preserves greater policy autonomy. In my main tests, I found a strong and negative relationship between the length of a host state government’s time horizon and the number of national treatment policy carve outs indicating that host state governments with longer time horizons were less inclined to conclude BITs with highly legalized national treatment provisions than governments with short time horizons. Moreover, this result holds across regime types and is robust to the inclusion of different covariates, multiple model specifications and controlling for selection into BITs.

Home state government time horizons, on the other hand, consistently display no statistically significant relationship with the number of national treatment carve outs. While these results do not reinforce the supporting evidence found in the case of host state time horizons, they are not unexpected. In Chapter 3, I argued that as host states are likely to be net recipients of dyadic FDI constraints on their ability to regulate investment from their treaty partner will be more consequential. As a result, home state governments with longer time horizons will have a comparatively lower incentive to build in policy autonomy. This is especially so as home state governments will have countervailing incentives as net exporters to protect their investors abroad through fewer, rather than more, carve outs. Thus, in the case of home states, the wish to protect investors abroad may cancel out the already lower desire for autonomy resulting in a null relationship between time horizons and the number of national treatment carve outs. However, in the next chapter, I find that
home state time horizons do display a systematic relationship with legalization in the case of the legalization of delegation suggesting that one must be cautious before concluding that home state time horizons have no bearing on BIT legalization.
Table 4.4: Negative Binomial Regression Models of National Treatment Carve Outs - Controlling for Selection

<table>
<thead>
<tr>
<th>Host Regime Type</th>
<th>Autocracy</th>
<th>Democracy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Host Regime Type</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Autocratic Time Horizon (Host)</td>
<td>-0.109*</td>
<td>0.400***</td>
</tr>
<tr>
<td>Pr(Regime Failure) (-)</td>
<td>(0.078)</td>
<td>(0.145)</td>
</tr>
<tr>
<td>Democratic Time Horizon (Host)</td>
<td>0.008</td>
<td>0.012</td>
</tr>
<tr>
<td>Party Age (+)</td>
<td>(0.369)</td>
<td>(0.202)</td>
</tr>
<tr>
<td>Democratic Time Horizon (Home)</td>
<td>0.326</td>
<td>0.627***</td>
</tr>
<tr>
<td>Age of Democracy (Home)</td>
<td>(0.423)</td>
<td>(0.238)</td>
</tr>
<tr>
<td>North-South BIT</td>
<td>-1.337*</td>
<td>0.298</td>
</tr>
<tr>
<td>Years Since Independence (Host)</td>
<td>-0.112</td>
<td>-0.196</td>
</tr>
<tr>
<td>Host Share of Dyadic Wealth</td>
<td>-0.105</td>
<td>0.193</td>
</tr>
<tr>
<td>GDP p.c. Growth (Host)</td>
<td>-0.021</td>
<td>0.008</td>
</tr>
<tr>
<td>Time Counter</td>
<td>-0.008</td>
<td>0.055</td>
</tr>
<tr>
<td>Executive Constraints (Host)</td>
<td>-0.166</td>
<td>-0.126</td>
</tr>
<tr>
<td>Executive Constraints (Home)</td>
<td>0.315</td>
<td>0.552</td>
</tr>
<tr>
<td>Pr(Host Signs BIT)</td>
<td>-0.694</td>
<td>-1.556</td>
</tr>
<tr>
<td>Pr(Home Signs BIT)</td>
<td>0.974</td>
<td>-0.183</td>
</tr>
<tr>
<td>Constant</td>
<td>-0.865</td>
<td>-7.849*</td>
</tr>
</tbody>
</table>

Bootstrapped standard errors in parentheses. Significance levels determined according to bias corrected and accelerated (BCa) confidence intervals. *p < 0.1, **p < 0.05, ***p < 0.01
CHAPTER 5
DELEGATION IN INVESTMENT AGREEMENTS

5.1 Introduction

Almost all BITs contain a provision that addresses how disputes that may arise between host governments and investors should be settled. In the vast majority of treaties, these provisions allow for the delegation of dispute settlement authority to international arbitrators. Moreover, this delegation of authority is often highly legalized. For example, many treaties allow a wide range of disputes to be brought before arbitration and also enable investors to take host governments directly to arbitration without the specific approval of either treaty partner. Many treaties also specify that governments are bound by the decisions taken by international arbitrators.

Such highly legalized delegation is critical to BITs’ abilities to make governments’ commitments to foreign investors more credible. Allowing investors direct access to binding international arbitration enables them to successfully inflict costs on governments who violate their investment commitments. These costs can be audience or reputation based as arbitration can make public governments’ failure to comply
with their obligations. Costs can also be financial as arbitrators are able to award aggrieved investors compensation which governments must pay. By raising the potential of such costs and giving investors an avenue through which they can seek redress when they believe their rights have been violated by a host government, governments’ commitments gain credibility. However, as before, greater credibility comes at the expense of policy autonomy. Highly legalized delegation of dispute settlement authority removes from governments the final right of interpretation of their commitments to foreign investors, and the right to determine whether or not their behavior is in compliance with those commitments. Thus, international arbitrators can constrain governments’ policy autonomy by deeming their preferred policies incompatible with their commitments to foreign investors. Moreover, governments may find that arbitrators’ interpretations of their treaty commitments diverge considerably from the meaning they intended those commitments to have when the treaty was originally drafted, leading to unexpected constraints on their policy freedom.

Although delegation of dispute settlement authority in BITs is frequently highly legalized, some governments choose to conclude BITs in which the legalization of delegation is diminished in some manner. For example, some treaties limit the scope of issues that can be brought before arbitration. This suggests that some governments are less willing than others to submit to the constraints on their policy posed by greater legalization of delegation. The theory I develop in Chapter 3 argues that such reluctance to be constrained by high legalization is associated with governments that have longer time horizons. In this chapter, I use an original data set of measures of the legalization of delegation of dispute settlement authority in BITs to evaluate
the extent to which legalization of delegation can be explained by government time horizons. In contrast to the previous chapter, I find that home governments with long time horizons are more wary of constraints on their policy autonomy and are more likely to conclude BITs with less legalized delegation of dispute settlement authority. However, host state government time horizons do not display a statistically significant relationship with the legalization of delegation.

5.2 Legalization of Delegation: Credibility & Constraint

Legalization of delegation is the extent to which states delegate authority to third parties to implement agreements. This implementation can take two primary forms: interpretation and application of rules with a view to resolving disputes; elaboration of imprecise rules and their enforcement (Abbott et al. 2000). The degree of legalization of both of these forms of delegation varies across institutions. At the high end of the legalization scale decisions taken by third parties are binding and are taken on the basis of general rules. Delegation is least legalized when the processes of dispute resolution or rule development are open to political negotiation and bargaining and parties to a dispute are free to reject decisions taken by third parties without censure or punishment. With respect to dispute resolution forms of delegation, access by private groups and individuals to the legal process and their ability to initiate legal proceedings is associated with the highest levels of legalization as is the

1 More general and wide-ranging treatments of delegation that do not confine themselves to the context of legalization are offered by Bradley and Kelley (2008), and Hawkins et al. (2006b), among others.
granting of broad authority of third parties to interpret and supplement rules and the specification of general (non ad-hoc) rules of procedure by which adjudicatory bodies reach decisions (Keohane, Moravcsik & Slaughter 2000, Abbott et al. 2000).

Delegation in BITs is of the dispute resolution variety with almost all BITs providing for some delegation to third parties - international investment arbitrators - to resolve disputes between host governments and foreign investors. In the majority of BITs, this delegation is highly legalized in several respects. First, dispute settlement provisions typically afford international investment arbitrators compulsory jurisdiction (see Bradley & Kelley 2008, Alter 2008) by including states’ pre-consent to arbitral processes (Yackee 2007). Second, the contracting states pre-consent in the BIT to be bound by the decisions of the arbitration panel hearing the dispute. Third, rules of procedure by which cases may be brought to arbitration and how arbitration panels are to be established and function are clearly outlined. In this regard, reference is often made to standing procedural rules established by organizations such the International Center for the Settlement of Investment Disputes (ICSID) and the United Nations Commission on International Trade Law (UNCITRAL) (UNCTAD 2007a). Fourth, investors have the right to initiate dispute settlement proceedings against a host government independent of the approval of either party to the BIT. Such access to the arbitration process by private actors is unusual in

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2BITs also delegate authority for the settlement of disputes between BIT partners. However, I do not address this aspect of delegation in BITs because it is extremely rare for two BIT partners to seek resolution of their disagreements with another through arbitration.

3International investment arbitrators are usually highly experienced international commercial lawyers engaged in private practice, i.e. they are not government employees.
international commercial law where individuals must often petition their government to act on their behalf if they wish to air their grievances before a dispute settlement body (e.g. World Trade Organization). Furthermore, most BITs do not require that investors exhaust local judicial remedies before being able to initiate international arbitration proceedings. Finally, international arbitrators are authorized to pass judgment on any dispute concerning investments between foreign investors and host governments and to therefore interpret any provisions in the BIT.\footnote{A typical example of such a highly legalized delegation of dispute settlement authority is found in the BIT between Australia and India. The relevant clause is reprinted in Appendix C for the reader’s convenience.}

In Chapter 2, I outlined how delegation helps governments make more credible commitments. The extent to which this is so depends on the degree of legalization of delegation. The high degree of legalization of delegation in most BITs is a crucial component of their ability to enhance states’ credibility in the eyes of foreign investors. Recall that governments frequently have strong political incentives to deviate from the commitments they make to foreign investors. If states do not pre-consent to arbitration, or the results of arbitral decisions are not binding, than governments are able to effectively avoid being held to account by international arbitrators if they violate their commitments to MNEs. MNEs are less likely to find government commitments more credible as a result of dispute settlement provisions in BITs if governments are able to avoid international arbitration and the reputation and material costs it can bring. Therefore, compulsory jurisdiction and the bindingness of arbitral decisions are important elements of the credibility enhancing capacity of the delegation of dispute settlement authority in BITs (see Bradley &
Kelley 2008). This is particularly so if international arbitrators are granted a broad mandate and can hear a wide range of disputes. In addition, by giving private actors – MNEs – direct access to arbitration, investors can be confident that their grievances will be heard by arbitrators rather than having to depend on their home states to commence dispute settlement proceedings on their behalf. This is important as investors’ home states may wish to avoid becoming involved in disagreements between important foreign governments and their own nationals. More generally, legalization of the dispute settlement process helps to make commitments to foreign investors more credible because it depoliticizes the process allowing disputes to be resolved by impartial actors on the basis of legal principles and formal commitments rather than through interstate bargaining. Depoliticization is likely to make investors more confident that governments will be held to their commitments in the dispute settlement process as governments are less able to negotiate and horse-trade their way out of their commitments (see Soloway 2003).

While highly legalized delegation of dispute settlement authority can help governments make credible commitments, it can also significantly constrain their policy autonomy (Allee & Peinhardt 2010). This is because the authority to interpret the meaning of states’ legal obligations to investors and their compliance with those commitments in a specific context is ceded by governments to international arbitrators that are able to act with considerable independence of government influence (Alter 2008, Keohane, Moravesik & Slaughter 2000) and, crucially, governments
have to accept and comply with the interpretations and judgments made by arbitrators. Governments are no longer free to govern issues affecting foreign investment completely as they wish because international arbitrators can pass judgment on their policy choices, and their interpretations, not the government’s, are final (Van Harten 2007). Moreover, compulsory jurisdiction and direct access to arbitration granted to investors make it difficult for governments to avoid the constraining effects of arbitration on their policy space.

It has been suggested that the sovereignty costs of delegation are tempered by the fact that states usually retain some residual power to revoke authority from delegated agents and thus they are only under control of third parties so long as they want to be (Hathaway 2008). This is largely not true in the case of BITs. While arbitrators are appointed for each case on an ad hoc basis and states can choose not to nominate an arbitrator in the future if they are dissatisfied with her performance, investors and states typically have equal authority in the selection of arbitrators. Furthermore, the delegation of dispute settlement authority in a broader sense cannot be immediately revoked because most BITs, reflecting the long term outlook of many investors, contain provisions that specify BIT obligations stay in force for a decade or longer into the future after a BIT is abrogated.^[5]

Highly legalized delegation leads to constraints on government policy autonomy

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^[5]This is an essential component of BITs’ capacity to promote policy credibility. If governments can easily revoke the authority of international arbitrators to decide investor-state disputes by withdrawing from a BIT and ignoring the decisions taken by tribunals then BITs provide little additional disincentive to reneging on commitments (see Hawkins et al. 2006a).
because governments’ and arbitrators’ interpretations over the compatibility of government policies with treaty obligations have the potential to diverge. This is because arbitrators are concerned with the accurate application of legal principles and governments are concerned with pursuing their own political and economic objectives, and adopting policies that will please their supporters and strengthen their hold on power, and thus the two are unlikely to have the same preferences motivating their interpretations of treaty commitments (see Bradley & Kelley 2008).\textsuperscript{6}

Furthermore, even if governments’ interpretations of their commitments are not self-serving, there is still a risk that arbitrators will interpret obligations in a manner unintended by them when originally establishing those obligations (Abbott & Snidal 2000, Alter 2008, Hathaway 2008). This results in potentially unexpected and unintended constraints on government policy as arbitrators rule certain policies that governments had originally viewed as acceptable to be incompatible with their legal obligations in BITs. For example, Argentina has frequently sought to claim that its violation of tariff based public utilities contracts, discussed in previous chapters, was not a violation of its BIT commitments because it was done in response to a national crisis and was necessary to preserve domestic order.\textsuperscript{7} However, investment arbitrators have not been persuaded that widespread disorder meriting abrogation

\textsuperscript{6}Divergent preferences between arbitrators and host states are not entirely negative from a government’s perspective as it enables BITs commitments to be credible (see Majone 2001, Hawkins et al. 2006\textsuperscript{a}). BITs would do little to enhance states’ commitments to foreign investors if arbitrators went along with whatever interpretations and policies BIT signatories wished to pursue, regardless of how self-serving they may be.

\textsuperscript{7}In Chapter 4 it was noted that measures take to preserve order and security are often carved out of treaty obligations such as national treatment.
of public utilities contracts was impending. Thus, arbitrators and the government of Argentina have had divergent interpretations over what constitutes order and disorder in the context of Argentina’s BIT provisions and the arbitrators’ interpretations have been final (Newcombe & Paradell 2009).

Figure 5.1: Outcomes of Arbitration Cases Brought Under Investment Treaties (Source: UNCTAD International Investment Agreement Database)

More evidence that governments and arbitrators will have diverging interpretations is to be found in the significant number of arbitration cases brought under

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8See, for example, CMS Gas Transmission v. Argentina (Award, 12 May 2005); LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v. Argentina (Decision on Liability, 3 Oct. 2006); Enron Corporation and Ponderosa Assets, L.P. v. Argentina (Award, 22 May 2007).
BITs in which awards are made against governments or which governments choose to settle. Figure 5.1 shows the outcomes of treaty based arbitration cases since 1993 (not including those still pending) that have been recorded by UNCTAD. Most treaties do not require states and investors to make arbitration procedures, and their outcomes, public and thus the cases included in Figure 5.1 represent only a subset of investment arbitration activity since 1993. However, what is evident is that since the early 1990s, more arbitration cases are being initiated by investors and many of those end in rulings against the state, illustrating that governments and arbitrators will have different interpretations regarding their BIT commitments. Furthermore, those cases that are settled after proceedings begin also provide evidence of diverging interpretations as governments are most likely to seek a settlement if they anticipate that arbitrators will not interpret their conduct and their commitments as they do. After all, why would a government choose to contest investors’ claims before arbitration if it did not believe it had complied fully with its commitments and why would it later agree to a settlement if it did not feel that the arbitrators hearing the case were likely to disagree the government’s interpretation?

