ARE BITS SUCH A BRIGHT IDEA? EXPLORING THE IDEATIONAL BASIS OF INVESTMENT TREATY ENTHUSIASM

Jason Webb Yackee[*]

> To neglect the role of ideas in political economy... is to miss an important component of the economic and political worlds. It is ideas, in the form of economic theories and the policies developed from them, that enable national leaders to chart a course through turbulent economic times, and ideas about what is efficient, expedient, and just that motivate the movement from one line of policy to another.[1]

This article explores the ways that focusing on policymakers' changing ideas about the value of foreign direct investment (FDI) can help us to understand the "massive and sudden proliferation" of bilateral investment treaties (BITs) over the past twenty years, which has rightly been described as a "remarkable" event in international law.[2] States have concluded more than 2,000 such treaties as of 2002,[3]

---

[*] Fellow, Gould School of Law, University of Southern California; J.D., Duke University School of Law. The author may be contacted at jason.yackee@alumni.duke.edu.

[1]Peter A. Hall, Conclusion: The Politics of Keynesian Ideas, *in* THE POLITICAL POWER OF ECONOMIC IDEAS: KEYNESIANISM ACROSS NATIONS 361 (Peter A. Hall ed., 1989) [hereinafter Hall].

[2]Kenneth J. Vandevelde, *The Political Economy of a Bilateral Investment Treaty*, 92 AMER. J. INT'L L. 621 *passim* (1998) [hereinafter Vandevelde]. The popularity of BITs appears to have caught many observers by surprise. For instance, in 1983 Earl Fry argued, quite wrongly as it turned out, that "Bilateral . . . agreements may also help to standardize [investment] rules of the game . . . . Even in this case, however, agreements will generally be among a few of the advanced industrial nations and will have only a

and an increasing amount of foreign direct investment (FDI) flows between the developed and less developed worlds are covered by the treaties' legal protections.[4] If the current mania for BITs shows any immediate signs of abating, it is largely a function of the twin facts that the number of relevant pairs of states without a pre-existing BIT is declining, and that states are increasingly forgoing the bilateral model to incorporate BIT-like provisions in multilateral treaties, such as Chapter 11 of the North American Free Trade Agreement (NAFTA),[5] Chapter 10 of the Central American Free Trade Agreement (CAFTA),[6] or Part III of the Energy Charter Treaty (ECT).[7]

What explains the widespread popularity of BITs and equivalent treaty instruments? Despite the undeniable importance of the treaties both from an economic and an international legal perspective, the reasons for their sustained popularity have received little theoretical attention. The most important existing explanation argues that the BIT phenomenon is best understood as a "competition for capital," whereby rational states, seeking to promote economic growth through an influx of FDI, attempt to divert foreign capital from their economic competitors by adopting investor-friendly policy regimes, of which BITs are the cornerstone.[8] In its strongest form, the thesis suggests that developing country policy toward FDI operates as an OPEC-like cartel. In this view, developing countries can collectively benefit by jointly maintaining a BIT-free world, where host country sovereignty is

---

minor impact on business-government linkages." EARL H. FRY, THE POLITICS OF INTERNATIONAL INVESTMENT 165 (1983).

[3]United Nations Conference on Trade and Development, Dispute Settlement: Investor-State 41, UNCTAD/ITE/IIT/30 (2003).

[4]Organisation for Economic Cooperation and Development [OECD], *Trends and Recent Developments in Foreign Direct Investment* at 18-20 & Table 6 (June 2005), *in* OECD International Investment Perspectives (forthcoming 2005), *available at* http://www.oecd.org/dataoecd/13/62/35032229.pdf.

[5]North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 612 (entered into force Jan. 1, 1994), *available at* http://www.sice.oas.org/trade/nafta/naftatce.asp.

[6]U.S.-Central American Free Trade Agreement (June 1, 2004), *available at* http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html.

[7]European Energy Charter Treaty, Dec. 17, 1994, 34 I.L.M. 360, *available at* http://www.encharter.org/upload/1/TreatyBook-en.pdf.

[8]*See especially* Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 660 (1998) [hereinafter Guzman]; Zachary Elkins, Andrew Guzman, and Beth Simmons, *Competing for Capital: the Diffusion of Bilateral Investment Treaties, 1960-2000*. (August 1, 2004). International Legal Studies Program. International Legal Studies Working Papers Series, Paper 2, *available at* http://repositories.cdlib.org/ils/wp/2.

king and foreign investors enjoy few international legal rights or guarantees. Companies wishing to invest abroad will have no choice but to invest on the developing countries' unfavorable terms. But those same developing countries also face individual incentives to "cheat" by offering foreign investors more extensive protections, in order to capture outsized portions of available investment. These incentives to cheat, the argument goes, explain the (virtually pre-ordained) failure of the developing countries to achieve the "New International Economic Order" (NIEO) of the 1970s, a central plank of which was the idea of extensive host state control over foreign investment.

There is undoubtedly some truth to this parsimonious explanation, which indeed enjoys support from scholars of a more neoclassical bent[9] as well as from those on the left.[10] However, in this article I caution against assuming, as the competition for capital thesis implicitly does, that developing country enthusiasm for BITs is the natural or equilibrium state of affairs. I draw on recent literature in political science on the power of ideas to suggest that the popularity of BITs can not be fully understood without better taking into account the *ideational basis* of the BIT phenomenon. In particular, I focus on the ways in which BITs and FDI fit into developing country ideas about proper development strategy. My main conclusion is that we should not be lulled into thinking that developing countries have embraced BITs – and through them, FDI – because BITs and FDI "are," in the objective sense, "good" for them, either individually or perhaps even collectively. Rather, we should recognize that the current enthusiasm is due at least in part to the subjective (if widely held) *belief* in the developmental value of BITs and of the FDI they are thought to attract. This distinction may seem pedantic, but it is also important, because it suggests we should not take for granted that the liberalizing trends of the past twenty years will continue, nor that the pro-investment status quo will necessarily persist. This is because ideas and beliefs are imminently susceptible to change, and policies based upon them can be expected to change as well.

The article proceeds as follows. Section I reviews recent work in comparative political economy to introduce an ideational approach to understanding the adoption of public policy. Section II applies the approach to examine the ways in which developing country ideas about

---

[9] *See generally* Guzman, *supra* note 8, *passim*.

[10] M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 266 (2004) [hereinafter SORNARAJAH] ("There has been intense activity in the area of bilateral investment treaties . . . . Developing states are intent on attracting foreign investment, and there is competition for the investment that is available.").

development policy and the developmental role of FDI have changed over the last forty years. Section III discusses the more important implications of the analysis. The paper closes with a brief concluding section.

I. IDEAS IN THEORY

This article's central argument – or, more modestly, its principal suggestion – is that the BIT phenomenon cannot be fully understood without recognizing that it is based in part on particular shared ideas about the state's proper role vis-à-vis foreign investors and, more generally, the best ways to promote a particular kind of economic development.

Whether operating as Weber's "switchmen" of history,[11] or as Keynes' "defunct economist,"[12] the social science literature has long suggested that ideas can play an important role in influencing states' policy choices. Ideational theory has enjoyed its most recent renaissance in the field of comparative political economy, which typically defines ideas as "subjective claims about descriptions of the world, causal relationships, or the normative legitimacy of certain actions."[13] Importantly, for ideational theorists these subjective beliefs do more than to simply "rationalize strategies chosen for other [e.g. objective] reasons" – instead, subjective beliefs actually serve to guide policymakers' actions.[14] Ideational theories contrast most notably, though are not necessarily inconsistent with, rational choice theories of public policy, the latter of which the competition for capital thesis essentially is. Rational choice theories purport to identify an actor's supposedly "objective" interest – e.g. power, votes, money – and posit that the actor will rationally seek to maximize that interest within given institutional constraints. The key difference between rationalist

[11] "Not ideas, but material and ideal interests, directly govern men's conduct. Yet very frequently the 'world images' that have been created by 'ideas' have, like switchmen, determined the tracks along which action has been pushed by the dynamic of interest." Max Weber, *The Social Psychology of the World Religions*, *reprinted in* FROM MAX WEBER: ESSAYS IN SOCIOLOGY 280 (H. H. Gerth & C. W. Mills eds., 1958).

[12] "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slave of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back." JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 383 (1936).

[13] Craig Parsons, *Showing Ideas as Causes: The Origins of the European Union*, 56 INT'L ORG. 47, 48 (2002) [hereinafter Parsons].

[14] *Id*. at 49.

and ideational accounts of public policy is that in rationalist accounts it is the analyst who stipulates what the actor should be expected to desire, based on the analyst's understanding of the actor's objective position, and it is likewise the analyst who stipulates how, precisely, the actor should be expected to most efficiently achieve that desire.[15] By implication, and absent some sort of Darwinian natural selection process, the actor himself is also aware of his objective interests, and of how to best achieve them. In its most extreme view, this approach leads to the "deemphasis of ideas in and of themselves, since they are seen mainly as a thin disguise for the play of interests and power.... what Clifford Geertz has called the 'interest theory' of ideology, where ideas are seen as a 'mask and a weapon.'" [16]

An ideational approach, in contrast, emphasizes that "[t]he interests of actors are constructed by [their] shared ideas rather than given by nature."[17] Policymakers are often uncertain about their true or objective interests, and about the best ways to achieve those interests. This uncertainty means that they must "interpret their interests through ideas that can vary independently from their objective positions."[18] Ideas are thus considered "the subjective components of actors' perceived 'interests.'"[19] An actor's goals are not fixed and predetermined by his "objective position," but rather reflect his mutable and subjective "beliefs about the nature of the universe, and about right and wrong," that is, about what he would like to achieve.[20] Nor can we expect the actor to always choose the "best" way to achieve those goals, as the particular path chosen will itself depends on the actors' equally subjective and mutable causal beliefs.[21] As Professors Goldstein and Keohane summarize this view,

> when we view politics as an arena in which actors face continual uncertainties about their interests and how to maximize them,

[15]Judith Goldstein & Robert O. Keohane, *Ideas and Foreign Policy: An Analytic Framework*, *in* IDEAS & FOREIGN POLICY: BELIEFS, INSTITUTIONS, AND POLITICAL CHANGE 3, 13 (Judith Goldstein & Robert O. Keohane eds., 1993) [hereinafter Goldstein & Keohane].

[16]Kathryn Sikkink, *Development Ideas in Latin America: Paradigm Shift and the Economic Commission for Latin America*, *in* INTERNATIONAL DEVELOPMENT AND THE SOCIAL SCIENCES: ESSAYS ON THE HISTORY AND POLITICS OF KNOWLEDGE 228, 234 (Frederick Cooper ed., 1997) [hereinafter Sikkink].

[17]Martha Finnemore & Kathryn Sikkink, *Taking Stock: The Constructivist Research Program in International Relations and Comparative Politics*, 4 ANN. REV. POL. SCI. 391, 406 (2001) [hereinafter Finnemore & Sikkink].

[18]Parsons, *supra* note 13, at 50.

[19]*Id.* at 49.

[20]Goldstein & Keohane, *supra* note 15, at 13.

[21]*Id.* at 13.

> the need for ideas to act as road maps becomes apparent. Ideas serve the purpose of guiding behavior under conditions of uncertainty by stipulating causal patterns or by providing compelling ethical or moral motivations for action. Ideas can be broad or narrow; they can stipulate what is right or wrong, provide new social visions, or merely suggest what economic policy will steer a nation toward increased wealth.[22]

This sort of ideational approach has been used with some success to identify the effects of changing ideas on such diverse phenomena as the realization of the post-World War II "class compromise" and the rise of the welfare state upon which the compromise was based,[23] decolonization,[24] and the development of the European Union.[25]

Ideational approaches do, however, face well-known limitations, including most prominently the problems of determining which ideas policymakers actually and sincerely hold, and which ideas they espouse merely as "intellectual rationales" for actions taken on the basis of unspoken objective interests.[26] As a consequence, ideational theories have had great difficulty empirically demonstrating simple causation, e.g. that ideas actually *do*, rather than just *should* matter. And perhaps the main weakness of the approach is its frequent failure to demonstrate the relative influence of ideas compared to non-ideational factors.[27] These are indeed serious problems, and I do not attempt to resolve them here.

My goal is much more modest. In the following section, I discuss how ideational theory can provide a more nuanced explanation of the developing countries' remarkable embrace of BITs and foreign investment than the competition for capital thesis currently provides.

---

[22] *Id.* at 16.

[23] Hall, *supra* note 1, at 366.

[24] Robert H. Jackson, *The Weight of Ideas in Decolonization: Normative Change in International Relations*, *in* IDEAS & FOREIGN POLICY: BELIEFS, INSTITUTIONS, AND POLITICAL CHANGE 111-38 (Judith Goldstein & Robert O. Keohane eds., 1993).

[25] Parsons, *supra* note 13; Geoffrey Garrett & Barry R. Weingast, *Ideas, Interests, and Institutions: Constructing the European Community's Internal Market*, *in* IDEAS & FOREIGN POLICY: BELIEFS, INSTITUTIONS, AND POLITICAL CHANGE 173-206 (Judith Goldstein & Robert O. Keohane eds., 1993). The kind of ideational approach described herein should be viewed as a segment of the much larger and diverse constructivist research program, which is well-described in Finnemore & Sikkink, *supra* note 17, at 405-06.

[26] For two critiques along these lines, see John Kurt Jacobsen, *Much Ado About Ideas: The Cognitive Factor in Economic Policy*, 47 WORLD POL. 283, 285 (1995) [hereinafter Jacobsen]. *Cf.* Mark M. Blyth, *"Any More Bright Ideas?" The Ideational Turn of Comparative Political Economy*, 29 COMP. POL. 229, 246 (1997).

[27] Parsons, *supra* note 13, at 49.

In other words, my aim is limited to showing the plausibility of the thesis that ideas "matter" in the context of explaining the popularity of BITs, rather than showing that, as an empirical matter, they actually do. The latter demonstration, if possible, would necessarily entail in-depth case studies that are beyond the scope of this brief article. However, in making my argument I do draw on examples from particular cases, most especially from the experience of Latin America.[28] This is because Latin American has been the source of structural theories of development, which have accurately been described as "one of the most influential [development] ideologies" to have emerged from the Third World.[29] As I discuss below, structural models of development provided the main source of developing country hostility to foreign investors over the period of study. And it was in Latin America that structural thinking had its greatest policy influence.

II. CHANGING IDEAS OF DEVELOPMENT

The previous section suggested that, as a general matter, subjective beliefs of policymakers are worthy of study because they define what policymakers want to achieve, and they also provide the scientific paradigms for achieving it.[30] In the specific context of BITs, the value of an ideational approach is that it can help us make sense of what seems to be an intriguing historical puzzle: how do we explain the fact that in the 1960s and early 1970s less developed countries (LDCs) appeared to exhibit a collective hostility toward FDI, especially as measured by their activities within the United Nations Conference on Trade and Development (UNCTAD) and the United Nations General Assembly, and yet by the 1980s and late 1990s, many of those same LDCs were adopting domestic and international legal frameworks – with BITs as their centerpiece – that were extremely investor-friendly?[31] In other words, how do we explain this change in LDC policy toward foreign investors?

We should, of course, be cautious about overdrawing the distinction between the two periods. The developing countries' most

[28]For a discussion of the methodological problems associated with empirically demonstrating the causal effects of ideas on public policy, see Albert S. Yee, *The Causal Effects of Ideas on Policies*, 60 INT'L ORG. 69 (1996). Ideational arguments are especially resistant to statistical analysis. *Id*. at 73.

[29]Sikkink, *supra* note 16, at 228.

[30]Jacobsen, *supra* note 26, at 292.

[31]Guzman, *supra* note 8, was one of the first to highlight the puzzle and to address it in a theoretically sophisticated manner.

extreme expressions of disdain for the rights of foreign investors in the various UN fora in the 1970s can in large part be dismissed as cheap talk offered up in a relatively powerless multilateral body where extreme political posturing tends to carry little consequence. And as discussed below, developing countries' development strategies never completely renounced a role for FDI.[32] Furthermore, as to the modern era, Vandevelde has provided the valuable service of reminding us that despite the rhetoric of a supposed triumph of liberalism in foreign investment law, BITs are, for the most part, only imperfect and incomplete manifestations of neoliberal economic theory.[33] That said, the difference between the developing countries' acceptance of FDI in the earlier and later periods, both in rhetoric and practice, is nonetheless rather striking and worthy of analysis.

An ideational approach suggests that the current enthusiasm for BITs is premised on three nested ideas: first, that relatively unrestricted FDI inflows are normatively desirable – that is, that FDI inflows promote economic growth; second, that BITs are effective at increasing FDI inflows beyond what they otherwise would be; and third, that the value of this additional FDI adequately outweighs the host state's potentially significant sacrifice of sovereignty in the BIT. Indeed, this is the "grand bargain" of investment treaties.[34] For an ideational approach to convincingly explain the developing countries' increasing willingness to enter into this bargain, it must be able to show that developing country policymakers' acceptance of these ideas has changed over time. In fact, there is some evidence that policymakers' beliefs in the normative desirability of FDI as part of their development strategies have changed substantially since the heyday of the NIEO. Two events stand out in particular: the discrediting and declining influence of structural theories of development – import substitution industrialization (ISI) and its close but radicalized relative,

---

[32]For example, Craig Murphy argues that the developing and developed countries were not so very far apart in their approaches to balancing national sovereignty with the rights of foreign investors. CRAIG MURPHY, EMERGENCE OF THE NIEO IDEOLOGY 71 (1984) [hereinafter MURPHY].