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9 The years refer to the year in which the case was initiated, not the year the ruling was passed. Many cases initiated since 2004 are still pending and therefore there is no outcome to record yet.

10 Here I assume that it is unlikely that a government will allow a dispute with an investor to go to arbitration if it does not believe it has a strong case against the investor’s claim that the government has violated its commitments. Governments are likely to seek to settle the dispute before costly arbitration proceedings begin if they believe that their behavior can be interpreted as violating their obligations to foreign investors.
5.3 Limiting the Legalization of Delegation

As noted above, in the majority of BITs, the legalization of delegation is very high whereby states pre-consent to submit any dispute with investors to international arbitration and arbitral decisions are binding. However, given the constraints that delegation places on policy autonomy, governments clearly have incentives to seek to limit the legalization of delegation and preserve greater policy space for themselves. Some governments have sought to scale back the degree of legalization of delegation in their BITs in several ways.

Keohane et al. (2000) argue that the extent to which arbitral bodies are able to hear cases and render judgments independent of government influence and interests is determined in part by the breadth of their mandate. Thus, one way governments have sought to ensure their interests are maintained and policy autonomy promoted is by shrinking the mandate of international arbitrators and limiting the scope of disputes that can be submitted to arbitration. In some treaties, delegation of dispute settlement authority is limited to disputes relating to commitments in the treaty itself, as opposed to any investment disputes that may arise. This means that the BIT does not authorize disputes relating to private contracts between BIT signatories and investors to be automatically submitted to arbitration. Other treaties limit arbitrators’ scope further by allowing disputes relevant to only a subset of BIT commitments, such as disagreements over the amount of compensation to be paid to investors following an act of expropriation. Thus, as certain categories of policy are carved out of national treatment commitments (Chapter 4), so too are certain categories of disputes that can arise between host governments and investors carved
out of the delegation of dispute settlement authority to international arbitrators. A second and more extensive limitation of the legalization of delegation occurs in a smaller share of BITs in which governments do not pre-consent to arbitration of any disputes (Yackee 2007), thus removing from delegation compulsory jurisdiction and the ability of firms to directly take MNEs to arbitration. Finally, the most extreme limitation of legalization is simply to refrain from delegation at all and indeed a small number of BITs include no provisions allowing investors to take disputes to international arbitration at all. In such cases, any resolution of disputes is not legal but must be achieved through political means such as negotiation and bargaining.

Each of these methods of scaling back the legalization of delegation clearly creates greater policy freedom for governments. By limiting the types of disputes that arbitration panels have the authority to hear, governments limit the number and type of policy decisions that arbitrators can pass judgment over and potentially reject. By choosing to refrain from pre-consenting to investor-state dispute settlement, governments retain a veto over whether or not disputes with investors can be brought before arbitration. If governments anticipate that arbitrators will interpret their behavior as incompatible with their BIT obligations, they can choose not to consent to arbitration. This allows governments to pursue policies that arbitrators may have deemed illegitimate in light of their earlier commitments to MNEs while not facing the censure of arbitrators and the associated reputation and monetary costs it can bring. The omission of a provision for international arbitration of investor-state disputes takes this one step further by forcing all disputes to be settled through negotiation. This means governments never risk having arbitrators rule against their
policies and actions and interpret their commitments in a manner that diverges from their own interpretations.

In Chapter 3, I argued that the legalization of BITs could be explained by government time horizons and that governments with longer time horizons design BITs with lower levels of legalization in order to preserve greater policy autonomy to respond to shifting conditions. Applying this argument in the context of delegation, and in light of the preceding discussion of how the legalization of delegation can be reduced in BITs, yields the following hypotheses:

**Delegation Hypothesis**: Governments with longer time horizons are more likely to conclude BITs that limit the types of disputes that can be submitted to arbitration, do not include states’ pre-consent to arbitration or do not include any provision for the international arbitration of investor-state disputes than governments with shorter time horizons.

**Delegation Hypothesis (a)**: Autocratic governments whose regimes are less vulnerable to collapse are more likely to conclude BITs that limit the types of disputes that can be submitted to arbitration, do not include states’ pre-consent to arbitration or do not include any provision for the international arbitration of investor-state disputes than autocratic governments whose regimes are more vulnerable.

**Delegation Hypothesis (b)**: Democratic governments led by a more highly institutionalized party are more likely to conclude BITs that limit the types of disputes that can be submitted to arbitration, do not include
states’ pre-consent to arbitration or do not include any provision for the international arbitration of investor-state disputes than democratic governments led by a less institutionalized party.

I expect these hypothesis to hold in the case of BITs because delegation by states in investment treaties is self-binding (see Alter 2008). It is states’ commitments and how well governments’ legislation and policies fit those commitments that are being evaluated by international investment arbitrators. BITs outline very few, if any, obligations that foreign investors must comply with. Consequently, foreign investors are the claimants and governments the defendants in all but a handful of arbitration cases brought under BITs. I would not expect the posited relationship between time horizons and the legalization of delegation to hold in cases when delegation is other-binding, i.e. in cases where governments delegate to agents the authority to evaluate the behavior of other actors, who are typically private individuals. This is because such instances of delegation pose little threat to government policy autonomy.\[11\]

\[11\] In a recent study, Allee and Peinhardt (2010) develop an approach to measuring “legal delegation” in BITs that focuses on ICSID as an arbitration venue. It is unclear in their analysis if this approach aims to capture the legalization of delegation as conceptualized by Abbott et al. (2000) and in this dissertation. However, if their study of “legal delegation” is indeed an analysis of the “legalization of delegation”, I believe the approach I pursue in this chapter is a more accurate conceptualization and operationalization of legalization of delegation when applied to investor-state dispute settlement in BITs. For a detailed explanation of why this is so, please consult Appendix D.
5.4 Evaluating the Argument

5.4.1 Data and Measurement

*Legalization of Delegation*

In line with the discussion above of how the legalization of delegation of dispute settlement authority is limited in BITs, I coded the investor-state dispute settlement provisions of a random sample of BITs as belonging to one of the four categories detailed in Table 5.1. When a treaty contains an “umbrella clause”, and its investor-state dispute settlement clauses fall under category 3, it is recoded as falling into category 4. An umbrella clause appears in several BITs and is typically a pledge by treaty signatories to respect all other commitments undertaken towards foreign investors. The effect of such a clause is to bring non-treaty related commitments such as those enshrined in domestic legislation and in private contracts between the government and the investor under the umbrella of the treaty (Newcombe & Paradell 2009) and thus commitments beyond the treaty itself can now be submitted to international arbitration, which is what category 4 specifies. In addition, a treaty’s dispute settlement provision only falls under category 2 if the subset of obligations that can be the subject of arbitration is very small. For example, several treaties only allow disputes over the amount of compensation for expropriation to be arbitrated. If a treaty only excludes a small number of obligations from arbitration, then the scope of its arbitration provisions are considered almost treaty wide and thus category 3 or 4 is more appropriate.

12The same sample employed in Chapter 4 is employed here.
Table 5.1: Legalization of Delegation in Sample of 346 BITs

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Percentage of Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No provision is made for investors to take host governments before <em>international</em> arbitration or there is no pre-consent by the treaty signatories to international arbitration of investor-state disputes.</td>
<td>6</td>
</tr>
<tr>
<td>2</td>
<td>States pre-consent for disputes related to a subset of obligations under the BIT to be submitted to international arbitration.</td>
<td>7</td>
</tr>
<tr>
<td>3</td>
<td>States pre-consent for disputes related to obligations within or interpretations/applications of the BIT to be submitted to international arbitration.</td>
<td>11</td>
</tr>
<tr>
<td>4</td>
<td>States pre-consent for disputes related to investments or any disputes between an investor and BIT signatory to be submitted to international arbitration, i.e. disputes need not be related to BIT obligations.</td>
<td>76</td>
</tr>
</tbody>
</table>
Although the four categories of delegation specified above can be viewed as moving in order from lower to higher levels of legalization, in the empirical analysis below I employ a dummy variable that collapses categories 1-3 into a single category, to be compared to category 4. The rationale for doing so is that category 4 is clearly the most popular accounting for the type of delegation in 76 percent of the sample. Thus the comparison is made between highest level of legalization of delegation (category 4) and what might be described as a single category comprised of all lower levels of legalization.

5.4.2 Results

To test the legalization of delegation hypotheses, I use the same set of covariates employed in Chapter 4. To avoid repetition, I refer the reader to section 4.4 for a discussion of how these variables are constructed and how they relate to legalization in BITs; the rationales presented in Chapter 4 explaining how these variables influence the legalization of obligation apply equally to delegation. Results for logistic regression models of the legalization of delegation are presented in Table 5.2. As before, the expected sign on the coefficients is included in parentheses next to the variable names for host and home state time horizons.\textsuperscript{13}

The estimates for host state government time horizons across both models do not provide support for the hypotheses linking government time horizons to the legalization of delegation in BITs. While the signs on the coefficients are in the expected

\textsuperscript{13}The expected signs are different to those in Chapter 4 because a positive value on the dependent variable here (i.e. a value of 1) indicates greater legalization.
Table 5.2: Logistic Regression Models of the Legalization of Dispute Settlement Delegation

<table>
<thead>
<tr>
<th>Host Regime Type</th>
<th>Autocracy</th>
<th>Democracy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Autocratic Time Horizon (Host)</td>
<td>0.161 (0.159)</td>
<td>-0.296 (0.257)</td>
</tr>
<tr>
<td>$Pr(\text{Regime Failure})$ $(+)$</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Host)</td>
<td>-1.790*** (0.61)</td>
<td>-1.212** (0.523)</td>
</tr>
<tr>
<td>$Party \text{ Age} (-)$</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Home)</td>
<td>2.046** (0.795)</td>
<td>0.769 (0.505)</td>
</tr>
<tr>
<td>Age of Democracy (Home)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age of Democracy (Host)</td>
<td>-0.027 (0.26)</td>
<td></td>
</tr>
<tr>
<td>North-South BIT</td>
<td>0.879 (0.829)</td>
<td>0.566 (1.007)</td>
</tr>
<tr>
<td>Years Since Independence (Host)</td>
<td>-0.823** (0.377)</td>
<td>-0.466** (0.183)</td>
</tr>
<tr>
<td>Host Share of Dyadic Wealth</td>
<td>-1.818 (1.477)</td>
<td>-0.327 (1.276)</td>
</tr>
<tr>
<td>GDP p.c. Growth (Host)</td>
<td>-0.027 (0.042)</td>
<td>0.081 (0.050)</td>
</tr>
<tr>
<td>Time Counter</td>
<td>0.197*** (0.048)</td>
<td>-0.019 (0.116)</td>
</tr>
<tr>
<td>Executive Constraints (Host)</td>
<td>0.219 (0.211)</td>
<td>0.225 (0.230)</td>
</tr>
<tr>
<td>Executive Constraints (Home)</td>
<td>0.710 (0.520)</td>
<td>1.008* (0.586)</td>
</tr>
<tr>
<td>Constant</td>
<td>-8.827* (4.552)</td>
<td>-1.826 (5.513)</td>
</tr>
</tbody>
</table>

Two-way clustered (on host and home state) robust standard errors in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$
direction, the estimates are not statistically significant. Thus, I am unable to reject
the null hypothesis and cannot confidently conclude that there is a systematic rela-
tionship between host governments’ time horizons and the legalization of delegation.
However, the expected relationship between time horizons and legalization is present
and statistically significant at the 0.01 or 0.05 levels for governments in home states.
Thus, when home state governments are led by older, more institutionalized parties
with longer time horizons they are more likely to conclude BITs in which delegation
is legalized at the highest level.

The substantive nature of this effect is best illustrated by the following example.
When the largest party in the home state government is a relatively young five years
old the predicted probability that its BITs will include the delegation of authority
for the settlement of disputes at the highest level of legalization is 0.99 when the host
state is an autocracy and 0.92 when the host state is democratic. Thus, home state
governments led by young parties almost always concludes BITs in which delegation
is highly legalized. However, when the government in the home state is led by a more
mature party with a longer time horizon, such as the Christian Democratic Party
in Germany which has existed for 55 years, the predicted probability that its BITs
will include highly legalized delegation of dispute settlement authority is much lower:
0.70 when the host state is autocratic and 0.40 when the host state is democratic.
Thus, as far as home states are concerned, the likelihood that the legalization of
delegation will be below its highest level increases with the age and time horizons of
their governing parties.  

\[^{14}\text{Predicted probabilities calculated holding all other covariates at their mean and mode values.}\]
Among the other independent variables, the number of years that the host state has been independent exhibits a negative and consistently statistically significant relationship with the legalization of delegation, failing to achieve significance in only one of the eight models (the first model in Table 5.3). The negative sign indicates that governments in states that have been independent for longer will be more likely to limit the legalization of the delegation of dispute settlement authority. This result offers evidence against the argument that newly independent states will be jealous of their sovereignty and policy freedom and will therefore eschew greater legalization of their international obligations.

Few of the other covariates exhibit consistently statistically significant effects with the exception of time. BITs in which the host state is autocratic have become more likely to have legalization of delegation at the highest level over time. However, time displays no significant relationship with the legalization of delegation in BITs in which the host state is democratic. Another important result is that, with one exception, the coefficient estimates for host and home state executive constraints fail to achieve statistical significance in any model in Table 5.3, indicating once more that the need for credibility plays less of a role in determining the level of legalization than a functionalist explanation for the legalization of BITs would predict.

Overall, the results provide mixed support for the argument that government time horizons shape the legalization of delegation in BITs. I find a robust and statistically significant relationship between home state government time horizons and the legalization of delegation whereby home state governments with long time horizons are more likely to conclude BITs in which the legalization of delegation is diminished
to some degree. However, while I do not find any statistically significant correlation between host state government time horizons and the legalization of delegation.

5.5 Conclusion

Following the discussion of obligation in the previous chapter, this chapter applied and evaluated the theory linking time horizons to preferences over legalization in the context of another dimension of legalization: delegation. The chapter focused on the delegation of authority to international arbitrators to settle disputes between investors and host governments. The trade-off inherent in legalization between credibility and autonomy is clearly present in the delegation of dispute settlement authority in BITs. When delegation is highly legalized, investors find governments’ commitments more credible because they can directly challenge government violations of those commitments and cause governments to suffer audience, reputation, and financial costs. The potential of having to pay such costs serves to deter governments from violating their commitments, thus making those commitments more credible. However, governments who highly legalize delegation in their BITs will risk

\[\text{15} \text{For methodological reasons I am not able to test the robustness of these results after accounting for selection into BITs as I did in Chapter 4 and I as do below in the empirical analysis of BIT precision. As indicated above, the dependent variable takes on the value of zero in only 24 percent of observations which equates to a small number of observations with zeros in the models, once observations are dropped due to missing data and the sample is split according to host and home state regime types. The distribution of the dependent variable across the values of several independent variables in uneven and while this is not a problem in the main models, it leads to samples being drawn in the bootstrap resampling that exhibit separation.}\]
their policy space being constrained by international arbitrators who interpret their policies as being incongruent with their commitments to foreign investors.

Using original data, I find that delegation of dispute settlement authority in BITs is typically highly legalized, but that some governments do attempt to limit the authority of arbitrators by weakening the legalization of their dispute settlement provisions. My argument that governments with long time horizons prize policy autonomy to a greater degree than governments with short time horizons and therefore conclude less legalized BITs receives modest support when tested using this delegation data. Both home and host state governments with long time horizons prefer less legalized delegation of dispute settlement authority, however this relationship is only statistically significant with respect to home states. Thus, the host - home state pattern of results in this chapter diverges from my original expectations as expressed in Chapter 3, i.e. the relationship between host state time horizons and legalization should be more robust than the relationship between home state time horizons and legalization because host states are net importers of FDI and are more concerned about constraints on their policy autonomy as a result.

What explains why a systematic relationship between time horizons and legalization of delegation is uncovered for home states but not for host states? One possible explanation is that the delegation of dispute settlement authority in BITs is uniquely pivotal to their role as credibility enhancing devices. Indeed, many of the costs that BITs generate for commitment violations are produced through the dispute settlement process. Therefore, credibility seeking host governments, even those with longer time horizons, may be more willing to allow their policy autonomy to
be constrained by highly legalized delegation. Home state governments on the other hand do not have an urge for credibility to the same extent as host state governments because they anticipate less FDI inflows from their treaty partner. Thus, they may find the considerable constraints associated with highly legalized delegation in BITs excessive. If this explanation has merit and the legalization of delegation in BITs is indeed unique in its ability to generate credibility and constraints, the unexpected home-host pattern of results found in this chapter should only exhibit itself with respect to delegation. Whether or not this is so will become clearer after evaluating how well the theory explains the legalization of BITs with respect to the third dimension of legalization: precision. It is this I turn to in the next chapter. However, in the concluding chapter I return to this discussion of whether or not delegation is unique and why home state governments’ time horizons unexpectedly display a more robust relationship with legalization of delegation than host state governments’ time horizons.
CHAPTER 6
PRECISION OF OBLIGATIONS IN INVESTMENT AGREEMENTS

6.1 Introduction

In this chapter I evaluate how well government time horizons explain variation in the third dimension of legalization in BITs: precision. The relationship between precision, credibility and policy autonomy is comparatively complex because it is conditioned by the delegation of dispute settlement authority. When the legalization of delegation is low, the final right of interpreting treaty commitments and governments’ compliance with them falls to governments themselves. In this context, precision promotes credibility and constrains policy autonomy because it limits self-serving interpretations of BIT commitments by governments. However, when the legalization of delegation is high such that governments pre-consent to arbitration of a wide range of investor-state disputes, precision works against credibility and promotes policy autonomy. This is because under highly legalized delegation, the final duty of interpretation when there is a disagreement between investors and governments belongs to international arbitrators. Thus, governments wishing to preserve
policy autonomy will use precision to limit the discretion that arbitrators have to interpret their treaty commitments and prevent arbitrators from adopting expansive interpretations which impose greater constraints on policy. However, less precision promotes the credibility of governments’ commitments under highly legalized delegation because it enables investors to claim that commitments should be interpreted and applied in a broader context. It follows that if the theoretical argument developed in Chapter 3 is accurate, and governments with longer time horizons calibrate the legalization of their BITs to promote greater policy autonomy, then they will prefer more precise BITs when the delegation of dispute settlement authority is highly legalized, but will conclude less precise BITs when delegation is less legalized.

I test this proposition using original data on the precision of policy commitments in BITs. I use treaty length as a measure of precision but take great care to standardize BITs stylistically before calculating the number of words they contain. Using this measure, I find that the legalization of delegation does shape the effect of host state government time horizons on treaty precision. When treaty partners pre-consent to the arbitration of a wide-range of disputes, host state governments with longer time horizons sign longer, more precise BITs. However, when such pre-consent is absent, host state governments with longer time horizons conclude less precise BITs. Furthermore, once again using original data, I am able to control for the substantive scope of each treaty (the range of issues and policies each treaty covers) in my empirical analysis. While the results for host state time horizons offer clear and robust support for the theory, I do not find a consistent relationship between home state government time horizons and treaty precision.
6.2 Precision: Credibility & Constraint

An obligation is precise when it “specifies clearly and unambiguously what is expected of a state or other actor (in terms of both the intended objective and the means of achieving it) in a particular set of circumstances” (Abbott et al. 2000, 412). In highly developed and institutionalized legal settings, obligations can be specified as precise rules or general standards of conduct and in both cases effectively constrain and guide actors’ behavior. The critical difference is that high precision rules reflect an *ex ante* decision by the community as to what behaviors are acceptable while general standards of conduct lead to *ex post* decisions, usually by judicial bodies such as courts, about acceptable behavior (Abbott et al. 2000). International politics is institutionally thin possessing few highly developed judicial or administrative organs that states can turn to with ease and frequency to interpret imprecise rules or obligations. As a result, the actors responsible for interpreting obligations enshrined in formal institutions are the very states whose conduct those obligations are meant to govern (Abbott et al. 2000). Therefore, when commitments are more precise in international politics, they offer more effective guidance to governments. It follows that if a critical dimension of legalization is for legal rules to play an effective role in guiding and coordinating state behavior, then a high degree of precision is associated with a high level of legalization.

Precision is similar to obligation and delegation in that greater legalization leads to greater credibility of commitments but credibility comes at the expense of policy autonomy. International agreements such as BITs are incomplete contracts which are
open to interpretation (Hawkins et al. 2006a). The poorly developed judicial institutions in most areas of international relations mean that commitments undertaken by states are interpreted by governments. Therefore, when commitments are expressed as vague or general standards of behavior, they are open to inconsistent and self-serving interpretations by governments seeking to pursue whichever policies they deem likely to ensure continued political support. Consequently, vague and general commitments will lack credibility as other actors know that governments can escape their commitments through “creative” interpretations of their obligations. Such escape becomes much more difficult, and commitments become more credible, when they are expressed with greater precision and leave little scope for interpretation by governments. However, it is this removal of discretion in the interpretation of commitments that causes greater precision to lead to greater constraints on government policy. When commitments are less precise, policy autonomy is less constrained as governments can form interpretations of their policy commitments such that their preferred policies will be in compliance with those commitments.

With respect to investment agreements, imprecise BITs allow states to select from, and pursue, a greater range of policies whilst still being able to claim that they are in compliance with their BIT obligations. On the other hand, precise BITs more clearly and unambiguously establish the incompatibility of a range of investment-related policies with the commitments undertaken in BITs, minimizing the scope for self-serving interpretations of those commitments, and constraining signatory governments’ policy choices to a much greater degree. The removal of ambiguity
and the possibility of self-serving interpretations of BIT commitments makes those commitments more credible in the eyes of foreign investors.

If one follows this perspective to its logical conclusion, governments with long time horizons seeking to limit constraints on their policy making autonomy should, as in the case of delegation and obligation, seek lower levels of legalization with respect to precision and conclude imprecise treaties. However, in order to understand the implications of precision for credibility and policy autonomy, it must be analyzed in conjunction with delegation because delegation determines whose freedom of interpretation is constrained by greater precision. If an institution delegates dispute settlement authority with a high degree of legalization, interpretation of the rules and commitments enshrined in that institution shifts from the founders of that institution (states) to those charged with settling disputes (third-party arbitrators) (Alter 2008). In this context, imprecision, rather than providing states with greater scope for interpreting their commitments as they wish, provides arbitrators with greater scope for interpretation. Low precision affords arbitrators, not states, more discretion and therefore opens the door to arbitrators taking expansive interpretations of treaty commitments that place significant constraints on governments’ policy autonomy. Moreover, low precision increases the risk that arbitrators will adopt interpretations of treaty commitments that are inconsistent with the original preferences and intentions of the governments that drafted the treaty. In contrast, more precise treaties will circumscribe arbitrators’ scope for interpretation and better ensure that arbitrators interpret states’ commitments in the manner the treaty signatories intended more often than not (Hawkins et al. 2006a).
The implications of this argument for the link between precision and policy autonomy are clear: when delegation is highly legalized, as is the case in most BITs (see Table 5.1), greater precision reduces unwanted and unexpected constraints on policy autonomy by lowering the probability of unintended interpretations of treaty commitments by arbitrators. This interpretation of the relationship between precision and policy autonomy under high delegation echoes Abbott et al.’s (2000) proviso that while high precision typically constrains governments’ discretion over public policy, “imprecision is not synonymous with state discretion, however, when it occurs within a delegation of authority and therefore grants to an international body wider authority to determine its meaning” (415). It is worth noting that in the case of BITs there is no appellate body to which governments can turn to when they encounter unexpected and highly constraining interpretations of their commitments to MNEs. Moreover, international investment arbitrators are not bound by precedent in their decision making. Thus, the precision and clarity with which commitments are specified in BIT texts are a crucial factor in shaping the interpretations of arbitrators and the constraints that such interpretations may place on government policy.

The ability for treaty precision to shape the level of discretion that arbitrators have to constrain policy autonomy has been raised with respect to NAFTA’s Chapter 11 (NAFTA’s BIT-like investment chapter) (VanDuzer 2002). Many have argued that NAFTA’s provisions are excessively broad and have allowed arbitrators to adopt overly expansive interpretations of expropriation provisions in Chapter 11 and in doing so to rule legitimate attempts by NAFTA member governments at environmental

\footnote{See also Bradley and Kelley (2008) on this point.}
regulation incompatible with their Chapter 11 commitments (Tollefson 2003). This has led to a widespread call for clarification of provisions in Chapter 11 through interpretive notes issued by the NAFTA members to guide arbitrators’ interpretations (Soloway 2003). Thus, general and imprecise language in Chapter 11 has, in the eyes of some, led to unintended interpretations by arbitrators that constrain governments’ freedom to implement environmental regulations and the solution has been to add precision through interpretive notes that specify the intended meaning of Chapter 11’s provisions in greater detail. It would be difficult to find a more apt illustration of the argument that precision can help maintain policy autonomy under highly legalized delegation.

How does high legalization of delegation shape the effect of greater precision on credibility? When investors do not have to worry about self-serving interpretations by governments, less precision makes commitments more credible. It is difficult to anticipate all future circumstances and conditions when drafting an agreement (Hawkins et al. 2006a) and therefore investors, safe in the knowledge that arbitrators are impartial, will view their rights as better protected when arbitrators are able to easily adapt general commitments and investor protections contained in imprecise BITs to specific circumstances as they arise. One of the points made by Jensen (2006) in his discussion of credible commitments to MNEs is that investors don’t desire credibility in the form of a static policy environment. Rather, they want policy to be flexible and adaptive but consistently hospitable and favorable to MNEs. Imprecise treaties afford arbitrators such flexibility in how they interpret and
apply governments’ policy commitments. On the other hand, more precise BIT obligations may lead to difficult or awkward applications of investor protections when unanticipated circumstances arise.

Furthermore, investors will find governments’ commitments more credible under highly legalized delegation when precision is low because vague and open-ended commitments leave more room for investors to challenge government policies that harm their interests. This is because when commitments are expressed in general terms, investors can more easily make a case for them to be applied to a wide variety of circumstances. While governments may be concerned about expansive interpretations arising from vague treaty provisions, investors can capitalize on the potential for such interpretations to maximize the protection afforded to them in investment treaties. The greater scope that investors have to protect their interests using BITs, the more credible governments’ commitments to protect investors’ rights, as outlined in BITs, become. In contrast, more precise BIT provisions will often more clearly rule out the applicability of investor protections to certain contexts, limiting the protection that BITs afford investors.\(^2\)

\(^2\)For a more general discussion of how greater credibility is gained through delegation when agents have a high degree of discretion see Hawkins et al. (2006a). Keohane et al. (2000) make a different but related point, which is that arbitrators will have greater scope for making judgments independent of the preferences and interests of governments when uncertainty concerning the appropriate interpretation of applicable rules and norms is high (as is the case when those rules are vague and imprecise).
6.3 Tracing Variation in Precision

In order to help the reader better understand how BIT provisions can be made more or less precise, and how precision can affect policy autonomy and credibility, I will compare provisions in different BITs addressing three core subjects: absolute standards of treatment, expropriation, and transfers of funds. In doing so, I will focus on the context in which legalization of delegation is high, as is this the case in most BITs.

Almost all BITs contain a commitment to a minimum or absolute standard of treatment of foreign investment. This commitment typically includes a pledge to afford investments fair and equitable treatment, and protection and security. The BIT between Canada and El Salvador illustrates this commitment stated in its most general terms (the relevant text is in italics):

Article II: Promotion and Protection of Investments
Each Contracting Party shall encourage the creation of favourable conditions for investors of the other Contracting Party to make investments in its territory.

Each Contracting Party shall accord investments or returns of investors of the other Contracting Party:

fair and equitable treatment in accordance with principles of international law,

and full protection and security
The U.S. - Rwanda BIT is an example of a more precise approach:

Article 5: Minimum Standard of Treatment

1. Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.

2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide:

   (a) “fair and equitable treatment” includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and

   (b) “full protection and security” requires each Party to provide the level of police protection required under customary international law.

3. A determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article.

Annex A - Customary International Law
The Parties confirm their shared understanding that “customary international law” generally and as specifically referenced in Article 5 and Annex B results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 5, the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens.

The language in the U.S. - Rwanda BIT clearly does more to guide the interpretation of the commitment to fair and equitable treatment and full protection and security according to international law by outlining the types of behavior expected of governments (paragraphs 2(a) and 2(b)) as well as making clear that the promise of fair and equitable treatment should not oblige governments to treat foreign investors better than the minimum standard according to customary international law. Annex A also guides international arbitrators by specifying clearly the treaty drafters intended meaning and understanding of “customary international law”. Moreover, the desire to guide interpretation is clear in the second paragraph with the words “for greater certainty”. The Canada - El Salvador BIT in contrast makes no attempt to clarify what the treaty drafters mean by principles of international law, fair and equitable treatment and full protection and security, leaving international arbitrators greater scope in how they interpret these legal concepts and apply them to specific disputes between investors and governments.

Another important BIT provision addresses expropriation of investors’ assets.
Expropriation clauses typically specify the conditions under which expropriation can occur and establish an obligation for governments to compensate investors. The U.S. experience with Chapter 11 arbitration under NAFTA has led it to develop more precise expropriation provisions in its free trade and investment agreements to guide the interpretations of arbitrators. Gantz (2004) argues this point with respect to the U.S. - Chile free trade agreement, but the effort for greater precision is manifest in U.S. BITs as well, such as the U.S. BIT with Uruguay, which includes an expropriation annex (Annex B) that contains almost identical language to the more precise provisions in the U.S. - Chile free trade agreement. Below is the text of the main article addressing expropriation followed by the annex:

Article 6: Expropriation and Compensation 1. Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (expropriation), except:

(a) for a public purpose;
(b) in a non-discriminatory manner;
(c) on payment of prompt, adequate, and effective compensation; and
(d) in accordance with due process of law and Article 5(1) through (3).

2. The compensation referred to in paragraph 1(c) shall:

(a) be paid without delay;
(b) be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place (the date of expropriation);

(c) not reflect any change in value occurring because the intended expropriation had become known earlier; and

(d) be fully realizable and freely transferable.

3. If the fair market value is denominated in a freely usable currency, the compensation referred to in paragraph 1(c) shall be no less than the fair market value on the date of expropriation, plus interest at a commercially reasonable rate for that currency, accrued from the date of expropriation until the date of payment.