[33]Vandevelde, *supra* note 2, *passim*.

[34]Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain*, 46 HARV. INT'L L. J. 67 (2005) [hereinafter Salacuse & Sullivan]. For a similar analysis see SORNARAJAH, *supra* note 10, at 207, who observes that "The rationale for the treaty itself is the promise of protection for the capital that is received . . . . In the belief that foreign investment will be forthcoming, there is a surrender of sovereignty on the part of the state that hopes to receive the . . . foreign investment." This is also evident from the preambles of the treaties, which generally reaffirm that the goal of many BITs is to promote and encourage FDI.

dependency theory – beginning in the mid-1970s and early 1980s, and the collapse of communism in the late 1980s and early 1990s.

The Decline of ISI and Dependency. Structural theories of development emerged most directly out of work by Paul Prebisch, Hans Singer, and others in the 1950s, and were widely publicized under the auspices of the Economic Commission for Latin America (ECLA).[35] Prebisch's basic thesis was that the Third World's failure to develop was due to the structure of economic relations between the developed North and the underdeveloped South, and that economic growth in the developed countries could not be counted on to promote growth in the developing world.[36] This was in large part because the developing countries' economies were based on the production and export of primary goods, and primary goods, according to Prebisch, faced a declining terms of trade vis-à-vis the manufactured goods produced by the developed world.[37] The essential policy prescription derived from Prebisch's work was that the key to development was industrialization. To achieve industrialization, developing country governments were encouraged to take an interventionist approach by implementing a strategy of import substitution industrialization, or ISI, in which "[l]arge-scale comprehensive planning, rather than the market, was assumed to be the appropriate instrument."[38] The basic idea of ISI was that developing countries could alter the structure of North-South economic relations in their favor by promoting the development of an indigenous manufacturing capacity.[39] The strategy called for raising tariff walls and other barriers against imports of manufactured goods from the North, and reinvesting capital, especially that earned from the export of primary goods or from foreign investors, in the local production of consumer and industrial goods previously purchased abroad.[40]

Of course, the textbook model of an ISI development strategy, to the extent that such a model exists, was implemented to various degrees and in various ways. As Bruton observes, "the extent to which a particular country's decision makers thought along these lines

---

[35]Henry J. Bruton, *A Reconsideration of Import Substitution*, 36 J. ECON. LIT. 903, 905 (1998) [hereinafter Bruton]. ECLA has been described as "not only the most important economic institution in Latin America, but probably the most influential economic institution based in the Third World." Sikkink, *supra* note 16, at 228.

[36]Bruton, *supra* note 35, at 906.

[37]*Id*. at 905.

[38]*Id.* at 907.

[39]In Bruton's words, "The very idea of import substitution implied this: keep out that which is now imported from the North and produce it at home." *Id.* at 908.

[40]*Id.* at 911-13.

depended on a great variety of additional factors."[41] This was true even within Latin America.[42] But it is nonetheless undeniable that ISI's basic tenets had broad appeal across the developing world, and were "widely accepted inside and outside of Latin America in one form or another" by Third World policymakers, economists, and academics, including, despite popular perception, those in East Asia.[43]

For present purposes, the essential feature of ISI to note is its ambivalent approach to foreign direct investment. On the one hand, ISI both encouraged and depended upon foreign investors. By raising barriers against imports from the North, ISI encouraged multinational corporations to consider moving production into ISI countries in order to service the domestic market.[44] And developing countries following an ISI strategy depended on this foreign investment to provide access to technology and to the foreign capital necessary to finance industrialization, especially when foreign exchange reserves or foreign lending or aid was insufficient.[45]

---

[41]*Id.* at 909.

[42]Sikkink, *supra* note 16, at 231 ("Classic ECLA thought had more influence in some Latin American countries than in others. Achieving the most influence in Chile and Brazil, it met with enthusiasm in Central America and the Caribbean, but enjoyed less influence in Mexico, Peru, Colombia, and Argentina").

[43]Bruton, *supra* note 35, at 905 n.3, 906. On the experience of ISI in East Asia, *see generally* Robert Wade, *Industrial Policy in East Asia: Does it Lead or Follow the Market*, *in* MANUFACTURING MIRACLES: PATHS OF INDUSTRIALIZATION IN LATIN AMERICA AND EAST ASIA 231-66 (Gary Gereffi & Donald L. Wyman, eds., 1990) [hereinafter GEREFFI & WYMAN] and Chi Schive, *The Next Stage of Industrialization in Taiwan and South Korea*, GEREFFI & WYMAN at 267-91. In terms of implementation, ISI made the least inroads in the poorest African states, in which "there was little or no heritage of producing, marketing, or technological learning, and essentially none of economic management and policy making," and which failed to "actively pursue an import substitution (or any other) strategy." Bruton, *supra* note 35, at 918, 926. That said, Bruton finds that several of the larger African countries did pursue ISI in the 1960s, albeit in an "ad hoc" fashion. *Id*. at 918. Tazania is perhaps the most prominent African example. *See* MAGNUS BLOSTRÖM & BJÖRN HETTNE, DEVELOPMENT THEORY IN TRANSITION: THE DEPENDENCY DEBATE AND BEYOND: THIRD WORLD RESPONSES 145-54 (1984) [hereinafter BLOSTRÖM & BJÖRN]. India also implemented an ISI-like strategy of industrialization. Bruton, *supra* note 35, at 906.

[44]KATHRYN SIKKINK, IDEAS AND INSTITUTIONS: DEVELOPMENTALISM IN BRAZIL AND ARGENTINA 45 (1991) [hereinafter SIKKINK].

[45]On the role of foreign direct investment in Mexico and Brazil's experience with ISI, see generally Barbara Stallings, *The Role of Foreign Capital in Economic Development*, *in* GEREFFI & WYMAN 55-89 [hereinafter Stallings]. On the prominent role of FDI in Brazil's development strategy, see generally Samuel A. Morley and Gordon W. Smith, *Import Substitution and Foreign Investment in Brazil*, 23 OXFORD ECONOMIC PAPERS 120, 126-35 (1971) [hereinafter Morley & Smith]. More generally, Bruton argues that ISI "put primary emphasis on capital formation as the source of growth," and that [m]ost observers considered . . . that the savings of the poor countries had to be

On the other hand, ISI's treatment of foreign investment was markedly different from the neoclassical development philosophy previously (and currently) in vogue, and in which many developing countries essentially maintained an "open door for investment and the protection of property rights of foreign investors."[46] The key difference was that ISI recognized a far greater managerial role for the state, which would attempt to direct foreign investment to those areas deemed most likely to aid the industrialization effort through the use of selective inducements and other policy mechanisms.[47] The idea was not to end reliance on foreign investment entirely, but rather to render foreign investment subservient to the perceived development needs of the state, as part of what Bloström and Hettne call "programmed industrialization."[48] A good sense of the desired role for FDI can be gleaned from the Cocoyoc Declaration of 1974, which emerged out of an UNCTAD-sponsored gathering of LDC development experts in Cocoyoc, Mexico. The Declaration emphasized the notion of "self-reliance," not "autarky":

> We believe that one basic strategy of development will have to be increased national self-reliance. It does not mean autarky.... It does mean self-confidence, reliance primarily on one's own resources, human and natural, and the capacity for autonomous goal-setting and decision-making. It excludes dependence on outside influences and power that can be converted into political pressure. It excludes exploitative trade patterns depriving countries of their natural resources for their own development. There is obviously a scope for transfer of technology, but the thrust should be on adaptation and the generation of local technology.[49]

ISI's innate ambivalence toward FDI tilted more toward outright hostility as subsequent scholars, most notably Andre Gunder Frank, Fernando Cardoso, and Theotonio Dos Santos, critiqued, extended, and radicalized Prebisch's ideas into what has become known as

---

supplemented by foreign savings." Bruton, *supra* note 35, at 907.

[46]SIKKINK, *supra* note 44, at 44.

[47]Morley & Smith, *supra* note 45, at 130. See also Bruton, *supra* note 35, at 910-11, who notes that essential to ISI was the ability of developing countries to devise and implement "plans" that would "announce a growth (of GDP and some sectors) target and then allocate the anticipated investment among the sectors of the economy believed necessary to achieve the target."

[48]BLOSTRÖM & HETTNE, *supra* note 43, at 42.

[49]Cocoyoc Declaration 1974 *available at* http://www.southcentre.org/publications/onundrum /conundrum-06.htm#P719_166711.

dependency theory. Dependency theory was in fact much less a unified theory of development than a collection of "more or less articulate notion[s],"[50] "more a mood rather than a set of precise propositions,"[51] about the economic relationships between the developing and developed world. But whatever its ambiguities, at the heart of dependency thinking, as at the heart of ISI, was the "feeling that... powerful foreign companies were not performing dynamically enough to satisfy the needs of national development." [52] The major problems with FDI were said to be such things as the unwillingness of multinational corporations to reinvest profits in the host country, causing a net outflow of capital which tended to impoverish rather than enrich the host state; the failure of foreign investment to lead to promised technology and skill transfer; the ability of multinational corporations to manipulate profits and avoid taxes and capital controls; the failure of multinational corporations to introduce developmentally appropriate technologies; and the failure of foreign investments to benefit poorer regions or areas outside of the investment enclave.[53]

In the face of these and other perceived failings, the natural policy prescription of dependency theory was to more completely establish host country "sovereignty and restore control over the pace and direction of national development."[54] In countries like Chile, where the feeling of *dependencia* was especially acute, the theory manifested itself in spectacular expropriations and nationalizations of foreign investments, most notably in the copper industry.[55] The Chilean experience under Allende proved particularly instructive to the developing world. For example, Craig Murphy attributes the particularly investor-hostile posturing at the UNCTAD III conference in 1972 to the conference's location in Santiago, which attracted "the most radical staff members from the third world economic ministries" and encouraged the delegates to "reflect on the power [that foreign investors] in cooperation with their home governments wielded over third world states."[56]

---

[50]BLOSTRÖM & HETTNE, *supra* note 43, at 2.

[51]THEODORE H. MORAN, MULTINATIONAL CORPORATIONS AND THE POLITICS OF DEPENDENCE: COPPER IN CHILE 58 (1974) [hereinafter MORAN].

[52]*Id.* at 8.

[53]For a list of common complaints about FDI, see PAUL E. SIGMUND, MULTINATIONALS IN LATIN AMERICA: THE POLITICS OF NATIONALIZATION 14-15 (1980). Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L. J. 470 (2000).

[54]MORAN, *supra* note 51, at 58.

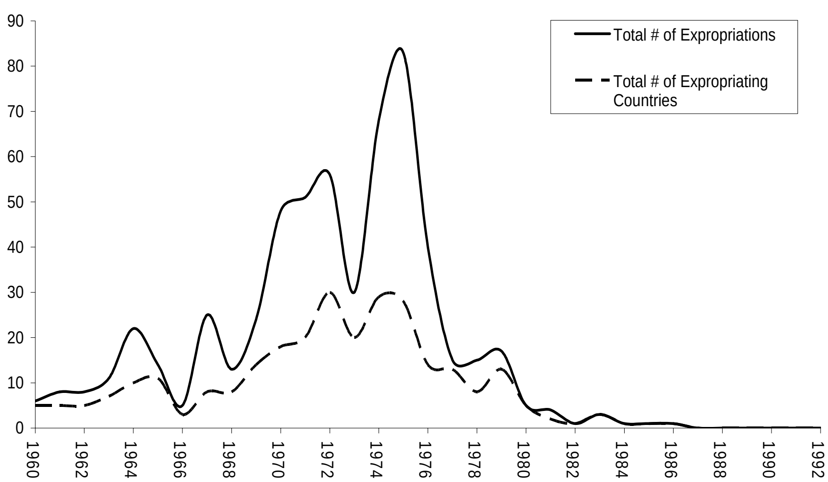
[55]*See generally* MORAN, supra note 51, *passim*.

[56]MURPHY, *supra* note 32, at 103.

Even before UNCTAD III, the notion of dependency, like ISI before it, was gaining relatively wide appeal,[57] in large part because it provided a useful way for third-world policymakers and theorists "to understand the most recent problems experienced by third world countries, the problems associated with [transnational corporations] and existing impediments to the transfer of technology."[58] Because of the relative incoherence of dependency theory and the ambiguities of its policy prescriptions, especially as compared to earlier development theories supporting ISI, it would be a fool's errand to attempt to identify the extent to which particular developing states actually implemented the theory. However, it is widely accepted that by the late 1960s most members of the third world were expressing concern over their perceived dependence on foreign investors.[59] A simple count of the number seizures of foreign property over the period gives some sense – perhaps the best possible one – of the growing practical influence of notions of dependency.

Figure 1: Annual LDC Expropriation Events, 1960-1992

Source: Michael S. Minor, The Demise of Expropriation as an Instrument of LDC Policy, 1980-1992, 1994 J. Int'l Bus. Studies 177.



[57]On the popularity and diffusion of dependency theory, *see generally* BLOSTRÖM & HETTNE, *supra* note 43, *passim*.
[58]MURPHY, *supra* note 32, at 92.

While the most prominent of these expropriations and nationalizations involved the natural resource sectors, this was not always the case. Jodice, for instance, finds that 48.7 percent of all expropriations from 1960-1970 involved the manufacturing, services, transportation, communications, and banking and insurance sectors.[60] And while Latin America has been the focus of most case studies of expropriation, due in large part to high-profile seizures in Chile and Peru, "Africa and the Middle East exhibited high[er] levels of expropriation given their share of world [FDI]."[61] The global and sectoral breadth of the phenomenon thus suggests that structural theories of development – and particularly their more investor-hostile elements – had gained great popularity and persuasiveness in the Third World, not just as abstract theories, but as policies to be put into practice.

What explains this popularity? No doubt one explanation was the haziness of the structural theories' basic tenets and policy prescriptions. For example, in his study of the influence of Keynesianism, Hall finds that the "very ambiguity of Keynesianism ideas enhanced their power in the political sphere."[62] This ambiguity allowed policymakers to tweak and mold Keynes' ideas, which were more of a "general posture than a specific creed," to make those ideas fit into the particular political and institutional context, not as theoretically consistent and complete policies, but as "casts of thought."[63] In the context of ISI and dependency theory, the inherent flexibility of the underlying ideas similarly meant that states were free to experiment with implementation in various ways and to various degrees.[64]

---

[59] *Id*. at 81.

[60] David A. Jodice, *Sources of Change in Third World Regimes for Foreign Direct Investment, 1968-1976*, 34 INT'L ORG. 177, 180-82 (1980) [hereinafter Jodice].

[61] *Id.* at 182.

[62] Hall, *supra* note 1, at 367.

[63] *Ibid*.

[64] Sigmund, *supra* note 53, provides a particularly useful comparison of the nationalization strategies of Chile, Peru, and Venezuela.

More fundamentally, the basic attractiveness of investor-hostile structural theories of development appears to have initially sprung from the perception that neoclassical economic policies – the main perceived alternative – had contributed to Latin America's "striking failures" during the Great Depression and World War II.[65] Even countries that insisted on pursuing rather traditional development strategies in the immediate post-war years began to sense that a relatively laisser-faire development policy was not worth the candle.[66] Moran, for instance, traces the Chilean nationalizations of the 1970s to the widespread disillusionment with earlier attempts in the 1950s and early 1960s to promote development by creating a "good investment climate" that would supposedly promote a "flood of new [foreign] investment."[67] By the mid-1960s, "[t]he period of the 'good investment climate' had come to be considered a disastrous setback in the march away from *dependencia*."

But as Sikkink argues, the popularity of structural theories was driven not just by beliefs in the failures of neoliberal, pro-investor policies, but also by the apparent accomplishments of ISI. For example, until the 1970s Latin American countries that implemented ISI-type policies experienced rather dramatic rates of economic growth,[68] an "achievement[] [that] was significantly higher than anyone anticipated in the early 1950s."[69] This "initial success" greatly aided the diffusion of ISI and dependency thinking and practice across the Third World,[70] and undoubtedly inspired developing countries to take an increasingly hard-line stance against the legal rights, both international and domestic, of foreign investors. C. Fred Bergsten summed up the popular (and from the foreign investor's perspective, disturbing) view in a 1974 article in Foreign Affairs:

> Virtually every country in the world... is levying increasingly stringent requirements on foreign firms... Few countries ask any longer the simplistic question: "Do we want foreign investment?" The issue is how to get foreign investment on the terms which are best for them, and

[65]Sikkink, *supra* note 16, at 240-41.
[66]*See* MURPHY, *supra* note 32, at 42-44.
[67]MORAN, *supra* note 51, at 94-118.
[68]Sikkink, *supra* note 16, at 241.
[69]Bruton, *supra* note 35, at 916.
[70]Sikkink *supra* note 16, at 241. Murphy also attributes the diffusion of dependency thinking to the fact that by 1970, dependency theorists and sympathizers "held prestigious jobs in universities in all third world regions as well as in the African and Latin American UN research arms." MURPHY, *supra* note 32, at 109.