4. If the fair market value is denominated in a currency that is not freely usable, the compensation referred to in paragraph 1(c) converted into the currency of payment at the market rate of exchange prevailing on the date of payment shall be no less than:

   (a) the fair market value on the date of expropriation, converted into a freely usable currency at the market rate of exchange prevailing on that date, plus

   (b) interest, at a commercially reasonable rate for that freely usable currency, accrued from the date of expropriation until the date of payment.

5. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the
TRIPS Agreement, or to the revocation, limitation, or creation of intellectual property rights, to the extent that such issuance, revocation, limitation, or creation is consistent with the TRIPS Agreement.

Annex B

Expropriation

The Parties confirm their shared understanding that:

1. Article 6(1) is intended to reflect customary international law concerning the obligation of States with respect to expropriation.

2. An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.

3. Article 6(1) addresses two situations. The first is known as direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.

4. The second situation addressed by Article 6(1) is known as indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.

   (a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:

   (i) the economic impact of the government action, although the fact
that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;

(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and

(iii) the character of the government action.

(b) Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.

This lengthy and detailed discussion of expropriation stands in stark contrast to the expropriation provisions of several other treaties such as the BIT between Sweden and Albania:

Article 4
Expropriation and Compensation
(1) Neither Contracting Party shall take any measures depriving, directly or indirectly, an investor of the other Contracting Party of an investment unless the following conditions are complied with:

(a) the measures are taken in the public interest and under due process of law;

(b) the measures are distinct and not discriminatory; and

(c) the measures are accompanied by provisions for the payment of
prompt, adequate and effective compensation, which shall be transferable without delay in a freely convertible currency.

(2) The provisions of Paragraph (1) of this Article shall also apply to the returns from an investment as well as, in the event of liquidation, to the proceeds from the liquidation.

The difference in the degree of precision between the two BITs is clear. The U.S. - Uruguay BIT attempts to guide arbitrators’ interpretation of concepts such as “direct expropriation” and “indirect expropriation” and to outline what types of government action do and do not fall under these classes of behavior (Annex B, paragraphs 3 and 4). It also makes clear the factors that should determine the level of compensation to be paid to investors (Article 6, paragraphs 2-4). The Sweden-Albania BIT in contrast simply refers to direct and indirect takings and “adequate and effective” compensation without elaboration, leaving arbitrators a wide berth to determine what these entail in practice. Note that in paragraph 4(b) of Annex B in the U.S. - Uruguay BIT the text makes clear that acts taken to promote public welfare should not be regarded as indirect expropriation. This ensures greater policy space for governments to employ regulatory policies to promote welfare objectives. As the Sweden-Albania BIT provides no interpretive guidance in this respect, the contracting parties run the risk that their attempts at legitimate regulation for public welfare will be interpreted as indirect expropriation by international arbitrators. However, the imprecision of the Sweden-Albania BIT’s expropriation provisions and the discretion it gives investment arbitrators allows foreign investors the opportunity to potentially successfully challenge regulatory policies aimed at promoting public
welfare as acts of indirect expropriation if they detract from the value of their investments. This makes the promise to refrain from indirection expropriation more credible in the Sweden-Albania BIT.

The final type of clause to be examined pertains to transfers of funds. One of the major concerns of MNEs is that they will not be able repatriate profits and earnings and therefore many BITs include an article that guarantees foreign investors freedom to transfer funds. Some BITs, such as the treaty between Turkey and Moldova, establish this commitment in comparatively general terms:

ARTICLE IV

Repatriation and Transfer

1. Each Party shall permit in good faith all transfers related to an investment to be made freely and without unreasonable delay into and out of its territory. Such transfers include:

(a) returns,

(b) proceeds from the sale or liquidation of all or any part of an investment,

(c) compensation pursuant to Article III,

(d) reimbursements and interest payments deriving from loans in connection with investments,

(e) salaries, wages and other remunerations received by the nationals of one Party who have obtained in the territory of the other Party the corresponding work permits relative to an investment,

(f) payments, arising from an investment dispute.
2. Transfers shall be made in the convertible currency in which investment has been made or in any convertible currency at the rate of exchange in force at the date of transfer, unless otherwise agreed by the investor and the hosting Party.

Other treaties, such as the BIT between Austria and Jordan elaborate further:

ARTICLE 7

Transfers

(1) Each Contracting Party shall guarantee that all payments relating to an investment by an investor of the other Contracting Party may be freely transferred into and out of its territory without delay. Such transfers shall include, in particular

   a) the initial capital and additional amounts to maintain or increase an investment;

   b) returns;

   c) payments made under a contract including a loan agreement;

   d) proceeds from the sale or liquidation of all or any part of an investment;

   e) payments of compensation under Articles 5 and 6;

   f) payments arising out of the settlement of a dispute;

   g) earnings and other remuneration of personnel engaged from abroad in connection with an investment.

(2) Each Contracting Party shall further guarantee that such transfers
may be made in a freely convertible currency at the market rate of exchange prevailing on the date of transfer in the territory of the Contracting Party from which the transfer is made.

(3) In the absence of a market for foreign exchange, the rate to be used shall be the most recent exchange rate for conversion of currencies into Special Drawing Rights.

(4) Notwithstanding paragraph (1) b) a Contracting Party may restrict the transfer of a return in kind in circumstances where the Contracting Party is permitted under the GATT 1994 to restrict or prohibit the exportation or the sale for export of the product constituting the return in kind. Nevertheless, a Contracting Party shall ensure that transfers of returns in kind may be effected as authorised or specified in an investment agreement, investment authorisation, or other written agreement between the Contracting Party and an investor or investment of the other Contracting Party.

(5) Notwithstanding paragraphs (1) to (4), a Contracting Party may prevent a transfer through the equitable, non-discriminatory and good faith application of measures to protect the rights of creditors, relating to or ensuring compliance with laws and regulations on the issuing, trading and dealing in securities, futures and derivatives, reports or records of transfer, or in connection with criminal offences and orders or judgements in
administrative and adjudicatory proceedings, provided that such measures and their application shall not be used as a means of avoiding the Contracting Party’s commitments or obligations under this Agreement.

The critical differences between the two BITs are paragraphs 4 and 5 in the Austria-Jordan BIT which outline in detail certain conditions under which governments can legitimately limit transfers of funds. Not only does this preserve regulatory space for governments by allowing them to protect the rights of creditors and ensure compliance with local laws but it also makes clear to international arbitrators that such regulation is not a breach of the BIT. The Moldova-Turkey BIT in contrast does not specify that such regulatory acts should not be regarded as violations of the guarantee of free transfer of funds. As a result, if either Turkey or Moldova should attempt to justify preventing transfers in order to protect creditors’ rights, ensure compliance with local laws and so forth, it is entirely up to the international arbitrator to determine if this is an acceptable reason for preventing transfers. The acceptability of such reasoning is made plain in the Austria-Jordan BIT leaving less to the arbitrators’ discretion. However, the general nature of the free transfers guarantee in the Moldova-Turkey BIT produces a more credible commitment to free transfers because it allows investors to potentially successfully claim that attempts made to block their transfers of capital are a violation of their right of free transfer, even when their transfers are prevented to protect the rights of creditors and ensure compliance with local laws.
6.4 Empirical Expectations

According to Abbott et al. (2000), “precise sets of rules are often, though by no means always, highly elaborated or dense, detailing conditions of application, spelling out required or proscribed behavior in numerous situations, and so on” (413). This association of precision with a high degree of elaboration and detail strongly suggests that treaties and agreements in which rules are expressed with greater precision should be longer than treaties which are less precise. Indeed, one noticeable trait of more precise treaty provisions in the examples above is that they are longer than their less precise counterparts. Therefore, in order to evaluate empirically the determinants of BIT precision, I use treaty length - measured as the number of words in the treaty text - as a proxy measure for precision, whereby a more precise treaty is one that is longer and contains more words. Other studies of delegation have adopted similar approaches when attempting to gauge the precision of delegation contracts and the extent to which acts of delegation afford agents discretion in the interpretation of their mandate (Huber & Shipan 2002).

Figures 6.1 and 6.2 provide graphical illustrations of the distribution of treaty length in a sample of 342 treaties and the median length of treaties in the sample concluded during different time periods. The sample of BITs employed here is the same as that used in Chapter 4. While the total sample contains texts for 346 treaties, there is no word count for four of these because either they are either so poorly photocopied and scanned that an accurate word count is not possible or because they are written in non-latin scripts that make accurately counting words very difficult (e.g. Russian). While there is considerable variation in treaty length,
it is clear from Figure 5.1 that the dominant range is 1500-2000 words and that the vast majority of BITs are between 1000 and 2500 words in length. Furthermore, Figure 5.2 suggests that BITs have been getting longer and more precise over time.

As precision is a dimension of legalization, for reasons outlined in previous chapters I expect that government time horizons will help explain why we observe such variation in the length and precision of BITs. To recap the argument, governments with longer time horizons will seek to calibrate the level of legalization of their BITs to preserve policy autonomy. This typically entails greater legalization and thus
Figure 6.2: Median Length of BITs in Sample of 342 Treaties Over Time
less precision. When obligations are expressed in vague and general terms, governments have more room for self-serving interpretations. However, this relationship is reversed when legalization of delegation is high, because governments have an incentive to limit discretion vis-à-vis the interpretation of treaty commitments when the final duty of interpretation falls to a third party - international arbitrators in the case of BITs - instead of themselves. Thus, the impact of government time horizons on treaty length and precision is conditioned by the legalization of delegation. This argument reflects Hypothesis 2 in Chapter 3 which posits that while governments with longer time horizons will typically prefer less legalization of their commitment in order to preserve greater policy autonomy, when design choices are made with respect to other aspects of legalization such that more rather than less legalization promotes policy autonomy, governments will prefer more legalization. In the case of delegation and precision in BITs, when a high level of legalization of delegation is included in a BIT, greater policy autonomy is achieved through greater legalization with respect to precision. Thus, my empirical expectations regarding the length of BITs and government time horizons can be expressed as follows:

**Precision Hypothesis 1**: Governments with longer time horizons are more likely to conclude longer (more precise) BITs than governments with shorter time horizons when the delegation of dispute settlement authority is highly legalized.

**Precision Hypothesis 1(a)**: Autocratic governments whose regimes are less vulnerable to collapse are more likely to conclude longer (more precise)
BITs than autocratic governments whose regimes are more vulnerable, when the delegation of dispute settlement authority is highly legalized.

**Precision Hypothesis 1(b)**: Democratic governments led by a more highly institutionalized party are more likely to conclude longer (more precise) BITs than democratic governments led by a less institutionalized party when the delegation of dispute settlement authority is highly legalized.

**Precision Hypothesis 2**: Governments with longer time horizons are more likely to conclude shorter (less precise) BITs than governments with shorter time horizons when the delegation of dispute settlement authority is not highly legalized.

**Precision Hypothesis 2(a)**: Autocratic governments whose regimes are less vulnerable to collapse are more likely to conclude shorter (less precise) BITs than autocratic governments whose regimes are more vulnerable when the delegation of dispute settlement authority is not highly legalized.

**Precision Hypothesis 2(b)**: Democratic governments led by a more highly institutionalized party are more likely to conclude shorter (less precise) BITs than democratic governments led by a less institutionalized party when the delegation of dispute settlement authority is not highly legalized.
6.5 Evaluating the Argument

6.5.1 Data and Measurement

*Precision*

In developing a measure of treaty length (number of words) as a proxy for treaty precision, I had two main objectives. My first objective was to develop coding rules that would standardize the format of the treaties included in the sample to the greatest extent possible and thus minimize the potential for differences in treaty drafting styles to influence the word count. My second objective was to exclude, as much as possible, content unrelated to substantive commitments regarding the treatment of foreign investors or the treaty’s regulation of this treatment. For example, some governments are inclined to attach protocols, annexes or agreed minutes to the main texts of treaties while others do not. The rule in these cases was to count whatever in these protocols, annexes, letters and so forth entailed a substantive rule or commitment that would not have been out of place in the main body of the treaty. Any other language, such as long introductions to protocols or diplomatic niceties were not counted so as not inflate the word count of treaties that expressed commitments outside of the main body of the treaty that could just as easily have been expressed in it. Likewise when exchanges of letters or minutes were reprinted to acknowledge receipt by both parties, the reprint was not counted at all as it simply repeated already counted material. Any references to exchange of instruments of ratification or the date the treaty came into force, if outside of the main body of the treaty, were not counted as few treaties include such references and they are unrelated to
the precision of substantive treaty commitments. Non-substantive material that was counted are the title of the treaty and references to the place and date of signature as these are standard across all treaties and do not, therefore, distort comparison of the degree of precision in substantive commitments across treaties. In a final effort to promote standardization of treaties, Huber and Shipan’s (2002) language multiplier was used to correct for the fact that expressing the same substantive ideas in different languages takes different amounts of words.

A final coding decision was not to include words that pertained directly to dispute settlement. The theoretical focus here is on the how the precision of commitments affects how states and arbitrators are able to interpret those commitments and what types of host state policies are compatible with them. Thus, my objective is to measure the precision of substantive policy commitments regarding the treatment of foreign investors and their assets and much of the language in dispute settlement clauses in BITs is procedural. Consequently, the length or precision of dispute settlement clauses does not really affect how the acceptability of state policies will be evaluated. This is not to understate the importance of the content of dispute settlement clauses nor do I deny that important commitments are present within them.

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3 If these are included multiple times in a treaty (e.g., at the end of a protocol) they are not counted a second time because, as noted above, not all treaties choose to place commitments in protocols.

4 The number of words in each treaty in the sample was, where possible, calculated using Microsoft Word’s word count facility. The words in treaty texts that did not come in a format that was compatible with Microsoft Word were counted by hand.

5 Indeed, these commitments are the subject of Chapter 5.
Rather, I wish to draw a distinction between substantive commitments to investors and procedural details regarding dispute settlement and stress that the differences in the lengths of dispute settlement provisions across treaties are typically due to differences in the detail with which signatories wish to specify legal procedure for settling disputes. This is most pronounced when treaties simply refer disputes to the International Center for the Settlement of Investment Disputes (ICSID) which has established procedures that need not be repeated in BITs, as opposed to treaties which allow for other arbitration venues and therefore must specify in greater detail what procedures must be followed. Thus, to include the length of dispute settlement provisions is to include aspects of the treaty that are not relevant to the theoretical arguments presented above regarding treaty precision and constraints on policy autonomy.

Delegation: Pre-consent to Arbitration

In order to measure the legalization of delegation of dispute settlement authority, upon which I argue the effect of time horizons on treaty length is conditioned, I employ a dummy variable that reflects whether or not treaty signatories pre-consent to international arbitration of investor-state disputes. Specifically, the variable takes a value of 1 when governments pre-consent in the BIT to binding arbitration of disputes applying to any aspect of the BIT or to any aspect of the BIT and non-BIT related matters. The variable takes a value of zero when there is either no arbitration provision in the treaty, no pre-consent to arbitration or pre-consent is confined to a narrow subset of issues in the treaty.

The careful reader will note that this pre-consent to arbitration variable is a
modified version of the dummy variable used as the dependent variable in the tests of legalization of delegation in Chapter 5. The only difference between the two measures is that when the level of legalization falls under category 3 in the legalization of delegation coding scheme (see Table 5.1), it is now coded as a 1 instead of a 0. The reason for using this slightly different measure is that the dependent variable in the analysis of delegation was designed to capture the difference between the highest level of legalization, which is the dominant outcome, and all other levels of legalization. Category 3 - delegation of the authority to settle disputes pertaining to the BIT - still entails a significant delegation of authority and therefore I expect that governments will be concerned about reining in the discretion that arbitrators possess in interpreting their BIT obligations when delegation is legalized to that level. In contrast, I expect this concern to be less when there is no pre-consent to arbitration or it is highly limited, as is the case in categories 1 and 2.

6.5.2 Results

To evaluate the precision hypotheses, I estimate four linear regression models of treaty length whose results are presented in Table 6.1. As I expect the effect of time horizons on treaty length to be conditioned by the legalization of delegation, the main independent variables in these models are interaction terms involving the pre-consent to arbitration dummy variable and either the home or host state government’s time horizons. The measures for government time horizons and the control variables

\footnote{Interaction terms involving home and host state time horizons are introduced into the models separately due to collinearity between them.}
employed are the same as those used previously in the analyses of obligation and delegation. As the measures of time horizons I employ vary across regime types, separate models are estimated for democratic and autocratic host states. No models are estimated for autocratic home states because, as noted in previous chapters, the number of non-democratic home states in the sample is very small. Thus, in all four models the home state is a democracy. Interpretation of the marginal effects of covariates of interest directly from regression results can be difficult when they are part of one or more interaction terms (Kam & Franzese 2007). Therefore, I include several figures in this section to ease interpretation.

In the first model in Table 6.1, the estimate for the interaction between autocratic host government time horizons and pre-consent to arbitration is statistically significant at the 0.01 level, indicating that the effect of autocratic time horizons on treaty length depends on the delegation of dispute settlement authority. The direction of this effect is illustrated in Figure 6.3 which plots the marginal effect of a one percentage point increase in the probability of regime failure on treaty length when the treaty does and does not include pre-consent to arbitration. The bars represent 95 percent confidence intervals for the estimates of the marginal effect. The plot on the left in Figure 6.3 indicates that on average, a one percentage point increase in the probability of regime failure effects a 62 word drop in the number of words in the treaty when that treaty delegates substantial dispute settlement authority to

7The time horizon variables have been mean-centered to ease interpretation of the effect of the pre-consent to arbitration variable.

8Marginal effects in Figure 6.3 are based on model 1 in Table 6.1.
Table 6.1: Linear Regression Models of the Length of BIT Texts

<table>
<thead>
<tr>
<th>Host Regime Type</th>
<th>Autocracy</th>
<th>Democracy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Autocratic Time Horizon (Host)</td>
<td>53.7***</td>
<td>-44.1***</td>
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<tr>
<td>Pr(Regime Failure)</td>
<td></td>
<td></td>
</tr>
<tr>
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</tr>
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<td>173.3***</td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Home)</td>
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<td>261.0*</td>
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<tr>
<td>Party Age</td>
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<td></td>
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<td>-74.5</td>
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<td>North-South BIT</td>
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<td>-389.4*</td>
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<td>Years Since Independence (Host)</td>
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<td>1180.0**</td>
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<tr>
<td>Adjusted R²</td>
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<td>0.10</td>
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</table>

Two-way clustered (on host and home state) robust standard errors in parentheses
* p < 0.1, ** p < 0.05, *** p < 0.01
Figure 6.3: Marginal Effect on Treaty Length of a One Percentage Point Increase in the Probability of Host State Regime Failure
international arbitrators. However, when a treaty does not delegate such authority, a one percentage point increase in the probability of regime failure is associated with a 54 word increase in treaty length. These results provide support for the hypotheses developed above which posit that as time horizons lengthen (in this case the probability of regime failure diminishes), governments will craft longer BITs when delegating substantial authority to arbitrators, and shorter treaties when delegation is limited.

Further support for this argument is found in the results for democratic host states presented in model 3 where once more the interaction between host state government time horizons and pre-consent to arbitration is statistically significant at the 0.01 level. The marginal effect of a one year increase in the age of the largest government party is displayed in Figure 6.4 along with 95 percent confidence bands. As party age enters the model after a logarithmic transformation the marginal effects diminish at higher values of party age. The important trend to notice is that for all values of party age, the marginal effect is positive when pre-consent to arbitration is present in the treaty and negative when it is absent. Thus, as democratic host state governments’ time horizons increase, they sign longer treaties when those treaties include significant delegation of dispute settlement authority and shorter treaties when they do not. This conforms with my theoretical expectations and matches the pattern displayed by autocratic host governments.

The results for home state time horizons are inconsistent, varying considerably depending on the regime type of the host state. When the host state is a democracy

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9Marginal effects in Figure 6.4 are based on model 3 in Table 6.1.
Figure 6.4: Marginal Effect on Treaty Length of a One Year Increase in the Age of the Host State’s Largest Governing Party

(a) Pre-Consent Arbitration

(b) No Pre-Consent to Arbitration
(model 4), the results for home state time horizons are as expected. The coefficient for the interaction term between home state time horizons and pre-consent to arbitration is statistically significant at the 0.01 level and the substantive effect, displayed in Figure 6.5, indicates that home state governments with longer time horizons will conclude longer treaties when a pre-consent to arbitration is present, but will conclude shorter and less precise treaties when there is no pre-consent to arbitration. This mirrors the pattern of results for host state government time horizons and confirms my theoretical expectations.

However, when the host state is an autocracy (model 2), the interaction term between home state government time horizons and pre-consent to arbitration fails to achieve statistical significance indicating that the relationship between home state time horizons and treaty precision is not contingent on the pre-consent to arbitration. Therefore, to gauge the effect of home state government time horizons on treaty precision I turn to model 1 in which the effect of home state government time horizons is estimated while not accounting for any interactive relationship with pre-consent to arbitration. The coefficient for home state government time horizons in this model is positive and statistically significant at the 0.1 level, suggesting that as time horizons lengthen for home governments, they will conclude more precise BITs, irrespective of whether or not a significant pre-consent to arbitration is present.

None of the control variables display a consistently statistically significant effect across all four models in Table 6.1. Indeed, one notable trend is that the signs on the coefficients for several control variables change depending on whether or not the host state is a democracy or an autocracy. For example, in all models where the host state
Figure 6.5: Marginal Effect on Treaty Length of a One Year Increase in the Age of the Home State’s Largest Governing Party (Democratic Host)

(a) Pre-Consent Arbitration

(b) No Pre-Consent to Arbitration
is an autocracy, the North-South dummy variable exhibits a negative relationship with treaty length that is statistically significant at the 0.1 level. However, when the host state is a democracy this relationship is positive and not statistically significant. The estimate of the effect of years since independence is negative and statistically significant when the host state is a democracy but positive when the host is an autocracy. Similarly, the coefficient for pre-consent to arbitration - which due to the mean-centering of the time horizon variables indicates the effect of including a pre-consent to arbitration when the relevant time horizon measure is at its mean value - is negative when the host is a democracy but positive when the host is an autocracy.

Robustness Checks

Overall the results in Table 6.1 provide substantial confirmatory evidence for the hypotheses developed earlier in the case of host state government time horizons. However, the results for home state government time horizons are inconsistent across models in which the host state is a democracy and an autocracy. To test the robustness of these results, I re-estimate the models in Table 6.1 controlling for selection into BITs as in Chapter 4. To a large extent the key results from the original analysis hold after controlling for selection. Statistical significance weakens slightly for the variable interacting autocratic host government time horizons and pre-consent to arbitration, with the estimated effect now only significant at the 0.1 level. The effect of the interaction between democratic host government time horizons and pre-consent

10 The full results of this re-estimation are presented in Tables E.1 and E.2 in Appendix E.
to arbitration continues to be statistically significant at the 0.05 level and in the same direction as does the interactive effect between democratic home government time horizons and pre-consent to arbitration when the host state is a democracy. Similarly, the length of home state government time horizons continue to be positively related to treaty precision (significant at the 0.1 level) regardless of whether or not a pre-consent to arbitration is present. Among the control variables, the one noteworthy difference is that, after controlling for selection, the positive relationship between home state executive constraints and treaty length is now statistically significant at the 0.1 level in all models when the host is democratic. This suggests that more constrained home governments may sign longer treaties. However, the estimates for home state executive constraints are still not statistically significant when the host state is an autocracy.

To further test the robustness of the results presented Table 6.1, I re-estimate the models including four new covariates. Three of these new variables measure some aspect of the contents of BITs. My aim in including these variables is to address the potential critique that treaty length is an imperfect proxy for precision because some treaties may be longer than others not because they address the same issues with greater precision, but because they address a wider range of issues and policies. Overall, this problem is greatly diminished in this study because BITs are highly similar in terms of their objectives, the issues they cover and the manner in which these issues are addressed (UNCTAD 2007a). However, there remain some pockets of variation and while it is not possible to control for all of them, I identify and account
for three types of treaty provision: a) umbrella clauses; b) national treatment; and 
c) right of establishment.\footnote{Umbrella clauses and national treatment obligations have been discussed already. The right of establishment refers to whether or not governments pledge to forego some or all of their power to screen and reject incoming FDI in their BITs, thereby affording potential foreign investors a “right” to establish operations. This typically takes the form of most-favored nation or national treatment for incoming pre-entry FDI.}

I choose to focus on these three types of BIT provision because they are strong indicators of the overall substantive scope of a treaty. This is because all three provisions are not common to all treaties and all significantly expand the range of investment policies and issues brought under a treaty’s scope. For example, as argued in Chapter 4, national treatment targets all policies that may discriminate between foreign and local firms. In the absence of a national treatment commitment, such discriminatory policies fall beyond the treaty’s scope. Similarly, the right of establishment brings policies regarding the admission of FDI under the scope of the treaty while an umbrella clause brings non-treaty based policy commitments under the protection of the treaty. Thus, all three types of BIT provision increase the number of policy issues covered by the treaty and therefore, I argue, they are more typically found in treaties that are more expansive overall in the issues they wish to regulate. Consequently, controlling for whether or not these provisions are included in the treaty serves as a reliable indicator of how substantively broad a treaty is and as these provisions are found in more expansive treaties, I expect to find a positive relationship between the inclusion of these provisions and the length of BITs.

For each of the three BIT provisions highlighted here, I include a dummy variable indicating whether or not they are included in the BIT. I also include a fourth
dummy variable in the model which takes the value of 1 if one of the treaty partners is a member of NAFTA. Chapter 11 of NAFTA has been a source of much recent arbitration and NAFTA members have learnt from this experience and adapted their BITs accordingly, often making them longer. Some of the longest BITs have been concluded by NAFTA partners as a result. In the sample used here, the median length for treaties where one partner is a NAFTA member is 3337 words while the median treaty length for treaties signed between two non-NAFTA members is 1748 words. This significant difference in median treaty length suggests that the NAFTA experience is influencing treaty precision for NAFTA members and that this may be skewing the results. Adding four new variables to control for treaty content and NAFTA membership greatly risks over-fitting the models. Therefore, in order to include these new variables I drop some of the other independent variables whose results are not significant in the original analyses: host and home state executive constraints and host and home state age of democracy.

The results of these new models controlling for the presence or absence of different treaty provisions are presented in Table 6.2. One of the most noticeable effects of the four new variables is that model fit improves remarkably across all models with the adjusted $R^2$ increasing significantly. This suggests that treaty content explains a significant amount of the variation that we observe in treaty length, and that with just three new variables much of the relationship between content and length is captured. As expected, the coefficients on the treaty content variables are positive across all models. These coefficients are statistically significant at the 0.05 level for

\footnote{If I drop alternative control variables instead of these, the main results do not change significantly.}
Table 6.2: Linear Regression Models of the Length of BIT Texts Controlling for Treaty Provisions

<table>
<thead>
<tr>
<th>Host Regime Type</th>
<th>Autocracy</th>
<th>Democracy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Autocratic Time Horizon (Host)</td>
<td>49.3**</td>
<td>-36.4***</td>
</tr>
<tr>
<td>Pr(Regime Failure)</td>
<td>(22.1)</td>
<td>(10.6)</td>
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<tr>
<td>Autocratic Time Horizon (Host) X Pre-consent to Arbitration</td>
<td>-99.3***</td>
<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Host)</td>
<td></td>
<td>-452.2***</td>
</tr>
<tr>
<td>Party Age</td>
<td></td>
<td>(136.3)</td>
</tr>
<tr>
<td>Democratic Time Horizon (Host) X Pre-consent to Arbitration</td>
<td></td>
<td>525.7***</td>
</tr>
<tr>
<td>Party Age</td>
<td></td>
<td>(132.4)</td>
</tr>
<tr>
<td>Democratic Time Horizon (Home)</td>
<td>-16.0</td>
<td>94.0</td>
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<tr>
<td>Party Age</td>
<td>(32.5)</td>
<td>(77.6)</td>
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<tr>
<td>Democratic Time Horizon (Home) X Pre-consent to Arbitration</td>
<td>-121.0</td>
<td></td>
</tr>
<tr>
<td>Party Age</td>
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<td></td>
</tr>
<tr>
<td>Pre-consent to Arbitration</td>
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<td>88.4</td>
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<tr>
<td></td>
<td>(116.8)</td>
<td>(115.4)</td>
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<tr>
<td>North-South BIT</td>
<td>-236.1***</td>
<td>-280.7***</td>
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<tr>
<td></td>
<td>(108.6)</td>
<td>(119.1)</td>
</tr>
<tr>
<td>Years Since Independence (Host)</td>
<td>17.5</td>
<td>18.9</td>
</tr>
<tr>
<td></td>
<td>(35.1)</td>
<td>(28.8)</td>
</tr>
<tr>
<td>Host Share of Dyadic Wealth</td>
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<td>-184.5</td>
</tr>
<tr>
<td></td>
<td>(148.3)</td>
<td>(133.1)</td>
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<tr>
<td>Time Counter</td>
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<td>6.6</td>
</tr>
<tr>
<td></td>
<td>(6.5)</td>
<td>(7.9)</td>
</tr>
<tr>
<td>GDP p.c. Growth (Host)</td>
<td>5.2</td>
<td>6.6</td>
</tr>
<tr>
<td></td>
<td>(4.3)</td>
<td>(4.1)</td>
</tr>
<tr>
<td>Umbrella Clause</td>
<td>166.7***</td>
<td>206.3**</td>
</tr>
<tr>
<td></td>
<td>(57.1)</td>
<td>(61.2)</td>
</tr>
<tr>
<td>National Treatment</td>
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<td>111.1</td>
</tr>
<tr>
<td></td>
<td>(68.4)</td>
<td>(82.2)</td>
</tr>
<tr>
<td>Right of Establishment</td>
<td>1785.8***</td>
<td>1796.3***</td>
</tr>
<tr>
<td></td>
<td>(479.5)</td>
<td>(489.3)</td>
</tr>
<tr>
<td>NAFTA</td>
<td>542.5***</td>
<td>588.3***</td>
</tr>
<tr>
<td></td>
<td>(66.5)</td>
<td>(82.3)</td>
</tr>
<tr>
<td>Constant</td>
<td>1323.7***</td>
<td>1308.7***</td>
</tr>
<tr>
<td></td>
<td>(242.7)</td>
<td>(329.3)</td>
</tr>
<tr>
<td>N</td>
<td>115</td>
<td>115</td>
</tr>
<tr>
<td>Adjusted R²</td>
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<td>0.66</td>
</tr>
</tbody>
</table>

Two-way clustered (on host and home state) robust standard errors in parentheses

* p < 0.1, ** p < 0.05, *** p < 0.01
the umbrella clause and at the 0.01 level for right of establishment. However, the
dummy variable for national treatment fails to achieve statistical significance in all
but one model. Moreover, the coefficient on the right of establishment variable is
much larger than the coefficient associated with the other content variables.