> indeed how to use the power of the firms to promote their own national goals.[71]

Bergsten went on to warn, not so accurately it turned out, that then-current ideas about the proper role of foreign investors in national development strategies would lead to "investment wars" in which host states would increasingly regulate and limit the activities of multinational corporations.[72]

By the time Bergsten's article was published, the structural star was already beginning to fade, as problems with the ISI development model and with anti-investor policies became increasingly obvious, both to economists and to policymakers.[73] Particularly important, Bruton argues, was the greater awareness that ISI as a general development strategy had caused "[s]evere [economic] distortions, modest headway in reducing unemployment, poverty, and inequality, and little evidence of productivity growth."[74] As regards hard-line policies toward foreign investors, the LDC's initial experiences were not necessarily discouraging. For instance, Moran notes that as of 1973, Chile's nationalization of its copper mines was considered to be relatively successful.[75] But by 1980 the economic costs of nationalization were becoming much more obvious. As Sigmund observed in that year,

> In Latin America and elsewhere in the Third World, it appears that a less ideological and more economic or cost-benefit approach to the treatment of foreign investment is now beginning to emerge. Ironically, while nationalization is now perceived as easier to carry out, Latin American governments are increasingly aware that alternative approaches can achieve the goals of nationalization without its costs.[76]

Particularly instructive for the developing countries, he suggests, was the now-evident failure of the Chilean nationalizations, which had been beset by "the combination of economic incompetence and heightened politicization [that] produce[d] instability and repressive government rather than social justice."[77] More generally, Sigmund

---

[71]C. Fred Bergsten, *Coming Investment Wars?* 53 FOREIGN AFF. 135, 136 (Oct. 1974).
[72]*Id*. at 151-52.
[73]Bruton, *supra* note 35, at 919-20.
[74]*Id*. at 919.
[75]MORAN, *supra* note 51, at 249.
[76]SIGMUND, *supra* note 53, at 275.
[77]*Id.* at 274.

observes that by the late 1970s there was a "growing recognition that nationalization may not be the simple remedy for underdeveloped nations that some have claimed it to be – that, particularly when nationalization takes a confrontational form, its economic costs may considerably outweigh its benefits."[78] This did not mean that developing countries now assumed that their interests and the interests of foreign investors would "automatically coincide," but there was an increasing perception, at least, that "the national interest in development and the investor's interest in profit *may* coincide in several areas."[79]

Structural models of development were also dealt severe blows by economic turmoil of the early 1980s. As Caporaso notes, by that time "the field of development" theory was in "disarray" due to empirical failures to correctly predict which countries would or would not develop.[80] In addition, Latin America, long the center of gravity of structural theory and practice, was disproportionately affected by the debt crisis. In an attempt to learn from their mistakes, developing country policymakers increasingly turned to the supposed lessons of the East Asian "miracle" to provide an alternative model of development.[81] In contrast to Latin America, the experiences of East Asian countries like Taiwan and South Korea seemed to many observers to illustrate that consistently high growth rates could be achieved through an "outward orientation" combined with minimal government interference.[82] In particular, at the center of what Bruton calls the "new orthodoxy" of the East Asian model was "acceptance – even encouragement – of private foreign investment" and a de-emphasis on the notion of economic independence from foreign entities.[83] Malaysia and Thailand, whose "great success," according to Bruton, "seemed to be a consequence of their openness, especially their unqualified acceptance of foreign direct investment,"[84] provided especially influential models.

In reality, this popular view of the East Asian model was somewhat inaccurate, as the East Asian model relied, in particular phases, on substantial government involvement in investment decisions

---

[78]*Id.* at 261.

[79]*Id.* at 275-76 (emphasis added).

[80]James A. Caporaso, *Dependency Theory: Continuities and Discontinuities in Development Studies*, 34 INT'L ORG. 605 (1980).

[81]Bruton, *supra* note 35, at 924-32.

[82]*Id.* at 928-29.

[83]*Id.* at 926.

[84]*Id.* at 928.

and a relative aversion to ceding control of those decisions to foreign direct investors, such that FDI was a relatively unimportant part of their development strategies.[85] But whatever the realities, the important point for this analysis is that East Asia provided a new, widely accepted idea of the best way to develop,[86] and countries like Mexico and Brazil increasingly turned toward foreign investors to help them make the transition from ISI-influenced development strategies to a more Asian-inspired, outward-oriented strategy of export promotion.[87] The end result was that, by 1993, The Economist could crow that "governments all across the world, especially in developing countries, are queuing up to attract multinational[corporations]. The United Nations, which spent decades tut-tutting about these firms and drawing up codes of conduct to control them, now spends much of its time advising countries on how best to seduce them."[88]

The Collapse of Communism. The decline of structural theories of development generally, and of anti-foreign investor sentiment and policies specifically, also owes much to the contemporaneous discrediting of the communist economic model. ISI and dependency theory relied to a varying but not unimportant extent on Marxist and neo-Marxist economic notions to justify an active state role in managing development and a suspicion of foreign capital.[89] As the discussion above suggests, the influence of Marxism declined in non-Communist countries well before the upheavals of 1989 and the disintegration of the Soviet Union in 1992. But ideational theories often emphasize that the implementation of a persuasive idea – here, neoclassical theories of development and the perceived benefits of FDI – depends on the extent to which those ideas are embedded in state institutions.[90] In the case of Eastern Europe and the Soviet Union,

---

[85]On the relative unimportance of FDI in Taiwan and South Korea, see generally Stallings, *supra* note 45.

[86]Bruton traces the influence of this reading of the East Asian lesson to a series of influential reports by the World Bank in the late 1980s and early 1990s, the ideas contained in which became known as the "Washington Consensus." Bruton, *supra* note 35, at 927-29.

[87]GARY GEREFFI, *Big Business and the State*, *in* GEREFFI & WYMAN at 99.

[88]Bill Emmott, *Multinationals: Back in Fashion*, THE ECONOMIST, March 27, 1993, at SS5.

[89]On the influence of the Marxist tradition on structural theories of development, see generally BLOSTRÖM & HETTNE, *supra* note 43, at ch. 1.

[90]*See* SIKKINK, *supra* note 44, at 248-51. As Hall notes, "[i]f . . . ideas have real power in the political world . . . they do not acquire political force independently of the constellation of institutions and interests already present there." Hall, *supra* note 1, at 390.

where Communism was deeply embedded, such policies could not emerge as viable alternatives until those authoritarian institutions had begun to disintegrate.[91] The exception that seems to prove the rule is China, which began opening its doors to FDI through the creation of special economic zones soon after Mao's death in 1976.[92]

It is unsurprising that once the old regimes dramatically and suddenly disintegrated, new leaders quickly and reflexively embraced an often extreme version of neoclassical development theory, since by that time there was no other apparent alternative.[93] This was

---

[91]To get a sense of Communism's disfavor for foreign investors, it is instructive to compare "foreign capital penetration scores" for Communist and non-Communist developing countries. These scores are calculated by taking the amount of foreign capital in a developing country, dividing by the country's gross domestic product, and multiplying by 100. Data compiled by de Soysa and Oneal show that Poland and Hungary had scores of 0.108 and 0.003, respectively, in 1980, and not all that much higher in 1990. (Comparable data for other Communist countries is not available). Penetration scores in the rest of the developing world were remarkably higher, indicating a far greater reliance on foreign investment. For example, the average Latin American penetration score in the same year was 6.39. Indra de Soysa & John R. Oneal, *Boon or Bane? Reassessing the Productivity of Foreign Direct Investment*, 64 AM. SOC. REV. 766, 779-80 App. A (1999) [hereinafter de Soysa & Oneal]. This is not to say that the Communist countries completely eschewed FDI until 1992. There were earlier initiatives at opening the doors, just a crack, to private Western capital, most notably Yugoslavia's development of a legal framework for foreign investment in 1967. This development was, at the time, apparently "unprecedented" in post-World War II Eastern Europe. Michael L. Burack, *American Private Direct Investment in Eastern Europe: Intersection of Business Interests and Foreign Policy*, 21 STANFORD L. REV. 877, 881 (1969). Despite the occassional limited initiative at attracting FDI, the pre-transition Eastern European countries appear to have primarily relied on external borrowing and trade to fund their foreign currency needs, with FDI emerging as an important source of foreign capital only in the early 1990s. *See, e.g.*, Hajna Istvanffy Lorinc, *Foreign Debt, Debt Management Policy, and Implications for Hungary's Development*, 44 SOVIET STUD. 997, 1003 Table 2. The Hungarian case shows that FDI inflows were nil in the early 1980s and did not begin to increase significantly until 1991.

[92]Shyam J. Kamath, *Foreign Direct Investment in a Centrally Planned Economy: The Chinese Case*, 39 ECON. DEV. & CULTURAL CHANGE 107 (1990). Kamath explains the Chinese decision as one of economic necessity, but it is also clear that the changes in Chinese policy toward FDI would not have occurred absent the transfer of power to Deng Xiaoping's moderate wing of the Communist Party. In this sense, the Chinese case does not seem so different from the cases of other ex-Communist countries, whose embrace of FDI was also triggered by dramatic political change.

[93]For instance, Oyzranzowski and Paleczny-Zapp attribute Poland's ready adoption of "shock therapy" to the inability of Polish economists, trained exclusively in now-defunct Marxist methods, to offer "any meaningful alternatives" to the suggestions of American advisers such as economist Jeffrey Sachs. Bronislaw Oyranowski and Magda Paleczny-Zapp, *From One Economic Ideology to Another: Poland's Transition from Socialism to Capitalism*, 7 INT'L J. POL., CULTURE, AND SOC. 43, 47 (1993). More generally, the ideational literature suggests that new ideas are particularly influential in

particularly true given the perceived failure of what Sikkink calls the "heterodox" policies adopted briefly by such countries as Argentina and Brazil in the 1980s, "which were seen as a middle ground between the neoliberalist and structuralist policies of the past" but which were also widely viewed as failing to "shock" those economies back into low inflation and growth. Furthermore, the discrediting of the Communist model and the perceived inadequacies of "middle ground" development strategies were accompanied by the apparent success of neoliberal "experiments," most prominently in Chile, where neoclassical policies in the 1980s coincided with rapid growth and low inflation.[94] More importantly for the adoption of BITs, the neoclassical development ideas that the ex-Communist countries embraced envisioned an unusually prominent role for foreign investors, since in the Communist development scheme domestic capital markets were thin, inefficient, and unlikely to provide sufficient capital to promote growth during the transition to democracy and capitalism.[95] FDI, coupled with extensive privatization, was thus considered the keystone of the post-transition reforms, to be carried out under a sense of economic crisis. Figure 2 illustrates the remarkable degree to which the transition economies have taken to the lesson.

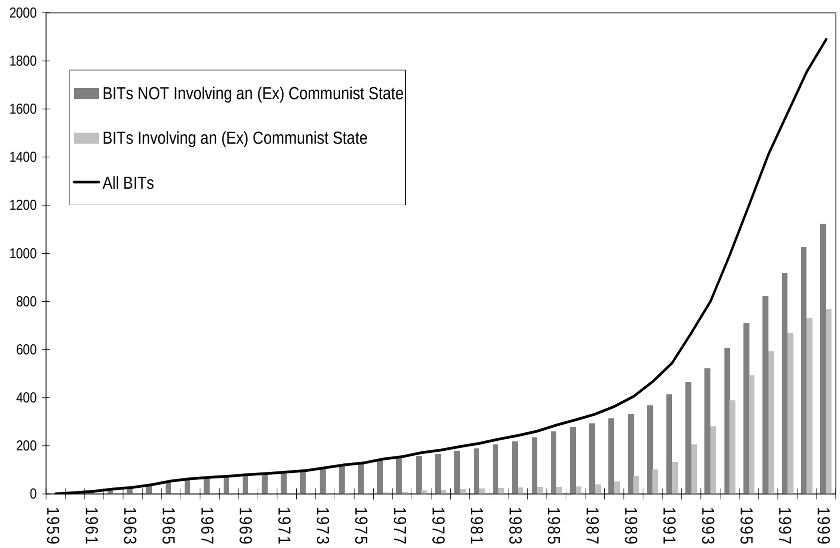
---

the face of "dramatic policy failures or crises." Sikkink, *supra* note 16, at 235 & n.14.

[94]Sikkink, *supra* note 16, at 242-43. In fact, Sikkink suggests that Chile's positive experiences with liberalization played an important role in promoting a "paradigm shift" in ECLA over the period, so that by 1990, ECLA theorists had largely abandoned traditional ECLA theories of development in favor of the neoliberal model. *Id*. at 241-49.

[95]Nauro F. Campos & Fabrizio Coricelli, *Growth in Transition: What We Know, What We Don't, and What We Should*, 40 J. ECON. LITERATURE 793, 803 (2002).

Figure 2: Cumulative Signed BITs, 1959-1999
Source: Author's Calculations



It is thus clear that a very large portion of the current BIT phenomenon is due to the pro-treaty fervor of the ex-Communist states. It should also be noted that Table 2 understates the ex-Communist states' acceptance of a prominent role for FDI in their development strategies, as many of these states are also signatories to the ECT,[96] which, as indicated above, also creates a favorable international legal regime for foreign investments in certain sectors, and others are, or most likely soon will be, members of the European Union,[97] whose internal rules regarding the treatment of intra-Union

[96]States marked with a "*" have signed but not ratified the ECT; all other listed states have ratified the treaty: Albania, Armenia, Austria, Australia*, Azerbaijan, Belarus*, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Cyprus, Denmark, Estonia, European Communities, Finland, France, Georgia, Germany, Greece, Hungary, Iceland*, Ireland, Italy, Japan, Kazakhstan, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Moldova, Mongolia, Netherlands, Norway*, Poland, Portugal, Romania, Russian Federation*, Slovakia, Slovenia, Spain, Sweden, Switzerland, Tajikistan, The former Yugoslav Republic of Macedonia, Turkey, Turkmenistan, Ukraine, Uzbekistan, United Kingdom. Energy Charter Treaty, *available at* http://www.encharter.org/index.jsp (last visited Nov. 17, 2005).

[97]Bulgaria, Croatia, and Romania are "candidate" EU countries; the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia have recently become EU members. European Union, *available at*

foreign investment are far more liberal and enforceable than the most pro-investor BIT.

III. THE IMPLICATIONS OF AN IDEATIONAL APPROACH FOR THE FUTURE OF BITS

I noted in Section I that ideational and rational choice explanations of the BIT phenomenon are not necessarily inconsistent. The ideational literature reviewed above suggests that developing countries have adjusted their ideas about development and foreign investment to the perceived failures and successes of alternative development paradigms. This in turn suggests that the developing countries' current embrace of BITs, and of the foreign investment they are said to attract, is less a reversion to a political-economic equilibrium, or of an objectively rational competition for capital, than it is the result of a process of what Hall has described as "social learning," whereby the developing countries have "deliberate[ly] attempt[ed] to adjust the goals or techniques of policy in response to past experience and new information."[98] This process of adjustment clearly has some elements of rationality to it, especially as the analysis suggests that developing countries update their beliefs and practices in response to new evidence. In that sense, the competition for capital thesis is not necessarily wrong in suggesting that developing countries' foreign investment policies have responded to incentives in rationalistic ways, broadly understood.

However, ideational theory does highlight the very real imperfections of the social learning process. This is the approach's primary contribution. Policymakers are not ineluctably driven toward adopting the objectively rational, utility-maximizing policies, but rather tend to draw questionable conclusions in unscientific ways from slim empirical evidence. This is particularly evident in the misguided lessons drawn from observing the East Asian "miracle." As discussed above, policymakers tended to exaggerate the extent to which the East Asian model was based on non-interference in the market and on FDI. In fact, the East Asian model was based on relatively heavy government intervention in the market and disfavored surrendering investment decisions to foreign direct investors.

The gap between objective evidence and subjective belief is also evident in the fact that anti-investor structural theories of

---

http://europa.eu.int/abc/index_en.htm# (last visited Nov. 16, 2005).

[98]Peter A. Hall, *Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain*, 25 COMP. POL. 275, 278 (1993) [hereinafter Hall].

development gained such widespread popularity despite the lack of much empirical evidence to support their most basic propositions. Indeed, Murphy argues that dependency theory was persuasive precisely *because* the issues with which it was concerned – primarily the contributions of multinational corporations to Third World development – were "relatively new, relatively unstudied."[99] Dependency theory was influential not because there was a convincing case that it presented an objectively accurate picture of the world, but because it provided a "readily available explanation of [Third World] problems without contradicting any other [T]hird [W]orld assumptions."[100]

This is not to say that objective, empirical evidence is irrelevant to the persuasiveness of a given idea. Indeed, Murphy argues that "empirical scientific study" provides the best means to arbitrate between competing development ideologies.[101] But it does suggest that the particular (pro-investment) ideas of the day are likely to be more unstable than is commonly recognized, especially in the absence of hard, supporting evidence that would render incipient competing ideas inherently unpersuasive and resistant to faulty "lessons learned." This is because, in the absence of hard evidence, policymakers are more easily able and likely to jettison their faith in BITs and FDI in response to unforeseen economic crises or to the accumulation of theoretical and empirical anomalies.[102] So what evidence is there to support the ideational status quo? Recall that the BIT phenomenon rests on three nested ideas. Empirical support for those ideas is remarkably slim, as the following suggests.