The reason for the variation in statistical significance and the size of the coef-
ficients of the treaty content variables may be explained by the difference in the
prevalence of these provisions in the universe of BITs. 81 percent of treaties in
the sample used here contain a national treatment provision, indicating that most
treaties are expansive enough to include discriminatory policies within their scope.
Umbrella clauses are less common, appearing in 47 percent of treaties while the right
of establishment is included in only six percent of treaties. Given how uncommon
the right of establishment is, one can infer that only the most expansive treaties
that seek to govern an unusually wide range of policies will take up the issue of
establishment. Thus, we find a large and strong relationship between the right of
establishment and treaty length. Umbrella clauses meanwhile indicate a moderately
expansive treaty in that the average treaty will not be broad enough in scope such
that it includes non-BIT related commitments, but more expansive treaties will do
so through umbrella clauses. Finally, the dummy variable for NAFTA membership
is, as expected, positively related to treaty length however this relationship is only
statistically significant when the host state is autocratic.

With respect to the main variables of theoretical interest, the interaction terms in-
volving host state government time horizons and pre-consent to arbitration continue
to be statistically significant, however the size of their estimated effects, illustrated
Figure 6.6: Marginal Effect of a One Percentage Point Increase in the Probability of Host State Regime Failure (Controlling for Treaty Provisions)
Figure 6.7: Marginal Effect on Treaty Length of a One Year Increase in the Age of the Host State’s Largest Governing Party (Controlling for Treaty Provisions)

(a) Pre-Consent Arbitration

(b) No Pre-Consent to Arbitration
graphically in Figures 6.6 and 6.7, is now smaller. Figure 6.6 illustrates that when the host state is an autocracy and we hold all other factors constant a one percentage point increase in the probability of regime failure effects a 50 word drop in the number of words in the treaty, when that treaty delegates substantial dispute settlement authority to international arbitrators through a pre-consent to arbitration. However, when a treaty does not include a pre-consent to arbitration, a one percentage point increase in the probability of regime failure is associated with a 49 word increase in treaty length. Thus, as before, autocratic host state governments with longer time horizons will conclude longer treaties when there is a pre-consent to arbitration and shorter treaties when there is no pre-consent.

The marginal effects for democratic host state government time horizons are presented in Figure 6.7. The graphs indicate that while the magnitude of the effect of time horizons is now smaller (compare to Figure 6.4), the pattern of the effects is the same. When treaties include a pre-consent to arbitration, democratic host governments led by older parties conclude longer treaties than governments led by younger parties. However, this relationship is reversed when there is no pre-consent to arbitration whereby raising the age of the largest party in government causes a treaty to become shorter. Thus, my initial results regarding the relationship between host state government time horizons and treaty length have proven to be robust to controlling for treaty content, and particularly how expansive a treaty is in terms of issues covered.

\[13\] Marginal effects in Figures 6.6 and 6.7 are based on estimates from models 1 and 3 respectively. The bars in Figure 6.6 and the dotted lines in Figure 6.7 both represent 95 percent confidence bands for the marginal effects.
The initial results regarding the effects of home state government time horizons were mixed. When the host state was an autocracy home state government time horizons were positively associated with treaty length regardless of the whether or not a pre-consent to delegation was present in the treaty. However, when the host state was democratic, home state governments with longer time horizons concluded longer BITs when those treaties included a pre-consent to arbitration and shorter treaties when they did not. After controlling for treaty content and NAFTA membership, home state time horizons exhibit no statistically significant relationship with treaty length in any of the models. Thus, the initial results for democratic home state time horizons are not robust, and based on the analysis here, there is no consistent, systematic and statistically significant relationship between home state time horizons and treaty length.

6.6 Conclusion

At the core of the theory developed in Chapter 3 is the argument that governments’ legalization preferences will reflect how sensitive they are to constraints on their freedom to develop and implement investment related policies. This chapter enabled a careful test of this causal logic because the relationship between policy autonomy and legalization with respect to precision shifts depending on the legalization of delegation. Thus, in the analysis of precision, one is able to see if the relationship between government time horizons and legalization tracks this shift such that when governments have long time horizons they seek to legalize their BITs in a manner that
promotes greater policy autonomy regardless of whether or not this entails greater or less legalization.

The empirical analysis in this chapter provides considerable support for the theory. Using an original measure of treaty precision in BITs, I find that host state governments with longer time horizons seek to preserve policy autonomy by concluding more precise BITs when broad pre-consent to arbitration is present and less precise BITs when it is not. Moreover this result is robust to controlling for selection into BITs and to the inclusion of covariates measuring the substantive scope of the treaty which is a potential confounding factor when using treaty length as a proxy for precision.

Home state government time horizons were not found to have a robust or consistent relationship with treaty precision. One possible explanation of this outcome is that it reflects my original expectation that the time horizons- legalization relationship is more likely to hold with respect to host states rather than home states as the former are more likely to be concerned about constraints on their policy autonomy as they are net importers of dyadic FDI. An alternative explanation is that home state governments with long time horizons preserve policy autonomy through diminished legalization of delegation, rather than through precision. In Chapter 5, I found that home state governments with longer time horizons did scale back the legalization of delegation. It is plausible therefore that home state governments with long time horizons are less concerned by the legalization of precision because their sovereignty and policy autonomy concerns have been addressed in the legalization
of delegation. This potential for trading off levels of legalization and policy autonomy in different dimensions of legalization, and prioritizing restraining legalization in some dimensions over others, is a subject I discuss in greater depth in the concluding chapter.

An issue that arises when considering multiple related dimensions of institutional design, as I have done in this chapter, is the separability of preferences over different design dimensions and the sequencing of design choices. In this chapter I have assumed that decisions about treaty precision follow design choices regarding delegation, i.e. the design of precision takes place under the shadow of a given level of legalized delegation. This implies that decisions over the legalization of delegation and precision are taken sequentially and independently. An alternative approach would be to consider delegation and precision as jointly determined and governments’ preferences over the legalization of both dimensions as inseparable, i.e. delegation and precision are designed together as a package of institutional features. Pursuing this plausible alternative perspective in future research is likely to provide further insights into how governments’ preferences over legalization form, and how they shape institutional design outcomes with respect to legalization.
CHAPTER 7
CONCLUSION

7.1 Introduction

The number of BITs governing relations between foreign investors and national governments has increased significantly since the first BIT was signed in 1959. Governments sign BITs because they have the potential to help them attract greater FDI by making their commitments to afford MNEs a stable, secure and profitable investment environment more credible. However, BITs can also serve as powerful constraints on governments’ policy autonomy and cause governments’ attempts at regulation of investors’ activities to result in costly international arbitration.

In this dissertation, I have argued that the extent to which these effects of BITs manifest themselves is a product of their design, and particularly their degree of legalization. These variations in BIT legalization have largely gone unnoticed in extant research into BITs, with scholars choosing to focus on the determinants of BIT signing and the effects of BITs on FDI while treating BITs as substantively homogenous. Thus, there is a genuine blind spot in the existing literature which this dissertation seeks to bring into view. Furthermore, the dissertation forwards
an explanation for when and why governments will choose to legalize their BITs to differing degrees.

The main argument I make is that governments’ preferences over the legalization of their BITs are a function of their time horizons. Governments with long time horizons calibrate the legalization of their BITs to afford themselves greater autonomy to develop and implement investment related policies and regulations. They do this because the effects of FDI on their economies and core constituencies are varied and contingent on a range of factors such as the ownership structure of the MNE and the extent to which it develops linkages with the local economy. Governments that expect to govern long into the future therefore prize having the freedom to employ policies that allow them to ensure a steady stream of benefits from investment into the local economy, even in the face of shifting political and economic conditions. I further argue that domestic politics and institutions including regime type, autocratic regime structure and party institutionalization play a critical role in shaping governments’ time horizons, and thus their legalization preferences.

The basis for the empirical analysis in this dissertation is an original data set of design features in a random sample of 346 BITs. Using this data, I construct original measures of three dimensions of legalization - obligation, delegation and precision - which are the dependent variables in my analyses. I find that government time horizons display a strong relationship with legalization and that governments with long time horizons are more likely to conclude BITs at a level of legalization (usually lower) that promotes greater policy autonomy. In the case of obligation and precision, this holds with respect to net importers of dyadic FDI - host states - and
in the case of delegation, I find that the time horizons of net exporters - home states - display a statistically stronger relationship with legalization. The overall results illustrate that governments’ time horizons do shape the legalization of the investment treaties they sign and the manner in which they do so is consistent with the argument that governments seek levels of legalization that promote greater policy autonomy when their time horizons are longer.

Having briefly summarized the central question, argument and empirical results in the dissertation above, I devote the rest of this chapter to discussion of the theoretical contributions made by the dissertation, the generalizability of the argument and directions for future research. I also address the strengths of my empirical strategy and discuss the pattern in my results whereby host state governments’ time horizons are not systematically related to the legalization of delegation but home state time horizons are. I offer a potential explanation for why this pattern emerges which suggests that future scholarship will benefit from evaluating how governments resolve trade-offs across, as well as within, dimensions of legalization. I conclude the chapter with a discussion of more general lessons and suggestions for future research that emerge from the dissertation.

7.2 Theoretical Contributions

This study presents the first comprehensive theory of the legalization of BITs, and one of the first theoretical discussions of any kind of variation in BIT design to date. Existing research has sought to explain the decision to delegate dispute settlement authority in BITs (Allee & Peinhardt 2010) and the use of reservations in BITs
concluded by the U.S. (Crisp et al. 2010), however no study has clearly focused on the legalization features of BITs, and certainly none has attempted to develop a single theoretical explanation for the full set of legalization dimensions.

However, the theoretical contribution of this dissertation is not confined to legalization or investment treaties alone. This is because the argument linking time horizons to governments’ legalization preferences is generalizable to other contexts in international politics where institutions are legalized to varying degrees. Indeed, generalizing from the argument developed in Chapter 3, one can argue that whenever governments face an institutional design trade-off in which policy autonomy may be sacrificed to a greater or lesser degree, *ceteris paribus*, governments with longer time horizons are more likely to choose design features that promote policy autonomy than governments with shorter time horizons. Such an explanation is likely to be particularly valuable when functionalist explanations fall short, as in cases such as BITs when the institutions across which there is variation in design seek to solve similar structural problems. Kahler (2002), among others, has suggested that a way to improve theories of institutional design is to recognize that the preferences of the actors seeking to solve the problem can vary. Thus, the theory developed in this dissertation contributes to attempts to reveal governments’ preferences by offering an explanation for how and why government preferences over institutional designs that constrain government policy can vary.

The introduction of varying time horizons to explain governments' preferences over institutional legalization is the dissertation’s main theoretical innovation. Analysis of the role played by the time horizons of political leaders itself is not novel.
Scholars such as those investigating the political business cycle have long appreciated that the time horizon of a government shapes its incentive structure leading it to favor some policies over others. However, while some studies have noted in passing that governments’ time horizons may influence the design of international institutions (e.g. Abbott & Snidal 2000), to the best of the author’s knowledge, none have sought to theorize and empirically investigate the relationship between time horizons and institutional design. Thus, by systematically incorporating time horizons into the study of international institutional legalization, this study makes a potentially powerful contribution to scholarship on institutional design. This is particularly so because assumptions about time horizons have been used to critique leading rationalist/functionalist explanations of institutional design. The essence of the critique is that political leaders have short time horizons and therefore the long term functions/consequences of institutions cannot be used to explain their design (see section 3.4.1). By theoretically integrating varying time horizons, as I do, one does not need to assume long or short time horizons on the part of institutional designers, nor does one need to abandon the assumption that institutions are designed by rational actors.

My time horizons-based approach also makes an important contribution to theories of institutional design that link uncertainty to institutional flexibility. Such theories argue that when faced with uncertainty, states will design institutions which are more flexible (e.g. Koremenos, Lipson & Snidal 2001). The critical concepts of “uncertainty” and “flexibility” are relatively broad and therefore applicable in a
wide range of contexts. However, to the extent that flexibility in institutional design relates to governments having greater freedom to modify and adapt policies in response to shifting conditions, I offer an explanation for when governments will and will not be concerned by uncertainty regarding future circumstances. Specifically, only governments with long time horizons are likely to care about uncertainty because only they anticipate needing to contend with changing circumstances and unexpected events in the future.

Over a decade ago, Martin and Simmons (1998) lamented the lack of theoretical and empirical work done to illuminate the links between domestic politics and international institutions. Although some progress has been made since then, there is still a dearth of well-developed generalizable theoretical propositions that link domestic politics and the design of international institutions. The theory I develop helps to illuminate the relationship between international institutional design and domestic politics because, as I show in some detail, domestic institutions such as regime type, party institutionalization, and autocratic regime structure are key factors in determining the time horizons of governments involved in the process of institutional design. Thus, through their effects on time horizons, domestic political factors shape the preferences of governments vis-à-vis institutional design, and particularly institutional legalization.

7.3 Empirical Analysis and Results

To the best of my knowledge, this is the first study that seeks to systematically test the explanatory power of a theory of international institutional legalization on
each of its three dimensions of delegation, obligation and precision. As such, the empirical analysis is uniquely demanding. Furthermore, this study stands out in the study of legalization in its attention to systematic methods of measurement and data collection, and in the use of a comparatively large number of cases in its empirical analysis. The advantage of a large sample is that I am able to employ statistical techniques which allow me to control for alternative and competing explanations of legalization, and account for factors such as selection into BITs when testing the explanatory power of time horizons.

The results of these statistical tests illustrate vividly that time horizons play a critical role in shaping the legalization of international investment agreements. Indeed, no other independent variable exhibits a similarly consistent and statistically significant relationship with the degree of legalization across all three dimensions. For all dimensions of legalization, the results confirm that as government time horizons lengthen, the legalization of BITs is calibrated to promote greater policy autonomy. However, while evidence of this relationship applies primarily to host states, as expected in the cases of obligation and precision, with respect to delegation I found that no statistically significant relationship exists between host state government time horizons and the legalization of delegation.

What explains this pattern? Why do host state governments with long time horizons appear more amenable to constraints on their policy autonomy with respect to the legalization of delegation? One plausible explanation is that delegation of dispute settlement stands out as the most critical credibility enhancing element in

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1 See section 3.6.3.
BITs. Dispute settlement alone generates reputation, audience as well direct financial costs (through the payment of compensation) for host governments that do not abide by their commitments. Dispute settlement is also critical because it augments or diminishes the credibility of commitments made throughout the treaty because when a dispute over a commitment can be arbitrated, violation of that commitment becomes more costly. Thus, to highly legalize delegation is to raise the credibility of commitments throughout the treaty and therefore legalization of delegation is uniquely effective in making commitments to investors more credible.

This perspective has been taken by other scholars studying BITs. Several legal scholars in particular have highlighted the highly legalized dispute settlement provisions in most BITs as their single most important dimension and argued that these provisions are what sets BITs apart from other investment protection instruments (Ginsburg 2005, Franck 2007a, Franck 2007b). Furthermore, some have suggested that it is the dispute settlement provisions that are key to promoting policy credibility and overcoming the obsolescing bargain (Guzman 1998).²

If delegation of dispute settlement authority stands out as uniquely effective in generating credibility, it is possible that host state governments who seek credibility do not wish to significantly weaken the legalization of delegation in BITs as this would overly obstruct BITs’ abilities to serve as credibility enhancing mechanisms. The distribution of values on the legalization of delegation scale provides evidence that governments think along these lines (see Table 5.1). In 87 percent of BITs in the

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²The integral nature of the dispute settlement provisions is arguably why they have been the locus of extant research into BITs in political science (e.g. Yackee 2007, Allee & Peinhardt 2010).
sample used in this dissertation, governments pre-consent to arbitrate disputes pertaining to BIT obligations or any obligations governments have undertaken towards MNEs. On the other hand, only seven percent of BITs in the sample contain no pre-consent to arbitration at all. This suggests that for host states seeking to sign a BIT and improve their credibility in the eyes of MNEs, highly legalized delegation of dispute settlement authority approaches a *sine qua non* condition in BITs. Realizing this, even host state governments with long time horizons do not seek to weaken the legalization of delegation in BITs, but instead seek to carve out policy autonomy for themselves in specific treaty obligations and through greater precision. Indeed, this may be the optimal design strategy for host states because it allows them to gain the credibility benefits of a widespread pre-consent to arbitration and then to build in policy autonomy in those areas of BITs that they are most concerned about through reducing the legalization of obligation and greater precision.

While this argument may explain the pattern in results for host state government time horizons, the matter of the results for home state time horizons remains. In two out of the three dimensions of legalization under consideration home state time horizons displayed no statistically significant relationship with the degree of legalization. In Chapter 3, I argued that the relationship between time horizons and legalization should be weaker for home states than for host states as the former receive comparatively little FDI from their treaty partners and thus are exposed to few constraints on policy as a result of greater legalization. Furthermore, home state governments have a greater interest in protecting their investors abroad which makes them more amenable to greater legalization. However, the findings of no systematic relationship
between home state time horizons and the legalization of obligation and precision call into question whether or not the theory should apply to home state governments.

In my view, the theory does apply to home states because home state governments are concerned about constraints on their policy autonomy. Countries such as the U.S. and Canada, which are typically home states, make an effort in their BITs to introduce design features that help preserve policy discretion. For example, the most recent Canadian model BIT includes carve outs for the environment for a wide range of provisions. Moreover, as I argue in Chapter 3, typical host countries are becoming more significant FDI exporters over time, causing BITs to increasingly threaten the policy autonomy of their potential home state treaty partners. Thus, home state governments with long time horizons have growing incentives to seek to preserve policy autonomy. Finally, the finding that home state governments with longer time horizons prefer less legalized BITs in the case of delegation suggests that home state governments are indeed concerned about maintaining policy autonomy in some legalization contexts.

The question then is why do home state governments with long time horizons care about delegation in particular. One possible answer derives from the discussion above with respect to host states, which is that delegation is a uniquely powerful commitment device but, as a result, it also generates the greatest constraints on policy. This prompts home state governments with longer time horizons to be particularly concerned about policy autonomy in the case of delegation and to therefore seek lower levels of legalization. The reason why home state governments with long time horizons eschew greater legalization in the case of delegation while their host
government counterparts are more amenable to it is that home state governments do not value credibility to the same extent as host governments. This is because home state governments expect to receive comparatively less FDI from their treaty partner and thus there are fewer gains to be had for home states, in the form of increased investment, from agreeing to the high level of credibility and constraint that highly legalized delegation brings.

What are the potential implications of this discussion for my broader theory of legalization preferences? The most direct implication is that the \textit{magnitude} of credibility and autonomy generated by legalization potentially differs across dimensions of legalization. In the case of BITs, it is the legalization of delegation that conveys greatest credibility, but there is no reason to think that it could not be obligation or precision in other institutional contexts. It is important therefore to consider how governments’ legalization preferences are affected by this difference in magnitude and how that may shape how they resolve the credibility-autonomy trade-off. The evidence in this study suggests that when the stakes are high - a dimension of legalization offers high credibility in exchange for high constraint on policy autonomy - governments who prize credibility the greatest (in this case host state governments) will be more inclined to prefer greater credibility at the price of constrained policy autonomy whilst those governments who are less keen to advance their credibility will be more inclined and prefer lower levels of legalization. Thus, while my analysis has focused on sensitivity to constraints on policy autonomy, in future research it
may be fruitful to bring in anticipated gains from credibility as a factor that conditions how time horizons shape governments’ preference over legalization and the credibility-autonomy trade-off.

A second implication is that dimensions of legalization are closely interrelated. This was illustrated theoretically and empirically with respect to precision and its interaction with delegation. However, the empirical results across all three dimensions of legalization also suggest that governments are strategic in how they legalize different dimensions of legalization, balancing greater legalization in one area for less legalization in another. This indicates that governments’ preferences may therefore be quite complex, trading off not only credibility and autonomy within particular dimensions of legalization, but also across dimensions of legalization. The strong relationships I find in this study between the degree of legalization and time horizons for each dimension of legalization lead me to be cautiously confident that governments’ time horizons will shape how governments resolve credibility-autonomy trade-offs across dimensions as well as within them. Presently, however, I leave systematic investigation of this to future research.³

A further implication of this discussion, that is specific to the study of BITs, is that there is some value in disaggregating host and home states. At the center of the explanation offered above for the pattern in results for home and host states is each treaty partner’s relative propensity to export FDI to its treaty partner. However, the

³It is worth noting that only by adopting an expansive empirical strategy, as I do, that involves analysis of all three dimensions of legalization, was it possible to identify the potential existence of design trade-offs across different dimensions of legalization.
dyad-specific nature of identifying home and host state means that a diverse collection of states are labeled “host” and “home” respectively. This masks considerable variation within each of these categories with respect to the potential to export FDI. For example, in their treaties with the U.K. both Tonga and India are the host state. However, Tonga and India differ considerably in their potential to export FDI to the U.K. and thus treaties with these two states present different challenges to policy autonomy for the U.K. government. As India exports far more FDI that Tonga, the U.K. is likely to be more concerned about threats to policy autonomy in its treaty with India than in its treaty with Tonga and this will affect its approach to treaty design. It is the pooling of such diverse treaty partners that pose different threats to policy autonomy for home states that may be contributing the null finding between home state government time horizons and legalization in the case of delegation and precision. Future research will benefit from moving away from the traditional home-host distinction that captures dyad-specific relative propensities to export FDI to consider treaty partners’ absolute propensities. Knowing how likely each treaty partner is to export FDI is important if one wishes to control for how how salient BIT policy constraints are likely to be.

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4This is less problematic for host states because there is less variation in the potential to export FDI across home states with many of home states being advanced industrial economies that can and do export large amounts of FDI.

5The growing prevalence of model BITs will mean researchers must also consider aggregate trends in a state’s treaty partners’ capacity to export foreign investment. For example, it is possible that as developing countries have begun to export more FDI, developed countries’ model BITs have become less legalized.
7.4 Conclusion: Looking Forward

This chapter has reviewed the dissertation’s theoretical argument and empirical analysis and discussed the contributions it has made in both areas as well as the ways in which it has sought to improve upon existing research. Therefore, in this final section I turn to highlighting broad lessons and suggestions for future investigation. The first of these lessons is that not all BITs are the same and some contain designs that promote credibility more than others. While I have sought to explain these differences, particularly with respect to legalization, it is also important for scholars investigating the effects of BITs to acknowledge their heterogeneity and it would behoove them to incorporate this variety across BITs into their theoretical and empirical analyses. In particular, scholars investigating whether or not BITs generate greater FDI inflows may benefit from considering if a BIT that is legalized to promote greater credibility helps governments attract more FDI than a BIT that is legalized in a manner that produces less credibility. The collection of mixed results regarding the relationship between FDI and BITs may be due to the tendency of researchers to treat BITs as homogenous when they are not.

A second lesson is that the dimensions of legalization should be studied together, or more generally, multiple features of institutional design should be studied together. One of the common traits among extant empirical analysis of legalization in international politics is their focus on only one of the three dimensions of legalization at a time. However, the analysis in this study - particularly Chapter 6 - suggests that in some cases it is wise to consider how the individual dimensions of legalization interact. Admittedly this increases the data collection burden on researchers
as they need to gather data on multiple dimensions of legalization. Nevertheless, it is likely that governments’ preferences over the legalization of one dimension will sometimes be influenced by the legalization of other dimensions as they anticipate the effects of institutions as a whole. Indeed, in the preceding section I suggest that governments may even act strategically in how they trade-off different levels of legalization in different dimensions. Moreover, as I suggest in the conclusion to Chapter 6, in some cases it may not be possible to separate governments’ preferences over different design features and thus scholars will need to analyze “packages” of design features rather than each feature in isolation. Thus, in future, researchers may find it insightful to explore, theoretically and empirically, how the different components of legalization interact when seeking to explain both the determinants and effects of legalization in international politics.

A third lesson is that scholars interested in explaining variation in the design and legalization of international institutions may find it fruitful to investigate preferences as well as the structure of the problem those institutions are created to solve. In order to develop theories of institutional design based on actors’ preferences, one needs to first establish the identity of the relevant actors. This is likely to change across issue areas and contexts and will often require researchers to move beyond focusing on the unitary nation-state and consider the preferences of sub-state actors. However, it will be a rare circumstance in which the preferences of governments - which are the key actors in this study - are not relevant. This is because it is governments that negotiate the design of international institutions and choose to approve or reject different design options. Furthermore, in many instances governments will
benefit from or be harmed by different design options, especially when the design features in question affect the policy options that governments have. Thus, governments have both opportunity and motive to influence the design of international institutions. Consequently, governments’ preferences will often be a good place to begin investigating preferences over institutional design.

The final lesson is that further research into the relationship between domestic political processes and institutions, and international institutional design, is worthwhile. This is particularly so if scholars wish to investigate the role played by sub-state political actors in the institutional design process as domestic politics is likely to play a central role in shaping their abilities to influence the design of international institutions and their design preferences. Such research will be most effective when it fully considers how relevant actors’ incentives are shaped by domestic political competition and institutions in a manner that embraces political complexity at the domestic level and eschews focusing only on simplified indicators of domestic politics, such as regime type, because such simplifications mask important differences at the domestic level. Indeed, as this dissertation illustrates, important differences exist between governments belonging to the same type of regime.

Several of these lessons and suggested paths for future research are not new. Furthermore, many of them require more data collection and suggest embracing heterogeneity in areas where homogeneity has often been assumed. This places greater empirical and theoretical demands on researchers. However, it is hoped that this study and the results it finds provide some evidence that such avenues of research are worth pursuing.
Appendix A

BIVARIATE PROBIT MODEL OF BIT SIGNING

In Chapters 4 and 6 I control for selection into BITs using the predicted probabilities from several partial observability bivariate probit models of BIT signing. As noted in Chapter 4, a bivariate probit model allows me to model separately the factors that lead a host and a homes state to conclude a BIT with one another. To estimate the models I use the full random sample of 3600 dyads noted in chapter to estimate the model from which the BITs analyzed in Chapters 4 and 6 are drawn. The unit of observation is the dyad-year for the years 1975-2006. Following Stone (2008), when a BIT is signed between the two members of a dyad the dyad is dropped from the estimation for subsequent years. Standard errors are robust to clustering on the dyad.

Four separate models are estimated that reflect the host-home regime type profiles used in the main models of BIT legalization in the empirical chapters. In each bivariate probit model model I include variables from these main models - time horizon, regime type (home state only), regime age, (host state only) and economic growth (host state only) variables - as well several other variables identified in the literature as influencing whether or not two states conclude a BIT with each other.
The first of these additional variables is the level of economic development of the potential treaty partners. As host states often seek to attract greater investment to spur growth and technological development, they should have stronger preferences to sign a BIT when they are particularly underdeveloped. On the other hand, home states should be more eager to sign a BIT when a host state is more economically developed as its workforce is likely to be more educated and its domestic market larger and thus it will be an attractive destination for its investors. Moreover, if the home state is very developed economically, it will likely have, or expect to have, greater FDI outflows to the host and thus more incentive to conclude a BIT. For both the host and home states, development is measured by taking the log of GDP per capita. GDP data is obtained from the Gleditsch’s (2002) Expanded Trade and GDP Data v5.0. I also control for whether or not the host has a common law system as some studies have found a positive and robust relationship relationship between a common law system of government and the rate of BIT participation (Elkins, Guzman & Simmons 2006). Data on the system of law is from Mitchell and Powell (2008).

I expect that a home state will be particularly concerned about signing BITs when there is heavy investment activity by its citizens in a host state. Unfortunately, the availability of bilateral FDI data is inconsistent at best and there is very little data for dyads involving non-OECD states. Thus, to proxy for the level of FDI exposure a home state has in the host state I employ two measures. Colonies and their metropole, and alliance partners (Gowa 1988) are often closely linked economically and thus states with a shared colonial heritage or a shared alliance are likely
to display higher levels of investment activity between themselves. Therefore two dummy variables for whether or not the home and host state share an alliance and whether or not the host state was a former colony of the home state are included in the model for the home state to capture the level of investment exposure the home state may have in the host state. Data on alliance membership and colonial ties are taken from Leeds (2005) and the ICOW (N.d.) data set respectively.

Investment agreements are also more likely to be concluded by states that have reasonably developed diplomatic relations with one another. Therefore, I control for whether or not a home state has formal diplomatic representation in the host state either through an embassy or consulate, and whether or not the host state is formally represented in the host state using two dummy variables. Data on diplomatic representation is taken from the Correlates of War Diplomatic Exchange Data Set (Bayer 2006).