A. The Empirical Effect of BITs on FDI.

---

[99]MURPHY, *supra* note 32, at 111-12.

[100]*Id.*

[101]*Id.* at 6.

[102]Sikkink, *supra* note 16, at 235-36. As Finnemore and Sikkink note, ideational theorists have often described a temporal link between dramatic crises and failures and the emergence and acceptance of new ideas. Others, drawing on Thomas Kuhn's *The Structure of Scientific Revolutions* (1962) have suggested that crises and failures are not always necessary to render a new idea persuasive, and that new ideas may gain adherents as old ideas become burdened by "the accumulation of small discrepancies that cannot be explained by the old model." Finnemore & Sikkink, *supra* note 17, at 406-07. As described above, the Latin American experience seems to better fit the latter model; the East European experience the former.

Take for one the idea that BITs are effective at attracting FDI inflows. As Sornarajah notes, "[t]he proposition that foreign investment flows are beneficial to economic investment is based on the tenets of economic liberalism. It is th[is] assumption that has driven the sudden growth in the number of foreign investment treaties."[103] And while he exaggerates in claiming that this assumption is an "untested hypothesis,"[104] the empirical case for BITs remains far weaker than one would expect at this rather late stage in the game. I am aware of only three published statistical studies of the empirical relationship between BITs and FDI inflows, and only two of these appear in peer-reviewed academic journals. A close review of the handful of available empirical studies of the link between BITs and FDI flows suggests that economists remain far from consensus on the proper methods or models to employ, or the proper conclusions to draw from the various results.[105] Perhaps most importantly, the various studies reach contradictory, or at least inconsistent, results. For example, a study by the World Bank finds that signing a BIT can actually cause a *decrease* in FDI inflows.[106] Another study, published in the Harvard International Law Journal, finds only limited evidence that BITs signed with the United States – but not BITs signed with other OECD countries – are effective at achieving their central purpose.[107] A third unpublished paper presents mixed results, the most surprising of which is that BITs are ineffective at increasing FDI flows to high-risk developing countries.[108] In marked contrast, in a fourth study Neumayer and Spess find that signing additional BITs has statistically significant and far from negligible positive impacts on FDI inflows.[109]

---

[103]SORNARAJAH, *supra* note 10, at 268.

[104]*Id*. at 215 n.32.

[105]For example, Eric Neumayer and Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?*, WORLD DEV. (*forthcoming* 2005) [hereinafter Neumayer & Spess], are especially critical of competing studies, which, they claim, suffer from a number of methodological and data-related inadequacies that render their results less than reliable.

[106]Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract FDI? Only a Bit . . . and They Could Bite* (World Bank Policy Research, Working Paper No. 3121, June 2003), *available at* http://ideas.repec.org/p/wbk/wbrwps/3121.html.

[107]Salacuse & Sullivan, *supra* note 34.

[108]Jennifer Tobin & Susan Rose-Ackerman, *Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties* (Yale Law School Center for Law, Econ. & Pub. Pol'y Research, Paper No. 293) *available at* http://www.yale.edu/outside/html/faculty/sroseack/FDI_BITs_may02.pdf.

[109]Neumayer & Spess, *supra* note 105, at 28. See also Peter Egger & Michael Pfaffermayr, *The Impact of Bilateral Investment Treaties on Foreign Direct Investment*,

What are we to make from the confusion? One suggestion is that the developing countries' widespread faith in the ability of BITs to attract FDI inflows appears to be precisely that – faith, an idea largely unsupported by objective, scientific evidence.[110]

B. FDI Promotes Economic Growth.

The oft-unstated assumption in the BIT literature is that FDI, which BITs are supposed to attract, is normatively desirable. The basic notion is that developing states accept BITs, and a greater role for foreign investors in the host economy, because FDI promotes economic growth. The evidence that FDI promotes growth is both theoretically and empirically better-supported than is the argument that BITs promote FDI, though the matter is far from beyond debate.[111] For example, one economist has suggested that even today, "[f]ormal economic reasoning has contributed little to the emergence of this optimistic consensus" about the value of FDI inflows.[112] From an ideational perspective, however, it is important to keep in mind Hall's point that "policies are made within a framework of ideas and standards that specify not only the goals of policy and the kind of instruments that can be used to attain them, but also *the very nature of the problems they are meant to be addressing.*"[113] In this case, the main danger is that the developing countries' understanding of the "problem they mean to address" may shift from the problem of income growth to that of income distribution.

---

32 J. COMP. ECON. 788 (2004), which also reports a statistically significant relationship between BITs and FDI. The point of this section is not to critique or arbitrate among the various studies. But it should be noted that they all suffer from a potentially quite serious limitation – the failure to account or control for substantive differences in the various treaties, particularly differences in the strength of the legal protections contained in the treaties.

[110]The premise behind Neumayer and Spess's conclusions – that foreign investors actually and systematically take BITs into account when making investment decisions – is, to my knowledge, unsupported by any empirical studies. It also would seem to at least partially contradict the well-established finding that FDI is "sticky," in the sense of being relatively unresponsive over the short term to changes in the potential host country's investment environment. *See* THEODORE H. MORAN, FOREIGN DIRECT INVESTMENT AND DEVELOPMENT: THE NEW POLICY AGENDA FOR DEVELOPING COUNTRIES AND ECONOMIES IN TRANSITION 87-92 (1998).

[111]See generally de Soysa & Oneal, *supra* note 91, who discuss the debate but find strong evidence that FDI is positively correlated with economic growth.

[112]Andrés Rodríguez-Clare, *Multinationals, Linkages, and Economic Development*, 86 THE AM. ECON. REV. 852 (1996).

[113]Hall, *supra* note 98, at 279 (emphasis added).

The consequences of such a shift may very well be a retreat away from openness to FDI. As Vandevelde has pointed out, "liberalism promises only the maximization of productivity. It makes no promises concerning the distribution of wealth that will result."[114] It is beyond the scope of this article to address the question of whether FDI inflows exacerbate or mitigate the maldistribution of income or wealth within host states, though it is worth noting that Vandevelde considers the evidence mixed either way.[115] The more important point is that the maldistribution of resources – particularly of natural resources, and most particularly of land – was a major factor behind the anti-investor sentiment of the 1960s and 1970s. The concentration of resources in the hands of a few remains a sensitive issue in much of the developing world today, [116] and should developing country governments begin to believe that economic liberalization by itself will not necessarily resolve the issue, or, more importantly, that FDI is part of the problem, they will likely be tempted to invade (or at least scale back) the property rights of foreign investors in an attempt to relieve popular pressures for redistribution.

More subtly, there appears to be a growing recognition that even if FDI on net does positively impact economic growth, not all FDI is necessarily beneficial to the host economy. Most notably, even the International Monetary Fund now cautions that "developing countries should be cautious about taking too uncritical an attitude toward the benefit of FDI", and that "transfer of control [of domestic companies to foreigners] may not always benefit the host country because of the circumstances under which it occurs, problems of adverse selection, or excessive leverage."[117] While such an admission is quite surprising, given the great extent to which the IMF and its sister institution, the World Bank, have traditionally promoted relatively unqualified openness to foreign investment, it accords with other recent work in economics that accords a more nuanced role to FDI in the development process.[118] From an ideational perspective, this development is particularly significant because it suggests that what Sornarajah calls the "the fervour for economic liberalism" has begun

---

[114]Vandevelde, *supra* note 2, at 516.

[115]Vandevelde, *supra* note 2, at 517.

[116]*See* Juan Forero, *Venezuela Land Reform Looks to Seize Idle Farmland*, N.Y. TIMES, Jan. 30, 2005 at A1.

[117]Prakash Loungani & Assaf Razin, *How Beneficial is Foreign Direct Investment for Developing Countries?*, 38 FIN. & DEV. (June 2001), *available at* http://www.imf.org/external/pubs/ft/fandd/2001/06/loungani.htm.

[118]*See, e.g.*, Bruton, *supra* note 35, at 929-30.

to recede, if only at that margins. If this is the case, then Sornarajah is correct that we can expect that ideological "challenges to investment treaties will grow more strident."[119]

C. The Relative Cost of BITs.

Finally, it is important to recognize that the current enthusiasm for BITs depends in large part on the perception that the costs of entering the treaties are small relative to the benefits the treaty will provide. This idea is, of the three, perhaps the most susceptible to change, because the true scope of the developing countries' sacrifice is only now becoming clear.[120]

From where might these high costs arise? Many if not most BITs contain provisions governing disputes between the host state and foreign investor, under which the host state provides its advance consent to investor-initiated, binding, and exclusive arbitration before the International Centre for the Settlement of Investment Disputes (ICSID) or other international arbitral facilities. These arbitration provisions are striking because traditionally private parties had no power to bring a direct claim within the international legal system; only governments could bring claims on behalf of such parties. The provisions are especially significant because they cede authority to an independent body to impose binding interpretations of the often-ambiguous rights and duties contained in a given BIT's substantive provisions. By consenting in advance to such determinations, host states have relinquished a remarkable degree of sovereignty.