A final set of variables seeks to capture competitive diffusion dynamics that have been shown to play a role in BIT signing (see Elkins, Guzman & Simmons 2006). Specifically, host states compete with each other to create hospitable environments that attract foreign capital while home states compete to create secure destinations for their investors. Thus, the decision to sign a BIT is influenced by whether or not other potential competitors for FDI are signing BITs with the other state. I account for this in two ways. First, for each state I include a measure the other state’s total BIT experience, which is the log of the total number of BITs signed by the other treaty partner. This measure broadly captures the pressure one state has to sign with a BIT with other state. If a host state’s dyad partner has signed
many BITs, it will likely feel more pressure to sign a BIT too to avoid losing out on investment from the dyad partner. Similarly, if a home state’s dyad partner has signed many BITs, the home state will likely feel pressure to sign a BIT with it too so that its investors are not uniquely disadvantaged by having to invest in its dyad partner without the protection of a BIT. A second, more targeted measure of competitive pressure to sign a BIT with one’s dyad partner is the share of countries in one’s region with whom one’s dyad partner has already concluded a treaty. If one assumes that a state’s direct competition for FDI comes from its neighbors than a government will feel greater pressure to sign a BIT with a country if it already has a BIT with a large proportion of its neighbors/peer competitors. The results of the bivariate probit models are presented in Tables A.1 and A.2.
Table A.1: Partial Observability Bivariate Probit Models of BIT Signing

<table>
<thead>
<tr>
<th>Host Regime Type</th>
<th>Autocracy</th>
<th>Democracy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BIT Partner</strong></td>
<td>Host</td>
<td>Home</td>
</tr>
<tr>
<td>Autocratic Time Horizon (Host)</td>
<td>-0.004</td>
<td>(0.020)</td>
</tr>
<tr>
<td><strong>Pr(Regime Failure)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Host)</td>
<td>-0.091*</td>
<td>(0.051)</td>
</tr>
<tr>
<td><strong>Party Age</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Home)</td>
<td>-0.181</td>
<td>(0.196)</td>
</tr>
<tr>
<td>GDP p.c. (Host)</td>
<td>-1.772***</td>
<td>(0.593)</td>
</tr>
<tr>
<td>GDP p.c. (Home)</td>
<td>0.043***</td>
<td>(0.016)</td>
</tr>
<tr>
<td>Partner’s BIT Experience</td>
<td>0.067</td>
<td>(0.076)</td>
</tr>
<tr>
<td>Share of States in a Region With Whom Partner Has a BIT</td>
<td>6.745***</td>
<td>(2.108)</td>
</tr>
<tr>
<td>Diplomatic Representation</td>
<td>-0.017</td>
<td>(0.193)</td>
</tr>
<tr>
<td>Common Law System (Host)</td>
<td>0.337</td>
<td>(0.258)</td>
</tr>
<tr>
<td>Age of Democracy (Home)</td>
<td>0.163**</td>
<td>(0.083)</td>
</tr>
<tr>
<td>Executive Constraints (Host)</td>
<td>0.114*</td>
<td>(0.064)</td>
</tr>
<tr>
<td>Executive Constraints (Home)</td>
<td>0.074</td>
<td>(0.079)</td>
</tr>
<tr>
<td>Host Former Colony</td>
<td>0.063</td>
<td>(0.263)</td>
</tr>
<tr>
<td>Alliance</td>
<td>-0.130</td>
<td>(0.147)</td>
</tr>
<tr>
<td>Constant</td>
<td>17.367***</td>
<td>(5.395)</td>
</tr>
<tr>
<td><strong>ρ</strong></td>
<td>-0.688**</td>
<td>(0.191)</td>
</tr>
<tr>
<td><strong>N (Dyad-years)</strong></td>
<td>12308</td>
<td>9388</td>
</tr>
</tbody>
</table>

Standard errors in parentheses robust to clustering on the dyad

* p < 0.1, ** p < 0.05, *** p < 0.01
Appendix B

THE EFFECT OF DOUBLE TAXATION TREATIES ON NATIONAL TREATMENT CARVE OUTS FOR TAXATION
Table B.1: Logistic Regression Models of National Treatment Carve Outs for Taxation

<table>
<thead>
<tr>
<th>Host Regime Type</th>
<th>Autocracy</th>
<th>Democracy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Autocratic Time Horizon (Host)</td>
<td>-0.181</td>
<td></td>
</tr>
<tr>
<td>Pr(Regime Failure)</td>
<td>(0.142)</td>
<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Host)</td>
<td>0.274</td>
<td></td>
</tr>
<tr>
<td>Party Age</td>
<td>(0.255)</td>
<td></td>
</tr>
<tr>
<td>Democratic Time Horizon (Home)</td>
<td>0.505</td>
<td>-0.037</td>
</tr>
<tr>
<td>Party Age</td>
<td>(0.476)</td>
<td>(0.312)</td>
</tr>
<tr>
<td>Age of Democracy (Home)</td>
<td>-0.538</td>
<td>0.591</td>
</tr>
<tr>
<td></td>
<td>(0.77)</td>
<td>(0.42)</td>
</tr>
<tr>
<td>Age of Democracy (Host)</td>
<td>-0.058</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.287)</td>
<td></td>
</tr>
<tr>
<td>North-South BIT</td>
<td>0.618</td>
<td>0.861</td>
</tr>
<tr>
<td></td>
<td>(1.334)</td>
<td>(0.719)</td>
</tr>
<tr>
<td>Years Since Independence (Host)</td>
<td>0.054</td>
<td>-0.334*</td>
</tr>
<tr>
<td></td>
<td>(0.399)</td>
<td>(0.171)</td>
</tr>
<tr>
<td>Host Share of Dyadic Wealth</td>
<td>-3.545*</td>
<td>0.74</td>
</tr>
<tr>
<td></td>
<td>(2.143)</td>
<td>(0.943)</td>
</tr>
<tr>
<td>GDP p.c. Growth (Host)</td>
<td>0.013</td>
<td>0.032</td>
</tr>
<tr>
<td></td>
<td>(0.042)</td>
<td>(0.031)</td>
</tr>
<tr>
<td>Time Counter</td>
<td>0.056</td>
<td>0.065</td>
</tr>
<tr>
<td></td>
<td>(0.062)</td>
<td>(0.078)</td>
</tr>
<tr>
<td>Executive Constraints (Host)</td>
<td>-0.459**</td>
<td>0.177</td>
</tr>
<tr>
<td></td>
<td>(0.216)</td>
<td>(0.141)</td>
</tr>
<tr>
<td>Executive Constraints (Home)</td>
<td>-0.664</td>
<td>0.088</td>
</tr>
<tr>
<td></td>
<td>(0.527)</td>
<td>(0.456)</td>
</tr>
<tr>
<td>Double Taxation Treaty</td>
<td>0.291</td>
<td>-0.235</td>
</tr>
<tr>
<td></td>
<td>(0.778)</td>
<td>(0.419)</td>
</tr>
<tr>
<td>Constant</td>
<td>3.945</td>
<td>-6.581*</td>
</tr>
<tr>
<td></td>
<td>(5.312)</td>
<td>(3.621)</td>
</tr>
</tbody>
</table>

N: 79 122  
AIC: 123 180  

Two-way clustered (on host and home state) robust standard errors in parentheses

* p < 0.1, ** p < 0.05, *** p < 0.01  

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Appendix C

INVESTOR-STATE DISPUTE SETTLEMENT CLAUSE
(AUSTRALIA-INDIA BIT)

Article 12

Settlement of disputes between an investor and a Contracting Party

1. Any dispute between an investor of one Contracting Party and the other Con-
tracting Party in relation to an investment of the former under this Agreement shall,
as far as possible, be settled amicably through negotiations between the Parties to
the dispute.

2. Any such dispute which has not been amicably settled may, if both Parties agree,
be submitted;

   (a) for resolution, in accordance with the law of the Contracting Party which has
   admitted the investment to that Contracting Party’s competent judicial or adminis-
   trative bodies; or

   (b) to international conciliation under the Conciliation Rules of the United Na-
   tions Commission on International Trade Law.

3. Should the Parties fail to agree on a dispute settlement procedure provided under
paragraph 2 of this article or where a dispute is referred to conciliation but conciliation proceedings are terminated other than by signing of a settlement agreement, the dispute may be referred to Arbitration. The Arbitration procedure shall be as follows:

(a) if the Contracting Party of the investor and the other Contracting Party are both Parties to the Convention on the Settlement of Investment Disputes between States and Nationals of other States, 1965, and both Parties to the dispute consent in writing to submit the dispute to the International Centre for Settlement of Investment Disputes such a dispute shall be referred to the Centre;

(b) if both Parties to the dispute so agree, under the Additional Facility for the Administration of Conciliation, Arbitration and Fact-Finding Proceedings; or

(c) to an ad hoc arbitral tribunal by either Party to the dispute in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law, 1976, subject to the following provisions;

(i) The Arbitral Tribunal shall consists of three arbitrators. Each Party shall select an arbitrator. These two arbitrators shall appoint by mutual agreement a third arbitrator, the Chairperson, who shall be a national of a third State. All arbitrators shall be appointed within two months from the date when one of the Parties to the dispute informs the other of its intention to submit the dispute to arbitration;

(ii) If the necessary appointments are not made within the period specified in sub-paragraph (c)(i), either Party may, in the absence of any other agreement,
request the President of the International Court of Justice to make the necessary appointments;

(iii) The arbitral award shall be made in accordance with the provisions of this Agreement;

(iv) The tribunal shall reach its decision by a majority of votes;

(v) The decision of the arbitral tribunal shall be final and binding and the Parties shall abide by and comply with the terms of its award;

(vi) The arbitral tribunal shall state the basis of its decision and give reasons upon the request of either Party;

(vii) Each Party concerned shall bear the cost of its own arbitrator and its representation in the arbitral proceedings. The cost of the Chairperson in discharging his or her arbitral function and the remaining costs of the tribunal shall be borne equally by the Parties concerned. The tribunal may, however, in its decision direct that a higher proportion of costs shall be borne by one of the two Parties, and this award shall be binding on both Parties.

4. Once an action referred to in paragraphs 2 and 3 of this Article has been taken, neither Contracting Party shall pursue the dispute through diplomatic channels unless:

(a) the relevant judicial or administrative body, the Secretary General of the Centre, the arbitral authority or tribunal or the conciliation commission, as the case may be, has decided that it has no jurisdiction in relation to the dispute in question; or
(b) the other Contracting Party has failed to abide by or comply with any judgment, award, order or other determination made by the body in question.
Appendix D

EVALUATION OF AN ICSID BASED ALTERNATIVE MEASURE OF LEGALIZED DELEGATION

In a recent study, Allee and Peinhardt (2010) analyze variation in dispute settlement clauses in BITs from the perspective of legal delegation. Critical to how they conceptualize and measure legal delegation is the forum for arbitration, and particularly whether or not ICSID is one, or the only, forum for arbitration identified in the BIT. Allee and Peinhardt argue that ICSID is the most important arbitration institution and that it is superior to other institutions and ad hoc arbitration panels. According to them, ICSID represents the “highest degree of delegation among options for settling investor-state disputes” (4) because: a) it has a secretary-general that can determine ICSID’s jurisdiction and appoint arbitrators if necessary; b) it was founded by an international convention; c) it has ties to the World Bank giving it “institutional gravitas” and leverage over states; d) ICSID awards are binding; e) ICSID awards carry the same effect as if an award was made by a domestic court. Furthermore, under ad hoc arbitration procedural and practical matters are less streamlined than under ICSID and other institutionalized bodies focus more on private commercial arbitration where states are not a party to the disputes.
For Allee and Peinhardt, legal delegation is greatest when BITs include a provision for the settlement of disputes through international arbitration, and ICSID is the only forum available. The next greatest degree of delegation is delegation to ICSID as one of several arbitration venues and the lowest level of delegation is no delegation to any international arbitral body (or delegation to domestic authorities). The reason why exclusive delegation to ICSID represents the highest level is because “the inclusion of multiple options for disputes settlement opens the door to delay and removes the efficiency gains associated with exclusive delegation to ICSID” (7). Allee and Peinhardt also argue that governments seeking to protect investors will prefer ICSID and bargain for binding dispute settlement while host governments that typically attract more FDI than they export will be wary of delegation to ICSID because it generates sovereignty costs and arbitration can be costly.

Although Allee and Peinhardt use the legalization literature to frame their analysis, it is unclear in their discussion if “legal delegation” is the same as “legalized delegation”. If indeed it is, then Allee and Peinhardt’s ICSID based approach suggests an alternative way in which to approach the legalization of dispute settlement measures in BITs. However, I believe it possesses several flaws and that the approach I adopt in Chapter 5 more accurately taps into the legalization of delegation.

While many of Allee and Peinhardt’s arguments about the relative merits of ICSID are valid, some of the features unique to ICSID that they identify (e.g. institutional gravitas) do not reflect greater legalization, as conceptualized by Abbott et
Moreover, they overstate the uniqueness of ICSID’s attributes. For example, BITs can and do contain provisions for binding arbitration that may be conducted at fora other than ICSID; ICSID is not necessary for bindingness. Furthermore, while the provision in the ICSID convention that causes awards decisions to have the effect of an award made under domestic law is important, alternative instruments such as the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) exist that make non-ICSID awards decisions enforceable domestically (UNCTAD 2007a). In addition, the idea that ICSID alone represents the highest level of legal delegation for “efficiency” reasons bears little relation to legalization as conceptualized here. Indeed, the argument that ICSID alone is the best option for legal protection of investors is misleading for even proponents of ICSID acknowledge that it is not always the best forum for arbitration (Reed, Paulsson & Blackaby 2004) and legal practitioners point out that ICSID arbitration is more costly and time-consuming than alternatives. Moreover, the threat of delay as a result of multiple venues being offered for arbitration is also overstated. Firstly, many BITs allow investors to choose their preferred venue thus removing from governments the opportunity to interfere in and delay the process of venue selection (UNCTAD 2007a) whilst giving investors the opportunity to forum shop. Second, the increased demand for ICSID arbitration has led to a backlog of cases causing investors to pursue arbitration at

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1 While alternative conceptualizations of legalization exist, Allee and Peinhardt base their discussion only on Abbott et al.

2 Comment made by a Turkish investment lawyer in an interview with the author in December 2009, Ankara, Turkey.
alternative venues rather than wait for room on the ICSID docket.\footnote{This point was raised by Todd Allee during his presentation “Contingent Credibility: The Reputational Effects of Investment Treaty Disputes on Foreign Direct Investment” at the Globalization, Institutions and Economic Security Workshop, The Ohio State University, October 31, 2008.} Thus, having multiple venues available, as opposed to just ICSID, can make legal resolution of disputes more swift.

Finally, Allee and Peinhardt’s arguments with respect to the sovereignty costs of delegation to ICSID are similar those that I make with regard to constrained policy autonomy through legalized delegation. However, the critical factor, I argue, is not delegation to ICSID but delegation to independent international arbitrators who have the power to take binding decisions and award compensation. Indeed, while they focus on ICSID, their discussion of sovereignty costs and constrained autonomy focuses on the difference between delegating to ICSID and delegation to a domestic authority. They do not directly suggest that sovereignty is limited to a greater or lesser extent when delegation is to ICSID or to an alternative international arbitration venue. Thus, from a legalization perspective, I argue that arbitration before ICSID is not necessarily unique from many other arbitration options and that exclusive arbitration to ICSID is not distinct from delegation to ICSID and other alternative arbitration venues. It follows that there is therefore no reason to surmise that delegation to ICSID is necessarily unique with respect to constraints imposed on policy autonomy. For these reasons, I favor the conceptualization and measurement of legalization of delegation in BITs developed in Chapter 5 over the approach pursued by Allee and Peinhardt.
Appendix E

TABLES FOR TESTS OF ROBUSTNESS OF RESULTS IN

CHAPTER 6
Table E.1: Linear Regression Models of the Length of BIT Texts Controlling for Selection: Autocratic Host States

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<tr>
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<td>-378.0**</td>
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N: 98

Bootstrapped standard errors in parentheses. Significance levels determined according to bias corrected and accelerated (BCa) confidence intervals.

* p < 0.1, ** p < 0.05, *** p < 0.01
Table E.2: Linear Regression Models of the Length of BIT Texts Controlling for Selection: Democratic Host States

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N = 115

Bootstrapped standard errors in parentheses. Significance levels determined according to bias corrected and accelerated (BCa) confidence intervals.

* p < 0.1, ** p < 0.05, *** p < 0.01
Appendix F

DESCRIPTIVE STATISTICS
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URL: http://correlatesofwar.org


Choi, Seung-Whan & Yiagadeesen Samy. 2008. “Reexamining the Effect of Democra-
tic Institutions on Inflows of Foreign Direct Investment in Developing Coun-

Clague, Christopher, Philip Keefer, Stephen Knack & Mancur Olson. 1996. “Prop-
erty and Contract Rights in Autocracies and Democracies.” *Journal of Eco-


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URL: http://ideas.repec.org/p/wbk/wbrwps/2613.html


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