Unsurprisingly, foreign investors have increasingly invoked their right to arbitration, and arbitral tribunals have not been shy about exercising jurisdiction. In the process these tribunals have

[119] SORNARJAH, *supra* note 10, at 268.

[120] To suggest that the true sovereignty costs of BITs is only now becoming clear does not, as some have claimed, denigrate the acumen of developing country lawyers who may have been involved in negotiating them. For instance, Vicuña has protested that the claim that developing countries did not understand the full import of the various BIT provisions at the time of signing is "paternalistic" and that "lawyers from developing countries are not dummies." Francisco Orrego Vicuña, *Regulatory Expropriations in International Law: Carlos Calvo, Hononary NAFTA Citizen*, 11 N.Y.U. ENV'T'L L.J. 19, 30 (2003). This is no doubt true, but it is also true that the wording of most BITs is highly ambiguous in many important areas, and that arbitral tribunals have so far not been overly stingy in interpreting those ambiguities in favor of foreign investors. Furthermore, it must be remembered that it is politicians – not lawyers – who decide whether to sign and ratify a given BIT, and politicians, especially those who lack legal training, may be much less likely to understand what is being given up.

begun to clarify many of the ambiguities in ways that expand, rather than limit, the scope of the treaties. This seems to be the case, for example, in decisions dealing with the rights of shareholders and bondholders to bring suit under BITs as "investors"[121] and the meaning of such vague concepts as the "fair and equitable treatment" due investors.[122] It is also likely to be the case as tribunals wrestle with the potentially expansive notion of "indirect expropriations" or the reach of the so-called "umbrella clause," which makes ordinary breaches of contract arbitrable under many BITs. Argentina's current travails provide a particularly severe view into the latent sovereignty costs of BITs. Argentina currently faces the daunting prospect of defending its policy responses to its 2001 economic crisis in over 30 pending ICSID arbitration cases.[123] By one estimate, Argentina is likely to lose most of these disputes, facing awards in the hundreds of millions of dollars.[124] This threat has led the Argentine government to adopt the extreme legal position that its BIT obligations are unconstitutional under Argentine law and thus unenforceable.[125] Argentina's

---

[121]*See, e.g.*, Stanimir A. Alexandrov, *The "Baby Boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals—Shareholders as "Investors" under Investment Treaties*, 6 J. WORLD INVESTMENT & TRADE 387 (2005).

[122]*See, e.g.*, Barnali Choudhury: *Evolution or Devolution?—Defining Fair and Equitable Treatment in International Investment Law*, 5 J. WORLD TRADE & INVESTMENT 297 (2005).

[123]Carlos E. Alfaro & Pedro M. Lorenti, *The Growing Opposition of Argentina to ICSID Arbitral Tribunals: A Conflict Between International and Domestic Law?*, 5 J. WORLD INVESTMENT & TRADE 417 (2005) [hereinafter Alfaro & Lorenti].

[124]*Id*. For a comprehensive list of the cases, see Carlos E. Alfaro, *Argentina: ICSID Arbitration and BITs Challenged by the Argentine Government*, Mondaq.com (Dec. 21, 2004), *available at* www. mondaq.com [hereinafter Alfaro].

[125]On Argentina's legal strategy, see generally Alfaro & Lorenti, *supra* note 123. Alfaro, an Argentine lawyer, draws the following lesson from Argentina's experience under the BITs, a lesson consonant with this article's analysis:

> The future does not look promising for BITs or for ICSID development. Developed countries enthusiastically supported open markets and privatization during the nineties in the belief that private investments will flow and improve the standard of living of their people. In implementing the legal framework necessary to attract foreign investments they entered into BITs and agreed to submit any controversy to foreign arbitration.
>
> When confronting a crisis like in the case of Argentina in 2001, private parties in many cases rushed to file their arbitral demands to better position themselves for negotiations. It has not caused the desired effect. Much to the contrary Governments has reacted negatively and ICSID runs now the risk of becoming politically "out of fashion". The number of cases filed has produced a backlash for the future. Countries are now less willing

experience is in many respects unique. But it may also be viewed as simply the most acute example of the much broader "looming legitimacy crisis" of investment treaty arbitration, which, according to Franck, risks igniting a public backlash against the treaties.[126] In short, the costs of investment treaties are rapidly becoming much clearer to developing states. In the absence of appropriate corrective mechanisms,[127] the consequence is likely to be a slowdown in the rate of new signings, and perhaps, even, the repudiation of existing treaties.

IV. CONCLUSION

As Sikkink has argued, "[t]he expanded availability of international investment [can] be perceived as an opportunity or as a danger, depending on the ideas held by policymakers."[128] In highlighting her work and that of others in comparative political economy, I have tried to show that ideational theories of public policy can help explain the shift in developing countries' acceptance of international legal rights for foreign direct investors, especially when comparing ideas about development prevalent in the developing world in the 1950s, 1960s, and early 1970s with those predominant in the 1980s and 1990s.

I should emphasize, however, that this article has not attempted to explain or predict individual state decisions to sign a particular BIT. Undoubtedly a host of factors enter such decisions, and the above analysis goes very little toward offering a fully specified, multivariate theory of why developing state X signs and ratifies a BIT with developed state Y at time T. A more complete discussion would take into account, for example, the possibility of coercion by powerful home countries or multilateral institutions like the IMF or World Bank. Domestic politics is likely important as well in determining whether a state will pursue investor-friendly or investor-hostile development policies.[129] The Chilean case, once again, offers a

---

to accept submitting themselves to arbitration and foreign jurisdiction.

Alfaro, *supra* note 124.

[126]Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1523 (2005).

[127]Franck discusses a number of possible measures to alleviate the legitimacy crisis, though her primary focus is on the creation of an appellate mechanism to resolve conflicting awards. *Id.* at 1522.

[128]SIKKINK, *supra* note 44, at 19.

[129]On the role of political factors in influencing state decisions to expropriate and

powerful example of this latter point. There, the country's policies toward foreign investors shifted quickly and relatively dramatically upon Pinochet's assumption of office following Allende's assassination.[130] And of course, the example of Eastern Europe shows that political transitions may be essential to the adoption of new ideas.

But it also seems likely that as an idea grows more pervasive and persuasive, and its rival alternatives less so, these non-ideational factors will matter somewhat less in determining whether a given state will implement the favored investment policies of the day. In this regard, it is particularly noteworthy that national figures such as Cardoso and Castro have in recent years shifted their views, and the policies of their states, from shunning foreign investment to embracing it. Cardoso's transformation is illustrative of the decline in importance of partisanship. Widely regarded as the father of dependency theory, as the center-left president of Brazil in the 1990s he nonetheless adopted an aggressively pro-investment development policy, publicly and prominently wooing foreign investors by, among more substantive actions, declaring in a nationally televised address that "we need foreign capital."[131] This blunt acknowledgement was almost as surprising as Castro's, who in 1993, during a speech celebrating the 40th anniversary of his assault on the Moncada Barracks, frankly admitted the remarkable change in Cuban attitudes toward FDI: "Who would have thought that we, so doctrinaire, we who fought foreign investment, would one day view foreign investment as an urgent need?... [G]reater opening for foreign investment is one of the solutions we have to tackle the difficult situation we face."[132] For the moment, then, it seems as if most policymakers view BITs as a bright idea. But the main point of this article is that just as those ideas have swung one way, so may they swing back the other. This is particularly likely to happen if promoters of BITs fail to respond to incipient but growing concerns over the lack of hard empirical support for the fundamental assumptions underlying the treaties' grand bargain.

---

nationalize foreign investments, see generally Jodice, *supra* note 60.

[130] *See generally* MORAN, *supra* note 51.

[131] James Brooke, *Brazil Paves Way for More Foreign Investment*, N.Y. TIMES, Feb. 17, 1995 at A8. Cardoso followed a pro-FDI policy throughout his presidency. *See, e.g.*, Matt Moffett, *Brazil Bets Big on Winning Back Foreigners*, WALL ST. J., Sept. 9, 1998 at A14.

[132] A transcript of Castro's speech is available at http://lanic.utexas.edu/la/cb/cuba/castro/1993/19930727. Castro's new attitude toward foreign investment was given legal substance in the Foreign Investment Act of 1995 (Law 77), *available at* http://www.cubagov.cu/ingles/otras_info/cpi/ley.htm.